Defense Logistics Agency

AGENCY FINANCIAL REPORT

Transaction Fund (Unaudited)

The Nation's Combat Logistics Support Agency

2019 FISCAL YEAR

About the Agency Financial Report

The Defense Logistics Agency (DLA) Transaction Fund (TF) 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 TF financial statements and other reports. The principal financial statements[1] have been prepared to report the financial position and results of DLA TF's operations. The financial statements and accompanying notes have been prepared from the books and records of DLA TF using guidance from the following applicable laws and regulations for which DLA TF 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 TF unless specifically noted otherwise. DLA TF's financial results are unaudited and there are limitations due to underlying processes that support the principal financial statements. DLA TF 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 TF, including its history, mission, and organizational structure; DLA TF'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.

Other Information (Unaudited)

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

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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*

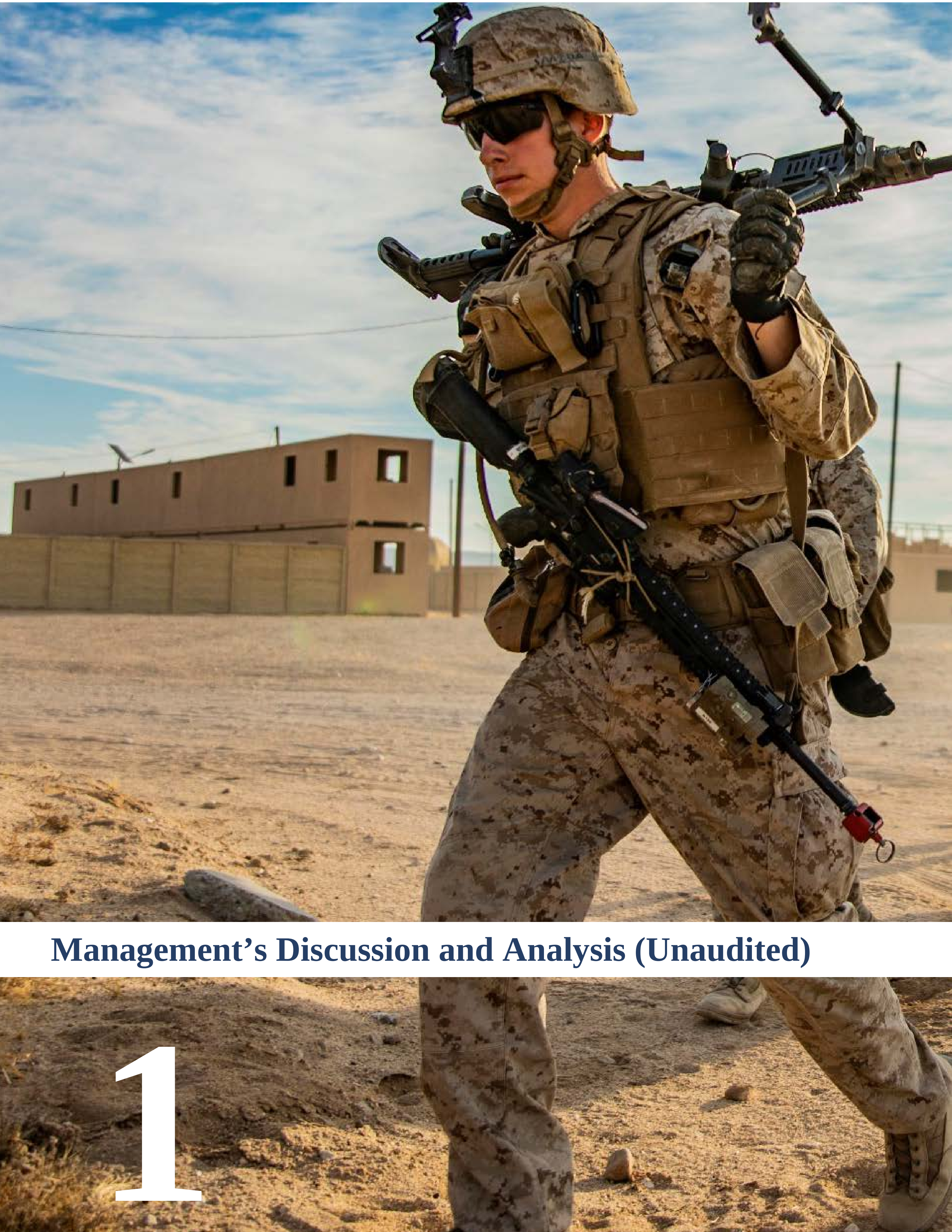
Our Independent Public Accounting (IPA) firm issued a Disclaimer of Opinion on DLA's FY2019 Transaction Fund (TF). Information gleaned through this effort will be extremely valuable in our on-going efforts to improve all aspects of DLA TF operations. The IPA reported material weaknesses in key areas 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)

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

DLA Director Army Lt. Gen. Darrell K. Williams delivers the keynote address at the 149th Commencement Ceremony at his alma mater, Hampton University, Hampton, Virginia.

IN THIS SECTION

Management's Discussion and Analysis (Unaudited)

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 60^{th} 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 TF 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 TF employs approximately 70 civilian personnel, whose labor is paid from DLA TF.

The National Defense Authorization Act (NDAA) is the U.S. Federal law that provides Congressional approval that authorizes the acquisition of Strategic & Critical (S&C) materials. Over the course of three legislative periods (FYs 2014, 2017, and 2018) Congress authorized, through NDAAs, the National Defense Stockpile (NDS) to begin acquiring stocks of fifteen S&C materials with a dollar value not to exceed $105.0 million[2]. The remaining acquisition authority will continue to be executed in FY2020 and beyond.

Workers excavate a site at Urban Mining Company's facility for manufacturing neodymium/iron/boron magnets in San Marcos, Texas.

[2] Current authorization is **THE STRATEGIC AND CRITICAL MATERIALS STOCKPILING ACT** (50 U.S.C. § 98 et seq.) (As amended through Public Law 115-232, the National Defense Authorization Act for Fiscal Year 2019).

How DLA TF Accomplishes its Mission

DLA Strategic Materials (SM) is responsible for the operations and management of the NDS. DLA TF is a single fund that supports the NDS program whose mission is to provide for the acquisition and retention of stocks of certain S&C materials, and to encourage the conservation and development of sources of S&C materials within the United States. DLA SM therefore strives to decrease and preclude a dangerous and costly dependence upon foreign sources or a single point of failure for supplies of such materials in times of national emergency. DLA SM operational goals for the NDS include ensuring efficient and responsible resource stewardship and the highest environmental standards.

Along with providing oversight and acquisition and retention of stockpile materials, DLA SM provides for the conversion and upgrade of stockpile materials to prevent obsolescence, the recycling strategic materials from end-of-life Government items, and disposes of excess stocks for operational funding. DLA SM performs analysis, planning, procurement, and management of materials critical to national security. DLA SM serves clients through a unique combination of technical expertise, global/geopolitical material supply analysis, and management and tracking of broad range and existing future critical materials.

Revenues are generated through auctions to pre-qualified customers of stocks determined excess to DoD needs. This revenue captured to the NDS is the source of funding for operational expenditures and new material acquisitions. DLA TF is a revolving account created by the Stockpiling Act to support the operation of the NDS.

An M1A1 Abrams tank drives down a dirt road during a training event on Camp Lejeune, N.C., July 21, 2016. The event brought together active and reserve Marines to train for possible future deployment. The TF stockpile consists of materials such as boron, which is used in tank armor.

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 TF. DoD produces an Annual Performance Report (APR) for all its components (including DLA TF) 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 TF 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 1.3: Address Risk

Ensure readiness and lethality across the end-to-end supply chain by reducing risk, improving efficiency, and optimizing retail and industrial support. DLA will continue to address risk areas (operational, cyber security, terrorism, counterfeiting) across the TF operation to improve operational resiliency and security.

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 the 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 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 3.2: DoD Interagency Partnerships

Collaborate with DoD and interagency partners to develop solutions that optimize DLA support to sustainment operations, government efficiency, support to major acquisition programs, business reform, and policy objectives. DLA focus on developing solutions and building relationships brings a full range of capabilities to the long-term, strategic goals of the U.S. government.

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 DLA implements corrective actions and address deficiencies identified in the annual statement of assurance (SOA).

CC 1 – Enterprise Enablers

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

Enterprise Enablers Objectives

- 1 Innovation
- 2 Data Management
- 3 Technology
- 4 Cybersecurity

CC 2 – People and Culture

The 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)

Performance Measure 1: Materials Upgrade (Tin)

This performance measure relates to the objective described above: **1.3** Address Risk

Along with providing oversight and acquisition and retention of stockpile materials, DLA SM provides for the conversion and upgrade of stockpile materials to prevent obsolescence and the recycling of strategic materials from end-of-life Government items. A major initiative in recent years has been the remelting of tin, improving the quality and grade of stocks, and making them better suited for current and future Defense applications in support of the Warfighter. This initiative also reduces risk to the Warfighter by ensuring adequate materials are available, as necessary.

Executing the NDS mission by ensuring efficient, and responsible stewardship is paramount to DLA SM operational goals. In addition to directing the acquisition, storage and disposition of S&C materials, SM manages a comprehensive environmental safety and operational health in support of the NDS.

The NDS stockpile contains tin inventory that has been degraded due to tin pest. A tin material upgrade ("tin remelt") process works to stop the degradation and restore the tin. This work is carried out through an agreement with Rock Island Arsenal Joint Manufacturing and Technology Center.

In FY2018, DLA TF had an agreement with Rock Island Arsenal that expired. There was a two month lapse in service, November and December of FY2019. Although a new agreement was funded for Rock Island Arsenal in FY2019, the lapse in service was the primary reason for the decrease in actuals in FY2019 (approximately 68,200 lbs., (8.0%)) from FY2018. The following performance reporting is based on pounds of degraded tin shipped for recycling.

Outbound Tin Material		
	FY2019	**FY2018**
Outbound Tin Material	781,420 Lbs.	849,663 Lbs.

