Defense Logistics Agency Working Capital Fund Fiscal Year 2004

Annual Financial Statement Report (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

Annual Financial Statements Fiscal Year 2004

(Unaudited)

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For the Fiscal Year Ended September 30, 2004

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 5.2 million items and disseminates logistics cataloging information for more than 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.

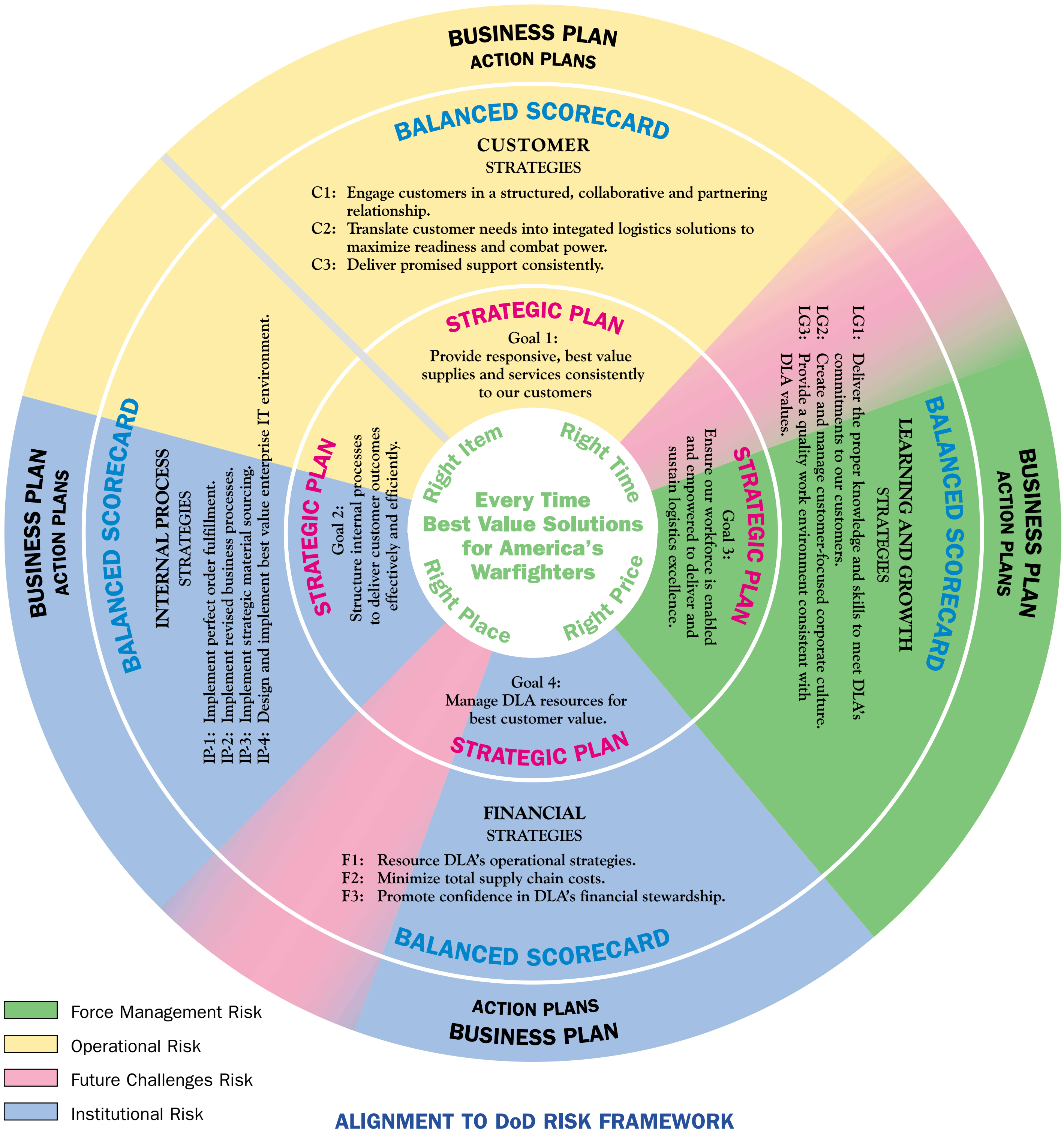
DLA has institutionalized a four-level approach to planning to formalize, align, and integrate a planning and performance measurement process. DLA's Strategic Plan is the top level with its focus on long-term outcomes. The DLA Enterprise Balanced Scorecard (BSC) — our performance plan — is the second 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. Furthermore, as the Agency transforms from a legacy system (SAMMs) to BSM, we are in the process of developing an integrated approach to measuring enterprise performance at various levels to include supply chain, customer, and weapon system.

Our Strategic Management System maps and tracks transformation strategies. These strategies and objectives in the DLA Strategic Plan and Balanced Scorecard are focused on our customer transformational needs and are aligned with the DoD Risk Framework/Scorecard. The color-coded alignment wheel, provided below, and an alignment matrix communicate — 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. Engage customers in a structured, collaborative and partnering relationship.

Strategy 1.2. Translate customer needs into integrated logistics solutions to maximize readiness and combat power.

Strategy 1.3. Deliver promised support consistently.

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.

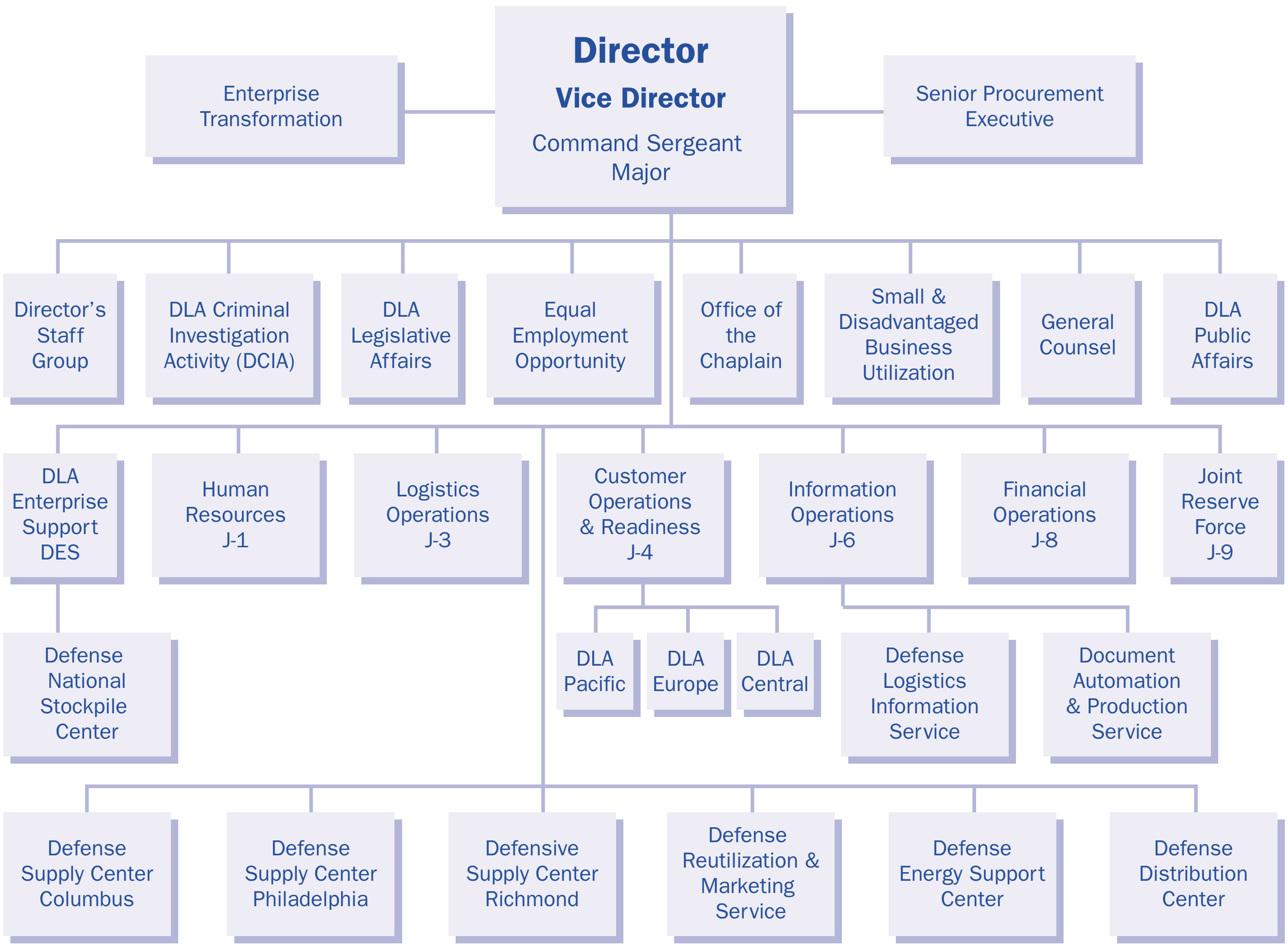
Strategy 4.2. Minimize total supply chain costs.

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

Organization

DLA maintains a global presence and accomplishes its mission with approximately 22,900 civilian personnel, 511 active duty personnel, and 637 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 and DLA Central in 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) is responsible for the end-to-end supply chain management of DLA's eight supply chains, providing logistics and acquisition policy, guidance and oversight, and monitoring supply chain performance. J-3 is the principal strategic, operational and tactical planner for DLA business operations, championing best business practices, business systems modernization, and value-added logistics solutions for the warfighter. J-3 oversees the daily operation of the DLA Logistics Field Activities
- Customer Operations and Readiness (J-4) leads DLA's transformation efforts in customer relations management by serving as an enterprise customer advocate within DLA. J-4 enables readiness and sustainment through deeper insight into the warfighter's requirements; improves warfighter and international support; and expands joint planning and DLA tactics, techniques, and procedures for contingencies by establishing mid and long-term customer strategies. J-4 serves as the head of the entire DoD logistics sector under the Critical Infrastructure Protection Program.
- 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 two field activities: the Defense Logistics Information Service 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, implementing and executing 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 Enterprise Services (DES) oversees common corporate/enterprise mission support across all of DLA such as environment, safety and occupational health, installation management, morale welfare and recreation, public safety, protocol and special events, DLA Europe and DLA Pacific support, and the administration of the Defense National Stock pile Center. DES 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 04, DLA executed a total budget program of more than $32 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:

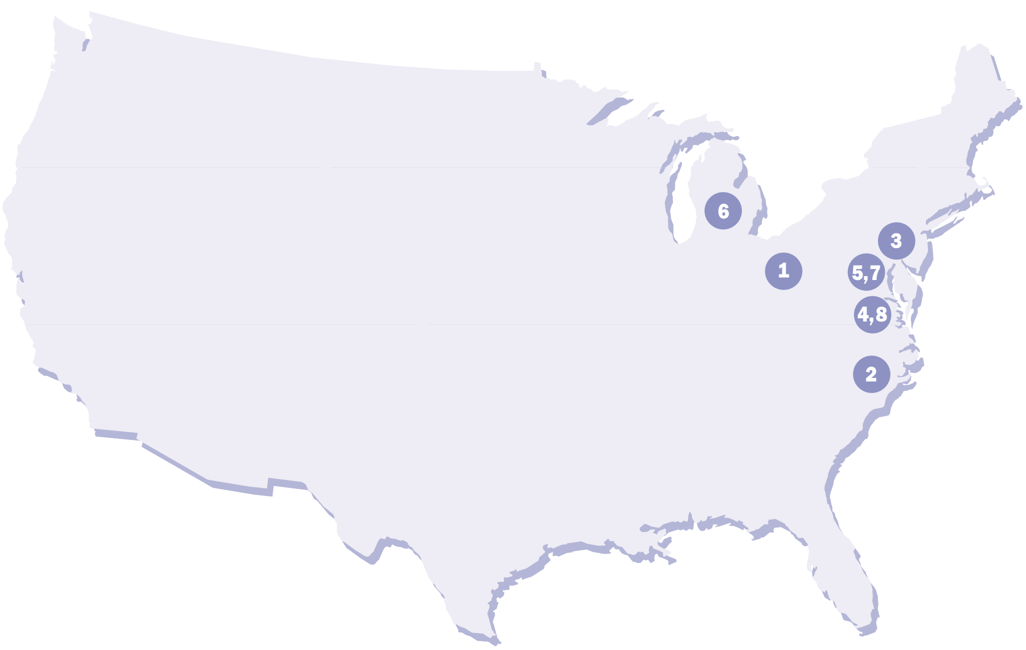
Supply Management: The Supply Management activity group provides customer support through its management of logistics processes. This includes centralized management of logistics catalog information, energy, consumable spare parts, food, pharmaceuticals, medical and surgical supplies, and clothing and 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, 78 percent of the liabilities, and 88 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, kitting, and set assembly or disassembly. The Distribution activity group is under the control of the Defense Distribution Center in New Cumberland, PA, and includes 25 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 185 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, DoD is unable to implement all elements of the standards due to financial management systems limitations. 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 04 with total assets valued at approximately $18.4 billion and liabilities of $3.4 billion from the Consolidated Balance Sheet and a net operating gain of slightly less than $182 million on program costs of approximately $28.2 billion and revenues of approximately $28.3 billion from the Consolidated Statement of Net Cost.

Systems and Controls

The DLA system of internal accounting and administrative controls in effect during the Fiscal Year ended September 30, 2004, 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 04 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 deficiencies, 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 reengineered 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 became operational in November 2003; BSM interface with DLA's procurement legacy systems became operational in May 2004; and Release 2 became operational in July 2004. Following the Assistant Secretary of Defense for Network Information and Integration approval in first quarter, FY 05, BSM will begin rollout in January 2005. This rollout--over 21 monthly increments — will eventually convert 5.2 million items and approximately 5400 users into the BSM system by September 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 supply chain management. 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. In December 2003, DLA was directed to converge FAS with BSM. The newly designated BSM energy system is expected to achieve full operational capability by 2007, after which BSM energy supply chain management will be integrated with BSM within the DLA enterprise architecture.

Management Controls

The DLA Management Control Program (MCP) is fully developed, and the DLA Headquarters (HQ DLA), Business Offices and Field Activities (FA) have continued to make progress in the expanded reporting of weaknesses and controls. Continued recognition of current process improvements to ensure existing internal controls remain in place or are being enhanced. Each directorate/major office has an MCP program monitor assigned to oversee the program. The program monitors are responsible for ensuring their directorate/major office follows the prescribed requirements and regulations as set forth in the DLA and OMB guidelines; provides assistance regarding the performance of objective assessments, and reports weaknesses and concerns arising from those assessments.

DLA reviews risk areas annually for inclusion in the development of Management Control (MC) Objectives to be assessed for the fiscal year. The core objectives are developed and included in the MCP for each directorate/FA. All assessments are reviewed and approved by senior management at the local level, then at the HQ DLA level.

MCP performance standards are part of DLA's supervisory/managerial performance plans and include MCP responsibilities. The HQ DLA Internal Support Review (ISR) program requires updated status reports on weaknesses and concerns addressed by the MCP. Additionally, all weaknesses are now addressed in the DLA Business Plan with status updates each quarter of the FY.

DLA Criminal Investigation Activity worked closely with other DLA Field Activities to ensure all objectives were evaluated and weaknesses identified before negative actions occurred.

Progress within the DLA Financial Operations (J-8), Comptroller's Office included participation in identifying and resolving internal control deficiencies; development of DLA One Book chapters/procedures; development or refinements to Concept of Operations and agreements with customers and providers; and continued recognition of current process improvements to ensure existing internal controls remain in place or are enhanced. The J-8 reviewed current business practices and assessed management controls; conducted biweekly audit updates, and performed risk analysis as part of their evaluation.

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, 2004, 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 04 Annual Statement of Assurance demonstrates the progress made toward institutionalizing the DLA MCP.

Procurement Management Reviews (PMRs) establish accountability for all contracting functions by measuring and evaluating each contracting office's performance. The categories that PMR teams assess include procurement integrity, utilization of government business practices, compliance with laws and regulations, and overall efficiency and effectiveness of the procurement function. These assessments — along with the daily contract oversight responsibilities of the activity — ensure that assets, program responsibilities, and contracting operations have been reasonably insulated against fraud, waste, abuse, and/or mismanagement; and can be used to evaluate the efficiency and effectiveness of each activity's management control program. The frequency of reviews is based on an annual risk assessment.

