DEFENSE LOGISTICS AGENCY

THE NATION'S COMBAT LOGISTICS SUPPORT AGENCY

Agency Financial REPORT

TRANSACTION FUND

(UNAUDITED)

Fiscal Year 2020

Noble Partner

Army Sgt. Dylan Weiss and Spc. Anthony Roller establish a perimeter around a simulated enemy compound during Noble Partner at Vaziani Training Area, Georgia, Sept. 15, 2020. The exercise is designed to enhance force readiness and interoperability.

Photo By: Army Spc. Isaiah Matthews

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 principal 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;**
- **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, *Financial Reporting Requirements*, as amended*;***
- **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.***

All information within this report pertains to DLA TF unless specifically noted otherwise. DLA TF's financial results are unaudited because there are limitations to underlying processes and internal controls 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 DLA's history at a glance, 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.

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, fraud reduction reporting, and payment integrity reporting.

---

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

FY2020
Transaction Fund
Agency Financial Report

JERSEY FAST-ROPE

Special warfare airmen assigned to the New Jersey Air National Guard participate in fast-rope training with a Marine Corps UH-1Y Venom helicopter at Joint Base McGuire-Dix-Lakehurst, N.J., Oct. 10, 2019.

Photo Credit: Air National Guard Master Sgt. Matt Hecht

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

MESSAGE FROM THE DIRECTOR

On behalf of the Defense Logistics Agency (DLA), I am pleased to present the Fiscal Year (FY) 2020 Agency Financial Report. This is DLA's 59th year of existence and throughout our proud history we have always successfully responded in support of the Nation's and the Department's end to end logistics requirements. In FY2020, DLA continued to support relief efforts for natural disasters, such as wildfires that destroyed 11 million acres of land and a record number of hurricanes and tropical storms. DLA also awarded 21,000 contract actions with obligations of over $2 billion to assist the Department's and other Federal Agencies response to the Coronavirus-19 (COVID-19) pandemic. 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 works relentlessly to efficiently and effectively serve the Warfighter and our partners as they accomplish their respective missions.

I am honored to be DLA's 20th Director, and my charge is to continue finding the right solutions to meet the needs of our combatant command, the Services and our Nation. We are postured to continuously learn and grow as an organization while we maintain our passion to find effective solutions. At DLA, our key mission is supporting the Warfighter and providing effective logistics support to the operating forces of our Military Services at the lowest possible cost to the taxpayer. To accomplish our goals of delivering world-class support to the Warfighter and maintaining accountability, the Agency has devoted itself to the following five Lines of Effort, two Critical Capabilities and three Cross-Cutting Efforts:

► LINES OF EFFORT

- **Warfighter Always:** 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

► CROSS-CUTTING EFFORTS

- **Auditability:** Is everyone's responsibility
- **DoD Reforms:** Gain efficiencies and maximize savings
- **Supply Chain Security:** Strengthening operational resilience

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.

This year, our Independent Public Accounting (IPA) firm, Ernst and Young, LLP, issued a Disclaimer of Opinion on DLA's Transaction Fund (TF) Financial Statement. Information obtained 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, and completeness of records. DLA also continues to identify material weaknesses in the same areas.

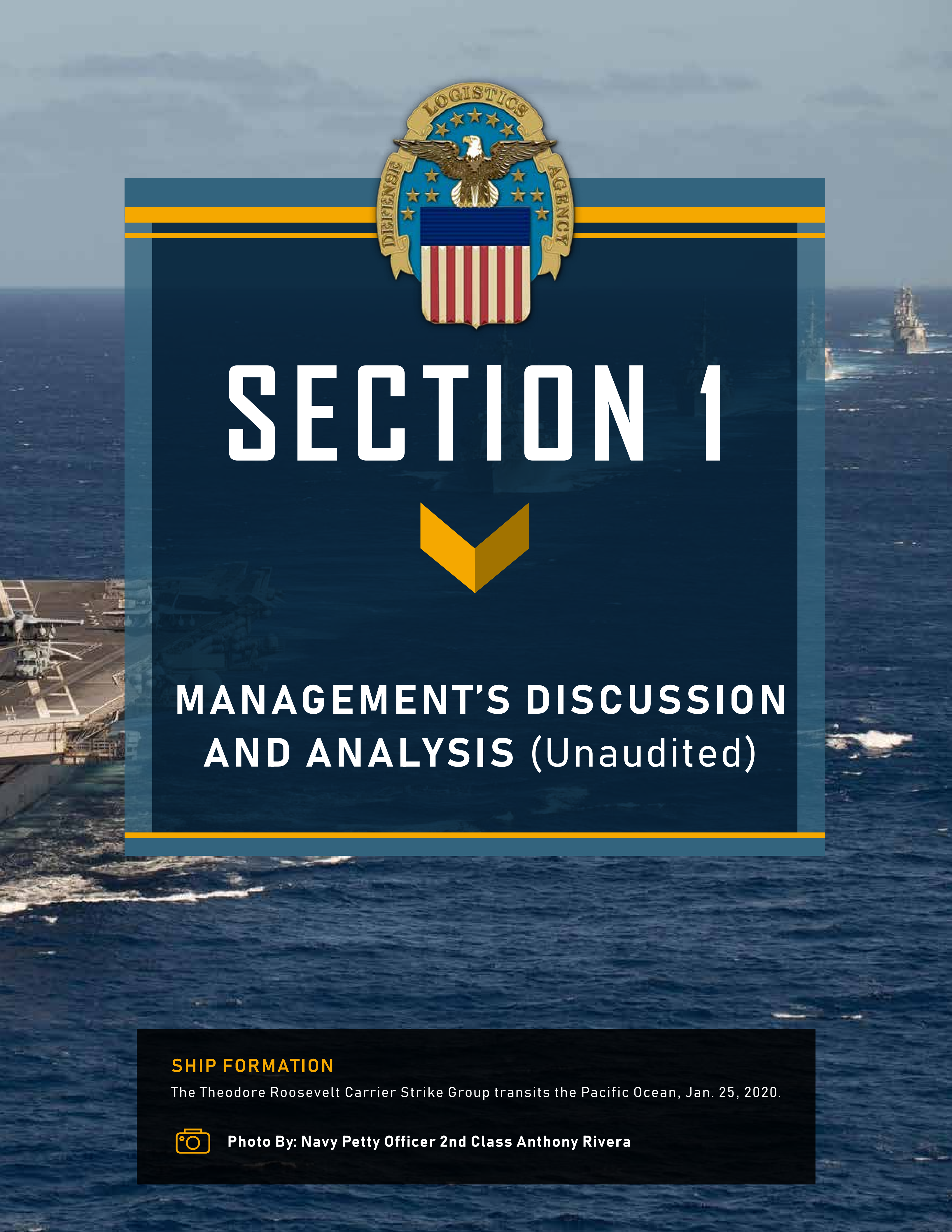
With the establishment of the DLA Enterprise Risk Management (ERM) Program Office in late FY2019 the Agency began implementation and execution of the Risk and Internal Control Program. In FY2020, the ERM Program Office focused their efforts across DLA in building the foundational tenets for managing risk and internal controls by developing an ERM framework, establishing DLA's Risk Appetite Statement and identifying the top critical risks for the Agency.

The DLA is focusing on reviewing the audit results, identifying root causes of conditions, prioritizing resources, and developing corrective action plans to fix the conditions associated with identified material weaknesses. As DLA looks toward the future, efforts will focus on reengineering end to end processes, identifying risks, designing and testing controls, and prioritizing remediation efforts. In addition, DLA is reviewing all aspects of OMB Circulars A-123, Management's Responsibility for Enterprise Risk Management and Internal Control and A-136, Financial Reporting Requirements to incorporate necessary Enterprise-wide operational and financial reporting process changes that will ensure that our financial statements are accurate and reliable.

In the future, DLA will continue to resource 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 foundation, we will continue to be the Nation's Combat Logistics Support Agency. WARFIGHTER ALWAYS!

M. C. SKUBIC
VADM, SC, USN
Director

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



SECTION 1

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

SHIP FORMATION

The Theodore Roosevelt Carrier Strike Group transits the Pacific Ocean, Jan. 25, 2020.

Photo By: Navy Petty Officer 2nd Class Anthony Rivera

IN THIS SECTION

SECTION 1
Management's Discussion and Analysis (Unaudited)

MISSION AND ORGANIZATIONAL STRUCTURE

DLA's History at a Glance

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 1958 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 (HQ). Through its Defense Contract Administration Services (DCAS), DSA 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 DSA new authorities and missions. On January 1, 1977, DoD changed DSA's name to the Defense Logistics Agency. Less than a decade later, Congress identified DLA as a Combat Support Agency in the Goldwater-Nichols Act of 1986. In 1988, DLA (also referred to as 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.

Cruise Escort

Coast Guard crew members travel in a 29-foot response boat after completing a cruise ship escort in Charleston, S.C., Jan. 30, 2020. **Photo By: Navy Petty Officer 2nd Class Ryan Dickinson**

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 re-engineered its HQ so that only six organizations, rather than 42, reported directly to the Director. As a result of Base Realignment and Closure (BRAC) 88, DLA moved its HQ 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 HQ 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 $6.9 billion, provided more than 180.5 million field meals, supplied nearly 2.0 million humanitarian daily rations, and sourced more than 3.0 billion U.S. gallons of fuel. During retrograde operations, the Agency continued to supply 100 percent of food, fuel, and medical supplies for the remaining forces, as well as most of their clothing, construction materials, and spare parts.

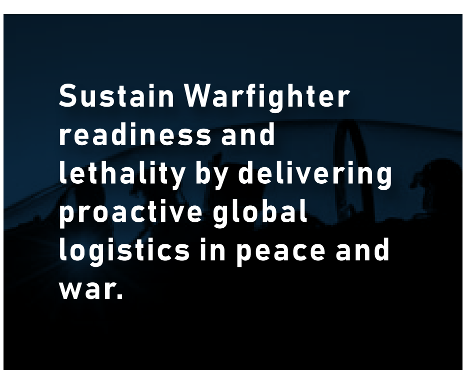
In addition to its operational support, DLA provided logistical aid for humanitarian and relief missions. In October-November 2012, it offered unprecedented support in the wake of Hurricane Sandy. In September 2014, it helped the U.S. Agency for International Development combat the deadly Ebola virus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

As DLA approaches its 60th anniversary, it continues to provide logistics, acquisition, and technical services to 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



VISION

VALUES

What DLA Does

Shipyard Spritz

A dock worker cleans the anchor chain of the USS Mount Whitney as the command and control ship undergoes a regularly scheduled overhaul at the San Giorgio Del Porto shipyard in Genoa, Italy, Sept. 24, 2020. **Photo By: Navy Petty Officer 2nd Class Scott Barnes**

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 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 60 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.

How DLA TF Accomplishes its Mission

The 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.) (the Act). The mission of the National Defense Stockpile (NDS) program 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. The major activity within the DLA TF is the acquisition and storage of Strategic Materials (SM) as part of managing and operating the Nation's NDS. DLA SM strives to decrease and preclude a dangerous and costly dependency 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 of 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, management of existing critical materials, and broad range tracking of future critical materials.

(50 U.S.C. §98, et seq.) (the Act). DLA SM revenues are generated through auctions to pre-qualified customers of stocks determined excess to DoD needs as determined by Congress through the Annual Sales Plan (ASP) and is the source of funding for operational expenditures and new material acquisitions.

Flightline Four

Air Force aircrew members walk back to the base operations building at Altus Air Force Base, OK., after a flight, March 31, 2020. **Photo By: Air Force Tech. Sgt. Kenneth Norman**

Organizational Chart

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

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. DoD produces an Annual Performance Report (APR) for all its components (including DLA TF) and will include its FY2020 APR with its FY2022 Congressional Budget Justification. The APR is located at: https://cmo.defense.gov/Publications/Annual-Performance-Plan-and-Performance-Report/.

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), two Critical Capabilities (CCs) and three Cross-Cutting Efforts (CCEs). These goal-oriented objectives and forward-looking initiatives are designed to strengthen DLA's efforts in sustaining Warfighter readiness and the Nation's responsiveness as described:

Lines of Effort: A mechanism to link multiple goal-oriented objectives that focus efforts toward establishing operational and strategic conditions.

Critical Capabilities: A means that is considered a crucial enabler for a center of gravity to function as such and is essential to the accomplishment of the specified or assumed objective(s).

Cross Cutting Efforts: Efforts that support, impact or significantly influence more than one LOE. Identified to ensure deliberate consideration, greater coordination and synchronization during planning and execution, both within and external to DLA.

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, CCEs, 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 DLA 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 Interagency Partnerships
3.3 Industry Partnerships
3.4 Public Engagement

Objective 3.2: DoD and 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's 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 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 Transfer 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 .

CCE 1 AUDITABILITY

Auditability is a cross-cutting effort and is everyone's responsibility from the Director down to the warehouse worker and across the enterprise as a whole. The audit requires full engagement to understand our operations, adequately document processes, implement strong internal controls and enhance Information Technology (IT) general controls. Audit sustainment will improve enterprise business operations, reduce cycle times, and ultimately maximize Warfighter support. DLA will develop corrective action plans that address changes to the end-to-end processes that span across the enterprise, improving DLA's core business cycles.

CCE 2 DoD REFORMS

In response to the President's call for governmental reform and under the Direction of the Chief Management Officer, DoD is reviewing, changing and singling up processes, where appropriate, to gain efficiencies and maximize savings to reinvest into Service readiness. To support this effort, DLA's central Reform Program Management Office coordinates with DoD reform teams and integrates reform efforts across the Agency.

CCE 3 SUPPLY CHAIN SECURITY

Supply Chain security is a cross-cutting effort to ensure DLA has the connections and communication in place to operate in a contested or degraded operational environment. Interruption of DLA supply chain operations compromises our Nation's ability to deliver combat power and execute critical missions. DLA's efforts are focused on maintaining the integrity and access to key data; engaging with valid and reputable vendors who produce quality supplies and services; and building resiliency and redundancy into processes and systems to ensure continuity of operations.

CC 1 ENTERPRISE ENABLERS

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

Enterprise Enablers Objectives

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

CC 2 PEOPLE AND CULTURE

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 & Culture Objectives

1. Develop Leaders
2. Resource the Enterprise
3. Manage the Talent
4. Sustain our People
5. Fortify the Culture
6. Perform and Reward
7. Build Connections
8. Protect the Workforce

Simulator Scene

Airmen drive an all-terrain vehicle during combat survival training at Eglin Air Force Base, FL., Aug. 13, 2020. **Photo By: Air Force Staff Sgt. Joseph Pick**

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. Section 6 (a) (3) of the Strategic and Critical Materials Stock Piling Act (50 U.S.C. § 98 et seq.) provides authority for the upgrading, refining, or processing of any material in the stockpile to establish such material in a form suitable for storage and immediate use in a National Emergency. This includes readiness for infusion into a supply chain to support National defense, if required.

A major initiative in recent years has been the reprocessing of tin to rid it of "tin pest". This is a condition of oxidation resulting in deterioration of the metal and loss of content due to flaking and crumbling. This upgrade program, which re-melts the infected stocks, provides for the removal of oxide from the melt. The result is improved quality and grade of stocks returned to the Stockpile. This returns the tin (metal ingots) to a form and grade equal to tin currently traded in terminal markets and available for consumption in the usual markets. This initiative also reduces risk to the Warfighter by ensuring the readiness of Stockpile materials, when required.

Beginning in FY2018, DLA SM entered into an agreement with Rock Island Arsenal (RIA) to begin a pilot program to re-melt infected lots of Stockpile tin as a means of ridding them of tin pest. The program was successful at removing the oxide (tin pest) and returned tin ingots of grade containing no oxide. The program continued until all infected tin was improved by reprocessing (948 bundles; one bundle equals approximately one metric ton). This work was carried out through a multi-year agreement with RIA.

In FY2018, DLA SM shipped 380 bundles to RIA for reprocessing. In FY2019, 348 bundles were shipped to RIA. A two-month service lapse in FY2019 contributed to a reduction in shipments to RIA by 32 fewer bundles (8.4%) over FY2018. In FY2020, 220 bundles were shipped—a 36.8% decrease over FY2019.

The original FY2020 target for bundles shipped to RIA for re-melting was 280. However, upon re-evaluation, DLA SM found that 60 bundles included in the FY2020 target were in an acceptable condition and did not require remelting. This concluded the program and the agreement with RIA was discontinued on June 30, 2020.

The remaining original tin inventory is deemed "pest free" and stored in climate-controlled warehouse space that prevents the development of tin pest disease. As a result, the re-melt program has concluded.

The following performance reporting is based on bundles of degraded tin shipped for reprocessing under the statutory authority of the Stockpile.

Outbound Tin Material (Bundles)				
	FY2020 Target	**FY2020 Actuals**	**FY2019 Actuals**	**FY2018 Actuals**
Outbound Tin Material	280	220	348	380

Figure 3: Outbound Tin Material in FY2018 through FY2020

Performance Measure 2: Sales versus Contract Awards

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

The DLA SM targets that current year material sales amounts are equal to the aggregate of current year contract awards, as all the contracts signed each year are typically consummated that year.

Any variances between contract awards and sales are typically due to timing of shipments; if a contract is signed late in the financial period the actual shipment (and the sales recognition) may be delayed until the following period.