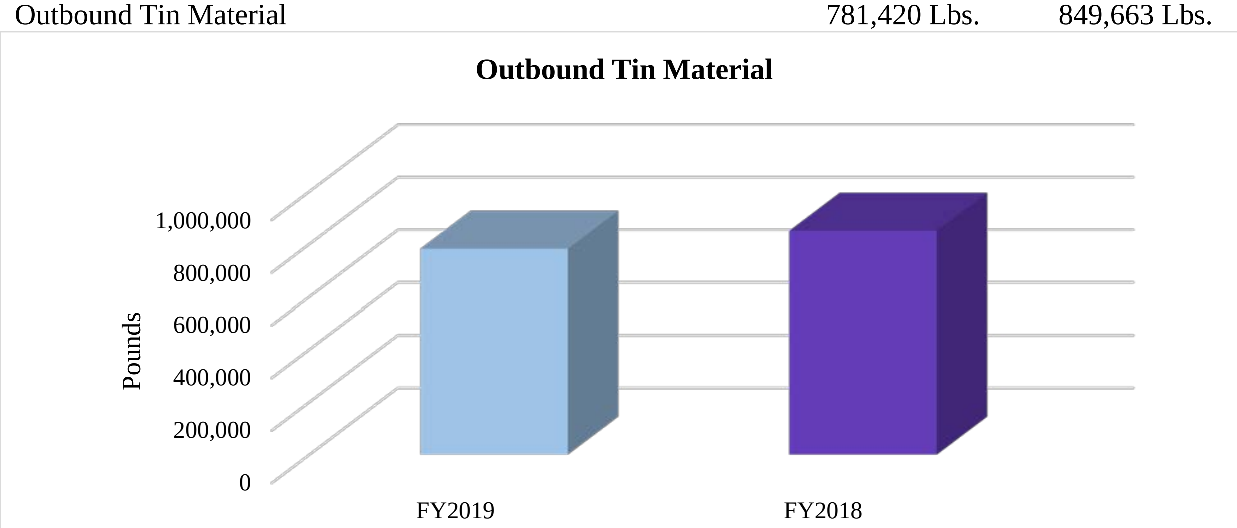


Figure 3: Outbound Tin Material in FY2019 from FY2018

Performance Measure 2: Super Alloy Scrap Recovered for Reuse

This performance measure relates to the objective described above: **3.2** DoD and Interagency Partnerships.

The DLA SM executes its statutory authority to recover and recycle valuable strategic materials otherwise lost to demilitarization and disposal, collaborating with DLA Disposition to identify and recover valuable materials with additional usefulness to DoD.

FY2019 scrap recovery was well below FY2018 (approximately 313,500 lbs., (38.7%)) due to the acquisition of unexpected materials in FY2018 that was not replicated in FY2019.

In FY2018, the maintenance groups at Tinker Air Force Base participated in the "Clean Out the Attic" initiative to remove damaged and or used parts from inventories to turn-in to DLA TF as scrap. This initiative resulted in the acquisition of unexpected materials.

DLA SM Super Alloy Scrap Recovered for Reuse		
	FY2019	**FY2018**
Super Alloy Scrap Recovered for Reuse	495,868 lbs.	809,408 lbs.

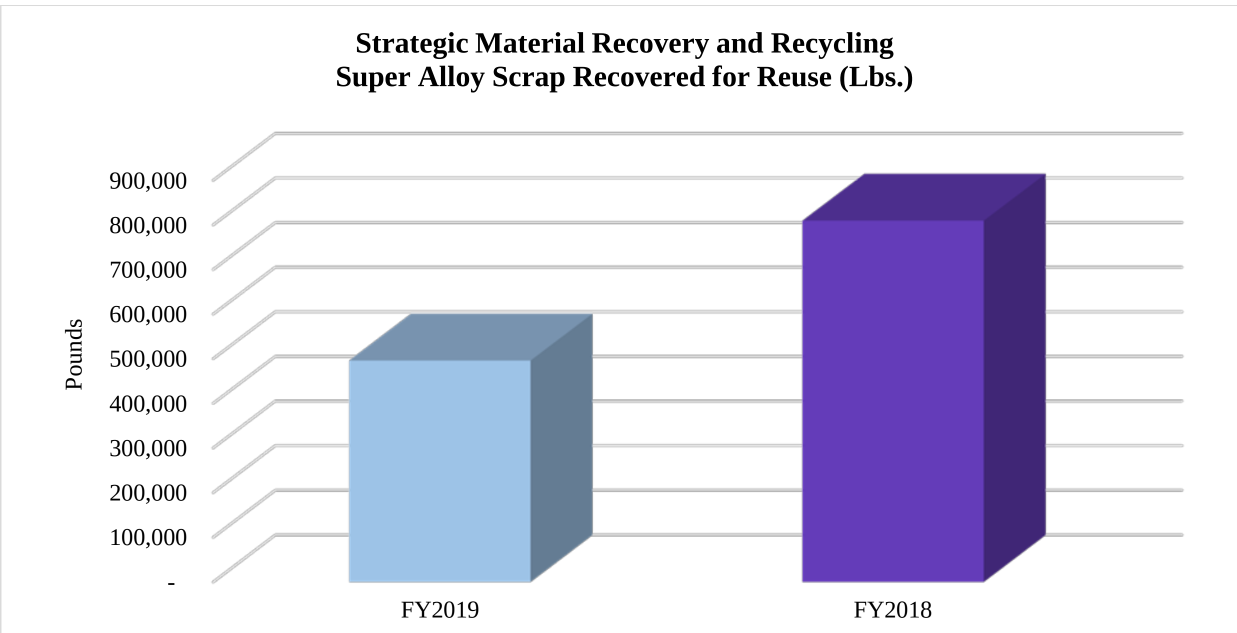


Figure 4: Super Alloy Scrap Recovered for Reuse in FY2019 from FY2018

Performance Measure 3: DLA Roadmap to Auditability

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

Currently, DLA TF receives a disclaimer of opinion on its financial statements. DLA TF 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 TF 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. GAAP and OMB Circular A-136 requirements. The following timeline summarizes the occurrence of events that propelled DLA into a corrective action posture.

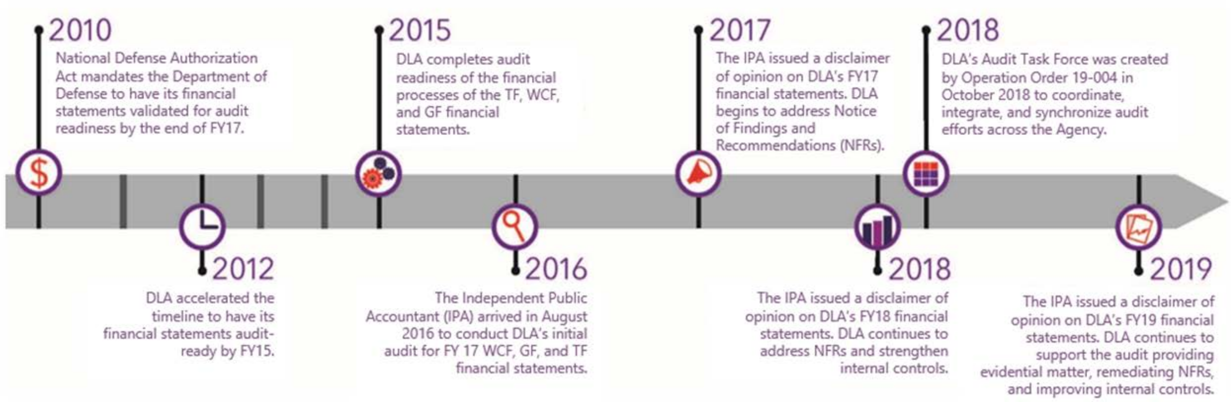


Figure 5: DLA Auditability Timeline

Analysis of Financial Statements and Stewardship Information

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

The principal financial statements of DLA TF include the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and the 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 TF 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 TF's management is responsible for the integrity and objectivity of the financial information presented in the statements. DLA TF is dedicated in its pursuit of financial management excellence.

DLA TF restated FY2018 balances because of actions completed to correctly recognize the sale of stockpile materials. The FY2018 gains on sale of stockpile materials net of gross costs reported for revenue earned in the prior year Statement of Net Cost was corrected to be reported separately as Earned Revenue and related Gross Cost on the restated FY2018 Statement of Net Cost, resulting in no impact in the overall Net Cost. DLA is taking corrective actions related to the causes of the restatements.

A summary of DLA TF's 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 executing DLA TF programs, less earned revenue. Budgetary resources are funds available to DLA TF to incur obligations, to pay for goods and services, and to sell products to customers. The summary section also includes an explanation of significant changes for each DLA TF financial statement.

Changes In Key Financial Measures
As of and for the Years Ended September 30, 2019 and 2018 (dollars in millions)

Net Financial Condition	2019 (Unaudited)	2018 (Unaudited)	Increase/Decrease $	Increase/Decrease %
Fund Balance with Treasury	$ 287.3	$ 294.1	$ (6.8)	(2.3%)
Stockpile Materials	779.2	785.8	(6.6)	(0.8%)
General PP&E, and Accounts Receivable and Other	1.2	1.5	(0.3)	(20.0%)
Total Assets	$ 1,067.7	$ 1,081.4	$ (13.7)	(1.3%)
Accounts Payable	$ 7.1	$ 2.2	$ 4.9	222.7%
Federal Employment Benefits and Other Liabilities	3.5	2.9	0.6	20.7%
Environmental and Disposal Liabilities	17.6	17.6	0.0	0.0%
Total Liabilities	$ 28.2	$ 22.7	$ 5.5	24.2%
Cumulative Results of Operations	$ 1,039.5	$ 1,058.7	$ (19.2)	(1.8%)
Total Net Position	$ 1,039.5	$ 1,058.7	$ (19.2)	(1.8%)
Total Liabilities and Net Position	$ 1,067.7	$ 1,081.4	$ (13.7)	(1.3%)
Net Cost of Operations	$ 19.9	$ 11.3	$ 8.6	76.1%
Budgetary Resources	$ 274.4	$ 279.2	$ (4.8)	(1.7%)

Figure 6: Changes In Key Financial Measures

Soldiers unpack ammunition and prepare it for use during predeployment training at Fort Riley, Kansas. Ammunition management for training ammunition is normally conducted through the Total Ammunition Management Information System-Redesigned (TAMIS–R). If the same type of ammunition is for use in operational missions, it is managed under the Standard Army Ammunition System-Modernization (SAAS–MOD).

Assets – What DLA TF Owns and Manages

Assets represent materials owned or managed by DLA TF that can be used to accomplish its mission as the Nation's Combat Logistics Support Agency. The DLA TF's largest asset is stockpile materials. These stockpile materials represent just over $779.2 million, approximately 73.0% of total assets as of September 30, 2019, an amount $6.6 million, 0.8% lower than the balance as of September 30, 2018; this diminution is primarily a reduction in materials held for sale ($3.6 million, 11.2%), stockpile materials no longer required per the NDAA.