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 Independent Public Accountant (IPA) firm to conduct Discovery (focused assessments using audit procedures) on the areas that have not yet undergone a review and/or audit. During FY 04, the DoD Comptroller issued a detailed set of Financial Improvement Initiative Business Rules and Assertion Requirements. Many of the requirements in the Business Rules are included in the *Financial Transformation Plan* and the discovery process. 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.

DLA continues to address deficiencies previously reported through self-discovery or auditability assessments conducted by IPA firms. The corrective action process is documented and promulgated throughout the enterprise. DLA progress with corrective action activity is reported on a monthly basis to the DLA Audit Committee and quarterly to the Corporate Board through Balance Scorecard metrics. During FY 04, 17 Plans of Action and Milestones (POAMs) were reported as completed. Within each POAM, the process owners determine which milestones are considered "critical" to the completion of the POAM. During FY 04, 63 critical milestones in the 44 POAMs being tracked were reported as completed. In accordance with the DoD Comptroller Business Rules, validation of the corrective action must be conducted. DLA plans to utilize both IPA and Internal Review resources to conduct the validation work immediately following completion of the corrective actions. DLA will continue to develop corrective action POAMs as the discovery process continues to disclose audit impediments and deficiencies across all business systems, controls and processes.

We made further improvements to the FY 04 financial statements and compilation process by meeting the accelerated timelines for submission. Despite this improvement, the financial statements are not yet auditable. Our inability to obtain a favorable audit opinion on our financial statements continues to be reported 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 04 Annual Statement of Assurance.

Other Accompanying Information

End-To-End Supply Chain Integration: DLA is transforming from a manager of supplies to a world class manager of supply chains; providing uninterrupted end-to-end supply chain support to the warfighter. To fully accomplish this End-To-End Supply Chain Integration (SCI) initiative, DLA will need to transform its business support methods and processes into a disciplined integrated framework that delivers improved and total integrated logistics solutions to the warfighter. DLA's goals for this effort are:

- Provide end-to-end supply chain integration.
  - – Integrate and leverage existing capabilities.
  - – Lead when opportunities exist.
  - – Partner with the Services and private industry when they don't.
- Provide portfolio of services beyond consumable item management.
  - – Tailored . . . from warfighter need to satisfaction, retrograde, and disposal.
- Develop single enterprise view of the entire supply chain.
  - – Measure by supply chain.
  - – Hold provider accountable.

A two-phased Integrated Process Team (IPT) approach was established to address the End-To-End SCI issues surrounding the eight affected DLA supply chains. The Phase I IPT identified the necessary resource requirements for this new mission, and performed an initial mapping and gap analysis of each supply chain. The Phase II IPT will develop a Concept of Operations document to outline the roles, responsibilities and relationships for the Headquarters and Field Activity SCI personnel; identify potential initiatives for bridging the gaps in the supply chains; and, rationalize the SCI, Business Systems Modernization and Customer Relationship Management programs.

Executive Agent (EA) is one of six major DoD initiatives to accelerate transformation of logistics capabilities over the next five to ten years. An Executive Agent is defined as *"The Head of a DoD Component to whom the Secretary of Defense or the Deputy Secretary of Defense has assigned specific responsibilities, functions and authorities to provide defined levels of support for operational missions, or administrative or other designated activities that involve two or more of the DoD Components."* The Deputy Under Secretary of Defense for Logistics and Materiel Readiness (DUSD L&MR) tasked DLA to lead joint working groups to perform assessments of four commodity supply chains: subsistence, bulk fuels, construction and barrier materiel, and medical materiel. DLA was also directed to perform an assessment for the clothing and textiles commodity. All of these EA assessments have been accomplished and Joint Concepts of Operation and DoD Directives were completed to guide implementation. Specifically:

- The DoD Directive for Bulk Petroleum EA was signed on August 11, 2004. The DLA implementing actions for Bulk Petroleum included: 1) the establishment of the Component Steering Group (CSG) as the forum to make continual improvements in the efficiency and effectiveness of the bulk petroleum supply chain and 2) the commission of teams to work specific issues in the development and implementation of short and long term plans for improving DoD bulk petroleum operations.
- The DoD Directive for Medical Materiel EA was signed on August 23, 2004. Implementing actions for medical materiel EA include: 1) completion of a "Rock Drill" exercise which validated EA implementation objectives and identified supply chain gaps; 2) reconvening of the joint integrated process team (JIPT) to address supply chain gaps in strategic and operational relationships, requirements program management and financial structure, distribution, systems and information, and readiness assessment.
- The DoD Directive for Subsistence EA was signed on September 27, 2004. DLA EA implementing actions for subsistence include: 1) establishment of a Joint Subsistence Policy Board; 2) a theater requirements and the field feeding plan; and 3) the development and fielding of a common food management system. DLA is partnering with USTRANSCOM to identify gaps and seams in the distribution process and to improve visibility of items. The remaining EA staff packages are in the coordination process.

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 76 reservists to support Operations ENDURING FREEDOM and IRAQI FREEDOM. Collectively, these reservists logged more than 13,600 man-days of support to DLA Contingency Support Teams, field activities, and headquarters missions. Four additional DLA reservists — providing more than 720 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. Four more reservists were on active duty supporting DLA during FY04 than in FY03. The remaining 561 reservists provided 5,400 man-days of operational support to the various stateside DLA activities during their annual training.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated and Combined Financial Statements

As of and for the Years Ended September 30, 2004 and 2003

UNAUDITED

Consolidated Balance Sheets

As of September 30, 2004 and 2003
(In Thousands)

	2004 Consolidated	2003 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	1,366,954	1,475,360
Other Assets (Note 4)	–	720
TOTAL INTRAGOVERNMENTAL ASSETS	1,366,954	1,476,080
Cash and Other Monetary Assets (Note 5)	7,298	6,443
Accounts Receivable (Note 3)	443,592	526,941
Inventory and Related Property (Note 6)	14,683,932	12,166,093
General Property, Plant and Equipment (Note 7)	1,708,290	1,519,683
Other Assets (Note 4)	229,166	211,110
Total Assets	**$ 18,439,232**	**$ 15,906,350**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 184,824	$ 169,254
Other Liabilities (Note 11 and Note 12)	71,271	75,064
Total Intragovernmental Liabilities	256,095	244,318
Accounts Payable (Note 9)	2,372,375	2,236,340
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities (Note 13)	278,596	315,843
Environmental Liabilities (Note 10)	56,722	68,796
Other Liabilities (Note 11 and Note 12)	388,294	282,791
Total Liabilities	**$ 3,352,082**	**$ 3,148,088**
NET POSITION		
Cumulative Results of Operations	15,087,150	12,758,262
Total Net Position	**$ 15,087,150**	**$ 12,758,262**
TOTAL LIABILITIES AND NET POSITION	**$ 18,439,232**	**$ 15,906,350**

The accompanying notes are an integral part of these statements.

UNAUDITED

Consolidated Statements of Net Cost

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 14.A)	2004 Consolidated	2003 Consolidated
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 2,484,088	$ 2,273,794
Less: Intragovernmental Earned Revenue	(25,504,526)	(23,426,481)
Intragovernmental Net Costs	(23,020,438)	(21,152,687)
Gross Costs With the Public	24,787,279	22,953,606
Less: Earned Revenue From the Public	(1,948,838)	(1,095,492)
Net Costs With the Public	22,838,441	21,858,114
Total Net Cost	**(181,997)**	**705,427**
NET COST OF OPERATIONS	**$ (181,997)**	**$ 705,427**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Net Position

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 15)	2004 Consolidated	2003 Consolidated
BEGINNING BALANCES	**$ 12,758,262**	**$ 12,021,576**
Budgetary Financing Sources:		
Appropriations used	1,768,839	1,209,000
Transfers-in/out without reimbursement	(35,500)	–
Other budgetary financing sources	100,910	253,337
Other Financing Sources:		
Transfers-in/out without reimbursement	175,117	(153,465)
Imputed Financing Sources	137,524	133,241
Total Financing Sources	2,146,891	1,442,113
Net Cost of Operations	**(181,997)**	**705,427**
ENDING BALANCES	**$15,087,150**	**$ 12,758,262**

The accompanying notes are an integral part of these statements.

UNAUDITED

Combined Statements of Budgetary Resources

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 16)

	2004 Combined	2003 Combined
BUDGETARY RESOURCES:		
Budget Authority:		
Appropriations received	$ 1,768,839	$ 364,000
Contract authority	30,796,612	26,861,314
Net transfers (+/-)	–	845,000
Unobligated balance:		
Beginning of period	209,214	840,758
Net transfers, actual	(35,500)	125,000
Spending authority from offsetting collections:		
Earned		
Collected	28,131,489	24,762,064
Receivable from Federal sources	(246,855)	556,771
Change in unfilled customer orders		
Advance received	9,489	(48,432)
Without advance from Federal sources	100,217	718,900
Subtotal	27,994,340	25,989,303
Recoveries of prior year obligations	–	–
Permanently not available	(29,383,561)	(26,852,598)
Total Budgetary Resources	**$ 31,349,945**	**$ 28,172,777**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 31,428,160	$ 27,963,562
Subtotal	31,428,160	27,963,562
Unobligated balance:		
Apportioned	(78,215)	(13,834)
Other available	–	1
Unobligated Balances Not Available	–	223,048
Total, Status of Budgetary Resources	**$ 31,349,945**	**$ 28,172,777**

UNAUDITED

Combined Statements of Budgetary Resources (Continued)

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 16)	2004 Combined	2003 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 7,862,592	$ 7,125,765
Obligated Balance, Net — end of period:		
Accounts receivable	(1,801,284)	(2,048,139)
Unfilled customer order from Federal sources	(2,774,352)	(2,674,133)
Undelivered orders	10,892,928	9,689,047
Accounts payable	3,066,286	2,895,820
Outlays:		
Disbursements	30,053,812	25,951,065
Collections	(28,140,979)	(24,713,632)
Subtotal	1,912,833	1,237,433
Net Outlays	**$ 1,912,833**	**$ 1,237,433**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Financing

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 17)	2004 Consolidated	2003 Consolidated
RESOURCES USED TO FINANCE ACTIVITIES:		
Budgetary Resources Obligated		
Obligations incurred	$ 31,428,160	$ 27,963,562
Less: Spending authority from offsetting collections and recoveries	(27,994,342)	(25,989,303)
Obligations net of offsetting collections and recoveries	3,433,818	1,974,259
Net obligations	3,433,818	1,974,259
Other Resources		
Transfers in/out without reimbursement	175,117	(153,465)
Imputed Financing Sources	137,525	133,241
Net other resources used to finance activities	312,641	(20,224)
Total resources used to finance activities	**3,746,459**	**1,954,035**

UNAUDITED

Consolidated Statements of Financing (CONTINUED)

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 17)	2004 Consolidated	2003 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	(1,222,459)	(1,361,565)
Unfilled Customer Orders	109,707	670,470
Resources that fund expenses recognized in prior periods	(50,455)	(104)
Resources that finance the acquisition of assets	(24,079,948)	(1,681,433)
Other	(175,117)	153,466
Total resources used to finance items not part of the net cost of operations	(25,418,272)	(2,219,166)
Total resources used to finance the net cost of operations	**(21,671,813)**	**(265,131)**
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)
Increase in environmental and disposal liability	–	68,655
Increase in exchange revenue receivable from the public	–	(1,690)
Other	23,358	135,665
Total components of Net Cost of Operations that will require or generate resources in future periods	23,358	101,417
Components not Requiring or Generating Resources		
Depreciation and amortization	142,874	137,022
Revaluation of assets or liabilities	252,334	732,323
Cost of Goods Sold	21,115,958	
Other	(44,709)	(204)
Total components of Net Cost of Operations that will not require or generate resources	21,466,458	869,141
Total components of net cost of operations that will not require or generate resources in the current period	**21,489,816**	**970,558**
Net Cost of Operations	**$ (181,997)**	**$ 705,427**

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, 2004 and 2003

Note 1. Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements have been prepared to report the financial position and results of operations for the Defense Logistics Agency (DLA), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Reform Act (GMRA) of 1994, and other appropriate legislation. 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 the books and records of the 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").

The DLA has not yet or is unable to fully implement all applicable Federal accounting standards. Reported values and information for the DLA's 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, such as imputed costs and liability estimates, is derived from third-party providers. Most non-financial feeder systems were designed to support reporting requirements that focused on management concerns, such as asset accountability and funds control, rather than supporting the preparation of financial statements. The DLA continues to implement process and system improvements to address the limitations of its financial and non-financial feeder systems.

A more detailed explanation of these financial statement elements is provided in the applicable footnotes.

B. Mission of the Reporting Entity

The DLA's 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.

The DLA provides supply support, technical/logistics services and quality support to all branches of the military and other non-DoD customers. The services it provides fall into the following working capital funds (WCFs) 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.

C. Appropriations and Funds

The DoD receives its appropriations and funds as general funds, working capital (revolving) funds, trust funds, special funds, and deposit funds. The DoD Components use these appropriations and funds to execute their missions and report on resource usage.

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, the DLA is provided two forms of budgetary authority: contract authority and anticipated reimbursement authority. The DLA's Supply Management, Distribution, and DRMS activities are provided contract authority for both operations and capital programs. The 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 orders; whereas, anticipated reimbursement authority requires the receipt of customer orders 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 are not designed to collect and record financial information on an accrual basis. Efforts are underway to determine the actions required to bring the systems and processes into compliance. In the meantime, some financial data is 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 or at the point where inventory items are sold. The financial statements include adjustments to accrue a portion of the revenue. Revenue is not earned to offset costs incurred by the DRMS activity group's transfer and donation programs.

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. The 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.

F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the 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 the 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. See Note 14 for disclosure of adjustment amounts.

G. Accounting for Intragovernmental Activities

The DoD, 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 either do not reflect, or were adjusted to reflect, the results of the following events:

- <u>Public Debt</u>
  The Department's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

- <u>Civilian/Military Retirement Systems</u>
  The DLA's 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. The DLA finances only a portion of the civilian and military pensions. And while reporting and funding civilian pensions under CSRS and FERS is the responsibility of the Office of Personnel Management (OPM), the DLA recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits in its Statement of Net Cost. In addition, the DLA recognizes a corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

- <u>Actuarial Liability</u>
  The DLA reports the unfunded actuarial liability for civilian personnel in their financial statements. The DLA obtains a liability annually from the Department of Labor.

- **Intragovernmental Elimination**
  Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the Department or between two or more federal agencies. However, the Department cannot accurately identify all Intragovernmental transactions by customer because the DoD's systems do not post and track buyer and seller data in a manner that allows for the matching of related transactions between the DoD entities. It is the DoD policy that seller entities provide revenue, accounts receivable, and unearned revenue balances from their records to buyer entities. The buyer entities adjust their corresponding balances to match the data provided by the seller, unless a waiver has been granted to the buyer. The DLA is not a waived entity. Intra-DoD (Intragovernmental) balances are then eliminated.

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 Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Customers may be required to make payments in advance.

I. Funds with the U.S. Treasury

The Department's financial resources are maintained in U.S. Treasury accounts. The DFAS, the Military Services, the U.S. Army Corps of Engineers (USACE) disbursing stations, and the Department of State financial service centers process the majority of cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury (Treasury), by appropriation, on interagency transfers, collections received, and disbursements issued. The Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in its system. When differences between DoD FBWT accounts and the Treasury's records occur, they are to be reconciled. Differences between accounting offices' detail-level records and the Treasury's FBWT accounts are disclosed in Note 1.Y. This note displays the differences caused by in-transit disbursements and unmatched disbursements (which are not recorded in the accounting offices' detail-level records).

J. Foreign Currency

DLA conducts a significant portion of its operations overseas. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. DLA does not separately identify currency fluctuations.

K. Accounts Receivable

As presented in the Balance Sheet statement, accounts receivable include accounts, claims, 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. In accordance with the DoD policy, the DLA does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are resolved between the agencies. See Note 3, Accounts Receivable for material disclosures.

L. Loans Receivable

DLA has no loans receivable.

M. Inventories and Related Property

The predominant amount of DLA inventories is currently reported at an approximation of historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The LAC method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability for inventory items, they do not maintain historical cost data necessary to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, “Accounting for Inventory and Related Property.” Additionally, these systems cannot produce financial transactions using the United States Standard General Ledger (USSGL), as required by the Federal Financial Management Improvement Act of 1996. Through the implementation of new systems and business processes, DLA will transition its non-energy inventories to the Moving Average Cost (MAC) method and its energy inventory to a transactional First-In First-Out (FIFO) methodology.

