Defense Logistics Agency

AGENCY FINANCIAL REPORT

General Fund (Unaudited)

The Nation's Combat Logistics Support Agency

2019 FISCAL YEAR

About the Agency Financial Report

The Defense Logistics Agency (DLA) General Fund (GF) Agency Financial Report (AFR) provides financial and summary performance results enabling the president, Congress, and the American people to assess its accomplishments, and to understand its financial results and operational functions. The AFR consists of DLA GF financial statements and other reports. The principal financial statements[1] have been prepared to report the financial position and results of DLA GF's operations. The financial statements and accompanying notes have been prepared from the books and records of DLA GF using guidance from the following applicable laws and regulations for which DLA GF is unable to provide assurance:

- Federal Managers' Financial Integrity Act (FMFIA) of 1982;
- Chief Financial Officers (CFO) Act of 1990;
- Government Management Reform Act (GMRA) of 1994;
- Federal Financial Management Improvement Act (FFMIA) of 1996;
- Reports Consolidation Act of 2000;
- Government Performance and Results Act (GPRA) Modernization Act of 2010;
- Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012;
- Fraud Reduction and Data Analytics Act (FRDAA) of 2015;
- Office of Management and Budget (OMB) Circular A-136, as amended, *Financial Reporting Requirements*;
- OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management (ERM) and Internal Control*; and
- OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*.

The AFR is available on the DLA website at: https://www.dla.mil/HQ/Finance/Offers/FinancialReports/.

All information within this report pertains to DLA GF unless specifically noted otherwise. DLA GF's financial results are unaudited and there are limitations due to underlying processes that support the principal financial statements. DLA GF continues to implement processes and system improvements addressing these limitations. The AFR consists of three primary sections:

Management's Discussion and Analysis (Unaudited)

This section provides a high-level overview of DLA GF, including its history, mission, and organizational structure; DLA GF's overall performance related to its strategic goals and primary objectives; financial analysis; management's assurance on internal controls; system analysis; compliance with laws and regulations; and forward-looking information.

[1] Refer to the Financial Section Introduction for definition of principal financial statements.

Financial Section (Unaudited)

This section contains a message from the CFO; audit reports; management's response to the audit reports; financial statements and the accompanying notes; as well as Required Supplementary Stewardship Information (RSSI); and Required Supplementary Information (RSI).

Other Information (Unaudited)

This section details DLA GF's compliance with, and commitment to, specific regulations. It includes performance and management analyses, recommendations and payment integrity reporting.

THIS PAGE INTENTIONALLY LEFT BLANK

Table of Contents

THIS PAGE INTENTIONALLY LEFT BLANK

Message from the Director

On behalf of the Defense Logistics Agency (DLA), I present the Fiscal Year (FY) 2019 Agency Financial Report. This report provides a summary of our programs, accomplishments, challenges, and stewardship of the resources entrusted to us by the American Public and our partner Agencies. As responsible stewards of taxpayer dollars, DLA will work relentlessly to ensure the Warfighter and our partners are served efficiently and effectively.

The DLA, as the Nation's Combat Logistics Support Agency, has a proud history of supporting the Warfighter and providing effective logistics support to the operating forces of our Military Services at the lowest possible cost to the taxpayer. As we continue to improve our performance, DLA acquired more resources to accomplish our critical missions to defend the Nation including increasing the workforce. To accomplish our goals of delivering world-class support to the Warfighter and of continued accountability, the Agency has devoted resources to five Lines of Effort and two Critical Capabilities:

Lines of Effort:

- ***Warfighter First:*** *Strengthen Service and Combatant Command Readiness and Lethality*
- ***Global Posture:*** *Prepared for Immediate Action*
- ***Strong Partnerships:*** *Leverage the Joint Logistics Enterprise, Interagency, Industry, and Partner and Allied Nations*
- ***Whole of Government:*** *Support to the Nation*
- ***Always Accountable:*** *Assured Supply Chain, Financial and Process Excellence*

Critical Capabilities:

- ***Enterprise Enablers:*** *Innovation, Data Management, Technology, and Cybersecurity*
- ***People and Culture:*** *The heart of everything we do. If you take care of your people, the mission will happen*

Our Independent Public Accounting (IPA) firm issued a Disclaimer of Opinion on DLA's FY2019 General Fund (GF). Information gleaned through this effort will be extremely valuable in our on-going efforts to improve all aspects of DLA GF operations. The IPA reported material weaknesses in key areas involving policies and procedures, critical asset accounting procedures, financial information systems and reporting.

The DLA is taking a strategic approach to comply with Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. The DLA has formed the Audit Task Force to enhance internal control over operations as well as over financial reporting to remediate material weaknesses. The Agency has allocated resources to address findings reported in prior year audits through corrective action plans.

The DLA is focusing on reviewing the audit results, prioritizing needed changes, and continuously developing plans to fix identified problems. We have already identified steps that will drive efficiencies and help prioritize remediation efforts in FY2020 across DLA.

As we look forward, DLA will continue to commit resources and manage the global supply chain – from raw materials to end user to disposition – for the Army, Navy, Air Force, Marine Corps, Coast Guard, combatant commands, other Federal Agencies, and partner and allied nations. With our agile and professional workforce as our solid foundation, we will continue to be the Nation's best Combat Logistics Support Agency.

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Management's Discussion and Analysis (Unaudited)

SECTION 1 – MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

IN THIS SECTION

Mission and Organizational Structure

History

The origins of DLA date back to World War II when America's huge military buildup required the rapid procurement of vast amounts of munitions and supplies. After the war, a commission headed by former President Herbert Hoover recommended the central management of common military supplies and services. Integrated management began in 1952 with a joint Army- Navy-Air Force Support Center and continued a few years later when the Department of Defense (DoD) assigned the department-wide management of certain commodities to individual services. Thus, the Army became the military's sole buyer of food and clothing; the Navy managed medical supplies, petroleum, and industrial parts for all the services; and only the Air Force purchased electronic items.

Although centralizing wholesale stocks, this "single manager" system did not provide the uniform methods recommended by the Hoover Commission. Each single manager operated under the procedures of its parent service, and customers had to use as many sets of procedures as there were managers. On October 1, 1961, Secretary of Defense Robert McNamara eliminated this complexity by consolidating single-managers into one Agency. Called the Defense Supply Agency (DSA), this new organization began operations on January 1, 1962. Employing fewer people than the single managers and keeping less inventory in its warehouses, DSA immediately began to save the government money.

DSA grew substantially in 1965 when the Office of the Secretary of Defense (OSD) consolidated contract management functions under its headquarters. Through its Defense Contract Administration Services (DCAS), the Agency oversaw the performance of most of the Nation's defense contractors.

After its success in providing supplies to forces in Southeast Asia, DSA began receiving provisioning responsibilities Outside the Continental United States (OCONUS). In 1972, it assumed the responsibility for overseas property disposal and the worldwide procurement, management, and distribution of coal and bulk petroleum. In 1973, it began providing food for mess halls and commissaries.

The Federal government continued to recognize DSA's accomplishments by giving the Agency new authorities and missions. On January 1, 1977, DoD changed DSA's name to DLA. Less than a decade later, Congress identified DLA as a Combat Support Agency in the Goldwater-Nichols

Act of 1986. In 1988, the Agency assumed management of the Nation's strategic materials from the General Services Administration (GSA). Two years later, DoD consolidated virtually all contract administration functions within DLA. In response, the Agency elevated the DCAS to a command: the Defense Contract Management Command.

The DLA continued to undergo major reorganizations in the 1990's. In April 1990, DoD gave DLA the mission of overseeing the services' distribution depots. Eventually, this mission became the responsibility of DLA Distribution. In March 1993, the Agency reengineered its headquarters so that only 6 organizations, rather than 42, reported directly to the Director. As a result of Base Realignment and Closure (BRAC) 88, DLA moved its headquarters from Cameron Station, VA, to Fort Belvoir, VA, in 1995. As a result of BRAC 93, it merged its Defense Electronic Supply Center in Dayton, OH, with its Defense Construction Supply Center in Columbus, OH. It called the consolidated center Defense Supply Center Columbus. As part of the same BRAC, the Defense Personnel Supply Center moved from southern Philadelphia to co-locate with the Defense Industrial Supply Center in northern Philadelphia. Finally, Defense Printing Services, renamed Defense Automated Printing Service, transferred to DLA in October 1996.

As the new millennium began, DLA rose to meet new challenges. In 2001, the Agency renamed its headquarters for United States (U.S.) Army Lt. Gen. Andrew T. McNamara, its first director. DLA responded rapidly to the terrorist attacks on the U.S. homeland later that year, providing outstanding logistical support to multiple commands in Operation ENDURING FREEDOM. Beginning in 2001, DLA processed more than 6.8 million requisitions with a total value of more than $6.9 billion, provided $21.2 million in humanitarian support, and supplied more than 2.3 billion U.S. gallons of fuel to support that conflict. To support Operation IRAQI FREEDOM, DLA processed 6.4 million requisitions worth more than $6.89 billion, provided more than 180.5 million field meals, supplied nearly 2 million humanitarian daily rations, and sourced more than 3 billion U.S. gallons of fuel. During retrograde operations, the Agency continued to supply 100 percent of food, fuel, and medical supplies for the remaining forces, as well as most of their clothing, construction materials, and spare parts.

In addition to its operational support, DLA provided logistical aid for humanitarian and relief missions. In October-November 2012, it offered unprecedented support in the wake of Hurricane Sandy. In September 2014, it helped the U.S. Agency for International Development combat the deadly Ebola virus in West Africa. More recently, DLA delivered disaster relief to Haiti and the Southeastern U.S.; sustained Iraqi and Syrian refugees; helped the U.S. Forest Service fight fires; and provided resources to secure the Nation's southern border.

As DLA approaches its 60th anniversary, it continues to provide logistics, acquisition, and technical services to the DoD components (including the U.S. Army, Navy, and Air Force), other Federal Agencies, and public entities. Wherever the U.S. goes, DLA is there.

Mission, Vision, and Values

The DLA's mission, vision, and values are integral parts of the Agency which are represented through its efforts and impact around the world.

Mission

Sustain Warfighter readiness and lethality by delivering proactive global logistics in peace and war.

Vision

DLA is the Nation's Combat Logistics Support Agency: global, agile and innovative, focused on the Warfighter first.

Values

Leadership, professionalism, and technical knowledge through dedication to duty, integrity, ethics, honor, courage and loyalty.

What DLA GF Does

The DLA reports to the Office of the Under Secretary of Defense (OUSD) for Acquisition and Sustainment through the Assistant Secretary of Defense for Sustainment. As the Nation's Combat Logistics Support Agency, DLA manages the global supply chain – from raw materials to end user to disposition – for the components of the DoD (including the U.S. Army, Navy, and Air Force), other Federal Agencies, and public entities. DLA sources and provides nearly all the consumable items America's military forces need to operate, from food, fuel and energy to uniforms, medical supplies, and construction material. DLA provides support around the clock and around the world to meet the needs of America's Armed Forces and other designated customers in times of peace, National emergency, and war. DLA supports DoD objectives and missions with involvement in the full range of military operations from participation with multi-national forces engaged in large-scale combat operations, weapons and spares provisions, peacekeeping efforts, and emergency support to humanitarian assistance.

The DLA GF employs approximately 450 civilian personnel, whose labor is paid from DLA GF.

The National Defense Authorization Act (NDAA) is the U.S. Federal law specifying annual budget and expenditures of the DoD.

Paratroopers with the 173rd Airborne Brigade meet World War II veterans during a ceremony June 1, 2019 in Bricqubec-en-Contin, France to honor two B-17s that were shot down, one of more than 80 events to commemorate the 75th anniversary of D-Day the Normandy region June 1-9. The DLA provided meals, Meals, Ready-to-Eat (MREs), bottled water and cots to support the more than 1,300 U.S. service members supporting the commemoration events.

How DLA GF Accomplishes its Mission

There are five major activities/appropriations of DLA GF: The DLA GF receives appropriations from the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) in Treasury Index (TI)-97, along with Other Defense Organizations (ODOs). OUSD(C) uses a data element referred to as a 'limit' to differentiate the various ODOs under TI-97. Defense-wide (DW) appropriations are allotted to DLA GF include: (1) Operation and Maintenance (O&M), (2) Procurement Defense-wide (PDW), (3) Research, Development, Test and Evaluation (RDT&E), (4) Military Construction (MILCON), and (5) Family Housing O&M. The appropriations provide the funding to incur obligations and to pay for goods and services. DLA GF sub-allots RDT&E and MILCON funding to other DoD organizations (e.g. Defense Microelectronics Activity (DMEA)).

Operation and Maintenance (O&M) (funds available year(s):1)

The DLA GF uses appropriations to support the sustainment of ongoing mission support initiatives at the Agency level and department wide. The O&M appropriation continues the path to achieving full spectrum readiness and advances the DoD's multi-pronged, multi-year approach to build a more lethal and ready force with targeted investments in training, equipment, industrial readiness, microcircuit emulation, soldier and family programs.

Procurement Defense – Wide (PDW) (funds available year(s):3)

As the Nation's Combat Logistics Support Agency, DLA procures, manages, stores, and distributes items the military needs to operate. Commodities include everything from maritime and land weapons systems support to medical supplies. DoD uses the appropriations to obtain various categories of material, such as, new military hardware, aircraft, armored vehicles, and other major equipment; upgrades to existing equipment, including extending service life or remanufacturing existing systems; weapons and ammunition, ranging from air-to-air missiles to rounds for individual rifles; and spare parts, particularly those that are centrally managed.

Research, Development, Test & Evaluation (RDT&E) (funds available year(s):2)

To maintain technological superiority on the battlefield, the DoD relies on scientific and technical knowledge developed in large measure through RDT&E. DLA's RDT&E funding is appropriated in IV Research, Development, Test and Evaluation.

DLA's Research & Development (R&D) is a program is funded by the RDT&E appropriation that enables supply-chain innovation that directly supports the Warfighter. The program's goal is to deliver innovative and responsive solutions to the Warfighters and other valued customers. In FY2019, RDT&E was appropriated a total of $325.0 million.

Family Housing and Military Construction (MILCON) (funds available year(s):5)

For reporting purposes, due to the materiality and size of Family Housing, DLA GF combined the Family Housing Program with MILCON in its Statements of Net Cost for presentation purposes.

Family Housing (O&M, Defense-Wide (funds available year(s):1)

The Family Housing appropriations encompass Military Family Housing and includes all DoD Component family housing, leases of real property utilized by DoD Components for family housing, and associated family housing support services appropriations. Family Housing is meant to provide for the housing and support services, as authorized by law, which are necessary to meet the requirements of the DoD. The appropriation is financed and managed in a cost effective and efficient manner to support the stated requirements, and to maximize the use of available appropriated resources. DLA GF will no longer have Family Housing Appropriation after FY2019 as we have divested all our Family Housing units.

Military Construction (MILCON) (funds available year(s):5)

MILCON appropriations provide for major construction to replace or renovate DoD Fuels, Distribution, and Inventory Control Point facilities around the world. DLA's funds are sub-allotted to the U.S. Army Corps of Engineers (USACE) and U.S. Naval Facilities Engineering Command (NAVFAC) for execution. In FY2019, $148.2 million was sub-allotted to USACE and $21.5 million was sub-allotted to NAVFAC. In FY2018, $103.6 million was sub-allotted to USACE and $72.8 million was sub-allotted to NAVFAC. Projects include fuel hydrant systems encompassing entire aircraft parking ramps, six hundred plus operations and HQ facilities, and retail gas stations.

Organizational Structure

Below is DLA's organizational chart. Appendix B contains further explanation of the Staff Directors and Field Activity Commanders (J/D) Codes.

Figure 1: DLA Organizational Chart

Annual Performance Report

The DLA has chosen to produce an AFR for DLA GF. DoD produces an Annual Performance Report (APR) for all its components (including DLA GF) and will include its FY2019 APR with its FY2021 Congressional Budget Justification. The APR is located at: https://cmo.defense.gov/Publications/Annual-Performance-Plan-and-Performance-Report/.

Performance Goals, Objectives, and Results

The DLA has established performance assessments of its programs for purposes of assessing Agency performance and improvement, based on the GPRA Modernization Act of 2010. The Performance Goals, Objectives, and Results within this section are aligned to DLA's 2018-2026 Strategic Plan and provides a summary of DLA's five Lines of Effort (LOEs) and two Critical Capabilities (CCs). These goal-oriented objectives and forward-looking initiatives are designed to strengthen DLA's efforts in sustaining Warfighter readiness and the Nation's responsiveness. The key initiatives that have specific Director's emphasis in DLA's Strategic Plan for 2018-2026 are shown in the LOEs and CCs below.

Figure 2: Lines of Effort and Critical Capabilities

The LOEs, CCs and objectives in the section below are derived from DLA's 2018-2026 Strategic Plan; however, there are specific objectives and key performance measures that are applicable to the GF and have been identified accordingly below.

LOE 1 Warfighter First

The DLA's number one priority, Warfighter First, is sustaining the full range of military operations in an increasingly complex global environment.

Warfighter First Objectives

1.1 Nuclear Enterprise
1.2 Readiness and Lethality
1.3 Address Risk
1.4 Predictive Technology
1.5 Warfighter Trust
1.6 Space Enterprise
1.7 Support to DoD Reform
1.8 Demand Projections

Objective 1.2: Readiness and Lethality

Link performance to service and Combatant Command (CCMD) readiness and lethality. DLA must be ready to support Warfighters engaged in any possible operation while achieving the efficiencies the Nation and customers expect. DLA will prioritize wargame and exercise participation training and realistic logistics scenarios that ensure DLA validates the Concepts of Operations.

Objective 1.4: Predictive Technology

Anticipate and position solutions for Warfighter requirements by combining big data, predicative analytics, automation, artificial intelligence, sustained supply chain visibility and continuous communication.

Through employment of trend analysis and predictive algorithms, DLA is able to consistently predict and position the right logistics solution on time, every time.

Objective 1.5: Warfighter Trust

Continually earn the Warfighter's trust as the Nation's Combat Logistics Provider. DLA will make it fast and easy for Warfighters to work with DLA by quickly understanding the customers' current requirements and anticipating their future needs.

Objective 1.8: Demand Projections

Working collaboratively with DLA's service, Whole of Government and Industry partners, DLA will improve projections and reduce demand planning errors to increase service readiness and the buying power for DoD and supported Federal Agencies.

LOE 2 Global Posture

The DLA's logistics presence and posture must enable the Nation's ability to protect its global interests. The speed and complexity of global crises require resilient networks, robust partnerships, and quickly integrated teams. DLA will position resources for rapid use, build more deployable capabilities, and strengthen DLA partnerships using integrated logistics and contracting services.

Global Posture Objectives

2.1 Strategic Positioning
2.2 Single Point of Entry
2.3 Expeditionary Capabilities
2.4 Expanded Solutions
2.5 Joint Reserve Force

Objective 2.1: Strategic Positioning

Strategically position DLA's capabilities where the Warfighter needs them most. DLA supports service members around the world by providing comprehensive logistics support and services, even in the most austere environments.

LOE 3 Strong Partnerships

Mission accomplishment requires close collaboration and strong relationships with critical stakeholders: the Joint Logistics Enterprise (JLEnt), other government partners, suppliers, and allies. DLA must sustain partnerships and synchronize efforts with these entities to help DoD and the Nation address immediate needs and long-term challenges.

Strong Partnerships Objectives

3.1 Joint Logistics Enterprise Partnerships
3.2 DoD and Interagency Partnerships
3.3 Industry Partnerships
3.4 Public Engagement

Objective 3.1: Joint Logistics Enterprise Partnerships

Partner across the Joint Logistics Enterprise (JLEnt) to improve support for current and emerging requirements. Basing our efforts in Joint Publication 4.0, DLA will strengthen our partnerships through engagement with JLEnt entities and cooperatively facilitate progress toward mutual goals, objectives, and expectations of our partners.

Objective 3.3: Industry Partnerships

Work with industry to ensure a capable defense industrial base, generate innovative and efficient solutions, and maintain a secure and resilient supply chain. By building on DLA's strong relationships with industry partners, DLA will deliver cost-effective, innovative solutions. DLA's supplier engagement plan will guide us. DLA will continuously assess the strength of our industrial capabilities and develop responses to vulnerabilities, reduce single points of failure and implement best practices.

LOE 4 Whole of Government

The DLA's global network and expertise in supply chain management can improve efficiency and increase effectiveness of the Whole of Government partners. Collaboration ensures a healthy, viable base of suppliers able to surge when needed. Working alongside these Whole of Government partners in domestic and international operations, DoD and DLA strengthen the ability to serve National interests.

Whole of Government Objectives

4.1 Crisis Response
4.2 Provider of Choice
4.3 Expand Support to Federal Agencies

Objective 4.3: Expand Support to Federal Agencies

Support interagency and DoD reform initiatives. DLA's core competencies can offer the most cost-effective, efficient solutions to DLA's Whole of Government partners. DLA will assess other Agencies' solutions for their value to the government and adopt solutions that enhance DLA's Warfighter support. DLA will actively participate in Federal initiatives to eliminate duplication, capitalize on economies of scale and create additional category management opportunities for the DoD.

LOE 5 Always Accountable

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

Always Accountable Objectives

5.1 Cost Consciousness
5.2 Auditability
5.3 Value Innovation
5.4 Mitigate Risks
5.5 Transform Cost Structure to Reduce Rates and Improve Transparency

Objective 5.2: Auditability

Attain and sustain auditability through process excellence and sound financial stewardship. DLA will achieve an unmodified financial statement audit opinion using thoroughly documented processes, automated tools and general controls that are secure and compliant. DLA will continue to document, evolve and test processes to ensure it implements corrective actions and addresses deficiencies identified in the annual Statement of Assurance (SOA).

CC 1 – Enterprise Enablers

DLA recognizes innovation, data management, technology and cybersecurity are intertwined. These four CCs support DLA's LOEs and are essential for DLA's workforce to accomplish strategic and operational objectives.

Enterprise Enablers Objectives

1 Innovation
2 Data Management
3 Technology
4 Cybersecurity

CC 2 – People and Culture

DLA will continue to attract, develop, engage and retain a diverse, highly skilled, mission-focused workforce, strengthen current and emerging workforce competencies, leverage and expand leadership programs, and foster an environment that unlocks the full potential of DLA employees in order to meet current and future mission demands.

People Objectives

1 Develop Leaders
2 Resource the Enterprise
3 Manage the Talent
4 Sustain our People

Culture Objectives

5 Fortify the Culture
6 Perform and Reward
7 Build Connections
8 Protect the Workforce

Performance Measures (Unaudited)

The primary DLA GF appropriations are O&M, PDW, RDT&E, Family Housing and MILCON. O&M, RDT&E and MILCON represents greater than 95.0% of DLA's GF. Relevant DLA GF performance measures for these appropriations are presented below.

Operation & Maintenance

The DLA GF O&M appropriation has two major sub programs, DoD Programs and HQ DLA Programs. For DoD Programs, O&M funds the Defense Agencies Initiative (DAI). For the DLA HQ Programs, O&M funds Contingency Logistics (CL), Procurement Technical Assistance Program (PTAP), and the Warstopper.

Contingency Logistics

This performance measure relates to the objectives described above: **4.3**, Expand Support to Federal Agencies; **1.5**, Warfighter Trust; and **1.8**, Demand Projections.

The CL program supports military unique (DoD-Mandated) tasks, such as readiness support that a commercial distribution company would not experience. For FY2019, the CL budget is $49.7 million, which comprises 13.0% of the O&M budget of $380.0 million.

By the end of FY2019, DLA GF was able to process DMSMS cases within an average 2.1 days in FY2019, resulting in a 22.2% efficiency compared to FY2018, which was an average of 2.7 processing days.

The DLA GF CL success was a result of continued employee trainings, aggressive coordination with the military, and increased demand planning with vendors and customers.

The DLA GF CL identified three risks, risk of obsolescence of parts prior to use, risk of ability to supply customers with safety data when needed, and risk of ability to fully transition to a new information technology.

The DLA GF CL has taken various measures to address these potential risks. Mitigation actions taken include, increasing the level of training for employees and improving communication and coordination with the military to understand future needs.

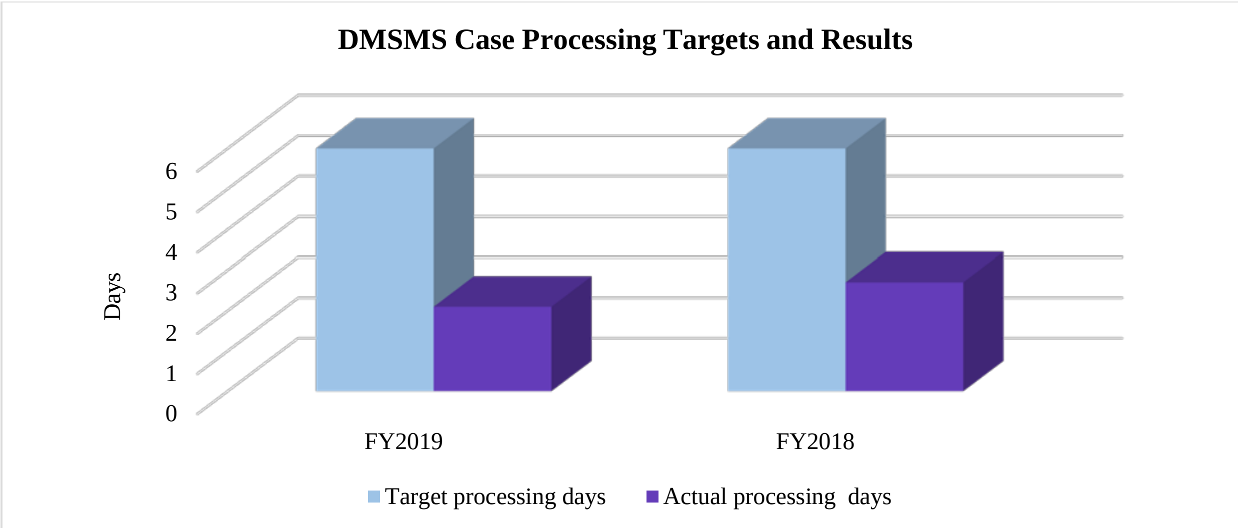


Figure 3: DMSMS Case Processing Targets and Results - Chart

Procurement Technical Assistance Program

This performance measure relates to the objective described above: **3.1**, JLEnt Partnerships.

The PTAP was authorized by Congress in 1985 to expand the number of businesses capable of participating in the government marketplace. The program provides matching funds through cooperative agreements with state and local governments and non-profit organizations for the establishment of Procurement Technical Assistance Centers (PTACs) to provide procurement assistance. PTACs have a local presence in 48 states, Washington, D.C., Puerto Rico and Guam. Other PTACs specialize in assistance to Federally recognized Indian tribes and Alaska Native entities, their members and reservations throughout the country.

State-wide-PTACs Regional county-wide PTACs Bureau of Indian Affairs PTACs

Figure 4: PTAC presence across the U.S., Puerto Rico and Guam

Under the PTAP, DoD provides financial assistance to PTACs that serve as a resource for local businesses to provide access to information and training related to contracting and subcontracting opportunities with DoD, other Federal agencies, and State and local governments.

PTACs provide day-to-day assistance to businesses in the form of services that include helping prepare bids/proposals, marketing to potential buyers, setting up or improving quality assurance and accounting systems, complying with cybersecurity requirements, and resolving payment problems. Currently there are 93.0 PTACs operating across the U.S. During FY2019, PTAP was allotted $42.3 million (11.1%) of the total O&M budget, magnifying the importance of the program for DLA's success.

In the PTAP cost sharing program, DLA pays up to 75.0% for distressed areas, and 60.0% for non-distressed areas. Distressed areas represent areas that have a per capita income of 80.0% or less than the State average; or an unemployment rate that is 1.0% greater than the national average for the most recent 24-month period. DLA GF has capped its regional and state-wide PTAC assistance at $450,000 and $750,000, respectively.