Actual sales were very close to contract awards in FY2019, with sales $1.3 million (3.2%) higher than contract awards. As of September 30, 2020, actual sales lagged contract awards by $10.1 million (17.8%), driven by large contracts still in process at period end.

Regarding revenue for FY2020, the goal of $56.9 million was not achieved. FY2020 revenue was 82.1% of goal or $46.7 million. This was primarily attributed to softer markets and lower market prices due to the COVID-19 pandemic.

With the shuttering of production in China and the U.S. earlier this calendar year due to the pandemic, market demand and market prices fell throughout the calendar year 2020. The greatest decrease in market price was attributed to a 12.7% fall in market value for Ferromanganese (FeMn). FeMn demand is primarily tied to steel production. The U.S. steel utilization rate (a key indicator of the health of steel production) fell from March to September 2020. DLA SM FeMn contracts awarded in October 2019 (expiring October 2020) saw a reduction in award value. These contracts are awarded with a 365-day period of performance with pricing formulas tied to industry market indices—thus value achieved rise and fall with the market.

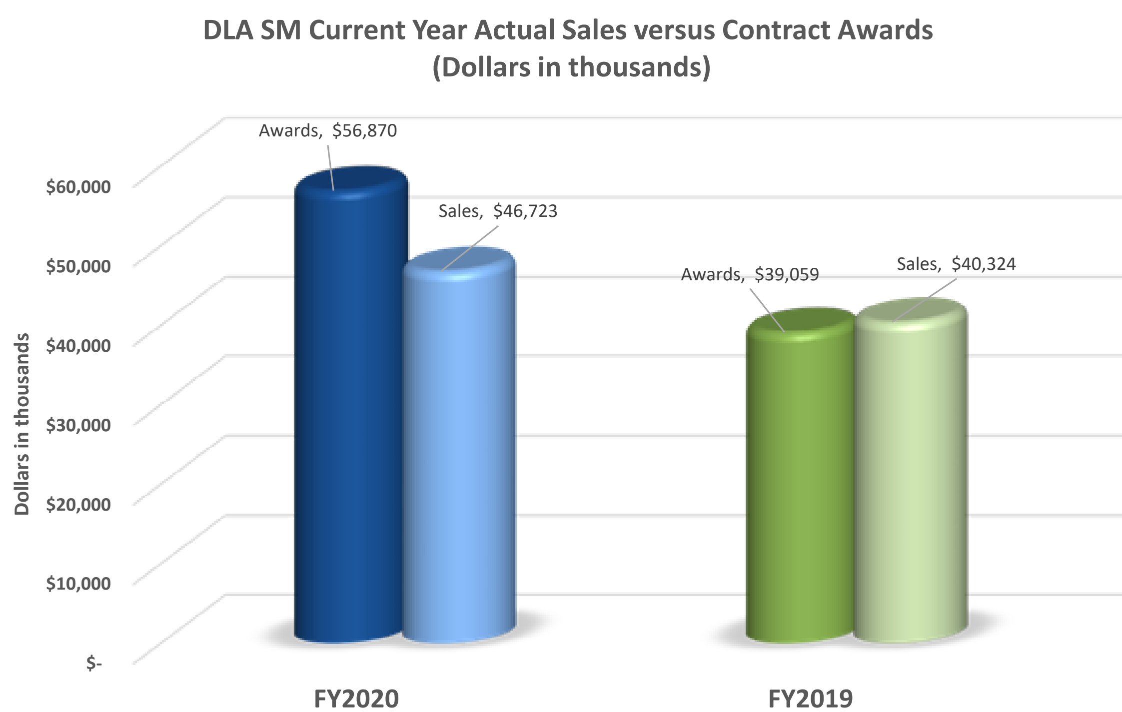


Figure 4: DLA SM Sales and Contract Awards

Performance Measure 3: DLA SM Actual Collections versus Anticipated Collections

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

The DLA TF is apportioned Spending Authority from Offsetting Collections to fund operational expenditures and strategic and critical materials purchases. Therefore, auditability hinges on metrics, controls and tracking over the movement of inventory, as it relates to disposals via public sales, and the corresponding accounting for the receipts of those sales to the TF.

Through comprehensive analyses and study, all NDS stocks undergo evaluation of need against a stringent set of criteria. The determinations from these analyses may result in authorization by Congress to acquire new materials and deem some current stocks excess. The National Defense Stock Piling Act provides authority for a public competitive sales program, which protects against an avoidable loss to the Government, and avoids undue disruption to the usual markets. The sale of excess stocks requires current existing legislative disposal authority along with an Annual Materials Plan (AMP). Congress typically provides disposal authority via the National Defense Authorization Act. Disposal authority, generally, provides quantity by material with no specific expiration. Additionally, the AMP provides for the ceiling limit quantity of any material sold in a given fiscal year.

DLA SM operates the Stockpile Sales Program. DLA SM has built an established customer base. All approved and potential customers have undergone review for financial responsibility and have cleared a set of criteria for participation in the Stockpile Sales Program. DLA SM conducts on-going outreach and canvassing to the approved customer base and marketplace to determine business outlook and forecasting regarding demand for materials in order to issue public sales offerings. Pricing tolerances are established in advance based upon fair market value assessments to aid in protecting against avoidable loss. Awarded sales and terms are documented in a bilateral Sales Contract.

The DLA SM creates an ASP to support the revenue projection as set forth in the Program Budget Review process. The ASP contains a mix of excess stocks, supported by the AMP believed to generate the anticipated collections authorized. Designated line items of inventory are made "available for sale" based on the ASP. These are the inventory items used to support sales offerings and generate revenue. Variances between the ASP and actual contract awards may occur due to market conditions. Collections are the result of execution under the sales contract terms. These collections serve to replenish the TF and support revolving fund operations of the NDS.

Collections related to earned revenue for FY2020 were $46.7 million or 73.0% of anticipated offsetting collections reported in DLA TF SF-132, *Apportionment and Reapportionment Schedule.* As collections follow as a result of revenue achieved (disclosed in performance measure 2) collections fell short of the FY2020 metric due to the impact of the COVID-19 pandemic on market prices.

Continued on next page –

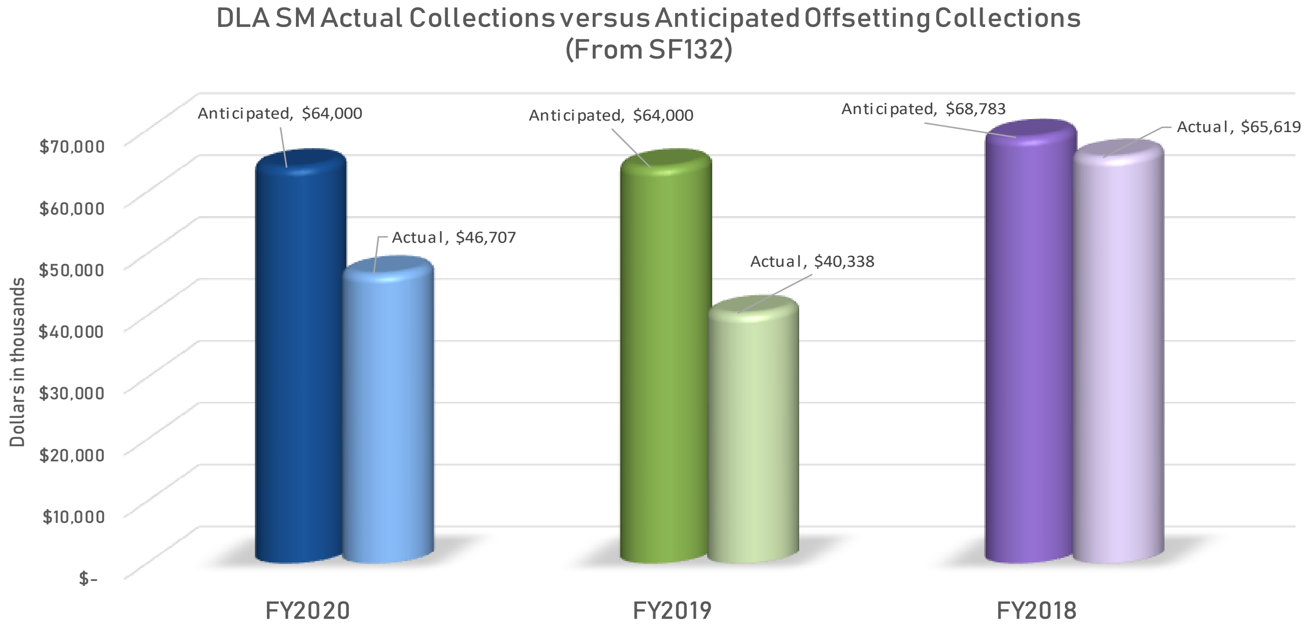


Figure 5: DLA SM Actual Collections versus Anticipated Offsetting Collections

Free Fall

Navy explosive ordnance disposal technicians conduct free-fall jumps during flight operations with the Spanish navy in Rota, Spain, Feb. 13, 2020. **Photo By: Navy Petty Officer 3rd Class Katie Cox**

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 FY2020, 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 preparation of the AFR by instilling sound fundamental practices in developing the AFR in accordance with OMB Circular A-136 financial reporting requirements, and the financial statements in accordance with U.S. Generally Accepted Accounting Principles U.S (GAAP).

Alpine Lookout

N An Army CH-47F Chinook sits atop a mountain in the Alps in Germany, Oct. 21, 2020. **Photo By: Army National Guard Staff Sgt. Garrett L. Dipuma**

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 financial statements and accompanying 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 financial 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.

A summary of DLA TF's changes in key financial measures for FY2020 and FY2019 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.

Simulator Scene

Navy Lt. Aaron Van Driessche, warfare tactics instructor at the Center for Surface Combat Systems Detachment San Diego, CA, pilots the Navy's virtual combat curriculum inside a newly launched portable simulator in San Diego, CA, Jan. 6, 2020, with sailors aboard the USS Paul Hamilton. **Photo By: Navy Petty Officer 2nd Class Joseph Millar**

Changes In Key Financial Measures

As of and for the Years Ended September 30, 2020 and 2019 (dollars in millions)

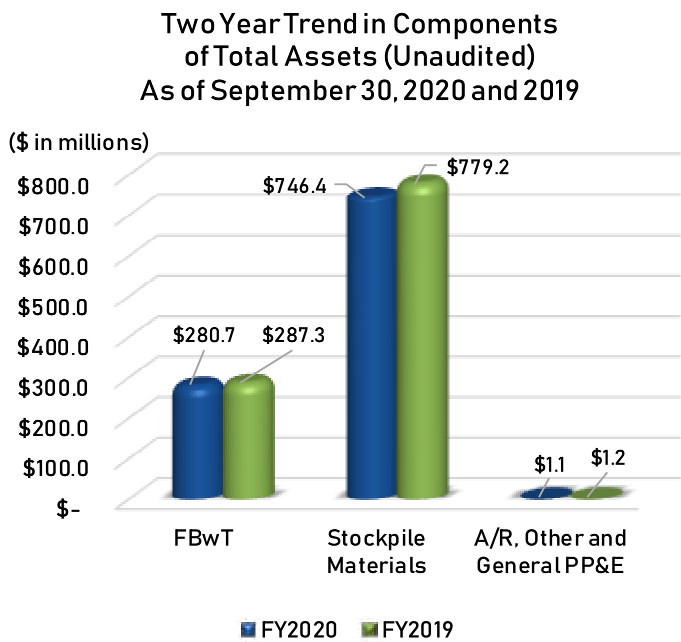
Net Financial Condition	FY2020 (Unaudited)	FY2019 (Unaudited)	Increase/Decrease $	Increase/Decrease %
Fund Balance with Treasury	$ 280.7	$ 287.3	$ (6.6)	(2.3%)
Stockpile Materials	746.4	779.2	(32.8)	(4.2%)
Accounts Receivable and General PP&E	1.1	1.2	(0.1)	(8.3%)
Total Assets	**$ 1,028.2**	**$ 1,067.7**	**$ (39.5)**	**(3.7%)**
Accounts Payable	$ 4.1	$ 7.1	$ (3.0)	(42.3%)
Federal Employment Benefits and Other Liabilities	6.3	3.5	2.8	80.0%
Environmental and Disposal Liabilities	11.1	17.6	(6.5)	(36.9%)
Total Liabilities	**21.5**	**28.2**	**(6.7)**	**(23.8%)**
Cumulative Results of Operations	1,006.7	1,039.5	(32.8)	(3.2%)
Total Net Position	**1,006.7**	**1,039.5**	**(32.8)**	**(3.2%)**
Total Liabilities and Net Position	**$ 1,028.2**	**$ 1,067.7**	**$ (39.5)**	**(3.7%)**
Net Cost of Operations	**$ 33.3**	**$ 19.9**	**$ 13.4**	**67.3%**
Budgetary Resources	**$ 265.5**	**$ 274.4**	**$ (8.9)**	**(3.2%)**

Figure 6: Changes In Key Financial Measures

Balance Sheets Summary

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, which represent $746.4 million or 72.6% of Total Assets as of September 30, 2020. DLA TF FBWT decrease of $6.6 million or 2.3% was primarily attributed to lower market demand due to the COVID-19 pandemic.



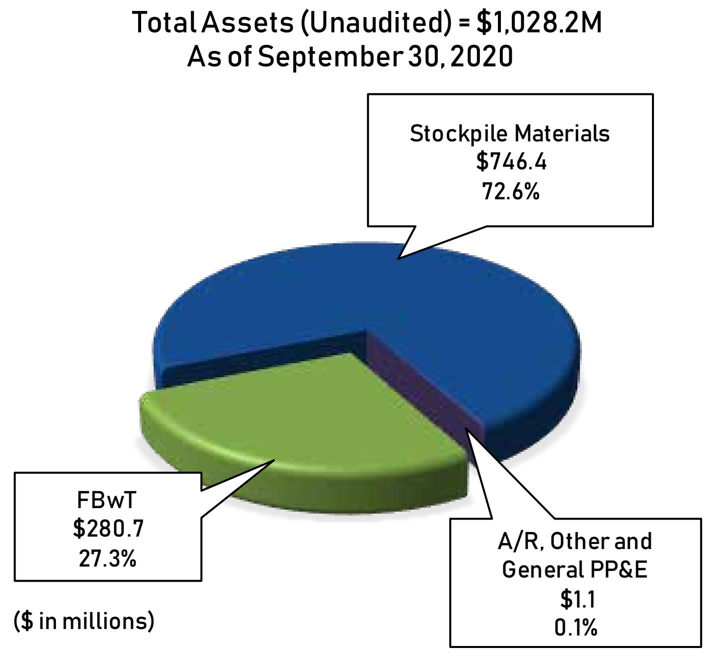
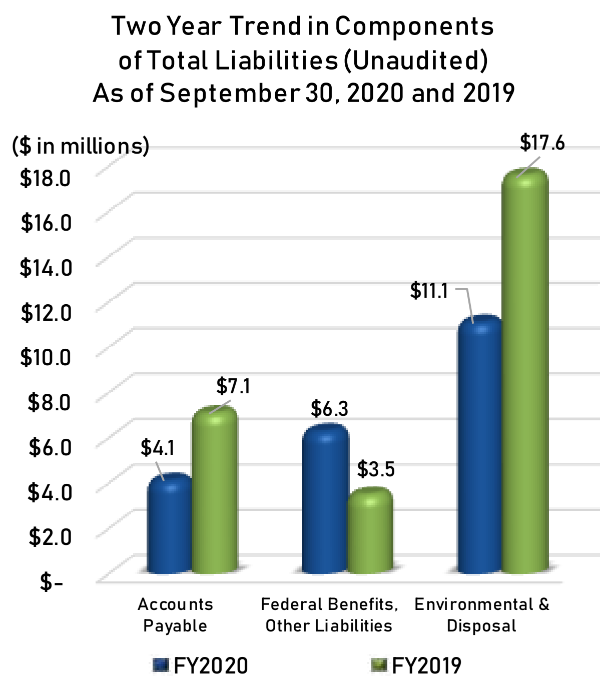


Figure 7: Total Assets as of September 30, 2020 and 2019

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, 2020 is Environmental and Disposal Liabilities (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 EL balance of $11.1 million represents 51.6% of Total Liabilities as of September 30, 2020. EL's decrease of $6.5 million or 36.9% from September 30, 2019 was primarily attributed to the completion of Non-BRAC corrective actions and a decrease in the estimate of Non-BRAC corrective actions. The decrease of $3.0 million in Accounts Payable was due to a decrease in acquisitions because management determined it was not in the government's best interest to continue awarding additional contracts considering the technical, supplier, and cost elements. The increase of $2.8 million in Other Liabilities was due to an increase in payments in advance received for strategic materials from non-Federal customers.



