Defense Logistics Agency

AGENCY FINANCIAL REPORT

Working Capital Fund (Unaudited)

The Nation's Combat Logistics Support Agency

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YEAR

About the Agency Financial Report

The Defense Logistics Agency (DLA) Working Capital Fund (WCF) 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 WCF financial statements and other reports. The principal financial statements[1] have been prepared to report the financial position and results of DLA WCF's operations. The financial statements and accompanying notes have been prepared from the books and records of DLA WCF using guidance from the following applicable laws and regulations for which DLA WCF is unable to provide assurance:

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

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

All information within this report pertains to DLA WCF unless specifically noted otherwise. DLA WCF's financial results are unaudited and there are limitations due to underlying processes that support the principal financial statements. DLA WCF 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 WCF, including its history, mission, and organizational structure; DLA WCF's overall performance related to its strategic goals and primary objectives; financial analysis; management's assurance on internal controls; system analysis; compliance with laws and regulations; and forward-looking information.

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

Financial Section (Unaudited)

This section contains a message from the CFO, audit reports, management's response to the audit reports, financial statements and the accompanying notes, as well as required supplementary information (RSI).

Other Information (Unaudited)

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

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Message from the Director

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

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

Lines of Effort:

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

Critical Capabilities:

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

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

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

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

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

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Management’s Discussion and Analysis (Unaudited)

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

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

IN THIS SECTION

Mission and Organizational Structure

History

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

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

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

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

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

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

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

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

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

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

Mission, Vision, and Values

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

Mission

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

Vision

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

Values

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

What DLA WCF Does

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

The DLA WCF employs approximately 25,200 civilian personnel, 530 active duty military personnel, and 660 reserve personnel who operate a global enterprise in 22 countries and 46 states. Civilian personnel are paid from DLA WCF while active duty military personnel and reserve personnel are paid from their respective military departments.

The National Defense Authorization Act (NDAA) is the U.S. Federal law specifying annual budget and expenditures of the DoD. As part of fulfilling the government's duty to be publicly accountable for budgetary resources, DLA WCF maintains accountability primarily through contract authority for its operating and capital programs, as it relates to its two major activity groups: Energy and Supply Chain Management (SCM). DLA WCF rigorously plans, executes and monitors budgetary resources, sales patterns, and rate of obligation in excess of $50 billion annually, while ensuring its mission of supplying American Warfighters with critical support. These resources are utilized in accordance with prevailing laws and regulations.

The DLA WCF has three major activity groups: Energy, SCM, and Document Services. Energy and SCM collaborate with Distribution and Disposition Services to form the six Major Subordinate Commands (MSCs) (as depicted in Figure 1 and 3). The Energy activity group manages the Energy MSC, and the SCM activity group manages the other five MSCs. The term MSC was devised by the DLA Director to reflect the flow of acquiring supplies, distributing supply materials, and disposing of excess supplies. In its support role, Distribution provides worldwide storage and distribution services to the nine supply chains described below, while Disposition Services partners with DLA WCF's supply chains, DoD components (including the U.S. Army, Navy, and Air Force), other Federal Agencies, and public entities to reutilize, transfer, sell, and donate surplus property and disposal of hazardous waste.

The third DLA WCF activity, Document Services operates independently and outside of the MSCs. Its role is to provide preferred DoD document and printing services, as well as provide those services to other Federal agencies.

The DLA WCF manages nine supply chains through the Energy and SCM activity groups, and supports more than approximately 2,400 weapon systems. The nine supply chains are: Aviation Systems, Land Systems, Maritime Systems, Fuel/Energy, Subsistence, Medical, Clothing and Textiles (C&T), Construction and Equipment (C&E), and Industrial Hardware (IH). The Energy activity group manages the Energy supply chain, and the SCM activity group manages the other eight supply chains. Agency leaders are committed to the continuous assessment and transformation of the organizational culture, size, structure, and alignment through enterprise integration and partnering with the private sector. Organizing as a single, integrated business enterprise enables DLA WCF to focus on supporting DoD components, other Federal agencies, and public entities, enhancing the Armed Forces' readiness, and providing for the Warfighter during contingency operations.

Figure 1: DLA MSC Chart

How DLA WCF Accomplishes its Mission

The DLA WCF has three major activity groups: Energy, SCM, and Document Services. The three major activity groups are described below:

Energy

The DLA Energy activity group provides the DoD components (including the U.S. Army, Navy, and Air Force), other Federal Agencies, and public entities with comprehensive energy solutions worldwide. To do so, DLA Energy manages the Energy supply chain for energy-related products and services from jet fuel and natural gas to quality assurance and utility services, and many more. DLA WCF manages the following major product areas: Aerospace Energy; Bulk Petroleum Products; Direct Delivery Fuels; and Installation Energy. Additionally, DLA Energy provides services such as Government Fuel Cards, quality-related services, international fuel agreements, utility services contracts and research and development (R&D) of alternative fuels to customers.

Supply Chain Management

The DLA SCM activity group is responsible for managing eight supply chains and associated weapons systems, and provides logistics and materiel process management policy, guidance, and oversight while conducting continuous assessments of supply chain performance. DLA WCF integrates strategic, operational, and tactical perspectives, command and control functions for contingency operations, and adaptive planning in order to influence the logistics supply chain. Additionally, DLA WCF operates a global network of distribution centers. DLA WCF's warehousing strategy is driven by the commitment to better serve Warfighters, co-locating with the armed forces, while placing supplies where they are most needed.

Document Services

Operating independently and apart from the nine supply chains discussed above, DLA Document Services is the preferred provider for document automation services to the DoD and is also designated as the single manager for printing and high-speed, high-volume duplicating in the DoD. Document Services provides printing, duplicating, and document automation services within the DoD to include document workflow conversion, electronic storage and output, multi-function devices, office printers, and distribution of hard copy and digital information. Through Document Services, DLA WCF helps customers reduce storage costs, increase efficiency of information sharing, and provides more functionality at a significantly lower cost.

Organizational Structure

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

Figure 2: DLA Organizational Chart

Figure 3: DLA Organizational Structure

Annual Performance Report

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

Performance Goals, Objectives, and Results

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

Figure 4: Lines of Effort and Critical Capabilities

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

LOE 1 Warfighter First

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

Warfighter First Objectives

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

Objective 1.2: Readiness and Lethality

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

Objective 1.3: 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 MSCs and improve supply chain resiliency and security.

Objective 1.4: Predictive Technology

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

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

Objective 1.5: Warfighter Trust

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

Objective 1.8: Demand Projections

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

LOE 2 Global Posture

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

Objective 2.4: Expanded Solutions

Expand the availability and use of logistics solutions to enable immediate action. DLA will use big data to provide accurate demand forecasts, stock levels, and positioning to enable rapid responses to emerging military service and CCMD requirements. DLA's flexible, responsive contracting and global services contracts bring additional capability to the fight when conditions warrant.

LOE 3 Strong Partnerships

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

Strong Partnerships Objectives

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

Objective 3.1: Joint Logistics Enterprise Partnerships

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

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.

Objective 3.4: Public Engagement

Engage with public entities to increase understanding and awareness of DLA's mission and operations. In collaboration with the OSD, DLA will actively engage with Congress, advisory boards, public media, and other stakeholders to facilitate partnerships, raise awareness of DLA operations, and highlight the contributions to the Nation.

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.

Objective 4.2: Provider of Choice

Extend DLA capabilities to support daily operations of other government partners. While providing uninterrupted support to the Warfighter, DLA will offer its collective expertise, focusing on supply chains and services where DLA offers a unique advantage. Drawing upon the global network of command and control capabilities, suppliers, and expertise, DLA will further extend its support to the Whole of Government.

Whole of Government Objectives

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

Objective 4.3: Expand Support to Federal Agencies

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

LOE 5 Always Accountable

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

Always Accountable Objectives

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

Objective 5.2: Auditability

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

Objective 5.4: Mitigate Risks

Strengthen risk management to ensure secure, agile and resilient Combat Logistics Support. DLA thoroughly manages risks associated with alternatives to deliver world-class logistics support. DLA must pay special attention to cyber risks and data integrity across the entire supply chain.

CC 1 – Enterprise Enablers

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

Enterprise Enablers Objectives

1 Innovation
2 Data Management
3 Technology
4 Cybersecurity

CC 2 – People and Culture

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

People Objectives

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

Culture Objectives

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

Performance Measures (Unaudited)

DLA Supply Chain Management (Non-Energy) – Performance Measure 1: Supply Chain Management Availability to Warfighters

This performance measure relates to the objectives described above: **1.3**, Address Risk; **1.4**, Predictive Technology; **1.5**, Warfighter Trust; **1.8**, Demand Projections; **2.1**, Strategic Positioning; and **2.4,** Expanded Solutions.

The DLA SCM strives to predict supply needs in order to more efficiently and effectively equip the Warfighter. As of September 30, 2019, DLA SCM is just shy of its target of having 90.0% supply availability across the board for all commands. SCM funding constraints to fill orders is a major factor contributing to supply availability shortfalls. DLA continues its efforts in meeting high supply availability expectations by employing smart budgetary resource use techniques, and leveraging rapid acquisition opportunities to meet expectations.

Supply Availability to Warfighters			
Military Command	**FY2019**	**FY2018**	**FY2017**
Army	**90.8%**	**88.1%**	**89.7%**
Air Force	**90.4%**	**88.7%**	**90.2%**
Marines	**88.9%**	**87.9%**	**88.4%**
Navy	**88.7%**	**87.5%**	**88.6%**
Average	**89.7%**	**88.1%**	**89.2%**

Figure 5: Supply Availability to Warfighters Chart

A sailor directs an MH-60S Seahawk helicopter to lower supplies onto the flight deck of the aircraft carrier USS Carl Vinson during a vertical replenishment with the fleet replenishment oiler USNS Yukon in the Pacific Ocean.

DLA Supply Chain Management (Non-Energy) – Performance Measure 2: "Wait Time" to Fill Supply Orders for Supply Chains

This performance measure relates to the objectives described above: **1.2**, Readiness and Lethality; **1.3**, Address Risk; **1.4**, Predictive Technology; **2.1**, Strategic Positioning; and **5.4**, Mitigate Risks.

The DLA WCF tracks the average amount of "wait time" that occurs to fill backorders for its SCM. DLA WCF aims to minimize the amount of time required to fill backorders to increase the readiness of the Warfighter. In FY2019, the SCM "wait time" results trended upwards significantly over the past two years. DLA WCF's emphasis on filling high priority non-mission capable supply backorders and weapon system readiness-based orders has allowed lower priority orders to age more than in the past. When those lower priority orders are not filled, they drive up the average "wait time".

The SCM "wait time" to fill backorders over the past three fiscal years is illustrated below for the following SCM supply chains: Aviation, Land, Maritime, C&E, Medical, C&T, Food (Subsistence), and IH. DLA WCF SCM applies variable strategic acquisition techniques to minimize supply wait times to efficiently and effectively supply the Warfighters.

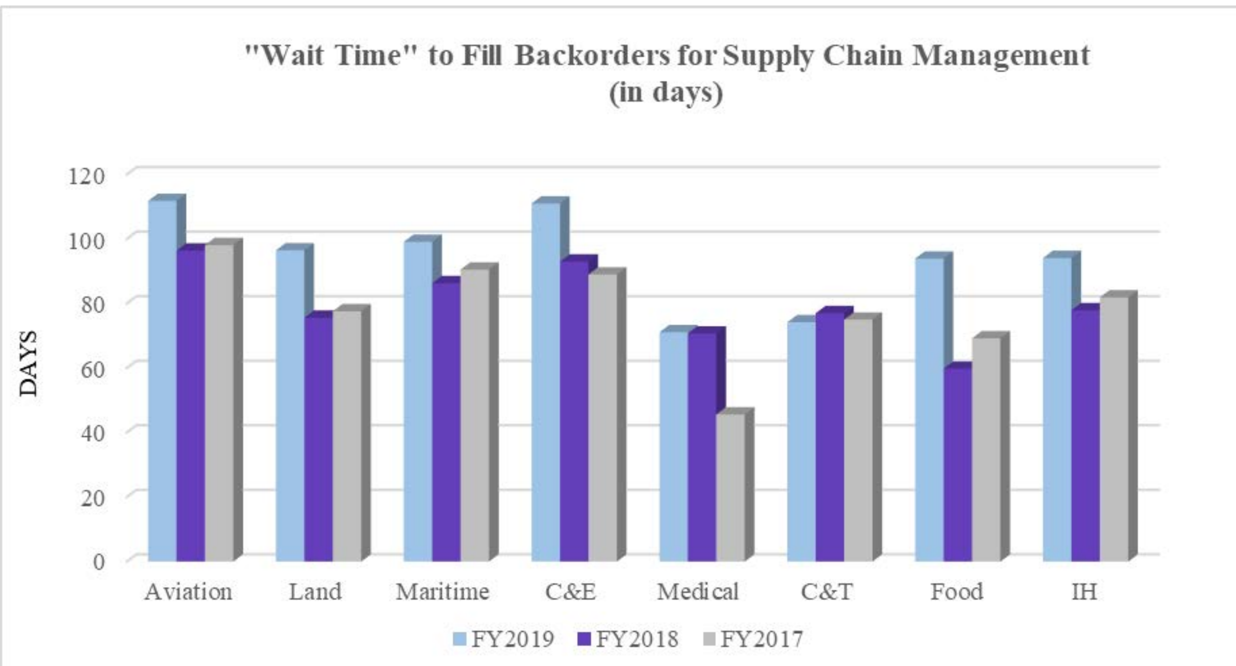

Figure 6: "Wait Time" to Fill Backorders for Supply Chain Management (in days) Chart

DLA Energy – Performance Measure 1: Fuel Sales by DoD Component

This performance measure relates to the objectives described above: **3.1**, JLEnt Partnerships; **3.2**, DoD and Interagency Partnerships; and **4.3**, Expand Support to Federal Agencies.

The DLA WCF supports other DoD Agencies through fuel sales. This allows for increased interagency support through self-sustainment of fuel. For FY2019, DLA Energy budgeted to sell 88.1 million barrels to DoD. Actual fuel sales in FY2019 to DoD components were 83.5 million barrels. Demand affects actual fuel sales year-over-year. DoD's mission dictates the amount of fuel DoD purchases. For example, if training or flying hours decreased for DoD components, less fuel would be purchased during the year.

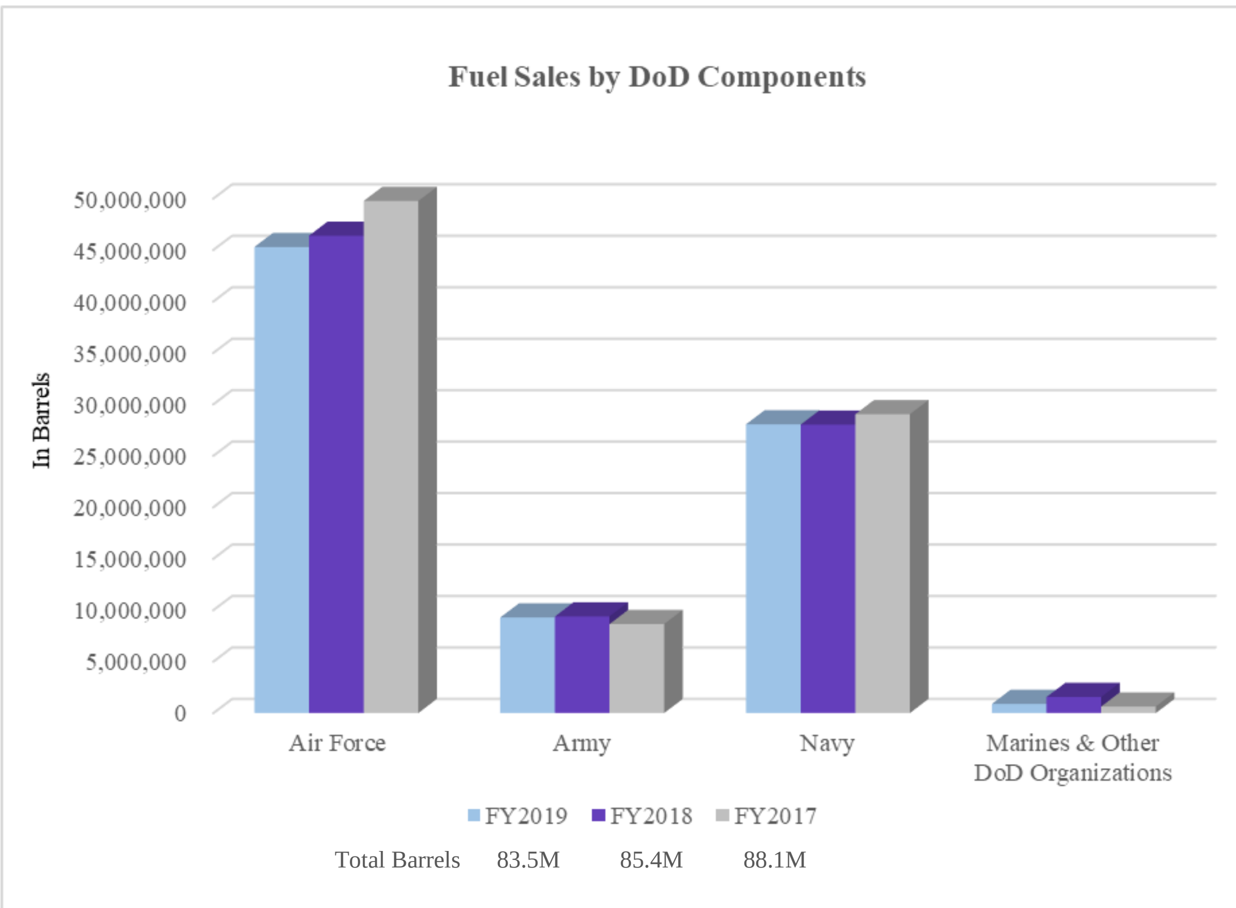

Figure 7: Fuel Sales by DoD Components Chart

DLA Energy – Performance Measure 2: Fuel Sales by Non-Federal Customers

This performance measure relates to the objective described above: **3.4**, Public Engagement.