SFFAS No. 3 distinguishes between "Inventory held for sale;" "Inventory held in reserve for future sale;" and "Excess, obsolete, and unserviceable inventory." Because operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel, the DoD policy does not recognize either a management or a valuation difference between inventory held for current sale or inventory held in reserve for future sales. Because DLA holds materiel based on military need and support for contingencies, DLA does not attempt to account separately for items held for “current” or “future” sale.

The net value of condemned materiel held at the DLA storage activities, and all excess materiel held by DRMS, is zero. It is DoD policy that the cost of disposal of this materiel is considered to be greater than the potential scrap value that would be realized by selling the materiel.

Related property consists of Operating Materials and Supplies (OM&S). OM&S are valued at standard purchase price. DLA uses the consumption method of accounting for OM&S, expensing material when it is issued to the end user.

N. Investments in U.S. Treasury Securities

The DLA has no investments in U.S. Treasury Securities.

O. General Property, Plant and Equipment

General Property, Plant & Equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. Also, the DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 for General PP&E. The DLA depreciates all General PP&E, other than land, on a straight-line basis.

P. Advances and Prepayments

The DLA records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. In addition, when the DLA receives the related goods and services, it recognizes advances and prepayments as expenditures and expenses. The DLA advances and prepayments consist primarily of progress payments to vendors for materiel purchases (contract financing), generally for long lead time Clothing and Textile items. See Note 4 for material disclosures.

Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property and the value equals or exceeds the current the DoD capitalization threshold (a capital lease), it is the DoD policy to record the applicable asset and liability. The policy also requires recording the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset’s fair value. The DoD deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest was necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases. In addition, the DLA classifies leases that do not transfer substantially all of the benefits or risks of ownership as operating leases and records payment expenses over the lease term.

R. Other Assets

The DLA conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. When necessary, the DLA provides financing payments to alleviate the potential financial burden on the contractor that long-term contracts can cause.

The Federal Acquisition Regulations allow the Department to make financing payments, under fixed price contracts, that are not based on a percentage of completion. The DLA reports these financing payments as advances or prepayments in the "Other Assets" line item. The DLA treats these payments as advances or prepayments because the DLA becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the DLA is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the DLA for the full amount of the advance.

S. 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 the DLA. The uncertainty will be resolved when one or more future events occur or fail to occur. The DLA recognizes contingencies as liabilities when past events or exchange transactions occur, a future loss is probable and the loss amount can be reasonably estimated.

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

T. Accrued Leave

Liabilities reported by the DLA include civilian annual leave and military leave that have been accrued and not used as of the balance sheet date. The liabilities reported at the end of the accounting period reflect the current pay rates.

U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

- Unexpended Appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated in support of for which legal liabilities for payments have not been made.
- Cumulative Result of Operations for WCF represents the excess of revenues over expenses less refunds to customers and returns to the U.S. Treasury since fund inception.

V. Treaties for use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities, which are located overseas obtained through various international treaties and agreements negotiated by the Department of State. The DoD purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaty expires. The DoD's fixed assets decrease by not renewing a treaty or not reaching agreements. Therefore, in the event treaties or other agreements are terminated, and use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

W. Comparative Data

Financial statement fluctuations greater than 10 percent between 4th Quarter, FY 2003 and 4th Quarter, FY 2004 are explained within the Notes to the Financial Statements.

X. Unexpended Obligations

The DLA obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods/services not yet delivered.

Y. Problem Disbursements

(Amounts in thousands)	Sep 2003	Sep 2004	(Decrease)/ Increase from 2003 to 2004
1. Total Problem Disbursements			
A. Absolute Unmatched Disbursements	56,505.0	$ 35,615.0	$ (20,890.0)
B. Negative Unliquidated Obligations	1,905.0	1,453.0	(452.0)
2. Total In-transit Disbursements, Net	(13,178)	$ (7,739.0)	$ 5,439.0

The elimination of both problem disbursements and aged in-transits are two of the highest financial management priorities of the Under Secretary of Defense (Comptroller). The DFAS has efforts underway to improve the systems and to resolve all previous problem disbursements and to process all in-transit disbursements.

Data used for the 4th Quarter FY 2004 is from the August TI-97 consolidated problem disbursement (PD) reports. August 2004 PD reports are being used because not all the data was available from the centers in sufficient time to process the information into the required formats by the time the financial statements are due out.

Note 2. Nonentity and Entity Assets

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004			2003
	Nonentity	Entity	Total	Total
Intragovernmental Assets				
Accounts Receivable	$ –	$ 1,366,954	$ 1,366,954	$ 1,475,360
Other Assets	–	–	–	720
Total Intragovernmental Assets	$ –	$ 1,366,954	$ 1,366,954	$ 1,476,080
Non-Federal Assets				
Cash and Other Monetary Assets	$ 7,298	$ —	$ 7,298	$ 6,443
Accounts Receivable	2,396	441,196	443,592	526,941
Inventory and Related Property	–	14,683,932	14,683,932	12,166,093
General Property, Plant and Equipment	–	1,708,290	1,708,290	1,519,683
Other Assets	–	229,166	229,166	211,110
Total Non-Federal Assets	$ 9,694	$ 17,062,584	$ 17,072,278	$ 14,430,270
TOTAL ASSETS	**$ 9,694**	**$ 18,429,538**	**$ 18,439,232**	**$ 15,906,350**

Fluctuations and Abnormalities

Cash and other monetary assets, which consists of bid collections, increased by $854.8 thousand, or 13 percent, which is within the 25 percent variance that can occur in this account due to normal business activity.

Non-federal accounts receivable decreased by $7,080.9 thousand due to better management of overaged accounts receivable. More aggressive collection activities and write-off of uncollectible accounts has reduced the amount of accrued interest on the overdue receivables.

Information Related to Non-entity Assets

Asset accounts are categorized as either entity or non-entity. Entity accounts consist of resources that the agency has the authority use or when management is legally obligated to use the assets 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.

Cash and Other Monetary Assets: The $7,297.6 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.

Non-Federal Accounts Receivable: The $2,396.1 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 action.

Note 3. Accounts Receivable

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004			2003
	GROSS AMOUNT DUE	ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS	ACCOUNTS RECEIVABLE, NET	ACCOUNTS RECEIVABLE, NET
Intragovernmental Receivables	$ 1,366,954	N/A	$ 1,366,954	$ 1,475,360
Non-Federal Receivables, Net	449,917	(6,325)	443,592	526,941
TOTAL ACCOUNTS RECEIVABLE	**$ 1,816,871**	**$ (6,325)**	**$ 1,810,546**	**$ 2,002,301**

Allowance Method:

The primary allowance method used for calculating the allowance for estimated 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.

Fluctuations and Abnormalities

There was a $83,347.0 thousand decrease in Non-Federal Receivables primarily driven by aggressive collection actions. Actions included addressing over-aged receivables and validating documentation of the reporting balances.

Information Related to Accounts Receivable

Allocation of Undistributed Collections: The difference between collections reported to Treasury, cumulative from inception, and those recorded on the entity general ledger is referred to as undistributed collections. 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. Those that can be reconciled are considered as supported undistributed collections and are used to reduce the balance in accounts receivable. The Department of Defense policy, as stated in DoD FMR Volume 6B, Chapter 4, is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of federal and non-federal accounts receivable.

The account receivables are only reduced by the supported portion of undistributed collections. The unsupported portion is reclassified from USSGL 1310 — Accounts Receivable (either intragovernmental or non-federal) to USSGL 2400 – Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections (Non-Federal). USSGL 2400 is included in the other liabilities with the public line on the balance sheet and is discussed further in Note 11. The amount reclassified from USSGL 1310 to USSGL 2400 at September 30, 2004 was $86,737.1 thousand.

Elimination Adjustments: While the DLA's non-stockfund systems capture trading partner data at a transaction level in a manner that facilitates trading partner aggregations, the 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 the DLA's general ledgers.

Intragovernmental transactions are not fully reconciled. 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 that is compared to the total activity (except where the entity data can be derived directly from the general ledger accounts).

Total intra-DLA eliminations (eliminations between DLA business areas) were $113,957.8 thousand.

Intragovernmental Receivables Over 180 Days: The DLA systems which are capable of aging receivables have $190,761.5 thousand of intragovernmental receivables over 180 days (120 days for Supply Management Materiel). This aging category has not been adjusted to account for undistributed collections greater than 180 days or the elimination adjustments discussed above.

Non-Federal Receivables Over 180 Days: The DLA systems that are capable of aging receivables have $138,498.3 thousand of non-federal receivables over 180 days (120 days for Supply Management Materiel). This aging category has not been adjusted to account for undistributed collections greater than 180 days.

Note 4. Other Assets

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004	2003
Intragovernmental Assets		
Advances and Prepayments	$ –	$ 720
Non-Federal Assets		
Other Assets (With Public)	$ 229,166	$ 211,110
TOTAL OTHER ASSETS	**$ 229,166**	**$ 211,830**

Fluctuations

The intragovernmental other assets in FY 2003 of $720.5 thousand was attributable to a trading partner allocating advances to DLA instead of using actual records. At FY 2004, these allocations were challenged and the trading partner removed the advances.

Information Related to Other Assets

<u>Non-Federal Other Assets:</u> Other assets consist primarily (99.3%) of progress payments to vendors for materiel purchases (contract financing), generally for long lead time Clothing and Textile items. Other assets consist of progress payments to contractors of $227,588.8 thousand and other advances of $1,577.6 thousand.

Note 5. Cash and Other Monetary Assets

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004	2003
Cash	$ 7,298	$ 6,443
TOTAL CASH AND OTHER MONETARY ASSETS	**$ 7,298**	**$ 6,443**

Fluctuations and Abnormalities

Bid deposits exhibited a 13 percent overall increase for Fiscal Year 2004. Bid deposits can demonstrate a wide fluctuation during the normal course of DRMS business activities. For example, the deposits held by DRMS ranges from $4,123.0 thousand to $7,297.6 thousand over the last 12 months.

Information Related to Cash and Other Monetary Assets

Cash: Consists of cash resources under the control of the DLA, which can include coin, paper currency, purchased foreign currency, negotiable instruments, and amounts on deposit in banks and other financial institutions. The $7,297.6 thousand in cash represents deposits received from bidders.

Restriction on cash: The $7,297.6 thousand in cash represents bid deposits received by DRMS still remaining in suspense as of September 30, 2004. In accordance with DoD FMR Volume 11A, Chapter 5, bid deposits are recorded in suspense account X6501. At the time the successful 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, 2004 and 2003
(Amounts in thousands)

	2004	2003
Inventory, Net (Note 6.A.)	$ 14,675,912	$ 12,157,521
Operating Materials and Supplies, Net (Note 6.B.)	8,019	8,572
TOTAL	**$ 14,683,932**	**$ 12,166,093**

Note 6.A. Inventory, Net

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004				2003
	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method	Inventory, Net
Inventories Categories:					
Available and Purchased for Resale	$ 15,404,946	$ (734,996)	$ 14,669,950	Adjusted LAC/MAC	$ 12,147,004
Held for Repair	6,409	(447)	5,962	Adjusted LAC	10,517
Excess, Obsolete, and Unserviceable	3,438,181	(3,438,181)	–	NRV	–
TOTAL	**$ 18,849,536**	**$ (4,173,624)**	**$ 14,675,912**		**$ 12,157,521**

Legend for Valuation Methods

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

MAC = Moving Average Cost

NRV = Net Realizable Value

Fluctuations and Abnormalities

The inventory, gross increased by $2,931,151.0 thousand as shown below:

Fuel	$	1,810,472.8 thousand
Construction & Electronics	$	393,137.9 thousand
BSM	$	214,990.2 thousand
General	$	212,115.7 thousand
Clothing and Textile	$	163,872.1 thousand
Industrial	$	121,861.4 thousand
Medical	$	14,700.9 thousand

Increases in inventory are attributed to continued support that the DLA provided for Operation Enduring Freedom and Operation Iraqi Freedom. As part of these efforts, DLA has built inventory to support anticipated future demand. Some of the major drivers of increased inventory are as follows:

The increases in fuel are attributable to higher ending inventory balance of 1.8 million barrels ($118,000 thousand) and higher product cost ($52,500.0 thousand) of ending inventory. Overall, the ending inventory level increased by 1.8 million barrels in FY04 more than FY03. Increased fuel costs from $36.33 to $65.50 per barrel account for about $1,700.0 million. Ending inventory was about 59.5 million barrels. Additionally the Defense Energy Supply Center continues to capitalize fuel in accordance with phase 2.B, integrated material management directives, moving to a retail operation.

Increases in construction and electronics are due to support for the Army wheeled vehicle RESET programs, and lean forward strategy (buying in anticipation of future customer demands, i.e. extreme cold weather gear for troops in Afghanistan) and repair parts for the high-mobility multipurpose wheeled vehicle.

Clothing and textiles increase is due to increases in battle dress uniforms, extreme cold weather gear, combat boots, helmets, vests, eyewear, and tents.

Medical supply increases were offset somewhat by approximately $50,000.0 thousand decapitalization of Army single stock fund material and reassignment of $14,000.0 thousand to the Defense Supply Center Richmond.

The Business Systems Modernization (BSM) initiative is a movement from legacy systems which are managed by commodity, to an integrated system, which is managed by supply chain. DLA continued to transition from the legacy systems to BSM in FY 2004.

To arrive at the net inventory value, the DFAS applied the OSD(C) inventory model that resulted in a $734,996.4 thousand reduction in inventory value attributed to realized and unrealized holding period gains and losses. The revaluation for September 30, 2003 was approximately $410,000.0 thousand less. The primary reason for the change was the increase in the gains and losses accounts in the fuels commodity.

Inventory held for repair decreased by $4,500.0 thousand because of disposals and record clean-up.

Information Related to Inventory, Net

Examples of the DLA inventory include spare and repair parts, clothing and textiles, fuels, medical items, and Meals Ready to Eat. 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 available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the DLA. It also includes material held in reserve for future sale, due to 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 for the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready and mobile military force.

Excess, obsolete, and unserviceable (EOU) inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal. All of the $3,437.6 thousand held by DRMS is considered EOU, and therefore valued at zero using a revaluation allowance to reduce the gross value.

Inventory Valuation

BSM uses the moving average cost (MAC) method. The Fuels Automated System (FAS) uses transactional FIFO. 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 the legacy systems are valued at latest acquisition cost (LAC) and they approximate historical cost by using the OUSD(C) approved inventory model. 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 a July 6, 2001 memo, the OUSD(C) prescribed moving average cost as the inventory valuation method to be used within the Department. OUSD(C) also noted that the DoD component inventory 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, an alternative valuation methodology (model) has been mandated. The alternative valuation method attempts to convert latest acquisition cost (LAC) and standard price to MAC.

The total gross value of available and purchased for resale amount is composed of BSM and legacy elements as follows (in thousands):

Element	Amount	Valuation Method
BSM	$ 634,888.1	Moving Average Cost
Legacy	14,770,058.7	Adjusted LAC
Total (in thousands)	**$ 15,404,946.8**	

The gross value of the held for repair category is composed of BSM and legacy elements as follows (in thousands):

Legacy	$	5,291.5
BSM	$	1,117.9
Total	**$**	**6,409.4**

The gross value in the EOU account consists of amounts from Supply Management and the Defense Reutilization & Marketing Service (DRMS) as follows (in thousands):

Supply Management	$	570.2
DRMS	$	3,437,611.1
Total	**$**	**3,438,181.3**

Note 6.B. Operating Materials and Supplies, Net

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004				2003
	OM&S Gross Value	**Revaluation Allowance**	**OM&S, Net**	**Valuation Method**	**OM&S, Net**
OM&S Categories:					
Held for use	$ 8,019	$ 0	$ 8,019	Adjusted LAC/MAC	$ 8,572
Held for Repair	0	0	0	Adjusted LAC	0
Excess, Obsolete, and Unserviceable	0	0	0	NRV	0
TOTAL	**$ 8,019**	**$ 0**	**$ 8,019**		**$ 8,572**

Legend for Valuation Methods

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

MAC = Moving Average Cost

NRV = Net Realizable Value

Fluctuations and Abnormalities

The balance in held for use category of OM&S is $552.7 thousand less than in September 30, 2003.

Information Related to OM&S

DLA's operating materials and supplies (OM&S) are classified as "Held for Use." All DLA OM&S are held by the Document Automation and Production Service (DAPS).