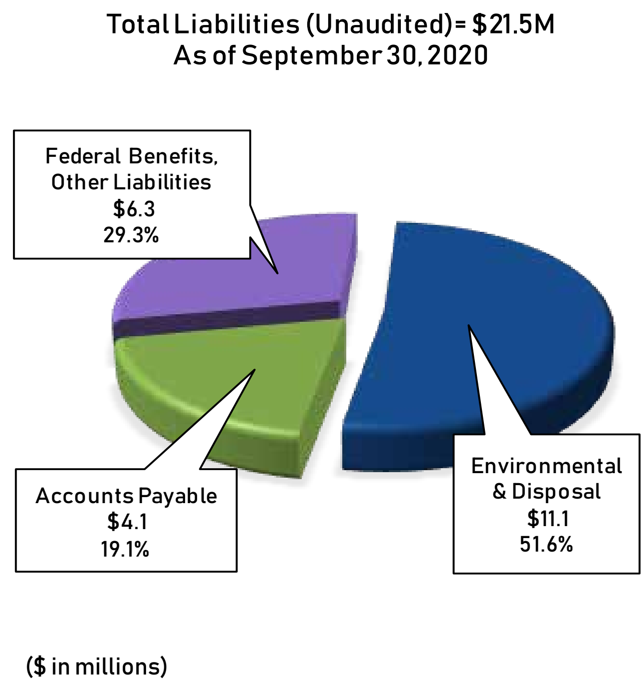


Figure 8: Total Liabilities as of September 30, 2020 and 2019

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 $1,006.7 million as of September 30, 2020 and $1,039.5 million as of September 30, 2019.

DLA TF RESULTS – Current Fiscal Year Net Cost of Operations

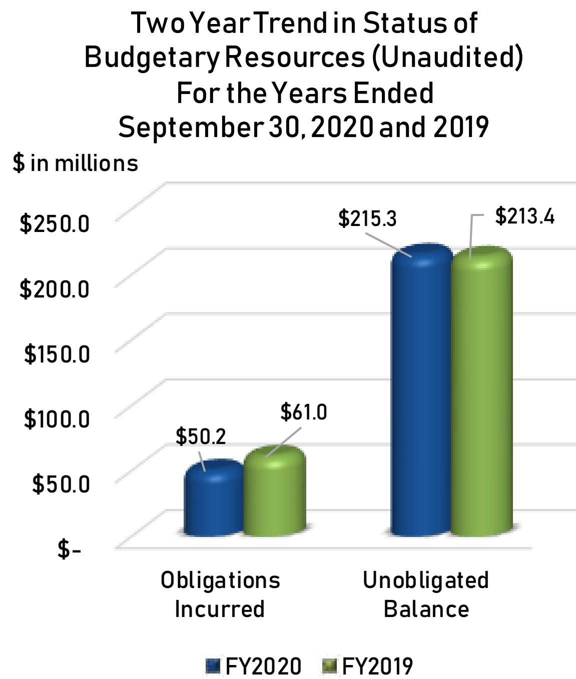
The DLA TF Statements of Net Cost reports one program: Operations, Readiness, and Support. Net Cost of Operations totaled $33.3 million for the year ended September 30, 2020 and $19.9 million for the year ended September 30, 2019. Net Cost of Operations increased $13.4 million, or approximately 67.3% over FY2019. The net increase was primarily due to a reduction in earned revenue related to the decline in the volume of sales for the following stockpile materials: High Carbon Ferrochrome, Tungsten, Chromium Metal, Ferromanganese, Tantalum Carbide Powder and Tungsten Metal powder.

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 $265.5 million for DLA TF for the year ended September 30, 2020. The authority was primarily derived from $214.7 million in unobligated balance from prior year budget authority, net, and $50.8 million in Spending Authority from Offsetting Collections in FY2020. Of the total budget authority available, DLA TF incurred a total of $50.2 million in obligations from salaries and benefits, purchase orders placed, contracts awarded, and similar transactions.

The net decrease in Total Budgetary Resources of $8.9 million or 3.2% was primarily due to reduced collections as a result of a decline in sales. Additionally, total obligations decreased by $10.7 million primarily due to reduced acquisition activities because management determined that it was not in the best interest of the government to award additional contracts considering the technical, supplier, and cost elements.



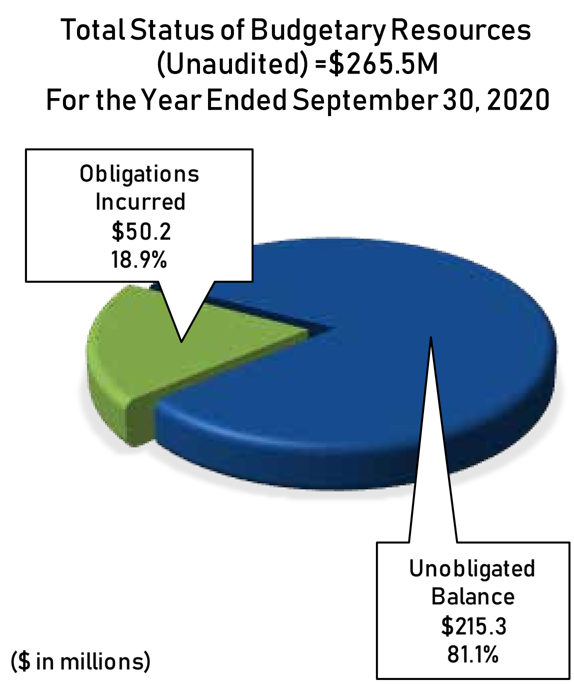


Figure 9: Total Status of Budgetary Resources for the Years Ended September 30, 2020 and 2019

LIMITATIONS OF THE FINANCIAL STATEMENTS

The DLA TF principal financial statements[2] 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 Federal Accounting Standards Advisory Board (FASAB) and the form and content requirements for Federal government entities specified by OMB Circular A-136, 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 continues to address IT and financial audit NFRs to strengthen system controls and financial and regulatory compliance with corrective action plans that include developing requests for systems changes. DLA has begun planning and defining requirements for a major systems upgrade to SAP's 4th generation Enterprise Resource Planning (ERP) system (S/4), which will be an enterprise cloud based system. SAP S/4 will provide enhanced reporting of financial information on the full accrual accounting basis and streamline data between IT systems, which DLA continues to consolidate and rationalize through the migration of major legacy systems.

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 as promulgated by FASAB 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.

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

Hurricane Cleanup

Members of the Louisiana National Guard clear roads in Lake Charles, La., Aug. 27, 2020, after Hurricane Laura made landfall in the southwestern part of the state. **Photo By: Army Staff Sgt. Josiah Pugh**

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 Statement of Assurance (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 2020

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 2020

As Director of the Defense Logistics Agency (DLA), I recognize DLA is responsible for managing risks and maintaining effective internal controls 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 controls 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 provides no assurance that internal controls over operations, reporting, and compliance are operating effectively as of September 30, 2020.

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 *Summary of Management's Approach to Internal Control Evaluation* section provides specific information on how DLA conducted this assessment. Based on the results, DLA provides no assurance that internal controls over operations and compliance are operating effectively as of September 30, 2020.

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 *Summary of Management's Approach to Internal Control Evaluation* section, provides specific information on how DLA conducted this assessment. Based on the results, DLA provides no assurance that internal controls over reporting and compliance are operating effectively as of September 30, 2020.

DLA also 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 *Summary of Management's Approach to Internal Control Evaluation* section provides specific information on how DLA conducted this assessment. Based on the results, DLA provides no 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, 2020.

DLA conducted an assessment of entity-level controls including fraud controls in accordance with the Green Book, OMB Circular No. A-123, the Payment Integrity Information Act of 2019, and GAO Fraud Risk Management Framework. Based on the results of the assessment, DLA provides no assurance that entity-level controls including fraud controls are operating effectively as of September 30, 2020.

To address these deficiencies, DLA established the Enterprise Risk Management (ERM) Program Management Office (PMO) in 2019 and appointed a Chief Risk Officer to address the full spectrum of DLA's risk portfolio and key internal controls across all organizational and business aspects. This will enable DLA 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. Moreover, DLA developed corrective actions to address the shortfalls in the OMB A-123 Program and senior leaders at all levels of the organization are committed to incremental improvements to establishing a risk based controls environment. DLA continues to build the institutional capacity to execute an effective OMB A-123 Program and demonstrates measurable progress that includes:

- Established a robust, multi-layered ERM governance structure, including a Senior Management Council (SMC) to identify, escalate, and respond to risks in a methodical way and implement internal controls in the high priority areas

- Designated and appointed key officials within the Agency, including a Senior Accountable Official (SAO) to oversee the OMB A-123 Program, a Chief Risk Officer (CRO) to coordinate DLA's existing ERM efforts, and a Risk Management and Internal Control (RMIC) Manager to facilitate and coordinate the Agency's A-123 Program

- Established and staffed DLA's ERM Program Management Office with team members well versed in risk management, internal control and audit

- Developed an ERM Framework to address predictable and unpredictable risk events

- Initiated the development of institutional capacity to implement A-123 by conducting seven A-123 workshops focused on Program Overview, End-to-End Business Processes, Assessable Units, Enterprise Risk Management, Risk Management Process, Fraud Risk Management, and Internal Control

- Developed DLA's first Risk Appetite Statement and identified Agency's "top 3 most critical risks" to focus risk-mitigation activities at the enterprise level

- Developed and implemented an ERM dashboard to track DLA's top 3 most critical risks

- Published a comprehensive A-123 Program instruction (DLAI 5010.40) that is sought after by the DoD Enterprise Risk Management Community of Practice and other DoD organizations to use as benchmark for developing the Department's DODI 5010.40

- Developed a comprehensive manual, DLAM 5010.40, Risk Management (Vol I) and Internal Control (Vol II) that provides the concepts for implementing and executing an effective A-123 Program

DLA also consistently strives to create a "culture of accountability" to ensure compliance with laws, regulations, policies, and the execution of key processes. Examples of this include the Agency-wide circulation of the Director's "Tone at the Top" message and monthly employee accountability assessments and supervisory assurance certifications.

DLA has also synchronized its efforts between the ERM PMO and Audit Task Force to strengthen the Agency's A-123 Program and audit infrastructure. This new approach leverages a risk-based methodology to facilitate the integration of internal controls, risk management activities and audit remediation. The effort includes establishing an aggressive plan to validate Transaction Fund beginning balances and inventory existence, completeness and valuation for Fiscal Year 2021 to support a favorable audit opinion.

Point of contact for this action is Kelleye Elmore at (571) 205-3397 or kelleye.elmore@dla.mil.

M. C. SKUBIC
VADM, SC, USN
Director

Summary of Internal Control Assessment

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 and FFMIA

Federal Managers' Financial Integrity Act

The DLA management evaluated the system of internal control in effect during the current fiscal year according to the guidance prescribed in the GAO Green Book and OMB Circular A-123.

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 expected benefits and (2) the benefits include reducing the risk associated with failing to achieve the stated objectives. 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. The projection of any system evaluation to future periods is subject to risks 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 providing a statement of no 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 the SOA. 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 of reasonable assurance for FY2020 and reports a statement of "no assurance" for Internal Control over Reporting (ICOR) and Internal Control over Operations (ICOR-O). In addition, DLA is unable to provide assurance that internal controls over financial systems (ICOFS) are in compliance with FMFIA and FFMIA.

The DLA's FY2019 SOA package followed the structure of the financial statement audit NFRs for documenting the individual material weaknesses associated with ICOR and ICOFS. DLA's FY2019 SOA package included a total of 233 ICOR material weaknesses (consolidated into seven material weaknesses for AFR presentation), 78 ICOFS non-conformances (consolidated into four non-conformances for AFR presentation), and three ICOR-O material weaknesses across the General Fund (GF), TF, and Working Capital Fund (WCF).

For FY2020, the SOA package is only required to include self-identified material weaknesses and significant deficiencies for internal DoD reporting because the financial statement audit NFRs are already being reported and tracked separately. The audit related ICOR and ICOFS material weaknesses that have not yet been remediated are reported in the Summary of Financial Statement Audit and Management Assurances Other Information (OI) section. Per the June 2019 DoD Financial Improvement and Audit Remediation Report, financial statement audit findings and Corrective Action Plans (CAPs) "are entered into a centralized database managed by the Office of the Deputy Chief Financial Officer (ODCFO)." DLA's SOA Package FY2020 Material Weaknesses and Significant Deficiencies template included a total of three material weaknesses in the area of ICOR-O. The three FY2020 ICOR-O material weaknesses, summarized in the table below, are consistent with the ICOR-O material weaknesses reported by DLA in the FY2019 AFR.

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 will perform an analysis, develop and update policies and procedures, test controls, and conduct implementation procedures to remediate the deficiencies associated with this finding.
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.

The DLA is working to improve the documentation around DLA's end-to-end business processes and has not performed full-scale OMB Circular A-123 internal control testing during FY2020 in order to self-identify and track ICOR and ICOFS material weaknesses that remain unremediated from the FY2019 SOA package. To address these deficiencies, DLA established the ERM Program Management Office (PMO) in FY2019 and appointed a Chief Risk Officer (CRO) to address the full spectrum of DLA's risk portfolio and key internal controls across all organizational and business aspects. This will enable DLA 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. Moreover, 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 controls environment. DLA continues to build the institutional capacity to execute an effective OMB Circular A-123 Program and demonstrates measurable progress that includes:

- Established a robust, multi-layered ERM governance structure, including a Senior Management Council (SMC) to identify, escalate, and respond to risks in a methodical way and implement internal controls in the high priority areas.
- Designated and appointed key officials within the Agency, including a Senior Accountable Official (SAO) to oversee the OMB Circular A-123 Program, a CRO to coordinate DLA's existing ERM efforts, and a Risk Management and Internal Control (RMIC) Manager to facilitate and coordinate the Agency's OMB Circular A-123 Program.
- Established and staffed DLA's ERM Program Management Office with team members well versed in risk management, internal control and audit.
- Developed an ERM Framework to address predictable and unpredictable risk events.
- Initiated the development of institutional capacity to implement OMB Circular A-123 by conducting seven OMB Circular A-123 workshops focused on Program Overview, End-to-End Business Processes, Assessable Units, Enterprise Risk Management, Risk Management Process, Fraud Risk Management, and Internal Control.
- Developed DLA's first Risk Appetite Statement and identified the top three most critical risks to focus risk-mitigation activities at the enterprise level.
- Developed and implemented an ERM dashboard to track DLA's top three most critical risks.
- Published a comprehensive OMB Circular A-123 Program instruction that is sought after by the DoD Enterprise Risk Management Community of Practice and other DoD organizations to use as a benchmark for developing the Department's instruction.
- Developed a comprehensive Risk Management and Internal Control manual that provides the concepts for implementing and executing an effective OMB Circular A-123 Program.

The DLA consistently strives to create a "culture of accountability" to ensure compliance with laws, regulations, policies and the execution of key processes. Examples of this include the Agency-wide circulation of the Director's "Tone at the Top" message and monthly employee accountability assessments and supervisory assurance certifications.

The DLA has also synchronized its efforts between the ERM PMO and Audit Task Force to strengthen the Agency's OMB Circular A-123 Program and audit infrastructure. This new approach leverages a risk-based methodology to facilitate the integration of internal controls, risk management activities and audit remediation. The effort includes establishing an aggressive plan to validate Transaction Fund beginning balances and inventory existence, completeness and valuation for FY2021 to support a favorable audit opinion.

The DLA's Summary of Financial Statement Audit and Management Assurances for SOA package and audit related material weaknesses are presented in the 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 the OMB Circular A-123, Appendix D compliance determination framework to perform a review of data for each of the FFMIA compliance indicators and associated analysis in order to determine compliance with FFMIA. Based on the application of the framework and associated analysis of relevant FFMIA compliance indicators available, DLA 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: the disclaimer of opinion on the FY2019 financial statements; and material weaknesses over internal controls over reporting and information system non-compliance related to financial system security were reported in FY2019 and FY2020 in areas that corresponded to FFMSRs.

Federal Accounting Standards[3]:

High-risk factors that indicate non-compliance in this area include: the disclaimer of opinion on the FY2019 financial statements and material weaknesses over internal controls over reporting reported by DLA in FY2019 and FY2020 in areas that related to compliance with Federal accounting standards.

USSGL at the Transaction Level:

High-risk factors that indicate non-compliance in this area include the disclaimer of opinion on the FY2019 financial statements and material weaknesses over internal controls over reporting reported in FY2019 and FY2020 in areas that related to implementation of the USSGL at the transaction level.

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. 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.

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

FFMIA Section 803(a) Requirement	Remediation Activities	Target Date	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.	FY2021 - FY2023	• Finance • Information Operations • Acquisition • 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 U.S. GAAP as established by the FASAB.	FY2021 - FY2023	• Finance • Information Operations • Acquisition • 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.	FY2021 - FY2023	• Finance • Information Operations • Acquisition • Logistics Operations

Compliance with Laws and Regulations

Anti-Deficiency Act

The Anti-Deficiency Act (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 for DLA TF.

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 (DQP) 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. During FY2020, DLA continued to build upon this plan, which sets forth DLA's process for reviewing, monitoring, and reporting the required data, as well as how DLA will continue to improve the process. At this time, DLA, as a component of DoD, continues to rely on the Department's DQP to satisfy the OMB requirement, while DLA continues to develop a separate DQP and test plans to assess controls impacting data quality.

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. Defense Finance and Accounting Service (DFAS) prepares the Treasury Report on Receivables, a report for the debt receivable, 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 is unable to provide assurance over compliance with the Charge Card Act but has multiple layers of processes and controls in place to identify fraudulent purchases.