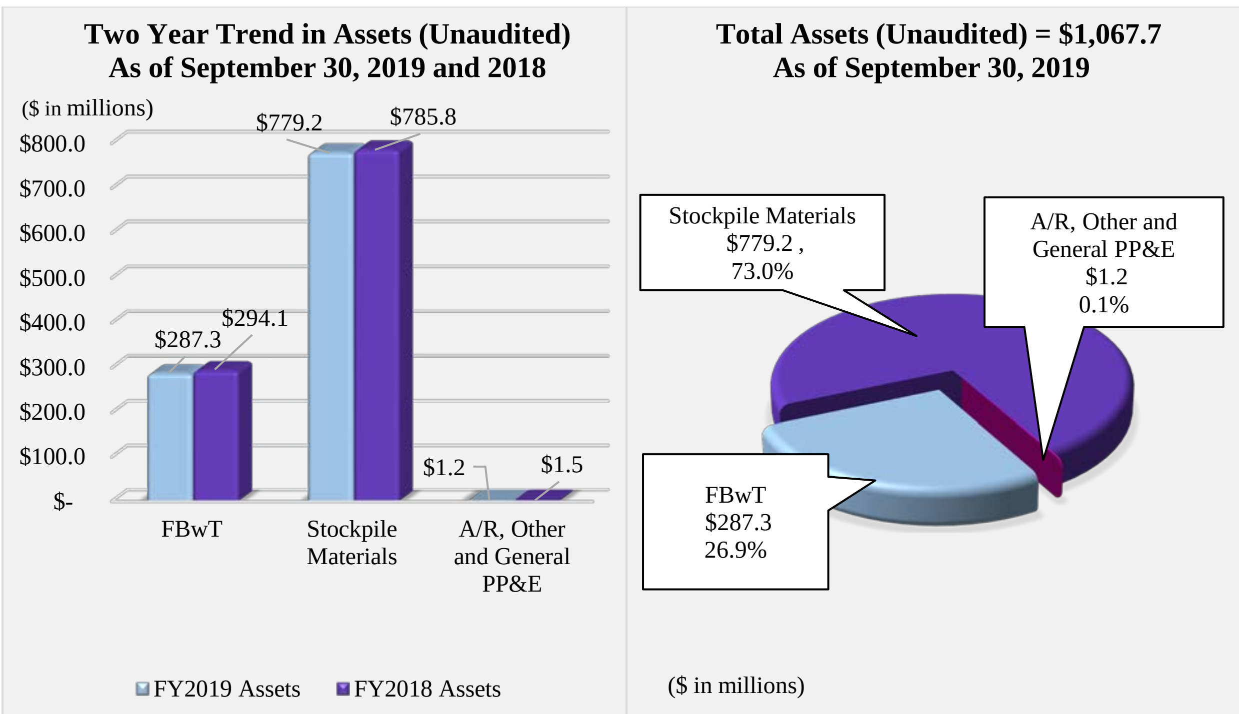


Figure 7: Total Assets as of September 30, 2019 and 2018

Liabilities – What DLA TF Owes

Liabilities are the amounts owed to the public and Federal Agencies for goods and services provided but not yet paid for. The largest liability as of September 30, 2019 is EL, which is associated with restoration of environmental sites on real property that DLA TF does not own but has received funds to execute and manage. The Environmental and Disposal Liabilities (EL) balance of $17.6 million represents 62.2% of Total Liabilities as of September 30, 2019.

Accounts Payable, which includes amounts owed but not yet paid to the public and Federal Agencies for goods and services received has a balance of $7.1 million, constituting 25.3% of total liabilities. The Accounts Payable balance as of September 30, 2019 is $4.9 million higher than that of September 30, 2018, reflecting a comparatively higher level of purchases at the end of fourth quarter FY2019 for which payment had not yet been made.

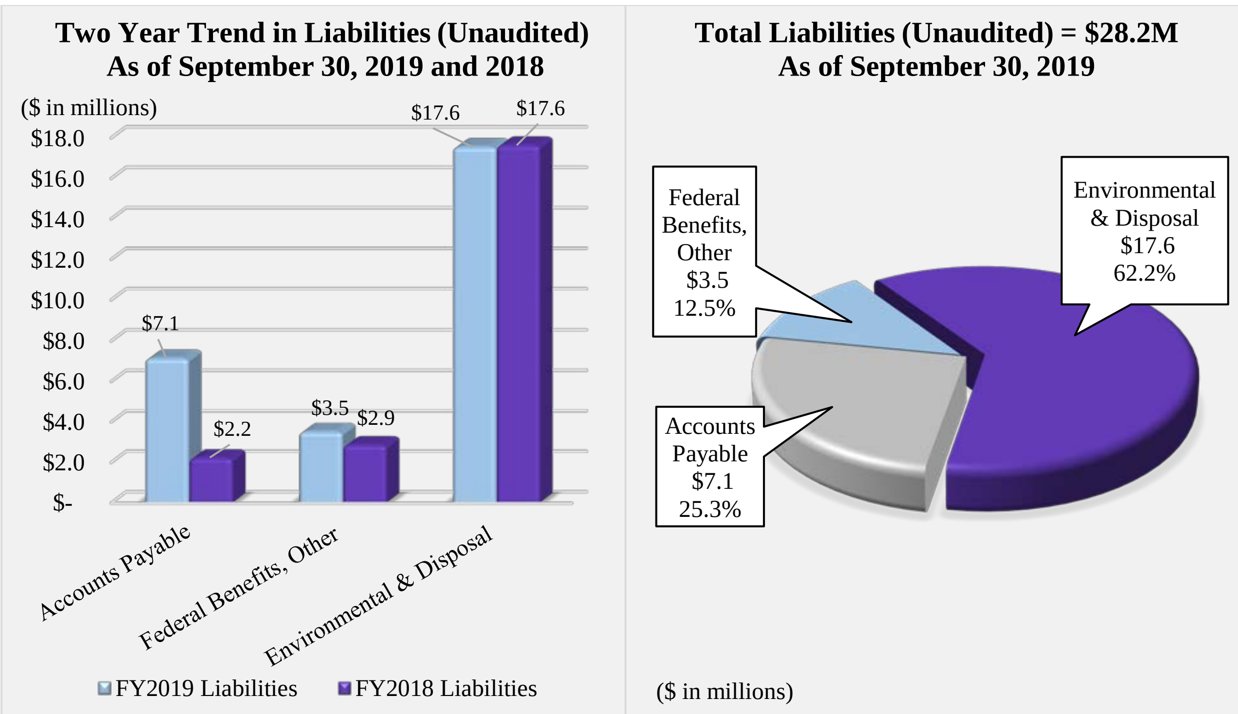


Figure 8: Total Liabilities as of September 30, 2019 and 2018

Ending Net Position – What DLA TF has Done Over Time

Net position represents primarily the accumulation of revenue and expenses, as represented in DLA TF balances reflected in the Statements of Changes in Net Position. DLA TF Net Position is made up of Cumulative Results of Operation of $1,039.5 million as of September 30, 2019 and $1,058.7 million as of September 30, 2018.

DLA TF Results – Current Fiscal Year Net Cost of Operations

The DLA TF Statements of Net Cost is reported in one segment: Operations, Readiness, and Support. Net Cost of Operations totaled $19.9 million for the year ended September 30, 2019 and $11.3 million for the year ended September 30, 2018.

Budgetary Resources

DLA TF 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 the plan for efficiently and effectively achieving the strategic objectives to carry out the mission and to ensure that DLA TF manages its operations within the appropriated amounts using budgetary controls. Budgetary Resources are comprised of Unobligated Balances and New 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.

The Total Budgetary Resources is approximately $274.4 million for DLA TF for the year ended September 30, 2019. The authority was primarily derived from $233.6 million in unobligated authority carried forward from FY2018 and $40.8 million in Spending Authority from Offsetting Collections in FY2019. Of the total budget authority available, DLA TF incurred a total of $61.0 million in obligations from salaries and benefits, purchase orders placed, contracts awarded, and similar transactions.

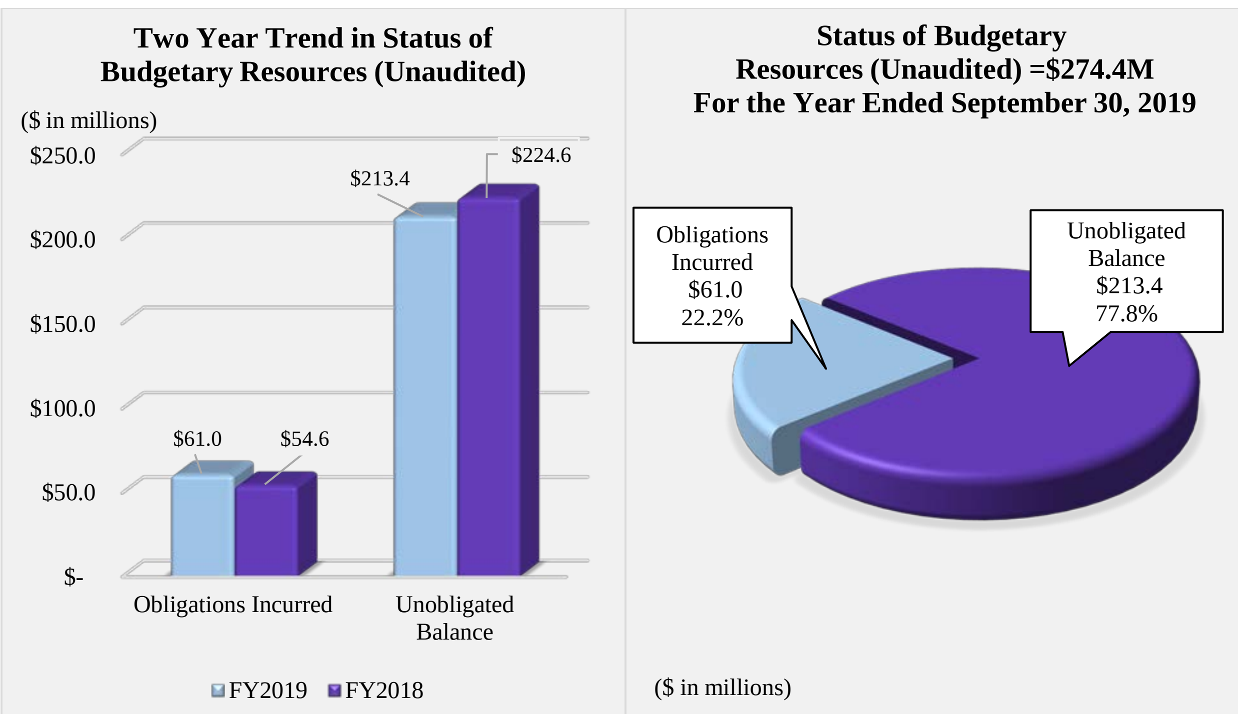


Figure 9: Status of Budgetary Resources for the Years Ended September 30, 2019 and 2018

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 TF 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.

2

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 were not applicable to DLA TF.

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.

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 TF notifies all appropriate authorities of any potential ADA violations. At this time, there are no known or potential ADA violations.

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

The DLA TF 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 TF 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. 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 TF were designed to record information on a budgetary basis.

The DLA TF continues to develop, improve, and refine the underlying financial and nonfinancial 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 TF continues to implement interim mitigation processes to address known limitations; additionally, DLA TF is remediating material weaknesses to the financial statement preparation process. DLA TF has several corrective actions underway intended to improve the underlying systems, business processes and internal controls.

The financial statements should be read with the realization 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 TF'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.