The DLA highlights its services to the public by selling fuel to various non-Federal parties. By doing so, DLA is building non-Federal partnerships with non-Federal customers (including commercial entities/agencies), as well as international partners. For FY2019, DLA Energy budgeted to sell 6.9 million barrels to non-Federal Customers. DLA Energy achieved its goal with actual fuel sales in FY2019 to non-Federal customers of 7.0 million barrels.

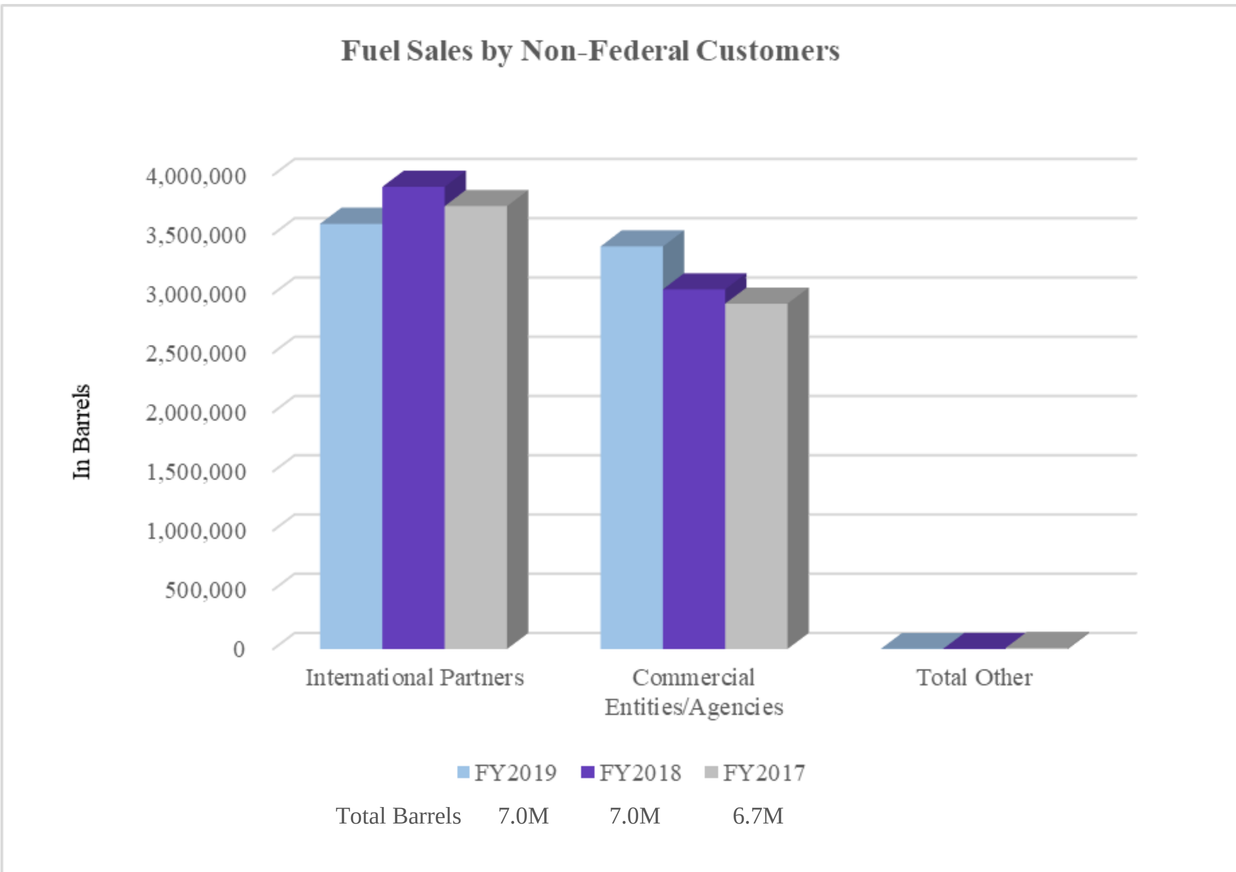

Figure 8: Fuel Sales by Non-Federal Customers Chart

DLA Energy – Performance Measure 3: Fuel Sales by Federal Civilian Agencies

This performance measure relates to the objectives described above: **3.2**, DoD and Interagency Partnerships and **4.2**, Provider of Choice.

In addition to providing fuel to DoD components and non-Federal entities, DLA WCF also sells fuel to Federal civilian Agencies. DLA WCF supports other Federal Agencies as they embark on their daily activities and accomplish their missions. DLA wholly supports the government and the entire Nation through its supply of fuel. For FY2019, DLA Energy budgeted to sell 3.7 million barrels to Federal Civilian Agencies. DLA Energy achieved its goal with actual fuel sales in FY2019 to non-Federal customers of 3.7 million barrels. Demand affects actual fuel sales year-over-year.

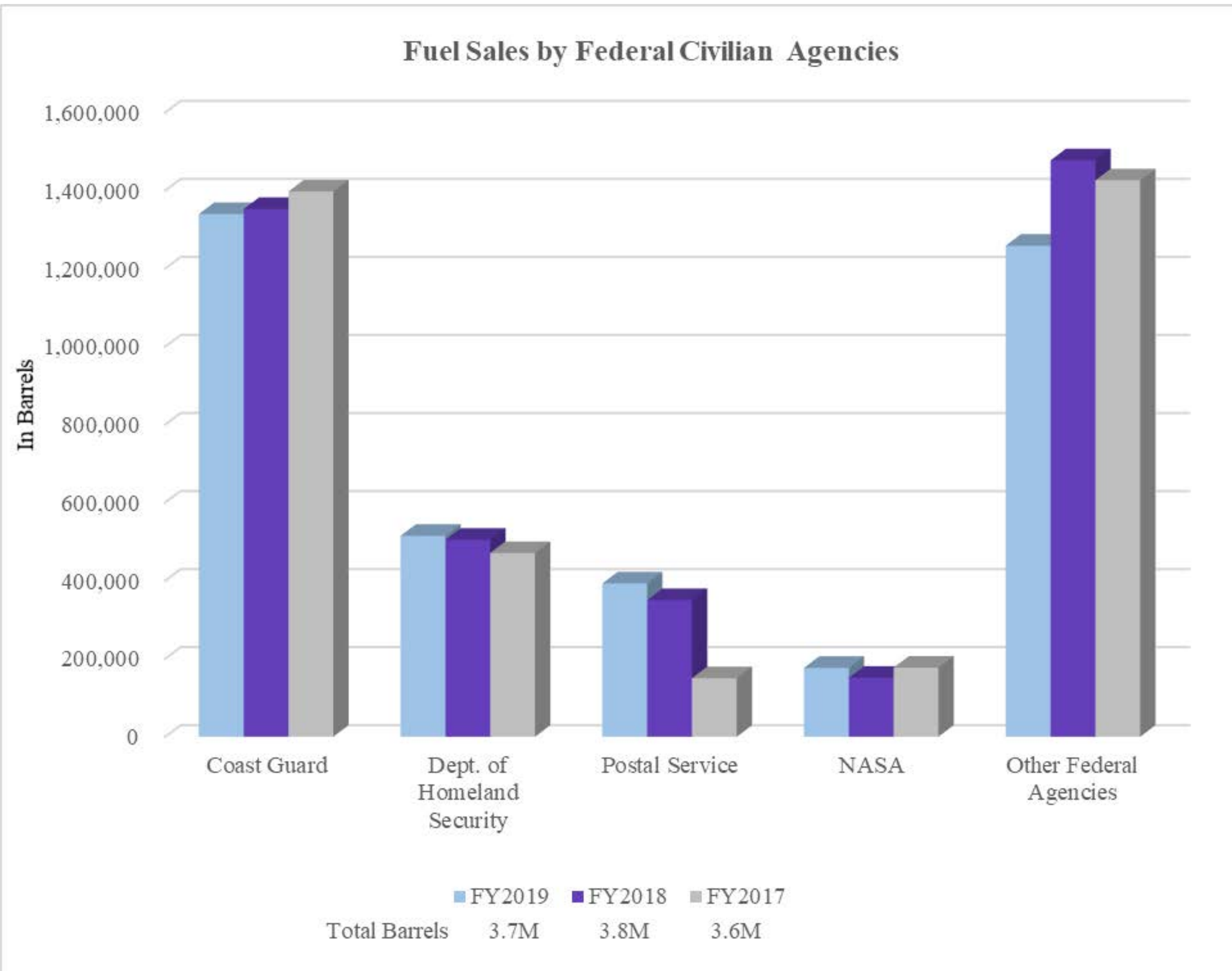

Figure 9: Fuel Sales by Federal Civilian Agencies Chart

Performance Measure: DLA Roadmap to Auditability

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

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

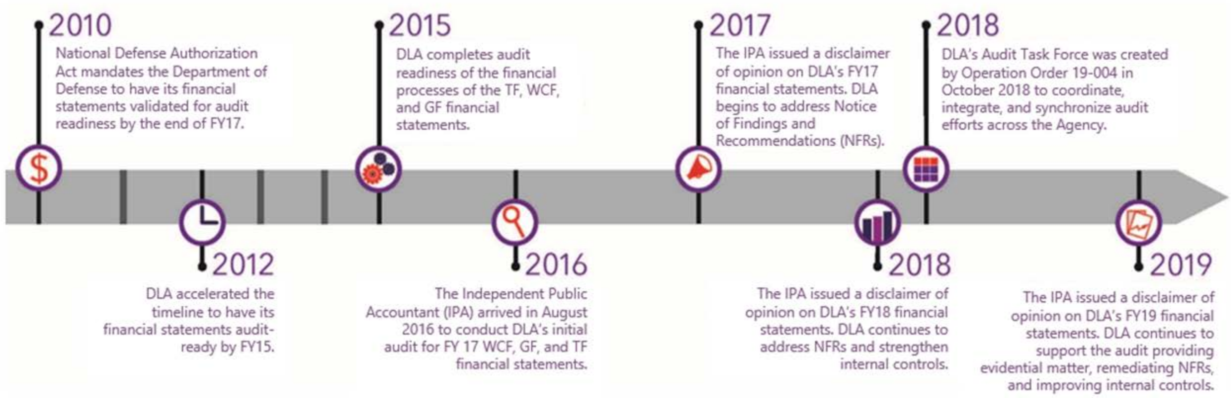

Figure 10: DLA Auditability Timeline

Analysis of Financial Statements and Stewardship Information

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

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

Overview of Financial Position

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

A summary of DLA WCF changes in key financial measures for FY2019 and FY2018 is presented in the following Analysis of Key Financial Measures. The table represents the budgetary resources available, assets on hand to pay liabilities, and the corresponding net position. The net cost of operations is the gross costs of DLA WCF three activity groups: Energy, SCM, and Document Services, less earned revenue. Budgetary resources are funds available for DLA WCF to incur obligations during the period of availability, fund operations, and sell products and services to customers. The summary section also includes an explanation of significant changes for each DLA WCF financial statement.

Changes In Key Financial Measures As of and for the Years Ended September 30, 2019 and 2018 (dollars in millions)				
			Increase/Decrease	
Net Financial Condition	**2019 (Unaudited)**	**2018 (Unaudited)**	**$**	**%**
Fund Balance with Treasury	$ 1,238.6	$ 1,798.5	$ (559.9)	(31.1%)
Accounts Receivable, Net and Other Assets	3,202.8	3,017.6	185.2	6.1%
Inventory and Related Property, Net	21,316.7	20,728.4	588.3	2.8%
General PP&E, Net	2,560.8	2,687.6	(126.8)	(4.7%)
Total Assets	$ 28,318.9	$ 28,232.1	$ 86.8	0.3%
Accounts Payable	$ 2,930.3	$ 3,267.8	$ (337.5)	(10.3%)
Federal Employment Benefits and Other Liabilities	509.6	873.2	(363.6)	(41.6%)
Environmental and Disposal Liabilities	1,272.2	1,508.0	(235.8)	(15.6%)
Total Liabilities	$ 4,712.1	$ 5,649.0	$ (936.9)	(16.6%)
Unexpended Appropriations	$ 291.1	$ 1,187.5	$ (896.4)	(75.5%)
Cumulative Results of Operation	23,315.7	21,395.6	1,920.1	9.0%
Total Net Position	$ 23,606.8	$ 22,583.1	$ 1,023.7	4.5%
Total Liabilities and Net Position	$ 28,318.9	$ 28,232.1	$ 86.8	0.3%
Net Cost of Operations	$ (127.9)	$ 942.3	$ (1,070.2)	(113.6%)
Budgetary Resources	$ 51,881.9	$ 53,904.2	$ (2,022.3)	(3.8%)

Figure 11: Changes In Key Financial Measures

A KC-46A Pegasus connects with an F-15 Strike Eagle for an aerial refueling test over California.

Balance Sheets Summary

Assets – What DLA WCF Owns and Manages

Assets represent amounts owned and managed by DLA WCF that can be used to accomplish its mission as the Nation's Combat Logistics Support Agency and consist of: Fund Balance with Treasury (FBwT), Inventory and Other Related Property, Net; Accounts Receivable, Net and Other Assets; and General Property, Plant and Equipment (PP&E), Net. DLA WCF's largest asset is Inventory and Related Property, Net, representing $21.3 billion and 75.3% of Total Assets as of September 30, 2019. Inventory and Related Property, Net largely consists of supply chain materials, equipment and repair parts, world-wide military supplies, and IH, primarily all held for sale. The net increase of $588.3 million and 2.8% in Inventory and Related Property, Net is primarily due to increase in stocks on hand and stock commodities, as well as increased Troop Support medical supplies for Warfighter readiness. DLA WCF's second largest asset group are the Accounts Receivables, Net and Other Assets, which are $3.2 billion and 11.3% of Total Assets as of September 30, 2019. DLA WCF experienced a surge in sales within DLA Troop Support - C&E, resulting in an overall net increase of $185.2 million and 6.1% in Accounts Receivables, Net and Other Assets. FBwT represents $1.2 billion and 4.4% of Total Assets as of September 30, 2019. FBwT decreased $559.9 million and 31.1% primarily due to a reduction in cash infusions received from OUSD reprogramming actions in FY2019 compared to FY2018 and an increase in supply chain inventory purchases.

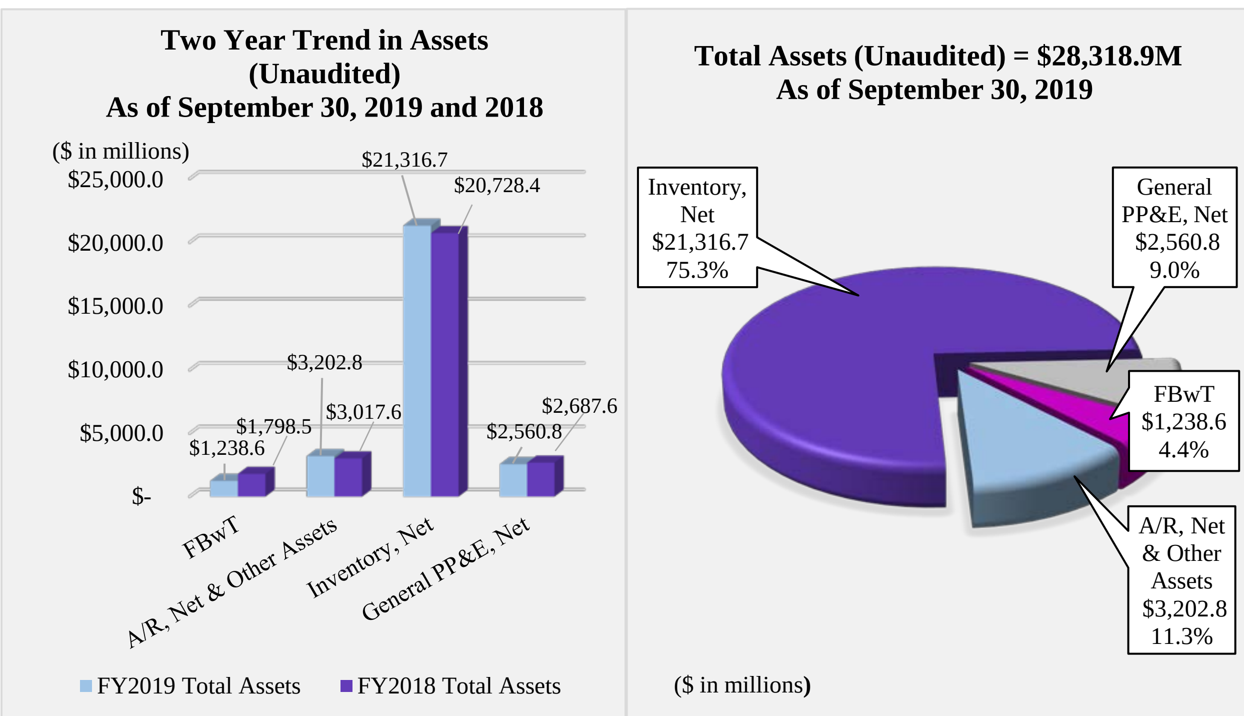

Figure 12: Total Assets as of September 30, 2019 and 2018

Liabilities – What DLA WCF Owes

Liabilities are the amounts owed to the Federal and public agencies for goods and services provided, but not yet paid for, to DLA WCF employees for wages and future benefits, Environmental Disposal Liabilities, and Other Liabilities. Accounts Payable, which includes amounts owed but not yet paid to the Federal and non-Federal Agencies for goods and services received by DLA WCF, is the largest liability reported at $2.9 billion and 62.2% of Total Liabilities. The overall decrease in Accounts Payable of $337.5 million and 10.3% was due to a reduction of fuel purchases and an increase in vendor disbursements in FY2019 compared to FY2018. The second largest liability is Environmental and Disposal Liabilities (EL), which DLA WCF receives appropriated funds to execute and manage the restoration of environmental sites on real property. As of September 30, 2019, the EL is $1.3 billion and 27.0% of Total Liabilities. The overall net decrease of $235.8 million and 15.6% in EL was primarily attributed to a decrease in DLA WCF Non-BRAC Environmental Closures Requirements. Finally, Other Liabilities, representing $509.6 million and 10.8% of Total Liabilities as of September 30, 2019, decreased $363.6 million and 41.6% primarily due to reduced demand for goods and services related to Federal Emergency Management Agency (FEMA) hurricane relief.