In order to mitigate the risk of fraud, DLA uses the DoD mandated Insight on Demand (IOD) system, which is an artificial intelligence data mining platform that automatically analyzes Government Purchase Card (GPC) data to identify and flag high risk transactions. Agency/Organization Program Coordinators (A/OPC) and Approving/Billing Officials (A/BO) review 100% of all flagged IOD data mining cases on a daily basis. A/OPCs complete a monthly checklist within IOD, which is a series of oversight questions related to appointment and training, and the Component Program Manager (CPM) review the monthly A/OPC reports within IOD to include corrective actions taken for any identified non-compliance. A/OPCs complete a semi-annual head of activity report within IOD that captures program oversight data, including the number of transactions flagged for review, findings, and corrective actions assigned. The A/OPCs brief their head of activity with the results. CPMs complete a semi-annual head of activity report within IOD that captures program oversight data at the Agency level and briefs to the Senior Procurement Executive.

In addition to IOD, DLA has processes in place for A/BOs, A/OPCs, and the CPMs to conduct transaction reviews and overall program compliance reviews in order to mitigate the risk of fraud and misuse. Major Subordinate Command (MSC) audit teams also conduct GPC reviews. As a result of IOD and DLA processes, transactions are reviewed by A/BOs, A/OPCs, and CPMs daily, monthly, semi-annually, and annually with corrective action assigned as appropriate.

On a daily basis, management approves all requirements before the cardholder makes the purchase. A/BOs approve the use of the GPC as the method of payment and review 100% of purchases made by cardholders. The A/OPCs perform a monthly review over a minimum of 6.0% of all cardholder transactions, take corrective action and provide results to the CPM for review. The A/OPCs and CPMs also review all monthly statement approval and certifications to identify any A/BO violations of segregation of duty policies.

CPM also conducts an annual comprehensive program review of each DLA GPC Activity, which includes a random sampling of cardholder transactions, appointment and training documentation, and overall program oversight responsibilities. The CPM assigns corrective actions as appropriate and provides results to senior leadership.

During FY2020, there were no instances of fraud identified as a result of reviews or audits.

Financial Systems

Financial Systems Strategy

The DLA Information Operations is DLA's knowledge broker, providing comprehensive, best practice IT support to 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

Twilight Training

Marines stand together at twilight during an integrated training exercise at Marine Air Ground Combat Center Twentynine Palms, Calif., Oct. 5, 2020. **Photo By: Marine Corps Lance Cpl. Zachary Zephir** 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.

Effective April 1, 2020, DLA reduced onsite operations to emergency and mission-essential/critical personnel only (i.e., meaning only those employees who must be physically present to perform necessary functions) in response to the COVID-19 pandemic. While operating in an emergency status due to COVID-19 precautions, telework-ready personnel not required to be onsite are required to telework. DLA is working with the Defense Information Systems Agency (DISA) to ensure the sustainment of DLA mass telework capability and partnering with the DoD CIO, National Security Agency (NSA), and industry on a longer term solution to provide the Secret Internet Protocol Router Network for teleworkers.

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 TF. The core of EBS is Systems Applications and Product's (SAP) Enterprise Resource Planning Central Component (ECC) version 6.0. This is an on-premise, 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.

The 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. Federal Program Agencies (FPAs) 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. The G-Invoicing required use date for FPAs for New Orders has been delayed from June 2021. The mandated implementation deadline of October 2022 for New Orders includes Orders with a Period of Performance beginning October 1, 2022 or later. FPAs must implement G-Invoicing for "In-Flight" Orders by October 2023. The mandated implementation deadline of October 2023 for "In-Flight" Orders includes the conversion of Orders with an open balance and a Period of Performance extending beyond September 30, 2023.

The implementation of 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.

The DLA's new Warehouse Management System (WMS) will simplify storage and distribution processes to better align with industry standards, creating a single warehousing system for all of DLA. WMS is being developed in the cloud to reduce infrastructure costs using Agile methodology. The benefits of Agile include faster time to market, reduced cost, reduced project risk, high quality products and solutions, immediate value, increased customer satisfaction, and an ability to adjust to requirement changes.

FORWARD-LOOKING INFORMATION

The following areas present 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's 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 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.

The DLA has a critical mission to support the Military Services, Combatant Commands, and other Federal Agencies; that includes supporting our Nation's response to COVID-19. The key to DLA's success is its people, and while DLA will respond professionally and swiftly to mission requirements related to COVID-19, DLA will also take necessary steps to protect and inform our workforce. Approximately 35% of our DLA workforce have been designated as "mission-critical onsite," which means they have to come into their workplaces throughout this crisis to continue DLA's vital work of supporting Warfighters and the whole-of-government response to the pandemic. This includes deploying overseas; executing our wholesale distribution operations; supporting our Disposition Services customers; enabling our Service customers at shipyards, readiness centers, and depots; keeping our installations safe and secure; performing necessary IT "touch labor"; issuing Common Access Card (CAC) cards and fingerprinting new employees; performing classified work; and many other functions requiring physical presence. As an employer, DLA will follow DoD policies and guidelines in taking any actions to address or mitigate the threat posed by COVID-19. This includes disseminating official information by appropriate public or military health authorities, leveraging workplace policies and flexibilities designed to protect our workforce, and activating "continuity of operations" plans should it become necessary. Each DLA major population center has its own plan for returning employees to the workplace, all based on common guidance for a condition-based, deliberate, and safe return. Different locations will go through the various phases on different timelines accounting for local conditions. DLA is monitoring workforce availability and conducting site capability and capacity assessments. DLA will continue to encourage completion of COVID-19 worksite related trainings and to develop methods to effectively hire and onboard personnel with a plan for virtual training and orientation.

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 DoD. DLA developed a 2018-2026 Strategic Plan and amended the plan in April 2019 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". DLA's Strategic Plan reaffirms and extends DLA's commitment to Warfighter readiness and lethality and to self-accountability. The plan describes five LOEs, two CCs, and three Cross-Cutting Efforts 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. Additionally, the Cross-Cutting Efforts: Auditability, DoD reforms and Supply Chain Security ensure synchronized efforts for interagency coordination and execution.

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.

The DoD and the DLA share the responsibility for implementing effective ERM to maintain operational efficiency and to protect the achievement of mission. ERM is a strategic capability that enables DLA to effectively deal with uncertainty and associated risk and opportunity. It utilizes a forward-looking, mission-oriented, and holistic approach to ERM that links risk to DLA's strategy and objectives. ERM enables the identification of potential risks and subsequent responses to those risks. ERM enables DLA to more effectively manage enterprise risks, consider constraints and dependencies between key risks, while creating and preserving the value DLA contributes to the National Defense Strategy, National Defense Business Operations Plan, and DoD objectives. ERM and Internal Control are components of the governance framework.

The DLA's culture of risk awareness continues to mature. Thorough risk assessments can identify, document, and communicate risk before it becomes an issue. Through ERM and Internal Control, DLA is taking a strategic approach to manage risk and drive DLA's mission.

The 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.**

The DLA is providing support to the U.S. response to COVID-19 in the areas of material support, planning, and acquisition and will continue to be a vital part of the worldwide logistics response. However, DLA is also a global enterprise, with resources and people around the world, both within and outside the Continental U.S. As such, DLA is tracking the virus and its impact to military operations and locations, as well as how communities are responding to the threat. DLA is fully engaged and monitoring COVID-19 changes from Occupational Safety and Health Administration (OSHA) and DoD as well as providing continual communication with employees through staff and site directors. DLA host site services are operating based on local and state guidance. DLA is continuing to monitor the readiness of first responders and documenting the execution of the risk manage process and risk acceptance at the appropriate leadership levels.

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.

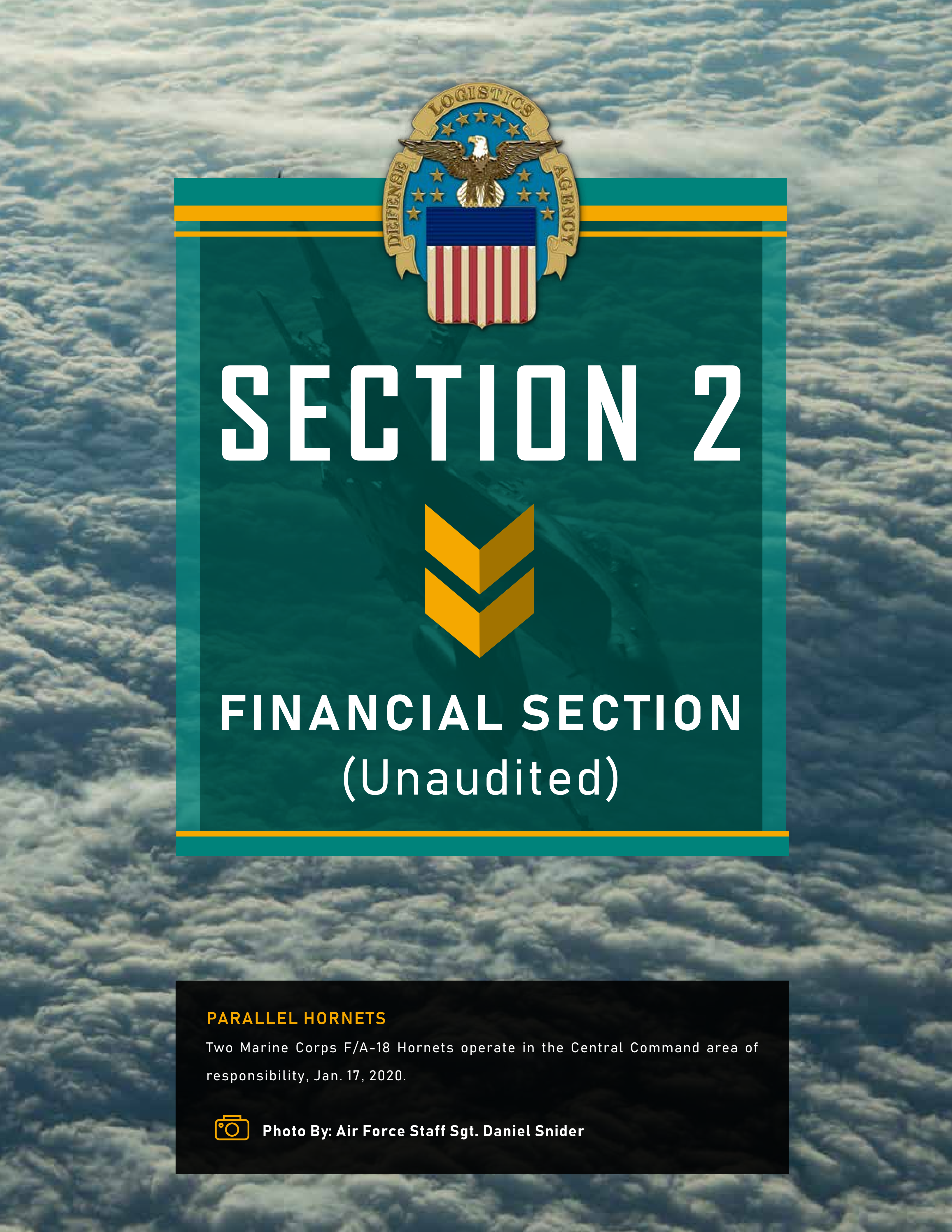
For technology, DLA Information Operations continuously evaluates the IT operating environment to identify potential opportunities to streamline and automate processes as well as ensure alignment with DoD and DLA Strategic Initiatives. One example of these types of efforts currently in process include increasing the use of cloud computing technologies and solutions. Many applications have already begun migration to cloud computing. A major initiative, ERP to cloud migration is scheduled for completion in the first quarter of FY2022. Simultaneously, DLA will perform a Business Transformation Study to define the scope and level of effort to conduct a Migration to Standard to SAP S/4 capability. DLA will conduct business process re-engineering to ensure use of the standard capability to the maximum extent possible to reduce cost, streamline business process to adopt industry best practices and allow for better innovation going forward. The full schedule for the Migration to Standard phase will be developed once the requirements have been defined and approved.

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, and authoritative financial data in support of DoD goals 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.

Exercise Prep

Marines prepare for an exercise at Vaziani Training Area, Georgia, Oct. 18, 2020. **Photo By: USMC**

SECTION 2 | FINANCIAL SECTION (Unaudited)



SECTION 2

FINANCIAL SECTION
(Unaudited)

PARALLEL HORNETS

Two Marine Corps F/A-18 Hornets operate in the Central Command area of responsibility, Jan. 17, 2020.

Photo By: Air Force Staff Sgt. Daniel Snider

IN THIS SECTION

SECTION 2

Financial Section (Unaudited)

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

NOVEMBER 2020 (TF)

"I am fully committed to ensuring DLA meets its stewardship responsibilities, and am proud to be part of a team of colleagues that works hard to develop strategies that strengthen our cross-functional partnerships internal and external to the Agency."

I am proud to join the Director in issuing our Fiscal Year (FY) 2020 Agency Financial Report (AFR), the fourth Defense Logistics Agency (DLA) has issued since starting the financial statement audit process. DLA Transaction Fund's (TF) FY2020 AFR highlights certain valuable insights into the overall financial operations, accomplishments, and challenges of the Agency, and this section of the AFR provides a comprehensive view of DLA TF financial activities. DLA remains committed to ensuring value, efficiency, and effectiveness, as well as ensuring outstanding stewardship to protect against fraud, waste and abuse in every program we manage.

During the unprecedented COVID-19 pandemic, DLA quickly responded to the needs of the Nation and Warfighter and collaborated with the Federal Emergency Management Agency and the Department of Health and Human Services procuring critical medical equipment and personal protective equipment (PPE) in support of the National response. As challenging as the operating environment became as a result of providing this additional support and protecting the staff, DLA was still able to accomplish its mission, while still protecting against fraud, waste or abuse.

Although 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, DLA continues to make tremendous strides, establishing the framework to correct material weaknesses by reviewing and establishing end-to-end business processes, identifying the financial statement and financial reporting risks, and designing and implementing the associated controls to address those risks.

The DLA enterprise continues to document and evaluate critical processes and controls to identify and address risks associated with financial reporting. 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. DLA continues to strive toward improved financial reporting, remediation of Notice of Findings and Recommendations, and improved financial data and internal controls with the goal of achieving an unmodified audit opinion. For DLA TF, we are enhancing our internal controls over operations, financial reporting, and financial systems.

I am fully committed to ensuring DLA meets its stewardship responsibilities, and am proud to be part of a team of colleagues that works hard to develop strategies that strengthen our cross-functional partnerships internal and external to the Agency. As DLA evolves and matures in the audit process, we will continue to learn and use that knowledge to improve and protect our business processes, allowing us to maximize our resources in support of the Warfighter. One of our highest priorities is to provide enhanced financial management and strong governance in support of our goals to identify and address risks, successfully manage challenges, including audit findings, and accomplish associated remediation actions necessary to address material weaknesses. WARFIGHTER ALWAYS!

J.ARTHUR HAGLER
Director, DLA Finance
Chief Financial Officer

AUDIT REPORTS

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

November 13, 2020

MEMORANDUM FOR SECRETARY OF DEFENSE
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 2020 and FY 2019 (Project No. D2020-D000FE-0054.000, Report No. DODIG-2021-025)

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, 2020, and 2019. The contract required EY to provide a report on internal control over financial reporting and compliance with laws and other matters, and to report on whether the DLA's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996. 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, Updated April 2020. 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 2020 and FY 2019 Financial Statements and related notes.

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

- The DLA did not have adequate 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 policies, procedures, or controls to evaluate the impact of suspense account transactions to Fund Balance With Treasury.

- The DLA did not support the accounts payable balance, expenses, or related budgetary balances, and it recorded accounts payable and expense transactions in the wrong periods. In addition, the DLA did not have overall policies, procedures, or internal controls to effectively implement accounting standards, and did not have adequate procedures to accrue for obligations incurred but not paid.

- The DLA did not have sufficient controls to review and identify inaccurate financial statement balances and footnote disclosures, lacked policies and procedures to validate account balances and monitor reporting variances between source systems, and did not provide detailed budgetary account listings that reconciled to the general ledger.

- The DLA did not implement appropriate internal controls, including the documentation of policies and procedures that described end-to-end business processes, roles and responsibilities, monitoring service providers, and remediation of audit findings.

- The DLA had weaknesses in the design and operation of information systems controls over financial data to include access controls, configuration

* 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.

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 Federal Financial Management Improvement Act of 1996 and Federal Managers' Financial Integrity Act of 1982.

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY's 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 Transaction Fund FY 2020 and FY 2019 Financial Statements and related notes. Furthermore, we do not express conclusions on the effectiveness of internal control over financial reporting, on whether the DLA's financial systems substantially complied with Federal Financial Management Improvement Act of 1996 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 13, 2020, and the conclusions expressed within the reports.

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

Lorin T. Venable

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

Attachments:
As stated

Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

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

Report of Independent Auditors

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

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the National Defense Stockpile Transaction Fund of the Defense Logistics Agency (DLA), which comprise the balance sheets as of September 30, 2020 and 2019, and the related statements of net cost, statements of changes in net position and statements of budgetary resources for the years then ended, and the related notes to the financial statements (the 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 (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Because of the matters 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 of these matters on the financial statement amounts and related disclosures involved is not currently determinable by DLA and could be material.

2011-3622160

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, 2020 and 2019.