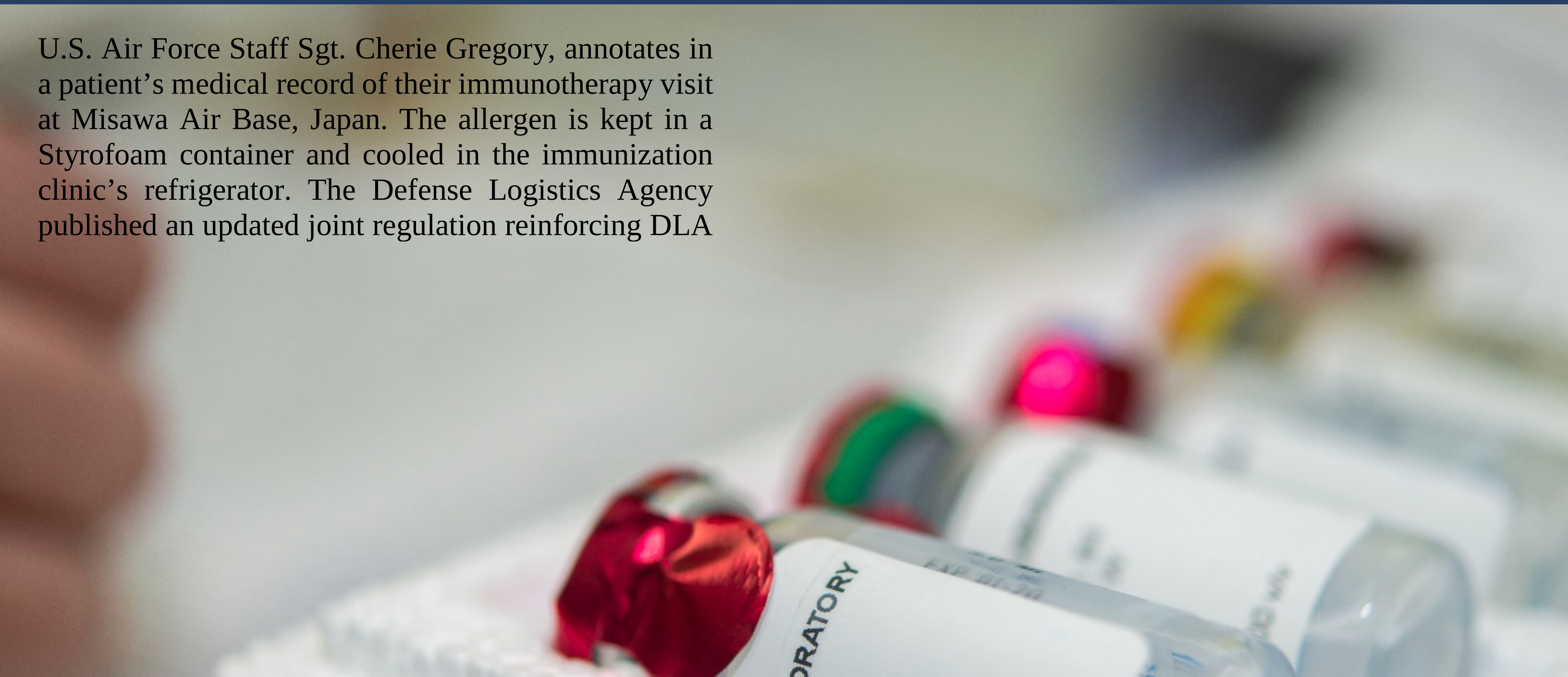
The DLA Finance is working on four major system initiatives: one initiative, G-Invoicing, is a Treasury mandated process to improve the reconciliation and coordination of intra-government payments. Federal Program Agencies will be required to use G-Invoicing to process intragovernmental buy/sell transactions. 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.

Financial Section (Unaudited)

2

SECTION 2 – FINANCIAL SECTION (Unaudited)



U.S. Air Force Staff Sgt. Cherie Gregory, annotates in a patient's medical record of their immunotherapy visit at Misawa Air Base, Japan. The allergen is kept in a Styrofoam container and cooled in the immunization clinic's refrigerator. The Defense Logistics Agency published an updated joint regulation reinforcing DLA

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 Transaction Fund's (TF) 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 TF financial activities.

The DLA received a Disclaimer of Opinion on the Agency's TF 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 TF, 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
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November 8, 2019

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

SUBJECT: Transmittal of the Independent Auditor's Reports on the Defense Logistics Agency National Defense Stockpile Transaction Fund Financial Statements and Related Notes for FY 2019 and FY 2018 (Project No. D2019-D000FE-0088.000, Report No. DODIG-2020-022)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY), to audit the Defense Logistics Agency (DLA) National Defense Stockpile Transaction Fund (Transaction 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 Transaction 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 Transaction 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 had deficiencies in its policies, procedures, and internal controls surrounding documentation of procurements and disbursements, validating the perpetual inventory systems by performing periodic physical counts, accumulating cost of inventory, and supporting inventory balances and transactions.
- 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 properly recognize revenue in accordance with generally accepted accounting principles.
- The DLA was unable to support the accounts payable balance, expenses, and related budgetary beginning balances; recorded transactions in the proper period; did not have 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 did not have 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 FFMIA 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

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Report of Independent Auditors

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

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the National Defense Stockpile Transaction 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 statement amounts involved is not currently determinable by DLA and could be material.

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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, 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.

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 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

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements* the financial statements of the National Defense Stockpile Transaction 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 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.

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. Inventory – Inventory is comprised of strategic and critical materials that can be used in times of national emergencies. The materials include ores, metals, alloys, chemicals, high-performance fibers and energetics. Policies, procedures and internal controls surrounding documentation of procurements and disbursements, validating the perpetual inventory systems by performing periodic physical counts, accumulating cost of inventory, and supporting inventory balances and transactions all had deficiencies. The combination of these deficiencies in aggregate results in a material weakness in internal control related to inventory. The matters identified related to inventory 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) process 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. Revenue – Revenue is earned when DLA sells goods to the public. DLA did not properly recognize revenue in accordance with U.S. generally accepted accounting principles (U.S. GAAP). This deficiency signified a material weakness in internal control related to revenue. The matters identified related to 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 obtains services from the public or other federal entities. DLA was unable to support the AP balance, expenses and related budgetary beginning 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. The 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 statements and incomplete or 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 (JVs) 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, risk 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.

Significant Deficiencies

We identified the following matter 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

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Appendix A – Material Weaknesses

I. Inventory

DLA's inventory is comprised of strategic and critical materials that can be used in times of national emergencies. The materials include ores, metals, alloys, chemicals, high-performance fibers and energetics. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability for all assets for which the agency is responsible. DLA's controls and processes do not exist or are not operating in several significant areas, specifically:

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

- **Inadequately Designed Controls over Inventory Processes.** The controls that have been implemented related to data entry and validation are not designed effectively. In addition, sufficient documentation does not exist to evidence the performance of the control activities.
- **Physical Inventory Counts.** DLA has not adequately designed controls over physical inventory counts. Adjustments for variances identified during the inventory count are not properly evaluated. Variance thresholds are established only by using the weight discrepancies without considering the monetary impact. As such, weight discrepancies below the threshold may be a material error and not adjusted in the general ledger and the financial statements.
- **Inventory Recorded in the Appropriate Period.** Policies and procedures are not in place to record transactions in the period that the transaction occurred or to accrue for transactions that occurred but were not posted at period-end. For example, quantity variances identified during the reconciliation of third-party inventory listings to DLA's general ledger system are not recorded in the proper period.
- **Inventory Impairment Analysis.** DLA policy requires an impairment analysis to be performed on a quarterly basis; however, the assessment is performed after the close of the reporting period. As a result, an impairment that existed at period-end is not appropriately reflected in the correct period.

B. **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 an inaccurate presentation of inventory on the balance sheet and in the related footnote disclosure. Specifically, DLA has neither implemented nor applied the costing and valuation methodologies set forth by Statement of Federal Financial Accounting Standards (SFFAS) No. 3, *Accounting for Inventory and Related Property.* For example:

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- Inventory is valued based on historical cost or market, unless the carrying amount of the material has suffered a permanent decline in value to an amount less than the cost. On a quarterly basis, an assessment is made to determine whether there are permanent declines in value. However, DLA does not have documentation that describes the valuation process, including the criteria used to determine whether a decline in value is temporary or permanent. In addition, the impairment assessment does not include procedures to perform a periodic review and to document the basis for determining that the benchmarks and inputs used for assessing whether a decline in value has occurred are appropriate.
- SFFAS No. 3 states that historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. However, DLA records the reconditioning costs associated with the refurbishment of inventory as a period cost rather than capitalized and included as part of the cost to bring the inventory to its current condition. In addition, inventory received from other federal agencies is not properly valued and recorded in accordance with SFFAS No. 3.

Recommendations

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

A. **Lack of or Inadequate Policies, Procedures and Controls over Inventory Processes.**

- **Inadequately Designed Controls over Inventory Processes.** Design and implement internal control activities and include criteria, analyses, reviews and supporting thresholds used in the execution of all relevant internal controls. Specifically, documents 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.
- **Physical Inventory Counts.** Design and implement controls over physical inventory counts. The controls should be designed to assess the monetary impact of variances, individually and in the aggregate.
- **Inventory Recorded in the Appropriate Period.** Design and implement policies and procedures, including controls to process and post transactions to the correct period in the general ledger, and that an accrual is recorded at period-end for transactions that should be posted to reflect recording in the proper period but have not been resolved.
- **Inventory Impairment Analysis.** Design procedures to perform an impairment analysis on a timely basis and record the impairment, as applicable, in the correct period.

B. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design policies and procedures to implement the accounting standard, SFFAS No. 3. The policies and procedures should consider:

- Determining the criteria for when a decline in value should be considered temporary or permanent, how the market value of specific commodities should be selected and performed, and what benchmarks are used to determine market value.

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- Ensuring that costs to bring inventory to its current condition, such as reconditioning costs, are properly capitalized.
- Ensuring that inventory transferred from federal entities is properly valued in accordance with U.S. GAAP.

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 on 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. In addition, DLA lacks controls to reconcile disbursements between the general ledger and Treasury's Secure Payment System (SPS). As a result, DLA is unable to accurately reconcile to U.S. Treasury.

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; the process to research and resolve differences between U.S. Treasury, disbursing system records and accounting system records within a timely basis; and the process to determine that DLA has sufficient cash on hand to meet current financial obligations.

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 SPS in order to verify that the data was processed correctly.

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III. Revenue

Revenue arises when DLA provides goods to the public. The amounts of these transactions make it critical for DLA to properly record and reconcile these transactions to ensure timely, appropriate recognition of costs to the end users. 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.

A. **Improper Revenue Recognition in Accordance with Accounting Standards.** DLA lacks policies, procedures and controls that are intended to properly document and review relevant facts and apply the appropriate revenue accounting under SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, which impacted the revenue and gross cost accounts on the statements of net cost. DLA misapplied the revenue recognition accounting principles set forth by SFFAS No. 7. Specifically, exchange revenue was being recorded and presented on a net basis, whereby revenue and cost of goods sold were recorded and presented as net revenue. In fiscal year 2019, DLA concluded that the accounting for the revenue transactions should be corrected and that adjustments were recorded by DLA to correct the error and to present revenue and cost of goods sold on a gross basis on the statements of net cost.

Recommendations

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

A. **Improper Revenue Recognition in Accordance with Accounting Standards.** Design and implement revenue recognition policies, procedures and controls in accordance with SFFAS 7. The policies should include considering the appropriate relevant facts to determine that revenue and cost of goods sold are properly recorded and presented in the financial statements.

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 accounts payable, expenses and the related budgetary balances; recording transactions in the proper period; documenting policies, procedures and controls in a sufficient manner; and designing and executing controls over the process to create and approve obligations and to review, record and pay invoices.