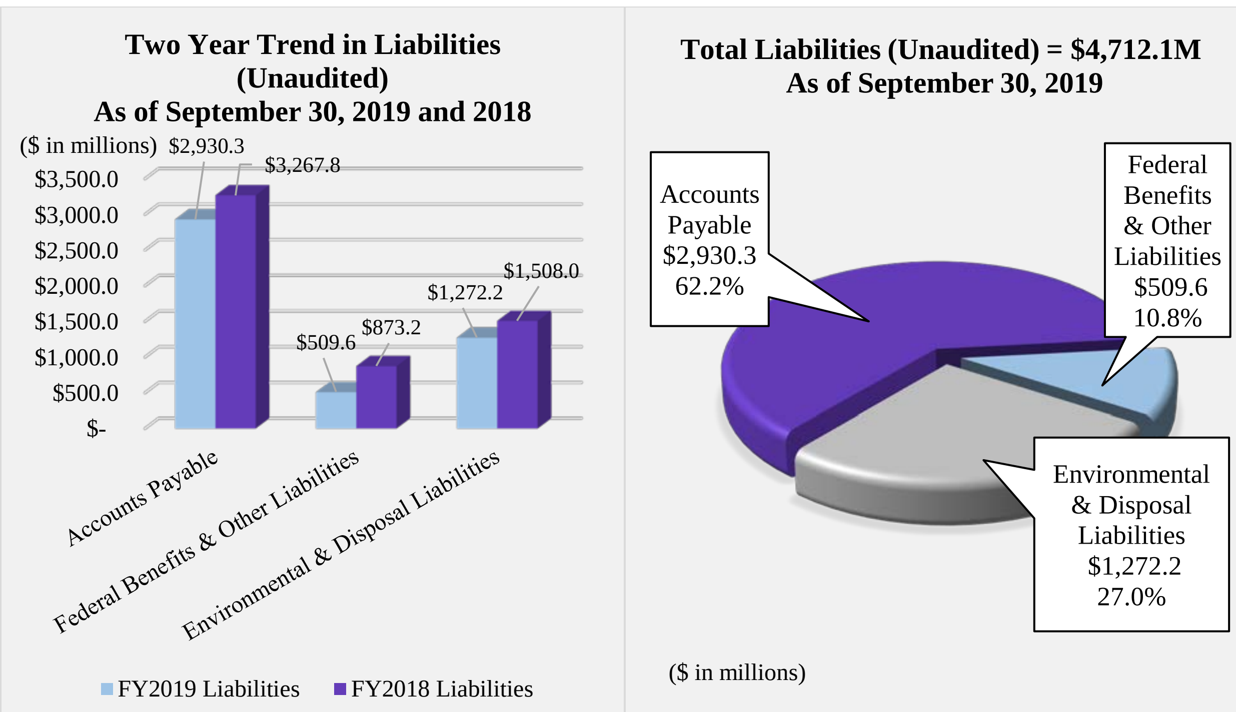

Figure 13: Total Liabilities as of September 30, 2019 and 2018

Ending Net Position – What DLA WCF has Done Over Time

Net position represents primarily the accumulation of revenue and expenses, and unexpended appropriations and other financing sources transferred in/out since inception, as represented in DLA WCF balances reflected on the Statements of Changes in Net Position. As of September 30, 2019 and 2018, total Net Position primarily consists of Cumulative Results of Operation of $23.3 billion and $21.4 billion, respectively, derived from producing goods and providing services for sale to Federal and non-Federal entities. This function is the primary source of sustaining DLA WCF in its key role of logistically supporting missions of America's Warfighters. The largest contributing factor of the overall net increase in Net Position of $1.0 billion and 4.5%, is mostly attributable to the price escalation of fuel in FY2019. Unexpended appropriations decreased by $896.4 million and 75.5% primarily due to the consumption of supplemental appropriations related to reprogramming of $1.0 billion and overseas contingencies operations (Title IX) of $205.9 million.

DLA WCF Results – Current Fiscal Year Net Cost of Operations

The DLA WCF operates under the mission of: *Sustain Warfighter readiness and lethality by delivering proactive global logistics in peace and war.* DLA WCF has three activity groups: SCM, Energy, and Document Services; all comprising a single, integrated business enterprise that operated for the year ended September 30, 2019, by incurring Gross Cost of $44.6 billion. The corresponding Earned Revenue of $44.7 billion for the year ended September 30, 2019, resulted in Net Cost of $127.9 million. Gross Cost increased by $2.8 billion and 6.7% for the year ended September 30, 2019 in comparison to year ended September 30, 2018. This is primarily attributed to a large growth in business related to the construction and equipment supply chain and an increase in costs of goods sold related to higher Energy fuel prices. Earned revenue increased by $3.9 billion and 9.4% for the year ended September 30, 2019 in comparison to year ended September 30, 2018. This is primarily attributed to increases in Sales-Customer Direct average sales price, C&E sales, and sales of material to the Army, Navy, Air Force, and foreign militaries.

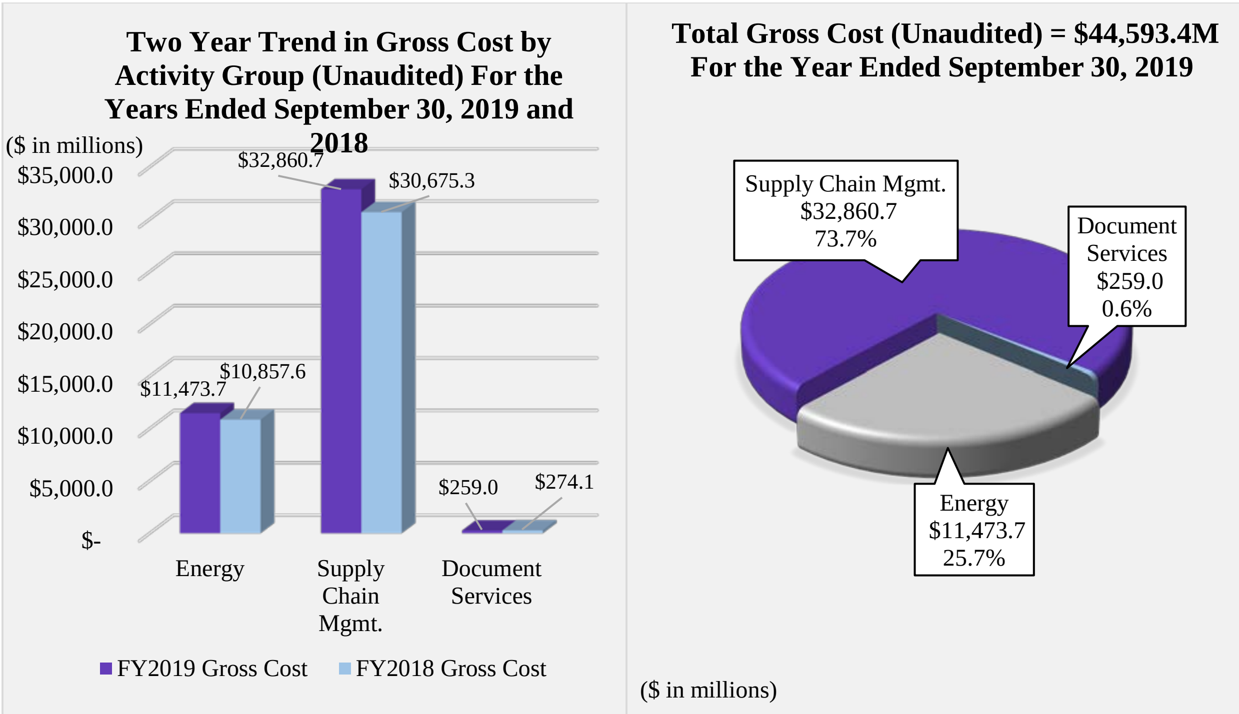

Figure 14: Gross Activity Costs for the Years Ended September 30, 2019 and 2018

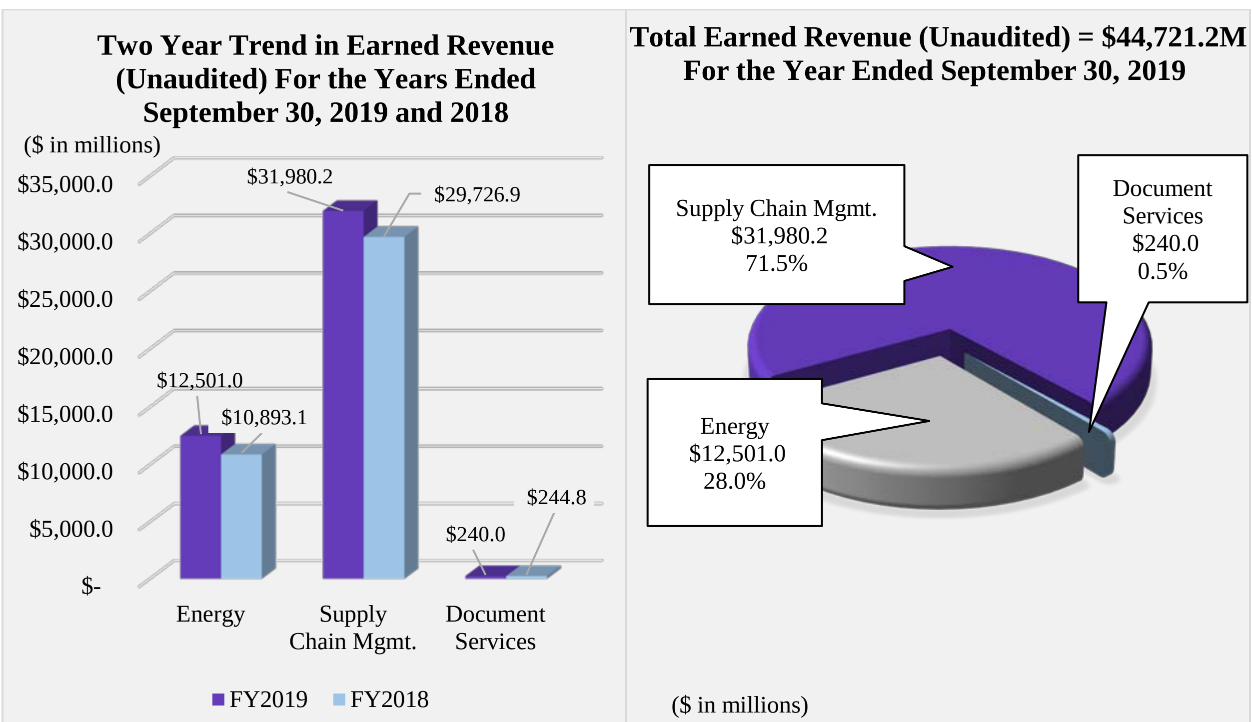

Figure 15: Earned Revenue for the Years Ended September 30, 2019 and 2018

Budgetary Resources

DLA WCF 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 WCF 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 DLA WCF primarily relies on Contract Authority to fund the majority of its operations. There was an overall net decrease in Total Budgetary Resources in FY2019 from FY2018 for $2.0 billion due mostly to a reduction of Contract Authority, resulting in related decreases in Obligations and Unobligated balances in FY2019 from FY2018.

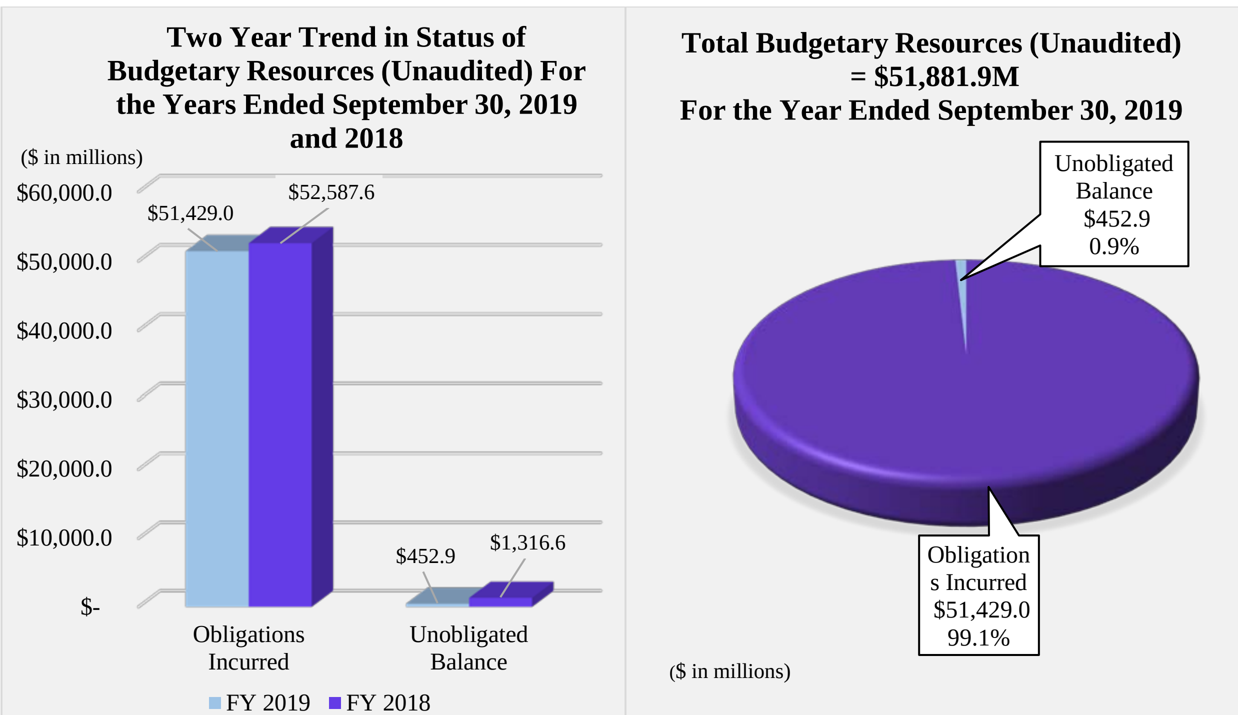

Figure 16: Status of Budgetary Resources for the Years Ended September 30, 2019 and 2018

Analysis of Systems, Controls, and Legal Compliance

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

Management Assurances

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

OCT 0 1 2019

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

THROUGH: OFFICE OF THE CHIEF MANAGEMENT OFFICER

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

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

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

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

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

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

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

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Summary of Internal Control Assessment

Federal Managers' Financial Integrity Act

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

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

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

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

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

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

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

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

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

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

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

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

Federal Financial Management Improvement Act

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

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

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

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

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

- Federal Accounting Standards[2]: High-risk factors that indicate non-compliance in this area include the disclaimer of opinion on the FY2018 financial statements and material weaknesses over internal controls over reporting and non-compliance related to financial system security were identified in FY2018 and FY2019 in areas that corresponded to this requirement across DLA.

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

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

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

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

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

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

Compliance with Laws and Regulations

Anti-Deficiency Act

The ADA Title 31 U.S.C. §1341, prohibits Federal employees from obligating funds in excess of an appropriation, or before funds are available, or from accepting voluntary services. As required by the ADA, DLA WCF notifies all appropriate authorities of any potential ADA violations. At this time, there are no known or potential ADA violations. In FY2018, DLA WCF had two ADA cases, which were closed in FY2019.

The DLA WCF 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 WCF is continuously evaluating the existing processes and controls to identify areas of improvement.