OM&S 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 customers, and continued improvements to the automated production of electronic documents are produced via CD-ROM disks. OM&S are accounted for using the consumption method.

Note 7. General Property, Plant and Equipment, Net

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004					2003
	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	$ 1,908,854	$ (1,189,149)	$ 719,705	$ 731,461
Software	S/L	2-5 Or 10	634,895	(294,828)	340,068	225,730
Equipment	S/L	5 Or 10	622,426	(374,136)	248,289	227,570
Construction-in-Progress	N/A	N/A	400,228	N/A	400,228	334,922
TOTAL GENERAL PP&E			**$ 3,566,403**	**$ (1,858,113)**	**$ 1,708,290**	**$ 1,519,683**

S/L = Straight Line

Fluctuations and Abnormalities

The Supply Management business area accounted for most of the $188,606.4 thousand (12 percent) variance. Software increased by $114,337.5 thousand, primarily related to the acquisition of new troop support system and BSM initiative. Construction in progress increased by $65,306.3 thousand, predominately due to new software not yet deployed ($56,300 thousand) and minor construction ($9,000.0 thousand). The software development was primarily for BSM. The minor construction was mostly associated with Distribution and Reutilization and Marketing business areas. Legacy accounting systems do not have an account to record software under development, therefore construction-in-progress is used.

Other Information Related to General PP&E, Net

The value of general PP&E real property in the possession of contractors is included in the values reported above for the major asset classes of land and buildings, structures, and facilities.

Note 8. Liabilities Not Covered and Covered by Budgetary Resources

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004			2003
	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	Total
Intragovernmental Liabilities				
Accounts Payable	$ 184,824	$ –	$ 184,824	$ 169,254
Other	9,107	62,164	71,271	75,064
Total Intragovernmental Liabilities	**$ 193,931**	**$ 62,164**	**$ 256,095**	**$ 244,318**
Non-Federal Liabilities				
Accounts Payable	$ 2,372,375	$ –	$ 2,372,375	$ 2,236,340
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	–	278,596	278,596	315,843
Environmental Liabilities	–	56,722	56,722	68,796
Other Liabilities	388,294	–	388,294	282,791
Total Non-Federal Liabilities	**$ 2,760,669**	**$ 335,318**	**$ 3,095,986**	**$ 2,903,770**
Total Liabilities	**$ 2,954,600**	**$ 397,482**	**$ 3,352,082**	**$ 3,148,088**

Fluctuations and Abnormalities

Other intragovernmental liabilities decreased by $6,926.4 thousand. The major driver of this change was a decrease in accrued liabilities to Treasury on overdue accounts receivable balances. The decrease was attributed to clean up efforts.

The $37,246.8 thousand decrease in actuarial liabilities is the result of a reduction to the actuarial FECA amount allocated to DLA. Military retirement benefits and other employment-related actuarial liabilities are computed annually for the Department of Defense based on formulas developed by the Department of Labor. The DoD amount is then allocated to all DoD agencies using a percentage derived from the prior three annual amounts paid by each agency.

The environmental liabilities shows a decrease of $12,074.2 thousand reflects the refinement of the process and methodology that DLA uses to develop clean-up costs. See Note 10 for additional explanation of the variance.

Information Related to Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources: Those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date.

Liabilities Covered by Budgetary Resources: Those that are incurred by the reporting entity which are covered by realized budget resources as of the balance sheet date. Budgetary resources encompass not only new budget authority, but also 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 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) 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 Office of Management and Budget (OMB) without further action by the Congress or without a contingency first having to be met.

Other Liabilities Not Covered by Budgetary Resources

Other intragovernmental liabilities consists of $59,768.3 thousand in accrued FECA and $2,396.1 thousand in amounts due representing interest receivable on overdue public accounts receivable that must be remitted to the Department of the Treasury upon receipt. See Notes 3 and 11 for additional information on the liability on interest receivable.

Note 9. Accounts Payable

As of September 30, 2004 and 2003 (Amounts in thousands)	2004			2003
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
Intragovernmental Accounts Payable	$ 184,824	N/A	$ 184,824	$ 169,254
Non-Federal Accounts Payable	2,370,827	1,548	2,372,375	2,236,340
Total Liabilities	**$ 2,555,651**	**$ 1,548**	**$ 2,557,199**	**$ 2,405,594**

Fluctuations and Abnormalities

No variance explanation is required.

Information Related to Accounts Payable

Intragovernmental accounts payable consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Non-federal payables (also known as public payables) include amounts owed to non-federal government entities. The amount shown as interest, penalties and administrative fees represents interest and other fees accrued on overdue non-federal accounts payable.

Undistributed Disbursements: Intragovernmental transactions are not fully reconciled. Those that can be reconciled are considered as supported undistributed disbursements and are used to adjust the balance in accounts payable. The Department of Defense policy, as stated in DoD FMR Volume 6B, Chapter 4, is to allocate supported undistributed disbursements between federal and non-federal categories based on the percentage of federal and non-federal accounts payable. As a result of the undistributed disbursements, the accounts payable were adjusted downward in the amount of $99,424.4 thousand.

A portion of the undistributed disbursements cannot be reconciled to known differences, such as unmatched disbursements or intransit disbursements, and are considered 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 U.S. Standard General Ledger 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 by the DLA was $(188,006.2) 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. For reporting purposes, DLA receives information from other intragovernmental activities as to the amount of payables to be eliminated. DoD guidance mandates that DLA adjust its records to agree to this information, by reclassifying between **fed-**

eral and non-federal accounts payable. Only the eliminations entries between DLA activities are reflected on DLA's financial statements. Total intra-DLA eliminations were $113,957.8 thousand.

The 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 can not be accomplished with the existing time constraints or with anticipated resources.

Note 10. Environmental Liabilities and Disposal Liabilities

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004			2003
Other Accrued Environmental Costs (Non-DERP funds)	**Current Liability**	**Non-current Liability**	**Total**	**Total**
Active Installations-Environmental Corrective Action	$ 8,524	$ 48,198	$ 56,722	$ 68,796
Total Liabilities	**$ 8,524**	**$ 48,198**	**$ 56,722**	**$ 68,796**

Fluctuations and Abnormalities

The other accrued environmental costs of $8,524.0 thousand, were obligated to support clean-up efforts at active Defense Energy Support Center (DESC) installations and were made available in the Supply Management Business Area operating account of the Defense Working Capital Fund. The $48,198.0 thousand is the amount programmed for clean up during the Program Objective Memorandum (POM) cycles and future years until clean up is completed. The cost variance of $12,074.2 thousand between reporting periods reflects the refinement of the process and methodology that DLA uses to develop clean-up costs. The basis for that refinement is the use the Remedial Action Cost Engineering Requirements (RACER) model to develop cost to clean-up information.

Environmental clean-up efforts at DLA are and will continue to be completed in accordance with federal and state laws and regulations. These laws are Comprehensive Environmental Response, Compensation, and Liabilities Act (CERCLA) also referred to the "Superfund"; Resource Conservation and Recovery Act (RCRA); and CERCLA Amendments called Superfund Amendments and Reauthorization Act (SARA).

Note 11. Other Liabilities

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004			2003
	Current Liability	Noncurrent Liability	Total	Total
Intragovernmental				
Judgment Fund Liabilities	$ 48	$ –	$ 48	$ –
FECA Reimbursement to the Department of Labor	26,481	33,287	59,768	59,613
Other Liabilities	11,454	0	11,454	15,451
Total Intragovernmental Other Liabilities	**$ 37,983**	**$ 33,287**	**$ 71,271**	**$ 75,064**
Non-Federal				
Accrued Funded Payroll and Benefits	$ 144,012	$ –	$ 144,012	$ 131,932
Advances from Others	128,521	–	128,521	119,031
Deposit Funds and Suspense Accounts	94,034	–	94,034	31,828
Other Liabilities	21,727	–	21,727	–
Total Non-Federal Other Liabilities	**$ 388,294**	**$ –**	**$ 388,294**	**$ 282,791**
Total Other Liabilities	**$ 426,277**	**$ 33,287**	**$ 459,566**	**$ 357,855**

Fluctuations and Abnormalities

The Judgement Fund liabilities increased because two contract dispute amounts to be repaid by DLA have not yet been paid.

Intragovernmental other liabilities decreased by $3,996.9 thousand. Accrued custodial liabilities decreased by $7,080.9 thousand because of effective clean up efforts in overdue public receivables. In addition, employer payroll liabilities increased by $3,084.0 thousand due to changes in employment expenses.

Deposit funds and suspense accounts increased by $62,206.2 thousand because unsupported undistributed collections reclassified to USSGL 2400 increased. The main driver of this increase is an ongoing problem with interfund clearing due to problems with implementing new software system.

The increase in non-federal other liabilities of $21,727.1 thousand is a result of the BSM system correctly reporting other liabilities, which was not available as a separate line from legacy systems in the past.

Information Related to Other Liabilities

Intragovernmental Other Current Liabilities (in thousands)

Types	FY 2004	FY 2003
Accrued Retirement	$ 3,457.4	$ 2,626.6
Accrued Life Insurance	69.8	53.5
Accrued Health Insurance	3,052.2	2,169.8
Accrued Custodial Liability	2,396.1	9,477.0
Accrued VSIP	2,478.4	1,123.9
Total (in thousands)	**$ 11,453.9**	**$ 15,450.8**

Intragovernmental Other Current Liabilities: The accrued custodial liability in the above table consists of interest receivable on overdue public accounts receivable. This liability arises from the fact that this interest and penalties receivable must be remitted to the Department of the Treasury upon receipt. See Notes 3 and 9 for additional information.

Non-Federal Other Liabilities: Consists of liabilities accrued on inventory in transit from vendors and customers.

Intragovernmental Reconciliation for Fiduciary Transitions With DOL and OPM: The department was able to reconcile the fiduciary balance with the OPM and the DOL. No material differences were identified during the reconciliation.

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 $86,737.1 thousand. See Note 3. The remaining $7,297.6 thousand consists of bid deposits. See Note 2.

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 the DoL. DoL pays the claim holders and prepares a chargeback to the applicable agency. The liability represents the chargeback amount to the applicable agency. Public Law 93-416, Section 8147 essentially gives agencies two years to pay the chargeback bill, allowing time for inclusion in their budgets. Therefore, there should be an unfunded liability in the statements for these two 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

Information Related to Commitments and Contingencies

The DLA is currently 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 use of the clauses was proper and in accordance with law, making the claims and suits unjustified. There is approximately $3,000,000.0 thousand at risk. DLA is not recognizing these as contingent legal liabilities in the financial statements because the amount or outcome of the cases is uncertain.

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

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004			2003
	Actuarial Present Value of Projected Plan benefits	(Less: Assets to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
FECA	$ 278,596	$ –	$ 278,596	$ 315,843
Total Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	**$ 278,596**	**$ –**	**$ 278,596**	**$ 315,843**

Fluctuations and Abnormalities

The $37,246.8 thousand decrease in actuarial liabilities is the result of a reduction to the actuarial FECA amount allocated to DLA. Military retirement benefits and other employment-related actuarial liabilities are computed annually for the Department of Defense based on formulas developed by the Department of Labor. The DoD amount is then allocated to all DoD agencies using a percentage derived from the prior three annual amounts paid by each agency.

Information Related to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

FECA

The DLA's actuarial liability for workers' compensation benefits is developed by the Department of Labor's (DOL) Employment Standards Administration (ESA) and provided to DLA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's 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.

The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions have not been updated for FY 2004; therefore, the FY 2003 rates are being utilized. Interest rate assumptions utilized for discounting are as follows:

2004
4.883% in Year 1
5.235% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. These factors were also used to adjust the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPM
2005	2.03%	4.14%
2006	2.73%	3.96%
2007	2.40%	3.98%
2008	2.40%	3.99%
2009+	2.40%	4.02%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection.

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

Fluctuations and Abnormalities

The changes in DLA total costs and revenue are provided below:

Total Revenue — In Thousands

Activity Group	FY2004	FY2003	Dollar Change	Percent Change
Distribution	2,565,868	2,377,007	188,861	8%
Supply Management	25,003,037	22,543,781	2,459,256	11%
Reutilization and Marketing	349,198	342,420	6,778	2%
Document Automation and Production	378,010	393,427	(15,417)	-4%
Total Gross Revenue – Intragovernmental and Public	**28,296,113**	**25,656,635**	**2,639,478**	**10%**

Total Costs — In Thousands

Activity Group	FY2004	FY2003	Dollar Change	Percent Change
Distribution	2,466,012	2,264,923	201,089	9%
Supply Management	24,984,123	23,462,753	1,521,370	6%
Reutilization and Marketing	303,031	261,970	41,061	16%
Document Automation and Production	360,951	372,415	(11,464)	-3%
Total Earned Costs – Intragovernmental and Public	**28,114,117**	**26,362,061**	**1,752,056**	**7%**
NET COSTS	**181,996**	**(705,426)**	**887,422**	

Total Earned Revenue

There was a gross increase in total earned revenue of $2,639,478.0 thousand. The main businesses that drove this increase were a $2,459,256.0 thousand increase in Supply Management and a $188,861.0 thousand increase in the Distribution activity.

The primary drivers for the Supply Management intragovernmental revenue increase are Operation Enduring Freedom and Operation Iraqi Freedom. These operations have caused an increase in sales across all supply chains of DLA.

Hardware sales across the commodities increased by $602,900.0 thousand.

Troop support revenue increased by $1,170.8 thousand.

The Defense Supply Center Philadelphia manages troop support items. The Center expanded its customer base through prime vendor contracts in the General and Industrial and Subsistence supply chains. Prime vendor contracts simplify customer ordering, provide quicker delivery of material, and increase item accessibility. The Center also continued to provide critical clothing and textile items such as: small arms protective inserts, chemical protective gear, tents, body armor, and advanced helmets. The Defense Energy Support Center revenue increased by $707,000.0 thousand due primarily to the increase in the price per barrel. Additionally, as the result of a claim, DESC will receive a refund of $25,600.0 thousand for a violation of crude oil regulations from 1973–1981.

Reutilization and Marketing increased revenue of $6,778.0 thousand is attributable to increased sales to the public, an increased rate of return, an improved scrap market, more property available for sale and an increase in the Asian market. This was offset by a reduction of transportation activity billing.

Total Gross Costs

The increase in total gross costs of $1,752,056.0 thousand resulted from business activity generated in the Distribution and Supply Management activity groups. The major contributors to the variances in this account are the increase in costs of goods sold, implementation of BSM, and personnel compensation.

Supply Management's increased costs of $1,521,370.0 thousand are reflective of its sales increases in support of Operation Iraqi Freedom and Operation Enduring Freedom. Supply Management materiel cost increased primarily as follows:

Distribution costs increased by $201,089.0 thousand primarily attributed to employees being hired, higher transportation costs, and increases in annual wages.

DESC's increase in cost is attributed to the rise in inventory valuation and the increased cost of fuels.

Information Related to Statement of Net Cost

Both costs and revenues were reduced by $842,749.9 thousand from intra-DLA eliminations.

The Consolidated Statement 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.

Note 14.B. Imputed Expenses

As of September 30, 2004 and 2003
(Amounts in thousands)

	2004	2003
Civilian Retirement	$ 59,848	$ 60,815
Civilian Health	74,578	64,379
Civilian Life Insurance	219	211
Judgment Fund	2,878	7,836
TOTAL IMPUTED EXPENSE	**$ 137,524**	**$ 133,241**

The Imputed Judgment Fund expense represents amounts paid by the Department of the Treasury that DLA is not required to reimburse.

Note 14.C. Exchange Revenue

Exchange Revenue — arises when a Government entity provides goods and services to the public or to another Government entity for a price, — "earned revenue." Exchange revenue includes most user charges other than taxes, i.e., regulatory user charges.

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. DLA establishes 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. 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 revenue being included in the eliminations entries.

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.

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, 2004 and 2003 (Amounts in thousands)	2004 Consolidated	2003 Consolidated
Civilian Retirement	$ 59,848	$ 60,815
Civilian Health	74,579	64,379
Civilian Life Insurance	219	211
Judgment Fund	2,878	7,836
TOTAL IMPUTED EXPENSE	**$ 137,524**	**$ 133,241**

Information Related to Statement of Changes in Net Position

Imputed Financing: The amounts that the Defense Logistics Agency remits to the Office of Personnel Management for employees covered by the CSRS, FERS, FEHB and FEGLI 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 and the employee contributions made on their behalf by the Defense Finance and Accounting Service. 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 data, on civilian employee's base salary and number of employees electing health benefits by reporting entity, to the OUSD(P&R). The OUSD(P&R) computes and validates the imputed expenses for civilian employee's retirement and other benefits and provides it to the reporting components.