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A. **Lack of or Inadequate Documentation of UDO, AP and Expenses Accounting Policies, Procedures and Controls.** DLA has not documented the end-to-end processes 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; 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; controls to close invalid UDO in a timely manner; and controls to review that the purchase order information is recorded accurately in order to record the obligation in the correct period.
- **Vendor Contracts.** DLA lacks controls to execute contracts in accordance with the Federal Acquisition Regulation (FAR), and record obligations timely for contracts, including Indefinite Quantity Contracts (IQC). An IQC was awarded, and the obligation was not recorded at the contract award date because the IQC did not have a guaranteed minimum at contract award date.
- **AP and Cash Disbursements.** DLA lacks controls to post goods receipts in a timely manner; review invoices prior to payment; and prevent rejected invoices from being paid (we found an instance where DLA rejected an invoice in Wide Area Workflow (WAWF), but DFAS was able to process this invoice for payment in the general ledger).
- **Expenses Recorded in the Appropriate Period.** DLA lacks controls to record expense transactions appropriately and accurately in the period that the transaction occurred. As a result, 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 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.

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C. **Lack of or Inadequate Documentation to Substantiate AP and Expense Transactions.** DLA was unable to provide documentation to support the existence of AP balances, or that 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, and upward and downward adjustments to UDO.

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 neither implemented nor applied the accounting set forth by SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts* and SFFAS No. 5, *Accounting for Liabilities of the Federal Government.* For example:

- DLA inappropriately expensed costs that should have been capitalized. For example, inventory purchased for resale was inappropriately expensed.
- 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. This results in an understatement of expenses and payables, and an overstatement of UDO.
- AP 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 Military Interdepartmental Purchase Requests 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 process cycle memoranda 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.
- **AP.** The documentation should include the process to evaluate the validity of accounts payable, including significantly aged AP and negative payables, 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.**

- **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; controls to close invalid UDO in a timely manner; and controls to validate that the purchase order information is recorded accurately in order to record the obligation in the correct period.
- **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 to prevent rejected invoices from being processed for payment.
- **Expenses Recorded in the Appropriate Period.** Design and implement controls to record expense transactions appropriately and accurately 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 to properly classify costs and payables in accordance with SFFAS No. 4 and 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 their financial position and results of operations.

A. **Lack of or Inadequate Documentation of Financial Reporting and Budgetary Processes.** DLA has not documented the end-to-end processes to account for budgetary receipt. The documentation does not sufficiently include a description of the process to record budget authority, the transfer process, and the Treasury warrant process.

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B. **Lack of Controls over Compliance with the TFM United States Standard General Ledger (USSGL).** DLA does not have controls to configure the general ledger posting logic 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. In addition, the posting logic for various inventory transactions, such as goods being sold and returned into inventory, do not meet the corresponding TFM business events.

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 the Total Actual Resources Collected account.
- **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.
- **Leases.** DLA has not established a policy, including controls, to account for its leasing arrangements, nor has it assessed whether the leasing arrangements should be accounted for as a capital or an operating lease set forth by SFFAS No. 5, *Accounting for Liabilities of the Government;* and SFFAS No. 6, *Accounting for Property, Plant and Equipment*. 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.
- **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 JVs in the general ledger and Defense Departmental Reporting System (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.

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- **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.

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 that: configure posting logic in the general ledger 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 balance for carry forward budgetary accounts.
- **Contingent Liabilities.** Design and implement controls related to litigation to identify, estimate, record and disclose contingent liabilities in the financial statements.
- **Leases.** Design policies and procedures to implement the appropriate accounting standards, specifically SFFAS No. 5 and SFFAS No. 6. The policies and procedures should establish 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 A-136.
- **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.

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- **Budgetary to Proprietary Tie Points.** Design and implement controls to reconcile budgetary to proprietary tie points and investigate variances.
- **Monthly or Quarterly Journal Voucher 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.

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 PO and SO 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 their 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 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.

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.

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; 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.

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 (SoD) 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:

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- 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.

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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.

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.

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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 on real property that DLA manages. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. However, we identified deficiencies in controls listed below, 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 the cost to complete estimates for environmental liabilities was supported. In addition, the estimate for the cost to complete, cleanup and restoration cost are 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.

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements,* the financial statements of the National Defense Stockpile Transaction 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.

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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

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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
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NOV 08 2019

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Fiscal Year (FY) 2019 Financial Statement Audit – Transaction 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 Transaction Fund (TF) 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, 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 TF 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 TF. The IPA was engaged to perform the audit of DLA TF 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 TF principal financial statements and the accompanying notes consist of the following:

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

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

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

4. The **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DLA TF, 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 - Transaction 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)	$ 287,318	$ 294,139
Total Intragovernmental Assets	**287,318**	**294,139**
Accounts Receivable	26	43
Stockpile Material (Note 3)	779,164	785,841
General Property, Plant, and Equipment, Net (Note 4)	1,242	1,464
TOTAL ASSETS	**$ 1,067,750**	**$ 1,081,487**
LIABILITIES (Note 5)		
Intragovernmental		
Accounts Payable	$ 1,511	$ 533
Other Liabilities (Note 6)	365	274
Total Intragovernmental Liabilities	**1,876**	**807**
Accounts Payable	5,631	1,686
Environmental and Disposal Liabilities (Note 7)	17,555	17,641
Other Federal Employment Benefits (Note 8)	2,198	1,745
Other Liabilities (Note 6)	952	847
TOTAL LIABILITIES	**28,212**	**22,726**
Commitments and Contingencies (Note 9)		
NET POSITION		
Cumulative Results of Operations	1,039,538	1,058,761
TOTAL NET POSITION	**1,039,538**	**1,058,761**
TOTAL LIABILITIES AND NET POSITION	**$ 1,067,750**	**$ 1,081,487**

The accompanying notes are an integral part of these statements.

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

	Unaudited 2019	Unaudited 2018 As Restated
Operations, Readiness & Support		
Gross Cost	$ 94,015	$ 92,755
Less: Revenue Earned	(74,158)	(81,425)
Net Cost	**19,857**	**11,330**
NET COST OF OPERATIONS	**$ 19,857**	**$ 11,330**

The accompanying notes are an integral part of these statements.

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

	Unaudited 2019	Unaudited 2018
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 1,058,761	$ 1,069,560
Other Financing Sources:		
Imputed Financing	634	531
Total Financing Sources	**634**	**531**
Net Cost of Operations	**19,857**	**11,330**
Net Change	**(19,223)**	**(10,799)**
CUMULATIVE RESULTS OF OPERATIONS	**1,039,538**	**1,058,761**
TOTAL NET POSITION	**$ 1,039,538**	**$ 1,058,761**

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - Transaction Fund
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	233,589	220,694
Spending Authority From Offsetting Collections	40,825	58,524
TOTAL BUDGETARY RESOURCES	**$ 274,414**	**$ 279,218**
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments	$ 60,974	$ 54,614
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	5,608	-
Unapportioned, Unexpired Accounts	207,832	224,604
Unexpired Unobligated Balance, End of Year	213,440	224,604
Total Unobligated Balance, End of Year	213,440	224,604
TOTAL BUDGETARY RESOURCES	**$ 274,414**	**$ 279,218**
OUTLAYS, NET		
Outlays, Net	6,821	(21,018)
AGENCY OUTLAYS, NET	**$ 6,821**	**$ (21,018)**

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 OUSD for Acquisition and Sustainment through the Assistant Secretary of Defense Sustainment. The DLA provides material 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 TF. These financial statements and accompanying notes herein only refer to the activities of DLA TF.

The NDS (commonly known as DLA Transaction Fund) is composed of S&C materials authorized for use during times of national emergencies. Initially authorized by the Strategic and Critical Materials Stock Piling Act of 1946, the NDS is a physical reserve of definite quantities of S&C materials, owned by the United States government, authorized for use during times of national emergencies. Executive Order 12626, issued February 25, 1988, designated the Secretary of Defense as the NDS Manager. The Secretary of Defense delegated the management responsibilities to the OUSD for Acquisition and Sustainment through the Assistant Secretary of Defense for Sustainment. The operational activities of the NDS are delegated to the Director of DLA.

DLA SM program is a distinct revolving fund which operates under the authority of the Strategic and Critical Materials Stock Piling Act (50 U.S.C.) §98, et seq. Under the Act, critical materials are stockpiled in the interest of national defense to preclude a dangerous and/or costly dependence upon foreign or single source suppliers. DLA SM Stockpile Manager administers the acquisition, storage, management, and disposal of the stockpile. The NDAA authorized the Stockpile Manager to acquire materials determined to be strategic and critical to meet defense, industrial, and essential civilian needs of the United States. The legislation further provided authority to dispose of certain materials, with proceeds deposited in the fund to finance future Stockpile operating costs and procurement of replenishment materials.

B. Basis of Presentation and Accounting

Basis of Presentation and Accounting: The DLA TF fiscal year ends September 30. The accompanying financial statements account for all resources for which DLA TF is responsible. These financial statements present the financial position, results of operations, changes in net position, and budgetary resources of DLA TF, as required by the CFO Act of 1990, expanded by the GMRA of 1994, and other applicable legislation. The financial statements are prepared from the books and records of DLA TF 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 TF 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 TF 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 TF 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 TF 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 TF 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 TF continues to implement interim mitigation processes to address these limitations. In addition, DLA TF 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 Activities: 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 TF. Intragovernmental liabilities are claims DLA TF 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 TF against public entities. Non-Federal liabilities are amounts that DLA TF owes to public entities. DLA TF is unable to accurately map its trading partners to separate Federal and Non-Federal transactions in accordance with TFM, Volume I, Part 2, Chapter 4700, *Federal Entity Reporting Requirements for the Financial Report of the United States Government*.

The DLA TF engages in transactions with other DoD and Federal entities that generate inter-DoD and intragovernmental balances; however, DLA TF 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 process is not fully implemented (refer to Note 1.C., *Departures from U.S. GAAP*, related to Intragovernmental/Intra-departmental and Non-Federal Activities).

Intra-departmental Transactions: On a DoD Agency-wide basis, DLA TF 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 TF 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 TF is unable to resolve the reconciling differences in amounts reported for the buyer/seller transactions reciprocal category with Other Defense Organizations (ODOs), (refer to Note 1.C., *Departures from U.S. GAAP*, related to Intragovernmental/Intra-departmental and Non-Federal Activities).

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 TF'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 EL, accounts payable, undelivered orders (UDOs), 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 TF strives to remediate its material weaknesses and record and report its financial activity in accordance with U.S. GAAP. Thus, DLA TF 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 TF financial statements although other departures from U.S. GAAP may exist that have not been identified.

Definition of Reporting Entity: The DLA TF 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 TF is unable to determine if there are consolidation entities that are required to be consolidated and disclosed in DLA TF 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 TF does not have policies and compliant processes in place to present its major program costs aligned with DLA TF 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 Activities: The DLA TF does not have compliant processes in place to separately report intragovernmental, intra-departmental, and non-Federal activities in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*.