Digital Accountability and Transparency Act of 2014

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

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

Debt Collection Improvement Act of 1996

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

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

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

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

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

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

Government Charge Card Abuse Prevention Act of 2012

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

Financial Systems

Financial Systems Strategy

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

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

Financial Management Systems Framework

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

Future Financial Management Systems Framework

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

Limitations of the Financial Statements

The DLA WCF principal financial statements[3] and accompanying notes are prepared to report the financial position and results of operations of DLA WCF, as required by the CFO Act of 1990, expanded by the GMRA of 1994, and 31 U.S.C. § 3515(b).

The DLA WCF is unable to fully implement all elements of U.S. Generally Accepted Accounting Principles (U.S. GAAP) as promulgated by the FASAB and the form and content requirements for Federal government entities specified by OMB Circular A-136, *Financial Reporting Requirements,* and other authoritative guidance. This is due to financial and nonfinancial management system limitations, as well as limitations on the underlying processes that support the principal financial statements. DLA WCF 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 WCF were designed to record information on a budgetary basis.

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

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

Forward-Looking Information

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

An Ever Changing Workforce

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

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

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

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

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

External Threats

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

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

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

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

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

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

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

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

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

Technological Advancement and Initiatives

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

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

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

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

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Financial Section (Unaudited)

2

SECTION 2 – FINANCIAL SECTION (Unaudited)

As part of DLA Disposition Services, DLA provides disposal services for hazardous materials.

IN THIS SECTION

Financial Section (Unaudited)

Message from the Chief Financial Officer

NOVEMBER 2019

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

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

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

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

J. ARTHUR HAGLER
Director, DLA Finance
Chief Financial Officer

Audit Reports

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

November 8, 2019

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

SUBJECT: Transmittal of the Independent Auditor's Report on the Defense Logistics Agency Working Capital Fund Financial Statements and Related Notes for FY 2019 and FY 2018 (Project No. D000FE-0087.000, Report No. DODIG-2019-023)

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

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the DLA Working Capital 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 Working Capital Fund FY 2019 and FY 2018 Financial Statements and related notes.

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

- The DLA did not have policies, procedures, and internal controls surrounding documentation of procurements and disbursements, tracking of inventory by owner, 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 support the existence, completeness, rights and obligations, or valuation of its Property, Plant and Equipment.

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

- The DLA did not have adequate policies, procedures, and internal controls to record accounts receivable and revenue transactions in the proper period in accordance with generally accepted accounting principles; was unable to support the balances recorded as accounts receivable; was unable to validate or explain the significant balance of aged receivables; did not have procedures to estimate valuation allowances against receivables; and did not support recorded transactions.

- The DLA recorded accounts payable and expense transactions in the wrong period; lacked overall policies, procedures, and internal controls related to obligations and invoice payments; and did not have adequate procedures to record accrued liabilities.

- The DLA did not have policies and procedures to validate budgetary account balances and monitor budgetary reporting variances between source systems.

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

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

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

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

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the DLA Working Capital Fund FY 2019 and FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control over financial reporting, or conclusions on whether the DLA's financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached reports, dated November 8, 2019, and the conclusions expressed within the reports.

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

Lorin T. Venable

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

Attachments:
As stated

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Report of Independent Auditors

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

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

Departure from U.S. Generally Accepted Accounting Principles

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

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Basis for Disclaimer of Opinion

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

Disclaimer of Opinion

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

Other Matters

Required Supplementary Information

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

Other Information

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

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

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Other Reporting Required by *Government Auditing Standards*

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

Ernst & Young LLP

November 8, 2019

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

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

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

Internal Control over Financial Reporting

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

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

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

Material Weaknesses

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

I. Inventory – Inventory is comprised of items held by DLA for resale or held by DLA on behalf of one of the military services. Policies, procedures and internal controls surrounding documentation of procurements and disbursements, tracking of inventory by owner, 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. Property, Plant and Equipment (PP&E) – PP&E includes real property, general equipment, internal use software and construction-in-progress. DLA has not completed an analysis of existence and completeness of PP&E records for which they are the financial reporting organization (FRO) or their process to value PP&E beginning balances and has weaknesses in the processes of maintaining and reconciling PP&E records. Therefore, DLA is unable to support the existence, completeness, rights and obligations, or valuation of its PP&E. The combination of these deficiencies in aggregate results in a material weakness in internal control related to PP&E. The matters identified related to PP&E are further described in Appendix A.

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

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IV. Accounts Receivable (AR) and Revenue – AR consists of amounts owed to DLA primarily related to the resale of goods and the provision of services. Revenue is earned when DLA sells goods and services to the public or other federal entities. DLA was unable to support the balances recorded as AR, validate or explain the significant balance of aged receivables. In addition, DLA did not have procedures to estimate valuation allowances against receivables and had not supported transactions recorded. Furthermore, DLA did not have adequate policies, procedures and controls to record AR and revenue transactions in the proper period in accordance with U.S. generally accepted accounting principles (GAAP). The combination of these deficiencies in aggregate results in a material weakness in internal control related to AR and revenue. The matters identified related to AR and revenue are further described in Appendix A.

V. 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 goods and services from the public or other federal entities. DLA was unable to support the AP balance, expenses and related budgetary balances. In addition, DLA did not have overall policies, procedures and internal controls for the procure to pay process, including the process to create and approve obligations and the process to review, record and pay invoices. Furthermore, DLA lacked adequate procedures to record obligations and accrue for liabilities incurred but not paid, and it recorded certain transactions in the procure to pay process in incorrect periods. 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.

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

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

VIII. 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 that, when aggregated, result in a material weakness. The deficiencies relate to the following four areas:

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

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

Significant Deficiencies

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

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

DLA's Response to Findings

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

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Purpose of this Report

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

Ernst + Young LLP

November 8, 2019

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Appendix A – Material Weaknesses

I. Inventory

DLA's inventory is comprised of petroleum and aerospace products, weapon system repair parts, food, clothing and medical supplies. Inventory also includes material from the military services designated for disposal or reutilization. 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 Documentation of Inventory Accounting Policies, Procedures and Controls.** DLA has not documented the processes related to the significant business activities for acquisition, movement, warehousing and disposition of inventory; the related risks for each business activity; and the control activities designed to mitigate risks of material misstatement in the financial statements. The documentation lacks an accurate description of the following: financial reporting, records management, physical count policies, accounting for third-party managed inventory, the Inventory Reconciliation Framework (IRF), the annual Chief Financial Officer (CFO) sample process and various other business processes.

B. **Lack of or Inadequate Documentation to Substantiate Inventory and Inventory-Related Transactions.** DLA was unable to provide documentation that inventory balances exist, or inventory transactions occurred and are accurately recorded in the financial statements. Specifically, documentation was not available to support:

- The completeness and accuracy of transactions recorded or the existence of balances in the general ledger and the accountable property system of record (APSR).
- Shipping terms for sales transactions to evidence when the title and risk of loss is transferred to the buyer.
- Balances recorded in the inventory detail reports from the financial reporting system that do not reconcile to the site-specific end-of-month report and component financial statements.
- Balances of fuel inventory held in pipelines or in-transit.
- Posting of transactions in the general ledger resulting from financial events (i.e., sales, purchases, gains and losses, including gains and losses resulting from physical inventory counts).

C. **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:

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- **Inadequately Designed Controls Over Inventory Processes.** For controls that have been implemented over significant Energy and Distribution processes, the controls are not designed to align with DLA policies or are not executed consistently. In addition, sufficient documentation does not exist to evidence the performance of the control activities.
- **Inventory Held for Others.** Inventory held on behalf of the military services is not always stored in physically segregated locations and instead, is commingled with similar inventory that could be owned by multiple owners. DLA lacks controls over the commingled inventory. DLA does not have policies and procedures to reconcile quantities of inventory by owner to the total physical inventory counts on a regular basis. As a result, gain/loss adjustments are not assigned to the appropriate owner and not recorded in compliance with DLA's policy.
- **In-Transit Inventory.** In-transit inventory relates to items that were accepted at the point of origin (free on board shipping point) and are in-transit to a DLA destination. Controls related to monitoring in-transit inventory balances do not exist. As a result, inventory recorded as in-transit from procurement points of origin has remained in-transit for several fiscal years, including amounts dating back to 2012.
- **Energy Inventory.** DLA policy requires that monthly or quarterly automated tank gauging (ATG) verifications be performed. In addition, DLA requires that manual readings of fuel tank levels be obtained by calibrated tape or calibrated rod in the absence of functional ATG systems. However, DLA lacks controls to monitor field-level sites for compliance with DLA Energy policies. In addition, DLA does not monitor or review documentation to validate that field-level sites are performing the monthly or quarterly verifications or that manual readings are obtained in the absence of functional ATG systems.
- **Posting Inventory Adjustments in the General Ledger.** DLA policy requires that errors between the APSR and the general ledger be reviewed and corrected by assigned users. Adjustments to correct the errors above a certain dollar threshold are reviewed by a supervisor. However, DLA does not have controls in place to prevent users from posting adjustments above the threshold or to detect that adjustments posted above the threshold were not reviewed.
- **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.

D. **Inadequate Policies, Procedures and Related Controls over Inventory Physical Counts.** The Department of Defense Financial Management Regulation (DoD FMR) requires that all inventory be counted at least annually, either in a full physical count or through cycle counts, to validate perpetual inventory accuracy. DLA has not adequately designed controls related to physical counts to validate the existence and completeness of inventory related to Supply, Aerospace or Disposition as required. For example:

- **Supply Inventory.** DLA policy requires the physical count of all items on two- or five-year cycles depending on inventory value. DLA is not in compliance with this policy or the DoD FMR. DLA implemented an annual statistical sampling count to supplement the cycle counts and mitigate potential weaknesses in completing full annual counts. However, the statistical sampling approach was not designed and executed appropriately. Errors identified in the sample were neither assessed to determine the root cause nor projected over the population to determine the potential financial significance of the errors.

- **Aerospace Inventory.** Periodic physical counts or measurements of Aerospace inventory are not performed.
- **Disposition Inventory.** Inventory physical counts are not required to be performed on all Disposition inventory received from the military services.

E. **Lack of Controls for the Reconciliation Between Inventory APSR and the General Ledger.** DLA utilizes the IRF to reconcile the inventory quantity balance in the general ledger to the inventory quantity balance in the APSRs. However, the IRF was not performed completely, accurately or timely. For example:

- The inventory reconciliations are not completed on a timely basis or within the normal financial statement close period (approximately 40-45 days from month-end).
- There were significant unreconciled variances totaling $434 million in the reconciliation for June 2019.
- The IRF does not include all appropriate general ledger accounts, including inventory in-transit between storage locations and inventories/stock on hand.

F. **Lack of Controls over Inventory Held by Third Parties.** DLA does not have a detailed listing of inventory by vendor that reconciles to the inventory recorded in DLA's general ledger, nor does DLA have a listing of all vendors who hold inventory on DLA's behalf. DLA is unable to support the balances of inventory held at third parties for each vendor. In addition, DLA recorded inventory at inactive vendors (i.e., vendors with which DLA no longer has a contractual relationship). As a result, DLA is unable to substantiate the existence and completeness of inventory held at third parties.

G. **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* and SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials.* For example:

- DLA values inventory using the moving average price (MAP). However, DLA is unable to provide supporting documentation of costs that are included or excluded to calculate the MAP.

- DLA began implementing inventory costing methodologies in accordance with SFFAS No. 48 in fiscal year (FY) 2016. However, DLA did not completely and accurately value inventory in accordance with SFFAS No. 48. For example, the values assigned for certain inventory items were based on the latest acquisition cost (LAC). The LAC values did not properly consider inventory acquired through the implementation date.
- DLA assigned zero-dollar values for more than 2,000 unique material numbers with combined quantities totaling more than 40 million. DLA was not able to provide the basis for the zero-dollar valuation for all materials.
- Work in process (WIP) inventory items or components are provided to a production facility for assembly or modification, or to make an end item. Policies and procedures are not in place to record all costs, such as the assembly and labor costs, incurred during the kitting or assembly process.
- Valuation allowances for various inventory items, including excess, obsolete and unserviceable (EOU) inventory, inventory held for repair, inventory held at net realizable value, etc., are not appropriately documented or supported. The documentation for the valuation allowance for inventory held for repair does not sufficiently describe the methodology used to estimate the allowance or describe the rationale for adopting the methodology being used and the factors used in the estimation process.

H. **Inadequate or Lack of Controls over Financial Reporting of Inventory.** DLA lacks controls to classify and present inventory appropriately in the financial statements. DLA accounting policy states that inventory balances are based on the following categories: inventory held for current sale, inventory held for future sale, EOU and inventory held for repair. DLA uses the inventory condition codes as the basis to classify inventory between each category. Controls are not in place to assign inventory the appropriate condition codes. In addition, DLA is unable to determine whether inventory classified as EOU meets the definition in SFFAS No. 3. As a result, DLA was unable to substantiate the amounts classified, presented or disclosed.

Recommendations

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

A. **Lack of or Inadequate Documentation of Inventory Accounting Policies, Procedures and Controls.** Document, update and finalize the process cycle memoranda (PCM) that document the end-to-end processes for inventory, including receiving, distributing, recording, processing and reporting. Perform a risk analysis and document risks associated with the DLA inventory business process. Review current control documentation and perform a gap analysis for internal controls at the financial statement assertion level.

B. **Lack of or Inadequate Documentation to Substantiate Inventory and Inventory-Related Transactions.**

- Develop and maintain documentation to support that inventory transactions occurred and are accurately recorded in the financial statements, including:
  - Standardizing data elements included in data extracts from APSRs and the general ledger.
  - Standardizing documentation requirements to support financial events.

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

- **Inadequately Designed Controls over Inventory Processes.** Design and implement internal control activities and include criteria, analyses, reviews and supporting thresholds used in the execution of all relevant internal controls. The control activities should align to and be executed consistently with DLA policies.
- **Segregating Inventory Held for Others.** Develop policies and procedures related to inventory held for others to include the following:
  - Properly identifying the inventory owner of the material, as appropriate, such as identifying the owner on material labels upon receipt or segregating the inventory by owner.
  - Recording inventory gains/losses for inventory held on behalf of others to the appropriate owner to properly account for the gains/losses.
- **In-Transit Inventory.** Develop and implement policies and procedures to properly validate in-transit inventory and to validate that balances are complete and accurate.
- **Energy Inventory.** Design policies, procedures and controls to monitor field-site compliance with DLA Energy policies. The controls should monitor the performance of monthly or quarterly verifications. In addition, DLA should monitor the performance of manual readings on tanks with malfunctioning ATGs.
- **Posting Inventory Adjustments in the General Ledger.** Design application-level controls that prevent users from posting transactions above their approved thresholds. Further, DLA's inventory process should include procedures to review transactions posted to verify that unauthorized transactions were not posted.
- **Inventory Recorded in the Appropriate Period.** Design policies, procedures and 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.

D. **Inadequate Policies, Procedures and Related Controls over Inventory Physical Counts.** DLA should design and implement policies, procedures and controls as follows:

- The inventory count for Supply, Aerospace and Disposition should include a requirement whereby quantities in the perpetual inventory system are supported via physical counts at least once a year, either through a wall-to-wall, year-end count or adequately designed cycle counts in compliance with the DoD FMR.

- The CFO sample inventory count program should be refined whereby DLA performs counts on all materials selected using statistical sampling and tests for existence and classification. In addition, the errors should be appropriately projected to the population.

E. **Lack of Controls for the Reconciliation Between Inventory APSR and the General Ledger.** Design policies and procedures to perform the IRF completely, accurately and timely. The policies should consider the following:

- Reconciling or resolving variances timely, including establishing thresholds for variances that require for a review to be performed.
- Including all inventory general ledger accounting codes in the IRF.

F. **Lack of Controls over Inventory Held by Third Parties.** Design controls over inventory held by third parties by performing a reconciliation of third-party managed inventory balances to the general ledger balances and developing a comprehensive listing of vendors and military services that hold DLA-owned inventory on behalf of DLA.

G. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design policies and procedures to implement the appropriate accounting standards, specifically SFFAS No. 3 and SFFAS No. 48. The policies and procedures should include:

- Substantiating that the inputs to the MAP calculation include or exclude costs as appropriate.
- Establishing opening inventory balances by valuing inventory using the deemed cost valuation methodologies in accordance with SFFAS No. 48 and verifying that inventory valuation complies with SFFAS No. 3 on a go-forward basis.
- Assigning a proper value and unit of measure at the time of receipt.
- Tracking and recording all costs incurred during the kitting or assembly process to the WIP inventory.
- Documenting the methodology and processes used to estimate valuation allowances for items, including EOU inventory, inventory held for repair, inventory held at net realizable value, etc.

H. **Inadequate or Lack of Controls Over Financial Reporting of Inventory.** Design and implement controls to assign inventory items to the appropriate condition code, including controls over EOU inventory classification in accordance with SFFAS No. 3.

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II. Property, Plant and Equipment

Property, plant and equipment (PP&E) is comprised of real property, general equipment, internal-use software (IUS) and construction-in-progress (CIP). In accordance with FMFIA, management is responsible for establishing and maintaining effective controls to achieve proper accountability for property and other assets for which the agency is responsible. However, DLA was unable to support the existence, completeness, rights and obligations, or valuation of its PP&E.

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

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

- Rights to real property assets, such as lease agreements, memoranda of agreement or memoranda of understanding.
- The quantity and values of the linear structures recorded in its financial systems.
- The completeness and existence of general equipment assets.
- The validity of PP&E additions and disposals.