In the course of its business, the DLA is occasionally found liable for various monetary damages in court decisions. These judgments are paid by the Department of the Treasury (Treasury) once the decision is final. These judgments may be either reimbursable by the DLA, in accordance with guidelines produced by Treasury, or imputed (not repaid) by the DLA activity involved. The amounts reported on the schedule above are those amounts paid by Treasury during the current fiscal year that are not required to be repaid. The reimbursable or imputed nature of the judgment is determined from information on a website maintained by Treasury for this purpose.

Note 16. Disclosures Related to the Statements of Budgetary Resources

As of September 30, 2004 and 2003 (Amounts in thousands)	2004	2003
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 11,122,094	$ 9,899,635
Available Borrowing and Contract Authority at End of the Period	$ 8,178,874	$ $6,765,825

Information Related to Statement of Budgetary Resources

Budgetary Resources Obligated For Undelivered Orders

Undelivered orders consist of $10,892,927.7 thousand in orders without advances and $229,166.4 thousand in orders with advances.

Available Borrowing and Contract Authority at the End of the Period:

Available contract authority represents the budgetary authority for use by DLA's Working Capital Fund. At the end of the year, contract authority available for obligation was zero because unobligated contract authority is withdrawn as part of the year-end pre-closing process. The amount shown in the table represents the cumulative (since inception) unliquidated realized contract authority and is comprised of the following:

- Beginning unliquidated contract authority $6,765,824.7 thousand.
- Contract authority realized current year $30,796,611.8 thousand.
- Current year earned authority from offsetting collections ($27,614,722.8) thousand.
- Appropriations received to liquidate contract authority ($1,768,839.0) thousand.

Budget Authority: Appropriations Received, Net Transfers, and Unobligated Balance: Net Transfers Actual.

DLA received $1,768,839.0 thousand in appropriations to liquidate contract authority. Of that amount, $1,566,324.0 thousand was directly appropriated for increased fuel costs in the DoD Emergency Supplemental Appropriation Act 2004 (P.L. 108-106) and the DoD Appropriations Act 2005 (P.L. 108-287). The remaining $202,515.0 thousand was received for spare parts, unused storage, fuel facilities studies and legacy systems costs.

Note 17. Disclosures Related to the Statements of Financing

Information Related to the Statement of Financing

The statement 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 statement 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 statement of budgetary resources), are not included in spending authority from offsetting collections and adjustments line on the statement of budgetary resources or on the statement of financing.

Explanation of Other Lines:

<u>Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations: Other:</u> This amount consists of $(179,493.9) of end-of-quarter Fund Balance With Treasury (FBWT) that is adjusted to transfer resources to component level. This transfer is done because FBWT is managed at the component level. In addition, there were transfers out of equipment from the Distribution group to other DoD agencies of $4,376.9 thousand.

<u>Components Requiring or Generating Resources in Future Period: Other:</u> This line consists of $48.9 thousand in Judgement Fund amounts under the Contract Dispute Act that are due to the Treasury in the future, $21,727.1 thousand in accrued liabilities on inventory in transit from vendors or customers, and $1,582.2 thousand in increase in FECA liability for the Supply Management Operations activity (other activities had decreases in FECA liability and that amount is included in resources that fund expenses recognized in prior periods).

<u>Components not Requiring or Generating Resources: Other:</u> This line is comprised of $6,750.8 thousand in increases in the allowance for bad debt, a $(36,947.6) thousand charge correcting unearned revenue, a $(13,098.4) thousand in a gain on disposal of assets that did not have a budgetary component and $3,648.0 thousand in miscellaneous expenses that did not require budgetary resources.

<u>Resources that Finance the Acquisition of Assets:</u> This line increased from a change in process. During FY03, this line included the inventory purchases, net of cost of goods sold (change in inventory). In FY04, this line included only the inventory purchased during the year. Cost of Goods Sold is now a separate line and showed an increase of $21,116 thousand for FY04.

<u>Increases in Annual Leave Liability:</u> This line decreased because DLA funded all its unfunded leave.

<u>Increase in Environmental and Disposal Liability:</u> This line decreased by $12,074.2 thousand because the calculation method had changed.

<u>Other Components Requiring or Generating Resources in Future Period:</u> This line decreased from a reduction in accrued FECA ($1,428.0 thousand) and a decrease of actuarial FECA ($37,247.0 thousand). Also, the judgment fund accrual increased by $48.8 thousand.

Other Information Related to the Statement of Financing

The statement of financing often requires adjustments to balance the statement because of imbalances between budgetary and proprietary amounts recorded in legacy accounting systems. The amount shown on resources that finance the acquisition of assets includes $130,359.1 thousand in the Supply Management Materiel activity group. The amount shown on components not requiring or generating resources: other includes $918.7 thousand in the Distribution activity group, $(56.4) thousand in the Supply Management Operations activity group, $(1,096.0) thousand in the DAPS activity group and $(1,179.8) thousand in the Reutilization and Marketing activity group.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Required Supplementary Stewardship Information

For the Years Ended September 30, 2004 and 2003

UNAUDITED

Heritage Assets

For the Years Ended September 30, 2004 and 2003

	Measurement Quantity	As of 10/01/03	Additions	Deletions	As of 09/30/04
Cemeteries & Archeological Sites	Sites	1	–	–	1
Buildings & Structures	Each	2	–	1	1

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 has been contacted provided concurrence with the project scope to ensure the historical integrity of the property is maintained with the planned project.

The Defense Supply Center — Richmond (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, 2004 and 2003

UNAUDITED

Real Property Deferred Maintenance

As of September 30, 2004
(In thousands)

FY 2004 sustainment requirements for DLA are from version 6.1 of the DoD Facilities Sustainment Model (FSM). The annual sustainment requirement for FY 2004 has been deflated from FSM 6.1 data for FY 06 for DLA. The requirements and funding represent facilities funded from Operations & Maintenance (O&M), Defense Wide Family Housing appropriations, and the Defense Wide Working Capital Fund (WCF), and from Non-Appropriated Funds (NAF). DLA sustainment data includes facilities that are multi-use heritage assets.

Annual Sustainment FY 2004

Property Type	1. Required	2. Actual	3. Difference
Buildings, Structures, and Utilities	$ 463,853	$ 224,900	$ 239,953

Annual Deferred Sustainment Trend

Property Type	FY 2001	FY 2002	FY 2003	FY 2004
Buildings, Structures, and Untilities	$ 222,400	$ 218,400	$ 293,400	$ 239,000

Restoration & Modernization Requirements

Property Type	End FY 2003	End FY 2004	Change
Buildings, Structures, and Untilities	N/A	$ 427,800	$ 472,800

Comprehensive real property condition information is unavailable as the majority of the facilities for which the Agency is responsible for sustainment or restoration and modernization since they 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. DoD 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 actual survey results will not be complete before the end of FY 05. Insufficient human and financial resources are available to annually assess all Agency facilities and manage the resulting data. As a result accurate restoration and modernization requirements are not available for all DLA sites. The estimates listed above are for DLA permitted sites. The facilities at these locations are predominantly C-1.

UNAUDITED

Required Supplemental Information — Part A, Intragovernmental Asset Balances

As of September 30, 2004
(In Thousands)

	Treasury Index	Accounts Receivable
The Judiciary	10	2
Executive Office of the President	11	1
Department of Agriculture	12	3,848
Department of Commerce	13	317
Department of the Interior	14	668
Department of Justice	15	6,282
Department of Labor	16	5,392
Navy General Fund	17	214,754
United States Postal Service	18	189
Department of State	19	1,233
Department of Treasury	20	2
Army General Fund	21	290,829
Office of Personnel Management	24	1
Smithsonian Institution	33	20
Department of Veterans Affairs	36	4,731
General Service Administration	47	19,602
National Science Foundation	49	72
Air Force General Fund	57	135,957
Federal Emergency Management Agency	58	60,548
Tennessee Valley Authority	64	23
Department of Transportation	69	18,503
Homeland Security	70	126
Agency for International Development	72	6
Department of Health and Human Services	75	5,361
National Aeronautics & Space Administration	80	8,715

UNAUDITED

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

As of September 30, 2004
(In Thousands)

	Treasury Index	Accounts Receivable
Armed Forces Retirement Home	84	280
Department of Energy	89	727
Independent Agencies	95	16,365
U.S. Army Corps of Engineers	96	8,240
Other Defense Organizations General Funds	97	94,212
Other Defense Organizations Working Capital Funds	97-4930	97,776
Army Working Capital Fund	97-4930.001	88,184
Navy Working Capital Fund	97-4930.002	116,573
Air Force Working Capital Fund	97-4930.003	167,379
Totals		**$ 1,366,954**

UNAUDITED

Required Supplemental Information — Part B, Intragovernmental Entity Liabilities

As of September 30, 2004
(In Thousands)

	Treasury Index	Accounts Payable	Other
Department of Agriculture	12	52	
Department of the Interior	14	1,308	
Department of Justice	15	1,599	
Department of Labor	16	880	59,768
Navy General Fund	17	5,185	
Department of State	19	84	
Department of the Treasury	20	182	49
Army General Fund	21	19,611	
Office of Personnel Management	24	255	9,058
Government Printing Office	4	5,977	
General Service Administration	47	18,430	
Central Intelligence Agency	56	6	
Air Force General Fund	57	22,448	
Homeland Security	70	2,279	
Department of Health and Human Services	75	26	
Department of Energy	89	12	
US Army Corps of Engineers	96	3	
Other Defense Organizations General Funds	97	1,009	
Other Defense Organizations Working Capital Funds	97-4930	55,963	
Army Working Capital Fund	97-4930.001	14,755	
Navy Working Capital Fund	97-4930.002	(1,573)	
Air Force Working Capital Fund	97-4930.003	36,333	
The General Fund of the Treasury	99	–	2,396
Totals		**$ 184,824**	**$ 71,271**

UNAUDITED

Required Supplemental Information – Part C, Intragovernmental Revenue

For the Year Ended September 30, 2004
(In Thousands)

	Treasury Index	Earned Revenue
The Judiciary	10	3
Executive Office of the President	11	872
Department of Agriculture	12	34,901
Department of Commerce	13	2,744
Department of the Interior	14	4,472
Department of Justice	15	22,264
Department of Labor	16	8,154
Navy General Fund	17	3,553,505
United States Postal Service	18	504
Department of State	19	8,830
Department of the Treasury	20	8,118
Army General Fund	21	7,075,725
Office of Personnel Management	24	34
Social Security Administration	28	(41)
Nuclear Regulatory Commission	31	20
Smithsonian Institution	33	113
Department of Veterans Affairs	36	14,292
General Service Administration	47	28,462
National Science Foundation	49	10,020
Air Force General Fund	57	3,030,857
Federal Emergency Management Agency	58	69,333
Tennessee Valley Authority	64	71
Environmental Protection Agency	68	6
Department of Transportation	69	97,873
Homeland Security	70	184
Agency for International Development	72	12

UNAUDITED

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

For the Year Ended September 30, 2004
(In Thousands)

	Treasury Index	Earned Revenue
Small Business Administration	73	153
Department of Health and Human Services	75	18,636
Independent Agencies	76	21
National Aeronautics and Space Administration	80	39,743
Department of Housing and Urban Development	86	98
Department of Energy	89	5,817
Department of Education	91	(10)
Independent Agencies	95	38,592
US Army Corps of Engineers	96	13,275
Other Defense Organizations General Funds	97	2,010,777
Other Defense Organizations Working Capital Funds	97-4930	1,327,605
Army Working Capital Fund	97-4930.001	1,928,857
Navy Working Capital Fund	97-4930.002	2,036,294
Air Force Working Capital Fund	97-4930.003	4,113,339
Architect of the Capitol		1
Totals		**$ 25,504,526**

UNAUDITED

Required Supplemental Information – Part E, Intragovernmental Nonexchange Revenue

For the Year Ended of September 30, 2004
(In Thousands)

	Treasury Index	Transfers-Out
Navy General Fund	17	26
Army General Fund	21	4,259
Other Defense Organizations Working Capital Funds	97-4930	(143,994)
Navy Working Capital Fund	97-4930.002	92
Totals		**$ (139,617)**

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 1400 weapon systems, as well as management responsibility for 1.6 million non-weapon system items. These non-weapon system items include: construction materiel, general supplies and troop support items such as food, clothing and textiles, and medical supplies. In addition DLA manages fuel and had net sales of 134 million barrels during FY 04. There are more than 11,400 civilian and 426 military personnel that support this business area. The Supply Management Activity Group generated revenue which totaled about $25.0 billion during FY 04. This is an increase of over $2.5 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 metrics directly support the DLA Strategic Plan goal to provide responsive, best value supplies and services consistently to our customers:

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

The following chart portrays our accomplishments from FY 01 through FY 04.

Weapon System Supply Availability				Goal	Actual
Service Branch	**FY 01**	**FY 02**	**FY 03**	**FY 04**	**FY 04**
Army	88.8%	90.7%	88.4%	88.5%	87.3%
Air Force	81.8%	84.0%	86.6%	86.6%	88.1%
Navy	84.4%	85.9%	87.2%	87.1%	89.9%
Marine Corps	90.3%	91.7%	88.2%	88.3%	87.0%
Total Services	**86.1%**	**88.0%**	**87.7%**	**N/A**	**87.9%**

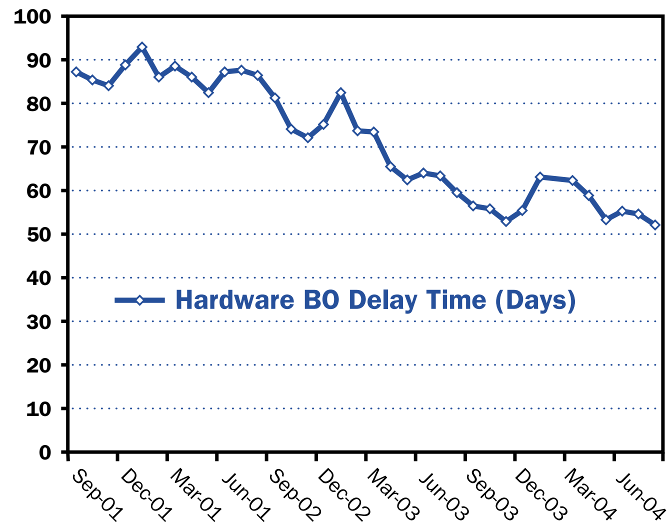
In response to events that were taking place overseas, the Department of Defense realigned funds from our Air Force and Navy customers to the Army. This resulted in lower than expected Air Force and Navy demand. Because we prepared our inventory to support demands greater than those received, we were able to provide the Air Force and Navy with better than expected supply support. Conversely, since the Army's and Marines Corps' FY 03 and FY 04 demands were greater than forecasted, Supply Availability dropped in both years. As we realigned our resources to meet this challenge, we delivered improved support to both the Army and Marine Corps customers throughout FY 04. We expect that level of support will continue in FY 05.

Customer Backorders and Backorder Delay Time: DLA measures and tracks its effectiveness in meeting customer requirements by reporting statistics on Customer Backorders and Backorder Delay Time as key components of the Performance Management Review process. This ensures maximum leadership visibility and management attention for these key metrics related to customer satisfaction, and has contributed to improvement by DLA in fulfilling customer requirements during FY 04.

The following equation explains the relationship between Backorders on Hand and Demand and Backorder Delay Time.

Backorders = (1-Supply Availability) * Average Daily Rate * Backorder Delay Time

As can be seen from the equation, Backorders on Hand are related to the Supply Availability (SA), the number of requisitions received (or Average Daily Demand Rate) and the time it takes to fill or release a requisition once it is on backorder. This means that SA can improve, but if the Average Daily Rate or the Backorder Delay Time increases the result could be that Backorders increase. DLA has focused efforts not only on improving SA but also on reducing the number of days items remain on backorder. DLA has streamlined the contract award process which includes increasing dramatically the percent of awards that are awarded automatically. As can be seen in the chart below, the Backorder Delay Time decreased from 87.1 days in September 2001 to 81.2 days in September 2002 to 56.4 days in September 2003 to 51.6 days in September 2004, a decrease over 3 years of 41% and a decrease over the last year of 8.5%.