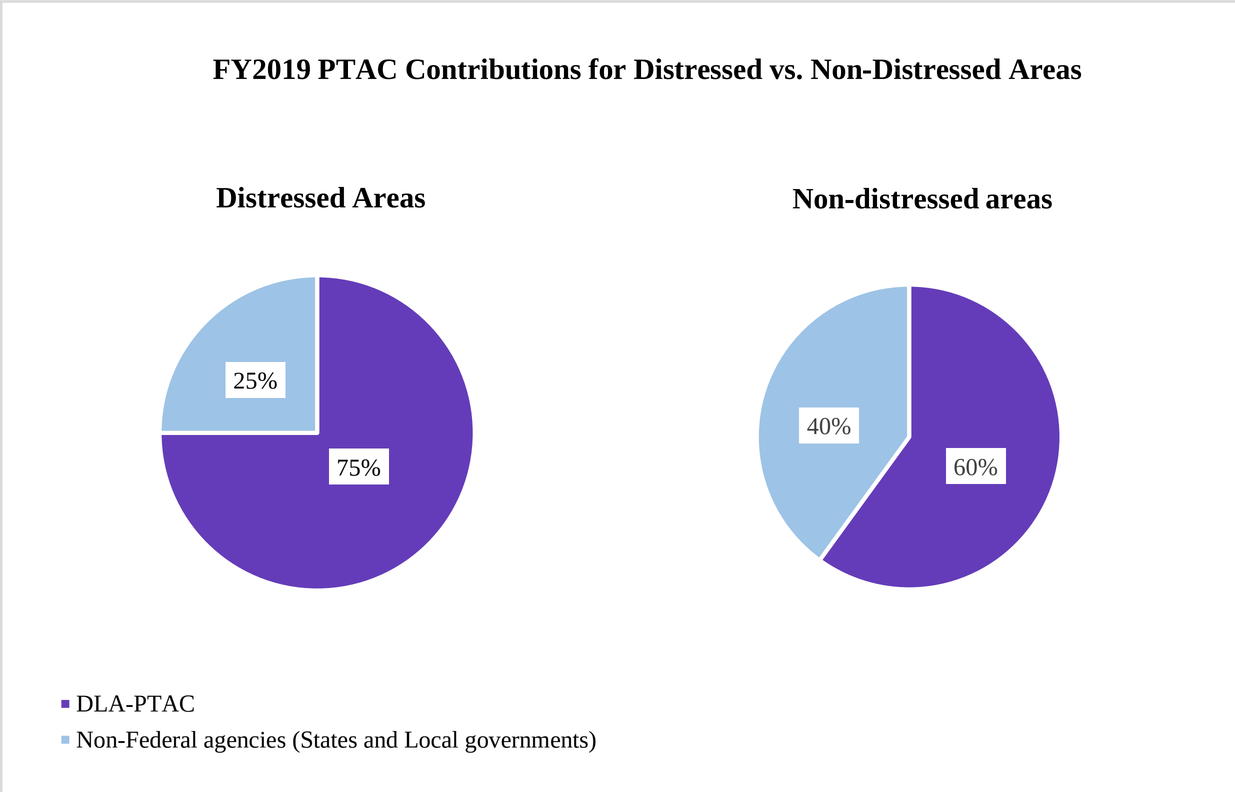


Figure 5: PTAC Contributions for Distressed vs. Non-distressed areas - Chart

In FY2019, PTAP received $27.4 million in non-federal funding by state and other local entities. In FY2019, PTACs served over 54,824 clients and spent 169,716 hours to assist these clients. In addition, the PTACs facilitated over 5,307 training and networking events and clients received more than 707,689 government contracts valued at approximately $26.3 billion. This helped to create and retain 559,150 jobs in FY2019. The average salary for the newly created jobs, according to the US Bureau of Labor and Statistics, is approximately $48,000.

Warstopper

This performance measure relates to the objective described above: **2.1**, Strategic Positioning.

The Warstopper program aims to complete industrial investments to meet critical readiness requirements and offset Service War Reserve Material. It also enables the completion of annual industrial base risk analysis to identify readiness vulnerabilities from DLA managed items.

The Warstopper program uses several mechanisms to measure performance. Examples include validated operational capability for industrial investments in medical readiness contracts and Land and Maritime, Energy, and Aviation supply chains; MRE surge capacity; and completed annual industrial base risk analysis. DLA GF also measures performance of its sub programs by reviewing return on investment and cost savings amounts.

The GF Warstopper program makes industrial investments in commercial entities to ensure secure technological capabilities and the availability of vital materials and resources that meet the surge of demand during wartime. Such investments result in savings associated with the costs of maintaining inventory on hand, avoidance of higher price to acquire technologies and other materials in time of demand. During wartime, DLA invests more funds than in peace time.

To mitigate potential future risks related to lack of demand for critical items and lack of future stable funding, DLA will continue to monitor critical industrial base elements with low demand and implement impactful industrial investments to reduce Warfighter risk. Furthermore, DLA will continue to monitor industrial specialist reports and independent post investment analysis to document program successes and support the need for increased program funding.

Defense Agencies Initiative

This performance measure relates to the objectives described above: **4.3**, Expand Support to Federal Agencies; **5.1**, Cost Consciousness; **5.2**, Auditability; **5.3**, Value Innovation; and **5.4**, Mitigate Risks.

The DAI is a financial management system of nine integrated business processes. The system provides real time, web-based accessible capabilities for financial managers and other DoD employees to make sound business decisions in support of the Warfighter. The DAI program continually demands innovation to meet the current dynamic technological and operational environment. As a result, in addition to O&M funding, the program also receives appropriations through DLA GF RDT&E appropriations. In FY2019, DAI was allotted $48.6 million of O&M funds, which represents 12.7% of the total O&M appropriation of $380.0 million. In FY2019, DAI was allotted $20.4 million of RTD&E funds, which constitutes 6.2% of the RDT&E appropriation of $325.0 million. Due to the nature of the DAI program, DLA GF presents a combined performance measure for both RDT&E and O&M.

For FY2019, DAI targeted to provide assurance that:

- 100.0% of DAI interfaces have data integrity checks in place to ensure no loss or corruption of data during transmission, as well as no loss of interoperability ac\ross business systems;
- 100.0% of financial transactions are traceable to all supporting transactions in the end-to-end process; and
- Agencies are able to grant user roles and permission changes in less than one business day after requests have been entered into the User Access Management (UAM) system.

In FY2019, DAI consistently and successfully granted system access on the same day requests were submitted and met targeted goals.

Research, Development, Test & Evaluation

This performance measure relates to the objectives described above: **5.1**, Cost Consciousness; **5.2**, Auditability; **5.3**, Value Innovation; **5.4**, Mitigate Risks; and **5.5**, Transform Cost Structure to Reduce Rates and Improve Transparency.

The RDT&E has two major cost categories: Advanced Technology Development and System Development and Demonstration.

Advanced Technology Development is comprised of three major sub programs: DMEA, Manufacturing Technology (ManTech) and Logistics Research and Development Technology Program. The sub programs were initiated to attain the goal of advancing technological developments. In FY2019, Advanced Technology Development was allocated $273.4 million, which comprises 84.1% of the total RDT&E Budget of $325.0 million. Of the $273.4 million, DMEA was sub-allotted $192.9 million, ManTech was allocated $62.4 million, and $18.1 million was allocated to Logistics Research and Development Technology. In FY2018, Advanced Technology Development was allocated $297.1 million, which comprised 83.5% of the total FY2018 RDT&E Budget of $355.8 million. DMEA was sub-allotted $241.9 million, ManTech was allocated $39.1 million, and Logistics Research and Development Technology was allocated $16.1 million. Although DMEA is not fully funded by DLA GF, OUSD sub-allots funds for DMEA to use through a DLA GF appropriation.

The System Development and Demonstration program is the second highest appropriation user in the RDT&E program: comprising 10 w. of the RDT&E allocated budget of $325.0 million. This program is comprised of three major subprograms; DAI[2] (also discussed in the O&M section), which was allocated $20.4 million, the Defense Retired and Annuitant System 2 subprogram (DRAS2) was allocated $10.3 million, and the DoD Enterprise Systems Development and Demonstration subprogram was allocated $3.1 million.

Defense Microelectronics Activity

This performance measure relates to the objectives described above: **1.4**, Predictive Technology, **3.3,** Industry Partnerships.

GF DMEA accomplishes its mission for DoD by providing a guaranteed and trusted source of supply of microelectronic parts that are essential to combat operations. DMEA provides solutions for defense, intelligence, special operations, cyber and combat missions, as well as microelectronic components that are unobtainable in the commercial market.

In FY2019, DMEA set the following goals to improve industrial-based manufacturing:

- Meet 100.0% of assigned CCMD and Special Operations Command (SOCOM) microelectronic needs;
- Provide timely and cost-effective advanced technology solutions in response to asymmetric threats; and to modernize aging weapons systems; and
- Modernize and enhance engineering assistance for microelectronic components.

The program goals used to evaluate performance include continuity of support and successful execution of CCMD and SOCOM, microeconomics engineering requests; assistance and support operations; and the ability to fulfill components requests timely.

[2] DAI is funded by both O&M and RDT&E

In FY2019, DMEA accomplished the following:

- Provided specialized engineering assistance requests and capabilities to systems in various areas; and
- Provided consistent and timely support for electronics and microelectronic foundry technologies and weapon systems development.

The above accomplishments were impacted by:

- Volume and quality of internal talent;
- Design and assembly capabilities (software, tools, and talent); and
- Partnerships and collaboration with Defense and commercial industry.

To mitigate the risk of obsolescence and keep pace with workload demand, DMEA program office continues to increase staffing and modernize acquisition strategy for management.

Manufacturing Technology Program

This performance measure relates to the objectives described above: **1.2**, Readiness and Lethality; **1.**4, Predictive Technology; and **3.3,** Industry Partnerships.

The DLA ManTech program enables DLA to explore and develop innovative solutions to improve and modernize manufacturing processes directly aligned to the National Defense Strategy (NDS). The program aims to rebuild military readiness for a more lethal force and achieve reform through greater performance and affordability, predictive analytics and continuous communication.

In FY2019, the ManTech program targeted 40.0% transition of R&D projects to implementation. ManTech measures successful R&D project implementation by reducing material costs and lead time and improving quality of material, hard-to-source critical parts, and the sharing of information between military service needs and industry capabilities.

As of September 30, 2019, DLA ManTech achieved the following program results:

- Saved an estimate of $1.0 million per advanced microcircuit application, which is an average of $100.0 million per year savings to the U.S. military;
- Reduced the manufacturing process rate by 12.0% in die cast coating, resulting in savings of over $1.8 million to the U.S. military over the next 10 years;
- Defined a standardized procedure to manufacture an M1A1 tank impeller, which improved the DoD supply chain process; and
- Successfully validated technical data conversions from two to three dimensional data.

Defense Retired and Annuitant System

This performance measure relates to the objectives described above: **4.3**, Expand Support to Federal Agencies; **5.1**, Cost Consciousness; **5.2**, Auditability; **5.3**, Value Innovation; **5.4**, Mitigate Risks; and **5.5**, Transform Cost Structure to Reduce Rates and Improve Transparency.

DRAS2 is a software development program that replaces the legacy DRAS system. The legacy DRAS system was comprised of 11 separate sub-systems and ran more than 30 mainframe software applications to pay military retirees, surviving family members receiving annuities, voluntary separation agreement recipients, victims of abuse, and recipients of combat related service disabilities. In FY2019, DRAS2 accounted for 30.5% of the System Development and Demonstration budget.

DRAS2 planned to complete new development in FY2019 with an objective of achieving full deployment in FY2021. At the beginning of FY2019, DRAS2 transitioned to an agile software development approach and began measuring development on a points based system.

Funding continues to present the greatest challenge for DRAS2. In FY2019, DRAS2 suffered a more significant Unfunded Requirement (UFR) resulting in the reduction of the DRAS2 system integrator support. As a result, DRAS2 will defer requirements into FY2020 and beyond.

Military Construction

This performance measure relates to the objectives described above: **1.2**, Readiness and Lethality and **1.5**, Warfighter Trust.

The MILCON program provides funds for major construction to replace or renovate DoD fuel depots and Industrial Capabilities Program (ICP) facilities around the world. DLA sub-allots MILCON funds to USACE and NAVFAC, which are DLA's primary design and construction agents for the MILCON program. Projects include fuel hydrant systems encompassing entire aircraft parking ramps, six hundred plus operations and HQ facilities, and retail gas stations.

In FY2019, the Facilities Modernization division within Installation Management brought to completion thirteen MILCON projects. The total value of these projects was over $334 million. Projects ranged in scope from fuel hydrant systems encompassing entire aircraft parking ramps, to six hundred plus person operations and HQ facilities, to a new ship-refueling pier. Prices ranged from nearly $90.0 million down to just over $4.0 million. Working with DLA partners, the USACE and NAVFAC, DLA GF awarded nine of nine projects authorized and appropriated, valued at a total of $157.2 million.

The MILCON projects are prone to various risks including risk of increased project costs, bids exceeding program amounts and funding limitations. In FY2019, the goal was to award 80.0% of projects requested. GF MILCON awarded 60.0%. The 20.0% deviation was due to funding limitations and will be awarded at the time funds are available.

DLA Roadmap to Auditability

This performance measure relates to the objective described above: **5.2**, Auditability.

Currently, DLA GF receives a disclaimer of opinion on its financial statements. DLA GF is striving to obtain an unmodified audit opinion from its IPA in the future. Since receiving a disclaimer of opinion each year from FY2017 through FY2019, DLA GF has taken a two track approach in resolving major impediments in efforts to strive for an unmodified audit opinion: (1) improving the reliability and fair presentation of financial data reported in the AFR by virtue of addressing Notice of Findings and Recommendations (NFRs); and (2) developing, improving, and refining the underlying end-to-end processes that support the compilation of the AFR by instilling sound fundamental practices in developing all sections of the AFR in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and OMB Circular A-136 requirements. The following timeline summarizes the occurrence of events that propelled DLA GF into a corrective action posture.

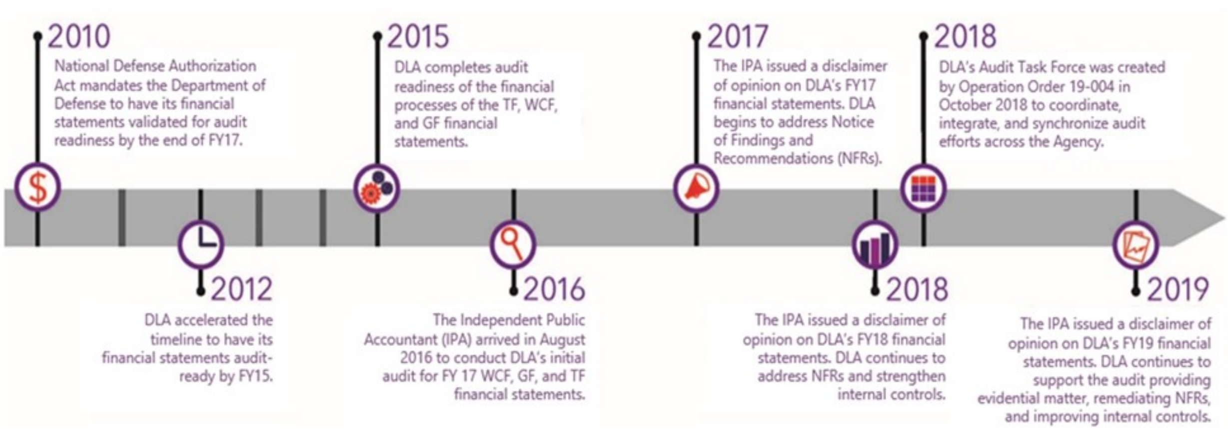


Figure 6: DLA Auditability Timeline

Analysis of Financial Statements and Stewardship Information

This analysis presents a summary of DLA GF's financial position and results of operations, and addresses the relevance of major changes in the types and amounts of assets, liabilities, costs, revenues, obligations, and outlays.

The principal financial statements of DLA GF include the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and the Combined Statements of Budgetary Resources. These principal statements and related notes are included in the Financial Section of this AFR.

Overview of Financial Position

Preparing DLA GF financial statements is a vital component of sound financial management and is intended to provide accurate, accountable, and reliable information that is useful for assessing performance, allocating resources, and for targeting areas for future programmatic emphasis. DLA GF's management is responsible for the integrity and objectivity of the financial information presented in the statements. DLA is dedicated in its pursuit of financial management excellence.

A summary of DLA GF changes in key financial measures for FY2019 and FY2018 is presented in the following Analysis of Key Financial Measures. The table represents the budgetary resources available, assets on hand to pay liabilities, and the corresponding net position. The net cost of operations is the gross costs of DLA GF five programs: O&M, PDW, RDT&E, Family Housing, and MILCON less earned revenue. Because of the materiality and nature of the program, DLA combines the Family Housing Program with MILCON for reporting purposes in the Statements of Net Cost. Budgetary resources are funds available for DLA GF to incur obligations to pay for goods and services prior to the cancellation of funds. The summary section also includes an explanation of significant changes for each DLA GF financial statement.

Changes In Key Financial Measures				
As of and for the Years Ended September 30, 2019 and September 30, 2018 (dollars in millions)				
			Increase/Decrease	
Net Financial Condition	**2019**	**2018**	**$**	**%**
Fund Balance with Treasury	$ 1,421.4	$ 1,438.4	$ (17.0)	(1.2%)
Accounts Receivable and Other Assets	11.8	10.3	1.5	14.6%
General PP&E	728.7	611.8	116.9	19.1%
Total Assets	$ 2,161.9	$ 2,060.5	$ 101.4	4.9%
Accounts Payable	$ 71.1	$ 78.4	$ (7.3)	(9.3%)
Federal Employment Benefits and Other Liabilities	15.2	13.9	1.3	9.4%
Environmental and Disposal Liabilities	81.2	88.3	(7.1)	(8.0%)
Total Liabilities	$ 167.5	$ 180.6	$ (13.1)	(7.3%)
Unexpended Appropriations	$ 1,361.0	$ 1,374.2	$ (13.2)	(1.0%)
Cumulative Results of Operations	633.4	505.7	127.7	25.3%
Total Net Position	$ 1,994.4	$ 1,879.9	$ 114.5	6.1%
Total Liabilities and Net Position	$ 2,161.9	$ 2,060.5	$ 101.4	4.9%
Net Cost of Operations	$ 701.9	$ 727.4	$ (25.5)	(3.5%)
Budgetary Resources	$ 1,543.8	$ 1,589.1	$ (45.3)	(2.9%)

Figure 7: Changes in Key Financial Measures

Marine Corps recruit shoots an M320 grenade launcher during training at West Point, N.Y., Aug. 1, 2019.

Balance Sheets Summary

Assets – What DLA GF Owns and Manages

Assets represent amounts owned and managed by DLA GF that can be used to accomplish its mission as the Nation's Combat Logistics Support Agency. The DLA GF largest asset is Fund Balance with Treasury (FBwT), which represents 65.7% of Total Assets at just over $1,421.4 million as of September 30, 2019. This is a ($17.0 million) and (1.2%) decrease compared to the September 30, 2018 balance. General Property, Plant, and Equipment (PP&E) represents $728.7 million and 33.7% of Total Assets, which is an increase of $116.9 million and 19.1% from the September 30, 2018 balance. General PP&E is primarily comprised of construction-in-progress (CIP).

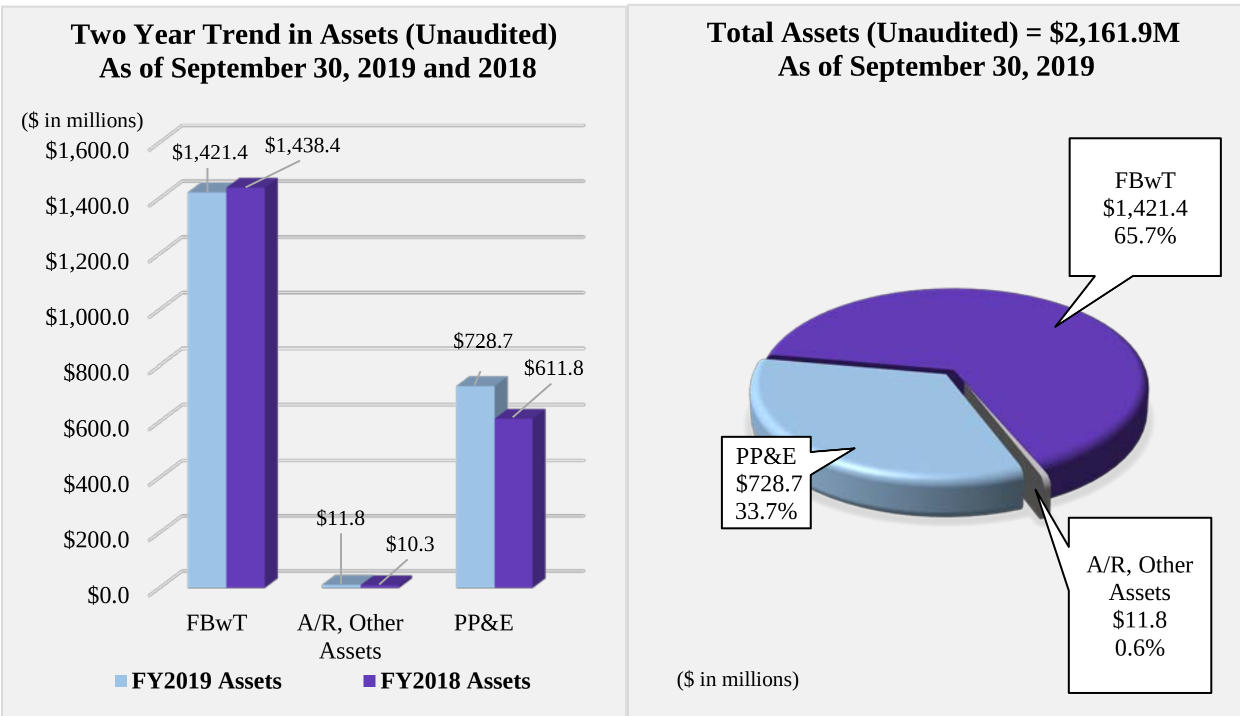


Figure 8: Total Assets as of September 30, 2019 and 2018

Liabilities – What DLA GF Owes

Liabilities are the amounts owed (1) to non-Federal and Federal entities for goods and services provided but not yet paid; (2) to DLA employees for wages and future benefits; (3) for environmental disposal liabilities; and (4) for other liabilities. As of September 30, 2019, Environmental and Disposal Liabilities (EL) represent $81.2 million and 48.5% of Total Liabilities. The second largest liability is Accounts Payable, which comprises $71.1 million and 42.4% of Total Liabilities. Accounts Payable shows a ($7.3 million) and (9.3%) net reduction over the September 30, 2018 balance. Federal Benefits and Other Liabilities represent $15.2 million and 9.1% of Total Liabilities.

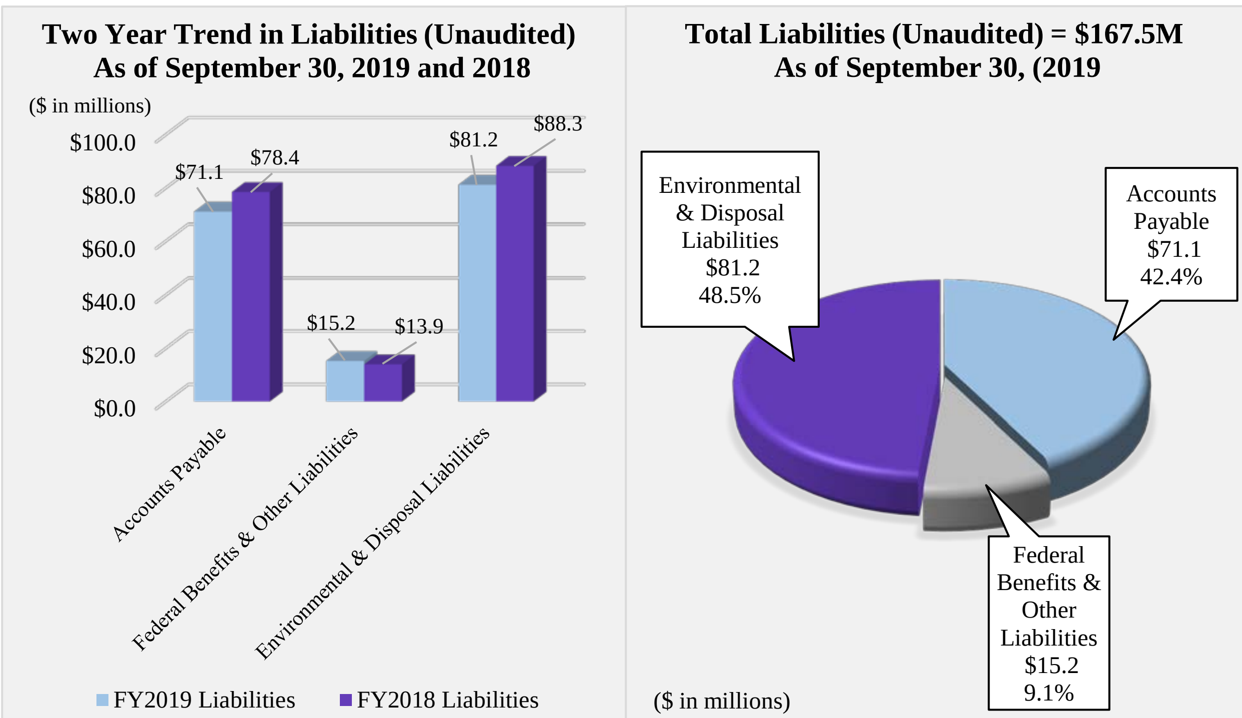


Figure 9: Total Liabilities as of September 30, 2019 and 2018

Ending Net Position – What DLA GF Has Done Over Time

Net position represents primarily the accumulation of Revenue and Expenses, and Unexpended Appropriations and Other Financing Sources transferred in/out since inception, as represented in DLA GF balances reflected in the Statements of Changes in Net Position. Total Net Position in the amount of $1,994.4 million is made up of (1) Unexpended Appropriations and (2) Cumulative Results of Operations.

DLA GF Results – Current Fiscal Year Net Cost of Operations

The DLA GF applies management over five programs: O&M, RDT&E, PDW, MILCON, and Family Housing. Net Cost is grouped by four major components, combining MILCON and Family Housing into one. For the year ended September 30, 2019, O&M represents the largest portion of Net Cost of Operations at $334.0 million and 47.6% of Net Cost of Operations for the year ended September 30, 2019. RDT&E represents the second largest portion of Net Cost of Operations at $272.6 million and 38.8% for the year ended September 30, 2019.

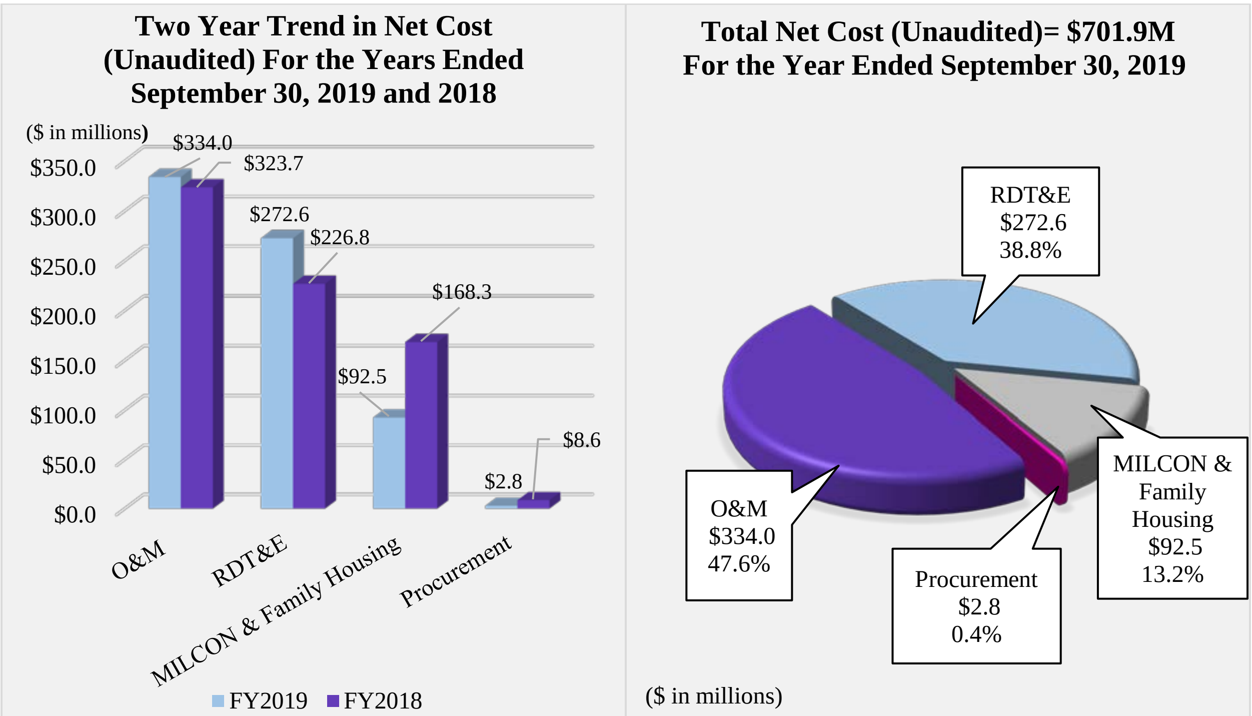


Figure 10: Comparative Net Cost by Program for the Years Ended September 20, 2019 and 2018

Budgetary Resources

DLA GF Budgetary Resources

The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds. The budget represents our plan for efficiently and effectively achieving the strategic objectives to carry out our mission and to ensure that DLA GF manages its operations within the appropriated amounts using budgetary controls. Budgetary Resources are comprised of Unobligated Balances and Obligations Incurred. Unobligated balances represent balances that have not yet been committed by contract or other legally binding action. Obligations incurred refers to balances for which there has been legally binding action. DLA GF primarily funded through appropriations from Congress for all of its operations.