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

- **Inadequately Designed Controls over PP&E Processes.** Controls that have been implemented are not designed adequately. For example, the information used in the control activity is not assessed for completeness and accuracy. In addition, sufficient documentation does not exist to evidence the performance of the control activities. As a result, DLA is unable to demonstrate that the control is operating effectively.
- **IUS.** DLA policy states that IUS assets are recorded as in-service PP&E upon the completion of the asset. However, IUS activity is not evaluated to determine whether the activity should be capitalized or expensed and to identify when assets are completed and should be placed in service.
- **Reconciliation of PP&E Note Disclosure.** The reconciliation between the APSR, general ledger and PP&E note disclosure in the financial statements is not performed.

D. **Lack of Controls to Record Similar Assets on a Consistent Basis.** Inconsistencies in the application of the accounting policies prevent DLA from properly accounting for and recording all assets in the financial systems. For example, generators may be grouped within an asset (i.e., building) or recorded separately as unique assets.

E. **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 PP&E on the balance sheet and in the related footnote disclosure. Specifically, DLA has neither implemented nor applied the accounting and valuation methodologies set forth by SFFAS No. 5, *Accounting for Liabilities of the Government; Capital Leases*; SFFAS No. 6, *Accounting for Property, Plant and Equipment*; SFFAS No. 10, *Accounting for Internal Use Software*; and SFFAS No. 50, *Establishing Opening Balances for Property, Plant and Equipment*. For example:

- DLA is unable to support the values assigned to real property and general equipment assets, including substantiating that the application of SFFAS No. 6 and SFFAS No. 50 was consistent and appropriate. To account for a significant number of assets that have not been valued, DLA assigned placeholder values to these assets until the valuation process is completed, resulting in misstatements in the financial statements.
- DLA is unable to support the values assigned to IUS assets in accordance with SFFAS No. 10.
- DLA has not established a policy to account for its leasing arrangements, nor has DLA assessed whether the leasing arrangements should be accounted for as a capital or an operating lease. As a result, the financial statements do not include disclosures for its policy to account for lease arrangements, any operating lease commitments and future minimum payments due.

Recommendations

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

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

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

- Develop documentation to substantiate that DLA is the financial reporting organization for the real property assets, including linear structures, recorded in the financial statements.
- Develop documentation to substantiate that all of DLA's general equipment assets are recorded accurately and completely.

- Assess the data elements in the APSR to allow DLA to differentiate between assets that have been added to or removed from the capital PP&E population and assets that have changed or to assign a unique identifier to each asset that allows for additions and disposals to be identified.

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

- **Inadequately Designed Controls over PP&E Processes.** Design and implement internal control activities that include criteria, analyses, reviews and supporting thresholds used in the execution of all relevant internal controls.
- **IUS.** Design and implement policies and procedures that require IUS activity to be reviewed for proper capitalization and recorded in the appropriate period.
- **Reconciliation of PP&E Note Disclosure.** Design and implement procedures to reconcile between the APSR, general ledger, the financial statements and related note disclosures.

D. **Lack of Controls to Record Similar Assets on a Consistent Basis.** Develop and implement controls to consistently account for and record similar PP&E assets in the financial system.

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

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

III. 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 in 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; correct and review Defense Automatic Addressing System (DAAS) rejects; research and resolve differences between U.S. Treasury, disbursing system records, and accounting system records within a timely basis (the DRRT report contains transactions that are aged more than 60 days, including transactions that are aged more than 3 years); and properly review cash balances throughout the year to prepare cash projections and determine whether DLA has enough cash to meet financial obligations.

B. **Inappropriate Policies and Procedures for Recording Cash Receipts.** DLA does not have an appropriate process to record cash upon receipt in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. Interfund transactions are not processed by U.S. Treasury until month-end reporting; however, DLA records the cash collection transaction in the general ledger prior to when the transactions occur resulting in a misstatement of cash balances.

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

Recommendations

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

A. **Lack of or Inadequate Documentation of FBwT Accounting Policies, Procedures and Controls.** Finalize the documentation of the end-to-end process for FBwT. The documentation should include the process to perform regular and recurring reconciliations of the suspense account data; the process to identify and correct DAAS rejects timely; the process to research and resolve differences between U.S. Treasury, disbursing system records and accounting system records on a timely basis; and the process to determine that DLA has sufficient cash on hand to meet current financial obligations.

B. **Inappropriate Policies and Procedures for Recording Cash Receipts.** Design and implement policies and procedures to properly record a debit to cash and a credit to accounts receivable (AR) when the cash transaction has occurred, and cash has been received at U.S. Treasury.

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

IV. Accounts Receivable and Revenue

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

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

- **UCOs.** Documentation does not include the process to identify, research and resolve unreconciled amounts for UCOs and the process to review the validity of significantly aged UCOs in the general ledger despite being closed through other business processes and systems.
- **AR.** Documentation does not include the process to evaluate the collectability and validity of significantly aged AR (receivables include a significant amount of aged receivables (greater than 180 days)); the process to review, reconcile or clear negative accounts receivable balances in a periodic and consistent manner; and the process to account for, calculate and post the allowance for doubtful accounts.
- **Nonstandard Revenue.** Documentation does not include the process for the proper accounting treatment for cash advances received and sales transactions related to nonstandard revenue, such as emergency management situations and disaster relief efforts.

B. **Lack of or Inadequate Controls over AR, Revenue and Cash Collection Processes.** DLA lacks or has inadequate controls, including the design of controls, over the following:

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- **AR and Cash Collections.** DLA lacks controls to substantiate the validity of AR balances, including the use of a single account for multiple customers, and to apply collections from customers accurately and timely. As a result, invalid AR transactions were recorded in the financial statements.
- **MIPR Transactions.** Military Interdepartmental Purchase Requests (MIPRs) are sales orders received from the military services. DLA lacks controls to prevent services from being performed beyond the terms of the MIPR and to prevent duplicate MIPR transactions from being recorded in the general ledger. As a result, duplicate MIPR sales orders were recorded in the general ledger. In addition, there were instances where revenue recorded, in aggregate, exceeded the MIPR funding amount, or the services were performed outside the period of performance.
- **Revenue Recorded in the Appropriate Period.** DLA lacks controls to record revenue transactions appropriately and accurately in the period that the transaction occurred. As a result, a significant number of transactions were not posted in the correct accounting period.
- **Fuel Exchange Agreements.** DLA does not have adequately designed controls around the fuel exchange agreement (FEA) process. For example, DLA does not reconcile the amounts receivable from, or payable to, foreign governments. In addition, sufficient documentation does not exist to evidence the performance of the control activities. As such, DLA is unable to demonstrate that the control was operating effectively.

C. **Lack of or Inadequate Documentation to Substantiate AR and Revenue Transactions.** DLA was unable to provide documentation that AR and UCO balances exist, or that revenue transactions occurred and are accurately recorded in the financial statements. Specifically, documentation was not available to support that:

- The AR balances (federal and nonfederal), UCO and deferred revenue transactions are complete and accurate, and reconcile to the general ledger and that the balances exist.
- The revenue transactions recorded, including emergency management situations and disaster relief efforts, are complete and accurate and have occurred.

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. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.* DLA performs services for other federal agencies without funding and records receivables from these transactions. DLA is unable to support revenue recognized from unfunded agreements, nor is an analysis performed on the collectability of the receivable related to those agreements. Uncollected billings related to unfunded agreements have been outstanding since FY 2014.

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Recommendations

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

A. **Lack of or Inadequate Documentation of AR and Revenue Accounting Policies, Procedures and Controls.** Document, update and finalize the PCMs that document the end-to-end processes for AR and revenue.

- **UCOs.** The documentation should include the process to reconcile UCOs between the general ledger and sales legacy module completely, accurately and timely and to review the aged UCO balances for validity.
- **AR.** The documentation should include the process to evaluate the collectability and validity of significantly aged AR (AR includes a significant amount of aged receivables (greater than 180 days)); the process to review, reconcile or clear negative AR balances in a periodic and consistent manner; and the process to account for calculating and posting the allowance for doubtful accounts.
- **Nonstandard Revenue.** The documentation should include the financial reporting requirements during emergency management situations, including disaster relief efforts. The policies should include acceptable deviations from the normal business process, documentation requirements and timelines for completion.

B. **Lack of or Inadequate Controls Over AR, Revenue and Cash Collection Processes.**

- **AR and Cash Collections.** Design and implement controls to assess the existence and completeness of the receivable balances, including significantly aged receivables; controls to limit a customer account to a single customer, rather than a group of customers; and controls to properly, accurately and timely post payments and credits to customer accounts.
- **MIPR Transactions.** Design and implement controls for MIPR transactions that include system controls to prevent services from being provided beyond the terms of the MIPR (e.g., period of performance, funding amount) and to prevent duplicate MIPR transactions from being recorded in the general ledger.
- **Revenue Recorded in the Appropriate Period.** Design and implement controls to properly record revenue transactions in the appropriate period; controls to monitor sales transactions at or near period-end; controls to record revenue based on the proper triggering event; and controls to manage and maintain documentation to substantiate the revenue transaction.
- **Fuel Exchange Agreements.** Design, document and implement controls around the FEA process and include criteria, analyses, reviews and supporting thresholds used in the execution of all relevant internal controls.

C. **Lack of or Inadequate Documentation to Substantiate AR and Revenue Transactions.**

- Develop documentation, including detailed listings of account balances, to substantiate that the population of AR (federal and nonfederal), UCO and deferred revenue transactions are complete and accurate and that the balances in the population exist. The listing should be reconciled to the general ledger.
- Develop documentation to substantiate that the population of revenue transactions recorded, including emergency management situations and disaster relief efforts, are complete and accurate and have occurred.

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design and implement policies, procedures and controls to properly recognize revenue earned and to assess the collectability of the receivable related to unfunded work orders in accordance with SFFAS No. 7 and the DoD FMR.

V. Accounts Payable and Expense

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 AP, expenses and the related budgetary balances; recording transactions in the proper period; documenting policies, procedures and controls; and designing and executing controls over the processes to create and approve obligations and to review, record and pay invoices.

A. **Lack of or Inadequate Documentation of UDO, AP and Expenses Accounting Policies, Procedures and Controls.** DLA has not documented the end-to-end 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; the process to record invoices, including interfund transactions received, in the general ledger and submitted to DFAS for timely payment; 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:

- **Inadequately Designed Controls over AP and Expense Processes.** Controls that have been implemented are not designed effectively. For example, the information used in the control activity is not assessed for completeness and accuracy. In addition, sufficient documentation does not exist to evidence the performance of the control activities.
- **UDO.** DLA lacks controls to approve and record obligations in a timely manner; controls to record upward and downward adjustments to UDO accurately and timely; and controls to close invalid UDO in a timely manner. For example, samples selected for downward and upward adjustments with the absolute value of approximately $158 million and $105 million, respectively, were recorded inaccurately.
- **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, more than 67% of the IQCs awarded did not have an obligation recorded at the contract award date because the IQC did not have a guaranteed minimum at contract award date.
- **AP and Cash Disbursements.** DLA lacks controls to post goods receipts in a timely manner; review invoices prior to payment; and post payments, including payments that fail to post systematically, in a timely manner.
- **Expenses Recorded in the Appropriate Period.** DLA lacks controls to record expense transactions appropriately and accurately in the period that the transaction occurred. As a result, 10 instances in our sample of 25 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, including AP, negative payables, UDO (paid and unpaid) and upward and downward adjustments to delivered and undelivered orders.

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** DLA does not have policies, procedures and controls to effectively implement accounting standards. Specifically, DLA has neither implemented nor applied the accounting set forth by SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*; SFFAS No. 5, *Accounting for Liabilities of the Federal Government*; and SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. For example:

- DLA inappropriately expensed costs that should have been capitalized. For example, inventory purchased for resale was inappropriately expensed.
- AP and accrued liabilities are not recorded appropriately. For example, DLA policy allows for a liability to be recorded without confirming whether a transfer of title has occurred or service has been rendered. Further, DLA policy requires that only activities submitted by the contractors on the last day of the month are accrued and liabilities incurred prior to the last day of the month are not accrued.
- DLA does not match revenue with the related cost of sales where the customers place the order directly with the vendor, such as medical, clothing and textile sales. DLA does not record the revenue earned at the same time the liability is recorded.
- DLA processes allow for payment without receipt, thus resulting in a negative payable balance. This occurs when payment is made prior to the goods receipts being posted in the general ledger. This results in an understatement of expenses and payables, and an overstatement of UDO.

Recommendations

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

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

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

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

- **Inadequately Designed Controls over AP and Expense Processes.** Design and implement internal control activities and include criteria, analyses, reviews and supporting thresholds used in the execution of all relevant internal controls.
- **UDO.** Design and implement controls to approve and record obligations in a timely manner; controls to record upward and downward adjustments to UDO accurately and timely; and controls to close invalid UDO in a timely manner.
- **Vendor Contracts.** Design and implement controls to execute contracts in accordance with the FAR and record obligations timely for contracts, including IQC.
- **AP and Cash Disbursements.** Design and implement controls to post goods receipts in a timely manner; review invoices prior to payment; and post payments, including payments that fail to post systematically, in a timely manner.
- **Expenses Recorded in the Appropriate Period.** Design and implement controls to record expense transactions appropriately and accurately in the period that the transaction occurred and controls to monitor expense transactions at or near period-end.
- **Transactions Recorded at the Detailed Level.** Design and implement controls to comply with the FFMIA and reconcile the transaction-level detail to the summarized postings in each account.

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

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design and implement policies, procedures and controls to record expenses incurred in the proper period; to properly classify costs; and to match revenue with the related cost of sales in accordance with SFFAS No. 4, SFFAS No. 5 and SFFAS No. 7.

VI. 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 posting logic in the general ledger to be compliant with the USSGL and 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 recoupment from returns, disposal and material transfers, and service revenue transactions 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 Total Actual Resources Collected and Contract Authority Carried Forward accounts. As a result, DLA is unable to substantiate beginning balances recorded on the financial statements.
- **Trading Partner Transactions.** DLA does not have controls in place to validate and reconcile trading partner eliminations. Adjustments made to AR, AP, revenue, expenses and undisbursed funds are not appropriately supported. A complete reconciliation is not performed at the agreement level to the trading partner adjustments that are being made. As a result, trading partner adjustments are recorded in Defense Departmental Reporting System (DDRS) as "top-side" adjustments and are identified as "unsupported" by DFAS.
- **Contingent Liabilities.** DLA does not have adequate controls to identify and account for contingent legal liabilities that should be recorded or disclosed in the financial statements.
- **Interfaces Between Feeder Systems and the General Ledger.** DLA does not have adequate controls to interface and post transactions between feeder systems and the general ledger appropriately. As a result, failed interface transactions are not reviewed and resolved in a timely manner.
- **Financial Statement Close Process.** DLA does not have adequately designed controls around the annual close and reconciliation processes, such as 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.

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- **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 DDRS to reconcile DLA's budgetary accounts to the proprietary accounts.
- **Monthly or Quarterly JV Adjustments.** DLA does not have controls to review and approve JV adjustments recorded in the general ledger and DDRS by DLA and DFAS for completeness, accuracy and validity. As a result, a comprehensive listing of adjustments made is not maintained to allow DLA to determine the appropriateness of each JV adjustment recorded by their service provider.
- **Financial Statement Review Process.** The level of review of the financial statements and footnote disclosures was insufficient to detect and correct misstatements in the financial statements and related disclosures. As a result, inaccurate balances and disclosures were reported in the financial statements and notes. For example, line items were not appropriately classified between federal and nonfederal; supporting documentation did not support the balances recorded in the notes; and the financial statements are not prepared in conformity with U.S. GAAP as described in Note 1, Significant Accounting Policies, which did not sufficiently describe changes or noncompliance in U.S. GAAP reporting.

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

Recommendations

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

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

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

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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 carryforward budgetary accounts.
- **Trading Partner Transactions.** Design and implement controls to perform a reconciliation at the agreement level to validate trading partner eliminations, which includes identifying, researching and resolving variances between DLA general ledger data and trading partners.
- **Contingent Liabilities.** Design and implement controls related to litigation to identify, estimate, record and disclose contingent liabilities in the financial statements.
- **Interfaces Between Feeder Systems and the General Ledger.** Design and implement controls to review and resolve interface transactions that fail to post to the general ledger.
- **Financial Statement Close Process.** Develop and implement controls around the annual close and reconciliation process, which includes a complete, accurate and timely reconciliation of the UTB to the ATB.
- **Budgetary to Proprietary Tie Points.** Design and implement controls to reconcile budgetary to proprietary tie points and investigate variances.
- **Monthly or Quarterly JV Adjustments.** Design and implement controls to review and approve JV adjustments recorded in the general ledger and DDRS by DLA and DFAS for completeness, accuracy and validity prior to posting.
- **Financial Statement Review Process.** Design and implement controls to sufficiently review the quarterly financial statements and disclosures; to detect and correct misstatements; and to review that the financial statements and disclosures are complete and prepared in accordance with U.S. GAAP.

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.

VII. Oversight and Monitoring

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

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

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

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

Recommendations

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

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

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

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

VIII. Information Systems

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

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

The deficiencies relate to the following areas:

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

Access Controls

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

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

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

- Access was not restricted to authorized users with a business need, was not reviewed and documented prior to provisioning, and was not assigned in accordance with the principle of least privilege.
- User access and activity was not monitored and tracked for routine access recertification, revalidation of privileged access, and terminated or inactive users.
- Audit logs, security violations, and sensitive user activity were not tracked, monitored,

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resolved, or configured appropriately within systems.