Inter-Entity Cost (Note 10): The DLA TF 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 Cost to Net Outlays (Note 13): The DLA TF 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 is not able to account for FBwT in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, due to its inability to identify and reconcile the reported differences between DLA's general ledger and Treasury. Monthly journal vouchers are made to adjust the FBwT balances in DLA TF financial statements to match U.S. Treasury records.

Accounts Receivable and Revenue (Notes 1.G. and 1.R.): The DLA TF does not have policies and compliant processes in place to recognize revenue 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:

- *Revenue Recognition:* In FY2019, DLA TF made adjustments to correct the error of recognizing gains on the sale of stockpile material rather than as revenue and the related cost of goods sold. As such, DLA TF restated the FY2018 balances reported in the prior year Statement of Net Cost to properly recognize the sale of stockpile material as revenue and related cost of goods sold in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, (refer to Note 12, *Restatements of FY2018 Statement of Net Cost);* and
- *Advances from Others*: The DLA TF records accounts receivable although advance collections have been received prior to the sale. This is not in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities.*

Stockpile Materials (Note 1.H. and Note 3): The DLA TF does not have policies and compliant processes in place to account for stockpile material in accordance with SFFAS 3, *Accounting for Inventory and Related Property* and SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. Furthermore, DLA TF has not completed establishing inventory and related property beginning balances using deemed cost and has not made an unreserved assertion as permitted by SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials* (effective FY2017). More specifically, DLA TF does not have proper policies and procedures to address accurate recording of inventory quantities in the proper period; inventory valuation process; and existence and completeness of its stockpile material.

General Property, Plant and Equipment, Net (Note 1.I. and Note 4): The DLA TF does not have policies and compliant processes in place to account for general PP&E, net, at historical cost (HC), in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*. Supportable general PP&E, beginning balances have not been established for general equipment using the alternative valuation methods permitted by SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment* (effective FY2017). In addition, DLA TF 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*. Finally, the DLA TF 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*.

Leases (Note 1.J.): The DLA TF does not have polices 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 (IUS)*. As such, DLA TF does not have any capital or operating leases recorded in the financial statements as of and for the years ended September 30, 2019 and 2018.

Accounts Payable, Expenses, and Undelivered Orders (Note 1.L. and Notes 5 and 11): The DLA TF does not have policies and compliant processes in place to account for accounts payable, expense accruals, and the related UDO's 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 TF 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 TF's accounting system. This results in an understatement of current year expenses and payables, and an overstatement of UDOs; and
- *Undelivered Orders*: The DLA TF does not have sufficient policies and procedures in place to record obligations at the time contracts are awarded. In addition, DLA TF is unable to support the UDO balance in the accounting system.

Environmental and Disposal Liabilities (Note 1.M. and Note 7): The DLA TF does not have polices and compliant processes to account for costs related to cleanup in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government* and Auditing Technical Release 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*.

Commitments and Contingencies (Note 1.K. and Note 9): The DLA's TF 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 TF has not completed analyzing all 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 TF 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 TF upon implementation. DLA TF has not completed the process of evaluating the effects of adopting this pronouncement and is unable to determine the materiality of changes that adopting this pronouncement will have on its financial position, results of operations, changes in net position, and 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 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. Funding Sources

The DLA TF receives annual apportionments of spending authority from offsetting collections from Non-Federal sources from OUSD based on expected sales of materials that have been deemed excess to the needs of the Stockpile. The proceeds from the sale of materials are DLA TF's major source of authority used to fund operations. The funds in this revolving fund do not expire, but remain available for the NDS subject to congressional and OUSD approval as part of the annual apportionment process.

F. Fund Balance with Treasury

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

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

On a monthly basis, the DLA TF 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 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 TF's accounting system. Undistributed amounts can be a result of timing, invalid line of accounting, and invalid Treasury Account Symbol (TAS) information, and unsupported and unreconciled differences

The DLA TF's 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.

(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

The DLA TF customers remit estimated payments in advance for material ordered. DLA TF records accounts receivables when items are sold to pre-qualified customers that are in excess of the original advance payment. The existing accounts receivable balance is current. DLA TF generally does not have uncollectable receivables and therefore, does not establish an allowance for doubtful accounts.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivables and Revenue.)

H. Stockpile Materials

The DLA TF has two classifications of stockpile materials as described below:

Stockpile Materials Held for Sale: Stockpile material held for sale is comprised of designated materials based on the annual sales forecast.

Stockpile Materials Held in Reserve for Future Use: Stockpile material held in reserve for future use is comprised of S&C materials held due to statutory requirements for use in national defense, conservation or national emergencies. They are not held with the intent of selling in the ordinary course of business.

Valuation: Both stockpile material classifications are valued at HC and Lower Cost or Market (LCM). They are recorded as assets when acquired and recorded as expenses when sold.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Stockpile Materials and Note 3, *Stockpile Materials.)*

I. General Property, Plant and Equipment, Net

The DLA TF's General PP&E consists of general equipment used to facilitate the Agency's mission. DLA TF uses the Straight-Line (S/L) method to calculate and record depreciation expense. The S/L method is based on the acquisition cost and expensed over the asset's useful life in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment.*

The DLA TF continues to validate its PP&E balances by verifying the existence and completeness, confirming rights and obligations by validating documentation from the Military Services to ensure DLA TF is the appropriate FRO, and documenting processes through reviewing and updating policy guidance to define the procedures used for the valuation method. DLA has not yet finalized the inventory process for their PP&E. Accordingly, DLA TF has not made an unreserved assertion, in accordance with SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, that the opening balances of PP&E for FY2019 are presented fairly in accordance with U.S. GAAP.

Capitalization Threshold: The DLA TF's General PP&E assets are recorded at the historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the $250,000 capitalization threshold; however, some of the assets capitalized after October 1, 2013 did not exceed the $250,000 capitalization threshold. The PP&E assets acquired prior to October 1, 2013 were capitalized at various thresholds and are carried at the remaining net book value,

The DLA TF also capitalizes improvements added to existing General PP&E assets, if the improvements equal or exceed the capitalization threshold, extend the useful life or increase the size, efficiency, or capacity of the asset.

Depreciation Method and Useful Life:

Asset Classes	Depreciation Method	Useful Life (Years)
General Equipment	S/L	5-10

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to General Property, Plant, and Equipment, Net, and Note 4, *General Property, Plant, and Equipment, Net.*)

J. Leases

As of and for the years ended September 30, 2019 and 2018, DLA TF has not completed the process of developing policies and procedures to identify, evaluate, 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.)

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 TF recognizes contingent liabilities in DLA TF'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 TF evaluates all contingent liabilities based on three criteria; probable, reasonably possible and remote.

The DLA TF 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 TF 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 9, *Commitments and Contingencies*, of the financial statements. DLA TF does not disclose or record contingent liabilities where the loss is considered remote.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Commitments and Contingencies and Note 9, *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 Sheet dates 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 Sheet dates are referred to as unfunded liabilities (refer to Note 6, Liabilities Not Covered by Budgetary Resources).

Current and Noncurrent Liabilities: The DLA TF 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 TF expects to settle within the 12 months of the Balance Sheet dates. Noncurrent liabilities represent liabilities that DLA TF does not expect to be settled within the 12 months of the Balance Sheet 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 TF. DLA TF 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 TF also accrues liabilities incurred at month-end but not yet recorded using data from Third Party Payment Systems, GPCs, various feeder systems, and estimates of costs incurred when goods or services received but not invoiced.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses, and Undelivered Orders, Note 6, *Liabilities Not Covered by Budgetary Resources*, and Note 7, *Other Liabilities.*)

M. Environmental and Disposal Liabilities

An EL 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 TF 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 TF identifies and estimates accrued EL through its annual cost-to-complete (CTC) process. DLA TF's 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.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities, Note 8, *Environmental and Disposal Liabilities.*)

N. Payroll and Annual Leave Accruals

Accrued payroll consists of salaries, wages, and other compensation earned by employees, but not yet disbursed as of the Balance Sheet dates. DLA TF 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 TF 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 TF. DLA TF 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 TF. As a result, DLA TF recognizes an intragovernmental liability, not covered by budgetary resources, for the claims paid by DOL that will be reimbursed by DLA TF (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 TF'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 TF 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 cumulative results of operations. Cumulative results of operations includes the net difference between expenses and losses and financing sources, including revenues and gains, since the inception of the activity.

R. Revenue and Other Financing Sources

Exchange and Non-exchange Revenue: The DLA TF classifies revenue as either exchange revenue or non-exchange revenue. Exchange Revenue arises when DLA TF sells the materials that have been deemed excess to the needs of the Stockpile. The proceeds from the sale of materials are DLA TF's major financing source and are used to fund the operation. In addition, materials are offered for sale on the open market and are awarded through competitive bidding. Non-exchange revenue is derived from the government's sovereign right to demand payment, such as specifically identifiable, legally enforceable claims. Non-exchange revenue is considered to impact the cost of DLA's operations and is therefore reported in the Statements of Changes in Net Position as a financing source.

Other Financing Sources: Other financing sources include 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.

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

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

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 TF's program 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 Statements of Budgetary Resources

During FY2019, changes were made to the presentation of the Statements of Budgetary Resources in accordance with guidance provided in OMB Circular No. 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:		
Available	$ 5,608	$ -
Unavailable	232,941	250,201
Obligated Balances not yet Disbursed	48,769	43,938
Total Fund Balance with Treasury	**$ 287,318**	**$ 294,139**

Status of Fund Balance with Treasury presents the budgetary and proprietary resources that constitute DLA TF 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 Balances 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 budgetary authority and non-budgetary FBwT such as non-fiduciary deposit funds. As of September 30, 2019 and 2018, DLA TF does not have a balance for non-budgetary FBwT.

The following tables summarizes the undistributed collections and disbursements between U.S. Treasury and DLA for FY2019 and FY2018:

2019 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)

Transaction Type	Treasury Balance	DLA TF Trial Balance	Balances Not Yet Recorded in DLA Accounting System - Undistributed
Collections	$40,337	$40,339	$ (2)
Disbursements	$47,159	$46,998	$161

2018 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)

Transaction Type	Treasury Balance	DLA TF Trial Balance	Balances Not Yet Recorded in DLA Accounting System - Undistributed
Collections	$65,619	$65,619	-
Disbursements	$44,601	$45,090	$(489)

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

Note 3: Stockpile Material (Unaudited)

Stockpile Material as of September 30, 2019 and 2018, respectively, consists of the following (dollars in thousands):

	Valuation Method	2019 Stockpile Material	2018 Stockpile Material
Stockpile Material Categories			
Held for Sale	HC/LCM	$ 28,502	$ 32,084
Held in Reserve for Future Use	HC/LCM	750,662	753,757
Total Stockpile Material		**$ 779,164**	**$ 785,841**

HC: Historical Cost

LCM: Lower of Cost or Market

Stockpile materials held for sale includes Ores, Metals, and Alloys authorized for sale. Held for sale material is designated based on the annual sales forecast. As of September 30, 2019 and 2018, stockpile materials held for sale estimated market value is $35.4 million and $33.8 million, respectively.