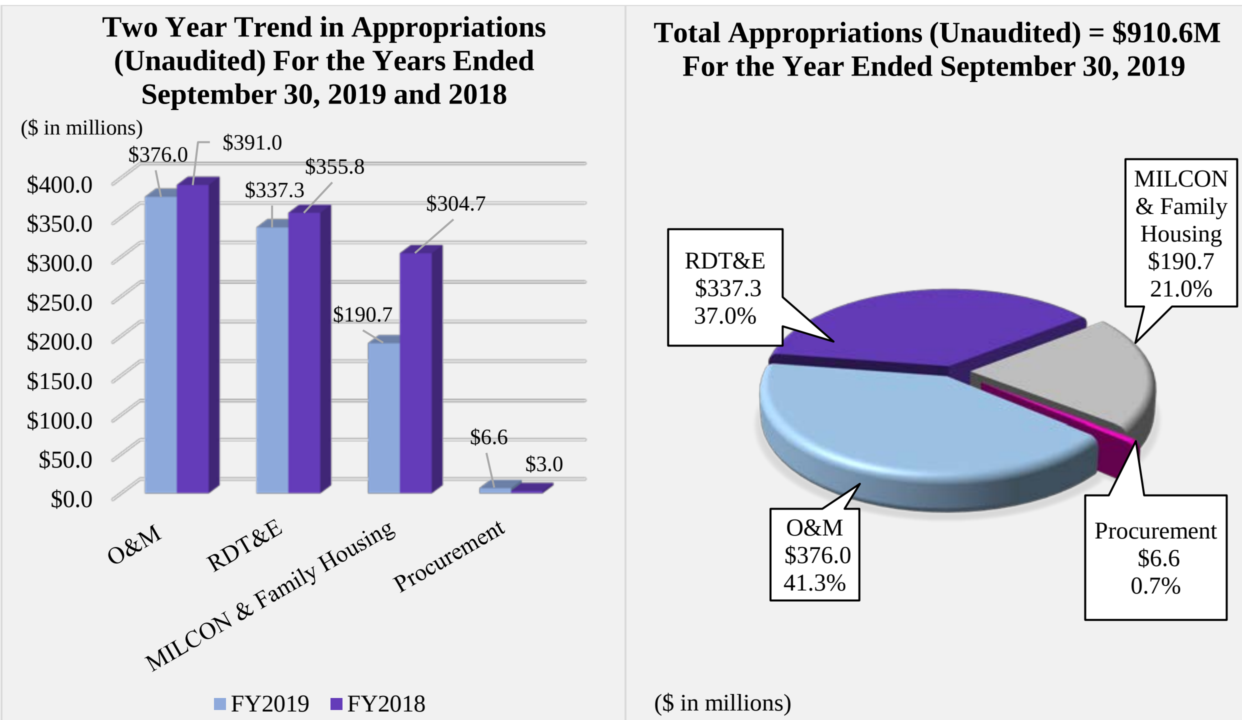
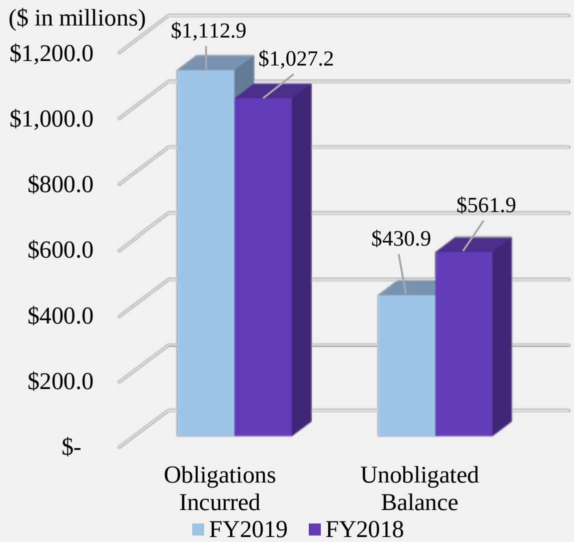


Figure 11: Appropriations by Category for the Years Ended September 30, 2019 and 2018

Two Year Trend in Status of Budgetary Resources (Unaudited) For the Years Ended September 30, 2019 and 2018



Total Budgetary Resources (Unaudited) = $1,543.8M For the Year Ended September 30, 2019

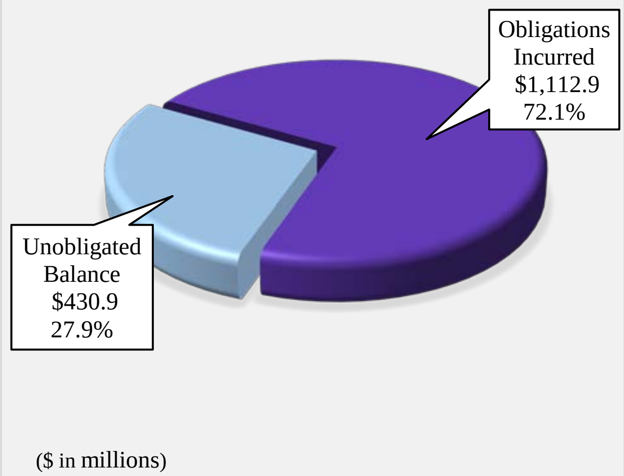


Figure 12: Status of Budgetary Resources for the Years Ended September 30, 2019 and 2018

Analysis of Systems, Controls, and Legal Compliance

The DLA management is responsible for establishing, maintaining, and assessing internal controls to provide reasonable assurance that the objectives of OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management (ERM) and Internal Control*, the FMFIA (31 U.S. Code (U.S.C.) 3512, Sections 2 and 4), and the FFMIA (Pub. L. 104-208), as prescribed by U.S. Government Accountability Office (GAO) Green Book, *Standards for Internal Control in the Federal Government*, are met. The appendices referenced within the annual SOA below are OMB Circular A-123 appendices and are not included in DLA GF AFR.

Management Assurances

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

OCT 0 1 2019

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

THROUGH: OFFICE OF THE CHIEF MANAGEMENT OFFICER

SUBJECT: Annual Statement of Assurance Required Under the Federal Managers' Financial Integrity Act (FMFIA) for Fiscal Year 2019

As Director of the Defense Logistics Agency (DLA), I recognize DLA is responsible for managing risks and maintaining effective internal control to meet the objectives of Sections 2 and 4 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. DLA conducted its assessment of risk and internal control in accordance with the OMB Circular No. A-123, "Management's Responsibility for Enterprise Risk Management and Internal Control"; and the Green Book, GAO-14-704G, "Standards for Internal Control in the Federal Government." Based on the results of the assessment, DLA is unable to provide assurance that internal controls over operations, reporting, compliance, are operating effectively as of September 30, 2019.

DLA conducted its assessment of the effectiveness of internal controls over operations in accordance with OMB Circular No. A-123, the GAO Green Book, and the FMFIA. The "Internal Control Evaluation (Appendix C)" section provides specific information on how DLA conducted this assessment. Based on the results, DLA is unable to provide assurance that internal controls over operations and compliance are operating effectively as of September 30, 2019.

DLA conducted its assessment of the effectiveness of internal controls over reporting (including internal and external financial reporting) in accordance with OMB Circular No. A-123, Appendix A. The "Internal Control Evaluation (Appendix C)" section, provides specific information on how DLA conducted this assessment. Based on the results of the assessment, DLA is unable to provide assurance that internal controls over reporting (including internal and external reporting) as of September 30, 2019, and compliance are operating effectively as of September 30, 2019.

DLA conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with FMFIA and OMB Circular No. A-123, Appendix D. The "Internal Control Evaluation (Appendix C)" section provides specific information on how DLA conducted this assessment. Based on the results of this assessment, DLA is unable to provide assurance that the internal controls over the financial systems are in compliance with the FMFIA, Section 4; Federal Financial Management Improvement Act (FFMIA) of 1996, Section 803; and OMB Circular No. A-123, Appendix D, as of September 30, 2019.

DLA conducted an assessment of entity-level controls including fraud controls in accordance with the Green Book, OMB Circular No. A-123, the Fraud Reduction and Data Analytics Act (FRDAA) of 2015, and GAO Fraud Risk Management Framework. Based on the results of the assessment, DLA is unable to provide assurance that entity-level controls including fraud controls are operating effectively as of September 30, 2019.

Point of contact for this action is Kelleye Elmore and can be reached at (571) 767-6957 or kelleye.elmore@dla.mil.

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Summary of Internal Control Assessment

Federal Managers' Financial Integrity Act

The DLA management evaluated the system of internal control in effect during the current year according to the guidance prescribed in OMB Circular A-123, *Management's Responsibility for Internal Control*, and the GAO Green Book, *Standards for Internal Control in the Federal Government.*

The objectives of the system of internal control of DLA are to provide reasonable assurance of:

- Effectiveness and efficiency of operations;
- Reliability of financial and nonfinancial reporting;
- Compliance with applicable laws and regulations; and
- Financial information systems compliance with the FMFIA.

The evaluation of internal controls extends to every responsibility and activity undertaken by DLA and applies to program, administrative, operational controls, and financial reporting. Furthermore, the concept of reasonable assurance recognizes that (1) the cost of internal controls should not exceed the benefits expected to be derived, and (2) the benefits include reducing the risk associated with failing to achieve the stated objectives. Moreover, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal control, including those limitations resulting from resource constraints, congressional restrictions, and other factors. Finally, projection of any system evaluation to future periods is subject to the risk that procedures may be inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate. Based on the preceding description, DLA is unable to provide a statement of reasonable assurance.

The DLA management did not methodically evaluate the system of internal control in accordance with the GAO Green Book and OMB Circular A-123 guidelines. There is not persuasive evidence to support a determination that Green Book principles are present and functioning and internal control components are operating together throughout the organization consistently. As a result, there is not an effective system of internal control for DLA in effect as of the date of this memorandum. Taken as a whole, DLA does not comply with the requirement to provide reasonable assurance that DLA operations, reporting, and compliance objectives were achieved. DLA is unable to provide a position on reasonable assurance for FY2019 and reports a statement of "no assurance" for Internal Control over Reporting (ICOR) and Internal Control over Operations (ICO). In addition, DLA is unable to provide assurance that internal controls over financial systems are in compliance with FMFIA and FFMIA.

In FY2019, DLA had a total of 233 ICOR and three ICO material weaknesses and 78 Federal Financial Management System non-conformances across DLA. The 233 ICOR material weaknesses and 78 instances of non-conformance with Federal financial system requirements were consolidated based on assessable units into seven ICOR material weaknesses and four instances of non-conformance with Federal financial system requirements (i.e., one Information Systems material weakness) for DLA AFR presentation purposes.

The DLA is working to improve the documentation around DLA's end-to-end business processes and has not performed full-scale A-123 internal control testing during FY2019. DLA has prioritized the remediation and monitoring of corrective actions relating to material weaknesses and has aligned internal Corrective Action Plans (CAPs) and deficiencies accordingly for tracking and reporting purposes where possible. DLA has identified material weaknesses at an enterprise level that are evaluated by fund. The status of DLA's unresolved material weaknesses are categorized into the following assessable units:

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)	
Material Weaknesses	**Corrective Action Summary**
Financial Reporting	The DLA will evaluate the current process used to create the trial balance reconciliations in order to prepare a timely, complete and accurate reconciled financial reporting package. DLA will assess the risks associated with the financial reporting process to generate the financial statements, including the complexity, extent of manual processes, decentralization and reliance on third party data. DLA will develop policies, procedures and controls to address the identified risks associated with financial statement compilation. The DLA will perform a complete tie-out of the AFR to verify compliance with OMB Circular A-136 requirements and retain all relevant supporting documentation for each section of the AFR. The DLA will review, clean up invalid records, and take corrective actions within the system as well as implement monitoring controls for periodic table maintenance and validation. DLA will also request the implementation of system changes to address underlying errors in the systemic posting logic. The DLA will update the existing Standard Operating Procedure (SOP) to include re-designed internal controls over the tie point reconciliations, such as tracking cumulative variances and management review/approvals. Currently, DLA is in the process of implementing procedures to correct identified reconciling differences, and mitigation plans will be developed and implemented in the interim until full implementation of system posting logic changes to reduce the risk of material misstatement and prevent further differences. The DLA will develop and implement DLA Enterprise wide policies, procedures, and internal controls, train personnel on new processes, and perform internal control testing.
Fund Balance with Treasury (FBwT)	In collaboration with the Defense Finance and Accounting Service (DFAS), DLA is developing a FBwT reconciliation process and policies and procedures to monitor/correct undistributed funds to assist DFAS with the research and clearing of identified variances.
Plan-to-Stock: Inventory*	The DLA is evaluating the current systems and differences in inventory to design and develop an inventory reconciliation process.
Order-to-Cash: Accounts Receivable and Revenue	The DLA will develop and document procedures with guidance for internal confirmation and reconciliation of customer balances to include review of collections in transit. DLA will review, clean up invalid records, and take corrective actions within the system to accurately assign trading partner

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)	
Material Weaknesses	**Corrective Action Summary**
	information. DLA will also implement controls to ensure monthly maintenance and validation of tables related to collections. The DLA will establish and document policies/procedures implementing internal controls to support the estimation of the allowance relating to non-Federal receivables. DLA plans to develop procedures with guidance for managing detailed customer statements to adequately substantiate the accounts receivable beginning balances recorded. DLA will also develop overarching evidential matter policy and update procedures to define adequate evidential matter for the various types of sales transactions. DLA's employees will be trained on the new roles, responsibilities and completion timelines for pulling evidential matter for required sales transactions.
Procure-to-Pay: Accounts Payable and Expenses	The DLA revised the Government Purchase Card (GPC) management process in order to ensure proper segregation of duties.
Acquire-to-Retire: Property, Plant, and Equipment (PP&E)	The DLA will perform a full physical inventory to establish a baseline for the real and general property assets owned. Once a baseline is established, DLA will ensure that an accurate listing of additions and deletions will be available through DLA's accounting system of record. DLA is revising the policies to define a consistent methodology for grouping of assets and developing internal controls to verify assets are recorded in the accounting system of record in accordance with policies. DLA is also evaluating the current process for the collection and retention of supporting documentation for assets. DLA is revising the property management process in order to design appropriate management controls related to the accounting and management of assets. DLA is also developing a timely and effective reconciliation process between real property asset listings and amounts presented in the notes to the financial statements. In FY2020, DLA will transfer its real property to the military departments per OUSD guidance.
Oversight and Monitoring	The DLA will develop an evaluation schedule and train personnel on the service provider function for civilian payment systems, including annual testing requirement of DLA controls mapped to Complementary User End Controls (CUECs). DLA will document compensating controls for systems that are deemed ineffective, and will also document the frequency for monitoring the identified compensating controls as well as the supporting evidential matter for monitoring. DLA will perform tests of design and effectiveness, assess control exceptions, and implement compensating controls, as required. The DLA will implement a more robust process for completing a timely evaluation of System and Organization Controls reports. Lastly, DLA will develop a Service Provider Program policy and procedures as part of ERM.

*Denotes material weaknesses that is not applicable to DLA GF.

Effectiveness of Internal Control over Operations (FMFIA § 2)	
Material Weaknesses	**Corrective Action Summary**
Supply Operations: Lack of policy and procedures in place over the management and oversight of First Article Test Exhibits	The DLA will establish and implement policies and procedures for identified areas, train affected personnel on new procedures, and conduct compliance reviews, tests of design, and tests of effectiveness for internal controls.
Contract Administration: Non-verification of supplier invoices	The DLA met with the OSD to discuss issues and alternatives regarding Receipt and Acceptance and has been participating in a Receipt and Acceptance Working Group to identify and resolve receipting issues.
Business Process Controls: Lack of procedures over the scrap management program	The DLA is working to define and publish policy/procedures to correct the OCONUS Scrap Program. DLA will perform risk assessments on recommendations including fraud risk. DLA will also develop and review the internal controls testing procedures.

Compliance with Federal Financial Management System Requirements (FMFIA § 4)	
Non-Conformances	**Corrective Action Summary**
Security Management	The DLA management plans to establish, document, disseminate, and test the continuous monitoring program with annual testing of critical controls. The program should produce evidentiary matter to substantiate that security control assessments occurred within the established timelines. DLA will also develop a template for reviewing controls and monitoring activities that will be distributed for OMB Circular A-123 testing.
Access Controls	The DLA will screen users with multiple accounts in order to identify roles for users with multiple accounts and reduce the number of invalid multiple accounts. DLA will also update the Auditing Implementation Guide to reflect approved usage of application log management systems. DLA plans to revise and implement an accounting system of record access and user account management desk guide. DLA will create and review monthly user reports to verify appropriate dialog users are granted access to change independent settings access. Lastly, DLA will implement guidance for systems users to obtain approved access request through the appropriate channel.
Segregation of Duties	The DLA will review the listing of functional roles and complete initial mapping for systems. DLA will also ensure each system has developed segregation of duties matrices.
Configuration Management	The DLA will update auditing procedures and define audit events resulting in additional capabilities to identify events associated with unauthorized changes. DLA will add a file change verification process as well as security management, configuration management, and segregation of duties to guidance to further supplement audit procedures to include awareness of permissible duties and roles associated with configuration changes.

The DLA's Summary of Financial Statement Audit and Management Assurances are presented in the Other Information (OI) section of this report.

Compliance with Federal Financial Management System Requirements (FMFIA § 4)	
Non-Conformances	**Corrective Action Summary**
Security Management	The DLA management plans to establish, document, disseminate, and test the continuous monitoring program with annual testing of critical controls. The program should produce evidentiary matter to substantiate that security control assessments occurred within the established timelines. DLA will also develop a template for reviewing controls and monitoring activities that will be distributed for OMB Circular A-123 testing.
Access Controls	The DLA will screen users with multiple accounts in order to identify roles for users with multiple accounts and reduce the number of invalid multiple accounts. DLA will also update the Auditing Implementation Guide to reflect approved usage of application log management systems. DLA plans to revise and implement an accounting system of record access and user account management desk guide. DLA will create and review monthly user reports to verify appropriate dialog users are granted access to change independent settings access. Lastly, DLA will implement guidance for systems users to obtain approved access request through the appropriate channel.
Segregation of Duties	The DLA will review the listing of functional roles and complete initial mapping for systems. DLA will also ensure each system has developed segregation of duties matrices.
Configuration Management	The DLA will update auditing procedures and define audit events resulting in additional capabilities to identify events associated with unauthorized changes. DLA will add a file change verification process as well as security management, configuration management, and segregation of duties to guidance to further supplement audit procedures to include awareness of permissible duties and roles associated with configuration changes.

The DLA's Summary of Financial Statement Audit and Management Assurances are presented in the Other Information (OI) section of this report.

Federal Financial Management Improvement Act

FFMIA was enacted to advance Federal financial management by ensuring that Federal financial management systems can routinely provide reliable financial information uniformly across the Federal government following OMB Circular A-123 Appendix D, *Compliance with the Federal Financial Management Improvement Act of 1996*. The FFMIA requires agencies to establish and maintain financial management systems that substantially comply with the following three FFMIA Section 803(a) requirements:

- Federal Financial Management System Requirements (FFMSRs)
- Federal Accounting Standards
- U.S. Standard General Ledger (USSGL) at the transaction level

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

The DLA leveraged OMB Circular A-123, Appendix D compliance determination framework to perform a review of data for each of the FFMIA compliance indicators and associated analysis in order to determine compliance with FFMIA. Based on the application of the framework and associated analysis of relevant FFMIA compliance indicators available, DLA had identified high-risk factors associated with all three FFMIA Section 803(a) requirements.

- FFMSR: High-risk factors that indicate non-compliance in this area include: Anti-Deficiency Act (ADA) violation reports in the prior FY; the disclaimer of opinion on the FY2018 financial statements; and material weaknesses over internal controls over reporting and non-compliance related to financial system security were identified in FY2018 and FY2019 in areas that corresponded to this requirement across DLA.

- Federal Accounting Standards[3]: High-risk factors that indicate non-compliance in this area include the disclaimer of opinion on the FY2018 financial statements and material weaknesses over internal controls over reporting and non-compliance related to financial system security were identified in FY2018 and FY2019 in areas that corresponded to this requirement across DLA.

- USSGL at the Transaction Level: High-risk factors that indicate non-compliance in this area include the disclaimer of opinion on the FY2018 financial statements and material weaknesses over internal controls over reporting and non-compliance related to financial system security were identified by DLA in FY2018 and FY2019 in areas that corresponded to this requirement across DLA.

The DLA has prioritized the remediation and monitoring of corrective actions relating to NFRs and has aligned internal CAPs and deficiencies to related NFRs for tracking and reporting purposes

[3] Refer to the Notes to the Financial Statements; Note 1.C, *Departures from U.S. GAAP*.

where possible. DLA reviewed the FY2018 deficiencies and aligned the deficiencies to the corresponding FFMIA Section 803(a) requirements. The table below summarizes the status of unresolved deficiencies associated with each of the FFMIA Section 803(a) requirements and remediation activities that are planned or underway, target dates, and offices responsible for bringing systems into compliance.

FFMIA Section 803(a) Requirement	Remediation Activities	Target Date (FY)	Responsible Offices
Federal Financial Management System Requirements	The DLA will continue to develop and document policies, procedures, and controls in order to comply with standards, laws, and regulations that promote reliable financial reporting and effective and efficient operations.	2020 - 2023	• Finance • Information Operations • Acquisition • J78 Audit and Process Excellence • Logistics Operations
Federal Accounting Standards Advisory Board (FASAB)	The DLA will continue to perform a root cause analysis to identify underlying issues as well as develop and document policies, procedures, and controls to maintain accounting data to permit reporting in accordance with GAAP as established by the FASAB.	2020 - 2023	• Finance • Information Operations • Acquisition • J78 Audit and Process Excellence • Logistics Operations
USSGL at the Transaction Level	To reduce the material risks of procedural and posting logic deficiencies and achieve compliance with applicable accounting regulations, DLA will identify non-compliant areas with a financial impact in processes across the enterprise. This approach will include creating and updating policies, procedures and internal controls, as well as requesting the implementation of system changes to address underlying errors in the systemic posting logic.	2020 - 2023	• J78 Audit and Process Excellence • Logistics Operations • Finance • Information Operations

During FY2019, DLA documented a financial management systems strategy to formalize DLA's strategic goals and objectives for achieving FFMIA compliance and improving financial management practices by ensuring that financial management systems that process DLA transactions consistently provide accurate, reliable, and timely financial information.

Compliance with Laws and Regulations

Anti-Deficiency Act

The ADA Title 31 U.S.C. 1341, prohibits Federal employees from obligating funds in excess of an appropriation, or before funds are available, or from accepting voluntary services. As required by the ADA, DLA GF notifies all appropriate authorities of any potential ADA violations. At this time, there are no known or potential ADA violations.

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

Digital Accountability and Transparency Act of 2014

The Digital Accountability and Transparency Act of 2014 (DATA Act) expands the Federal Funding Accountability and Transparency Act of 2006 to increase accountability and transparency in Federal spending, making Federal expenditure information more accessible to the public. It directs the Federal Government to use government-wide data standards for developing and publishing reports and to make more information, including award-related data, available on USASpending.gov. The standards and data allow stakeholders to track Federal spending more effectively.

In FY2019, DLA implemented a comprehensive Data Quality Plan in accordance with OMB Memorandum M-18-16, Appendix A to OMB Circular A-123, Management Reporting of Data and Data Integrity Risk. This plan leverages several well-established processes to monitor and improve procurement data quality. The DLA FY2019 SOA Data Quality Plan (dated June 20, 2019) sets forth the DLA process for reviewing, monitoring, and reporting the required data, as well as how DLA will continue to improve the process. DLA is unable to provide assurance over compliance with the DATA Act.

Debt Collection Improvement Act of 1996

The Debt Collection Improvement Act of 1996 (DCIA) requires that Federal Agencies refer delinquent debts to Treasury within 120 days and take all appropriate steps prior to discharging debts.

Intragovernmental receivables are considered collectible. Pursuant to Treasury's July 2019 policy on intragovernmental receivables, and as reflected in the Treasury Financial Manual (TFM) 2-4700, Appendix 6, no allowance for loss on accounts receivable should be recognized in Federal entities' accounting records or financial statements for intragovernmental receivables. Intragovernmental receivables should not be written off and should continue to remain on an entity's accounting ledger until resolved.

Consequently, the delinquent debt to be considered under the DCIA is non-Federal debt.

DFAS prepares a report for the debt receivable from the public (Treasury Report on Receivables at the end of each fiscal quarter), to notify Treasury of debt aged more than 120 days, as required by the DCIA.

Prompt Payment Act, 31 U.S.C. §§ 3901–3907

In 1982, Congress enacted the Prompt Payment Act (PPA) to require Federal Agencies to pay their bills on a timely basis, to pay interest penalties when payments are made late, and to take discounts only when payments are made by the discount date. DLA is unable to provide assurance over compliance with the PPA.

Government Charge Card Abuse Prevention Act of 2012

The Charge Card Abuse Prevention Act (Charge Card Act) requires agencies to establish and maintain safeguards and internal controls for purchase cards, travel cards, integrated cards, and centrally billed accounts. Furthermore, the Charge Card Act requires agencies to report purchase card violations, and the Inspector General to conduct periodic risk assessments of government charge card programs. DLA has implemented internal controls, and is committed to continued compliance with all aspects of the public law; however, DLA is unable to provide assurance over compliance with the Charge Card Act.

Financial Systems

Financial Systems Strategy

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

The DLA Information Operations continues to review audit findings from prior and current financial statement audits. DLA Information Operations works with DLA Finance and other business stakeholders to develop CAPs and resolve findings. Identified deficiencies are prioritized and aligned to the appropriate plans and system enhancements. In addition to identified audit findings, DLA Information Operations is working to become compliant with the Standard Financial Information Structure (SFIS) and Standard Line of Accounting (SLOA) in accordance with applicable Federal requirements. Improvements to general ledger posting logic to comply with the USSGL are also being implemented proactively to ensure all business events are mapped to the proper general ledger accounts. DLA Information Operations works with DLA Finance to build a roadmap for future financial system improvements based on budget availability, resource and system constraints. The financial systems strategy will support the overarching strategy of DLA to make an end-to-end process review aligned to financial statements line items with focus on risk and controls. DLA Information Operations will also continue to focus on remediating any issues associated with material weaknesses and DoD Chief Information Officer (CIO) priorities.

Financial Management Systems Framework

The DLA relies on the Enterprise Business System (EBS) as its accounting system of record, to process, track and report all business transactions which impact DLA's funds. The core of EBS is Systems Applications and Product's (SAP) Enterprise Resource Planning Central Component (ECC) version 6.0. This is an on-premises, commercial off-the-shelf (COTS) software which has been configured to meet DLA's business requirements. However, due to system limitations, accurate data is not always produced and DLA is unable to provide assurance that the financial systems are in compliance with Federal system security and accounting requirements. There are numerous feeder systems which interface to EBS. These include but are not limited to inventory and customer ordering systems. The Distribution Standard System (DSS) is a legacy inventory warehouse management system which interfaces with EBS. EBS also interfaces with multiple DFAS systems for the creation of financial statements, reports and Treasury cash management. DLA EBS has a single, enterprise general ledger which resides in SAP and is used for all funds.