Configuration Management

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

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

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

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

Segregation of Duties Controls

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

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

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

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

Security Management / Governance Over Implementation of Security Controls

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

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

The identified security management 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.
- Security controls were not identified, assessed, tested, or remediated completely within required timeframes.
- Management internal control procedures do not identify financially significant risks, establish and implement controls, track known risk exposes, and remediate control gaps.

Recommendations

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

Access and Segregation of Duties Controls

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

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.

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Appendix B – Significant Deficiency

I. Environmental Liabilities

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

A. **Inability to Reconcile EL Associated with its Real Property.** DLA is unable to completely and accurately reconcile EL associated with its real property, such as buildings, fuel storage tanks and pipelines, to the real property reported in its financial systems. In order to appropriately determine the existence and completeness of EL, the tanks and pipelines reported as real property assets should be considered.

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

Recommendations

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

A. **Inability to Reconcile EL Associated with its Real Property.** Design and implement policies and procedures to reconcile the buildings, tanks and pipelines in the environmental closure and asbestos liabilities estimate to the PP&E listings and investigate differences.

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

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

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

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

Compliance and Other Matters

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

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

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FFMIA

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

(a) Federal financial management system requirements

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

(b) Noncompliance with applicable federal accounting standards

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

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

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

FMFIA

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

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

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

DLA's Response to Findings

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

Purpose of this Report

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

Ernst + Young LLP

November 8, 2019

Management's Response to Audit Reports

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NOV 08 2019

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

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

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

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

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

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

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

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Introduction to Financial Statements

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

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

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

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

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

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

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

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

	Unaudited 2019	Unaudited 2018
ASSETS (Note 2)		
Intragovernmental		
Fund Balance with Treasury (Note 3)	$ 1,238,592	$ 1,798,507
Accounts Receivable (Note 4)	1,849,488	1,637,702
Other Assets (Note 5)	123,306	123,306
Total Intragovernmental Assets	**3,211,386**	**3,559,515**
Accounts Receivable, Net (Note 4)	1,143,780	1,169,378
Inventory and Related Property, Net (Note 6)	21,316,697	20,728,377
General Property, Plant and Equipment, Net (Note 7)	2,560,841	2,687,594
Other Assets (Note 5)	86,173	87,213
TOTAL ASSETS	**$ 28,318,877**	**$ 28,232,077**
Stewardship Property, Plant, and Equipment (Note 8)		
LIABILITIES (Note 9)		
Intragovernmental		
Accounts Payable	$ 188,045	$ 169,731
Other Liabilities (Note 10)	66,925	411,243
Total Intragovernmental Liabilities	**254,970**	**580,974**
Accounts Payable	2,742,214	3,098,036
Environmental and Disposal Liabilities (Note 11)	1,272,239	1,507,957
Other Federal Employment Benefits (Note 12)	180,535	201,935
Other Liabilities (Note 10)	262,152	260,120
TOTAL LIABILITIES	**4,712,110**	**5,649,022**
Commitments and Contingencies (Note 13)		
NET POSITION		
Unexpended Appropriations	291,040	1,187,496
Cumulative Results of Operations	23,315,727	21,395,559
TOTAL NET POSITION	**23,606,767**	**22,583,055**
TOTAL LIABILITIES AND NET POSITION	**$ 28,318,877**	**$ 28,232,077**

The accompanying notes are an integral part of these statements.

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

	Unaudited 2019	Unaudited 2018
Energy		
Gross Cost	$ 11,473,715	$ 10,857,648
Less: Earned Revenue	(12,501,054)	(10,893,077)
Net Cost	**(1,027,339)**	**(35,429)**
Supply Chain Management		
Gross Cost	32,860,648	30,675,298
Less: Earned Revenue	(31,980,171)	(29,726,878)
Net Cost	**880,477**	**948,420**
Document Services		
Gross Cost	258,988	274,087
Less: Earned Revenue	(240,007)	(244,798)
Net Cost	**18,981**	**29,289**
Total Gross Cost	**44,593,351**	**41,807,033**
Less: Total Earned Revenue	**(44,721,232)**	**(40,864,753)**
NET COST OF OPERATIONS	**$ (127,881)**	**$ 942,280**

The accompanying notes are an integral part of these statements.

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

	Unaudited 2019	Unaudited 2018
Unexpended Appropriations		
Beginning Balances	$ 1,187,496	$ 377,800
Budgetary Financing Sources:		
Appropriations Transferred-in/out	548,096	836,425
Appropriations Used	(1,239,240)	(26,729)
Other Adjustments	(205,312)	-
Total Budgetary Financing Sources	**(896,456)**	**809,696**
Total Unexpended Appropriations	**291,040**	**1,187,496**
Cumulative Results of Operations		
Beginning Balances	21,395,559	21,985,027
Corrections of Errors	-	1,344
Beginning Balances, as Adjusted	21,395,559	21,986,371
Budgetary Financing Sources:		
Appropriations Used	1,239,240	26,729
Nonexchange Revenue	3,900	(10,776)
Transfers-in/out Without Reimbursement	205,312	(650)
Other Financing Sources:		
Transfers-in/out Without Reimbursement	161,466	154,719
Imputed Financing	185,607	177,879
Other	(3,238)	3,567
Total Financing Sources	**1,792,287**	**351,468**
Net Cost of Operations	**(127,881)**	**942,280**
Net Change	**1,920,168**	**(590,812)**
Cumulative Results of Operations	**23,315,727**	**21,395,559**
TOTAL NET POSITION	**$ 23,606,767**	**$ 22,583,055**

The accompanying notes are an integral part of these statements.

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

	Unaudited 2019	Unaudited 2018
BUDGETARY RESOURCES		
Unobligated Balance From Prior Year Budget Authority, Net	$ 1,643,206	$ 497,050
Appropriations	48,096	836,425
Contract Authority	49,892,452	52,277,802
Spending Authority From Offsetting Collections	298,191	292,943
TOTAL BUDGETARY RESOURCES	**$ 51,881,945**	**$ 53,904,220**
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments	$ 51,429,049	$ 52,587,582
Unobligated Balance, End of Year:		
Apportioned, unexpired accounts	452,896	1,316,638
Unexpired Unobligated Balance, End of Year	452,896	1,316,638
Total Unobligated Balance, End of Year	452,896	1,316,638
TOTAL BUDGETARY RESOURCES	**$ 51,881,945**	**$ 53,904,220**
OUTLAYS, NET		
Outlays, net	$ 1,108,011	$ 1,113,770
AGENCY OUTLAYS, NET	**$ 1,108,011**	**$ 1,113,770**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

Note 1: Summary of Significant Accounting Policies (Unaudited)

A. Reporting Entity

Created in 1961, the DLA is a component of the U.S. DoD and reports to the OUSD for Acquisition and Sustainment through the Assistant Secretary of Defense Sustainment. 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, General Fund, and Transaction Fund. These financial statements and accompanying notes herein only refer to the activities of DLA WCF.

The DLA WCF has the three major activity groups (DLA Energy, DLA SCM, and DLA Document Services) and two support programs, included within DLA SCM, as described below, to execute its mission to provide supply, logistics, distribution, and disposition service support. These activities are DLA WCF's revenue generators, manage DLA WCF resources, and are responsible for daily business operations.

DLA Activity Groups:

1. **DLA Energy** (Fort Belvoir, Virginia) - provides petroleum products/lubricants, supply chain services, sustainment, restoration & modernization, transportation, aerospace energy, fuel quality/technical support, installation energy and utility services.

2. **DLA Supply Chain Management**:

    a. Troop Support (Philadelphia, Pennsylvania) - consists of 5 commodities:
        i. Subsistence – food support for the military all over the world;
        ii. C&T - clothing, textiles and equipment to U.S. service members other Federal agencies and partner nations;
        iii. C&E - construction materials, heavy equipment, tactical gear, firefighting equipment, minerals and precious metals to wood products, imaging and information equipment;
        iv. IH - industrial items such as screws, nuts, and bolts, typically referred to as bench stock or repair parts; and
        v. Medical - medical and pharmaceutical supplies.
    b. Aviation (Richmond, Virginia) - provides repair parts for aviation weapons systems.
    c. Land and Maritime (Columbus, Ohio) - provides repair parts for ground-based maritime, aviation and foreign military systems.

d. DLA Support Services Programs - DLA's Support Services Programs provide distribution support to SCM and may also perform disposition services on behalf of the three DLA Activity Groups, as well as other Federal entities and public entities.
    i. DLA Distribution (New Cumberland, Pennsylvania) - provides storage and distribution solutions, transportation planning, logistics planning and contingency operations, as well as operating a global network of 34 distribution centers.
    ii. DLA Disposition Services (Battle Creek, Michigan) - disposes of excess property by reutilization, transfer, and demilitarization, and conducts environmental disposal and reuse.

3. **DLA Document Services** (New Cumberland, Pennsylvania) – provides automated document production, printing services, digital conversion and document storage.

B. Basis of Presentation and Accounting

Basis of Presentation and Accounting: The DLA WCF fiscal year ends September 30. The accompanying financial statements account for all resources for which DLA WCF is responsible. These financial statements present the financial position, results of operations, changes in net position, and the combined budgetary resources of DLA WCF, 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 WCF activities in accordance with U.S. GAAP promulgated by the FASAB and presented in the format prescribed by the OMB Circular A-136, *Financial Reporting Requirements*, except as identified in Note 1.C., *Departures from U.S. GAAP*, and in the following paragraphs.

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

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

Therefore, DLA WCF 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 WCF identifies non-conforming data issues, the Agency will continue to implement interim mitigation processes to address these limitations. In addition, DLA WCF 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.

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 WCF. Intragovernmental liabilities are claims DLA WCF 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 WCF against public entities. Non-Federal liabilities are amounts that DLA WCF owes to public entities. DLA WCF is unable to accurately map its trading partners to separate Federal and Non-Federal transactions in accordance with TFM, Volume I, Part 2 Central Accounting and Reporting, Chapter 4700, Federal Entity Reporting Requirements for the *Financial Report of the United States Government*.

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

Intra-departmental Transactions: On a DoD Agency-wide basis, DLA WCF adjustments are based on the information provided by the seller/service provider unless a waiver is obtained. A waived entity is a DoD reporting entity believed to have complete, accurate, and supported seller or buyer side data. DLA WCF is a non-waived entity. The elimination adjustments for buyer/seller transactions are based on the buyer's accounts payable and expenses and the seller's accounts receivable and revenue records. The DLA WCF 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).

Inter-fund Transactions: Inter-fund transactions and balances among DLA WCF activities (Energy, SCM, and Document Services) are eliminated from the Balance Sheets, the Statements of Net Cost, and the Statements of Changes in Net Position. The Combined Statements of Budgetary Resources is presented on a combined basis in accordance with OMB

Circular A-136; therefore, inter-fund transactions have not been eliminated from this statement. DLA WCF presents the Statements of Net Cost based on activities rather than program costs, which is not in accordance with OMB Circular A-136 (refer to Note 1.C., *Departures from U.S. GAAP*, related to Statements of Net Cost).

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

Use of Estimates: The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclose contingent assets and liabilities as of the date of the financial statements, and report amounts of revenue and expenses for the year ended. DLA WCF'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 contingent liabilities, environmental and disposal liabilities, allowance for doubtful accounts, accounts payable, undelivered orders, Federal Employees' Compensation Act (FECA) liability, inventory defined as EOU, and allowance for inventory held for repair as of the date of these financial statements.

C. Departures from U.S. GAAP

Financial management systems and processes continue to be evaluated and modified as DLA WCF strives to remediate its material weaknesses and record and report its financial activity in accordance with U.S. GAAP. Thus, DLA WCF 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 WCF financial statements although other departures from U.S. GAAP may exist that have not been identified.

Definition of Reporting Entity: The DLA WCF 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 WCF is unable to determine if there are consolidation entities that are required to be consolidated and disclosed in DLA WCF 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 WCF does not have policies and compliant processes in place to present its major program costs aligned with DLA WCF mission and goals by responsibility segments in accordance with SFFAS 4, *Managerial Cost Accounting Concepts and Standards* and OMB Circular A-136.

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

Inter-Entity Cost (Note 15): The DLA WCF 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 18): The DLA WCF 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.G. and Note 3): The DLA WCF is not able to account for FBwT in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, due to its inability to identify and reconcile the reported differences between DLA WCF's accounting system and Treasury. Monthly journal vouchers are made to adjust the FBwT balances in DLA WCF financial statements to match U.S. Treasury records.

Accounts Receivable, Net, Revenue, and Unfilled Customer Orders (Notes 1.H. and 1.T., Notes 4 and 14): The DLA WCF does not have policies and compliant processes in place to (1) recognize revenue and record the related accounts receivable, net and unfilled customer order (UCO) balances from goods sold and services provided in the proper period; and (2) adjust revenue to the extent that realization of the full amount is not probable in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, and/or SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. More specifically:

- *Direct Sales - DLA WCF Holds the Inventory to be Sold:* In some instances, given the current distribution system that DLA WCF uses, revenue may be recognized before materials are shipped or delivered to the customer;
- *Direct Sales - Third Party Holds the Inventory to be Sold:* For inventory that is managed by a third party, revenue is recognized on the date DLA WCF bills the customer which may occur before materials are shipped or delivered to the customer;
- *Customer Direct Sales:* The customer direct process is where DLA WCF permits its customers to order goods directly from DLA WCF's authorized vendors. Under DLA WCF's business structure, DLA WCF has the obligation to pay the vendor and the right to collect payment from the customer. Therefore, DLA WCF incurs a liability and earns revenue at the time the customer accepts the goods from the vendor. However, while DLA WCF records an accrual for the liability incurred, DLA WCF does not account for the revenue earned at the same time in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting;*

- *Customer Returns:* The DLA WCF does not match the customer returns to the original sales orders and improperly decreases revenue, cost of goods sold, and contract authority liquidated for the amount of the return;
- *Excess, Obsolete, and Unserviceable:* The DLA WCF does not recognize the disposal of EOU inventory as a gain or loss based on the difference of the sales price and its Net Realizable Value (NRV) in accordance with SFFAS 3, *Accounting for Inventory and Related Property*;
- *Fuel Exchange Agreement business process:* The DLA WCF does not properly adjust the budgetary accounts when the netting of individual sales and purchase transactions occur. This is not in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary Financial Accounting*, which states that the budgetary accounts must reconcile to the proprietary accounts;
- *Unfilled Customer Orders*: The DLA WCF does not properly record UCO activity and is unable to support the UCO balance in the accounting system in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*;
- *Advances from Others*: The DLA WCF records accounts receivable although advance collections have been received prior to the sale. This is not in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities;*
- *Suspended Revenue:* The DLA WCF performs services for other Federal Agencies and records accounts receivable and revenue for these transactions without assessing the probability of collection; and
- *Foreign Currency:* The DLA WCF does not have a policy and compliant processes in place to determine the significant effects, if any, of changes in the exchange rate related to recording foreign currency transactions.

Inventory and Related Property, Net (Note 1.I. and Note 6): The DLA WCF does not have policies and compliant processes in place to account for inventory and related property, net or properly account for gains and losses on adjustments to inventory in situations where DLA WCF owns the same material as held for a customer 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 has not completed establishing inventory and related property beginning balances using deemed cost and has not made an unreserved assertion as permitted by SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials* (effective FY2017). More specifically:

- *Excess, Obsolete, Unserviceable*: The DLA WCF does not have procedures in place to review and determine if additional material in its accounting system should be classified as EOU in accordance with SFFAS 3, *Accounting for Inventory and Related Property*. Upon receipt of EOU from other components or military services, the asset is recorded incorrectly as a gain rather than a transfer-in. Upon disposition of EOU, the expense is recorded incorrectly as cost of goods sold rather than determining the gain or loss based on the sale price and NRV. The accounting treatment for both transfers-in and disposition of EOU are not in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*;

- *Excess, Obsolete, Unserviceable Carrying Amount:* The DLA WCF is unable to provide the carrying value of the inventory before it was identified as EOU inventory, in accordance with SFFAS 3, *Accounting for Inventory and Related Property*;
- The DLA WCF does not properly account for inventory provided to vendors against contracts and work orders for manufacturing and assembly in accordance with SFFAS 3, *Accounting for Inventory and Related Property*. These items should be initially accounted for as Raw Material, and then as Inventory Work in Process;
- The DLA WCF does not properly account for additional inventory costs in the manufacturing and assembly process, in accordance with SFFAS 3, *Accounting for Inventory and Related Property*;
- The DLA WCF does not have policies and procedures in place for management's criteria to determine the category of inventory in accordance with SFFAS 3, *Accounting for Inventory and Related Property; and*
- *Customer Direct:* In recording Customer Direct transactions, DLA WCF combines the purchase from the vendor and the cost of goods sold into a single entry in the accounting system that does not include the receipt or issuance of inventory.