Disclaimer of Opinion

Because of the significance of the matters 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 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 financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

Building a better working world

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 13, 2020, 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, grant agreements and other matters. The purpose of those reports is solely 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 the effectiveness of DLA's 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 13, 2020

2011-3622160

Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

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

Building a better working world

Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit 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 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, 2020, and the related statement of net cost, statement of 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 13, 2020. Our report disclaims an opinion on such financial statements because DLA was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

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) as a basis for designing 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 did not consider 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 preparing performance information ensuring efficient operations.

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 have not been identified. As described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

2011-3622160

Building a better working world

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. We consider the deficiencies described below and in Appendix A as items I. through VI. to be material weaknesses.

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. We consider the deficiencies described below and in Appendix B as items I. and II. to be 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 FBwT beginning and ending balances from the general ledger to U.S. Treasury. DLA implemented a process to reconcile the collection and disbursement activity from the general ledger to U.S. Treasury, however, DLA did not implement controls to assess the completeness and accuracy of the source data used in the reconciliation. In addition, DLA lacks policies, procedures and controls to evaluate the impact to FBwT for transactions in suspense accounts. The combination of these deficiencies in aggregate results in a material weakness in internal control related to FBwT. The matters identified related to FBwT are further described in Appendix A.

III. Accounts 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

2011-3622160

invoices. Furthermore, DLA lacked adequate procedures to record obligations and accrue for liabilities incurred but not paid, and it recorded 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.

IV. 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 account balances and monitor 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 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.

V. Oversight and Monitoring – DLA does not have an effective OMB Circular A-123 program, which impacted DLA's ability to appropriately identify and address significant risks for all key business processes. DLA has not implemented appropriate internal controls, including the documentation of policies and procedures that describe DLA's environment related to end-to-end business processes, monitoring of service providers, related parties, systems, risks and 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.

VI. 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.

2011-3622160

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. Revenue – Revenue is earned when DLA sells goods to the public. DLA records manual adjustments to present revenue and cost of goods sold in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The matters identified related to revenue are further described in Appendix B.

II. Environmental Liabilities (EL) – ELs are comprised of cleanup costs associated with the restoration of sites on real property that DLA manages. DLA lacks adequate policies, procedures and controls to validate its estimation methodology. The matters identified related to EL are further described in Appendix B.

Management's Response to Findings

DLA's responses to the findings identified in our engagement and relevant comments from DLA's management are provided in their accompanying letter dated November 13, 2020. Management'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 13, 2020

2011-3622160

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:

- **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 and reviewed for completeness and accuracy. 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:

- 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

2011-3622160

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.

- Inventory acquisition transactions are not recorded appropriately. For example, DLA recognizes a gain upon receipt of inventory and an expense upon receipt of the vendor invoice.

Recommendations

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

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

- **Physical Inventory Counts.** Design and implement controls over physical inventory counts. The controls should be designed to review adjustments recorded for completeness and accuracy and 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.

- Ensuring that costs to bring inventory to its current condition, such as reconditioning costs, are properly capitalized.

- Ensuring that inventory received from federal entities is properly valued in accordance with U.S. GAAP.

- Design and implement policies, procedures and controls to properly record inventory acquisition transactions 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 DoD suspense account contains transactions that are aged more than 60 days).

B. **Lack of Controls for the Reconciliation of FBwT Between the General Ledger and the U.S. Treasury.** DLA has not effectively designed controls to completely and accurately reconcile collections and disbursement data from the source systems to U.S. Treasury. In addition, DLA lacks controls to reconcile collections and disbursements between the general ledger and Treasury's Secure Payment System (SPS). As a result, DLA is unable to accurately reconcile the beginning and ending general ledger balances 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 and the process to research and resolve differences between U.S. Treasury, disbursing system records and accounting system records within a timely basis.

B. **Lack of Controls for the Reconciliation of FBwT Between the General Ledger and the U.S. Treasury.** Design and implement procedures to assess the completeness and accuracy of the collections and disbursements data from third party systems used in the reconciliation to U.S. Treasury.

2011-3622160

III. 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.

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). For example, IQCs were 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.

2011-3622160

- **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 an invoice was not properly cancelled and was paid in full, resulting in an undetected overpayment to the vendor).

- **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.

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. 1, *Accounting for Selected Assets and Liabilities*, 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 a misstatement 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.

2011-3622160

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. 1, SFFAS No. 4 and SFFAS No. 5.

IV. 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.

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. In addition, DLA has not designed processes or controls to implement new accounting standards.

- **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 to allow DLA to determine the appropriateness of each JV adjustment, including those recorded by their service provider.

- **Financial Statement Review Process.** The level of review of the financial statements and footnote disclosures was insufficient to detect and correct misstatements in the financial statements and related disclosures. As a result, inaccurate balances and disclosures were reported in the financial statements and notes. For example, line items are not appropriately classified between federal and non-federal; 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.

2011-3622160

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 and processes and controls to analyze the impact of new accounting standards.

- **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.

V. 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;

2011-3622160

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.

VI. 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.

DLA has made progress in remediating several prior year control deficiencies in the areas of least privileged access and segregation of duties. However, several repeat control deficiencies in the design and operation of information systems controls continue to remain unresolved.

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, Information Technology (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.

2011-3622160

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.

Configuration Management

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

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

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

- Both routine and emergency changes are not reviewed, approved, and tested in a non-production environment prior to release. The impact and functionality of configuration changes are not assessed prior to implementation.

- System configurations, baseline code, and production environments are not monitored and inspected for unauthorized changes.

- Users have access privileges enabling them to bypass the configuration management process and make changes directly to production.

Segregation of Duties Controls

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

2011-3622160

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.

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 exposures, and remediate control gaps.

2011-3622160

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.

- Identify and document conflicting roles, enforce established segregation of duties processes, and assess conflicts during account provisioning and management. Segregate conflicting roles where possible, and if unavoidable, document business rationale and monitor user activity.

Configuration Management

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

- Segregate conflicting roles between development and production environments.

Security Management / Governance Over Implementation of Security Controls

- Document risks and controls in place, identify gaps and complete corrective actions to strengthen the internal control environment. Improve documentation, test and validate controls, and remediate findings.

- Establish a process to evaluate and incorporate service provider reports, findings and controls into management's security documentation, governance process and application control environment.

2011-3622160

Appendix B – Significant Deficiency

I. 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 with SFFAS No. 7. Specifically:

- **Gross versus net.** Exchange revenue is recorded net of cost of goods sold at the transaction level. DLA records manual adjustments 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 costs of goods sold are properly recorded and presented in the financial statements.

II. 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. **Inadequate Controls Over Estimation Processes.** DLA does not have adequately designed controls around their analysis to retrospectively review the estimate, which includes comparing actual costs to estimates to validate the estimation methodology.

Recommendations

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

A. **Inadequate Controls Over Estimation Processes.** Design and implement controls to compare actual costs to estimates to see if any changes to the estimation methodology are necessary.

Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

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

Building a better working world

Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit 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, 2020, and the related statement of net cost, statement of 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 13, 2020. Our report disclaims an opinion on such financial statements because DLA was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of DLA, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the financial statements, as well as 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.

The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03, as described below. Additionally, 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.

Our Report on Internal Control Over Financial Reporting dated November 13, 2020, 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, and our recommendations to the specific issues presented.

2011-3622160

Building a better working world

As referenced in the Fiscal Year (FY) 2020 DLA Statement of Assurance, DLA provides no assurance that the internal controls over operations, financial systems, reporting and compliance are operating effectively in compliance with the Federal Managers' Financial Integrity Act (FMFIA), Section 4; FFMIA of 1996, Section 803; and OMB Circular No. A-123.

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 on Internal Control Over Financial Reporting, 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 Over Financial Reporting.

(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 Over Financial Reporting.

FMFIA

Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal

2011-3622160

Building a better working world

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 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 was not able to provide evidence that they are in compliance with significant aspects of OMB Circular A-123, which implemented FMFIA. DLA provided a FY 2020 Statement of Assurance, however there was not sufficient evidence that DLA fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level for each process identified. DLA provided evidence demonstrating that DLA has started to implement a testing strategy, however, DLA is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

Management's Response to Findings

DLA's responses to the findings identified in our engagement and relevant comments from DLA's management responsible for addressing the noncompliance are provided in the accompanying letter dated November 13, 2020. Management'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 results 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 13, 2020

2011-3622160

MANAGEMENT'S RESPONSE TO AUDIT REPORTS

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

NOV 13 2020

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Fiscal Year (FY) 2020 Financial Statement Audit – Transaction Fund

Thank you for the opportunity to comment on Ernst & Young, LLP, Independent Auditor Reports on the Defense Logistics Agency's (DLA), Transaction Fund (TF) financial statements for Fiscal Year 2020. We acknowledge and concur with the material weaknesses and the disclaimer of opinion.

DLA acknowledges the material weaknesses and control deficiencies identified in the areas of financial systems, internal controls and business processes that impact financial reporting, and will continue working to resolve the material weaknesses and strengthen internal controls around operations, reporting, and financial systems by prioritizing remediation efforts that will effect positive progress toward a favorable opinion.

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

M. C. SKUBIC
VADM, SC, USN
Director

INTRODUCTION TO PRINCIPAL FINANCIAL STATEMENTS

The principal financial statements and the accompanying notes (financial statements) included in this report are prepared pursuant to the requirements of the CFO Act of 1990 (Pub. L. 101-576), and expanded by GMRA (Pub. L. 103-356) and other applicable legislation. Other reporting requirements include the OMB Circular A-136, as amended. 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's financial statements and disclaimed an opinion on these financial statements. The Audit Reports, and Management's Response to the Audit Reports, accompany the unaudited financial statements.

The DLA TF financial statements consist of the following:

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, 2020 and 2019.

The Statements of Net Cost present the net cost of DLA TF operations for the years ended September 30, 2020 and 2019. DLA TF's net cost of operations is the gross cost incurred by DLA TF activities, less any exchange revenue earned and inter-entity eliminations from DLA TF activities.

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, 2020 and 2019.

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, 2020 and 2019.

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

Supply Prep

Personnel at Al Udeid Air Base, Qatar, prepare relief supplies for shipment to Beirut, Aug. 6, 2020. Marine Corps Gen. Kenneth F. McKenzie Jr., commander of U.S. Central Command, spoke with the commander of the Lebanese armed forces to inform him that three C-17 aircraft will bring relief supplies to Lebanon following an Aug. 4, 2020 explosion there. **Photo By: U.S. Central Command**

Defense Logistics Agency – Transaction Fund

BALANCE SHEETS

As of September 30, 2020 and 2019

(dollars in thousands)

	Unaudited FY2020	Unaudited FY2019
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$ 280,730	$ 287,318
Total Intragovernmental Assets	**280,730**	**287,318**
Accounts Receivable	38	26
Stockpile Materials (Note 3)	746,382	779,164
General Property, Plant and Equipment, Net (Note 4)	1,019	1,242
TOTAL ASSETS	**$ 1,028,169**	**$ 1,067,750**
LIABILITIES (Note 5)		
Intragovernmental		
Accounts Payable	$ 1,505	$ 1,511
Other Liabilities (Note 6)	371	365
Total Intragovernmental Liabilities	**1,876**	**1,876**
Accounts Payable	2,574	5,631
Environmental and Disposal Liabilities (Note 7)	11,115	17,555
Other Federal Employment Benefits (Note 8)	2,010	2,198
Other Liabilities (Note 6)	3,874	952
TOTAL LIABILITIES	**21,449**	**28,212**
Commitments and Contingencies (Note 9)		
NET POSITION		
Cumulative Results of Operations	1,006,720	1,039,538
TOTAL NET POSITION	**1,006,720**	**1,039,538**
TOTAL LIABILITIES AND NET POSITION	**$ 1,028,169**	**$ 1,067,750**

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, 2020 and 2019
(dollars in thousands)

	Unaudited FY2020	Unaudited FY2019
Operations, Readiness & Support		
Gross Cost	$ 95,815	$ 94,015
Less: Earned Revenue	(62,502)	(74,158)
Net Cost	**33,313**	**19,857**
NET COST OF OPERATIONS	**$ 33,313**	**$ 19,857**

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, 2020 and 2019
(dollars in thousands)

	Unaudited FY2020	Unaudited FY2019
Cumulative Results of Operations		
Beginning Balance	$ 1,039,538	$ 1,058,761
Other Financing Sources:		
Imputed Financing	495	634
Total Financing Sources	**495**	**634**
Net Cost of Operations	**33,313**	**19,857**
Net Change	**(32,818)**	**(19,223)**
Total Cumulative Results of Operations	**1,006,720**	**1,039,538**
TOTAL NET POSITION	**$ 1,006,720**	**$ 1,039,538**

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, 2020 and 2019
(dollars in thousands)

	Unaudited FY2020	Unaudited FY2019
BUDGETARY RESOURCES		
Unobligated Balance From Prior Year Budget Authority, Net	$ 214,702	$ 233,589
Spending Authority From Offsetting Collections	50,755	40,825
TOTAL BUDGETARY RESOURCES	**$ 265,457**	**$ 274,414**
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments	$ 50,248	$ 60,974
Unobligated Balance, End of Year:		
Apportioned, Unexpired	56,934	5,608
Unapportioned, Unexpired	158,275	207,832
Unexpired Unobligated Balance, End of Year	215,209	213,440
Total Unobligated Balance, End of Year	215,209	213,440
TOTAL BUDGETARY RESOURCES	**$ 265,457**	**$ 274,414**
OUTLAYS, NET		
Outlays, Net	$ 6,588	$ 6,821
AGENCY OUTLAYS, NET	**$ 6,588**	**$ 6,821**

The accompanying notes are an integral part of these statements.

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS (Unaudited)

Note 1: Summary of Significant Accounting Policies (Unaudited)

A. Reporting Entity

Created in 1961, 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. 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 WCF, GF, and DLA TF. These financial statements and accompanying notes herein only refer to the activities of DLA TF.

The NDS (commonly known as DLA TF) 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 U.S. 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.

The 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. The NDS Manager administers the acquisition, storage, management, and disposal of the stockpile. The NDAA authorized the NDS Manager to acquire materials determined to be strategic and critical to meet defense, industrial, and essential civilian needs of the U.S. 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[4] and presented in the format prescribed by the OMB Circular A-136, 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 based on concepts set forth by OMB Circular A-11, which provides instructions on budget execution. Budgetary accounting is designed to recognize the budgetary resources and the related status of those budgetary resources, including the obligation and outlay 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, 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 and budgetary accounting requirements as many of the

[4] FASAB is the official body for setting accounting standards of the U.S. government.

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 the accompanying notes in accordance with U.S. GAAP and in compliance with the reporting requirements of OMB Circular A-136. DLA is assessing financial feeder systems and processes and their conformance to existence, completeness, and accuracy requirements as required by U.S. GAAP and OMB Circular A-136. As DLA TF identifies non-conforming data issues, the Agency will continue to implement interim mitigation processes to address these limitations. In addition, DLA TF is remediating material weaknesses found in all end-to-end business process cycles pertaining to reconciliations and adequacy of the supporting documentation identified through audits and other compliance reporting.

Statements of Budgetary Resources: The budgetary accounting concepts are recognized in the Statements of Budgetary Resources. The Statements of Budgetary Resources present: (1) budgetary resources for the fiscal year; (2) status of those budgetary resources (includes obligated[5] amounts and unobligated[6] amounts for the fiscal year); and (3) Outlays[7], Net for the fiscal year, which is comprised of Outlays less Offsetting Receipts (cash transactions). DLA TF's budgetary resources[8] include unobligated balances of resources from prior years and new resources, consisting of spending authority from offsetting collections.

Intragovernmental and Non-Federal Transactions: Statement of Federal Financial Accounting Standards (SFFAS) 1, ***Accounting for Selected Assets and Liabilities***, distinguishes between Intragovernmental and Non-Federal assets and liabilities. Intragovernmental assets and liabilities arise from transactions among Federal entities. Intragovernmental assets are claims other Federal entities owe to DLA 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 Intragovernmental and non-Federal transactions in accordance with Treasury Financial Manual (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 transactions with other DoD and Federal entities in accordance with OMB Circular A-136 requirements and TFM 4700 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 Transactions).

Intra-departmental Transactions: DoD reporting entities reconcile with their trading partners at the detail transaction level. Detail transactions provide support for reported balances requiring elimination with trading partners. DLA TF is ultimately responsible for the accuracy of its trading partner data and initiating actions to reconcile balances with its trading partners; however, 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 Transactions). A DoD reporting entity unable to provide detail transactions at the appropriate time of the financial statement reporting cycle must adjust its balance to match the seller's or buyer's supportable data.

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.

---

[5] Per OMB Circular A-11, Section 20, "Obligation means a legally binding agreement that will result in outlays, immediately or in the future."

[6] Per OMB Circular A-11, Section 20, "Unobligated amount means the cumulative amount of budget authority that remains available for obligation under law in unexpired accounts. The term "expired balances available for adjustment"only refers to unobligated amounts in expired accounts."

[7] Per OMB Circular A-11, Section 20, "Outlay means a payment to liquidate an obligation (other than the repayment to the Treasury of debt principal)… Outlays are a measure of Government spending."

[8] Per OMB Circular A-11, Section 20, "Budgetary resources are amounts available to incur obligations in a given year. Budgetary resources consist of new budget authority and unobligated balances of budget authority provided in previous years."