Future Financial Management Systems Framework

In future years, DLA will be upgrading to SAP's S/4 cloud-based platform to replace ECC 6.0. This upgrade will provide enhanced capabilities for financial reporting and accounting. In addition, DLA is in the process of migrating from its legacy warehouse management system, DSS, to SAP's Enterprise Warehouse Management System. This will provide an integrated process of inventory movements and tracking, thereby improving inventory accounting accuracy. DLA will also be implementing system changes to meet the requirements of Treasury's G-Invoicing system. G-Invoicing will help address government-wide accounting elimination problems by ensuring trading partners have the same information for intragovernmental transactions. Finally, DLA will be implementing SAP's Financial Supply Chain Management (FSCM) module. FSCM will improve DLA's ability to manage over-aged accounts receivable and improve the timeliness of cash flow. DLA continuously works to rationalize and reduce the footprint of systems by consolidating to SAP/COTS systems wherever possible.

Limitations of the Financial Statements

The DLA GF principal financial statements[4] and accompanying notes are prepared to report the financial position and results of operations of DLA, as required by the CFO Act of 1990, expanded by the GMRA of 1994, and 31 U.S.C. § 3515(b).

The DLA GF is unable to fully implement all elements of U.S. GAAP as promulgated by the FASAB and the form and content requirements for Federal government entities specified by OMB Circular A-136, *Financial Reporting Requirements* and other authoritative guidance. This is due to financial and nonfinancial management system limitations, as well as limitations on the underlying processes that support the principal financial statements. DLA GF derives reported values and information for major asset and liability categories largely from nonfinancial systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with U.S. GAAP. DLA GF continues to implement process and system improvements addressing these limitations. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by U.S. GAAP, and most of the financial management systems used by DLA GF were designed to record information on a budgetary basis.

The DLA GF continues to develop, improve and refine the underlying financial and nonfinancial systems end-to-end processes and systems that support the compilation of the financial statements and notes in accordance with U.S. GAAP and other Federal regulations. DLA GF continues to implement interim mitigation processes to address known limitations; additionally, DLA GF is remediating material weaknesses to the financial statement preparation process. DLA GF has several corrective actions underway intended to improve the underlying systems, business processes and internal controls.

The financial statements should be read with the understanding that they are for a component of the U.S. Government.

[4] Refer to the Financial Section Introduction for definition of principal financial statements.

Forward-Looking Information

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

An Ever Changing Workforce

The DLA is a high-performing organization, and DLA's workforce is its greatest asset. The eight People and Culture objectives are the strategies that will assist DLA in mitigating several significant external factors that will affect DLA and its workforce.

Changing demographics are the first significant external factor. There are different generations working side-by-side in the DLA workplace and DLA civilians are playing an increasingly critical role in supporting global DoD missions. These changing demographics will require continued assessment of DLA's current human resources initiatives and new strategies to excel in areas such as recruitment, training and development, work-life balance, managing in a geographically dispersed environment while maintaining strong connections to DLA culture, knowledge transfer, leadership skills, labor management relations and a culture that fosters inclusiveness and employee engagement.

Our economy is the second external factor that influences the Federal government's ability to recruit top talent and retain its workforce. It is critical that DLA not only recruit and retain a diverse workforce, but also ensures the workforce has the critical skills necessary to operate in this constrained environment.

Technology is the third external factor that is rapidly transforming the way DLA works, plays and interacts with others. DLA must recruit, develop, and sustain a workforce that is technically proficient and agile to adopt emerging technologies, which requires innovative human capital management strategies.

The work environment is the last significant external factor to impact DLA's workforce. DLA's success as an organization is largely dependent on DLA's ability to achieve a high-performing, results-driven culture and to sustain that culture in light of changes to demographics, economics, and technology. These factors will impact each segment of DLA, and DLA Human Resources must strategically partner with leadership and the workforce to carry out DLA's mission. The use of change management techniques will assist in decreasing the uncertainty associated with changes as well as mitigate resistance to those changes.

External Threats

In response to the President's call for governmental reform and under the Direction of the Chief Management Officer, DoD is reviewing, changing, and setting up processes where appropriate to gain efficiencies and maximize savings to reinvest into service readiness. This is aligned to the LOE of Warfighter First.

The DoD as a whole faces numerous challenges – ranging from strategic competition and aggression from other nations and the threat of terrorism, to the concern of securing funding necessary to accomplish the mission. These threats directly affect DLA's mission and goals. As the Nation's Combat Logistics Support Agency, DLA monitors these external threats to ensure readiness and support of the Warfighter.

In addition, DLA continuously reviews its strategy to meet global mission requirements as prescribed by the DoD. DLA developed a 2018-2026 Strategic Plan to align with its principle to provide "effective logistics support to the operating forces of its military services" at the "lowest possible cost to the taxpayer". The DLA Strategic Plan reaffirms and extends DLA's commitment to Warfighter readiness and lethality and to self-accountability. The plan describes five LOEs and two CCs that DLA leverages to provide global, end-to-end supply chain solutions: Warfighter First, Global Posture, Strong Partnerships, Whole of Government, Always Accountable, People and Culture, and Enterprise Enablers. Each LOE or CC has specific objectives.

The "Always Accountable" LOE focuses on building trust and confidence in DLA's supply chain business by practicing cost consciousness and ethical behavior through reliability and transparency. DLA holds partners and suppliers to the same high standards. DLA aims to attain and sustain auditability through process excellence and sound financial stewardship. DLA strives to achieve a control system that will enable it to provide reasonable assurance over operations, reporting, and compliance. DLA will continue to document, evolve, and test its processes to ensure the Agency addresses weaknesses and deficiencies identified in this document.

Risk management is foundational to improve mission delivery, reduce costs, and focus corrective actions. Each Federal employee is responsible for safeguarding Federal assets and efficiently delivering services to the public. Strengthening risk management will ensure secure, agile, and resilient Combat Logistics Support. DLA is responsible for implementing management practices that effectively identify, assess, respond, and report on risks. ERM and Internal Control are components of the governance framework.

A culture of risk awareness is steadily maturing. Employees are empowered to use risk assessments proactively to pinpoint issues within their processes. Sufficient risk assessments proactively define, document, and communicate risk before it becomes problematic and adversely affects processes. DLA is taking a strategic approach to comply with OMB Circular A-123. DLA has formed an Audit Task Force to enhance the internal control over operations and financial reporting. The Agency has allocated resources to address findings through CAPs.

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

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

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

Technological Advancement and Initiatives

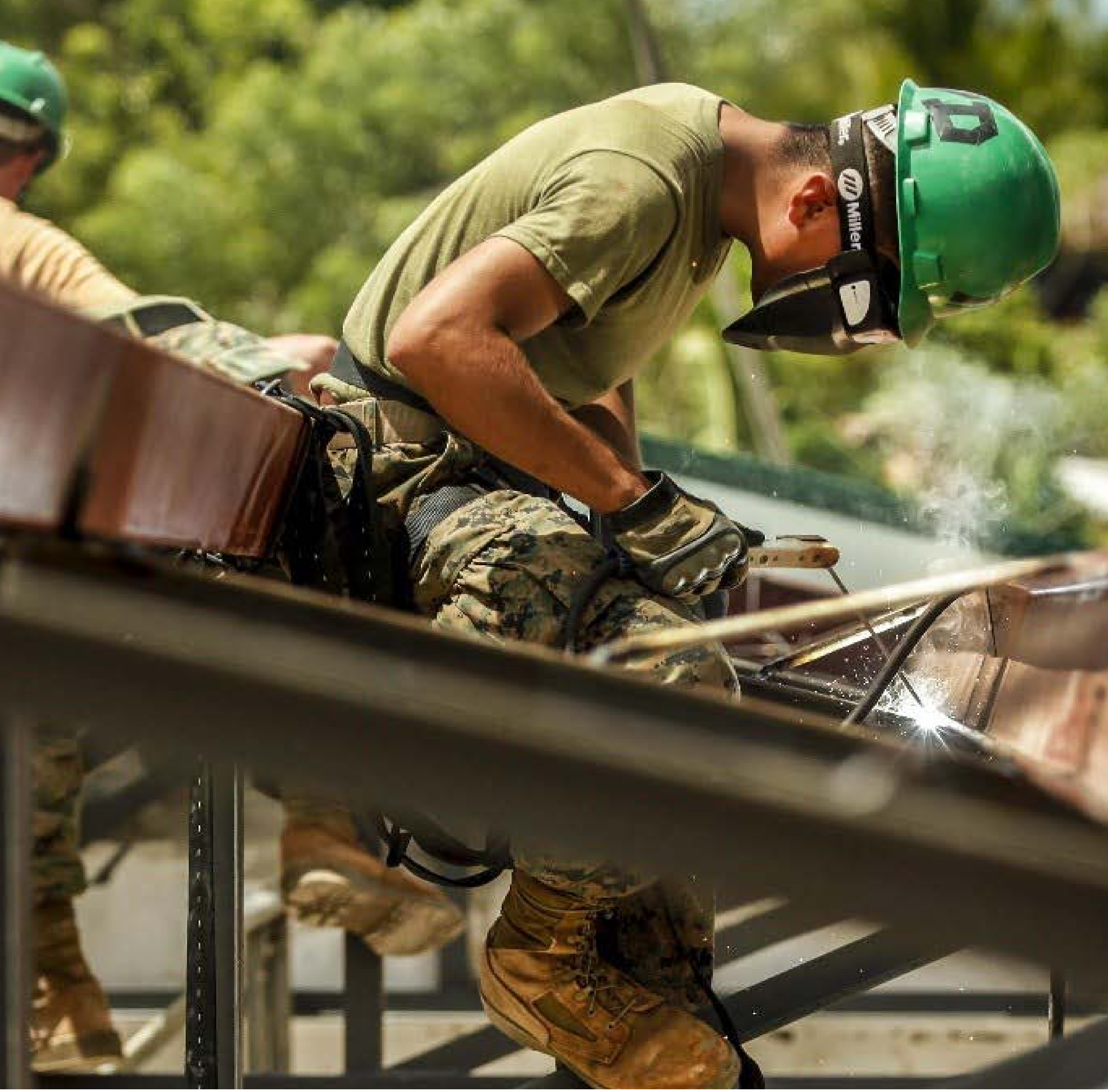
As part of the 2018-2026 Strategic Plan, DLA has the Enterprise Enablers CC. Enterprise Enablers focuses on Innovation, Data Management, Technology, and Cyber Security. Innovation allows DLA to adapt and overcome adverse circumstances in a timely manner and permits DLA to continue to support the Warfighter. DLA data assets include supply chain, acquisition, personnel, information management, and financial data, along with the infrastructure and exchanges that move it. Looking forward, effective data management will enable DLA to develop data and analysis as a service for its business users to facilitate access to it as well as data-driven decisions.

For technology, DLA Information Operations continuously evaluates the IT operating environment to identify potential opportunities to streamline and automate processes as well as ensure alignment with DoD and DLA Strategic Initiatives. One example of these types of efforts currently in process include increasing the use of cloud computing technologies and solutions. Many applications have already begun migration to cloud computing.

The DLA Finance is working on four major system initiatives: one initiative, G-Invoicing, is a Treasury mandated process to improve the reconciliation and coordination of intra-government payments. Federal Program Agencies will be required to use G-Invoicing to process intragovernmental buy/sell transactions. This process will remove the seller-side over-write requirements and require trading partners to reconcile variances. Second, the implementation of the DoD SLOA will improve interoperability between DoD business systems and provide better end-to-end funds traceability and eliminations reporting to enable successful audits in DoD. In addition, DLA is working to implement SAP's FSCM module. This module will enhance DLA's reporting and collection of aged accounts receivables to address audit concerns and improve DLA's cash position.

Finally, DLA provides funding for the development of the Defense Agencies Initiative (DAI). The DAI mission is to deliver auditable CFO Act compliant business environments for Defense Agencies. The goal is to provide accurate, timely, authoritative financial data in support of the DoD goal to standardize financial management practices, improve financial decision support, and support audit readiness. The DAI is a critical DoD effort to modernize the Defense Agencies' financial management capabilities.

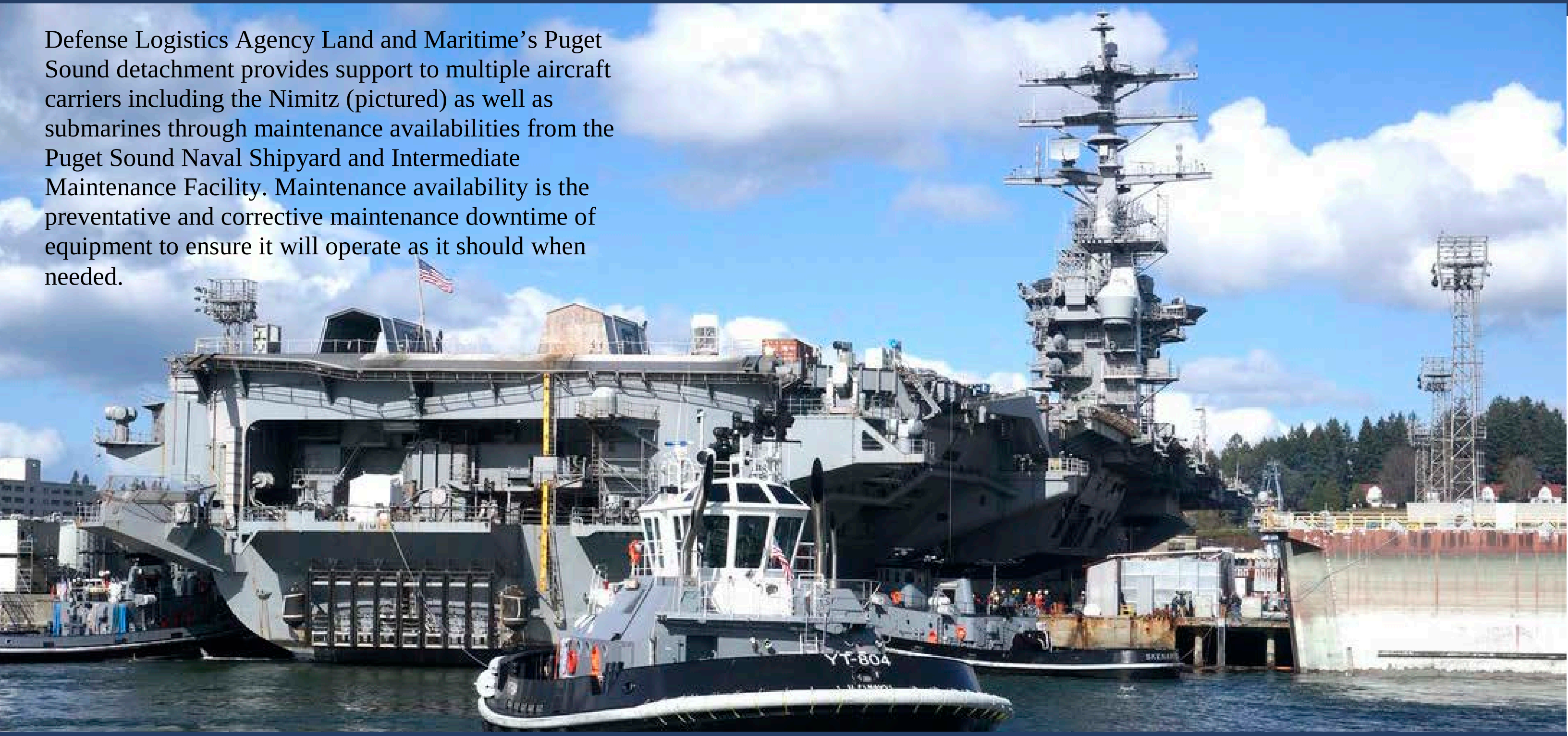
THIS PAGE INTENTIONALLY LEFT BLANK



Financial Section (Unaudited)

2

SECTION 2 – FINANCIAL SECTION (Unaudited)



Defense Logistics Agency Land and Maritime’s Puget Sound detachment provides support to multiple aircraft carriers including the Nimitz (pictured) as well as submarines through maintenance availabilities from the Puget Sound Naval Shipyard and Intermediate Maintenance Facility. Maintenance availability is the preventative and corrective maintenance downtime of equipment to ensure it will operate as it should when needed.

IN THIS SECTION

Message from the Chief Financial Officer

NOVEMBER 2019

I am proud to join the Director in issuing our Fiscal Year (FY) 2019 Agency Financial Report (AFR). This is the third year that Defense Logistics Agency (DLA) has undergone an audit. DLA General Fund's (GF) FY2019 AFR highlights certain valuable insights into the overall financial operations, accomplishments, and challenges of the Agency. DLA remains committed to ensuring value, efficiency, and effectiveness in every program. This section of the AFR provides a comprehensive view of DLA GF financial activities.

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

The DLA is continuing with Financial Transformation with the goal of achieving an unmodified audit opinion in the future. We continue to take a holistic, risk-based look at our enterprise, and have identified critical focus areas to address audit risks. These efforts include initiatives to improve the performance in accounting, financial operations, and customer service to enhance the value provided to the Warfighter and our partners. Key components of Financial Transformation include remediation of Notice of Findings and Recommendations from financial statement audits, enhancing the reliability of financial statement data, and ensuring the accounting process and related controls document approved policies. For DLA GF, we are enhancing our internal controls over operations, reporting, and compliance.

As I begin my first year as Chief Financial Officer at DLA, I am committed to ensure that DLA meets its stewardship functions. I am proud to be part of a team of colleagues that works hard to develop strategies that strengthen our cross-functional partnerships throughout the Agency. It is our plan to provide enhanced financial management governance and to address risks, new challenges including audit findings, and associated remediation.

J. ARTHUR HAGLER
Director, DLA Finance
Chief Financial Officer

Audit Reports

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

November 8, 2019

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

SUBJECT: Transmittal of the Independent Auditor's Reports on the Defense Logistics Agency General Fund Financial Statements and Related Notes for FY 2019 and FY 2018 (Project No. D2019-D000FE-0085.000, Report No. DODIG-2020-024)

We contracted with the independent public accounting firm of Ernst & Young, LLP (EY), to audit the Defense Logistics Agency (DLA) General Fund Financial Statements and related notes as of and for the fiscal years ended September 30, 2019, and 2018. The contract also required EY to provide a report on internal control over financial reporting and a report on compliance with laws and other matters, including whether the DLA's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency "Financial Audit Manual," June 2018. EY's Independent Auditor's Reports are attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the DLA General Fund financial statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with generally accepted accounting principles. Accordingly, EY did not express an opinion on the DLA General Fund FY 2019 and FY 2018 Financial Statements and related notes.

EY's separate report, "Internal Control over Financial Reporting," discusses seven material weaknesses related to the DLA's internal controls over financial reporting.* Specifically, EY's report describes the following material weaknesses:

- The DLA did not have policies, procedures, and controls to identify the costs associated with the construction of assets in order to properly value the assets and had weaknesses in the processes of maintaining and reconciling Property Plant &Equipment records.

- The DLA was unable to reconcile the Fund Balance with Treasury ending balances from the general ledger directly to the U.S. Treasury and did not have sufficient policies, procedures, and internal controls in place for the end-to-end Fund Balance with Treasury process.

- The DLA did not have adequate policies, procedures, and internal controls to record accounts receivable and revenue transactions in the proper period in accordance with generally accepted accounting principles and to properly identify valid unfilled customer orders; was unable to support the balances recorded as accounts receivable; and did not support recorded transactions.

- The DLA recorded accounts payable and expense transactions in the wrong period; lacked overall policies, procedures, and internal controls to create and approve obligations and to review, record, and pay invoices; and did not have adequate procedures to accrue for obligations incurred but not paid.

- The DLA lacked policies and procedures to validate budgetary account balances and monitor budgetary reporting variances between source systems.

- The DLA did not implement appropriate internal controls, including the documentation of policies and procedures that describe the DLA's environment related to end-to-end business processes, roles, and responsibilities; and monitoring of service providers, related parties, systems, risks, controls; and remediation of audit findings.

* A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statements in a timely manner.

- The DLA had weaknesses in the design and operation of information systems controls over financial data, including access controls; configuration management; segregation of duties controls; and security management and governance over implementation of security controls.

EY's additional report, "Compliance and Other Matters," discusses two instances of noncompliance with applicable laws and regulations. Specifically, EY's report describes instances in which the DLA's financial management systems did not comply with the Federal Financial Management Improvement Act of 1996 and the Federal Managers' Financial Integrity Act.

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the DLA General Fund FY 2019 and FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control over financial reporting, or conclusions on whether the DLA's financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters.

Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached reports, dated November 8, 2019, and the conclusions expressed within the reports.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

Lorin T. Venable

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

Attachments:
As stated

Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors

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

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the General Fund of the Defense Logistics Agency (DLA), which comprise the balance sheets as of September 30, 2019 and 2018, and the related statements of net costs, changes in net position and statements of budgetary resources for the years then ended and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, and the Office of Management and Budget Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements.* Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

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

Basis for Disclaimer of Opinion

DLA continues to have unresolved accounting issues and material weaknesses in internal controls that cause DLA to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on DLA's financial statements as of and for the years ended September 30, 2019 and 2018.

Disclaimer of Opinion

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

Other Matters

Required Supplementary Information

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

Other Information

We were engaged for the purpose of forming an opinion on the financial statements that collectively comprise DLA's basic financial statements. The Other Information, as listed in the Table of Contents, is presented for purposes of additional analysis and is not a required part of the financial statements.

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

EY
Building a better working world

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 8, 2019 on our consideration of DLA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering DLA's internal control over financial reporting and compliance.

Ernst + Young LLP

November 8, 2019

Building a better working world

Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the General Fund of the Defense Logistics Agency (DLA), which comprise the balance sheet as of September 30, 2019, and the related statements of net cost, changes in net position, and combined statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2019. That report states that, because of matters described in the Basis for Disclaimer Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2019 and the related notes to the financial statements.

Internal Control over Financial Reporting

In connection with our engagement to audit the financial statements, we considered DLA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of DLA's internal control. Accordingly, we do not express an opinion on the effectiveness of DLA's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

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

Building a better working world

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

Material Weaknesses

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

I. Property, Plant and Equipment (PP&E) – PP&E includes internal use software (IUS) and construction-in-progress (CIP). DLA does not have policies, procedures and controls to identify the costs associated with the construction of assets in order to properly value the assets and has weaknesses in the processes of maintaining and reconciling PP&E records. Therefore, DLA is unable to support the existence, completeness, rights and valuation of its PP&E. The combination of these deficiencies in aggregate results in a material weakness in internal control related to PP&E. The matters identified related to PP&E are further described in Appendix A.

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

III. Accounts Receivable (AR) and Revenue – AR consists of amounts owed to DLA primarily related to providing services to other federal agencies. Revenue is earned when DLA provides services to the public or other federal entities. DLA was unable to support the balances recorded as AR; properly identify valid unfilled customer orders and had not supported transactions recorded. In addition, DLA did not have adequate policies, procedures and controls to record AR and revenue transactions in the proper period in accordance with U.S. generally accepted accounting principles (GAAP). The combination of these deficiencies in aggregate results in a material weakness in internal control related to AR and revenue. The matters identified related to AR and revenue are further described in Appendix A.

IV. Accounts Payable (AP) and Expense – AP represents the amount owed to third parties by DLA for goods and services received. Expenses are incurred and recognized when DLA receives goods and services from the public or other federal entities. DLA was unable to support the AP balance, expenses and related budgetary balances. In addition, DLA did not have overall policies, procedures and internal controls for the procure to pay process, including the process to create and approve obligations and the process to review, record and pay invoices. Furthermore, DLA lacked adequate procedures to record obligations and accrue for liabilities incurred but not paid, and it recorded certain transactions in the procure to pay process in incorrect periods. This combination of these deficiencies in aggregate results in a material weakness in internal control related to AP and expense. The matters identified related to AP and expense are further described in Appendix A.

V. Financial Reporting – DLA's financial statement preparation process lacks sufficient controls to review and identify inaccurate balances on the financial statement and incomplete and inaccurate footnote disclosures. In addition, DLA lacks policies and procedures to validate budgetary account balances and monitor budgetary reporting variances between source systems, resulting in DLA recording unsupported journal vouchers (JV) to correct the variances. Furthermore, DLA is unable to provide detailed listings for budgetary accounts that reconcile to the general ledger. The combination of these deficiencies in aggregate results in a material weakness in internal control related to financial reporting. The matters identified related to financial reporting are further described in Appendix A.

VI. Oversight and Monitoring – DLA does not have an effective OMB Circular A-123 program, which impacted DLA's ability to appropriately identify and address significant risks for all key business processes. DLA has not implemented appropriate internal controls, including the documentation of policies and procedures that describe DLA's environment related to end-to-end business processes, monitoring of service providers, related parties, systems, risks, controls and remediation of audit findings. In addition, DLA does not perform proper review of data/reports used in the execution of key controls. The combination of these deficiencies in aggregate results in a material weakness in internal control related to oversight and monitoring. The matters identified related to oversight and monitoring are further described in Appendix A.

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

- Access Controls
- Configuration Management
- Segregation of Duties Controls
- Security Management/Governance over Implementation of Security Controls

The matters identified related to information systems are further described in Appendix A.

Building a better working world

Significant Deficiencies

We identified the following matters involving internal control over financial reporting and its operation that we consider to be a significant deficiency, as defined above:

I. Environmental Liabilities (EL) – ELs are comprised of cleanup costs associated with the restoration of sites on real property that DLA manages. DLA lacks formal policies, procedures and supporting documentation. The matters identified related to EL are further described in Appendix B.

DLA's Response to Findings

DLA's response to the findings identified in our engagement, as described above, is included in its letter dated November 8, 2019, which has been included at the end of this report. DLA's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements, and, accordingly, we express no opinion on it.

Purpose of this Report

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

Ernst + Young LLP

November 8, 2019

A member firm of Ernst & Young Global Limited

EY
Building a better working world

Appendix A – Material Weaknesses

I. Property, Plant and Equipment

Property, Plant and Equipment (PP&E) is comprised of internal use software (IUS) and construction-in-progress (CIP). In accordance with FMFIA, management is responsible for establishing and maintaining effective controls to achieve proper accountability for property and other assets for which the agency is responsible. However, DLA was not able to support the existence, completeness, rights and obligations, or valuation of its PP&E.

A. **Lack of or Inadequate Documentation of Accounting Policies and Procedures, Including Controls.** PP&E process documentation, policy memoranda and standard operating procedures fail to document the end-to-end processing of PP&E transactions and related internal control activities. Specifically, a complete inventory of IUS and a reconciliation of CIP has not been performed. DLA is in the process of establishing or revising its policies and procedures for performing the inventories and reconciliations on an ongoing basis.

B. **Lack of or Inadequate Documentation to Substantiate PP&E and PP&E-Related Transactions.** DLA was unable to provide documentation that PP&E balances exist, that transactions occurred or that DLA has rights to the PP&E recorded in the financial statements. Specifically, documentation was not available to support:

- **IUS.** The existence and rights of completed IUS assets recorded on the financial statements.
- **CIP.** The existence and completeness of CIP assets, including beginning balances, for 100% of the samples provided to DLA.

C. **Lack of or Inadequate Policies, Procedures and Controls over PP&E Processes.** DLA lacks or has inadequate policies, procedures and controls, including the design of controls over the following:

- **Inadequately Designed Controls over PP&E Processes.** Controls that have been implemented are not designed adequately. For example, the information used in the control activity is not assessed for completeness and accuracy. In addition, sufficient documentation does not exist to evidence the performance of the control activities. As a result, DLA is unable to demonstrate that the control is operating effectively.

- **IUS.** DLA policy states that IUS assets are recorded as in-service PP&E upon the completion of the asset. However, IUS activity is not evaluated to determine whether the activity should be capitalized or expensed and to identify when assets are completed and should be placed in service.

A member firm of Ernst & Young Global Limited

Building a better working world

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** DLA does not have policies, procedures and controls to effectively implement accounting standards, causing inaccurate presentation of PP&E on the balance sheet and in the related footnote disclosure. Specifically, DLA has neither implemented nor applied the accounting and valuation methodologies set forth by Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Government*; SFFAS No. 6 *Accounting for Property, Plant and Equipment*; and SFFAS No. 10: *Accounting for Internal Use Software*; and SFFAS No. 50: *Establishing Opening Balances for Property, Plant and Equipment.* For example:

- DLA is unable to support the values assigned to IUS in accordance with SFFAS No. 10.
- DLA has not established a policy to account for its leasing arrangements, nor assessed whether the leasing arrangements should be accounted for as a capital or an operating lease. As a result, the financial statements do not include disclosures for DLA's policy to account for lease arrangements, any operating lease commitments and future minimum payments due.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

A. **Lack of or Inadequate Documentation of Accounting Policies and Procedures, Including Controls.** Document, update and finalize the process cycle memoranda (PCM) that document the end-to-end processes for PP&E. Complete the inventory of real property, IUS and CIP to verify the existence and completeness of the accounting records.