Stockpile materials held in reserve for future use includes mercury. Based on the Mercury Export Ban Act that was signed into law on October 14, 2008, Federal Agencies are prohibited from conveying, selling or distributing metallic mercury that is under their control or jurisdiction. This includes stockpiles held by DoD. Beginning January 1, 2013, United States Federal agencies are prohibited from the sale, transport, and export of metallic mercury.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Stockpile Material.)

Note 4: General Property, Plant and Equipment, Net (Unaudited)

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

	2019		
	Acquisition Value	Accumulated Depreciation	Net Book Value
Major Asset Classes			
General Equipment	$ 2,337	$ (1,095)	$ 1,242
Total General PP&E	**$ 2,337**	**$ (1,095)**	**$ 1,242**

	2018		
	Acquisition Value	Accumulated Depreciation	Net Book Value
Major Asset Classes			
General Equipment	$ 2,337	$ (873)	$ 1,464
Total General PP&E	**$ 2,337**	**$ (873)**	**$ 1,464**

DLA TF General Equipment as of September 30, 2019 and 2018 was comprised of a mercury trailer and a front end loader.

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

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	$ 277	$ 202
Total Intragovernmental Liabilities	**277**	**202**
Non-Federal Liabilities		
Other Federal Employment Benefits	2,198	1,745
Environmental and Disposal Liabilities	9,116	8,800
Other	702	645
Total Non-Federal Liabilities	**12,016**	**11,190**
Total Liabilities Not Covered by Budgetary Resources	**12,293**	**11,392**
Total Liabilities Covered by Budgetary Resources	**15,919**	**11,334**
Total Liabilities	**$ 28,212**	**$ 22,726**

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

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. As of September 30, 2019 and 2018, the total liabilities covered by budgetary resources for environmental and disposal liabilities consists of $8.4 million and $8.8 million respectively.

Other Non-Federal Liabilities consists of current year unfunded annual leave earned by civilian employees but not yet paid. This category does not cover Federal employees. Unfunded annual leave includes restored leave, compensatory time, and credit hours as earned.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payables, Expenses, and Undelivered Orders, and Accounts Receivable and Revenue; Note 6, *Other Liabilities*; Note 7, *Environmental and Disposal Liabilities*; and Note 8, *Other Federal Employment Benefits*.)

Note 6: Other Liabilities (Unaudited)

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

2019	Current		Noncurrent		Total	
Intragovernmental						
FECA Reimbursement to DOL	$	53	$	224	$	277
Employer Contribution and Payroll Taxes Payable		88		-		88
Total Intragovernmental Other Liabilities		**141**		**224**		**365**
Non-Federal						
Accrued Funded Payroll and Benefits		250		-		250
Accrued Unfunded Annual Leave		702		-		702
Total Non-Federal Other Liabilities		**952**		**-**		**952**
Total Other Liabilities	**$**	**1,093**	**$**	**224**	**$**	**1,317**

2018	Current		Noncurrent		Total	
Intragovernmental						
FECA Reimbursement to DOL	$	40	$	162	$	202
Employer Contribution and Payroll Taxes Payable		72		-		72
Total Intragovernmental Other Liabilities		**112**		**162**		**274**
Non-Federal						
Accrued Funded Payroll and Benefits		202		-		202
Accrued Unfunded Annual Leave		645		-		645
Total Non-Federal Other Liabilities		**847**		**-**		**847**
Total Other Liabilities	**$**	**959**	**$**	**162**	**$**	**1,121**

FECA Reimbursement to DOL includes the accrued FECA liability paid by DOL but not yet reimbursed by DLA TF.

Employer Contributions 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.

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

Advances from Others includes 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.

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

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	
Non-Federal				
Environmental Corrective Action	$	17,524	$	17,588
Enviromental Closure Requirements		31		53
Total Environmental and Disposal Liabilities	**$**	**17,555**	**$**	**17,641**

The DLA's EL are comprised of two primary elements: (1) existing obligations supporting DLA TF environmental restoration programs, and (2) anticipated future costs necessary to complete environmental restoration requirements at DLA SM environmental restoration sites.

In FY2019, DLA TF utilized the Remedial Action Cost Engineering and Requirements (RACER) software to generate the FY2020 CTC estimates of anticipated future costs. Cost estimates related to environmental sites under SM were generated for 14 sites; seven sites with corrective action costs and seven sites with closure costs.

In FY2018, DLA TF utilized the RACER software to generate the FY2019 CTC estimates of anticipated future costs. Cost estimates related to environmental sites under Strategic Materials management were generated for seven Non-Base Realignment and Closure (Non-BRAC) Corrective Action sites and seven Non-BRAC Closure sites.

Types of Environmental and Disposal Liabilities: The DLA TF is responsible for the recognition, measurement, reporting, and disclosure of EL not eligible for funding under the Defense Environmental Restoration Program (DERP), also known as Non-BRAC EL, and Environmental Disposal for General Equipment. Non-BRAC EL are specifically related to past and current installation restoration activities and operations, and closure and disposal of facilities. All clean-up and disposal actions are done in coordination with regulatory Agencies, other responsible parties, and current property owners.

DLA TF reportable EL is under Other Accrued EL – Non-BRAC and includes the following line items:

- *Environmental Corrective Action*: EL associated with the cleanup sites not eligible for DERP funding, typically conducted under the Resource Conservation and Recovery Act (RCRA) or other Federal or state statutes and regulations.

- *Environmental Closure Requirements:* EL associated with the future closure/decommissioning of facilities on an installation that have environmental closure requirements to include fuel storage tanks and pipelines.
- *Non-Nuclear Powered General Equipment*: EL resulting from the disposal of non-nuclear powered general equipment. DLA TF 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 TF 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 TF is required to ensure all hazardous substance are removed prior to closing or disposing of assets such as Petroleum, Oil, and Lubricant (POL) storage tanks.

The DLA TF is required to comply with the following laws and regulations for corrective action where applicable: The Comprehensive Environmental Response, Compensation, and Liability Act; the Superfund Amendments and Reauthorization Act; 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 TF is named as a potentially responsible party by a regulatory Agency.

The DLA TF is required to report EL associated with closures in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant, and Equipment*.

Additionally, DLA TF is required to report EL associated with Non-Nuclear Powered General Equipment, commonly known as General Equipment, in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment* and Technical Releases 11 and 14 and follow applicable DLA TF policy and guidance related to general equipment.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating Periods: The DLA TF 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 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 TF utilizes historical contract or proposal costs to estimate EL. Any historical costs used in the creation of the estimates for DLA TF EL 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 TF EL estimates are reevaluated annually through updates to site/asset inventories and projected requirements. In addition, DLA TF 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 TF 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 Environmental and Disposal Liabilities: 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 or closure activities to a different degree than anticipated when calculating the estimates. EL can be further affected if investigation of the environmental sites reveal contamination levels that differ from the estimate parameters.

The stated total liability includes prior year obligations and the estimates of future costs necessary to complete requirements. DLA TF 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 TF uses RACER, as a parametric cost estimating tool, to create preliminary order of magnitude estimates. When available, site-specific historical contract or proposal costs are used to create site-level estimates.

The calculation of DLA EL relies on site/asset inventories. Asset inventories obtained from the DLA system of record provide the basis for asset-related EL estimates. The EL for these line items are estimated annually to account for changes to inventories.

The DLA TF conducted the annual Roll Forward process in accordance with DLA SOP, the DoD 7000.14-R Financial Management Regulations (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 material changes to DLA TF EL occurred between the approval of the original EL estimates and the financial reporting date of September 30, 2019. These material changes are included in the TF Environmental & Disposal Liabilities balance stated above.

Additionally, DLA TF conducted the annual EL Site Identification (ID) process that reviews the Environmental Event Repository used to track spills and releases at DLA TF locations and evaluates each event for Out-Year EL potentiality for use in the annual CTC and EL financial reporting. During the annual Site ID Process, environmental events were identified as Potential Out-Year ELs due to the lack of sufficient information/data. These sites will be re-evaluated during the next annual 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 TF EL balance.

Unrecognized Costs: The DLA TF systematically recognizes asset related EL over the useful life of PP&E assets in accordance with DoD FMR Volume 4, Chapter 13, Paragraph 130203 (April 2018). The total recognized Environmental Closure Requirements liability EL is stated above in the footnote and the associated unrecognized Closure EL is $17 thousand. DLA TF has no reportable Asbestos or General Equipment EL. Asset related EL are amortized based on the useful life of the assets as determined in DoD FMR Volume 4, Chapter 24 – Real Property, Paragraph 240206.B. Table 24-1 (June 2019) DoD Useful Lives for Depreciable Real Property Assets.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities; and Note 9, *Environmental and Disposal Liabilities*.)

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	$ 2,198	$ -	$ 2,198
Total Other Federal Employment Benefits	**$ 2,198**	**$ -**	**$ 2,198**

	2018		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	$ 1,745	$ -	$ 1,745
Total Other Federal Employment Benefits	**$ 1,745**	**$ -**	**$ 1,745**

Actuarial Calculations: The DLA TF actuarial liability for workers' compensation benefits is developed by the DOL Office of Workers' Compensation Programs and provided to DLA TF 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's 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 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) 2018 were also used to adjust the methodology's historical payments to current year constant dollars. The compensation COLAs and CPIMs used in the projections for various CBY were as follows:

CBY	COLA	CPIM
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 DLA TF. Changes in the liability from last year's analysis to this year's analysis were also examined by DLA TF, with any significant differences by DLA TF inspected in greater detail. The model has been stable and has projected the actual payments by DLA TF well.

Note 9: Commitments and Contingencies (Unaudited)

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	$ 17,555	$ -	$ -
Reasonably Possible		$ -	$ -
Legal Contingencies			
Probable	$ -	$ -	$ -
Reasonably Possible		$ -	$ 300

	2018		
	Accrued Liabilities	Estimated Range of Loss Lower End	Upper End
Environmental Contingencies			
Probable	$ 17,641	$ -	$ -
Reasonably Possible		$ -	$ -
Legal Contingencies			
Probable	$ -	$ -	$ -
Reasonably Possible		$ -	$ -

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

Note 10: 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 TF 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 TF financial statements.

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

Note 11: 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	$ 8,734	$ 10,016
Total Intragovernmental	**8,734**	**10,016**
Non-Federal		
Unpaid	32,557	31,430
Total Non-Federal	**32,557**	**31,430**
Total Undelivered Orders	**$ 41,291**	**$ 41,446**

UDOs represent the amount of goods and/or services ordered to perform DLA TF'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 TF does not have balances for paid intragovernmental and non-Federal UDOs.

Due to system limitations, DLA TF 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 Activities.)

Note 12: Restatements of FY2018 Statement of Net Cost (Unaudited)

The DLA TF restated the FY2018 balances reported in the prior year Statement of Net Cost to properly recognize the sale of stockpile materials due to a correction of an error. The FY2018 gains on sale net cost of stockpile material was corrected to report earned revenue and related cost of goods sold separately. This correction required adjustments to the FY2018 Statement of Net Cost by increasing gross cost and earned revenue by $36.8 million and $36.8 million, respectively, resulting in no impact in the overall Net Cost.