Use of Estimates: The DLA TF management has made certain estimates and assumptions when reporting assets, liabilities, revenue, and expenses and disclosures in the notes. 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: (1) environmental and disposal liabilities, (2) accounts payable accrual, (3) undelivered orders (UDOs) intragovernmental and non-Federal disclosure, and (4) 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. Therefore, 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 Transactions (Note 1.B.): The DLA TF does not have compliant processes in place to properly report and distinguish between intragovernmental, intra-departmental, and non-Federal transactions in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*.

Inter-Entity Cost (Note 1.R.): 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 11): 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 Fund Balance with Treasury (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, Revenue, and Gains (Notes 1.G. and 1.R.): The DLA TF does not have policies and compliant processes in place to: (1) identify, evaluate, record, and report an allowance for doubtful accounts related to intragovernmental receivables in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities,* and Technical Bulletin 2020-1, *Loss Allowance for Intragovernmental Receivables*; (2) adjust revenue to the extent that realization of the full amount is not probable in accordance with SFFAS 1, A*ccounting for Selected Assets and Liabilities,* and SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting;* and (3) recognize gains in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.* More specifically:

Accounts Receivable: The DLA TF records accounts receivable although advance collections have been received prior to the sale; and

Gains: The DLA TF improperly recognized gains when (1) acquiring purchased stockpile materials, and (2) receiving upgraded and/or reconditioned stockpile materials. (Refer to Note 1.C., *Departures from U.S. GAAP*, related to Stockpile Materials.)

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 stockpile material 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,

Inventory Quantities: The 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;

Stockpile Materials Acquisition: The DLA TF does not properly account for stockpile material acquisitions. For acquisitions of stockpile materials, DLA TF recognized a gain when purchased stockpile materials were received. DLA TF also recognized gross cost when approving the invoice for purchased stockpile materials. The cost of purchased stockpile materials should not be reported as a component of gross cost at the point the stockpile material is purchased, but rather when stockpile material is issued for use or sale. The results are an overstatement to total gross cost and total earned revenue reported in the Statements of Net Cost, however the net impact of the overstatements offset each other in Total Net Costs of Operations; and

Stockpile Materials Upgraded and/or Reconditioned: The DLA TF does not properly account for stockpile material upgraded and/or reconditioned transactions. The outbound and inbound movements of stockpile material during the stockpile material upgraded and/or reconditioned process does not meet the criteria for expense and revenue recognition. DLA TF recognized a loss when the stockpile materials were provided to a third-party entity for upgrade and/or reconditioning. When the stockpile materials were returned, DLA TF recognized a gain. The results are an overstatement to total gross cost and total earned revenue reported in the Statements of Net Cost; however, the net impact of the overstatements offset each other in Total Net Costs of Operations.

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 Property, Plant, and Equipment (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, 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 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 reported or disclosed as of September 30, 2020 and 2019.

Accounts Payable, Expenses, and Undelivered Orders (Note 1.L. and S., Notes 5 and 10): 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;

Expenses: The DLA TF improperly recognized the cost when (1) acquiring stockpile materials, and (2) receiving upgraded and/or reconditioned stockpile materials. (Refer to Note 1.C., *Departures from U.S. GAAP*, related to Stockpile Materials); 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 policies and compliant processes in place to reconcile asset listings. DLA accounts for costs related to cleanup, asset closure, and asbestos associated with general PP&E in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government; SFFAS 6, Accounting for Property, Plant, and Equipment*, and Federal Financial Accounting 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 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: The 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 and related Federal funding amounts required to be disclosed in a P3 note to the financial statements, if applicable.

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 this pronouncement and is unable to determine the materiality of changes that this pronouncement will have on its financial position, results of operations, changes in net position, and budgetary activity.

FASAB Statement No	SFFAS 54	SFFAS 57 (paragraphs 3 – 8, 11, and 12)
FASAB Standard	Leases: An Amendment of SFFAS 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 6, *Accounting of Property, Plant, and Equipment*	Omnibus Amendments FY2019
Adoption Required in FY	Deferred to FY2024	Effective FY2024

SFFAS 58, *Deferral of the Effective Date of SFFAS 54, Leases*, defers SFFAS 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment* until FY2024; earlier implementation is not permitted. SFFAS 54, *Leases,* 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.

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 a unique accounting code, which allows DLA TF to properly identify the transactions.

On a monthly basis, 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). 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 advanced payments in advance before material is shipped. In certain cases, the material delivered to the customer is in excess of the amount ordered. DLA TF establishes an accounts receivable for the amount of material delivered in excess of the advance payment received These amounts are minimal and historically are collected within 30-60 days. The risk of uncollected receivable is minimal; therefore, DLA TF does not establish an allowance for doubtful accounts.

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

H. Stockpile Materials

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

Stockpile Materials Held for Sale: Stockpile materials held for sale is comprised of materials deemed to be excess and have been identified for disposal based on the annual sales forecast.

Stockpile Materials Held in Reserve for Future Use: Stockpile materials 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.

Stockpile Materials Valuation: Both stockpile materials 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 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 Financial Reporting Organization (FRO), and documenting processes through reviewing and updating policy guidance to define the procedures used for the valuation method. DLA TF has not yet finalized the inventory and valuation process for their PP&E. Accordingly, DLA TF has not made an unreserved assertion that the opening balances of PP&E for FY2019 are presented fairly, in accordance with SFFAS 50, ***Establishing Opening Balances for General Property, Plant, and Equipment***.

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 or 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 the date of these financial statements, 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 reasonably estimable. 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 reasonably 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, Note 7, ***Environmental and Disposal Liabilities,*** 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.

Liabilities Covered and Not Covered by Budgetary Resources: Liabilities covered by budgetary resources include those liabilities for which Congress appropriated funds and are otherwise available to pay amounts due as of the Balance Sheet dates. Liabilities not covered by budgetary resources are amounts owed in excess of available, congressionally appropriated funds and, therefore, no budgetary resources are available to pay amounts due as of the Balance Sheet dates (refer to Note 5, ***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 12 months of the Balance Sheet dates. Noncurrent liabilities represent liabilities that DLA TF does not expect to be settled within 12 months of the Balance Sheet dates.

Accounts Payable: Accounts Payable includes amounts owed but not yet paid to Intragovernmental 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 5, *Liabilities Not Covered by Budgetary Resources*, and Note 6, *Other Liabilities*.)

M. Environmental and Disposal Liabilities

EL are 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 budget authority 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 7, *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 (Public Law 103-3) provides 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 actual future payments for 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.

In FY2020, the methodology for billable projected liabilities was revised to include, among other things: (1) an algorithmic model that relies on individual case characteristics and benefit payments (the FECA Case Reserve Model) and (2) incurred but not reported claims were estimated using the patterns of incurred benefit liabilities in addition to those of payments. The FY2019 methodology used a traditional paid loss development method with the FECA Case Reserve Model run concurrently to, among other things, test the validity of the FECA Case Reserve Model (refer to Note 5, *Liabilities Not Covered by Budgetary Resources* and Note 8, *Other Federal Employment Benefits*).

P. Pension Benefits

Based on the effective Federal government start date, DLA TF's civilian employees participate in either the Civil Service Retirement System (CSRS), a defined benefit plan, or the Federal Employees Retirement System (FERS), a defined benefit plan and contribution plan. 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 (OPM) 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. DLA TF is not responsible for and does not report CSRS or FERS assets, accumulated plan benefits, or liabilities applicable to its employees. OPM is responsible for and reports these amounts.

Q. Net Position

Net position is the residual difference between assets and liabilities and consists of cumulative results of operations. Cumulative results of operations consist of the net difference since inception between (1) expenses and losses, and (2) revenue, gains, and (3) Other financing sources.

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 operations and is reported in the Statements of Changes in Net Position as a financing source. For the years ended September 30, 2020 and 2019, respectively, DLA TF does not have activity related to non-exchange revenue.

Other Financing Sources: Other financing sources, other than exchange and non-exchange revenue, include additional inflows of resources that increase results of operations during the reporting period.

Imputed Financing and Imputed Cost: In certain cases, DLA TF receives goods and services from other Federal entities at no cost or at a cost less than the full cost to the providing 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 financing in the Statements of Changes in Net Position. DLA TF recognizes the following imputed cost and related imputed financing: (1) employee benefits administered by the OPM (i.e., retirement, health, life insurance benefits); and (2) claims settled by the Treasury Judgment Fund. 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 Accounts Receivable, Revenue, and Gains.)

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.)

Note 2: Fund Balance with Treasury (Unaudited)

Fund Balance with Treasury as of September 30, 2020 and 2019, respectively, consist of the following (dollars in thousands):

	FY2020	FY2019
Status of Fund Balance with Treasury		
Unobligated Balances:		
Available	$ 56,934	$ 5,608
Unavailable	182,133	232,941
Obligated Balances not yet Disbursed	41,663	48,769
Total Fund Balance with Treasury	**$ 280,730**	**$ 287,318**

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 Statements of Budgetary Resources because budgetary balances are supported by amounts other than FBwT.

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 unapportionment funds not available for obligation from offsetting collections.

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, 2020 and 2019, DLA TF does not have a balance for non-budgetary FBwT.

Other Information includes the following tables summarizing the undistributed collections and disbursements between U.S. Treasury and DLA TF as of September 30, 2020 and 2019, respectively:

2020 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)

Transaction Type	Treasury Balance based on CARS	DLA TF Trial Balance	Balances Not Yet Recorded in DLA Accounting System – Undistributed
Collections	$ 45,467	$ 49,502	$ (4,035)
Disbursements	$ 56,092	$ 56,221	$ (129)

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

Transaction Type	Treasury Balance based on CARS	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

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

Note 3: Stockpile Materials (Unaudited)

Stockpile Materials as of September 30, 2020 and 2019, respectively, consist of the following (dollars in thousands):

	Valuation Method	FY2020	FY2019
Stockpile Materials Categories			
Held for Sale	HC[9]	$ 17,391	$ 28,502
Held in Reserve for Future Use	HC[9]	728,991	750,662
Total Stockpile Materials		**$ 746,382**	**$ 779,164**

HC = Historical Cost

Stockpile materials held for sale is comprised of materials deemed to be excess and have been identified for disposal based on the annual sales forecast. Stockpile materials held for sale includes Ores, Metals, and Alloys authorized for sale. As of September 30, 2020 and 2019, stockpile materials held for sale estimated market value is $18.9 million and $35.4 million, respectively.

Stockpile materials held in reserve for future sale consist of a variety of industrial commodities including base and minor metals, ferrous and non-ferrous ores, metal powders and 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 Materials.)

[9] The DoD cost flow assumption policy for stockpile materials is Moving Average Cost (MAC); DLA SM, due to the nature of its operations, does not rely upon its cost flow assumption to determine Historical Cost as all inventory is specifically identifiable.

Rosy Outlook
A Navy F/A-18E Super Hornet takes off from the flight deck of the USS Dwight D. Eisenhower in the Atlantic Ocean, Oct. 1, 2020. The aircraft carrier is supporting naval operations to maintain maritime stability and security to ensure access, deter aggression and defend U.S., allied and partner interests. **Photo By: Navy Petty Officer 3rd Class Cameron Pinske**

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

General Property, Plant and Equipment, Net as of September 30, 2020 and 2019, respectively, consist of the following (dollars in thousands):

FY2020			
	Acquisition Value	Accumulated Depreciation	Net Book Value
Major Asset Classes			
General Equipment	$ 2,337	$ (1,318)	$ 1,019
Total General PP&E, Net	**$ 2,337**	**$ (1,318)**	**$ 1,019**

FY2019			
	Acquisition Value	Accumulated Depreciation	Net Book Value
Major Asset Classes			
General Equipment	$ 2,337	$ (1,095)	$ 1,242
Total General PP&E, Net	**$ 2,337**	**$ (1,095)**	**$ 1,242**

The DLA TF General Property, Plant and Equipment, Net as of September 30, 2020 and 2019 was comprised of a mercury trailer and a front-end loader.

The table below discloses current year activity for General Property, Plant and Equipment, Net as of September 30, 2020 (dollars in thousands):

FY2020	
General PP& E, Net - Beginning Balances	$ 1,242
Depreciation Expense	(223)
General PP& E, Net - Ending Balances	**$ 1,019**

(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, 2020 and 2019, respectively, consist of the following (dollars in thousands):

	FY2020	FY2019
Intragovernmental Liabilities		
Other	$ 271	$ 277
Total Intragovernmental Liabilities	**271**	**277**
Non-Federal Liabilities		
Other Federal Employment Benefits	2,010	2,198
Environmental and Disposal Liabilities	6,662	9,116
Other	780	702
Total Non-Federal Liabilities	**9,452**	**12,016**
Total Liabilities Not Covered by Budgetary Resources	**9,723**	**12,293**
Total Liabilities Covered by Budgetary Resources	**11,726**	**15,919**
Total Liabilities	**$ 21,449**	**$ 28,212**

Other Intragovernmental Liabilities are comprised of the 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, 2020 and 2019, the total liabilities covered by budgetary resources for environmental and disposal liabilities consist of $4.5 million and $8.4 million, respectively.

Other Non-Federal Liabilities consists of current year unfunded annual leave earned by civilian employees but not yet paid. 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, Revenue, and Gains; 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, 2020 and 2019, respectively, consist of the following (dollars in thousands):

FY2020	Current	Non-Current	Total
Intragovernmental Other Liabilities			
FECA Reimbursement to DOL	$ 53	$ 218	$ 271
Employer Contribution and Payroll Taxes Payable	100	-	100
Total Intragovernmental Other Liabilities	**153**	**218**	**371**
Non-Federal Other Liabilities			
Accrued Funded Payroll and Benefits	299	-	299
Liability for Advances and Prepayments	2,795	-	2,795
Accrued Unfunded Annual Leave	780	-	780
Total Non-Federal Other Liabilities	**3,874**	**-**	**3,874**
Total Other Liabilities	**$ 4,027**	**$ 218**	**$ 4,245**

FY2019	Current	Non-Current	Total
Intragovernmental Other Liabilities			
FECA Reimbursement to DOL	$ 53	$ 224	$ 277
Employer Contribution and Payroll Taxes Payable	88	-	88
Total Intragovernmental Other Liabilities	**141**	**224**	**365**
Non-Federal Other Liabilities			
Accrued Funded Payroll and Benefits	250	-	250
Liability for Advances and Prepayments	-	-	-
Accrued Unfunded Annual Leave	702	-	702
Total Non-Federal Other Liabilities	**952**	**-**	**952**
Total Other Liabilities	**$ 1,093**	**$ 224**	**$ 1,317**

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 includes salaries, wages, and other compensation earned by employees but not yet disbursed.

Liability for Advances and Prepayments includes collections for which DLA TF has not yet provided goods.

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.)

Note 7: Environmental and Disposal Liabilities (Unaudited)

Environmental and Disposal Liabilities as of September 30, 2020 and 2019, respectively, consist of the following (dollars in thousands):

	FY2020		FY2019	
Non-Federal Environmental and Disposable Liabilities				
Environmental Corrective Action	$	11,037	$	17,524
Environmental Closure Requirements		78		31
Total Environmental and Disposal Liabilities	**$**	**11,115**	**$**	**17,555**

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

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

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 Plant, Property, and Equipment. All cleanup and disposal actions are done in coordination with regulatory Agencies, other responsible parties, and current property owners.

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

Environmental Corrective Action includes 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 includes EL associated with the future closure/decommissioning of facilities on an installation that have environmental closure requirements.

The DLA TF assessed its general equipment inventory and does not currently have reportable TF EL for these or any other EL categories as listed on the DoD Financial Management Regulations (FMR) Volume 6B, Chapter 10 – *Note to the Financial Statements*, Paragraph 1017, Figure 10-31. *Environmental and Disposal Liabilities* (March 2020).

Applicable Laws and Regulations for Cleanup Requirements:

The DLA SM 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 SM 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 DLA SM operational site boundaries onto adjacent property or onto other sites where DLA SM is named as a potentially responsible party by a regulatory Agency. DLA TF reports corrective action-related EL in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government,* and Federal Financial Accounting Technical Release 2*, Determining Probable and Reasonable Estimable for Environmental Liabilities in the Federal Government.*

The DLA SM is also required to ensure all hazardous substances are removed prior to closing or disposing of Property Plant, and Equipment assets such as Petroleum, Oil, and Lubricant (POL) storage tanks and General Equipment in accordance with applicable Federal, State, and local laws and regulations. DLA TF reports EL associated with closures of Property Plant, and Equipment in accordance with SFFAS 5, ***Accounting for Liabilities of the Federal Government***, SFFAS 6, ***Accounting for Property, Plant, and Equipment***, and Federal Financial Accounting and Auditing Technical Release 11*, **Implementation Guidance on Cleanup Costs Associated with Equipment***, and Technical Release 14*, **Implementation Guidance on the Accounting for the Disposal of General 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 Federal Financial Accounting and Auditing Technical Release 11*, **Implementation Guidance on Cleanup Costs Associated with Equipment,*** and Technical Release 14*, **Implementation Guidance on the Accounting for the Disposal of General Property, Plant, and Equipment.***

Methods for Assigning Estimated Total Cleanup Cost to Current Operating Periods: To estimate future environmental costs, DLA TF utilizes a combination of historical or pre-negotiated contract costs, proposal costs, engineering estimates, and in the absence of other detailed information, parametric estimates created using the RACER software. Any historical costs used in the creation of the estimates for DLA TF EL are adjusted for inflation and reported in current year dollars. The RACER Steering Committee ensures that the RACER software is Validated, Verified, and Accredited (VV&A) in accordance with DoD Instruction 5000.61. The DoD is working with the RACER Steering Committee and stakeholders to identify improvements to RACER functionality, auditability, and documentation.