General Property, Plant and Equipment, Net (Note 1.J. and Note 7): The DLA WCF does not have policies and compliant processes in place to account for general PP&E, net, at historical cost, in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment* and SFFAS 10, *Accounting for Internal Use Software*. Supportable general PP&E beginning balances have not been established for buildings, general equipment, Construction-in-Progress (CIP), Internal Use Software (IUS), and IUS in Development using the alternative valuation methods permitted by SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment* (effective FY2017). In addition, DLA WCF does not have compliant processes in place to account for impairment of facilities and equipment in accordance with SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. More specifically:

- *Transferred assets:* The DLA WCF is unable to determine the valuation of real property and general equipment assets previously transferred from the military services in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*;
- *Internal-Use Software:* The DLA WCF is unable to substantiate the valuation of internal-use software in accordance with SFFAS 10, *Accounting for Internal Use Software* and SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*;
- *Internal-Use Software in Development:* The DLA WCF does not have the proper policies and compliant processes to identify IUS in Development balances in accordance with SFFAS 10, *Accounting for Internal Use Software;*
- *Construction-in-Progress Balances:* The DLA WCF does not have the proper policies and compliant processes to identify aged CIP balances in accordance with SFFAS 6, *Accounting for Property, Plant and Equipment*;
- *Capitalization:* The DLA WCF does not properly follow the policy and procedures for capitalization thresholds to effectively implement and consistently apply the threshold in accordance with SFFAS 6 *Accounting for Property, Plant, and Equipment* and SFFAS 10, *Accounting for Internal Use Software*;

- *Depreciation:* The DLA WCF does not properly follow the policy and procedures for depreciation and amortization to effectively implement and consistently apply the policy in accordance with SFFAS 6, *Accounting for Property, Plant and Equipment* and SFFAS 10, *Accounting for Internal Use Software*; and
- *Rights and Obligations:* The DLA WCF is unable to substantiate whether DLA WCF has the rights and obligations to the recorded General PP&E assets in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment.*

Leases (Note 1.K.): The DLA WCF does not have policies and compliant processes in place to identify, evaluate, record, and report for capital and operating leases in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*, SFFAS 6, *Accounting for Property, Plant, and Equipment*, and SFFAS 10, *Accounting for Internal Use Software*. As such, DLA WCF does not have any capital or operating leases recorded in the financial statements as of and for the years ended September 30, 2019 and 2018.

Other Assets - Advances and Prepayments (Note 1.L. and Note 5): The DLA WCF does not have policies and compliant processes in place to record advances and prepayments in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities.*

Accounts Payable, Expenses, and Undelivered Orders (Notes 1.N. and 1.U., Notes 9 and 16): The DLA WCF does not have policies and compliant processes in place to account for accounts payable, expense accruals, and the related Undelivered Orders (UDOs) in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, and SFFAS 5, *Accounting for Liabilities of the Federal Government*. More specifically:

- *Accrual methodology for liabilities:* The DLA WCF does not properly accrue liabilities in the period incurred, recognize the related expenses, and reduce UDOs. DLA WCF improperly expensed costs that should have been recorded as an asset;
- *Negative payable:* The DLA WCF 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 WCF's accounting system. This results in an understatement of current year expenses and payables, and an overstatement of UDOs; and
- *Undelivered Orders*: The DLA WCF does not have sufficient policies and procedures in place to record obligations at the time contracts are awarded. In addition, DLA WCF is unable to support the UDO balance in the accounting system.

Environmental and Disposal Liabilities (Note 1.O. and Note 11): The DLA WCF does not have policies and compliant processes in place to reconcile real property asset listings and to account 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 Auditing Technical Release 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*.

Commitments and Contingencies (Note 1.M. and Note 13): The DLA WCF 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 WCF has not completed analyzing all applicable business relationships to determine if these arrangements or transactions indicate the existence of Public-Private Partnership (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 WCF is unable to determine the nature of such partnerships, if applicable, and related Federal funding amounts required to be disclosed in a P3 note to the financial statements.

D. Pronouncements Recently Issued but Not Yet Effective

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

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

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

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

E. Appropriations and Funding

Initial Corpus: The DLA WCF received its initial corpus through an appropriation from the Defense Wide Working Capital Fund (DWWCF). The corpus financed initial operations to obtain goods and services sold to customers on a reimbursable basis to maintain the corpus. In addition, DLA WCF receives direct or supplemental appropriations through DoD reprogramming actions, Title V (Revolving and Management Funds), IX (Overseas Contingency Operations), and X (Required Additional Appropriations).

The DWWCF consists of six activity groups. DLA WCF operates three of the six activity groups, which include DLA Energy, DLA SCM, and DLA Document Services. DFAS and the Defense Information Systems Agency (DISA) operate the other three activity groups. DLA WCF is the cash manager for the DWWCF funding and is responsible for developing DWWCF activity group budget exhibits related to cash and monitoring cash execution. Although DLA WCF shares its accounting code with DFAS and DISA, each Agency receives their own separate Annual Operating Budget. The Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) uses a data element referred to as a 'limit' to differentiate the various ODOs under TI-97. DLA WCF uses limits assigned to the TI-97 organizations to track spending at a level below the Treasury Account Symbol (TAS) level.

Contract Authority: The DLA Energy and DLA SCM receive contract authority for their operating programs. DLA Energy and DLA SCM receive contract authority for their capital programs. Contract authority is a statutory authority under which contracts or other obligations may be entered into prior to receiving an appropriation, offsetting collection, or receipt for the payment of obligations. Subsequently, the contract authority liquidates through the receipt of customer funds.

Spending Authority from Offsetting collections: The DLA Document Services receives spending authority from offsetting collections for its operation program. Spending authority requires the receipt of customer orders prior to incurring obligations. The spending authority from offsetting collections comes from other Federal agencies, which funds reimbursable activities performed by DLA Document Services on their behalf.

F. Entity and Non-Entity Assets

The DLA WCF reports both entity and non-entity assets. Entity assets are assets that the reporting entity has authority to use in its operations. Management may have authority to decide how funds are used or it may be legally obligated to use the funds a certain way. Non-entity assets are not available for use in DLA WCF's normal operations. DLA WCF maintains stewardship accountability and reporting responsibilities for non-entity assets and will subsequently remit these non-entity assets to the Treasury. DLA WCF records a corresponding liability, custodial liability, for these accounts receivable (refer to Note 2, *Non-Entity Assets*).

G. Fund Balance with Treasury

The DLA WCF does not maintain cash in a commercial bank, but rather in the U.S. Treasury. DLA WCF's FBwT includes the amount available for DLA WCF 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 WCF's cash collections, disbursements, and adjustments.

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

On a monthly basis, DLA WCF 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 using the Cash Management Report (CMR). The CMR provides a summary cash position for each ODOs FBwT account by fiscal year and appropriation at the limit level. The adjustments represent the undistributed disbursements and collections amounts that have been reported to Treasury, but have not yet been posted to DLA WCF's accounting systems. Undistributed amounts can be a result of timing, invalid line of accounting, invalid TAS information, and unsupported and unreconciled differences.

The DLA WCF'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 WCF TAS. The transactions in suspense accounts include unidentified collections, disbursements, Recyclable Materials, and Intra-Governmental Payment and Collection Transactions at Month End. With the suspense account, there is a significant effort by DFAS to allocate the expenditures or collections to the individual ODOs.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Fund Balance with Treasury and Note 3, *Fund Balance with Treasury*.)

H. Accounts Receivable, Net

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

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

The DLA WCF presents its non-Federal accounts receivable net of an allowance for doubtful accounts, which is based on systematic methodology of grouped aged public accounts receivables. DLA WCF evaluates the allowance methodology and estimated allowance percentages quarterly based on historical average collections on aged public accounts receivable. The allowance for doubtful accounts is calculated based on the aged accounts receivable balances from the preceding month, with the exception of FEA accounts receivable, as these are reconciled in periodic settlements with the foreign governments (refer to Note 1.V. for additional information on FEA sales and settlements).

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivable, Net, Revenue, and Unfilled Customer Orders, and Note 4, *Accounts Receivable, Net.*)

I. Inventory and Related Property, Net

The DLA WCF inventory is comprised of material held at Energy and SCM and categorized into:

Inventory Held for Sale: Inventory that is in the process of production for sale or to be consumed in the production of goods for sale or in the provision of services for a fee. Refer to Note 1.A., *Reporting Entity,* for items held for sale by activity group. Additionally, DLA WCF has inventory held for sale, in-transit. This consists of material in transit from commercial and Government suppliers to the financial reporting entity or material in transit between storage locations.

Inventory Reserved for Future Sale: Inventory that is maintained and not readily available in the market or because there is more than a remote chance that they will eventually be needed (although not necessarily in the normal course of operations). Similar to the Inventory Held for Sale, the inventories primarily include weapon system repair parts from DLA Aviation and DLA Land and Maritime, and food and medical supplies from DLA Troop Support.

Inventory Held for Repair: Inventory that is damaged and requires repairs to make it suitable for sale, which includes consumable spares, repair parts and repairable items. Inventory Held for Repair is valued using the allowance method as described in SFFAS 3, *Accounting for Inventory and Related Property*, and DoD Financial Management Regulation (FMR), Volume 4, Chapter 4.

Excess, Obsolete, and Unserviceable Inventory: Excess inventory exceeds management requirements to meet DLA WCF's mission. Obsolete inventory is no longer needed due to technology, laws, customs, or operations per DoD FMR Volume 4, Chapter 4. Unserviceable inventory is damaged inventory that is more economical to dispose of than to repair.

Inventory Valuation: The DLA WCF uses the Moving Average Cost (MAC) method to value inventory Held for Sale, Reserved for Future Sale and Held for Repair. Inventory Held for Repair is valued at MAC less an allowance for the estimated repair cost. The allowance is calculated based on 2% of the total value of Inventory Held for Repair. The MAC is calculated each time inventory is purchased dividing the total cost of units available by the number of total units available.

The DLA WCF values EOU inventory at its expected NRV using: 1) the average sales price per unit sold for scrap items; or 2) the fair value rates associated with the inventory condition code as described in DoD FMR 7000.14-R Volume 15, Chapter 7 for items that are held by DLA SCM that have not been turned over to DLA Disposition Services for disposal.

EOU inventory is valued at its expected NRV. The DLA WCF - Disposition NRV factor is calculated using revenues and cost avoidance to DoD of reutilized and sold materials against the expenses incurred to manage EOU inventory.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Inventory and Related Property, Net, and Note 6, *Inventory and Related Property, Net.*)

J. General Property, Plant and Equipment, Net

The DLA WCF PP&E consists of buildings, CIP, structures, linear structures, IUS, IUS in development, and general equipment that are used to facilitate the Agency's mission. The land that these assets reside on is not owned by DLA WCF.

Capitalization Threshold: The DLA WCF General PP&E assets are recorded at historical acquisition cost plus improvements when an asset has a useful life of two or more years, and the acquisition cost exceeds the $250,000 capitalization threshold; however, some of the assets capitalized after October 1, 2013 do 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.

Depreciation Method and Useful Life:

Asset Classes	Depreciation/ Amortization Method	Useful Life (Years)
Buildings, Structures, and Facilities	Straight-line	20, 40 or 45
IUS	Straight-line	2-10
General Equipment	Straight-line	5-10
CIP	Not Applicable	Not Applicable
IUS in development	Not Applicable	Not Applicable

The DLA WCF reports Real Property that DLA derives primary economic benefit from (i.e., defined as 90% or more of the physical capacity of the Real Property to conduct its operations and carry out the programs and mission) and where DLA WCF is responsible for sustainment of the property. OUSD(C) established policy guidelines for financial statement reporting of real property assets: "Real property must be reported by an entity that derives primary economic benefit and is responsible for sustainment of the property." Based on this guidance, DLA WCF was determined to be the Financial Reporting Organization (FRO) for a large number of general equipment and real property transfers from the military services. Due to insufficient supporting documentation, DLA WCF is not able to confirm whether DLA WCF meets the definition of FRO for those specific assets.

The DLA WCF 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 WCF is the appropriate FRO, and documenting processes through reviewing and updating policy guidance to define the procedures used for the valuation method. DLA has not yet finalized the inventory process for their PP&E. Accordingly, DLA has not made an unreserved assertion, in accordance with SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, that the opening balances of PP&E for FY2019 are presented fairly in accordance with U.S. GAAP.

The DLA WCF determines the useful life of its PP&E using the asset classification and the type of assets (e.g., building, structure, linear structure, improvement, etc.) based on the Defense Accounting Guidance Research and Recommendation Paper: Issue 75, Estimated Useful Lives.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to General Property, Plant and Equipment, Net, and Note 7, *General Property, Plant and Equipment, Net.*)

K. Leases

As of and for the years ended September 30, 2019 and 2018, DLA WCF 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.)

L. Other Assets

Other assets include those assets such as civil service employee pay and travel advances, Strategic Petroleum Reserve and certain contract financing payments not reported elsewhere in the DLA WCF Balance Sheets.

The DLA Energy’s Strategic Petroleum Reserve consists of crude oil held by the Department of Energy (DoE) on behalf of the DoD. Public Law 102-396, Section 9149 enacted in November 1992 established the requirement for DoE to acquire and maintain a strategic petroleum reserve for national defense purposes. Section 9149 provided appropriations for the acquisition, storage, and drawdown of such reserve. Proceeds from sales of this reserve will be deposited to DoD's accounts and remain available until expended. DoE reports this crude oil in inventory in their financial statements, with an offsetting custodial liability to DoD. By law, the reserve cannot be drawn down or released to DoD without a Presidential Order along with the advice from the Secretary of Defense. As of September 30, 2019 and 2018, none of the reserve has been drawn upon, therefore the full inventory remains on hand with DoE.

The DLA SCM conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DLA WCF may provide financing payments. The Federal Acquisition Regulation, Part 32, defines contract financing payments as “authorized disbursements to a contractor prior to acceptance of supplies or services by the Government”.

Other Assets: Payments made in advance of the receipt of goods and services are recorded and reported as Other Assets in the Balance Sheets. DLA WCF's policy is to expense and/or properly classify assets when the related goods and services are received.

(Refer to Note 1.C., *Departures from U.S. GAAP,* related to Advances and Prepayments and Note 5, *Other Assets*.)

M. 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 WCF recognizes contingent liabilities in DLA WCF's Balance Sheets and Statements of Net Cost when the loss is determined to be probable and the amount can be estimated. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury. DLA WCF evaluates all contingent liabilities based on three criteria: probable, reasonably possible and remote.

The DLA WCF 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 WCF does not record an accrual for contingent liabilities if it is not probable and estimable, but does disclose those contingencies that are reasonably possible in Note 13, *Commitments and Contingencies,* of the financial statements. DLA WCF does not disclose or record contingent liabilities where the loss is considered remote.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Commitments and Contingencies, and Note 13, *Commitments and Contingencies.*)

N. Liabilities

Liabilities represent probable and measurable future outflows of resources as a result of past transactions or events and are recognized when incurred, regardless of whether there are budgetary resources available to pay the liabilities. However, liabilities cannot be liquidated without legislation providing resources and legal authority.
Covered and Uncovered Liabilities: Liabilities incurred that are covered by available budgetary resources as of the Balance Sheet dates are referred to as funded liabilities. Liabilities are covered by budgetary resources if they are funded by appropriations, provided that the resources are apportioned by OMB without further action by the Congress and without a contingency having to be met first. Budgetary resources include: (1) new budget authority, (2) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, (3) spending authority from offsetting collections (credited to an appropriation or fund account), and (4) recoveries of unexpired budget authority through downward adjustments of prior-year obligations. Liabilities that are not covered by available

budgetary resources as of the Balance Sheet dates are referred to as unfunded liabilities (refer to Note 9, *Liabilities Not Covered by Budgetary Resources*).

Liabilities Not Requiring Budgetary Resources: Liabilities that have not in the past required and will not in the future require the use of budgetary resources are referred to as liabilities not requiring budgetary resources.

Current and Noncurrent Liabilities: The DLA WCF 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 WCF expects to settle within the 12 months of the Balance Sheet dates. Noncurrent liabilities represent liabilities that DLA WCF does not expect to be settled within the 12 months of the Balance Sheet dates.

Accounts Payable: Accounts Payable includes amounts owed but not yet paid to Federal and non-Federal entities for goods and services received by DLA WCF. DLA WCF 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 when an invoice is received and posted without a goods receipt). DLA WCF 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.

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

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses, and Undelivered Orders, Note 9, *Liabilities Not Covered by Budgetary Resources*, and Note 10, *Other Liabilities.*)

O. Environmental and Disposal Liabilities

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

The DLA WCF 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 identifies and estimates accrued EL through its annual cost-to-complete (CTC) process. DLA's accrued EL are comprised of environmental cleanup costs associated with restoration of environmental sites on real property that it does not own but has received appropriated funds to execute and manage. These environmental sites may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, clean closure of assets, and post-closure costs related to the Agency's operations that result in hazardous waste. Due to noted deficiencies, DLA is not able to reconcile the population of real property assets that encompass the environmental sites closure and asbestos liabilities.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities, and Note 11, *Environmental and Disposal Liabilities.*)

P. 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 date. DLA 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 10, *Other Liabilities*).

Q. Other Federal Employment Benefits

The FECA liabilities provide income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from DLA WCF for these paid claims. The FECA liability consists of two elements.

The first element, accrued FECA liability, is based on claims paid by DOL but not yet reimbursed by DLA WCF. DLA WCF 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 WCF. As a result, DLA WCF recognizes an intragovernmental liability, not covered by budgetary resources, for the claims paid by DOL that will be reimbursed by DLA (refer to Note 9, *Liabilities not Covered by Budgetary Resources,* and Note 10, *Other Liabilities*).