Through aggressive leaning forward efforts implemented to meet an unprecedented level of demand of 15.3 million customer demands in FY 04, DLA was able to bring the number of customer backorders for spare and repair parts to historical lows in March 04. This decrease in backorders was accompanied by a decrease of 4.8 days in the backorder delay time over FY 04. In late August 2004, a large number of Aviation demands were received which, in spite of the decrease in delay time, resulted in an increase in our backorders on hand.

Customer requisitions increased by 9% in FY 04; however, there was an increase of only 4% in backorders on hand. The following chart shows that the number of backorders on hand at the end of the fiscal year as a percent of the total requisitions received during that year continued to decrease in FY 04 to 2.15%.

Hardware Spare Parts Requisitions and Backorders on Hand

(In Thousands)

	FY 01	FY 02	FY 03	Goal FY 04	Actual FY 04
Requisitions	$ 12,297.7	$ 12,550.1	$ 14,045.0	NA	$ 15,337.7
Backorders	422.5	314.3	318.7	274.5	330.0
Backorders on hand as % of total FY requisitions	**3.44%**	**2.50%**	**2.27%**	**N/A**	**2.15%**

Business System Modernization (BSM) Logistics Response Time: Prior to the migration of items from our legacy system into the concept demonstration for BSM, the Logistics Response Time (LRT) was 21.2 days. Following a period where LRT rose for all customers — due to the support requirements for Operation Iraqi Freedom — the LRT for these items dropped to an average LRT of 17.9 days, which is an improvement of 3.3 days or 15.6%.

FY 04 Accomplishments

Task Force — Restore Iraqi Oil (TF-RIO): Hostilities in Iraq resulted in damage to the Iraqi oil infrastructure and degraded control of the oil systems. The inability to make distribution caused severe fuel shortages. At the direction of the Under Secretary of Defense for Acquisition and Logistics, the Defense Energy Support Center (DESC) was given the Humanitarian Fuel Distribution mission to support the Iraqi populace. DESC served as the contracting agent for the Coalition Provisional Authority (CPA) that was established to facilitate the stabilization of Iraq and assist the Iraqi people in developing a democratic government. DESC also took steps to provide its logistical management services to meet the both commercial and private sectors' demand for electric power production. This politically sensitive and high profile mission lasted from 1 April 2004 to 15 August 2004.

Aviation Investment Strategy (AIS) 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 was 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 for 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	FY 04
AIS SA (Non-Engine)	29.9%	36.6%	62.4%	73.4%	78.7%	81.6%	82.9%
AIS SA (Engines)	41.7%	53.4%	70.2%	76.4%	85.5%	87.0%	89.9%

FY 01 AIS Investment Items	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
AIS SA (Non-Engine)	N/A	41.8%	47.4%	66.2%	77.3%	81.4%	81.4%
AIS SA (Engines)	N/A	47.3%	52.1%	67.4%	81.7%	86.5%	87.7%

FY 02 AIS Investment Items	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
AIS SA (Non-Engine)	N/A	N/A	41.0%	38.6%	65.6%	79.1%	81.2%
AIS SA (Engines)	N/A	N/A	41.5%	43.7%	73.9%	82.6%	90.8%

FY 03 AIS Investment Items	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
AIS SA (Non-Engine)	N/A	N/A	N/A	47.5%	46.0%	64.9%	74.5%
AIS SA (Engines)	N/A	N/A	N/A	42.5%	46.1%	65.9%	85.3%

Strategic Materiel Sourcing (SMS) Program: This program is DLA's successful adoption of best practices for Troop Support where over 90 percent of all DLA materiel purchases were shifted to long-term contracts. SMS is an umbrella initiative that focuses on stratifying and awarding high demand/sales and readiness driver hardware items through long-term contracts. The long-term agreements range from Strategic Supplier Alliances, to Prime Vendor Agreements, Corporate Contracts and standard long-term contracts. While SMS targets a relatively small subset (430,000 items) of the 5.2 million items managed by DLA, it is based on those national stock numbered parts that drive the Agency's business in terms of sales, demands, and readiness. During FY 04, DLA placed an additional 29,500 items under long-term agreements — bringing the Agency total to over 150,000. Over 60 percent of DLA's hardware financial obligations are now through long-term contracts. We expect to add 23,000 more items to long-term agreements in FY 05.

Strategic Supplier Alliances (SSA): SSAs are one of the key tools within the SMS umbrella. 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 $90 million in one-time inventory savings since the inception of the program. Significant savings in reduced lead-times and prices have also been realized. During FY 04, DLA established 11 new alliances bringing the Agency total to 26. We expect to add an additional three alliances in FY 05.

Performance Based Logistics (PBL) Implementation: DLA provided and continues to provide best value support to weapon system programs implementing PBL. DLA is providing integrated, end-to-end supply chain management for consumable parts and logistics services such as cataloging, logistics information, distribution, and disposal. DLA provided PBL support to weapon systems which performed and continue to perform superbly in OEF and OIF, including the F/A-18 E/F, JSTARS, C-17, and the Army's Common Ground Station. DLA's supply availability rate for parts coded to the F/A-18 E/F and JSTARS averaged 93% to 94% in FY 04.

Performance Based Agreements. In implementing our Customer Relationship Management (CRM) initiative in FY 04, DLA finalized overarching Performance Based Agreements (PBA) with each of the Military Services. These agreements formally define DLA performance commitments to a wide range of customers. They also represent a significant deviation from a practice that provided support based on historical demand patterns to a business-driven 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. To support this initiative, Partnership Agreement Councils were established with each Military Service. These Councils provide a forum to adjudicate performance issues through the PBAs and ensure support improvements by drawing from collaborative communications, coordinating substantive working agendas, and generally ensuring the continuous evolvement of CRM. In addition to the overarching PBAs, six PBAs supporting major commands or processes are in development and/or coordination.

Customer Touch. DLA initiated several new efforts to enhance and expand its support to the customer. First, the cadre of DLA Liaison Officers (LNO) was expanded to include an LNO to the U.S. Special Operations Command. Second, DLA-Central was established — with support from U.S. Central Command — to provide the Southwest-Asia theater with focused support and includes Customer Service Representatives in Kuwait, Qatar and Bahrain. Finally, a DLA Contingency Support Team was established in Iraq to support on-going OIF efforts.

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 04, DLA began developing a more robust customer survey program. Specifically, the new survey program will execute a multi-stage sampling approach to include not only mail-out surveys, but also telephone surveys and follow-ups. As a result, this survey approach will contain more targeted questions, focus on multiple aspects of customer satisfaction, and provide more discreet customer feedback. Consequently, these surveys should yield discrete information that will allow DLA to address specific customer concerns and more fully meet their expectations. In addition, the survey program will reinforce our focus, as specifically outlined in the DLA Strategic Plan, Balanced Scorecard, and the CRM initiative. It is anticipated that a multi-stage survey will be approved for use in FY 05.

	FY 00	FY 01	FY 02	FY 03	FY 04
Overall Satisfaction	75.3%	75.7%	78.8%	78.7%	N/A

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 04.

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 04 Goal	FY 04 Actual
Cost per Barrel of Fuel	$ 41.40	$ 64.87
Non-Energy Cost per Dollar of sale	$ .90	$ 1.00

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 $23.47 (56.7 percent) due to sales that were 9 million barrels higher than planned and a composite refined product cost of $45.88 that was $15.00 per barrel higher than the planned cost of $30.88.

The Non-Energy unit cost was $1.00 which exceeded the plan by $.10. The actual unit cost was higher than the plan to support OEF/OIF demands with enhanced inventory levels ($114.2 million); and to "lean forward" by procuring assets in anticipation of further demands (OEF/OIF, Army and Marine Corps depot maintenance equipment programs) and support the Military Services' efforts to reconstitute their inventories ($1,451.7 million).

DLA also measured and monitored financial performance of its Non-Energy business segment by comparing the cost recovery rate (CRR) approved in the budget to that which was executed. The CRR is a composite rate that is calculated by dividing its related operating costs by the cost of goods sold; and is used as an aggregate measurement of the costs that DLA incurred to generate a level of sales. The long-term financial goal is to achieve a break-even budget-related accumulated operating result. DLA's composite FY 04 CRR goal was 15.5 percent. The actual CRR was 11.8 percent, which was 3.7 percent lower than the FY 04 President's Budget and is attributed to increased sales that finished 16 percent ahead of the budgeted plan. This sales increase was directly related to OEF/OIF support, $5.5 billion; and $45.4 million in support of the Federal Emergency Management Agency's hurricane victim relief efforts.

Results

The Supply Management 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 $20 million. Even though support to OEF/OIF generated more than $1,451 million in excess revenue over expenses in our non-energy business, the market driven cost of petroleum almost fully offset this gain.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Supply Management

Comparative Financial Statements
As of and For the Years Ended September 30, 2004 and 2003

UNAUDITED

Comparative Balance Sheets

As of September 30, 2004 and 2003
(In Thousands)

	2004	2003
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	1,174,820	902,355
Other Assets (Note 4)	–	–
Total Intragovernmental Assets	1,174,820	902,355
Accounts Receivable (Note 3)	431,704	471,657
Inventory and Related Property (Note 6)	14,675,913	12,157,521
General Property, Plant and Equipment (Note 7)	1,017,491	844,688
Other Assets (Note 4)	228,715	211,097
Total Assets	**$ 17,528,643**	**$ 14,587,318**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 182,049	$ 323,735
Other Liabilities (Note 11 and Note 12)	43,464	47,569
Total Intragovernmental Liabilities	225,513	371,304
Accounts Payable (Note 9)	1,863,749	1,641,060
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	173,153	188,429
Environmental Liabilities (Note 10)	56,722	68,796
Other Liabilities (Note 11 and Note 12)	370,681	259,036
Total Liabilities	**$ 2,689,818**	**2,528,625**
NET POSITION		
Cumulative Results of Operations	14,838,825	12,058,693
Total Net Position	**$ 14,838,825**	**$ 12,058,693**
TOTAL LIABILITIES AND NET POSITION	**$ 17,528,643**	**$ 14,587,318**

UNAUDITED

Comparative Statements of Net Cost

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 14.A)

	2004	2003
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 1,955,489	$ 1,966,341
Less: Intragovernmental Earned Revenue	(23,147,100)	(21,701,243)
Intragovernmental Net Costs	(21,191,611)	(19,734,902)
Gross Costs With the Public	23,028,634	21,496,411
Less: Earned Revenue From the Public	(1,855,937)	(842,537)
Net Costs With the Public	21,172,697	20,653,874
Total Net Cost	**(18,914)**	**918,972**
NET COST OF OPERATIONS	**$ (18,914)**	**$ 918,972**

Comparative Statements of Changes in Net Position

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 15)

	2003	2002
BEGINNING BALANCES	**$ 12,058,693**	**$ 11,700,720**
Budgetary Financing Sources:		
Appropriations used	1,768,839	1,209,000
Transfers-in/out without reimbursement	(35,500)	
Other budgetary financing sources	70,319	(10,883)
Other Financing Sources:		
Transfers-in/out without reimbursement	877,284	3,865
Imputed Financing Sources	80,276	74,963
Total Financing Sources	2,761,218	1,276,945
Net Cost of Operations	**(18,914)**	**918,972**
ENDING BALANCES	**$ 14,838,825**	**$ 12,058,693**

UNAUDITED

Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2004 and 2003
(In thousands) (See Note 16)

	2004	2003
BUDGETARY RESOURCES:		
Budget Authority:		
Appropriations received	$ 1,768,839	$ 364,000
Contract authority	28,312,771	24,595,283
Net transfers, actual	–	845,000
Unobligated balance:		
Beginning of period	–	627,542
Net transfers, actual	(35,500)	125,000
Spending authority from offsetting collections:		
Earned		
Collected	24,415,058	22,136,132
Receivable from Federal sources	179,735	70,948
Change in unfilled customer orders		
Advance received	7,075	(46,849)
Without advance from Federal sources	87,665	740,827
Subtotal	24,689,533	22,901,058
Recoveries of prior year obligations		
Permanently not available	(26,458,378)	(24,275,876)
Total Budgetary Resources	**$ 28,277,265**	**$ 25,182,007**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 28,277,265	$ 25,182,006
Subtotal	28,277,265	25,182,006
Unobligated balance:		
Apportioned	–	–
Other Available	–	1
Total Status of Budgetary Resources	**$ 28,277,265**	**$ 25,182,007**

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Comparative Statements of Budgetary Resources (CONTINUED)

For the Years Ended September 30, 2004 and 2003 (In thousands) (See Note 16)	2004	2003
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net - beginning of period	$ 7,907,599	$ 6,838,744
Obligated Balance, Net - end of period:		
Accounts receivable	(1,432,804)	(1,253,069)
Unfilled customer order from Federal sources	(2,664,371)	(2,576,706)
Undelivered orders	10,577,835	9,442,476
Accounts payable	2,404,049	2,294,900
Outlays:		
Disbursements	27,032,756	23,301,376
Collections	(24,422,133)	(22,089,283)
Subtotal	2,610,623	1,212,093
Net Outlays	**$ 2,610,623**	**$ 1,212,093**

Comparative Statements of Financing

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 17)	2004	2003
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 28,277,265	$ 25,182,006
Less: Spending authority from offsetting collections and recoveries	(24,689,533)	(22,901,058)
Obligations net of offsetting collections and recoveries	3,587,731	2,280,948
Net obligations	3,587,731	2,280,948
Other Resources		
Transfers in/out without reimbursement (+/-)	877,283	3,865
Imputed Financing Sources	80,276	74,963
Net other resources used to finance activities	957,559	78,828
Total resources used to finance activities	**$ 4,545,290**	**$ 2,359,776**

UNAUDITED

Comparative Statements of Financing (CONTINUED)

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 17)

	2004	2003
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	$ (1,153,217)	$ (1,425,953)
Unfilled Customer Orders	94,740	693,978
Resources that fund expenses recognized in prior periods	(27,057)	–
Resources that finance the acquisition of assets	(24,019,491)	(1,625,665)
Other	(877,283)	(3,864)
Total resources used to finance items not part of the net cost of operations	(25,982,308)	(2,361,504)
Total resources used to finance the net cost of operations	**(21,437,018)**	**(1,728)**
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)
Increase in exchange revenue receivable from the public	–	68,796
Other	23,309	102,575
Total components of Net Cost of Operations that will require or generate resources in future periods	**23,309**	**107,154**
Components not Requiring or Generating Resources		
Depreciation and amortization	73,283	56,657
Revaluation of assets or liabilities (+/-)	237,356	756,979
Cost of Goods Sold	21,115,958	–
Other	(31,803)	(90)
Total components of Net Cost of Operations that will not require or generate resources	21,394,795	813,546
Total components of net cost of operations that will not require or generate resources in the current period	**21,418,104**	**920,700**
Net Cost of Operations	**$ (18,914)**	**$ 918,972**

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 25 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 $87.4 billion (at selling price) in DoD materiel, representing over 3.9 million items. In addition, they processed over 25.9 million receipt and issue transactions during FY 04, and their business services generated revenues of just less than $2.6 billion. This activity group employs approximately 8,400 civilian and 151 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. In FY 04 the responsibility for the DLA transportation management functions (with the exception of Medical and Subsistence items) were consolidated under the DDC. This program provides centralized transportation management support for all shipments, both first and second destination.

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 04 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 operating costs either by reengineering existing depot business processes or by inserting the market forces of competition into the distribution functions. As of the end of FY 04, eleven sites have been competed, with the government retaining depot operations at five sites, while the other six were contracted with private industry. The estimated long-term (FY 98-FY 11) net savings from these eleven competitions is in excess of $420 million. During FY 04, two of these competitions resulted in the retention of in-house depot operations at the Puget Sound, WA and Tobyhanna, PA distribution centers. Five additional depot sites are also undergoing this competitive process.