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 Site Identification (ID) process tracks environmental events such as spills and releases in an Environmental Event Repository and evaluates each event annually for EL potentiality to determine the annual CTC inventory. DLA TF EL estimates are created annually for all projected requirements to achieve site closure and are finalized and approved by July. The estimates are then reevaluated through a roll forward review to identify any material changes to previously approved estimates as of September 30, 2020. The Site ID, CTC, and roll forward processes are conducted in accordance with DLA policies and procedures, the DoD 7000.14-R FMR Volume 4, Chapter 13 – ***Environmental and Disposal Liabilities*** (April 2018) and OUSD memorandum for Strategy for Environmental & Disposal Liabilities Audit Readiness (September 30, 2015).

Revised CTC estimates and prior year obligations are reported in the balance as of September 30, 2020. As of the reporting date, no material changes in total estimated cleanup costs were identified through the roll forward review due to changes in laws, technology, or plans. In addition, DLA SM 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 will be reevaluated each year and 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 stated total TF EL includes prior year obligations and the estimates of future costs necessary to complete requirements. DLA SM has instituted extensive controls to ensure that these estimates are accurate and reproducible. The cost estimates produced through the EL 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. 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. DLA TF EL can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

The calculation of DLA TF EL relies on site/asset inventories. An asset inventory obtained from DLA SM provides 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 utilizes a formalized Site ID process to identify, track, and evaluate environmental events where the potential for an out-year EL exists but the EL is not probable and measurable. These environmental events will be re-evaluated in the following fiscal year 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 DLA 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, ***Environmental and Disposal Liabilities***, 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 $38.2 thousand. DLA TF has no reportable EL for Asbestos or General Equipment assets. Asset-related EL are amortized based on the useful life of the assets as defined in DoD FMR Volume 4, Chapter 24 – ***Real Property***, Paragraph 240206.B, Table 24-1: ***DoD Useful Lives for Depreciable Real Property Assets*** (October 2019).

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

Multihue View

Army helicopters participate in an aerial gunnery event at Grafenwoehr Training Area, Germany, July 20, 2020.

Photo By: Army Sgt. Justin Ashaw

Note 8: Other Federal Employment Benefits (Unaudited)

Other Federal Employment Benefits as of September 30, 2020 and 2019, respectively, consist of the following (dollars in thousands):

FY2020						
		Liabilities		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
Other Federal Employment Benefits						
FECA	$	2,010	$	-	$	2,010
Total Other Federal Employment Benefits	**$**	**2,010**	**$**	**-**	**$**	**2,010**

FY2019						
		Liabilities		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
Other Federal Employment Benefits						
FECA	$	2,198	$	-	$	2,198
Total Other Federal Employment Benefits	**$**	**2,198**	**$**	**-**	**$**	**2,198**

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 FY2020 and FY2019, respectively. Using averaging renders estimates that reflect historical trends over five years. The FY2020 and FY2019 methodologies for averaging the COLA rates used OMB provided rates for the current and prior four years; the FY2020 methodology also considered updated information for the current year that was provided by program staff. The FY2020 and FY2019 methodologies for averaging the CPIM rates used OMB provided rates for the current and prior four years; the FY2020 methodology also considered updated information for the current year that program staff obtained from the Bureau of Labor Statistics public releases for CPIM. DOL selected the interest rate assumptions whereby projected annual payments were discounted to present value based on interest rate assumptions on the U.S. Department of the Treasury's Yield Curve for Treasury Nominal Coupon (TNC) Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. Discount rates were based on averaging the TNC Yield Curves for the current and prior four years for FY2020 and FY2019, respectively.

Interest rate assumptions utilized for FY2020 discounting were as follows:

Year 1: 2.4% and thereafter (wage benefits)

Year 1: 2.3% 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)

Continued on next page -

2020 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
2021	1.9%	3.2%
2022	2.1%	3.2%
2023	2.2%	3.6%
2024	2.2%	4.0%
2025	2.3%	3.9%

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

The DOL Office of Inspector General issued in July 2020 a report that found that most Office of Workers' Compensation (OWCP) programs are experiencing or expecting delays and resource management issues as a result of increasing claims and social distancing mandates brought on by the COVID-19 pandemic. In general, there have been downward trends in the number of open claims and closed claims and payments; based on the average of the prior five chargeback CBYs, the number of open claims, closed claims, and payments have decreased. Federal employees who contract COVID-19 while in the performance of their Federal duties are entitled to workers' compensation coverage pursuant to FECA, which could affect future claims and payments.

Note 9: Commitments and Contingencies (Unaudited)

Accrued and reasonably possible environmental and legal contingent liabilities as of September 30, 2020 and 2019, respectively, consist of the following (dollars in thousands):

FY2020			
	Accrued Liabilities	Estimated Range of Loss	
		Lower End	Upper End
Environmental Contingencies			
Probable	$ 11,115	$ -	$ -
Reasonably Possible		$ -	$ -
Legal Contingencies			
Probable	$ -	$ -	$ -
Reasonably Possible		$ -	$ 300

Continued on next page -

FY2019						
		Accrued Liabilities	Estimated Range of Loss			
			Lower End		Upper End	
Environmental Contingencies						
Probable	$	17,555	$	-	$	-
Reasonably Possible			$	-	$	-
Legal Contingencies						
Probable	$	-	$	-	$	-
Reasonably Possible			$	-	$	300

Environmental Contingencies: The DLA TF has developed a process to identify, estimate, and record contingent EL. DLA TF does not estimate a potential range of loss in this process. Where DLA TF is aware of probable and measurable future outflow of resources due to a past event or exchange transaction, the appropriate program categories are reported in Note 7, *Environmental and Disposal Liabilities*.

Legal Contingencies: The DLA TF is a party in various administrative proceedings and legal actions related to claims for environmental damages, equal opportunity matters, and contractual bid protests.

Cases for which legal counsel determines an adverse outcome is reasonably possible and the possible financial outflow is measurable, are not recorded, but disclosed as reasonably possible for financial reporting purposes. DLA TF's Automated Workflow and Reporting System (AWARS) is used by the Office of General Counsel to assess the outcomes and possible liability amounts of open cases. The AWARS projects a maximum liability of approximately $300.0 thousand as of September 30, 2020 and 2019, respectively.

Commitments: The DLA TF does not have obligations related to canceled appropriations for contractual commitments or amounts for contractual arrangements that may require future financial obligations.

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

Note 10: Undelivered Orders (Unaudited)

UDOs for the years ended September 30, 2020 and 2019, respectively, consist of the following (dollars in thousands):

		FY2020		FY2019
Intragovernmental Undelivered Orders				
Unpaid	$	13,718	$	8,734
Total Intragovernmental Undelivered Orders		**13,718**		**8,734**
Non-Federal Undelivered Orders				
Unpaid		23,467		32,557
Total Non-Federal Undelivered Orders		**23,467**		**32,557**
Total Undelivered Orders	**$**	**37,185**	**$**	**41,291**

Continued on next page –

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, 2020 and 2019, DLA TF does not have balances for prepaid/advanced intragovernmental and non-Federal UDOs.

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

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

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

Reconciliation of Net Cost to Net Outlays for the years ended September 30, 2020 and 2019, consist of the following (dollars in thousands):

	FY2020		
	Intragovernmental	Non-Federal	Total
NET COST	**$ 11,958**	**$ 21,355**	**$ 33,313**
Components of Net Cost That are Not Part of Net Outlays			
PP&E Depreciation	-	(223)	(223)
Cost of Goods Sold	-	(41,222)	(41,222)
Net Gains	-	8,440	8,440
Increase/(Decrease) in Assets			
Accounts Receivable	-	12	12
(Increase)/Decrease in Liabilities			
Accounts Payable	6	3,057	3,063
Environmental Disposal Liabilities	-	6,440	6,440
Other Federal Employment Benefits	-	188	188
Other Liabilities:			
FECA Reimbursement to DOL	6	-	6
Employer Contribution and Payroll Taxes Payable	(12)	-	(12)
Accrued Funded Payroll and Benefits	-	(49)	(49)
Accrued Unfunded Annual Leave	-	(78)	(78)
Liability for Advances and Prepayments	-	(2,795)	(2,795)
Other Financing Sources			
Imputed Financing	(495)	-	(495)
Total Components of Net Cost That are Not Part of Net Outlays	**(495)**	**(26,230)**	**(26,725)**
NET OUTLAYS	**$ 11,463**	**$ (4,875)**	**$ 6,588**
Outlays, Net, Statements of Budgetary Resources			**6,588**
Reconciling Difference			**$ 0**

	FY2019		
	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)
Cost of Goods Sold	-	(26,365)	(26,365)
Net Gains	-	19,688	19,688
Increase/(Decrease) in Assets			
Accounts Receivable	-	(17)	(17)
(Increase)/Decrease in Liabilities			
Accounts Payable	(978)	(3,945)	(4,923)
Environmental Disposal Liabilities	-	86	86
Other Federal Employment Benefits	-	(452)	(452)
Other Liabilities:			
FECA Reimbursement to DOL	(75)	-	(75)
Employer Contribution and Payroll Taxes Payable	(17)	-	(17)
Accrued Funded Payroll and Benefits	-	(48)	(48)
Accrued Unfunded Annual Leave	-	(57)	(57)
Liability for Advances and Prepayments	-	-	-
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, Statements of Budgetary Resources			**6,821**
Reconciling Difference			**$ 0**

The Net Cost to Net Outlays Reconciliation schedule is intended to facilitate reporting of the Federal deficit reconciliation to the President's Budget within the Consolidated Financial Report of the U.S. Government.

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); (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).

More specifically, for FY2020, the key differences between the net cost and net outlays reconciliation for DLA TF include: (1) the cost of goods sold, which related to stockpile material transactions, representing the sales activity to non-Federal customers; (2) the net gains, which was primarily due to inventory movements related to the acquisition and upgrade/recondition of stockpile materials; and (3) the decrease in EL, which was primarily attributed to the decline in the Non-BRAC Environmental corrective actions. For FY2019, the key differences between the net cost and net outlays reconciliation for DLA TF include: (1) the cost of goods sold, which related to stockpile material transactions, representing the sales activity to non-Federal customers; and (2) the net gains, which was primarily due to adjustments for stockpile materials and inventory purchases.

The DLA TF does not have an established policy to identify and reconcile net cost 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.

The prior year presentation was modified to the current year presentation to facilitate the: (1) comparability between years for related activity; and (2) understanding of amounts reported in the reconciliation above to the principal financial statements and other related notes. The modification in the presentation had no net effect on the reconciliation as previously reported.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Reconciliation of Net Cost to Net Outlays, and Stockpile Materials Upgraded and/or Reconditioned.)

Engine Alcove

Airman 1st Class Johnathan Jenkins, 4th Component Maintenance Squadron aerospace propulsion apprentice, performs an augmented inspection on an F-15E Strike Eagle at Seymour Johnson Air Force Base, North Carolina, Oct. 28, 2020. Jenkins entered the engine to inspect the flame holder and spray rings for cracks. (U.S. Air Force photo by Airman 1st Class Kimberly Barrera) **Photo By: Airman 1st Class Kimberly Barrer**

SECTION 3 | OTHER INFORMATION (Unaudited)

SECTION 3

OTHER INFORMATION
(Unaudited)

SMOKY SPRINT

Marines participate in a simulated amphibious landing and assault through a mock town at Marine Corps Base Camp Pendleton, CA., Dec. 6, 2019, during Steel Knight, an annual exercise to test Marines and sailors across a range of environments and prepare them to counter aggression against a near-peer threat.

Photo By: Marine Corps Lance Cpl. Angela Wilcox

IN THIS SECTION

SECTION 3
Other Information (Unaudited)

Sea Replenishment
A Navy MH-60S Seahawk helicopter transports cargo to the flight deck of the aircraft carrier USS Harry S. Truman during a replenishment in the Arabian Sea, Jan. 23, 2020. **Photo By: Navy Seaman Apprentice Isaac Esposito Chacon**

MANAGEMENT CHALLENGES

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

September 14, 2020

MEMORANDUM FOR VICE ADMIRAL MICHELLE C. SKUBIC, 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 (OIG) sees ten areas where major challenges remain. The ten challenge areas are:

a. Contracting Officers Representatives. Based on two recently completed audits, OIG found significant concerns about the quality of contracting officers representatives work. Contracting officers representative files almost always contained inadequate evidence supporting monitoring of contractors. These results are important to DLA because the preponderance of our supplies and services are acquired through contract. Given the significant number of DLA contracts, in order to improve audit readiness, it is essential to improve contracting officer representative performance and quality of work.

b. Financial Liability Investigations. Based on numerous OIG investigations, financial liability investigations of property losses were inadequate and failed to hold responsible officials accountable for failure to maintain accountability of property under their control. In addition to including this on the Inspector General's management challenges letter, the OIG audit division has included an audit on this topic on the FY 2021 to FY 2023 audit and inspection plan.

c. Supply Chain Security, Risk Management and Nonconforming Inventory. While there are other causes, inadequate supply chain security or supply risk management are two of the causes that introduce nonconforming inventory into the DLA supply system. Regardless of the manner in which nonconforming inventory is inducted into the system, the potential risks to the warfighter remain the same. DLA must operationalize its supply chain security strategy by synchronizing, across the Enterprise, people, processes and tools to create an effective supply chain security posture. Additionally, the lack of domestically-based integrated supply chains increase risk to the process.

d. Activity Pricing and Cost Recovery Rate. Until DLA develops an accounting system that is sufficiently designed to assign and record accurate costs, then assigning costs to appropriate cost centers will be difficult and making decisions will be based on unauditable and potentially incorrect information.

e. DLA Cybersecurity and Resilient Networks. DLA's reliance on employees teleworking via less secure home networks in order to conduct daily business exposes the organization to new and increasing computer security threats. Specifically there are concerns with ensuring DLA's cyberspace operating environment remains secure and resilient in the midst of a contested operating environment, and with IT Continuity of Operations (COOP) plans for DLA's critical business system portfolio. With the increased telework associated with the pandemic, additional effort needs to make sure that employees remain as productive as possible and that new software, as well as major updates, are conducted in as seamless a manner as possible, while also encouraging employees to take personal responsibility for network security.

f. Evidential matter. Both financial and operating audit work continues to show that DLA's ability to locate appropriate evidential matter for audit readiness is just as important as appropriately processing the transaction.

g. Knowledge management. Knowledge management is the cross disciplinary / organizational process of creating, sharing, using, and managing the information of an organization. DLA needs to move from a tacit or ad hoc knowledge management mentality to a more proactive approach that synchronizes institutional knowledge, records management, information technology, and information product development to appropriately summarize our vast data into useful and actionable knowledge that management can act upon. Improved knowledge management will require a multi-organizational effort synchronizing both internal and external (DISA) efforts.

h. Business Process Documentation. DLA needs to sustain a robust organizational approach to address business process documentation in a manner that covers inception to conclusion. Over the past several years, there has been improvement in creating process maps that document processes from beginning to end (to include inputs from other organizations as well as handoffs to others). However, much remains to be done in: the identification of risks associated with a process, management evaluation and either acceptance or addressing the risk, and implementation of internal controls associated with all phases of the process.

i. Special Emphasis Programs. DLA has at least three special emphasis programs – PTAP (Procurement Technical Assistance Program), NWRM (Nuclear Weapons Related Material), and the strategic reserve – that, while currently in good shape, requires continual management emphasis.

j. Sales of DoD Property. Insufficient policy and oversight of DLA sales of property requires action to establish clear policy guidelines and oversight authority. This concern was formally recognized in a finding in FY18 during an Agency Management review and has not been corrected to date. Three components of DLA are involved in sales of DoD property: Disposition Services (which conducts the majority of sales,) Energy, and Strategic Materials. DLA Headquarters has limited expertise within the staff. Sales procedures and process are impacted by law and rules from several governmental agencies. Unclear policy proponency and corresponding lack of oversight of execution within DLA is an area of risk that requires mitigation and remediation.

It is necessary to address these challenges facing the organization in order for DLA to provide the best value to the taxpayer and the best support to the warfighter. Additionally, addressing each of these challenges will improve the internal control structure of DLA and thereby help the organization in implementing audit requirements, including actionable and supportable financial data.

WILLIAM A. RIGBY
Inspector General

SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

The audit reports on the FY2020 and FY2019 DLA TF financial statements identified six and seven material weaknesses respectively for DLA TF. Table 1 below provides a summary of the financial statement audit results for FY2020 and FY2019. In FY 2020, the Revenue material weakness was downgraded to a significatint deficiency. 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: FY2020 Summary of the Financial Statement Audit

Audit Opinion	Disclaimer				
Restatement	No				
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	7	-	1	-	6

The DLA's FY2019 SOA package followed the structure of the financial statement audit NFRs for documenting the individual material weaknesses associated with ICOR and ICOFS. DLA's FY2019 SOA package included a total of 233 ICOR material weaknesses (consolidated into seven material weaknesses for AFR presentation), 78 ICOFS non-conformances (consolidated into four non-conformances for AFR presentation), and three ICOR-O material weaknesses across the GF, TF, and WCF.