B. **Lack of or Inadequate Documentation to Substantiate PP&E and PP&E-related Transactions.**

- **IUS.** Develop documentation to substantiate that all of DLA's IUS assets exist and that DLA has the rights to the assets.
- **CIP.** Develop documentation to substantiate that all of DLA's CIP assets exist and are recorded completely and accurately.

C. **Lack of or Inadequate Policies, Procedures and Controls over PP&E Processes.**

- **Inadequately Designed Controls over PP&E Processes.** Design and implement internal control activities that include criteria, analyses, reviews and supporting thresholds used in the execution of all relevant internal controls. Specifically, evidential matter should be available to demonstrate that the control activity was performed; the scope of the review should be sufficient to identify and correct errors in the procedures performed; and the assessment of any variances should be performed appropriately.
- **IUS.** Design and implement policies and procedures that require IUS activity to be reviewed for proper capitalization and recorded in the appropriate period.

EY
Building a better working world

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design policies and procedures to implement the appropriate accounting standards, specifically SFFAS No. 5, SFFAS No. 6, SFFAS No. 10 and SFFAS No. 50. The policies and procedures should include:

- Assessing whether the values assigned to IUS assets is in accordance with SFFAS No. 10. In addition, evaluate alternative valuation methodologies available under SFFAS No. 50. SFFAS No. 50 permits the exclusion of IUS and IUS under development from the opening balance as of the opening balance date.
- Establishing an accounting policy to identify and account for leasing arrangements, including whether the leases should be accounted for and reported as capital or operating leases in accordance with SFFAS No. 5 and SFFAS No. 6. In addition, include the required disclosures for capital and operating leases in the financial statements in accordance with OMB Circular A-136.

II. Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in DLA's account with U.S. Treasury. Treasury's Financial Manual (TFM) Chapter 5100, Section 5120 requires agencies to implement effective and efficient reconciliation processes and perform timely reconciliations. However, deficiencies exist related to DLA's processes of recording and reconciling transactions involving FBwT.

A. **Lack of or Inadequate Documentation of FBwT Accounting Policies, Procedures and Controls.** DLA has not documented the end-to-end process to account for, monitor and report FBwT and FBwT-related transactions. Documentation does not include the process to determine the amounts recorded in suspense accounts and research and resolve differences between U.S. Treasury, disbursing system records and accounting system records within a timely basis (the DRRT report contains transactions that are aged more than 60 days, including transactions that are aged more than 3 years).

B. **Lack of Controls for the Reconciliation of FBwT Between the General Ledger and the U.S. Treasury.** DLA, in conjunction with DFAS, has implemented the CMR and DRRT processes as mechanisms to attempt to tie the general ledger to U.S. Treasury. However, the CMR and DRRT processes are not sufficient to produce a complete and accurate reconciliation of DLA's general ledger to U.S. Treasury. As a result, DLA is unable to accurately reconcile to U.S. Treasury.

Building a better working world

Recommendations

Consider the following corrective actions related to the conditions described above:

A. **Lack of or Inadequate Documentation of FBwT Accounting Policies, Procedures and Controls.** Finalize the documentation of the end-to-end process for FBwT. The documentation should include the process to perform regular and recurring reconciliations of the suspense account data and the process to research and resolve differences between U.S. Treasury, disbursing system records and accounting system records within a timely basis.

B. **Lack of Controls for the Reconciliation of FBwT Between the General Ledger and the U.S. Treasury.** In coordination with DFAS, obtain a system and organization controls (SOC) report for the CMR and DRRT and reconcile the transactions recorded in the general ledger to the transactions sent to the Secure Payment System (SPS) in order to verify that the data was processed correctly.

III. Accounts Receivable and Revenue

Accounts receivable (AR) consists of amounts owed to DLA. Revenue is earned when DLA provides services to the public or other federal entities. AR and revenue fall within the scope of DLA's order-to-cash process. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that revenues applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial reports and maintain accountability of assets. Because of the nature of its services, DLA has a significant volume of transactions in the order-to-cash process. This balance represents a substantial portion of their activity that involves receipt of funds by DLA in order to provide services to its ultimate consumers. The volume of these transactions makes it critical for DLA to properly record and reconcile these transactions to ensure timely, appropriate recognition of costs to the end users.

A. **Lack of or Inadequate Documentation of AR and Revenue Accounting Policies, Procedures and Controls.** DLA has not documented the end-to-end process to account for Unfilled Customer Orders (UCOs).

- **UCOs.** Documentation does not include the process to identify, research and resolve unreconciled amounts for UCOs and the process to review the validity of significantly aged UCOs in the general ledger despite being closed through other business processes and systems.

B. **Lack of or Inadequate Documentation to Substantiate UCOs, AR and Revenue Transactions.** DLA was unable to provide documentation that UCO and AR balances exist, revenue balances occurred and that transactions were recorded in the proper period. Specifically, documentation was not available to support:

A member firm of Ernst & Young Global Limited

- **UCOs.** The balance of UCO transactions is complete and accurate and reconciles to the general ledger.
- **Revenue.** Revenue transactions occurred and were recorded in the proper period.
- **AR.** Receivable balances are valid and have not been collected (i.e., existence and completeness).

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

A. **Lack of or Inadequate Documentation of Accounting Policies and Procedures, including Controls.** Documentation should include the process to reconcile UCOs between the general ledger and sales legacy module completely, accurately and timely and to review the aged UCO balances for validity.

B. **Lack of or Inadequate Documentation to Substantiate UCOs, AR and Revenue Transactions.** Develop documentation, including detailed listings of account balances, to substantiate that the balance of AR (federal and non-federal), UCO and revenue transactions are complete and accurate and that the balances exist or have occurred. The listing should be reconciled to the general ledger.

IV. Accounts Payable and Expenses

Accounts payable (AP) consists of amounts owed to vendors. Expenses are incurred and recognized when DLA obtains goods and services from the public or other federal entities. Undelivered Orders (UDOs) represent the amount of goods and/or services ordered which have not been received. AP, expenses and UDOs fall within the scope of DLA's procure-to-pay process. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenses and budgetary transactions applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial reports. Because of the nature of the services, DLA has a significant volume of transactions to procure goods and services to sell to its customers. Deficiencies exist in DLA's processes for recording and supporting the accounts payable and accruals, expenses and related budgetary balances; recording obligations and accounts payable in the proper period; documenting policies, procedures and controls; and designing and executing controls over the processes to create and approve obligations and to review, record and pay invoices.

A. **Lack of or Inadequate Documentation of UDO, AP and Expenses Accounting Policies, Procedures and Controls.** DLA has not documented the end-to-end process to account for UDO, AP and expense transactions.

- **UDO.** The documentation does not include the process to review the validity of significantly aged UDO. As a result, there is a significant number of UDO transactions that had no current-year activity.
- **AP.** The documentation does not include the process to evaluate the validity of AP, including significantly aged AP and negative payables; the process to record invoices in the general ledger and submit to DFAS for payment timely; and the process to pay invoices timely or assess interest penalties for late payments in accordance with the Prompt Payment Act.

B. **Lack of or Inadequate Controls over UDO, AP, Expenses and Cash Disbursement Processes.** DLA lacks or has inadequate controls, including the design of controls, over the following:

- **UDO.** DLA lacks controls to approve and record obligations in a timely manner; controls to record upward and downward adjustments to UDO accurately and timely; and controls to close invalid UDO in a timely manner.
- **Vendor Contracts.** DLA lacks controls to execute contracts in accordance with the Federal Acquisition Regulation (FAR) and to record obligations timely for contracts, including Indefinite Quantity Contracts (IQC). For example, more than 91% of the IQCs awarded did not have an obligation recorded at the contract award date because the IQC did not have a guaranteed minimum at the contract award date.
- **AP and Cash Disbursements.** DLA lacks controls to post goods receipts in a timely manner; review invoices prior to payment; and review payments that fail to post systematically in a timely manner.
- **Expenses Recorded in the Appropriate Period.** DLA lacks controls to record expense transactions appropriately and accurately in the period that the transactions occurred. As a result, two instances in our sample of 30 expense transactions were recorded in the incorrect period.
- **Transactions Recorded at the Detailed Level.** DLA lacks controls to comply with the Federal Financial Management Improvement Act (FFMIA), which requires transactions to be recorded at the detailed transaction level. DLA recorded transactions at a summary level for certain budgetary and proprietary accounts. As a result, each summary-level record contained multiple individual transactions. A reconciliation is not performed between detailed transactions posted to the proprietary accounts and the summarized postings to the corresponding budgetary accounts.

C. **Lack of or Inadequate Documentation to Substantiate AP and Expense Transactions.** DLA was unable to provide documentation to support the existence of accounts payable balances, or expense transactions that occurred are accurately recorded in the financial statements. Specifically, documentation was not available to support the transactions and balances for various accounts, such as accounts payable, negative payables, UDO (paid and unpaid), and upward and downward adjustments to delivered and undelivered orders.

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** DLA does not have policies, procedures and controls to effectively implement accounting standards. Specifically, DLA has not implemented or applied the accounting set forth by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. For example:

- DLA processes allow for payment without receipt, thus resulting in a negative payable balance. This occurs when payment is made prior to the goods receipts being posted in the general ledger, and it results in an understatement of expenses and payables and an overstatement of UDO.
- Accounts payable and accrued liabilities are not recorded appropriately. For example, DLA applied the straight-line method to calculate the accrual amount, but did not perform any assessment to determine whether this is an appropriate methodology. Particularly, for MIPRs that do not have a fixed monthly cost, the straight-line method is not appropriate.

Recommendations

Consider the following corrective actions related to the conditions described above:

A. **Lack of or Inadequate Documentation of UDO, AP and Expenses Accounting Policies, Procedures and Controls.** Update and finalize the PCMs that document the end-to-end processes for UDO, AP and expenses.

- **UDO.** The documentation should include the process to review the validity of significantly aged UDO, including a process to write off residual UDO for completed transactions.
- **Accounts Payable.** The documentation should include the process to evaluate the validity of accounts payable, including significantly aged AP and negative payables; the process to record invoices in the general ledger and submit to DFAS for payment timely; and the process to pay invoices timely or assess interest penalties for late payment in accordance with the Prompt Payment Act.

B. **Lack of or Inadequate Controls over UDO, AP, Expenses and Cash Disbursement Process**

- **UDO.** Design and implement controls to approve and record obligations in a timely manner; controls to record upward and downward adjustments to UDO accurately and timely; and controls to close invalid UDOs in a timely manner.

EY
Building a better working world

- **Vendor Contracts.** Design and implement controls to execute contracts in accordance with the FAR and record obligations timely for contracts, including IQCs.
- **AP and Cash Disbursements.** Design and implement controls to post goods receipts in a timely manner; review invoices prior to payment; and review payments, including payments that fail to post systematically, and ensure that they are posted in a timely manner.
- **Expenses Recorded in the Appropriate Period.** Design and implement controls to record expense transactions appropriately and accurately and in the period that the transaction occurred, and controls to monitor expense transactions at or near period-end.
- **Transactions Recorded at the Detailed Level.** Design and implement controls to comply with the FFMIA and reconcile the transaction-level detail to the summarized postings in each account.

C. **Lack of or Inadequate Documentation to Substantiate AP and Expense Transactions.** Develop documentation to support that AP balances exist, or that expense transactions occurred and are accurately recorded in the financial statements.

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design and implement policies and procedures to record expenses incurred in the proper period and classify costs and payables in accordance with SFFAS No. 5.

V. Financial Reporting

Financial reporting encompasses all aspects of operations affecting DLA's ability to produce reliable financial statements and disclosures. This process starts with establishing an effective governance structure to identify and assess risk and continues with developing a control environment that is effective and efficient to manage identified risks. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. However, deficiencies exist in DLA's processes related to the accumulation and presentation of financial position and results of operations.

A. **Lack of or Inadequate Documentation of Financial Reporting and Budgetary Processes.** DLA has not completely documented the end-to-end processes related to funds management. For example, the documentation does not sufficiently include a description of the process to record budget authority, the transfer process, and the Treasury warrant process.

B. **Lack of Controls over Compliance with the TFM United States Standard General Ledger (USSGL).** DLA does not have controls to configure the posting logic in the general ledger to be compliant with the USSGL, nor does it have controls to link business events to the correct posting logic. As a result, transactions are not recorded appropriately. For example, DLA inappropriately uses a general ledger account (negative payables) to track payments made without goods received and inappropriately combines entries to record the movement of budgetary funds through the apportionment and allotment process, which should be recorded separately.

C. **Lack of or Inadequate Controls over Financial Reporting Processes.** DLA lacks or has inadequate controls, including the design of controls, over the following:

- **Beginning Balances for Budgetary Accounts.** DLA does not have controls to verify the accuracy of the beginning balances for budgetary accounts, such as Total Actual Resources Collected and Contract Authority Carried Forward accounts. As a result, DLA is unable to substantiate beginning balances recorded on the financial statements.
- **Trading Partner Transactions.** DLA does not have controls in place to validate and reconcile trading partner eliminations. Adjustments made to accounts receivable, accounts payable, revenue, expenses and undisbursed funds are not appropriately supported. A complete reconciliation is not performed at the agreement level to the trading partner adjustments that are being made. As a result, trading partner adjustments are recorded in the Defense Departmental Reporting System (DDRS) as "top-side" adjustments and are identified as "unsupported" by DFAS.
- **Contingent Liabilities.** DLA does not have adequate controls to identify and account for contingent legal liabilities that should be recorded or disclosed in the financial statements.
- **Financial Statement Close Process.** DLA does not have adequately designed controls around the annual close and reconciliation processes, such as the following: the monthly or quarterly reconciliation between the unadjusted trial balance (UTB) and the adjusted trial balance (ATB) is not performed sufficiently and timely; the information used in the reconciliation of UTB to ATB is not complete and accurate; and the review of the procedures performed during the financial statement close process is not adequate.
- **Budgetary to Proprietary Tie Points.** DLA does not have adequately designed controls around the tie-point process. There are reconciliation issues between the budgetary and proprietary tie points. As a result, DFAS records unsupported monthly and quarterly JV in the general ledger and DDRS to reconcile DLA's budgetary accounts to the proprietary accounts.
- **Monthly or Quarterly JV Adjustments.** DLA does not have controls to review and approve JV adjustments recorded in the general ledger and DDRS by DLA and DFAS for completeness, accuracy and validity. As a result, a comprehensive listing of adjustments made is not maintained to allow DLA to determine the appropriateness of each JV adjustment recorded by their service provider.

- **Financial Statement Review Process.** The level of review of the financial statements and footnote disclosures was insufficient to detect and correct misstatements in the financial statements and related disclosures. As a result, inaccurate balances and disclosures were reported in the financial statements and notes. For example, line items are not appropriately classified between federal and nonfederal; supporting documentation did not support the balances recorded in the notes; and the financial statements are not prepared in conformity with U.S. GAAP as described in Note 1, Significant Accounting Policies, which did not sufficiently describe changes or noncompliance in U.S. GAAP reporting.
- **Receipt of Budgetary Funding.** DLA does not have adequate controls to identify variances in the reconciliation of budgetary funding, including the reconciliation to the public law.

D. **Lack of or Inadequate Documentation to Substantiate Budgetary Execution.** DLA is unable to provide detailed listings for budgetary accounts at the purchase order (PO) or sales order (SO) level that reconcile to the general ledger, such as delivered and undelivered orders and unfilled customer orders.

Recommendations

Consider the following corrective actions related to the conditions described above:

A. **Lack of or Inadequate Documentation of Financial Reporting and Budgetary Processes.** Document the funds management process and controls to accurately reflect all aspects of the end-to-end budget to execute process, including processes and controls performed by DLA and service providers.

B. **Lack of Controls over Compliance with the TFM United States Standard General Ledger (USSGL).** Design and implement controls to configure posting logic to be compliant with the USSGL; link business events to the correct posting logic; and post transactions as intended.

C. **Lack of or Inadequate Controls over Financial Reporting Processes.**

- **Beginning Balances for Budgetary Accounts.** Design and implement control activities to accurately state the beginning balances for carryforward budgetary accounts.
- **Trading Partner Transactions.** Design and implement controls to perform a reconciliation at the agreement level to validate trading partner eliminations, which includes identifying, researching and resolving variances between DLA general ledger data and trading partners.
- **Contingent Liabilities.** Design and implement controls related to litigation to identify, estimate, record and disclose contingent liabilities in the financial statements.
- **Financial Statement Close Process.** Develop and implement controls around the annual close and reconciliation process, which includes a complete, accurate and timely reconciliation of the UTB to the ATB.

- **Budgetary to Proprietary Tie Points.** Design and implement controls to reconcile budgetary to proprietary tie points and investigate variances.
- **Monthly or Quarterly JV Adjustments.** Design and implement controls to review and approve JV adjustments recorded in the general ledger and DDRS by DLA and DFAS for completeness, accuracy and validity prior to posting.
- **Financial Statement Review Process**. Design and implement controls to sufficiently review the quarterly financial statements and disclosures; to detect and correct misstatements; and to review that the financial statements and disclosures are complete and prepared in accordance with U.S. GAAP.
- **Receipt of Budgetary Funding**. Design and implement controls to perform an adequate reconciliation of the amounts recorded in the general ledger to the Consolidated Appropriations Act and the final report on budget execution and budgetary resources.

D. **Lack of or Inadequate Documentation to Substantiate Budgetary Execution.** Develop and implement procedures to generate complete and accurate listings of budgetary accounts at the purchase order and sales order level that reconcile to the general ledger.

VI. Oversight and Monitoring

Oversight and monitoring relate to DLA's lack of establishment and implementation of a sufficient enterprise-wide control environment as required by OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management Internal Control*.

A. **Lack of or Inadequate Documentation Around the OMB A-123 Program**. DLA has not documented the end-to-end process to oversee and monitor the enterprise-level risks and controls, including the OMB A-123 program. Specifically, DLA has not performed and documented a sufficient risk assessment at the enterprise and business process level to assess and document reporting matters, such as the complexity of programs, accounting estimates, related-party transactions and the extent of manual processes; a complete and accurate population of its assessable units, business processes and relevant controls that are responsive to and mitigate risks including fraud risks; and an assessment and plan for timely remediation of audit findings.

B. **Lack of or Inadequate Controls Around System-Generated Reports.** DLA lacks or has inadequate controls to verify the accuracy and completeness of system-generated reports required in the execution of controls.

A member firm of Ernst & Young Global Limited

Building a better working world

C. **Insufficient Oversight and Monitoring of Third-Party Service Providers.** Service organizations undergo examinations of internal controls over systems and processes supporting their customers. The results of these examinations are documented in SOC 1 reports and include the independent service auditor's report, the service organization's management assertions and identified Complementary User Entity Controls (CUECs) that users of the service organization (e.g., DLA) should have in place to supplement the service organization's internal controls. DLA does not perform sufficient oversight and monitoring of SOC 1 reports and does not sufficiently design, implement or monitor CUECs over its service providers.

D. **Insufficient Oversight and Monitoring of Funding Executed by Others.** Review controls are not designed effectively to monitor the execution of funding allotted to the Defense Microelectronic Activity (DMEA) and awarded to grantees through the Procurement Technical Assistance Center (PTAC) programs. Specifically, DLA does not perform a sufficient review of transactions that are recorded on their financial statements.

Recommendations

Consider the following corrective actions related to the conditions described above:

A. **Lack of or Inadequate Documentation Around the OMB A-123 Program.** Document the end-to-end process to oversee and monitor the enterprise-level risks and controls, including the OMB A-123 program. Perform and document a sufficient risk assessment at the enterprise and business process level to assess and document reporting matters. Document a complete and accurate population of its assessable units and business processes. Identify and assess the risks in each business process and design and implement relevant controls that are responsive to and mitigate these risks, including fraud risks. Perform an assessment and establish and execute the plan to remediate the audit findings timely.

B. **Lack of or Inadequate Controls Around System-Generated Reports.** Design and implement controls to verify the accuracy and completeness around system-generated reports used in the execution of controls. For example, the procedures should include: footing system generated reports; performing a tie-out of system generated reports to the general ledger system; verifying that the parameters used to generate the reports or data are appropriate; judgmentally selecting a sample of transactions or balances in the report; and validating that the transactions are accurate.

C. **Insufficient Oversight and Monitoring of Third-Party Service Providers.** Design and implement controls around the SOC 1 review process and validate that CUECs are properly identified, designed and are operating effectively.

D. **Insufficient Oversight and Monitoring of Funding Executed by Others.** Design and implement internal controls to review that transactions executed by others, but recorded in DLA's financial statements, are complete and accurate, and are supported by appropriate documentation.

EY
Building a better working world

VII. Information Systems

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

Our assessment of the Information Technology (IT) controls and the computing environment identified deficiencies in the design and operation of information systems controls.

The deficiencies relate to the following areas:

- Access Controls
- Configuration Management
- Segregation of Duties Controls
- Security management/Governance Over Implementation of Security Controls

Access Controls

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

The identified access control weaknesses in aggregate represent a significant risk to the DLA financial statements, IT environment, and financial applications. Absent or ineffective preventative controls and compensating detective controls expose financial systems and financial data to inappropriate access, unauthorized inputs, and inaccurate entries, resulting in significant risk to the financial statements.

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

- Access was not restricted to authorized users with a business need, was not reviewed and documented prior to provisioning, and was not assigned in accordance with the principle of least privilege.
- User access and activity was not monitored and tracked for routine access recertification,

revalidation of privileged access, and terminated or inactive users.

- Audit logs, security violations, and sensitive user activity were not tracked, monitored, resolved, or configured appropriately within systems.

Configuration Management

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

The identified configuration management and change control weaknesses in aggregate represent a significant risk to the DLA financial statements, IT environment, and financial applications. Absent or ineffective controls expose financial systems and financial data to unexpected impact from changes, inappropriate or unauthorized changes, and application errors in production.

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

- Both routine and emergency changes are not reviewed, approved, and tested in a non-production environment prior to release. The impact and functionality of configuration changes are not assessed prior to implementation.
- System configurations, baseline code, and production environments are not monitored and inspected for unauthorized changes.
- Users have access privileges enabling them to bypass the configuration management process and make changes directly to production.

Segregation of Duties Controls

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

The identified segregation of duties and conflicting role weaknesses in aggregate represent a significant risk to the DLA financial statements, IT environment, and financial applications. Absent or ineffective controls around segregation of duties allow users to circumvent processes and automated controls in place, obtain unnecessary or elevated access, and impact the integrity of financial data.

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

- Segregation of duties within the user provisioning process is not completed consistently across all applications. Management did not identify segregation of duties conflicts that consider both IT and business process roles and activities. Conflicting roles were not inspected and rationalized prior to provisioning.
- Application program management has not completely identified sensitive (financial transactions) roles in order to identify and implement appropriate segregation of duties.
- Administrator and super user privileges are not restricted through user groups and permissions. Users have the ability to create and assign roles to themselves.
- Business end users have access to roles intended for IT privileged users.

Security Management / Governance Over Implementation of Security Controls

An entity-wide information security management and internal control program is the foundation of a security control structure to address security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

The identified security management and governance weaknesses in aggregate represent a significant risk to the DLA financial statements, IT environment, and financial applications. Absent or ineffective controls around internal controls and governance compound data integrity risk by not monitoring third parties and not remediating known gaps timely.

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

- SOC reports are not monitored and reviewed to assess CUECs, the impact of service organization findings, identification of compensating controls, and resolution of control gaps. In addition, service level agreements (SLAs) are not reviewed and updated in a timely manner.
- Management internal control procedures do not identify financially significant risks, establish and implement controls, track known risk exposes, and remediate control gaps.

Building a better working world

Recommendations

Implement controls to address deficiencies in access controls, configuration management, segregation of duties and security management procedures to include:

Access and Segregation of Duties Controls

- Restrict access to authorized users in accordance with the least privilege principle. Review and approve all access, including justification of business needs.
- Routinely monitor and revalidate access needs for business users, privileged users, and inactive users.
- Monitor user activity, identify and audit security violations, and assess privileged and sensitive users and transactions. Identify and document conflicting roles, enforce established segregation of duties processes, and assess conflicts during account provisioning and management. Segregate conflicting roles where possible, and if unavoidable, document business rationale and monitor user activity.

Configuration Management

- Review, approve, and test changes prior to implementation, to include user testing and functionality assessments. Monitor source code, configurations, and production environments for unauthorized changes.
- Segregate conflicting roles between development and production environments.

Security Management / Governance over Implementation of Security Controls

- Document risks and controls in place, identify gaps, and complete corrective actions to strengthen the internal control environment. Improve documentation, test and validate controls, and remediate findings.
- Establish a process to evaluate and incorporate service provider reports, findings, and controls into management's security documentation, governance process, and application control environment.

Appendix B – Significant Deficiency

I. Environmental Liabilities

ELs are comprised of cleanup costs associated with the restoration of sites that DLA manages. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. However, we identified the following deficiency in internal controls, which, when aggregated, we consider to be a significant deficiency.

A. **Inability to Substantiate Cost to Complete Estimates.** DLA is unable to demonstrate that the methodology used to derive cost to complete estimates for environmental liabilities was appropriate. In addition, the estimates for the cost to complete, cleanup and restore is not supported.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

A. **Inability to Substantiate Cost to Complete Estimates.** Design and implement policies and procedures to document the process for preparing the cost to complete estimate and sufficiently describe the methodology used to derive the estimate. Develop the supporting documentation used to derive the estimate that substantiates and reconciles to the cost to complete estimate.

Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the General Fund of the Defense Logistics Agency (DLA), which comprise the balance sheet as of September 30, 2019, and the related statements of net cost, changes in net position, and statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2019. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2019 and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 19-03, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to DLA.

The results of our tests of compliance with laws, regulations and contracts described in the preceding paragraph disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03, and which are described below. In addition, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

Building a better working world

FFMIA

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

(a) Federal financial management system requirements

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

(b) Noncompliance with applicable federal accounting standards

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

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

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

FMFIA

Federal Managers' Financial Integrity Act (FMFIA) requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government* (commonly referred to as the "GAO Green Book") issued under the authority of FMFIA, establishes five components of internal control: Control

EY
Building a better working world

Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring. To determine if an entity's internal control system is effective, the Green Book requires management to assess the design, implementation and operating effectiveness of the five components of the entity's internal control system.

DLA has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book requirements, leading to inadequate control environment, risk assessment and monitoring processes.

DLA's Response to Findings

Our Report on Internal Control dated November 8, 2019 includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance with FFMIA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from DLA's management responsible for addressing the noncompliance are provided in the accompanying letter dated November 8, 2019. DLA's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Ernst + Young LLP

November 8, 2019

Management's Response to Audit Reports

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

NOV 08 2019

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Fiscal Year (FY) 2019 Financial Statement Audit – General Fund

Thank you for the opportunity to comment on the Independent Auditors' report on the audit of the Defense Logistics Agency's (DLA) FY 2019 General Fund (GF) financial statements. We concur with the conclusions.

The Independent Auditors, Ernst & Young, identified certain deficiencies in the areas of accounting processes, internal controls, financial reporting and financial systems. DLA will continue working to resolve the material weaknesses and strengthen internal controls around operations, reporting, and financial systems as we work within the tenets of the audit priorities set by the Office of the Under Secretary of Defense.

Challenges remain, and we have taken steps to further improve our audit posture as evidenced by the following actions:

- In FY 2019, DLA stood up an Audit Task Force to oversee and execute the coordination, integration and synchronization of audit efforts across the Agency to improve audit responsiveness.
- DLA also established the Office of Enterprise Risk Management that will drive the efforts for enterprise-wide risk management policies, internal controls policies, guidance and oversight to ensure enduring compliance with the Office of Management and Budget Circular A-123 requirements.

DLA will continue to work to enhance and mature the design and operating effectiveness of its internal controls to improve the reliability of the GF financial statements. I look forward to working collaboratively with the Office of Inspector General in support of future audits.

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Introduction to Financial Statements

The principal financial statements and the accompanying notes (financial statements) included in this report are prepared pursuant to the requirements of GMRA (Pub. L. 103-356) and the CFO Act of 1990 (Pub. L. 101-576), as amended by the Reports Consolidation Act of 2000 (Pub. L. 106-531), and other authoritative requirements and guidance. Other reporting requirements include the OMB Circular A-136, as amended, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these financial statements rests with the management of DLA GF. The IPA was engaged to perform the audit of DLA GF's financial statements and disclaimed an opinion on the financial statements. The Audit Reports, and Management's Response to the Audit Reports accompany the unaudited financial statements.