United States Central Command (CENTCOM) Deployment Distribution Operations Center (DDOC) Pilot Project. DLA's Director of Logistics Operations led the Agency's partnership effort with the United States Transportation Command (TRANSCOM), the Joint Munitions Command, and the Military Services on the United States Central Command (CENTCOM) Deployment Distribution Operations Center (CENTCOM DDOC) pilot project. The CENTCOM DDOC, a TRANSCOM Distribution Process Owner initiative, is a cross-command, cross-Service team that focuses on integrating movement of DLA and Military Service sustainment cargo; deploying forces and equipment; and managing in-theater stocks. The goal is to efficiently and effectively optimize the use of available assets by improving asset visibility, sustaining pipeline velocity, using Department of Defense transportation assets more efficiently. After dedicating countless hours to concept development and the refinement of operations, DLA deployed 22 personnel in three iterations of the CENTCOM DDOC. DLA's distribution experts designed and led the CENTCOM DDOC Sustainment Division, which managed and synchronized both strategic and operational movement of sustainment cargo. Numerous DLA state-side organizations provided "reach-back" support to ensure that DLA personnel in these forward positions had access to the information and resources necessary to solve tough distribution issues as they arose. DLA's participation in this important initiative epitomized the Agency's commitment to supporting the warfighter, and its customers reaped the benefits by way of improved in-transit visibility and decreased customer-wait-time.

Coordination with the Distribution Process Owner (DPO). During FY 04, the DDC participated with the U. S. Transportation Command (TRANSCOM) in their role as the DoD-designated Distribution Process Owner (DPO) on several initiatives to provide customer-desired results. We are active members of various Integrated Process Teams (IPTs). Those teams include: Distribution Funding and Budgeting, Joint Deployment & Distribution, End-to-End Distribution Architecture, Direct Vendor Delivery Improvements, Distribution Asset Visibility, Time Definite Delivery, and the Supply and Transportation Priority System. In addition to the DDC these groups are also represented by members from DLA HQ and U.S. TRANSCOM, as well as the Military Services and Joint Staff.

Enterprise Transportation. To provide an enterprise-level transportation optimizer that will ensure best value shipments and Time Definite Delivery the DDC is implementing the Distribution Planning & Management the System (DPMS).

Expansion of Theater Distribution. During FY 04, DLA opened three new Theater Distribution Platforms in key areas of responsibility.

- Defense Depot Guam Marianas (DDGM) provides forward stock positioning support and enhanced physical distribution services to the Armed Forces located in the Pacific Theater. Its distribution facilities are strategically positioned in Guam to reduce transportation and customer wait time. The depot provides distribution services and surge capability to all four service components to support the warfighters operating in the Area of Responsibility (AOR). While the commodities distributed by DDGM are primarily repair parts, it also provides consolidated shipment services as well as routine logistic support to the military community in Guam.

- Defense Depot Sigonella Italy (DDSI) provides forward stock positioning support and enhanced physical distribution services in conjunction with an expanding regional customer base. Its primary customers currently include the Aviation Support Division, Aviation Intermediate Maintenance Division, and Navy ships and squadrons operating in the Mediterranean region. Specialized handling and support services include managing the Navy's hazardous materiel, depot level repair part storage and distribution, and the complete range of material packing and shipping services. DDSI also provides expedited requisitioning and centralized receiving support to the military community throughout the Mediterranean.

- Defense Depot Kuwait Southwest Asia (DDKS) provides forward stock positioning support and enhanced physical distribution services to the Armed Forces located in the U.S. Central Command Area of Responsibility (AOR). Its distribution facilities are strategically positioned in Southwest Asia to reduce transportation and customer wait time. The depot provides distribution services and surge capability to components of all four Military Services to support the warfighters operating in the AOR. Current commodities distributed by DDKS are repair parts, barrier/construction materiel, clothing, textiles and tentage. DDKS also provides consolidated shipment and containerization services, as well as, routine logistic support to the military community in the DDKS theater of operations.

Pure Pallets Process. The Pure Pallet Process Concept arose from a need to provide more pinpoint distribution of air pallets shipped by DLA's consolidation and containerization points (CCPs) into the Central Command (CENTCOM) area of operations (AOR) following the deployment of troops into Iraq. The concept was a collective effort of Combined Forces Land Component Command (CFLCC), Combined Arms Support Command (CASCOM), DLA, and the Air Mobility Command (AMC). In November 2003, the existing CENTCOM pure pallet route plan was revised to implement the pure pallet concept. As a result, intermediate-level handling of shipments in the AOR was greatly reduced, resulting in a conservation of logistics assets and overall reduced Customer Wait Time (CWT) for CENTCOM customers. The key factor allowing DLA to more precisely consolidate these critical air shipments was permission from CENTCOM to hold cargo up to five days (vice two). This gave the CCP greater potential to build pallets destined to a single customer, rather than to multiple customers where breakdown and further redistribution workload would be required. Since implementation of the CENTCOM Pure Pallet Route Plan, there has been an on-going joint DLA-TRANSCOM effort to further increase the amount and types of cargo routed to the CCPs to expand the application of the pure pallet process. Process improvements identified to date include: 1) reductions to the flow of CCP-eligible materiel through the aerial ports and 2) reductions to CWT by as much as 9 days.

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.

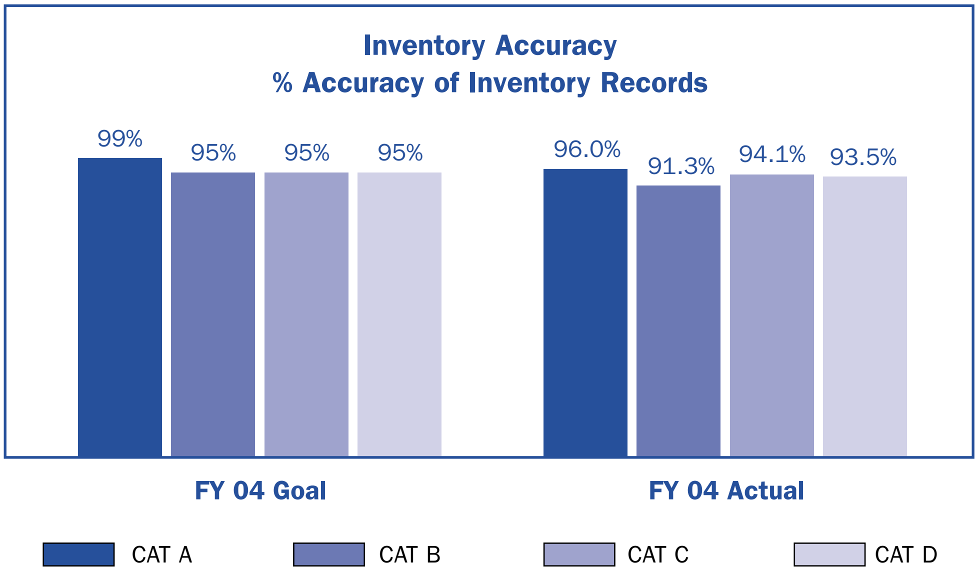
The FY 04 goals for inventory accuracy were: 99 percent for items in the high dollar strata (Category A) and 95 percent for the remaining three strata. Our record accuracy for the high dollar Category (A) was 96.5 percent; Category (B) was 91.3 percent; Category (C) was 94.1 percent; and Category (D) was 93.5 percent.

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

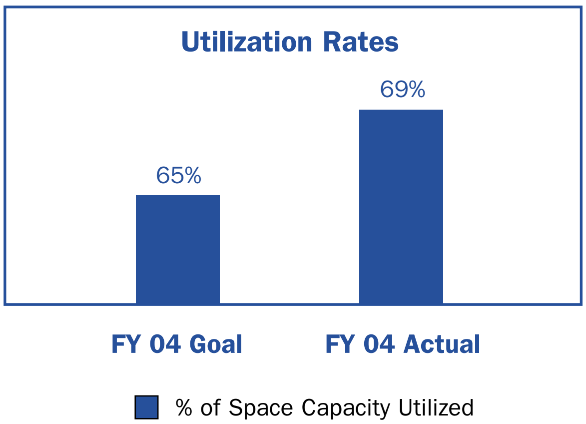
Category C:
On-Hand Balance < 50 **AND** Date of Last Inventory > 24 Months

Category D:
All Others



The FY 04 year-end performance sample inventory shows an improved performance in three of the four categories. Overall, eight depots have met the goal in all four categories with the remaining sites showing marked improvement. DDC has an aggressive plan to correct accountable balance records and provide training in distribution processes in order to achieve all the accuracy goals by FY 06.

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 04, our space utilization rate was 69 percent, which exceeded our goal by 4 percent.



Maintaining Process Performance: The increased workload experienced as a result of Operation Iraqi Freedom caused performance to dip during FY 03. DDC started FY 04 with a 3.7day average processing time for High Priority shipments and a 5.2 day average processing time for routine shipments. Operational streamlining and reengineering of the workplaces allowed DDC to continue to process even higher levels of workload than projected while improving performance to an average of 0.9 days for High Priority shipments in September 2004 and to an average of 1.0 day for Routine shipments in September 2004.

Financial Performance Measures

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

Unit Costs Results	FY 04 Goal	FY 04 Actual
Unit Cost-Total Composite Processing Rate	$ 20.39	$ 17.70
Unit Cost-Covered Storage	$ 2.935	$ 2.300

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 increased workload in support of Operations ENDURING FREEDOM/IRAQI FREEDOM (OEF/OIF) requirements to include increased depot maintenance workload and workload related to troop rotations. Receipts and issues increased 4.6 million lines (21.8 percent) over the initial FY 04 estimate. The actual covered storage workload was 9.8 million cubic feet greater than the 79.8 million that was 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 $100 million.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Distribution

Comparative Financial Statements
As of and for the Years Ended September 30, 2004, and 2003

UNAUDITED

Comparative Balance Sheets

As of September 30, 2004 and 2003
(In Thousands)

	2004	2003
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	286,238	696,983
Other Assets (Note 4)	–	–
Total Intragovernmental Assets	286,238	696,983
Accounts Receivable (Note 3)	553	1,020
General Property, Plant and Equipment (Note 7)	600,840	571,190
Other Assets (Note 4)	290	501
Total Assets	**$ 887,921**	**$ 1,269,694**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 83,004	$ 162,748
Other Liabilities (Note 11 and Note 12)	19,171	18,577
Total Intragovernmental Liabilities	102,175	181,325
Accounts Payable (Note 9)	370,618	197,593
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	75,835	91,327
Environmental Liabilities (Note 10)	–	–
Other Liabilities (Note 11 and Note 12)	33,646	31,393
Total Liabilities	**$ 582,274**	**$ 501,638**
NET POSITION		
Cumulative Results of Operations	$ 305,647	$ 768,056
Total Net Position	**$ 305,647**	**$ 768,056**
TOTAL LIABILITIES AND NET POSITION	**$ 887,921**	**$ 1,269,694**

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Comparative Statements of Net Cost

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 14.A)	2004	2003
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 1,263,275	$ 262,693
Less: Intragovernmental Earned Revenue	(2,560,166)	(2,375,833)
Intragovernmental Net Costs	(1,296,891)	(2,113,140)
Gross Costs With the Public	1,202,737	2,002,230
Less: Earned Revenue From the Public	(5,702)	(1,174)
Net Costs With the Public	1,197,035	2,001,056
Total Net Cost	**(99,856)**	**(112,084)**
NET COST OF OPERATIONS	**$ (99,856)**	**$ (112,084)**

Comparative Statements of Changes in Net Position

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 15)	2004	2003
BEGINNING BALANCES	**$ 768,056**	**$ 439,273**
Budgetary Financing Sources:		
Appropriations used	–	–
Other budgetary Financing Sources	37,026	269,844
Other Financing Sources:		
Transfers-in/out without reimbursement	(640,510)	(91,088)
Imputed Financing Sources	41,218	37,943
Total Financing Sources	(562,265)	216,699
Net Cost of Operations	**(99,856)**	**(112,084)**
ENDING BALANCES	**$ 305,647**	**$ 768,056**

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Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 16.A)

	2004	2003
BUDGETARY RESOURCES:		
Budget Authority:		
Contract authority	$2,482,365	2,070,486
Unobligated balance:		
Beginning of period	–	124,157
Spending authority from offsetting collections:		
Earned		
Collected	2,976,979	1,883,339
Receivable from Federal sources	(411,110)	493,669
Change in unfilled customer orders		
Without advance from Federal sources	9,674	(14,305)
Subtotal	2,575,542	2,362,703
Permanently not available	(2,575,542)	(2,362,703)
Total Budgetary Resources	**$ 2,482,365**	**$ 2,194,643**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ $2,482,365	$ 2,194,643
Subtotal	2,482,365	2,194,643
Unobligated balance:		
Apportioned		–
Unobligated Balances Not Available		
Total, Status of Budgetary Resources	**$ 2,482,365**	**$ 2,194,643**

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Comparative Statements of Budgetary Resources (CONTINUED)

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 16.A)	2004	2003
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ (191,123)	$ 68,479
Obligated Balance, Net — end of period:		
Accounts receivable	(286,834)	(697,944)
Unfilled customer order from Federal sources	(89,834)	(80,160)
Undelivered orders	238,251	193,910
Accounts payable	490,248	393,071
Outlays:		
Disbursements	2,340,846	1,974,882
Collections	(2,976,979)	(1,883,339)
Subtotal	(636,133)	91,543
Net Outlays	**$ (636,133)**	**$ 91,543**

Comparative Statements of Financing

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 17)	2004	2003
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 2,482,365	$ 2,194,643
Less: Spending authority from offsetting collections and recoveries	(2,575,542)	(2,362,703)
Obligations net of offsetting collections and recoveries	(93,177)	(168,060)
Net obligations	(93,177)	(168,060)
Other Resources		
Transfers in/out without reimbursement	(640,509)	(91,088)
Imputed Financing Sources	41,218	37,943
Net other resources used to finance activities	(599,291)	(53,145)
Total resources used to finance activities	**$ (692,468)**	**$ (221,205)**

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Comparative Statements of Financing (CONTINUED)

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 17)

	2004	2003
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	(45,132)	37,840
Unfilled Customer Orders	9,674	(14,305)
Resources that fund expenses recognized in prior periods	(16,460)	–
Resources that finance the acquisition of assets	(53,676)	(46,056)
Other	640,509	91,088
Total resources used to finance items not part of the net cost of operations	534,915	68,567
Total resources used to finance the net cost of operations	**(157,553)**	**(152,638)**
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	48,859	25,783
Total components of Net Cost of Operations that will require or generate resources in future periods	**48,859**	**(101)**
Components not Requiring or Generating Resources		
Depreciation and amortization	56,675	65,153
Revaluation of assets or liabilities	–	(24,498)
Other	973	–
Total components of Net Cost of Operations that will not require or generate resources	57,649	40,655
Total components of net cost of operations that will not require or generate resources in the current period	**57,698**	**40,554**
Net Cost of Operations	**$ (99,856)**	**$ (112,084)**

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 04, materiel with an acquisition value of $14.6 billion was turned in to DRMS and $1.7 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. The stock, store, and issue functions of usable property at 68 Continental United States (CONUS) DRMOs is undergoing A-76 competition. The final performance decision is projected to be made in March 2005 with transition of competed requirements to the service provider by the end of FY 2005.

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 04 mission was performed with approximately 1,500 civilian and 11 military personnel and generated revenues of almost $350 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 04 Accomplishments

DRMS made significant progress toward its Balanced Scorecard and FY 04 Game Plan objectives:

- Meet or exceed our customers' expectations
- Streamline and improve processes to deliver the most effective disposal services
- Create an environment to encourage innovative thinking and ensure that our workforce is enabled to deliver and sustain world-class performance
- Provide disposal services of maximum value

Key mission accomplishments include:

Activated a "customer focused" organization in April 2004 to more effectively meet the needs of our military customers and improve efficiency of overall operations. This infrastructure supports DRMS in:

- Building a more integrated relationship with our customers through clearly identified touch points.
- Developing innovative and effective disposal solutions, while improving the quality of our property management.
- Assessing and ensuring our compliance in an increasingly risk-conscious environment.
- Successfully implementing our vision and the outcome of the A-76 competition.

Supported contingency operations and deployed forces worldwide by deploying reservists, active duty and civilian personnel in support of Operation Joint Guardian/Forge (92 deployed), Operation Enduring Freedom (15 deployed), and Operation Iraqi Freedom (59 deployed).

Disposed of all excess property in a timely manner to enable the Navy and their tenants to successfully close Naval Station Roosevelt Roads.

Implemented the Environmental Management Systems (EMS) at all 106 "appropriate facilities" worldwide.

Completed a second successful retrograde of equipment containing polychlorinated biphenyls (PCBs) from U.S. military installations in Okinawa and Japan to a treatment facility in Kansas for decontamination and ultimate disposal. The equipment, both U.S. and foreign manufactured, contained low levels of PCBs prohibited by law from being imported into the United States. The Defense Logistics Agency had received a one-year exemption to the Toxic Substance Control Act importation ban on April 18, 2003. Extensive planning and cooperation by multiple federal departments, agencies, and the Military Services led to the completion of the retrograde `within the timeframe of the exemption.