	Unaudited 2018 As Previously Reported	Unaudited 2018 Adjustments	Unaudited 2018 As Restated
Operations, Readiness & Support			
Gross Cost	$ 55,988	$ 36,767	$ 92,755
Less: Revenue Earned	(44,658)	(36,767)	(81,425)
Net Cost	**11,330**	**-**	**11,330**
NET COST OF OPERATIONS	**$ 11,330**	**$ -**	**$ 11,330**

Note 13: Reconciliation of Net Cost to Net Outlays (Unaudited)

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

	2019		
	Intragovernmental	Non-Federal	Total
NET COST	**$ 13,542**	**$ 6,315**	**$ 19,857**
Components of Net Cost That are Not Part of Net Outlays			
PP&E Depreciation	-	(222)	(222)
Other	-	(6,677)	(6,677)
(Decrease) in Assets:			
Account Receivable	-	(17)	(17)
(Increase)/Decrease in Liabilities:			
Accounts payable	(978)	(3,945)	(4,923)
Salaries and benefits	(17)	(48)	(65)
Environmental and disposal liabilities	-	86	86
Other Liabilities	(75)	(509)	(584)
Other Financing Sources:			
Imputed Financing	(634)	-	(634)
Total Components of Net Cost That are Not Part of Net Outlays	**(1,704)**	**(11,332)**	**(13,036)**
NET OUTLAYS	**$ 11,838**	**$ (5,017)**	**$ 6,821**
Outlays, Net, Statement of Budgetary Resources			**6,821**
Reconciling Difference			$ -

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 U.S. 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 Statements 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).

The Other line consists of Cost of Goods Sold, Expenditures not Requiring Budgetary Resources, and Gains/Losses. Any reconciling difference would be attributed 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 TF 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. Acquisition of inventory balances should be but are not included in the Components of Net Outlays That are Not a Part of Net Cost. However, DLA TF will continue to investigate and resolve the causes of the items not included in the reconciliation and 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.)

Other Information (Unaudited)

3

SECTION 3 – OTHER INFORMATION (UNAUDITED)

Stockroom 01B holds DLA inventory.

IN THIS SECTION

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 TF financial statements identified 7 and 6 material weaknesses respectively for DLA TF. 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	**Yes**				
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Inventory	1	-	-	-	1
Fund Balance with Treasury	1	-	-	-	1
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	**6**	**1**	**-**	**-**	**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 FFMSR. 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 TF 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 System 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
Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
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	Law Enforcement Support Office/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.

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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. **c.** **Internal Control Over Reporting:** 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.	Material weaknesses and a summary of corrective actions must be reported to OMB and Congress through the AFR, DoD Performance and Accountability Report (PAR). Or other management reports. Progress against CAPs must be periodically assessed and reported to Agency management.

Category	Definition	Reporting
	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 its 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 Major Subordinate Commands 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's online web presence (http://www.dla.mil); interacts with external media; serves as DLA official spokesperson; manages DLA social media and public engagement policies, and develops programs that communicate DLA's role as a combat support Agency that adds value to the Defense Department, military services, Combatant Commands and the American people.

DLA TRANSFORMATION (DT) 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 INSPECTOR GENERAL (OIG) coordinates and synchronizes U.S. GAO and Department of Defense Office of Inspector General (DoDIG) audits with all DLA components; tracking, monitoring, and assessing the implementation of audit corrective actions and communicating completion results. They sustain strategic engagement with the Defense Counsel on Integrity and Efficiency and their subcommittees, as well as relationships with DoDIG Criminal Investigative Services, Military Criminal Investigation Services, and other law enforcement Agencies. DLA OIG also conducts administrative investigations and crime vulnerability assessments that align with Agency risks and strategic goals. The DLA OIG internal audit plan is derived from 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
A&FP	Accounting & Finance Policy Directorate
AFR	Agency Financial Report
APR	Annual Performance Report
BAA	Broad Agency Announcement
BRAC	Base Realignment and Closure
CAP	Corrective Action Plan
CARS	Central Accounting and Reporting System
CBY	Charge Back Year
CC	Critical Capabilities
CFO	Chief Financial Officer
CIO	Chief Information Officer
CMR	Cash Management Report
COLA	Cost-of-Living Adjustment
COTS	Commercial Off-the-Shelf
CPIM	Consumer Price Index Medical
CTC	Cost-to-Complete
CUEC	Complementary User End Controls
DAI	Defense Agencies Initiative
DATA	Digital Accountability and Transparency Act of 2014
DCAS	Defense Contract Administration Services
DCIA	Debt Collection Improvement Act
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service

DLA	Defense Logistics Agency
DoD	Department of Defense
DoDIG	Department of Defense Office of Inspector General
DOL	Department of Labor
DSA	Defense Supply Agency
DSS	Distribution Standard System
EBS	Enterprise Business System
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
FFMIA	Federal Financial Management Improvement Act
FFMSR	Federal Financial Management System Requirements
FMFIA	Federal Managers' Financial Integrity Act
FMR	Financial Management Regulation
FRDAA	Fraud Reduction and Data Analytics Act
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 of 1994
GPC	Government Purchase Card

GPRA	Government Performance and Results Act
GSA	General Services Administration
HC	Historical Cost
ICO	Internal Control over Operations
ICOR	Internal Control over Reporting
ID	Identification
IPA	Independent Public Accounting Firm
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Act of 2002
IT	Information Technology
IUS	Internal Use Software
J/D	Staff Directors and Field Activity Commanders
LOE	Lines of Efforts
MOCAS	Mechanization of Contract Administration Services
NDAA	National Defense Authorization Act
NDS	National Defense Stockpile
NFR	Notice of Findings and Recommendations
Non-BRAC	Non-Base Realignment and Closure
OCONUS	Outside of Continental United States
ODO	Other Defense Organizations
OI	Other Information
OIG	Office of Inspector General
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
OUSD	Office of the Under Secretary of Defense

OUSD-C	Office of the Under Secretary of Defense (Comptroller)
P3	Public-Private Partnership
PAR	Performance and Accountability Report
PP&E	Plant, Property, & Equipment
R&D	Research & Development
RACER	Remedial Action Cost Engineering and Requirements
RCRA	Resource Conservation and Recovery Act
S&C	Strategic & Critical Materials
S/L	Straight-Line
SAAS-MOD	Standard Army Ammunition System-Modernization
SFFAS	Statement of Federal Financial Accounting Standards
SFIS	Standard Financial Information Structure
SLOA	Standard Line of Accounting
SM	Strategic Materials
SOA	Statement of Assurance
SOC	Systems and Organizational Control
SOP	Standard Operating Procedure
TAMIS-R	Total Ammunition Management Information System-Redesigned
TAS	Treasury Account Symbol
TDD	Treasury Direct Disbursing
TF	Transaction Fund
TFM	Treasury Financial Manual
TNC	Treasury Nominal Coupon
U.S.	United States
U.S.C.	United States Code

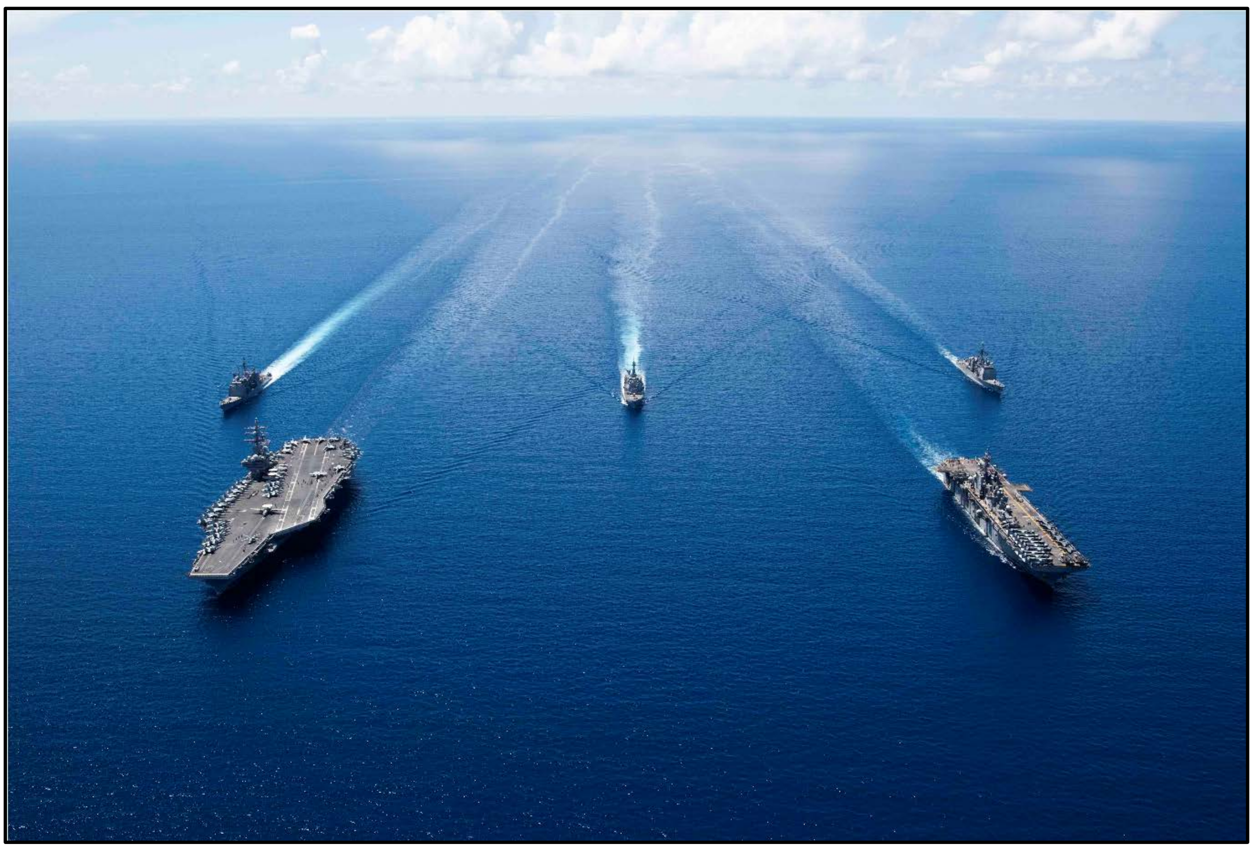
UDO	Undelivered Orders
USSGL	U.S. Standard General Ledger
WCF	Working Capital Fund

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 the Office of the CFO, for your time and efforts in preparing the AFR.

The DLA also would like to thank the Audit Task Force for coordinating the external audit of the agency's financial statements.

The DLA offers our sincerest thanks and acknowledgement to the 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.



The aircraft carrier USS Ronald Reagan, left, the amphibious assault ship USS Boxer and ships from the Ronald Reagan Carrier Strike Group and the Boxer Amphibious Ready Group conduct security and stability operations in the South China Sea, Oct. 6, 2019.

Marine Corps Sgt. Matthew J. Bragg gives stickers to children at a school in Capas, Philippines during a classroom construction project as art of Exercise Balikatan. DLA provided assistance during the 35th annual Balikatan exercises

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