The DLA GF principal financial statements and the accompanying notes consist of the following:

1. The **Balance Sheets** present those resources owned or managed by DLA GF that represent future economic benefits (assets), amounts owed by DLA GF that will require payments from those resources or future resources (liabilities), and residual amounts retained by DLA GF comprising the difference (net position) as of September 30, 2019 and 2018.

2. The **Statements of Net Cost** present the net cost of DLA GF operations for the years ended September 30, 2019 and 2018. The DLA GF's net cost of operations is the gross cost incurred by DLA GF activities, less any exchange revenue earned and inter-entity eliminations from DLA GF activities.

3. The **Statements of Changes in Net Position** present the change in DLA GF's net position resulting from the net cost of DLA GF's operations, budgetary financing sources, and other financing sources for the years ended September 30, 2019 and 2018.

4. The **Combined Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to the DLA GF, the status of these resources, and the net outlays of budgetary resources for the years ended September 30, 2019 and 2018.

5. The **Notes to the Financial Statements** provide detail and clarification for amounts in the principal financial statements.

Defense Logistics Agency - General Fund
Balance Sheets
As of September 30, 2019 and 2018
(dollars in thousands)

	Unaudited 2019	Unaudited 2018
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$ 1,421,378	$ 1,438,421
Accounts Receivable	11,782	10,231
Total Intragovernmental Assets	**1,433,160**	**1,448,652**
Accounts Receivable	2	1
General Property, Plant and Equipment (Note 3)	728,672	611,790
Other Assets (Note 4)	88	88
TOTAL ASSETS	**$ 2,161,922**	**$ 2,060,531**
LIABILITIES (Note 5)		
Intragovernmental		
Accounts Payable	$ 40,483	$ 24,970
Other Liabilities (Note 6)	1,949	2,236
Total Intragovernmental Liabilities	**42,432**	**27,206**
Accounts Payable	30,592	53,476
Environmental and Disposal Liabilities (Note 7)	81,169	88,270
Other Federal Employment Benefits (Note 8)	3,123	3,846
Other Liabilities (Note 6)	10,144	7,851
TOTAL LIABILITIES	**167,460**	**180,649**
Commitments and Contingencies		
NET POSITION		
Unexpended Appropriations	1,361,054	1,374,142
Cumulative Results of Operations	633,408	505,740
TOTAL NET POSITION	**1,994,462**	**1,879,882**
TOTAL LIABILITIES AND NET POSITION	**$ 2,161,922**	**$ 2,060,531**

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - General Fund
Statements of Net Cost
For the Years Ended September 30, 2019 and 2018
(dollars in thousands)

	Unaudited 2019	Unaudited 2018
Operations and Maintenance		
Gross Cost	$ 361,295	$ 343,327
Less: Earned Revenue	(27,258)	(19,612)
Net Cost	**334,037**	**323,715**
Procurement		
Gross Cost	2,839	8,607
Less: Earned Revenue	-	-
Net Cost	**2,839**	**8,607**
Research, Development, Test & Evaluation		
Gross Cost	320,787	255,603
Less: Earned Revenue	(48,215)	(28,787)
Net Cost	**272,572**	**226,816**
Family Housing and Military Construction		
Gross Cost	93,365	168,286
Less: Earned Revenue	(869)	-
Net Cost	**92,496**	**168,286**
Total Gross Cost	**778,286**	**775,823**
Less: Total Earned Revenue	**(76,342)**	**(48,399)**
NET COST OF OPERATIONS	**$ 701,944**	**$ 727,424**

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - General Fund
Statements of Changes in Net Position
For the Years Ended September 30, 2019 and 2018
(dollars in thousands)

	Unaudited 2019	Unaudited 2018
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 1,374,142	$ 1,222,277
Correction of Errors	-	5,113
Beginning Balances, as Adjusted	1,374,142	1,227,390
Budgetary Financing Sources		
Appropriations Received	901,829	1,049,080
Appropriations Transferred-in/out	16,476	6,563
Other Adjustments	(44,628)	(33,733)
Appropriations Used	(886,765)	(875,158)
Total Budgetary Financing Sources	**(13,088)**	**146,752**
TOTAL UNEXPENDED APPROPRIATIONS	**1,361,054**	**1,374,142**
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	505,740	660,284
Correction of Errors	-	474,943
Beginning Balances, as Adjusted	505,740	1,135,227
Budgetary Financing Sources		
Appropriations Used	886,765	875,158
Other Adjustments	(13,208)	(3,930)
Other Financing Sources		
Transfers-in/out Without Reimbursement	(47,335)	(776,420)
Imputed Financing	3,390	3,129
Total Financing Sources	**829,612**	**97,937**
Net Cost of Operations	**701,944**	**727,424**
Net Change	**127,668**	**(629,487)**
CUMULATIVE RESULTS OF OPERATIONS	**633,408**	**505,740**
TOTAL NET POSITION	**$ 1,994,462**	**$ 1,879,882**

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - General Fund
Combined Statements of Budgetary Resources
For the Years Ended September 30, 2019 and 2018
(dollars in thousands)

	Unaudited 2019	Unaudited 2018
BUDGETARY RESOURCES		
Unobligated Balance From Prior Year Budget Authority, Net	$ 566,711	$ 474,897
Appropriations	910,586	1,054,390
Spending Authority From Offsetting Collections	66,497	59,777
TOTAL BUDGETARY RESOURCES	**1,543,794**	**1,589,064**
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments	$ 1,112,894	$ 1,027,209
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	310,568	436,112
Unxpired Unobligated Balance, End of Year	310,568	436,112
Expired Unobligated Balance	120,332	125,743
Total Unobligated Balance, End of Year	430,900	561,855
TOTAL BUDGETARY RESOURCES	**$ 1,543,794**	**$ 1,589,064**
OUTLAYS, NET		
Outlays, Net	$ 877,512	$ 901,903
AGENCY OUTLAYS, NET	**$ 877,512**	**$ 901,903**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

Note 1: Summary of Significant Accounting Policies (Unaudited)

A. Reporting Entity

Created in 1961, the DLA is a component of the U.S. DoD and reports to the Office of the Under Secretary of Defense for Acquisition and Sustainment through the Assistant Secretary of Defense for Sustainment. The DLA provides materials and services to components of DoD (including the U.S. Army, Navy, and Air Force), other Federal Agencies, and public entities. DLA accomplishes its mission and goals through the operations of the Working Capital Fund, General Fund, and Transaction Fund. These financial statements and accompanying notes herein only refer to the activities of DLA GF.

Congress appropriates DLA GF amounts to DLA, which also grants authority to the OUSD and its Components to obligate those funds to support mission requirements. The DLA GF receives five appropriations, which include O&M; Family Housing; RDT&E; PDW; and MILCON.

B. Basis of Presentation and Accounting

Basis of Presentation and Accounting: The DLA GF fiscal year ends September 30. The accompanying financial statements account for all resources for which DLA GF is responsible. These financial statements present the financial position, results of operations, changes in net position, and the combined budgetary resources of DLA GF, as required by the CFO Act of 1990, expanded by the Government Management Reform Act (GMRA) of 1994, and other applicable legislation. The financial statements are prepared from the books and records of DLA GF activities in accordance with U.S. GAAP promulgated by the FASAB and presented in the format prescribed by the OMB Circular A-136, *Financial Reporting Requirements* except as identified in Note 1.C., *Departures from U.S. GAAP*, and in the following paragraphs.

The DLA GF financial statements reflect both accrual and budgetary accounting transactions, except as identified in Note 1.C., *Departures from U.S. GAAP*. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash. Budgetary accounting is designed to recognize the obligation of funds according to legal requirements, which in many cases is made prior to the occurrence of an accrual-based transaction. Budgetary accounting is essential for compliance with legal constraints and controls over the use of Federal funds.

However, DLA GF is unable to fully prepare financial statements in conformity with and implement all elements of U.S. GAAP (refer to Note 1.C., *Departures from U.S. GAAP*), the form and content requirements for Federal government entities specified by OMB Circular A-136, *Financial Reporting Requirements*, due to limitations of financial and nonfinancial management processes and systems that support the financial statements. In addition, the financial management systems used by DLA GF are unable to meet all full accrual accounting requirements as many of the financial and nonfinancial feeder systems and processes were not designed to collect and record financial information on the full accrual accounting basis as required by U.S. GAAP. These systems were designed to support reporting requirements for maintaining accountability over assets, reporting the status of Federal appropriations, and recording information on a budgetary basis, rather than preparing financial statements in accordance with U.S. GAAP.

Therefore, DLA GF is continuing the necessary actions required to bring its financial and nonfinancial systems and processes to generate financial statements and notes in accordance with U.S. GAAP and in compliance with the reporting requirements of OMB Circular A-136. Until all DLA GF financial feeder systems and processes are able to collect and report financial information as required by U.S. GAAP and OMB Circular A-136, DLA GF continues to implement interim mitigation processes to address these limitations. In addition, DLA GF is remediating material weaknesses found in end-to-end business process cycles pertaining to reconciliations and adequacy of the supporting documentation identified through audits and other compliance reporting.

Intragovernmental and Non-Federal Transactions: Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, distinguishes between Intragovernmental and Non-Federal assets and liabilities. Intragovernmental assets and liabilities arise from transactions among Federal entities. Intragovernmental assets are claims other Federal entities owe to DLA GF. Intragovernmental liabilities are claims DLA GF owes to other Federal entities. Whereas Non-Federal assets and liabilities arise from transactions with public entities. The term public entities encompasses domestic and foreign persons and organizations outside the U.S. Government. Non-Federal assets are claims of DLA GF against public entities. Non-Federal liabilities are amounts that DLA GF owes to public entities. Currently, DLA GF is unable to accurately map its trading partners to separate Federal and Non-Federal transactions in accordance with TFM, Volume I, Part 2, Central Accounting and Reporting, Chapter 4700, Federal Entity Reporting Requirements for the *Financial Report of the United States Government*.

The DLA GF engages in transactions with other DoD and Federal entities that generate inter-DoD and intragovernmental balances; however, DLA GF is unable to reconcile and resolve differences between balances and transaction with other DoD and Federal entities in accordance with TFM 4700 and OMB Circular A-136 guidance. The reconciliation process is not fully implemented (refer to Note 1.C., *Departures from U.S. GAAP*, related to Intragovernmental/Intra-departmental and Non-Federal Transactions).

Intra-departmental Transactions: On a DoD Agency-wide basis, DLA GF adjustments are based on the information provided by the seller/service provider unless a waiver is obtained. A waived entity is a DoD reporting entity believed to have complete, accurate, and supported seller or buyer side data. DLA GF is a non-waived entity. The elimination adjustments for buyer/seller transactions are based on the buyer's accounts payable and expenses and the seller's accounts receivable and revenue records. DLA GF is unable to resolve the reconciling differences in amounts reported for the buyer/seller transactions reciprocal category with ODOs, (refer to Note 1.C., *Departures from U.S. GAAP*, related to Intragovernmental/Intra-departmental and Non-Federal Transactions).

Inter-fund Transactions: Inter-fund transactions and balances among DLA GF appropriations are eliminated from the Balance Sheets, the Statements of Net Cost, and the Statements of Changes in Net Position. The Combined Statements of Budgetary Resources is presented on a combined basis in accordance with OMB Circular A-136; therefore, inter-fund transactions have not been eliminated from this statement. DLA GF presents the Statements of Net Cost based on appropriations rather than program costs, which is not in accordance with OMB Circular A-136 (refer to Note 1.C., *Departures from U.S. GAAP*, related to Statements of Net Cost).

Classified Activities: Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

Use of Estimates: The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclose contingent assets and liabilities as of the date of the financial statements and report amounts of revenue and expenses for the year ended. DLA GF's estimates are based on historical experience, current events and other assumptions that are believed to be reasonable under the circumstances. However, uncertainties associated with these estimates exist and actual results may differ from these estimates. Significant estimates reported in the financial statements include environmental and disposal liabilities, accounts payable, undelivered orders, and Federal Employees' Compensation Act (FECA) liability as of the date of these financial statements.

C. Departures from U.S. GAAP

Financial management systems and operations continue to be evaluated and modified as DLA GF strives to remediate its material weaknesses and record and report its financial activity in accordance with U.S. GAAP. Thus, DLA GF is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with U.S. GAAP. However, due to the financial management systems and operational limitations, the known departures from U.S. GAAP described below have been identified that impact DLA GF financial statements although other departures from U.S. GAAP may exist that have not been identified.

Definition of Reporting Entity: The DLA GF has not completed analyzing material applicable business relationships with other organizations to identify consolidation entities, disclosure entities, or related parties in accordance with SFFAS 47, *Reporting Entity* (effective FY2018). As a result, DLA GF is unable to determine if there are consolidation entities that are required to be consolidated and disclosed in DLA GF financial statements or disclosure entities and related parties, where the nature and magnitude of such relationships, are required to be disclosed in a Disclosure Entities and Related Parties note to the financial statements.

Statements of Net Cost: The DLA GF does not have policies and compliant processes in place to present its major program costs aligned with DLA GF mission and goals by responsibility segments in accordance with SFFAS 4, *Managerial Cost Accounting Concepts and Standards* and OMB Circular A-136.

Intragovernmental/Intra-departmental and Non-Federal Transactions: The DLA GF does not have compliant processes in place to separately report intragovernmental, intra-departmental, and non-Federal transactions in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*.

Inter-Entity Cost (Note 9): The DLA GF does not have compliant processes in place to recognize all significant inter-entity costs related to inputs of its goods or services provided to entities for a fee or user charge in accordance with SFFAS 55, *Amending Inter-Entity Cost Provisions* (effective FY2019). Generally, the fees and user charges should recover the full costs of those goods and services. Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold.

Reconciliation of Net Costs to Net Outlays (Note 11) The DLA GF does not have an established policy for the reconciliation of net cost to net outlays in accordance with SFFAS 53, Budget and Accrual Reconciliation.

Fund Balance with Treasury (Note 1.F. and Note 2): The DLA GF is not able to account for Fund Balance with Treasury in accordance with SFFAS 1, Accounting *for Selected Assets and Liabilities*, due to its inability to identify and reconcile the reported differences between DLA GF's accounting system and Treasury. Monthly journal vouchers are made to adjust the Fund Balance with Treasury balances in DLA GF financial statements to match US Treasury records.

Accounts Receivable, Revenue, and Unfilled Customer Orders (Notes 1.G. and 1.R.): The DLA GF does not have policies and compliant processes in place to (1) recognize revenue and record the related accounts receivable, net and unfilled customer order (UCO) balances from goods sold and services provided in the proper period; and (2) adjust revenue to the extent that realization of the full amount is not probable in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, and/or SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. More specifically, the DLA GF does not properly record UCO activity and is unable to support the UCO balance in the accounting system in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

General Property, Plant, and Equipment (Note 1.H. and Note 3): The DLA GF does not have policies and compliant processes in place to account for general PP&E, at historical cost, in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment* and SFFAS 10, *Accounting for Internal Use Software*. Supportable general PP&E, beginning balances have not been established for general equipment, Construction-in-Progress (CIP), and Internal Use Software (IUS) in Development using the alternative valuation methods permitted by SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment* (effective FY2017). In addition, DLA GF does not have compliant processes in place to account for impairment of facilities and equipment in accordance with SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. More specifically:

- *Transferred assets:* The DLA GF is unable to determine the valuation of real property and general equipment assets previously transferred from the Military Services in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*;
- *Construction-in-Progress Balances:* The DLA GF does not have the proper policies and compliant processes to identify aged CIP balances in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*;
- *Internal-Use Software in Development:* The DLA GF does not have the proper policies and compliant processes to identify IUS in Development balances in accordance with SFFAS 10, *Accounting for Internal Use Software;* and
- *Capitalization:* The DLA GF does not properly follow the policy and procedures for capitalization thresholds to effectively implement and consistently apply the threshold in accordance with SFFAS 6 *Accounting for Property, Plant, and Equipment* and SFFAS 10, *Accounting for Internal Use Software*.

Leases (Note 1.I.): The DLA GF does not have policies and compliant processes in place to identify, evaluate, record, and report for capital and operating leases in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*, SFFAS 6, *Accounting for Property, Plant, and Equipment*, and SFFAS 10, *Accounting for Internal Use Software*.

Accounts Payable, Expenses, and Undelivered Orders (UDO) (Note 1.L., Notes 5 and 10): The DLA GF does not have policies and compliant processes in place to account for accounts payable, expense accruals, and the related UDOs in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities* and SFFAS 5, *Accounting for Liabilities of The Federal Government*. More specifically:

- *Negative payable:* The DLA GF processes allow for payment without receipt, thus resulting in a negative payable. This occurs when a payment is made prior to the goods receipts being posted in DLA GF's accounting system. This results in an understatement of current year expenses and payables, and an overstatement of UDOs; and
- *Undelivered Orders*: The DLA GF does not have sufficient policies and procedures in place to record obligations at the time contracts are awarded. In addition, DLA GF is unable to support the UDO balance in the accounting system.

Environmental and Disposal Liabilities (Note 1.M. and Note 7): The DLA GF does not have policies and compliant processes in place to reconcile real property asset listings and to account for cleanup costs associated with general PP&E in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*; SFFAS 6, *Accounting for Property, Plant, and Equipment;* and Auditing Technical Release 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*.

Commitments and Contingencies (Note 1.K.) The DLA's GF did not complete its assessment of commitments and contingencies in accordance with SFFAS 5, *Accounting for Liabilities of The Federal Government* and SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government*.

Public-Private Partnerships: DLA GF has not completed analyzing all the applicable business relationships to determine if these arrangements or transactions indicate the existence of Public-Private Partnerships (P3) relationships, risk-sharing arrangements or transactions lasting more than five years between public and private sector entities, in accordance with SFFAS 49, *Public-Private Partnerships: Disclosure Requirements* (effective FY2019). As a result, DLA GF is unable to determine the nature of such partnerships, if applicable, and related Federal funding amounts required to be disclosed in a P3 note to the financial statements.

D. Pronouncements Recently Issued but Not Yet Effective

FASAB has issued the following pronouncements that may affect future financial presentation, as well as financial management practices and operations of DLA GF upon implementation. DLA GF has not completed the process of evaluating the effects of adopting this pronouncement and is unable to determine the materiality of changes that adopting will have on its financial position, results of operations, changes in net position, and combined budgetary activity.

FASAB Statement No.	FASAB Statement	Adoption Required in FY
SFFAS 54	*Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment*	2021
SFFAS 57	*Omnibus Amendments 2019*	Varies

SFFAS 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment* revises the current Federal financial reporting standards for lease accounting and requires that Federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. A Federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, contracts or agreements that transfer ownership, or intragovernmental leases.

SFFAS 57, *Omnibus Amendments 2019*, addresses consistency issues and other improvements that were identified during implementation and application of certain FASAB Statements. Specifically, SFFAS 57 (1) eliminates the required supplementary stewardship information (RSSI) category by rescinding SFFAS 8, *Supplementary Stewardship Reporting*, (2) updates references to leases in SFFAS 5, *Accounting for Liabilities of the Federal Government*, SFFAS 6, *Accounting for Property, Plant, and Equipment*, and SFFAS 49, *Public-Private Partnerships: Disclosure Requirements*, and (3) makes a minor change to SFFAS 6, *Accounting for Property, Plant, and Equipment*.

E. Appropriations and Funding

The DLA GF receives appropriations from the OUSD(C). OUSD(C) uses a data element referred to as a 'limit' to differentiate the various ODOs under TI-97. The appropriations provide the funding to incur obligations and to pay for goods and services. OUSD(C) receives the apportionment from OMB and allots to DLA GF.

O&M appropriation (funds available year(s):1) funds Administration and Service-Wide Activities such as DoD programs, DoD EBS, HQ DLA programs, and Environmental Programs. These programs are associated with DLA logistics mission as well as programs assigned to DLA GF from the DoD for budget administration purposes. DLA GF functions as either the executive agent responsible for program oversight and policy guidance or the budget administrator responsible for administrative support for these programs.

Procurement Defense-Wide appropriation (funds available year(s):3) funds mission essential equipment, including automated data processing, telecommunications equipment, and passenger carrying vehicles that afford a high degree of efficiency, effectiveness, and productivity in the accomplishment of DLA GF's logistics mission.

RDT&E appropriation (funds available year(s):2) funds the development of major upgrades to increase the performance of existing systems, the purchase of test articles, and the developmental testing and/or initial operational testing and evaluation prior to system acceptance. In addition, the RDT&E appropriation develops, manages, and implements innovative microelectronic solutions to enhance DoD mission capabilities. These capabilities are leveraged to develop low-volume, high mix fabrication processes for state-of-the-art technologies that meet the DoD's performance and reliability needs for legacy microelectronics that are unavailable from commercial foundries. RDT&E also helps ensure that advanced logistics concepts and business processes are used to accomplish the Agency's mission. The Logistics R&D program identifies the best commercial business practices and tailors them, as necessary, into the most effective business processes for DLA. The ManTech R&D program provides the critical link between invention and application. DLA sub-allots RDT&E authority to the DMEA.

Family Housing and Military Construction

Family Housing O&M appropriation (funds available year(s):1) funds the routine O&M of 92 military family housing units. Routine operation and maintenance includes management costs, utility costs and cyclical maintenance such as painting and renovations. There is no plan to receive additional funding beyond FY2019 for family housing. The housing units are being demolished and cleared.

MILCON appropriation (funds available year(s):5) funds the construction of facilities that support DLA GF's mission. These include DoD fuel infrastructure projects, and distribution and disposition facilities. DLA GF sub-allots MILCON authority to USACE and NAVFAC, which are DLA's primary design and construction agents for the MILCON program.

F. Fund Balance with Treasury

The DLA GF does not maintain cash in a commercial bank, but rather in the U.S. Treasury. DLA GF's FBwT includes the amount available for DLA GF to pay current liabilities and finance authorized purchases, except as restricted by law. The disbursing offices of DFAS, USACE, GSA, and the Department of State's financial service centers process DLA GF's cash collections, disbursements, and adjustments.

In recent years, DLA GF implemented Treasury Direct Disbursing (TDD), which provides DLA GF the capability to transmit directly from the accounting system to Treasury for disbursements. With the implementation of TDD, DLA GF has a unique accounting code allowing DLA GF to identify the transactions.

On a monthly basis, DLA GF adjusts its FBwT account balance to bring its cash balance to be in agreement with the U.S. Treasury cash balance reported on the Central Accounting and Reporting System (CARS) using the Cash Management Report (CMR). The CMR provides a summary cash position for each ODO's FBwT account by fiscal year and appropriation at the limit level. The adjustments represent the undistributed disbursements and collections amounts that have been reported to Treasury, but have not yet been posted to DLA GF's accounting system. Undistributed amounts can be a result of timing, invalid line of accounting, invalid TAS information, and unsupported and unreconciled differences.

The DLA GF accounting service provider, DFAS, uses suspense accounts to hold transactions temporarily prior to identifying the correct appropriation. Suspense account items represent the amounts that are reported to Treasury, but have not yet been classified to a DLA TAS. The transactions in suspense accounts include unidentified collections, disbursements, Intragovernmental Payment and Collection Transactions at Month End. With the suspense account, there is a significant effort by DFAS to allocate the expenditures or collections to the individual ODOs.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Fund Balance with Treasury and Note 2, *Fund Balance with Treasury.)*

G. Accounts Receivable

Accounts receivable represents amounts due to DLA GF by other Federal Agencies (intragovernmental) and the public (non-Federal). DLA GF's accounts receivable arise from sales of materials and services.

In accordance with Treasury, DLA GF does not recognize an allowance for doubtful accounts from other Federal Agencies. All intragovernmental accounts receivable are presented as gross amounts in the Balance Sheets.

The policy pertaining to allowance for doubtful accounts is based on a systematic methodology of grouped aged public receivables. DLA GF does not currently have material non-Federal receivables. Thus, DLA GF does not record an allowance for doubtful accounts.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivable, Revenue, and Unfilled Customer Orders.)

H. General Property, Plant, and Equipment

The DLA GF PP&E consists of IUS under development and Real Property Construction in Progress (CIP). The accounts are not subject to amortization or depreciation.

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

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to General Property, Plant, and Equipment and Note 3, *General Property, Plant, and Equipment.*)

I. Leases

As of and for the years ended September 30, 2019 and 2018, DLA GF has not completed the process of developing policies and procedures to identify, calculate, record and report capital and operating leases in accordance with SFFAS 5 *Accounting for Liabilities of The Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment.* (Refer to Note 1.C., *Departures from U.S. GAAP*, related to Leases.)

J. Other Assets

Other assets include those assets not reported elsewhere in DLA GF Balance Sheets, such as civil service employee pay, travel advances and advances and prepayments made in advance of the receipt of goods and services.

For advances and prepayments, the DLA GF's policy is to expense and/or properly classify the asset when the related goods and services are received.

K. Commitments and Contingencies

In accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*, as amended by SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation*, DLA GF recognizes contingent liabilities in DLA GF's Balance Sheets and Statements of Net Cost when the loss is determined to be probable and the amount can be estimated. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury. DLA GF evaluates all contingent liabilities based on three criteria; probable, reasonably possible, and remote.

The DLA GF recognizes that the estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recorded. If no amount within the range is a better estimate than any other amount, the minimum amount of the range is recorded and the range and a description of the nature of the contingency are disclosed.

The DLA GF does not record an accrual for contingent liabilities if it is not probable and estimable, but does disclose those contingencies that are reasonably possible in Note 7, *Commitments and Contingencies*, of the financial statements. DLA GF does not disclose or record contingent liabilities where the loss is considered remote.

As of September 30, 2019 and 2018, DLA GF had no Commitments and Contingencies that were reasonably possible or remote. The related probable contingent liabilities related to EL have been recognized in the financial statements.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Commitments and Contingencies.)

L. Liabilities

Liabilities represent probable and measurable future outflows of resources as a result of past transactions or events and are recognized when incurred, regardless of whether there are budgetary resources available to pay the liabilities. However, liabilities cannot be liquidated without legislation providing resources and legal authority.

Covered and Uncovered Liabilities: Liabilities incurred that are covered by available budgetary resources as of the Balance Sheets date are referred to as funded liabilities. Liabilities are covered by budgetary resources if they are funded by appropriations, provided that the resources are apportioned by OMB without further action by the Congress and without a contingency having to be met first. Budgetary resources include: (1) new budget authority, (2) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year, (3) spending authority from offsetting collections (credited to an appropriation or fund account), and (4) recoveries of unexpired budget authority through downward adjustments of prior-year obligations. Liabilities that are not covered by available budgetary resources as of the Balance Sheets dates are referred to as unfunded liabilities (refer to Note 5, *Liabilities Not Covered by Budgetary Resources*).

Current and Noncurrent Liabilities: The DLA GF discloses its other liabilities between current and noncurrent liabilities in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*. The current liabilities represent liabilities that DLA GF expects to settle within the 12 months of the Balance Sheets dates. Noncurrent liabilities represent liabilities that DLA GF does not expect to be settled within the 12 months of the Balance Sheets dates.

Accounts Payable: Accounts Payable includes amounts owed but not yet paid to Federal and non-Federal entities for goods and services received by DLA GF. DLA GF estimates and records accruals when services and goods are performed or received (i.e., Mechanization of Contract Administration Services (MOCAS) accrual related to contract financing and Negative Payable Accrual to adjust the timing issues that exist within EBS when an invoice is received and posted without a goods receipt). DLA GF also accrues liabilities incurred at month-end but not yet recorded using data from Third Party Payment Systems, Government Purchase

Cards, various feeder systems, and estimates of costs incurred when goods or services received but not invoiced.

Advances from Others: Advances from Others is cash received in advance of goods or services that have not been fully rendered are reported as Other Liabilities in the Balance Sheets.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses and Undelivered Orders, Note 5, *Liabilities Not Covered by Budgetary Resources,* and Note 6, *Other Liabilities.*)

M. Environmental and Disposal Liabilities

An environmental liability is a probable and reasonably estimable future outflow or expenditure of resources that exists as of the financial reporting date for environmental cleanup costs resulting from past transactions or events.