For FY2020, the SOA package is only required to include self-identified material weaknesses and significant deficiencies for internal DoD reporting because the financial statement audit NFRs are already being reported and tracked separately. Per the June 2019 DoD Financial Improvement and Audit Remediation Report, financial statement audit findings and CAPs "are entered into a centralized database managed by the ODCFO." DLA's FY2020 Material Weaknesses and Significant Deficiencies template included a total of three self-identified material weaknesses in the area of ICOR-O. In FY2019, the seven ICOR material weaknesses and four ICOFS non-conformances were based on financial statement audit NFRs accross all funds in the SOA package. However, DLA has determined these audit identified ICOR material weaknesses and ICOFS non-conformances are still present and have not been remediated in FY2020. The audit identified ICOR material weaknesses have been reassessed to align to DLA TF; therefore, the Acquire-to-Retire: Property, Plant and Equipment material weakness, which is not applicable to DLA TF, was removed from the ICOR material weaknesses in FY2020. In addition, the Order-to-Cash: Accounts Receivable and Revenue ICOR material weakness was resolved based on the FY2020 audit identified material weakness that was downgraded to a significant deficiency. The DLA Audit Task Force continues to separately track financial statement audit findings and CAPs related to the ICOR material weaknesses and ICOFS non-conformances and report these to the ODCFO.

The three self-identified FY2020 ICOR-O material weaknesses, summarized in the table below, are consistent with the ICOR-O material weaknesses reported by DLA in the FY2019 AFR.

Table 2 summarizes DLA's FY2020 material weaknesses associated with DLA TF.

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	Consolidated	Reassessed	Ending Balance
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	7	-	1	-	1	5

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	Consolidated	Reassessed	Ending Balance
Supply Operations: Lack of policy and procedures in place over the management and oversite of First Article Test Exhibits	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	-	-	-	-	3

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

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

Table 2: Summary of Management Assurances

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

Sunset Security

A Marine provides security around an MV-22 Osprey during aerial embarkation drills in Kuwait, Oct. 22, 2020..

Photo By: Marine Corps Lance Cpl. Andrew Skiver

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(Comptroller) 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(Comptroller) 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. In addition, DoD provides data for display on https://paymentaccuracy.gov. For detailed reporting on DoD payment integrity, refer to the OI section of the consolidated DoD AFR at: https://comptroller.defense.gov/ODCFO/afr2020.aspx.

Launch Prep

Airmen prepare an F-15E Strike Eagle for takeoff in Southwest Asia, Dec. 24, 2019. **Photo By: Air Force Senior Master Sgt. Ralph Branson**

Ammo Ops

Sailors transfer ordnance on the flight deck of the USS Nimitz in the Pacific Ocean, Oct. 22, 2019. **Photo By: Navy Seaman Keenan Daniels**

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 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 aligned its risk categories to the DoD risk categories 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 20 fraud risk events. Table 3 below summarizes DLA's overall risk ranking for the Fraud Risk categories:

Table 3: Summary of Fraud Risk Ranking

Risk Category	Low Risk Events	Medium Risk Events	High Risk Events	Total Risk Events
Fraud Risk	9	9	2	**20**

In FY2020, DLA is reporting fraud risks from the following sub-categories: *Large Contracts, Purchase, Payroll, Travel, Fleet Cards, Beneficiary Payments, Asset Safeguards, Grants, Information Technology & Security, and Other*. Fraud risks related to focus areas not previously mentioned are identified as "Other".

In accordance with the Fraud Reduction and Data Analytics Act of 2015, DLA facilitated fraud risk identification in the aforementioned susceptible areas. DLA aligned fraud risks related to DLA business processes in Table 4 below:

Continued on next page –

Table 4: Fraud Risks		
Fraud Risk Sub-Category	**Risk Description**	**Overall Risk Ranking**
Other	Fraud, Waste, Abuse, and Contract Failure: Fraud, waste, abuse, or mismanagement.	HIGH
Other	Counterfeit Parts: Counterfeit material within DoD acquisition systems and DoD life-cycle sustainment processes.	HIGH
Other	Compromised Commercial and Government Entity (CAGE) Codes: CAGE Codes for fraud schemes involving CAGE Compromise (i.e., Hopping or Jacking). CAGE Hopping is where a vendor receives a contract but delivers nonconforming parts or no parts at all, then "hops" to a new CAGE code before they get caught. CAGE Jacking is where a vendor registers a new CAGE code in the name of an existing business, substitutes their banking data for the legitimate business' data, then when awarded a contract under the guise of the legitimate business, sends invoices and gets paid, then either delivers nonconforming parts or no parts at all.	MEDIUM
Large Contracts	Fair and Reasonable Pricing: *Overpricing* - This encompasses inflated prices charged by the vendor for services or supplies rendered. *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
Payroll	Fictitious payroll payments to ghost employees and continued payments to separated employees due to administrative errors.	MEDIUM
Payroll	Unauthorized payroll adjustments	MEDIUM
Travel	Employees creating fictitious employees and travel vouchers for payment.	MEDIUM
Travel	Employees accessing the travel database and stealing social security numbers to open fraudulent bank accounts and deposit unauthorized travel reimbursements.	MEDIUM
Beneficiary Payments	Payments made for deceased and/or fictitious beneficiaries and false documentation submission to prolong disability payments.	MEDIUM

Table 4: Fraud Risks		
Fraud Risk Sub-Category	**Risk Description**	**Overall Risk Ranking**
Information Technology 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
Other	Knowledgeable employee doesn't report known or suspected fraud, waste or abuse to the Office of the Inspector General (OIG) Hotline Program.	MEDIUM
Purchase	GPC: Illegal, improper purchases, or improper payments.	LOW
Fleet Cards	Lack of or insufficient controls to monitor the utilization of fleet cards may lead to the risk of employees' misuse of the fleet card to purchase fuel for personal usage.	LOW
Asset Safeguards	Improper Handling of Controlled Materials: There is a risk of losing accountability of classified or AA&E shipments caused by not confirming drivers' clearance.	LOW
Asset Safeguards	Improper Handling of Controlled Materials: Not properly safeguarding classified material at the time of receipt.	LOW
Asset Safeguards	Improper Handling of Controlled Materials: Failure to take the proper precautions when transporting classified material.	LOW
Asset Safeguards	Improper Handling of Controlled Materials: Failure to check door seals and taking proper action when seals are broken or missing.	LOW
Asset Safeguards	Receipt and Acceptance: Inventory receipt and acceptance could be subject to a misstatement of actual inventory quantities received versus actual inventory quantities recorded.	LOW
Grants	Risk that cooperative agreement award recipients will use award funding for expenses that are not in the scope of the agreement. The aggregate value of DLA's 91 annual cooperative agreement awards is about $43 million. No individual award exceeds $1 million.	LOW
Other	Potential Fraud resulting from noncompliance with the standards of conduct and the Agency ethics program.	LOW

The DLA is in the process of implementing financial and administrative controls to mitigate the above fraud risks. DLA appointed a CRO 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 and is progressing with 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.

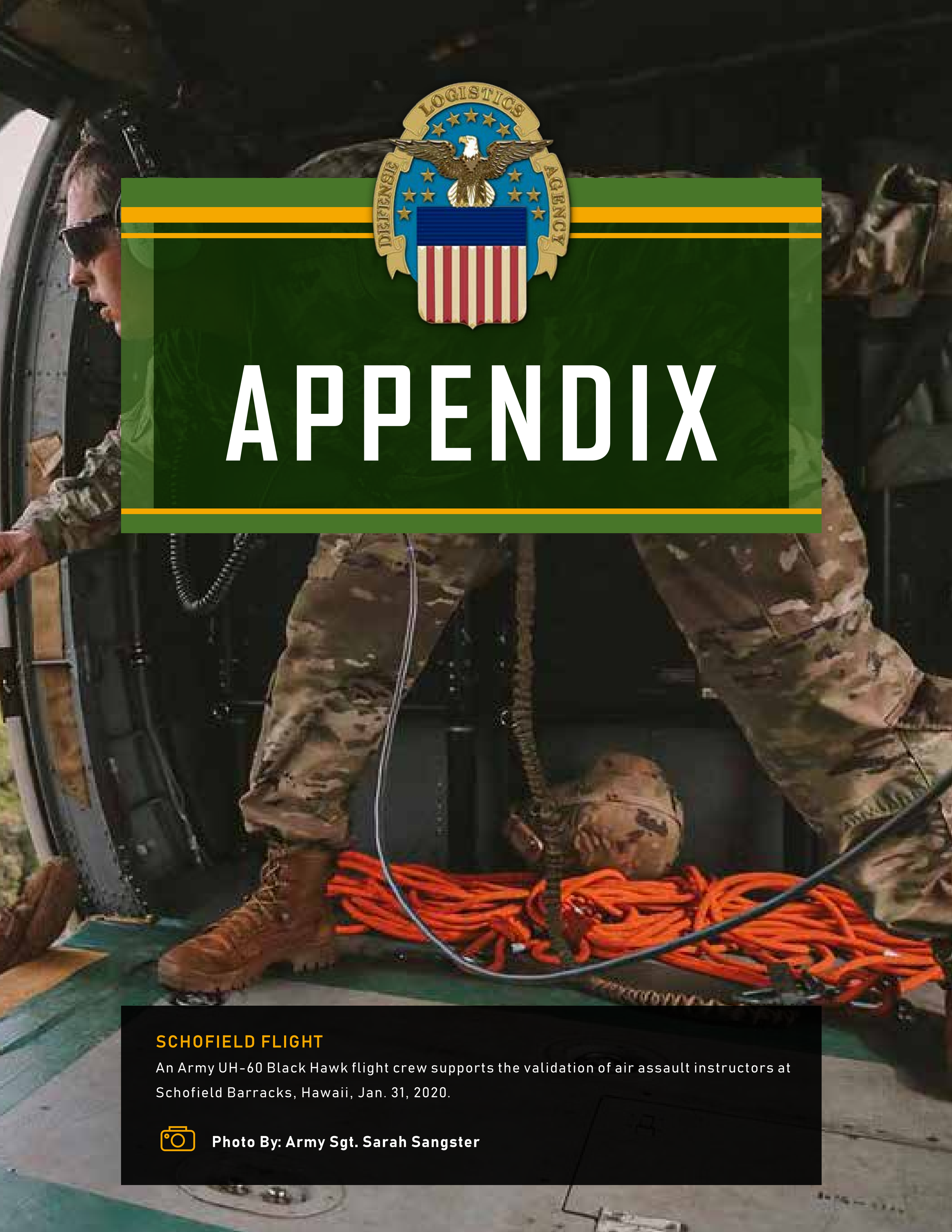
Pentagon Flyover

The Air Force and Navy flight demonstration squadrons, the Thunderbirds and the Blue Angels, fly over the Pentagon, May 2, 2020, as part of "America Strong," a collaborative salute from the two services to honor health care workers, first responders, service members and other essential personnel during the COVID-19 pandemic. **Photo By: Air Force Tech. Sgt. Ned T. Johnston**

Helicopter Watch

Marines track CH-53E Super Stallion helicopters using a Tracking Head Trainer, a weapon system used for training, in Okinawa, Japan, Oct. 23, 2020. **Photo By: Marine Corps Cpl. Ethan LeBlanc**

APPENDIX



APPENDIX

SCHOFIELD FLIGHT

An Army UH-60 Black Hawk flight crew supports the validation of air assault instructors at Schofield Barracks, Hawaii, Jan. 31, 2020.

Photo By: Army Sgt. Sarah Sangster

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.

Appendix A: Summary of FMFIA Definitions and Reporting (continued)

Category	Definition	Reporting
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 a material misstatement of the entity's financial statements will not be prevented, or detected and corrected before issuance. **D. Internal Control Over Compliance:** A material weakness in internal control over compliance is a condition where management lacks a process that reasonably ensures preventing a violation of law or regulation that has direct and material effect on financial reporting or significant effect on other reporting or achieving Agency objectives.	Material weaknesses and a summary of corrective actions must be reported to OMB and Congress through the AFR or other management reports. Progress against CAPs must be periodically assessed and reported to Agency management.

APPENDIX B: J/D CODES, DLA HQ PROGRAM SUPPORT STRUCTURE, ROLES AND RESPONSIBILITIES

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

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

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

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

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

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

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

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

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

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

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

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

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

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

DLA OFFICE OF THE INSPECTOR GENERAL (OIG) coordinates and synchronizes GAO and Department of Defense Office of 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.

Cold Look

A Marine checks the optic functionality of a guided missile system during Exercise Reindeer in Setermoen, Norway, Oct. 28, 2019. The U.S.-Norwegian exercise focuses on cold weather training and interoperability. **Photo By: Marine Corps Cpl. Brennon Taylor**

APPENDIX C: ABBREVIATIONS & ACRONYMS

A/BO	Approving/Billing Officials
A&FP	Accounting & Finance Policy Directorate
ADA	Anti-Deficiency Act
AFR	Agency Financial Report
AMP	Annual Materials Plan
A/OPC	Agency/Organization Program Coordinators
APR	Annual Performance Report
ASP	Annual Sales Plan
AWARS	Automated Workflow and Reporting System
BRAC	Base Realignment and Closure
CAC	Common Access Card
CAGE	Compromised Commercial and Government Entity
CAPs	Corrective Action Plans
CARS	Central Accounting and Reporting System
CBY	Charge Back Year
CCEs	Cross-Cutting Efforts
CCs	Critical Capabilities
CFO	Chief Financial Officers
Charge Card Act	Charge Card Abuse Prevention Act
CIO	Chief Information Officer
COLA	Cost of Living Adjustments
COTS	Commercial Off-The-Shelf
COVID-19	Coronavirus-19
CPIM	Consumer Price Index Medical
CPM	Component Program Manager
CRO	Chief Risk Officer
CSRS	Civil Service Retirement System
CTC	Cost-to-Complete
DAI	Defense Agencies Initiative
DATA Act	Digital Accountability and Transparency Act
DCIA	Debt Collection Improvement Act
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DISA	Defense Information System Agency
DLA	Defense Logistics Agency
DoD	Department of Defense
DOL	Department of Labor
DSA	Defense Supply Agency
DSCA	Defense Contract Administration Services
DSS	Distribution Standard System
DQP	Data Quality Plan
EBS	Enterprise Business System
ECC	Resource Planning Central Component
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
FeMn	Ferromanganese
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FFMSRs	Federal Financial Management System Requirements
FMFIA	Federal Managers' Financial Integrity Act
FMR	Financial Management Regulations
FPAs	Federal Program Agencies
FRDAA	Fraud Reduction and Data Analytics Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principle
GAO	Government Accountability Office
GF	General Fund
GMRA	Government Management Reform Act
GPC	Government Purchase Card
GPRA	Government Performance and Results Act
GSA	General Services Administration
HC	Historic Cost
ICO	Internal Control over Operations

ICOFS	Internal Controls over Financial Systems
ICOR-O	Internal Control over Operations
ICOR	Internal Control over Reporting
ID	Identification
IOD	Insight on Demand
IPA	Independent Public Accounting
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Information Act of 2002
IT	Information Technology
IUS	Internal Use Software
JLEnt	Joint Logistics Enterprise
LCM	Lower Cost or Market
LOEs	Lines of Effort
MAC	Moving Average Cost
MOCAS	Mechanization of Contract Administration Service
NDAA	The National Defense Authorization Act
NDS	National Defense Stockpile
NFRs	Notice of Findings and Recommendations
NSA	National Security Agency
OCONUS	Outside the Continental United States
ODCFO	Office of the Deputy Chief Financial Officer
ODOs	Other Defense Organizations
OI	Other Information
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OSD	Office of the Secretary of Defense
OSHA	Occupational Safety and Health Administration
OUSD	Office Under Secretary of Defense
P3	Public-Private Partnerships
PMO	Program Management Office
POL	Petroleum, Oil, and Lubricant
PPE	Personal Protective Equipment
PP&E	Property, Plant, and Equipment
PPA	Prompt Payment Act
PPE	Personal Protective Equipment
RACER	Remedial Action Cost Engineering and Requirements
RCRA	Resource Conservation and Recovery Act
S&C	Strategic & Critical
S/L	Straight-Line
RMIC	Risk Management and Internal Control
RIA	Rock Island Arsenal
SAP	Systems Applications and Product
SFFAS	Statement of Federal Financial Accounting Standards
SFIS	Standard Financial Information Structure
SLOA	Standard Line of Accounting
SM	Strategic Materials
SMC	Senior Management Council
SOA	Statement of Assurance
TAS	Treasury Account Symbol
TDD	Treasury Direct Disbursing
TF	Transaction Fund
TFM	Treasury Financial Manual
TNC	Treasury Nominal Coupon
U.S.	United States
UDOs	Undelivered Orders
USSGL	U.S. Standard General Ledger
VV&A	Validated, Verified, and Accredited
WCF	Working Capital Fund
WMS	Warehouse Management System

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 acknowledgment 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.

This page intentionally left blank

DEFENSE LOGISTICS AGENCY

8725 JOHN J. KINGMAN ROAD
FORT BELVOIR, VIRGINIA 22060
WWW.DLA.MIL