Developed a mutually beneficial disposal solution for the United States Military Forces on the British Indian Ocean Territory, Diego Garcia. While engaged in conducting military operations to support the global war on terrorism, the troops generated over a million pounds of scrap mixed metals. The team worked with complex regulations, laws, and procedures and developed a solution to dispose of the scrap that generated proceeds in excess of $44,000 in less than three months.

Conducted the first sale in Iraq of excess property during September, resulting in $26,250 in proceeds. Sales were also conducted in Qatar and Kuwait. Hazardous waste removal in Iraq included 298,580 gallons of used oil which were transported to Iraqi refineries for re-use. In Kuwait, DRMS established terms sales for the removal of M-series vehicles, batteries, and tires. This method of sale has allowed for the removal of 700,000 kilograms of M-series vehicles, 2.2 million kilograms of batteries, and 3.9 million tires.

Awarded a Central Asia (Afghanistan, Pakistan, Uzbekistan, and Kyrgyzstan) contract for hazardous waste disposal services with four option years with a potential aggregate cost of $4.9 million. In FY 04, hazardous waste generations disposed under this contract totaled 2.6 million pounds. In a related program, DRMS awarded an $800,000 multi-year option contract to dispose of hazardous waste generated by US Forces operating in the Philippines. During FY 04, this contract provided for the removal of 77,000 pounds of hazardous waste.

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 04, the R/T/D rate exceeded its goal of at least 17 percent of the line items of property available for disposal. DRMS successfully reutilized, transferred, or donated over 250,000 line items of excess property for an R/T/D rate of slightly over 20 percent.

- OPERATIONS ENDURING FREEDOM/IRAQI FREEDOM Reutilization: Total reutilization supporting these two contingencies surpassed 4,900 line items with a value of nearly $34 million. Examples of the types of items issued in support of these operations include vehicles, tanks, trucks, and body armor.
- 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 04, almost 1,300 were approved to participate in the program, and computers worth over $33 million 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 fill backorders.

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 table below depicts the unit cost results for each category.

The receiving unit cost was lower than planned due to higher than planned workload (i.e., receipts of 3.3 million line items vs. the plan of 3.1 million line items). The additional workload was attributed to support to Operation Enduring Freedom and Operation Iraqi Freedom (OEF/OIF).

The R/T/D unit cost was lower than planned primarily due to higher than planned workload (i.e., slightly more than 255,000 line items disposed by R/T/D vs. the plan of 191,000 line items). The additional workload was due to releasing thousands of line items of infrared textiles that had been in storage pending a determination on demilitarization characteristics; the reutilization of nuclear, biological and chemical (NBC) property to Joint Service Nuclear, Biological and Chemical Equipment Assessment facilities; and support to OEF/OIF.

The Useable Sales unit cost was lower than planned due to higher than planned workload (i.e., more than 634,000 line items of useable property sold vs. the plan of 461,000 line items). The additional workload was due to the release of large quantities of infrared textiles, a lower than expected downgrade to scrap rate, and continuing increases in the number of customers buying property from Government Liquidators, DRMS' commercial venture partner.

The Hazardous Waste Disposal unit cost was slightly over plan due to workload that was one percent below plan.

The Recycling/Disposal unit cost was lower than planned due to the processing of almost 18 percent more pounds of scrap than planned (1,017 million pounds vs. the plan of 863.4 million pounds). Much of this higher workload is attributed to support to OEF/OIF.

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 $46 million.

Financial Performance Measures	FY 04 Goal	FY 04 Actual
Cost incurred per line item of useable property received — Receiving	$ 29.551	$ 28.269
Cost incurred per line item — Reutilization/Transfer/Donation (R/T/D)	$ 287.016	$ 193.275
Cost incurred per Pound — Hazardous Waste Disposal	$ 41.406	$ 34.535
Cost incurred per line item — Useable Sales Proceeds	$ 0.180	$ 0.189
Cost incurred per Pound — Recycling / Disposal	$ 0.056	$ 0.048

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Reutilization and Marketing

Comparative Financial Statements
As of and for the Years Ended September 30, 2004 and 2003

UNAUDITED

Comparative Balance Sheets

As of September 30, 2004 and 2003
(In Thousands)

	2004	2003
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	508	669
Total Intragovernmental Assets	508	669
Cash and Other Monetary Assets (Note 5)	7,297	6,443
Accounts Receivable (Note 3)	11,297	13,179
Inventory and Related Property (Note 6)	–	–
General Property, Plant and Equipment (Note 7)	72,401	81,500
Other Assets (Note 4)	161	133
Total Assets	**$ 91,666**	**$ 101,924**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 6,331	$ 62,728
Other Liabilities (Note 11 and Note 12)	5,362	5,850
Total Intragovernmental Liabilities	11,693	68,578
Accounts Payable (Note 9)	64,558	25,180
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	17,593	20,882
Environmental Liabilities (Note 10)	–	–
Other Liabilities (Note 11 and Note 12)	45,927	42,525
Total Liabilities	**$ 139,771**	**$ 157,165**
NET POSITION		
Cumulative Results of Operations	(48,105)	(55,241)
Total Net Position	**$ (48,105)**	**$ (55,241)**
TOTAL LIABILITIES AND NET POSITION	**$ 91,666**	**$ 101,924**

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Comparative Statements of Net Cost

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 14.A)

	2004	2003
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 79,358	$ 36,425
Less: Intragovernmental Earned Revenue	(277,862)	(287,414)
Intragovernmental Net Costs	(198,504)	(250,989)
Gross Costs With the Public	223,672	225,546
Less: Earned Revenue From the Public	(71,336)	(55,006)
Net Costs With the Public	152,336	170,540
Total Net Cost	**(46,168)**	**(80,449)**
NET COST OF OPERATIONS	**$ (46,168)**	**$ (80,449)**

Comparative Statements of Changes in Net Position

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 15)

	2004	2003
BEGINNING BALANCES	**$ (55,241)**	**$ (88,404)**
Budgetary Financing Sources:		
Other budgetary Financing Sources	(6,434)	(5,624)
Other Financing Sources:		
Transfers-in/out without reimbursement	(43,370)	(56,810)
Imputed Financing Sources	10,773	15,148
Total Financing Sources	(39,031)	(47,286)
Net Cost of Operations	**(46,168)**	**(80,449)**
ENDING BALANCES	**$ (48,105)**	**$ (55,241)**

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Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 16)

	2004	2003
BUDGETARY RESOURCES:		
Budget Authority:		
Contract authority	$ 1,355	193,460
Unobligated balance:		
Beginning of period	278,731	51,057
Spending authority from offsetting collections:		
Earned		
Collected	349,149	344,324
Receivable from Federal sources	(981)	(3,004)
Change in unfilled customer orders		
Advance received	2,477	(1,677)
Without advance from Federal sources	(1,004)	(2,121)
Subtotal	349,641	337,522
Permanently not available	(349,640)	(58,791)
Total Budgetary Resources	**$ 280,087**	**$ 523,248**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 316,191	$ 244,517
Subtotal	316,191	244,517
Unobligated balance:		
Apportioned	(36,104)	55,683
Unobligated Balances Not Available	0	223,048
Total, Status of Budgetary Resources	**$ 280,087**	**$ 523,248**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 121,140	$ 157,374
Obligated Balance, Net — end of period:		
Accounts receivable	(11,933)	(12,915)
Unfilled customer order from Federal sources	70	(934)
Undelivered orders	61,646	37,406
Accounts payable	81,277	97,584
Outlays:		
Disbursements	308,256	285,876
Collections	(351,626)	(342,647)
Subtotal	(43,370)	(56,771)
Net Outlays	**$ (43,370)**	**$ (56,771)**

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Comparative Statements of Financing

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 17)

	2004	2003
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 316,190	$ 244,517
Less: Spending authority from offsetting collections and recoveries	(349,641)	(337,522)
Obligations net of offsetting collections and recoveries	(33,451)	(93,005)
Net obligations	(33,451)	(93,005)
Other Resources		
Transfers in/out without reimbursement	(43,370)	(56,810)
Imputed Financing Sources	10,773	15,148
Net other resources used to finance activities	(32,597)	(41,662)
Total resources used to finance activities	**$ (66,048)**	**$ (134,667)**
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	(24,269)	2,496
Unfilled Customer Orders	1,473	(3,797)
Resources that fund expenses recognized in prior periods	(3,456)	(104)
Resources that finance the acquisition of assets	(6,776)	(6,237)
Other	43,370	56,810
Total resources used to finance items not part of the net cost of operations	10,342	49,168
Total resources used to finance the net cost of operations	**(55,706)**	**(85,499)**
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, 2004 and 2003
(In Thousands) (See Note 17)

	2004	2003
Components not Requiring or Generating Resources		
Depreciation and amortization	$ 9,441	$ 12,205
Revaluation of assets or liabilities	0	(477)
Other	96	(114)
Total components of Net Cost of Operations that will not require or generate resources	9,537	11,614
Total components of net cost of operations that will not require or generate resources in the current period	**9,537**	**5,050**
Net Cost of Operations	**$ (46,168)**	**$ (80,449)**

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 worldwide network of 185 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 04, DAPS earned more than $378 million in revenue and employed approximately 824 people at year-end. Major customers were: Air Force (24.1 percent), Navy (28.9 percent), Army (21.3 percent), Defense Agencies (17.3 percent), and non-DoD customers (8.4 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 04 Major Accomplishments

Most Efficient Organization (MEO) Performance Review: During FY 04 the DAPS performance during the MEO first performance period was evaluated by an Independent Review (IR) Team. The conclusion of that review was that the MEO met its first performance period cost and performance goals.

DAPS Online (DOL): DAPS Online was fully implemented during FY 04 replacing Doc Access Online. By providing an internet link a customer can review cost estimates or check the status of an order. In addition to the link, the customer also receives an email confirming the receipt of the order and one with the final bill. As such, DOL provides visibility to the status of an order during demand fulfillment. Because DOL is interfaced with the Defense Working Capital Fund Accounting System (DWAS), accounting information is captured as the customer enters the order instead of relying on a manual entry by DAPS personnel.

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 72.3 million pages exceeded the goal of 61.2 million pages converted and represented an increase of 7.9 percent from FY 03.

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 04, DAPS achieved a rework percentage of .21 percent to beat our goal of .35 percent.

Customer Satisfaction: This performance metric measures satisfied customers as the percentage of customers ranking DAPS performance as “satisfied” or “very satisfied.” DAPS uses a survey, professionally prepared and administered by an independent entity to determine an overall customer satisfaction rating. DAPS FY 04 customer satisfaction rating was 88 percent, one percent higher than the last survey; but below the target of 93 percent. In addition, DAPS does receive customer feedback through an online questionnaire.

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.

Unit Costs Results	FY 04 Goal	FY 04 Actual
Unit Cost per In-House Production Unit	.0567	.0559

DAPS bettered its unit cost goal because actual in-house costs were lower than planned, $133.8 million versus $148.1 million, while the actual units produced were higher than planned, 2,391.7 million versus 2,533.3 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), reflects an excess of revenue over expenses of more than $17 million.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Document Automation and Production Service

Comparative Financial Statements
As of and for the Years Ended September 30, 2004 and 2003

UNAUDITED

Comparative Balance Sheets

As of September 30, 2004 and 2003
(In Thousands)

	2004	2003
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	436	25,702
Total Intragovernmental Assets	436	25,702
Accounts Receivable (Note 3)	38	2,491
Inventory and Related Property (Note 6)	8,020	8,572
General Property, Plant and Equipment (Note 7)	17,558	22,305
Other Assets (Note 4)	0	99
Total Assets	**$ 26,052**	**$ 59,169**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 8,489	$ 94,648
Other Liabilities (Note 11 and Note 12)	3,274	3,068
Total Intragovernmental Liabilities	11,763	97,716
Accounts Payable (Note 9)	73,450	9,657
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	12,015	15,205
Environmental Liabilities (Note 10)	–	–
Other Liabilities (Note 11 and Note 12)	(61,959)	(50,163)
Total Liabilities	**$ 35,269**	**$ 72,415**
NET POSITION		
Cumulative Results of Operations	(9,217)	(13,246)
Total Net Position	**$ (9,217)**	**$ (13,246)**
TOTAL LIABILITIES AND NET POSITION	**$ 26,052**	**$ 59,169**

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Comparative Statements of Net Cost

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 14.A)	2004	2003
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 28,716	$ 297,053
Less: Intragovernmental Earned Revenue	(362,147)	(387,027)
Intragovernmental Net Costs	(333,431)	(89,974)
Gross Costs With the Public	332,235	75,362
Less: Earned Revenue From the Public	(15,863)	(6,400)
Net Costs With the Public	316,372	68,962
Total Net Cost	**(17,059)**	**(21,012)**
NET COST OF OPERATIONS	**$ (17,059)**	**$ (21,012)**

Comparative Statements of Changes in Net Position

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 15)	2004	2003
BEGINNING BALANCES	**$ (13,246)**	**$ (30,013)**
Budgetary Financing Sources:		
Appropriations used	–	–
Other Financing Sources:		
Transfers-in/out without reimbursement	(18,286)	(9,432)
Imputed Financing Sources	5,256	5,187
Total Financing Sources	(13,030)	(4,245)
Net Cost of Operations	**(17,059)**	**(21,012)**
ENDING BALANCES	**$ (9,217)**	**$ (13,246)**

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Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 16)

	2004	2003
BUDGETARY RESOURCES:		
Budget Authority:		
Appropriations received	$ –	$ –
Contract authority	120	2,085
Unobligated balance:		
Beginning of period	(69,517)	38,002
Spending authority from offsetting collections:		
Earned		
Collected	390,303	398,269
Receivable from Federal sources	(14,498)	(4,842)
Change in unfilled customer orders		
Advance received	(63)	94
Without advance from Federal sources	3,882	(5,501)
Subtotal	379,624	388,020
Permanently not available	0	(155,228)
Total Budgetary Resources	**$ 310,228**	**$ 272,879**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 352,339	$ 342,396
Subtotal	352,339	342,396
Unobligated balance:		
Apportioned	(42,110)	(69,517)
Total, Status of Budgetary Resources	**$ 310,228**	**$ 272,879**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 24,975	$ 61,168
Obligated Balance, Net — end of period:		
Accounts receivable	(69,713)	(84,211)
Unfilled customer order from Federal sources	(20,216)	(16,333)
Undelivered orders	15,193	15,255
Accounts payable	90,710	110,265
Outlays:		
Disbursements	371,954	388,931
Collections	(390,241)	(398,363)
Subtotal	(18,287)	(9,432)
Net Outlays	**$ (18,287)**	**$ (9,432)**

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Comparative Statements of Financing

For the Years Ended September 30, 2004 and 2003
(In Thousands) (See Note 17)

	2004	2003
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 352,339	$ 342,396
Less: Spending authority from offsetting collections and recoveries	(379,624)	(388,020)
Obligations net of offsetting collections and recoveries	(27,285)	(45,624)
Net obligations	(27,285)	(45,624)
Other Resources		
Transfers in/out without reimbursement	(18,286)	(9,432)
Imputed Financing Sources	5,256	5,187
Net other resources used to finance activities	(13,030)	(4,245)
Total resources used to finance activities	**$ (40,315)**	**$ (49,869)**
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	160	24,052
Unfilled Customer Orders	3,819	(5,406)
Resources that fund expenses recognized in prior periods	(3,482)	–
Resources that finance the acquisition of assets	(3)	(3,475)
Other	18,286	9,432
Total resources used to finance items not part of the net cost of operations	18,780	24,603
Total resources used to finance the net cost of operations	**(21,535)**	**(25,266)**
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	0	(4,561)
Other	–	5,489
Total components of Net Cost of Operations that will require or generate resources in future periods	**0**	**928**

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Comparative Statements of Financing (CONTINUED)

For the Years Ended September 30, 2004 and 2003 (In Thousands) (See Note 17)	2004	2003
Components not Requiring or Generating Resources		
Depreciation and amortization	$ 3,474	$ 3,007
Revaluation of assets or liabilities	14,978	319
Other	(13,976)	–
Total components of Net Cost of Operations that will not require or generate resources	4,476	3,326
Total components of net cost of operations that will not require or generate resources in the current period	**4,476**	**4,254**
Net Cost of Operations	**$ (17,059)**	**$ (21,012)**

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