The DLA GF is responsible for accurate reporting of the EL and expense for the real property and/or equipment that it records and reports in its financial statements as assets, regardless of ownership by any Federal Agency. DLA GF identifies and estimates accrued EL through its annual cost-to-complete (CTC) process. DLA GF accrued EL are comprised of environmental cleanup costs associated with restoration of environmental sites on real property that it does not own but has received appropriated funds to execute and manage. These environmental sites may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, clean closure of assets, and post-closure costs related to the Agency's operations that result in hazardous waste. Due to noted deficiencies, DLA GF is not able to reconcile the population of real property assets that encompass the environmental sites closure and asbestos liabilities.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities and Note 7, *Environmental and Disposal Liabilities.*)

N. Payroll and Annual Leave Accruals

Accrued payroll consists of salaries, wages, and other compensation earned by employees but have not yet been disbursed as of the Balance Sheets dates. DLA GF accrues the cost of unused annual leave, including restored leave, compensatory time, and credit hours as earned and reduces the accrual when leave is taken. The payroll and annual leave accrual liability is accrued based on the latest pay period data for reporting purposes (refer to Note 6, *Other Liabilities*).

O. Other Federal Employment Benefits

The FECA liabilities provide income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the Department of Labor

(DOL), which pays valid claims and subsequently seeks reimbursement from DLA GF for these paid claims. The FECA liability consists of two elements.

The first element, accrued FECA liability, is based on claims paid by DOL but not yet reimbursed by DLA GF. DLA GF reimburses DOL for claims as funds are appropriated for this purpose. In general, there is a one to two-year period between payment by DOL and reimbursement to DOL by DLA GF. As a result, DLA GF recognizes an intragovernmental liability, not covered by budgetary resources, for the claims paid by DOL that will be reimbursed by DLA GF (refer to Note 5, *Liabilities Not Covered by Budgetary Resources*, and Note 6, *Other Liabilities*).

The second element, actuarial FECA liability, is the estimated liability for future payments and is recorded as a liability with the public, not covered by budgetary resources. The actuarial FECA liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. DOL determines the actuarial FECA liability annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value (refer to Note 5, *Liabilities Not Covered by Budgetary Resources*, and Note 8, *Other Federal Employment Benefits*).

P. Pension Benefits

The DLA GF's civilian employees participate in either the Civil Service Retirement System or the Federal Employees Retirement System, based on the effective Federal government start date. The employee pension benefit is managed at the OUSD level. The measurement of the service cost requires the use of an actuarial cost method and assumptions. The Office of Personnel Management administers these benefits and provides the factors that DLA GF applies to calculate and recognize imputed costs, as reported in its Statements of Net Cost, and a corresponding imputed revenue in the Statements of Changes in Net Position.

Q. Net Position

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

Unexpended Appropriations: Unexpended appropriations include the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also include amounts obligated for which legal liabilities for payments have not been incurred. DLA GF unexpended appropriations primarily consist of direct appropriations.

Cumulative Results of Operations: Cumulative results of operations includes the net difference between expenses and losses and financing sources which include revenues and gains, since the inception of the activity.

R. Revenue and Other Financing Sources

Exchange and Non-exchange Revenue: The DLA GF classifies revenues as either exchange revenue or non-exchange revenue. Exchange revenue arises when DLA GF provides goods or services to the public or other Federal entities in exchange for inflows of resources. Exchange revenue is presented on the Statements of Net Cost and serves to offset the costs of these goods and services. DLA GF revenue mainly consists of exchange revenue, which arises when DLA GF provides services to the public or Federal entities. Revenues from services in the O&M appropriation include support for Continuity of Operations; Law Enforcement Support Office; Morale, Welfare and Recreation; and Defense Travel System Support. Revenues from services in the RDT&E appropriation include support for the Next Generation Resource Management System; Mapping EBS; and Defense Information System Security.

Non-exchange revenue is derived from the government's sovereign right to demand payment, such as specifically identifiable, legally enforceable claims. DLA GF non-exchange revenue includes other financing sources (described below). Non-exchange revenue is considered to impact the cost of DLA GF's operations and is reported on the Statements of Changes in Net Position as a financing source.

Other Financing Sources: The DLA GF other financing sources come from unexpended appropriation transfers and non-expenditure transfer-in initiated by OUSD, and recognized as financing sources when used. Other financing sources also include transfers-in/out without reimbursement, and imputed financing with respect to costs subsidized by another Federal entity for employees' life insurance and pension benefits. These financing sources are non-exchange and do not require budgetary resources.

Transfers-in/out without reimbursement: Transfers-in/out without reimbursement include intragovernmental transfers of capitalized assets. The amount of the transfer is the book value of the transferring entity and if the book value is not known, the amount should be the estimated fair value at the date of transfer.

Imputed Financing Sources from Cost Absorbed by Others and Imputed Cost: In certain cases, operating costs of DLA GF are paid in full or in part by funds appropriated to other Federal entities. DLA GF includes applicable imputed costs in the Statements of Net Cost. In addition, Imputed Financing Sources from Cost Absorbed by Others is recognized on the Statements of Changes in Net Position as other financing source (non-exchange revenue). DLA GF recognizes the following imputed costs: (1) employee pension, post-retirement health, and life insurance benefits; and (2) post-employment benefits for separated and inactive employees to include unemployment insurance and workers compensation under the FECA.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivable, Revenue, and Unfilled Customer Orders.)

S. Expenses

Expenses are recognized when there are outflows, usage of assets, or incurrences of liabilities (or a combination) from carrying out activities related to DLA GF appropriations and missions, for which benefits do not extend beyond the present operating period. For financial reporting purposes, operating expenses are recognized in the period incurred.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses, and Undelivered Orders.)

T. Comparative Combined and Combining Statements of Budgetary Resources

During FY2019, changes were made to the presentation of the Combined and Combining Statements of Budgetary Resources in accordance with guidance provided in OMB Circular A-136. The change eliminated the section 'Memorandum Entries' and the related line, 'Net adjusted to unobligated balance brought forward, Oct 1.' As such, the FY2018 presentation conforms to the FY2019 presentation.

Note 2: Fund Balance with Treasury (Unaudited)

Fund Balance with Treasury as of September 30, 2019 and 2018, respectively, consists of the following (dollars in thousands):

	2019	2018
Status of Fund Balance with Treasury		
Unobligated Balance:		
Available	$ 310,568	$ 436,112
Unavailable	120,332	125,743
Obligated Balance not yet Disbursed	990,478	876,566
Total Fund Balance with Treasury	**$ 1,421,378**	**$ 1,438,421**

Status of Fund Balance with Treasury presents the budgetary and proprietary balances that constitute DLA GF FBwT. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations. Unobligated and obligated balances differ from the related amounts reported in the Combined Statements of Budgetary Resources because budgetary balances are supported by amounts other than FBwT (e.g., budgetary receivables).

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

Unobligated Balance – Unavailable includes the cumulative amount of budgetary authority that cannot be used to cover outstanding obligations due to expiration or cancellation of appropriation.

Obligated Balance Not Yet Disbursed includes funds that have been obligated for goods and services not received, and those received but not paid.

Non-budgetary FBwT consists of FBwT in unavailable receipt accounts and clearing accounts that do not have budget authority and non-budgetary FBwT such as non-fiduciary deposit funds. As of September 30, 2019 and 2018, DLA GF does not have a balance for non-budgetary FBwT.

The following tables summarize the undistributed collections and disbursements between U.S. Treasury and DLA GF as of September 30, 2019 and 2018, respectively:

2019 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)			
Transaction Type	**Treasury Balance based on CMR**	**DLA GF Trial Balance**	**Balances Not Yet Recorded in DLA Accounting System - Undistributed**
Collections	$264,565	$260,618	($3,947)
Disbursements	$3,016,409	$3,008,684	($7,725)

2018 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)			
Transaction Type	**Treasury Balance based on CMR**	**DLA GF Trial Balance**	**Balances Not Yet Recorded in DLA Accounting System - Undistributed**
Collections	$296,893	$310,087	$13,194
Disbursements	$3,777,112	$3,767,260	$(9,852)

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Fund Balance with Treasury.)

Note 3: General Property, Plant and Equipment (Unaudited)

General Property, Plant and Equipment as of September 30, 2019 and 2018, respectively, consists of the following (dollars in thousands):

	2019		
	Acquisition Value	**Amortization/ Depreciation**	**Net Book Value**
Major Asset Classes:			
Construction-in-Progress	$ 581,361	$ -	$ 581,361
Internal-Use Software in Development	147,311	-	147,311
Total General Property, Plant, and Equipment	**$ 728,672**	$ -	**$ 728,672**

	2018		
	Acquisition Value	**Amortization/ Depreciation**	**Net Book Value**
Major Asset Classes:			
Construction-in-Progress	$ 479,956	$ -	$ 479,956
Internal-Use Software in Development	131,834	-	131,834
Total General Property, Plant and Equipment	**$ 611,790**	**$ -**	**$ 611,790**

DLA CIP mainly consist of projects from USACE and NAVFAC. As of September 30, 2019, DLA GF continues review the CIP balance reported by the construction agents to DFAS and adjustments are made as applicable by DLA GF and DFAS.

The DLA GF maintains CIP and Internal-Use Software in Development. The accumulated CIP balances will be transferred to other entity or funds upon completion of the project and removed from DLA GF accounting records.

Per OUSD, Real Property Financial Reporting Responsibilities Update, DLA GF will transfer all real property assets to the installation host in FY2020. Due to the transfer, DLA GF will no longer report buildings, structures, and facilities as part of General PP&E. The installation host is the military department on whose installation a real property asset is located.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to General Property, Plant, and Equipment.)

Note 4: Other Assets (Unaudited)

Other Assets as of September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019	2018
Non-Federal Other Assets		
Advances and Prepayments	$ 1	$ -
Other Assets	87	88
Total Non-Federal Other Assets	**88**	**88**
Total Other Assets	**$ 88**	**$ 88**

Note 5: Liabilities Not Covered by Budgetary Resources (Unaudited)

Liabilities not Covered by Budgetary Resources as of September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019	2018
Intragovernmental Liabilities		
Other	$ 1,468	$ 1,823
Total Intragovernmental Liabilities	**1,468**	**1,823**
Non-Federal Liabilities		
Accounts Payable	5,941	9,105
Other Federal Employment Benefits	3,123	3,846
Environmental and Disposal Liabilities	73,122	79,615
Other	5,318	4,921
Total Non-Federal Liabilities	**87,504**	**97,487**
Total Liabilities Not Covered by Budgetary Resources	**88,972**	**99,310**
Total Liabilities Covered by Budgetary Resources	**78,488**	**81,339**
Total Liabilities	**$ 167,460**	**$ 180,649**

Other Intragovernmental Liabilities are comprised of the current year FECA accrual liability based on DOL records.

Accounts Payable include amounts owed but not yet paid to non-Federal entities for goods and services received by DLA GF.

Other Federal Employment Benefits are comprised of the current year FECA actuarial liability based on DOL records.

Environmental and Disposal Liabilities consist of probable and reasonably estimable future outflow or expenditure of resources that exist as of the financial reporting date for environmental cleanup costs resulting from past transactions or events.

Other Non-Federal Liabilities consist of unfunded annual leave earned by civilian employees but not yet paid.

As of September 30, 2019 and 2018, Total Liabilities Covered by Budgetary Resources include $8,047 thousand and $8,655 thousand, respectively, of Environmental and Disposal Liabilities. For additional details and disclosures refer to Note 6, *Other Liabilities*; Note 7, *Environmental and Disposal Liabilities*; and Note 8, *Other Federal Employment Benefits*.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses, and Undelivered Orders.)

Note 6: Other Liabilities (Unaudited)

Other Liabilities as of September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019		
	Current	Non-Current	Total
Intragovernmental			
FECA Reimbursement to DOL	$ 76	$ 319	$ 395
Employer Contribution and Payroll Taxes Payable	481	-	481
Other Liabilities	1,073	-	1,073
Total Intragovernmental Other Liabilities	**1,630**	**319**	**1,949**
Non-Federal			
Accrued Funded Payroll and Benefits	1,923	-	1,923
Advances from Others	-	1,680	1,680
Accrued Unfunded Annual Leave	5,318	-	5,318
Contract Holdbacks	675	32	707
Employer Contribution and Payroll Taxes Payable	516	-	516
Total Non-Federal Other Liabilities	**8,432**	**1,712**	**10,144**
Total Other Liabilities	**$ 10,062**	**$ 2,031**	**$ 12,093**

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

FECA Reimbursement to DOL include the accrued FECA liability paid by DOL but not yet reimbursed by DLA GF.

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

Intragovernmental Other Liabilities primarily consists of unemployment compensation liabilities.

Accrued Funded Payroll and Benefits consisting salaries, wages, and other compensation earned by employees but not yet disbursed.

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

Accrued Unfunded Annual Leave includes restored leave, compensatory time, and credit hours as earned.

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

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses and Undelivered Orders.)

Note 7: Environmental and Disposal Liabilities (Unaudited)

Environmental and Disposal Liabilities as of September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019	2018
Environmental and Disposal Liabilities		
Accrued Environmental Restoration Liabilities:		
Active Installations—Installation Restoration Program and Building Demolition and Debris Removal	$ 81,169	$ 88,270
Total Environmental and Disposal Liabilities	**$ 81,169**	**$ 88,270**

The DLA GF EL are comprised of two primary elements: (1) existing obligations supporting the Defense Environmental Restoration Account (DERA) and BRAC funded environmental restoration programs, and (2) anticipated future cost necessary to complete environmental restoration sites.

In FY2019 DLA GF utilized the Remedial Action Cost Engineering & Requirements (RACER) software to generate the FY2020 CTC estimates of anticipated future costs. Cost estimates were generated for 74 Accrued Environmental Restoration Liabilities Active Installations – Installation Restoration Program (IRP) EL sites. While DLA GF is responsible for recording BRAC Installations – IRP EL, it is reported in the DoD Component Level Statements under Consolidated ODO GFs.

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

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

DLA GF reportable EL is under Accrued Environmental Restoration Liabilities and BRAC Installations and includes the following line items:

- *Active Installations:* IRP EL associated with remedial actions eligible for funding under the DERP. These Remedial Actions may address hazardous substances, pollutants, and contaminants as defined in The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA); hazardous waste or hazardous constituents addressed under the Resource Conservation and Recovery Act (RCRA) corrective action process or other Federal or state statutes and regulations; and military munitions or Waste Military Munitions (WMM), chemical residues from military munitions, and munitions scrap at locations other than operational ranges associated with an active installation, when the environmental restoration activity is incidental to the IRP environmental restoration activity.
- *BRAC Installations:* IRP EL associated with the costs to address environmental cleanup at bases that are realigning or closing resulting from past activities which are part of DERP. While DLA GF is responsible for recording BRAC Installations – IRP EL, it is reported in the DoD Component Level Statements under Consolidated ODO GFs.
- *Non-Nuclear Powered General Equipment:* EL resulting from the disposal of non-nuclear powered general equipment. DLA assessed its General Equipment asset inventory and does not have reportable EL for Non-Nuclear Powered General Equipment.

Applicable Laws and Regulations for Cleanup Requirements: The DLA GF is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other prior activities, which may have created a public health or environmental risk. DLA GF is required to comply with the following laws and regulations where applicable: CERCLA; the Superfund Amendments and Reauthorization Act (SARA); the Resource Conservation and RCRA; and other applicable Federal, State, and local laws and regulations. Required cleanup may at times extend beyond Installation boundaries onto privately owned property or onto sites where DLA GF is named as a potentially responsible party by a regulatory Agency. DLA GF is required to report in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government* and Federal Financial Accounting and Auditing Technical Release No. 2, *Determining Probable and Reasonable Estimable for Environmental Liabilities in the Federal Government*.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating: The DLA GF uses the RACER software, an independently validated software application, to estimate future environmental costs. The RACER Steering Committee ensures that the software is Validated, Verified, and Accredited (VV&A) in accordance with DoD Instruction 5000.61. The DoD is working with the RACER Steering Committee and stakeholders to identify improvements to RACER functionality, auditability, and documentation. Additionally, DLA GF utilizes historical contract or proposal costs to estimate future EL. Any historical costs used in the creation of the estimates for DLA ELs are adjusted for inflation and reported in current year dollars. Detailed information on the estimating methodologies are provided in the DLA SOPs.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, or Applicable Laws and Regulations: The DLA GF EL estimates are reevaluated annually through updates to site inventories and projected requirements. In addition, DLA GF conducts an annual Roll Forward review to ensure estimates are accurate as of the financial reporting date. As of the reporting date, there were no material changes in total estimated cleanup costs due to changes in laws, technology or plans. In addition, DLA GF is not aware of any changes to estimates that would result from inflation, deflation, technology, plans, and/or pending changes to applicable laws and regulations. EL estimates may change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

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

The stated total liability includes prior year obligations and the estimate of future costs necessary to complete the requirements. DLA GF has instituted extensive controls to ensure that these estimates are accurate and reproducible. Due to the inherent uncertainty involved with environmental contamination and associated remedial actions, DLA GF uses RACER, as a parametric cost estimating tool to create a preliminary order of magnitude estimates. When available, site-specific historical contract or proposal costs are used to create site-level estimates.

The DLA GF conducted the CTC annual Roll Forward process in accordance with DLA GF EL CTC SOP, the DoD 7000.14-R FMR Volume 4, Chapter 13 – Environmental and Disposal Liabilities (April 2018) and the OUSD memorandum for Strategy for Environmental & Disposal Liabilities Audit Readiness (September 30, 2015). Based on the results of the annual Roll Forward process, it was determined that no material changes to DLA GF EL occurred between approval of the original EL estimates approval and the financial reporting date of September 30, 2019.

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

Environmental Commitments and Contingencies: The accrued and reasonably possible environmental contingent liabilities as of September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019		
	Accrued Liabilities	Estimated Range of Loss Lower End	Upper End
Environmental Contingencies			
Probable	$ 81,169	$ -	$ -
Reasonably Possible		$ -	$ -

	2018		
	Accrued Liabilities	Estimated Range of Loss Lower End	Upper End
Environmental Contingencies			
Probable	$ 88,270	$ -	$ -
Reasonably Possible		$ -	$ -

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities and Commitments and Contingencies.)

Note 8. Other Federal Employment Benefits (Unaudited)

Other Federal Employment Benefits as of September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	$ 3,123	$ -	$ 3,123
Total Other Federal Employment Benefits	**$ 3,123**	$ -	**$ 3,123**

	2018		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	$ 3,846	$ -	$ 3,846
Total Other Federal Employment Benefits	**$ 3,846**	$ -	**$ 3,846**

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

Actuarial Cost Method and Assumptions: DOL selected the COLA factors, consumer price index medical (CPIM) factors, and discount rate by averaging the COLA rates, CPIM rates, and interest rates for the current and prior four years for FY2019 and FY2018, respectively. Using averaging renders estimates that reflect historical trends over five years. DOL selected the interest rate assumptions whereby projected annual payments were discounted to present value based on interest rate assumptions on the U.S. Department of the Treasury's Yield Curve for Treasury Nominal Coupon (TNC) Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. Discount rates were based on averaging the TNC Yield Curves for the current and prior four years for FY2019 and FY2018, respectively.

Interest rate assumptions utilized for FY2019 discounting were as follows:

Year 1: 2.6% and thereafter (wage benefits)
Year 1: 2.4% and thereafter (medical benefits)

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (COLAs) and medical inflation factors (CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2019 were also used to adjust the methodology's historical payments to current year constant dollars. The compensation COLAs and CPIMs used in the projections for various CBY were as follows:

CBY	COLA	CPIM
2020	1.5%	2.9%
2021	1.9%	3.1%
2022	2.1%	3.1%
2023	2.2%	3.5%
2024	2.2%	3.9%

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

Note 9: Inter-Entity Cost (Unaudited)

Goods and services are received from other Federal entities at no cost or at a cost less than the full cost to the providing Federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by DLA GF are recognized as imputed cost in the Statements of Net Cost, and are offset by imputed revenue in the Statements of Changes in Net Position. Such imputed costs and revenues relate to employee benefits and claims. In accordance with SFFAS 55, *Amending Inter-Entity Costs Provisions*, unreimbursed costs of goods and services other than those identified above are not included in DLA GF financial statements.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Inter-Entity Cost.)

Note 10: Undelivered Orders (Unaudited)

Undelivered Orders for the years ended September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019	2018
Intragovernmental		
Unpaid	$ 597,403	$ 291,668
Total Intragovernmental	**597,403**	**291,668**
Non-Federal		
Unpaid	374,204	571,206
Prepaid/Advanced	1	-
Total Non-Federal	**374,205**	**571,206**
Total Undelivered Orders	**$ 971,608**	**$ 862,874**

UDOs represent the amount of goods and/or services ordered to perform DLA GF's mission objectives that have not been received. Unpaid UDOs represent obligations for goods and services that have not been received or paid. Whereas, paid UDOs represent obligations for goods and services that have been paid for in advance of receipt. For the years ended September 30, 2019, and 2018, respectively, DLA GF does not have balances for paid intragovernmental and non-Federal UDOs.

Due to system limitations, DLA GF estimates the allocation of intragovernmental and non-Federal UDOs based on funded liabilities excluding payroll and employee benefit liabilities.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses, and Undelivered Orders and Intragovernmental/Intra-departmental and Non-Federal Transactions.)

Note 11: Reconciliation of Net Cost to Net Outlays (Unaudited)

Reconciliation of Net Cost to Net Outlays as of September 30, 2019 consist of the following (dollars in thousands):

2019	Intra-governmental	Non-Federal	Total
NET COST	**$ 151,595**	**$ 550,349**	**$ 701,944**
Components of Net Cost That are Not Part of Net Outlays			
Offset to Capitalized Assets	-	274,875	274,875
Net Losses	-	(118,250)	(118,250)
Increase in Assets:			
Account Receivable	1,551	1	1,552
(Increase)/Decrease in Liabilities:			
Accounts Payable	(15,513)	22,884	7,371
Salaries and Benefits	(67)	(417)	(484)
Environmental and Disposal Liabilities	-	7,101	7,101
Other Liabilities	355	(1,155)	(800)
Other Financing Sources:			
Imputed Financing	(3,390)	-	(3,390)
Total Components of Net Cost That are Not Part of Net Outlays	**(17,064)**	**185,039**	**167,975**
Components of Net Outlays That are Not Part of Net Costs			
Acquisition of Capital Assets	-	7,593	7,593
Total Components of Net Outlays That are Not Part of Net Costs	**-**	**7,593**	**7,593**
NET OUTLAYS	**$ 134,531**	**$ 742,981**	**877,512**
Outlays, Net, Statement of Budgetary Resources			**877,512**
Reconciling Difference			**$ (0)**

The Net Cost to Net Outlays Reconciliation schedule is intended to facilitate reporting of the Federal deficit reconciliation to the President's Budget within the Consolidated Financial Report of the United States Government. This requirement is effective for the FY2019 Financial Statements and comparative presentation is not required in the initial year of implementation.

The Net Cost to Net Outlays Reconciliation schedule reconciles the Net Cost (reported in the Statements of Net Cost) to the Net Outlays (reported in the Statement of Budgetary Resources). The reconciliation clarifies the relationship between budgetary and proprietary accounting information. Examples of the reconciling items identified are: 1) Transactions which did not result in an outlay but did result in a cost; and 2) Unpaid expenses included in the net cost in this reporting period but not yet included in outlays. Components of net cost that are not part of net outlays are most commonly (a) the result of allocating assets to expenses over more than one reporting period (e.g., depreciation) and the write-down of assets (due to revaluations); (b) the temporary timing differences between outlays/receipts and the operating expense/revenue during the period; and (c) costs financed by other entities (imputed inter-entity costs).

For FY2019, net losses primarily represent an adjustment to CIP. Any reconciling difference would be attributable to limitations of financial and nonfinancial management processes and systems that support the financial statements, as disclosed in Note 1.B., *Basis of Presentation and Accounting*. In addition, DLA GF does not have an established policy to identify and reconcile net costs to net outlays and/or identify components of net cost or net outlays that have not been properly accounted for. As such, DLA GF will continue to investigate and resolve the causes of any reconciling differences as SFFAS 53, *Budget and Accrual Reconciliation*, continues to be implemented.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Reconciliation of Net Cost to Net Outlays)

Required Supplementary Stewardship Information

Research and Development

The DLA GF provides funding for various RDT&E programs. The Subsistence Network and Battery Network sub-programs incur expenses to support the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits

The Subsistence Network supports R&D projects that promote manufacturing and logistics improvements in the subsistence supply chain through advanced and emerging technologies. The program's accomplishments include:

- Determining measures to ensure milk quality and shelf life consistency for the Military Services;
- Researching the future of the subsistence prime vendor through the lens of emerging technology and improved in-transit visibility;
- Demonstrating the capability to use visualization and modeling and simulation of operational rations in the supply chain, and;
- Development of a MRE optimization and inspection modules for better MRE packaging performance.

The Battery Network was recognized for the FY2018 DoD ManTech Achievement Award for Supply Chain Improvement work on a Lithium-Ion Replacement for the tube-launched, optically-tracked, wireless-guided (TOW2) Missile Guidance System (MGS) Nickel Cadmium battery.

In collaboration with the U.S. Army Close Combat Weapon Systems Project Office, R&D developed and demonstrated a li-ion integrated power system to replace a suite of legacy equipment for the TOW2 MGS. This replacement mitigates obsolescence risk with a charging system that is no longer procurable and a diminishing nickel-cadmium material supply chain. Additionally, the new system significantly reduces weight and procurement costs and increases operational capability.

Other FY2019 significant achievements include the development of domestic lithium-ion cells optimized for soldier conformal (flexible) wearable batteries, to provide a 55% energy density increase (performs longer) at a 20% lower cost to manufacture. Another project is using novel ultraviolet curing (UV) technology for military batteries, which will reduce battery production costs for a variety of platforms.

R&D Costs (dollars in thousands):

	2019	2018
Subsistence Network	$ 719	$ 860
Battery Network	1,580	892
	$ 2,299	$ 1,752

Required Supplementary Information

Combining Statements of Budgetary Resources

The Combining Statements of Budgetary Resources combines the availability, status, and outlays of DLA GF budgetary resources. The below tables provide the Combining Statements of Budgetary Resources disaggregated by DLA GF programs for the years ended September 30, 2019 and 2018. As the Combining Statements of Budgetary Resources are prepared at appropriation level DLA GF presented the programs by appropriation. However, for reporting purposes, due to the materiality and size of Family Housing, DLA GF combined the Family Housing Program with MILCON in its Statements of Net Cost for presentation purposes.

Defense Logistics Agency - General Fund
Combining Statements of Budgetary Resources
For the Year Ended September 30, 2019
(dollars in thousands)

	Operations and Maintenance	Procurement	Research, Development, Test & Evaluation	Family Housing	Military Construction	2019 Total
BUDGETARY RESOURCES						
Unobligated Balance From Prior Year Budget Authority, Net	$ 91,759	$ 1,249	$ 56,140	$ 813	$ 416,750	$ 566,711
Appropriations	375,950	6,589	337,267	1,709	189,071	910,586
Spending Authority From Offsetting Collections	27,569	-	38,928	-	-	66,497
TOTAL BUDGETARY RESOURCES	**$ 495,278**	**$ 7,838**	**$ 432,335**	**$ 2,522**	**$ 605,821**	**$ 1,543,794**
STATUS OF BUDGETARY RESOURCES						
New Obligations and Upward Adjustments	$ 393,574	$ 1,958	$ 372,152	$ 1,687	$ 343,523	$ 1,112,894
Unobligated Balance, End of Year:						
Apportioned, Unexpired Accounts	14,525	4,880	50,349	22	240,792	310,568
Unxpired Unobligated Balance, End of Year	14,525	4,880	50,349	22	240,792	310,568
Expired Unobligated Balance	87,179	1,000	9,834	813	21,506	120,332
Total Unobligated Balance, End of Year	101,704	5,880	60,183	835	262,298	430,900
TOTAL BUDGETARY RESOURCES	**$ 495,278**	**$ 7,838**	**$ 432,335**	**$ 2,522**	**$ 605,821**	**$ 1,543,794**
OUTLAYS, NET						
Outlays, Net	$ 340,143	$ 5,190	$ 288,357	$ 529	$ 243,293	$ 877,512
AGENCY OUTLAYS, NET	**$ 340,143**	**$ 5,190**	**$ 288,357**	**$ 529**	**$ 243,293**	**$ 877,512**

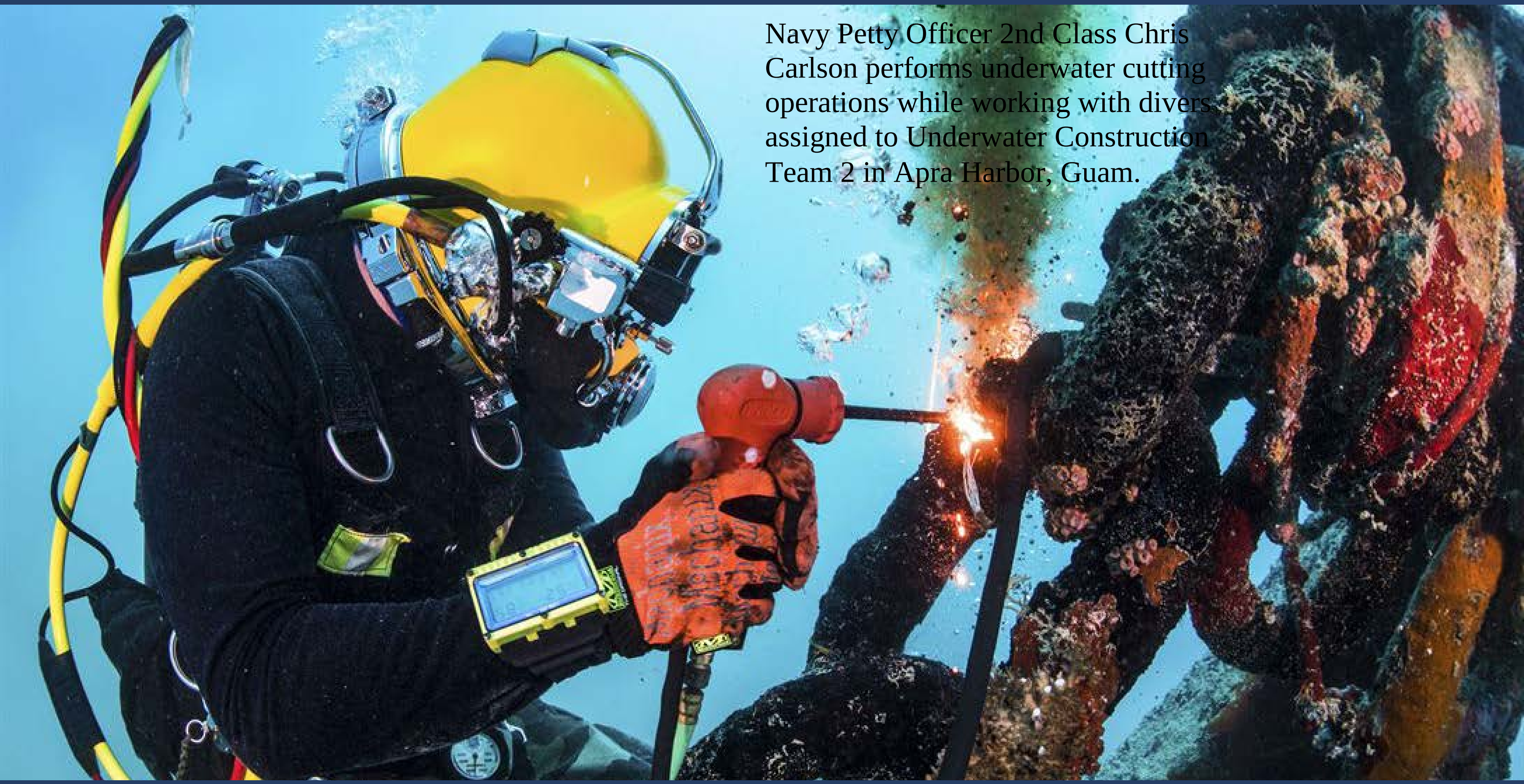
Defense Logistics Agency - General Fund
Combining Statements of Budgetary Resources
For the Year Ended September 30, 2018
(dollars in thousands)

	Operations and Maintenance	Procurement	Research, Development, Test & Evaluation	Family Housing	Military Construction	2018 Total
BUDGETARY RESOURCES						
Unobligated Balance From Prior Year Budget Authority, Net	$ 107,003	$ 10,446	$ 55,215	$ 1,102	$ 301,131	$ 474,897
Appropriations	390,985	2,951	355,779	992	303,683	1,054,390
Spending Authority From Offsetting Collections	20,501	-	39,276	-	-	59,777
TOTAL BUDGETARY RESOURCES	**$ 518,489**	**$ 13,397**	**$ 450,270**	**$ 2,094**	**$ 604,814**	**$ 1,589,064**
STATUS OF BUDGETARY RESOURCES						
New Obligations and Upward Adjustments	$ 415,828	$ 10,931	$ 408,257	$ 1,100	$ 191,093	$ 1,027,209
Unobligated Balance, End of Year:						
Apportioned, Unexpired Accounts	3,935	259	35,303	-	396,615	436,112
Unxpired Unobligated Balance, End of Year	3,935	259	35,303	-	396,615	436,112
Expired Unobligated Balance	98,726	2,207	6,710	994	17,106	125,743
Total Unobligated Balance, End of Year	102,661	2,466	42,013	994	413,721	561,855
TOTAL BUDGETARY RESOURCES	**$ 518,489**	**$ 13,397**	**$ 450,270**	**$ 2,094**	**$ 604,814**	**$ 1,589,064**
OUTLAYS, NET						
Outlays, Net	$ 335,460	$ 8,394	$ 275,450	$ 318	$ 282,281	$ 901,903
AGENCY OUTLAYS, NET	**$ 335,460**	**$ 8,394**	**$ 275,450**	**$ 318**	**$ 282,281**	**$ 901,903**

Other Information (Unaudited)

3

SECTION 3 – OTHER INFORMATION (UNAUDITED)



Navy Petty Officer 2nd Class Chris Carlson performs underwater cutting operations while working with divers assigned to Underwater Construction Team 2 in Apra Harbor, Guam.

IN THIS SECTION

Other Information (Unaudited)

Management Challenges

Summary of Financial Statement Audit and Management Assurances

Payment Integrity

Fraud Reduction Report

Management Challenges

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

August 1, 2019

MEMORANDUM FOR LTG DARRELL K. WILLIAMS, DIRECTOR, DLA

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

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

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

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

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

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

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

f. Ability to address IPA audit findings. While improvements have been noted in the last few months, overall DLA needs to move towards developing a robust organizational approach to address findings from the independent public accounting firm (EY) in a manner that covers inception to conclusion.

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

WILLIAM A. RIGBY
Inspector General

Summary of Financial Statement Audit and Management Assurances

The audit reports on the FY2019 and FY2018 DLA GF financial statements identified 7 and 7 material weaknesses respectively for the DLA GF. Table 1 below provides a summary of the financial statement audit results for FY2019 and FY2018. Although the material weaknesses overall are not resolved, DLA is continuing to develop CAPs to resolve specific findings associated with the material weaknesses.

Table 1: FY2019 Summary of the Financial Statement Audit					
Audit Opinion	Disclaimer				
Restatement	No				
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Property Plant, & Equipment	1	-	-	-	1
Fund Balance with Treasury	1	-	-	-	1
Accounts Receivable and Revenue	1	-	-	-	1
Accounts Payable and Expenses	1	-	-	-	1
Financial Reporting	1	-	-	-	1
Oversight and Monitoring	1	-	-	-	1
Information Systems	1	-	-	-	1
Total Material Weaknesses	**7**	**-**	**-**	**-**	**7**

The DLA management's SOA package for compliance with FMFIA follows the structure of the FY2018 financial statement audit NFRs for documenting the individual material weaknesses associated with ICORs and compliance with FFMSRs. DLA management's enterprise-wide FY2019 SOA package included a total of 233 ICOR material weaknesses and 78 material weaknesses related to non-conformance with Federal financial system requirements. The DLA enterprise-wide 233 ICOR material weaknesses and 78 instances of non-conformance with Federal financial system requirements were consolidated based on assessable unit into seven ICOR material weaknesses and four instances of non-conformance with FFMSR (i.e., one Information Systems material weakness) for DLA AFR presentation purposes. In FY2019, Contingency Planning was removed from the Federal financial management system non-conformances as internal control deficiencies associated with Contingency Planning were incorrectly disclosed in FY2018 and none were identified in FY2019. In addition, DLA management identified three ICO material weaknesses and downgraded one ICO material weakness to a significant deficiency in FY2019. The downgraded ICO material weakness over Procurement was related to a sole source provider for critical materials, and DLA was able to procure an additional supplier.

Table 2 below summarizes the FMFIA material weaknesses associated with all funds based on DLA management's FY2019 SOA packages.

Table 2: Summary of Management Assurances						
Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consol.	Reassessed	Ending Balance
Financial Reporting - Unresolved variances for key reconciliations	1	-	-	1	-	-
Financial Reporting - Period-end close review process requires improvement	1	-	-	1	-	-
Financial Reporting - Timely compilation of AFR and components	1	-	-	1	-	-
Financial Reporting - The budgetary to proprietary reconciliations for DLA GF are not performed on a timely basis and include cumulative differences with incomplete or unsupported explanations	1	-	-	1	-	-
Financial Reporting - The Eliminations issue was identified while performing period-end close procedures	1	-	-	1	-	-
Financial Reporting - Inadequate review of completeness and accuracy of system generated reports and data used in the execution of internal controls in the financial reporting process	1	-	-	1	-	-
Financial Reporting - Lack of sufficient review and monitoring of DFAS Systems and Organization Control (SOC) 1 report related to Financial Reporting	1	-	-	1	-	-
Financial Reporting - Insufficient documentation for calculation and posting of allowance for doubtful accounts	1	-	-	1	-	-

Table 2: Summary of Management Assurances						
Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	**No Assurance**					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consol.**	**Reassessed**	**Ending Balance**
Plan-to-Stock - Inventory reconciliation framework design and implementation	1	-	-	1	-	-
Acquire-to-Retire - Lack of Management Review for controls related to PP&E	1	-	-	1	-	-
Acquire-to-Retire - Lack of documentation of real property quantity	1	-	-	1	-	-
Acquire-to-Retire - Lack of evidence to support the rights assertion over real property assets	1	-	-	1	-	-
Acquire-to-Retire - Inconsistent policy for grouping real property and general equipment assets	1	-	-	1	-	-
Acquire-to-Retire - Lack of reconciliation between real property asset listing and the amounts recorded in the financial statements footnotes	1	-	-	1	-	-
Acquire-to-Retire - Inability to provide a listing of additions and deletions for real property or general equipment	1	-	-	1	-	-
FBwT - Lack of complete and accurate Department 97 Report Reconciliation Tool (DRRT) policies and procedures	1	-	-	1	-	-
FBwT - Inability to reconcile FBwT	1	-	-	1	-	-

Table 2: Summary of Management Assurances						
Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consol.	Reassessed	Ending Balance
Procure to Pay - Lack of segregation of duties in the GPC process	1	-	-	1	-	-
Acquire-to-Retire: Property, Plant and Equipment	-	1	-	-	-	1
Oversight and Monitoring	-	1	-	-	-	1
Financial Reporting	-	1	-	-	-	1
Fund Balance with Treasury	-	1	-	-	-	1
Plan-to-Stock: Inventory	-	1	-	-	-	1
Order-to-Cash: Accounts Receivable and Revenue	-	1	-	-	-	1
Procure-to-Pay: Accounts Payable and Expenses	-	1	-	-	-	1
Total Material Weaknesses	**18**	**7**	**-**	**18**	**-**	**7**

Table 2: Summary of Management Assurances						
Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consol.	Reassessed	Ending Balance
Supply Operations: Lack of policy and procedures in place over the management and oversight of First Article Test Exhibits	1	-	-	-	-	1
Procurement: Reliance on a sole source supplier for certain items within the Medical Supply Chain critical for war readiness	1	-	-	-	1	-
Contract Administration: Non-verification of supplier invoices	1	-	-	-	-	1
Business Process Controls: Lack of procedures over the scrap management program	-	1	-	-	-	1
Total Material Weaknesses	**3**	**1**	**-**	**-**	**1**	**3**

Table 2: Summary of Management Assurances						
Compliance with Federal Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	**Federal Systems do not conform to financial management system requirements**					
Non-Conformances	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Security Management	1	-	-	-	-	1
Access Controls	1	-	-	-	-	1
Segregation of Duties	1	-	-	-	-	1
Contingency Planning	1	-	-	-	1	-
Configuration Management	-	1	-	-	-	1
Total Non-Conformances	**4**	**1**	**-**	-	1	**4**

Based on DLA management's analysis of relevant FFMIA compliance indicators available at the time of this report, DLA identified a lack of compliance associated with all three FFMIA Section 803(a) requirements across all funds summarized in the table below.

Table 2: Summary of Management Assurances		
Compliance with Section 803(a) of the FFMIA		
	Agency	**Auditor**
1. Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
2. Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
3. USSGL at the Transaction Level	Lack of compliance noted	Lack of compliance noted

Payment Integrity

The Improper Payments Information Act of 2002 (IPIA) (Pub. L. 107-300), as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) (Pub. L. 111-204) and IPERIA; (Pub. L. 112-248), requires Agencies to review and assess all programs and activities they administer and identify those determined to be susceptible to significant improper payments (IPs), estimate the annual amount of IPs, and submit those estimates to Congress. In accordance with DoD 7000.14-R FMR, Volume 4, Chapter 14, *Improper Payments*, DoD components that entitle (i.e. process or compute) payments conduct risk assessments of their payment processes and random post-payment reviews to estimate IPs.

The OUSD(C) Accounting & Finance Policy Directorate (A&FP) compiles the Department-wide results annually as part of DoD's AFR. As DLA's Service Provider, DFAS entitles payments and provides the results of post-payment reviews to OUSD(C) A&FP on behalf of its customers. IPIA defines an IP as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes duplicate payments, any payment made to an ineligible recipient, any payment for an ineligible good or service, any payment for a good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts.

In accordance with the IPIA, as amended (31 U.S.C. 3321 note), and Appendix B of the OMB Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, dated August 27, 2019, DoD reports payment integrity information (i.e., IPs) at the Agency-wide level in the consolidated DoD AFR. For detailed reporting on DoD payment integrity, refer to the OI section of the consolidated DoD AFR at: https://comptroller.defense.gov/0DCFO/afr2019.aspx

Fraud Reduction Report

On June 30, 2016, Congress enacted the FRDAA. The FRDAA requires Agencies to conduct an evaluation of fraud risks; use a risk-based approach to design and implement financial and administrative control activities to mitigate identified fraud risks; collect and analyze data from reporting mechanisms on detected fraud to monitor fraud trends and continuously improve fraud detection through the use of data analytics; and use the results of monitoring, evaluation, audits, and investigations to improve fraud prevention, detection, and response. Fraud risk is a principle of risk assessment, which is one of the five components of entity level internal controls in accordance with the Green Book and OMB Circular No. A-123.

OMB Circular A-123 requires DLA to establish financial and administrative controls, through the Agency risk profile that address identified fraud risks around payroll, beneficiary payments, grants, large contracts, IT and security, asset safeguards, purchase, travel and fleet cards as well as collect and analyze data to help detect and monitor fraud. The ERM Project Management Office conducted enterprise-wide training on risk assessments that emphasized the minimum requirements for fraud. DLA identified five risk categories (Financial, Regulatory and Compliance, Operational, Fraud, and Cyber) that facilitated the identification, measurement, and reporting of risks as well as the development of DLA's risk profile. In the Fraud Risk category, DLA reported a total of 24 fraud risk events. DLA's overall risk ranking for the Fraud Risk category included the following:

Risk Category	Low Risk Events	Medium Risk Events	High Risk Events	Total Risk Events
Fraud Risk	13	8	3	**24**

The DLA used the ten DoD fraud risk sub-categories (Payroll, Beneficiary Payments, Grants, Large Contracts, IT and Security, Asset Safeguards, Purchase, Travel, Fleet Cards, and Commissary) to facilitate fraud risk identification in susceptible areas in accordance with the FRDAA of 2015. DLA was able to align to nine of the ten sub-categories and identified "Other" fraud risk categories related to DLA business processes. DLA's overall fraud risk rankings and risk mitigation status are as follows:

Fraud Risk Sub-Category	Risk Description	Overall Risk Ranking
Purchase	GPC: Access and analyze GPC cardholders for illegal or improper purchases	HIGH

Fraud Risk Sub-Category	Risk Description	Overall Risk Ranking
Others	Fraud, Waste, Abuse, and Contract Failure: Assess and analyze fraud, waste, abuse, or mismanagement	HIGH
Others	Counterfeit Parts: Assess and analyze risk to reduce the frequency and impact of counterfeit material within DoD acquisition systems and DoD life-cycle sustainment processes	HIGH
Large Contracts	Fair and Reasonable Pricing: Overpricing: Assess and analyze suspected overpricing. This encompasses inflated prices charged by the vendor for services or supplies rendered Bid Rigging: Assess and analyze bid rigging. This encompasses collusive price-fixing behavior in which competitors coordinate their bids on procurement contracts to guarantee the selection of a particular vendor	MEDIUM
Assets Safeguards	Unintentional Release of Controlled Property	MEDIUM
Assets Safeguards	Hazardous Material	MEDIUM
Assets Safeguards	LESO/1033 Program	MEDIUM
Others	Completeness of Inventory/Property Balance: Risk of fraud, waste, or abuse exists when Distribution Worker can generate and approve or certify shipments	MEDIUM
Others	Knowledgeable employees do not report known or suspected fraud, waste or abuse to the Office of the Inspector General (OIG) Hotline Program	MEDIUM
Others	Potential fraud resulting from noncompliance with the standards of conduct and the Agency ethics program	MEDIUM
IT and Security	Segregation of Duties: If the system has not documented specific Segregation of Duties policies and procedures, then there is a risk that staff and users will be unaware of guidance for ensuring proper Segregation of Duties in the system	MEDIUM

Fraud Risk Sub-Category	Risk Description	Overall Risk Ranking
Payroll	Fictitious payroll payments to ghost employees and continued payments to separated employees due to administrative errors	LOW
Payroll	Unauthorized payroll adjustments	LOW
Travel	Employees creating fictitious employees and travel vouchers for payment	LOW
Travel	Employees accessing the travel database and stealing social security numbers to open fraudulent bank accounts and deposit unauthorized travel reimbursements	LOW
Beneficiary Payments	Payments made for deceased and/or fictitious beneficiaries and false documentation submission to prolong disability payments	LOW
Fleet Cards	Lack of or insufficient controls to monitor the utilization of fleet cards may lead to risk of employee's misuse of the fleet card to purchase fuel for personal usage	LOW
Fleet Cards	Unauthorized use of GSA fleet cards used to purchase fuel for DLA's GSA-leased vehicles could incur unnecessary costs	LOW
Assets Safeguards	Improper Handling of Controlled Material: There is a risk of losing accountability of classified or Arms, Ammunition & Explosives shipments caused by not confirming drivers' clearance	LOW
Assets Safeguards	Improper Handling of Controlled Material: Not properly safeguarding Classified material at time of receipt	LOW
Assets Safeguards	Improper Handling of Controlled Material: Failure to take the proper precautions when transporting classified material	LOW

Fraud Risk Sub-Category	Risk Description	Overall Risk Ranking
Assets Safeguards	Improper Handling of Controlled Material: Failure to check door seals and taking proper action when seals are broken or missing	LOW
Assets Safeguards	Receipt and Acceptance: Inventory receipt and acceptance could be subject to a misstatement of actual inventory quantities received versus actual inventory quantities recorded at vendor managed storage facilities	LOW
Grants	Cooperative agreement award recipients will use award funding for expenses that are not in the scope of the agreement	LOW

The DLA is in the process of implementing financial and administrative controls to mitigate the above fraud risks. DLA appointed a Chief Risk Officer and is in process of developing and implementing an ERM and Internal Control program to address the full spectrum of DLA's risk portfolio and key internal controls across all organizational and business aspects. Once fully established, DLA will be able to modernize and integrate risk management and internal control activities into an ERM framework resulting in improved mission delivery, reduced costs, and corrective actions focused toward key risks. Furthermore, DLA developed corrective actions to address the shortfalls in the OMB Circular A-123 Program, and senior leaders at all levels of the organization are committed to incremental improvements to establishing a risk based control environment. Additionally, DLA outsourced, developed, and implemented OMB Circular A-123 training and specialized workshops for senior executives, assessable unit managers, process cycle integrators and process health organizations to ensure the workforce possesses the requisite skills to develop, implement, and sustain a robust system of risk and internal controls throughout the Agency.

THIS PAGE INTENTIONALLY LEFT BLANK

Appendix A: Summary of FMFIA Definitions and Reporting

Category	Definition	Reporting
Control Deficiency	**a.** Exists when the design, implementation, or operation of a control does not allow management or personnel, in the normal course of performing their assigned functions, to achieve control objectives and address related risks. **b. Deficiency in Design**: A deficiency in design exists when (1) a control necessary to meet a control objective is missing (2) an existing control is not properly designed so that even if the control operates as designed, the control objective would not be met. **c. Deficiency in Implementation**: A deficiency in implementation exists when a properly designed control is not implemented correctly in the internal control system. **d. Deficiency in Operation:** A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.	Internal to the organization and not reported externally. Progress against CAPs must be periodically assessed and reported to Agency management.
Significant Deficiency	A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet is important enough to merit attention by those charged with governance.	Internal to the organization and not reported externally. Progress against CAPs must be periodically assessed and reported to Agency management.
Material Weakness	**a.** A material weakness is a significant deficiency that the Agency Head or Director determines to be significant enough to report outside of the Agency as a material weakness. In the context of the Green Book (http://www.gao.gov/greenbook), non-achievement of a relevant principle and related component results in a material weakness. **b. Internal Control over Operations:** A material weakness in internal control over operations might include , but is not limited to conditions that: • Impacts the operating effectiveness of entry-level controls; • Impairs fulfillment of essential operations or missions; • Deprives the public of needed services; or • Significantly weakens established safeguards against fraud, waste, loss, unauthorized use, or misappropriation of funds, property, assets, or conflicts of interest.	Material weaknesses and a summary of corrective actions must be reported to OMB and Congress through the AFR, PAR. Or other management reports. Progress against CAPs must be periodically assessed and reported to Agency management.

Category	Definition	Reporting
	c. ICOR: A material weakness in internal control over external financial reporting is a deficiency, or a combination of deficiencies, in internal control, in that there is a reasonable possibility that there is a reasonable possibility a material misstatement of the entity's financial statements will not be prevented, or detected and corrected before issuance. **d. Internal Control Over Compliance:** A material weakness in internal control over compliance is a condition where management lacks a process that reasonably ensures preventing a violation of law or regulation that has direct and material effect on financial reporting or significant effect on other reporting or achieving Agency objectives.	

Appendix B: J/D Codes, DLA HQ Program Support Structure, Roles and Responsibilities

The following are DLA Enterprise-wide J/D Codes and DLA HQ Program Support Structures:

DLA HUMAN RESOURCES (J1) provides the full range of human resource services to include Operational, Human Performance, Talent Management, Performance Management, Labor Relations and Human Resources Policy for the DLA workforce. DLA Human Resources recruits, hires, trains, and sustains a mission-ready workforce for DLA and Human Resources customers, using world-class policies, processes, programs, and tools.

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

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

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

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

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

DLA OFFICE OF SMALL BUSINESS PROGRAMS (DB) provides small business advocacy and promotes small business utilization to strengthen the competency, capability, and commitment of the industrial base that fulfills DLA's mission as the Nation's Combat Logistics Support Agency. DLA Office of Small Business Programs is responsible for implementation of the

Procurement Technical Assistance Program to expand the number of businesses capable of participating in contracts with DoD, other Federal agencies, state and local governments, and government prime contractors.

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

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

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

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

DLA PUBLIC AFFAIRS (DP) provides public affairs support, communication strategy development, and engagement guidance to DLA senior leadership, staff, and subordinate commands. The DLA Public Affairs office develops and administers internal news and information; manages DLA social media and public engagement policies, and develops programs that communicate DLA’s role as a Combat Support Agency that adds value to the Defense Department, military services, CCMDs and the American people.

DLA TRANSFORMATION (DT) directorate synchronizes strategy, policy, and process to support the Warfighter, strengthen alliances and drive innovation. DT manages DLA’s strategic plan, executive governance forums, and the Agency-wide deployment of Enterprise Process Management, Continuous Process Improvement, Enterprise Organizational Alignment, and Enterprise Policy Management programs.

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

Appendix C: Abbreviations &Acronyms

ADA	Anti-Deficiency Act
AFR	Agency Financial Report
APR	Annual Performance Report
A&FP	Accounting & Finance Policy Directorate
BRAC	Base Realignment and Closure
CAP	Corrective Action Plan
CBY	Charge Back Year
CCMD	Combatant Command
CCs	Critical Capabilities
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CFO	Chief Financial Officer
CIP	Construction in Progress
CMR	Cash Management Report
COLAs	Cost of Living Adjustments
COTS	Commercial Off-the-Shelf
CL	Contingency Logistics
CPIM	Consumer Price Index Medical
CTC	Cost-to-Complete
DATA	Digital Accountability and Transparency Act of 2014
DAI	Defense Agencies Initiative
DCIA	Debt Collection Improvement Act of 1996
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DMEA	Defense Microelectronics Activity
DMSMS	Diminishing Manufacturing Sources and Material Shortages
DOD	Department of Defense
DODIG	Department of Defense Office of the Inspector General
DRAS	Defense Retired and Annuitant System
DSA	Defense Supply Agency
DSS	Distribution Standard System
DW	Defense-wide

EBS	Enterprise Business Systems
EL	Environmental and Disposal Liabilities
ERM	Enterprise Risk Management
FASAB	Federal Accounting Standards Advisory Board
FBwT	Fund Balance With Treasury
FECA	Federal Employees' Compensation Act
FFMSRs	Federal Financial Management System Requirements
FMR	Financial Management Regulation
FRDAA	Fraud Reduction and Data Analytics Act Of 2015
FSCM	Financial Supply Chain Management
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GF	General Fund
GMRA	Government Management Reform Act
GPRA	Government Performance and Results Modernization Act of 2012
GPC	Government Purchase Card
GSA	General Services Administration
HQ	Headquarters
ICO	Internal Control Over Operations
ICOR	Internal Control Over Reporting
IP	Improper Payment
IPA	Independent Public Accounting
IPERIA	Improper Payments Elimination and Recovery Act of 2012
IPIA	Improper Payments Act of 2002
IRP	Installation Restoration Program
IT	Information Technology
IUS	Internal Use Software
JLEnt	Joint Logistics Enterprise
LOE	Lines of Effort
ManTech	Manufacturing Technology

MGS	Missile Guidance System
MILCON	Military Construction
NAVFAC	U.S. Naval Facilities Engineering Command
NFR	Notice of Findings and Recommendations
OCONUS	Outside the Continental United States
ODOs	Other Defense Organizations
OI	Other Information
OIG	Office of Inspector General
OUSD	Office of the Secretary of Defense
O&M	Operation and Maintenance
PPA	Prompt Payment Act
PDW	Procurement Defense - Wide
PP&E	Property, Plant, & Equipment
PTAC	Procurement Technical Assistance Centers
PTAP	Procurement Technical Assistance Program
RACER	Remedial Action Cost Engineering an Requirements
RCRA	Resource Conservation and Recovery Act
RTD&E	Research, Development, Test & Evaluation

R&D	Research & Development
SAP	Systems Applications and Products in Data Processing
SFFAS	Statement of Federal Financial Accounting Standards
SLOA	Standard Line of Accounting
SOA	Statement of Assurance
SOC	System and Organization Control
SOCOM	Special Operations Command
SOP	Standard Operating Procedure
TAS	Treasury Account Symbol
TDD	Treasury Direct Disbursing
TF	Transaction Fund
TFM	Treasury Financial Manual
TI	Treasury Index
TNC	Treasury Nominal Coupon
US	United States
UFR	Unfunded Requirement
USACE	U.S. Army Corps of Engineers
UDO	Undelivered Orders
USSGL	U.S. Standard General Ledger
WCF	Working Capital Fund

Acknowledgments

This AFR was prepared with the energies and talents of many employees across DLA and contract partners. A special note of appreciation is extended to the many diligent employees in the Financial Reporting Division within in the Office of the CFO for your time and efforts in preparing the AFR.

We also would like to thank the Audit Task Force for coordinating the external audit of the Agency's financial statements.

We offer our sincerest thanks and acknowledgement to DLA Director, Senior Executive Leaders and their respective staff for their commitment to improve financial accountability and transparency, while executing the primary mission of Sustaining the Warfighter.

Airmen move a nitrogen cart from an E-8C Joint STARS aircraft at Robins Air Force Base, Ga., Sept. 2, 2019, ahead of Hurricane Dorian.

A soldier paints a child's face during Tank or Treat, a Halloween event at the 2nd Battalion, 69th Armored Regiment’s motor pool at Fort Stewart, Ga., Oct. 30, 2018.

Defense Logistics Agency
8725 John J. Kingman Road
Fort Belvoir, Virginia 22060

www.dla.mil