The second element, actuarial FECA liability, is the estimated liability for future payments and is recorded as a liability with the public, not covered by budgetary resources. The actuarial FECA liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. DOL determines the actuarial FECA liability annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value (refer to Note 9, *Liabilities not Covered by Budgetary Resources,* and Note 12, *Other Federal Employment Benefits*).

R. Pension Benefits

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

S. Net Position

Net position is the residual difference between assets and liabilities, and is comprised of Unexpended Appropriations and Cumulative Results of Operations.

Unexpended Appropriations: Unexpended appropriations consist of the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also are amounts obligated for which legal liabilities for payments have not been incurred. DLA WCF's unexpended appropriations primarily consist of supplemental appropriations and overseas contingency operations.

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

T. Revenue and Other Financing Sources

Exchange and Non-exchange Revenue: The DLA WCF classifies revenue as either exchange revenue or non-exchange revenue. Exchange revenue arises when DLA WCF provides goods or services to the public or other Federal entities in exchange for inflows of resources. Exchange revenue is presented on the Statements of Net Cost and serves to offset the costs of these goods and services. DLA WCF activities recognize the revenue from the sale of petroleum products from DLA Energy, weapon system repair parts from DLA Aviation and DLA Land and Maritime, food and medical supplies from DLA Troop Support, or from the reimbursements for goods and services provided to DoD activities, other Federal Agencies and the public. The sale of materials include DLA WCF's Direct sales and Customer Direct sales. DLA WCF's Direct sales are from DLA WCF stock to the customer, whereas Customer Direct sales are from the vendor directly to the customer.

Non-exchange revenue is derived from the government's sovereign right to demand payment, such as specifically identifiable, legally enforceable claims. DLA WCF non-exchange revenue includes interest penalties and administrative fees. Non-exchange revenue is considered to reduce the cost of DLA WCF's operations and is reported on the Statements of Changes in Net Position as a financing source.

DLA Energy Standard Fuel Price: The DLA WCF uses a Standard Fuel Price (SFP) per barrel of fuel sold to customers to include DoD, U.S. Coast Guard, and Foreign Governments. DLA WCF is responsible for recommending a SFP to OUSD(C). In the process of determining the recommended SFP, DLA WCF considers the amount necessary to recover the costs of the products and services. Upon receiving DLA WCF's proposed SFP, OUSD(C) performs an evaluation of the proposed SFP and determines the final SFP that DLA WCF is required to use for DLA WCF Energy sales.

The policies and procedures used in deriving the recommended SFP to OUSD(C) complies with the U.S. Code Title 10, § 2208 Working Capital Fund. However, as the OUSD(C) sets the final SFP, DLA WCF is unable to set the SFP at amounts necessary to recover the full costs of the products and services provided in the year of execution. In FY2018, OUSD(C) provided two prices. From October 1, 2017 to March 31, 2018, the SFP was $90.30 per barrel. From April 1, 2018 to September 30, 2018, the SFP increased to $115.92 per barrel. For the fiscal year ending September 30, 2019, DLA WCF provided cost based prices ranging from $103.84 to $144.78 and OUSD(C) set the price at October 1, 2018 at $125.16 per barrel. For the fiscal year ending September 30, 2019 the SFP allowed DLA WCF to recover the full costs of the goods and services provided. During the fiscal year ended September 30, 2018, DLA WCF did not recover the full costs of the goods and services provided based on the set SFP. However, the U.S. Code Title 10, § 2208 provides authority for DLA WCF to recover its costs over time.

Cost Plus: Federal civilian agencies and other authorized customers are charged cost plus, which includes the (1) Customer Direct acquisition cost of fuel billed to DLA Energy by the vendor on the day of delivery plus the cost plus rate and (2) DLA Direct average acquisition cost of fuel plus the cost plus rate. The cost plus rate for FY2019 is $0.05 per gallon. The cost plus rate for FY2018 is $0.045 cents per gallon.

Supply Chain Cost Recovery Rate: The DLA WCF establishes the selling price in two separate methods depending on the type of items. For Non-National Stock Numbers (NSNs), which include part numbers, local stock numbers or service materials as described in a vendor's product catalog or contract solicitation that a customer can order, the selling price is based on latest acquisition cost plus a Cost Recovery Rate (CRR). The latest acquisition cost is the cost of acquiring the goods and services. The CRR is a percentage added to the acquisition cost that allows DLA WCF to recover the full cost of the goods and services provided, including depreciation of capital assets, in accordance with U.S. Code Title 10, § 2208. For the years ended September 30, 2019 and 2018, DLA WCF's policies and procedures in setting the selling price and CRR is in compliance with the U.S. Code Title 10, § 2208.

For NSNs, a standard price is established annually. For NSNs, the selling price is based on the average acquisition cost over the course of the previous twelve months, other material cost (testing, transportation, etc.) and the CRR.

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

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

Imputed Financing Sources from Cost Absorbed by Others and Imputed Cost: In certain cases, operating costs of DLA WCF are paid in full or in part by funds appropriated to other Federal entities. DLA includes applicable imputed costs in the Statements of Net Cost. In addition, Imputed Financing Sources from Cost Absorbed by Others is recognized on the Statements of Changes in Net Position as other financing source (non-exchange revenue). DLA WCF recognizes the following imputed costs: (1) employee pension, post-retirement health, and life insurance benefits, and (2) workers compensation under FECA, and (3) losses in litigation proceedings.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivable, Net, Revenue, and Unfilled Customer Orders, and Note 14, *Exchange Revenue.*)

U. Expenses

Expenses are recognized when there are outflows, usage of assets, or incurrences of liabilities (or a combination) from carrying out functions related to DLA WCF's activity groups, 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.)

V. Transactions with Foreign Governments and International Organizations

The DLA WCF sells defense articles and services to foreign governments and international organizations under the provisions of the Arms Export Control Act of 1976. In addition, many of DLA WCF's fuel supply and services transactions with foreign governments are entered into, in accordance with DoD Directives 5530.3 and 2010.9, under international agreement statutory authorities

For FEA transactions, settlement occurs on a periodic basis as prescribed in the FEA. Upon settlement with the foreign country, the purchases of fuel from foreign governments net against sales to the foreign government. Settlement can be made either in fuel or cash. Settlement in fuel is based on the agreed upon price. For cash settlements, the agreements typically call for reciprocal pricing (i.e., prices cannot be more than the participants charge their military service components). Payment for fuel after offsetting quantities is based on a quantity and a price and is an arms-length transaction.

W. Cash and Other Monetary Assets

The DLA WCF cash and other monetary assets consist of bid deposits received from public sales customers and refund receivable from overpayments to a vendor. The amounts are held in escrow by DLA WCF until settlement occurs. Due to OUSD policy, the escrow account and the accompanying liability are not reported by DLA WCF, but rather reported on the consolidated ODO General Fund financial statements. As such, the DLA WCF Balance Sheets do not report other cash amounts.

X. Comparative Combined and Combining Statements of Budgetary Resources

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

Note 2: Non-Entity Assets (Unaudited)

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

	2019	2018
Non-Federal Assets		
Accounts Receivable	$ 4,513	$ 2,752
Total Non-Federal Assets	**4,513**	**2,752**
Total Non-Entity Assets	**4,513**	**2,752**
Total Entity Assets	**28,314,364**	**28,229,325**
Total Assets	**$ 28,318,877**	**$ 28,232,077**

The non-entity accounts receivable, net with non-Federal entities is related to interest, administrative fees, and penalties and fine receivables.

Note 3: Fund Balance with Treasury (Unaudited)

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

	2019	2018
Status of Fund Balance with Treasury		
Unobligated Balance Available	$ 452,896	$ 1,316,638
Obligated Balances Not Yet Disbursed	785,696	481,869
Total Fund Balance with Treasury	**$ 1,238,592**	**$ 1,798,507**

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

Unobligated Balance - Available represents 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 represents the cumulative amount of budgetary authority that cannot be used to cover outstanding obligations. As of September 30, 2019 and 2018, DLA WCF does not have unobligated – unavailable FBwT.

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

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

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

2019 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)			
Transaction Type	**Treasury Balance based on CMR**	**DLA WCF Trial Balance**	**Balances Not Yet Recorded in DLA Accounting System - Undistributed**
Collections	$42,059,899	$42,006,799	$53,100
Disbursements	$43,167,909	$43,149,937	$17,972

2018 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)			
Transaction Type	**Treasury Balance based on CMR**	**DLA WCF Trial Balance**	**Balances Not Yet Recorded in DLA Accounting System - Undistributed**
Collections	$38,506,320	$38,518,649	($12,329)
Disbursements	$39,620,090	$39,569,962	$50,128

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

Note 4: Accounts Receivable, Net (Unaudited)

Accounts Receivable, Net as of September 30, 2019 and 2018, respectively, consists of the following (dollars in thousands):

2019	Accounts Receivable	(Less Allowance for Non-Federal Doubtful Accounts)	Accounts Receivable, Net
Intragovernmental			
Energy	$ 263,164	-	$ 263,164
Supply Chain Management	1,544,557	-	1,544,557
Document Services	41,767	-	41,767
Total Intragovernmental	**1,849,488**	**-**	**1,849,488**
Non-Federal			
Energy	566,933	(11,003)	555,930
Supply Chain Management	932,027	(344,434)	587,593
Document Services	257	-	257
Total Non-Federal	**1,499,217**	**(355,437)**	**1,143,780**
Total Accounts Receivable	**$ 3,348,705**	**$ (355,437)**	**$ 2,993,268**

2018	Accounts Receivable	(Less Allowance for Non-Federal Doubtful Accounts)	Accounts Receivable, Net
Intragovernmental			
Energy	$ 294,584	-	$ 294,584
Supply Chain Management	1,316,063	-	1,316,063
Document Services	27,055	-	27,055
Total Intragovernmental	**1,637,702**	**-**	**1,637,702**
Non-Federal			
Energy	563,933	(29,761)	534,172
Supply Chain Management	973,411	(338,444)	634,967
Document Services	239	-	239
Total Non-Federal	**1,537,583**	**(368,205)**	**1,169,378**
Total Accounts Receivable	**$ 3,175,285**	**$ (368,205)**	**$ 2,807,080**

Of the total non-Federal accounts receivable, net, criminal restitutions, net consists of $50.5

million and $59.3 million, as of September 30, 2019 and 2018, respectively. The gross amount of criminal restitutions consist of $392.5 million and $393.3 million with a related allowance of doubtful accounts of $342.0 million and $334.0 million as of September 30, 2019 and 2018, respectively.

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

Note 5: Other Assets (Unaudited)

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

	2019	2018
Intragovernmental Other Assets		
Other	$ 123,306	$ 123,306
Total Intragovernmental Other Assets	**123,306**	**123,306**
Non-Federal Other Assets		
Outstanding Contract Financing Payments	37,106	87,171
Advances and Prepayments	49,067	42
Total Non-Federal Other Assets	**86,173**	**87,213**
Total Other Assets	**$ 209,479**	**$ 210,519**

Intragovernmental Other Assets of $123.3 million as of September 30, 2019 and 2018 is related to Strategic Petroleum Reserve for national defense purposes. This consists of crude oil held by the DoE on behalf of the DoD. The strategic petroleum reserve is valued at historical acquisition cost.

Non-Federal Outstanding Contract Financing Payments are related to business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DLA WCF may provide contract financing payments (refer to Note 1.M., *Other Assets*).

Non-Federal Advances and Prepayments of $49.1 million as of September 30, 2019 include adjustments related to payments without receipt.

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

Note 6: Inventory and Related Property, Net (Unaudited)

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

	Valuation Method	2019	2018
Inventory Categories:			
Held for Sale	MAC	$ 20,678,480	$ 19,988,049
Reserve for Future Sale	MAC	250,533	282,797
Held for Repair	MAC	86,783	93,173
Excess, Obsolete, and Unserviceable	NRV	302,634	366,221
Less: Allowance for Repairs		(1,733)	(1,863)
Total Inventory and Related Property, Net		**$ 21,316,697**	**$ 20,728,377**

NRV = Net Realizable Value; MAC = Moving Average Cost

As of September 30, 2019 and 2018, DLA SCM is holding $115.5 million and $129.7 million, respectively, of inventory not available for sale due to litigation.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Inventory and Related Property, Net.)

Note 7: General Property, Plant and Equipment, Net (Unaudited)

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

	2019		
	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value
Major Asset Classes:			
Buildings, Structures, and Facilities	$ 6,260,108	$ (4,279,373)	$ 1,980,735
Internal-Use Software	679,587	(583,605)	95,982
General Equipment	529,650	(414,590)	115,060
Internal-Use Software in Development	43,629	-	43,629
Construction-in-Progress	325,435	-	325,435
Total General PP&E, Net	**$ 7,838,409**	**$ (5,277,568)**	**$ 2,560,841**

	2018		
	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value
Major Asset Classes:			
Buildings, Structures, and Facilities	$ 6,450,536	$ (4,348,353)	$ 2,102,183
Internal-Use Software	669,576	(542,318)	127,258
General Equipment	662,363	(519,705)	142,658
Internal-Use Software in Development	43,075	-	43,075
Construction-in-Progress	272,420	-	272,420
Total General PP&E, Net	**$ 8,097,970**	**$ (5,410,376)**	**$ 2,687,594**

The DLA WCF Building, Structures, and Facilities primarily consist of fuel storage tanks, tanker hydration systems, supply chain warehouses, and office buildings. Software primarily consists of e-Procurement software, Risk Based Inspection software, and DAI software. General Equipment primarily consists of fuel handling systems, conveyor systems, scrap shredders, and electronic security systems. DLA WCF reclassified the IUS in Development in FY2018 to conform with the FY2019 presentation.

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

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

Note 8. Stewardship Property, Plant and Equipment (Unaudited)

Stewardship PP&E are assets with properties that resemble those of the General PP&E that are traditionally capitalized in the financial statements. Stewardship PP&E includes heritage assets. Heritage assets are items of historical, natural, cultural, educational, or artistic significance, (e.g., aesthetic) or items with significant architectural characteristics. Heritage assets are expected to be preserved indefinitely. In the case where a heritage asset serves both a heritage function and general government operations, the asset is considered a multi-use heritage asset. If DLA WCF had any multi-use heritage assets, they would be recorded and presented with general PP&E in the financial statements. However, as of September 30, 2019 and 2018, DLA WCF had no multi-use heritage assets.

The DLA WCF heritage assets have no impact on the Agency's ability to complete its ongoing mission. DLA WCF's policy is to preserve and maintain accountability for its heritage assets. DLA WCF's heritage assets consist of one building, one cemetery, two feeding stations, and a pasture (land). DLA WCF's heritage assets are resources that are managed for the public benefit to include compliance with required Federal laws, executive orders, DoD, governing standards, and other binding agreements.

The DLA WCF heritage assets at Richmond are components of the original Bellwood plantation which was sold to the Department of the Army in 1941 when the Installation was first created. Bellwood sits on a 23-acre parcel of land in the southeast corner of the larger 611-acre Defense Supply Center Richmond, a secure military facility located at 8000 Jefferson Davis Highway. The house was rehabilitated for use as the Officers' Club and became the social center of the Installation. The Bellwood house serves as a meeting hall and banquet space. The property also contains the Gregory Family cemetery, the historic elk pasture created by James Bellwood, and two feeding stations for the elk. Bellwood was originally listed in the Virginia Landmarks Register in 1973 and in the National Register of Historic Places in 1978. This updated nomination expands the boundaries to include the entirety of the elk pasture.

Note 9: Liabilities not Covered by Budgetary Resources (Unaudited)

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

	2019	2018
Intragovernmental Liabilities		
Other	$ 16,346	$ 17,620
Total Intragovernmental Liabilities	**16,346**	**17,620**
Non-Federal Liabilities		
Other Federal Employment Benefits	180,535	201,935
Environmental and Disposal Liabilities	1,162,657	1,493,749
Other	6,126	927
Total Non-Federal Liabilities	**1,349,318**	**1,696,611**
Total Liabilities Not Covered by Budgetary Resources	**1,365,664**	**1,714,231**
Total Liabilities Covered by Budgetary Resources	**3,341,933**	**3,934,791**
Total Liabilities Not Requiring Budgetary Resources	**4,513**	**-**
Total Liabilities	**$ 4,712,110**	**$ 5,649,022**

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

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

Environmental and Disposal Liabilities consist of probable and reasonably estimable future outflow or expenditure of resources that exist as of the financial reporting date for environmental cleanup costs resulting from past transactions or events. The total Liabilities Covered by Budgetary Resources as of September 30, 2019 and 2018, consists of $109.6 million and $14.2 million, respectively.

Other Non-Federal Liabilities primarily consists of contingent legal liabilities.

For additional details and disclosures related to Other Liabilities, refer to Note 10, *Other Liabilities*; EL refer to Note 11, *Environmental and Disposal Liabilities*; and Other Federal Employment Benefits refer to Note 12, *Other Federal Employment Benefits*.

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

Note 10: Other Liabilities (Unaudited)

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

	2019		
	Current	**Non-Current**	**Total**
Intragovernmental			
Advances from Others	$ 15,728	$ -	$ 15,728
Judgment Fund Liabilities	105	-	105
FECA Reimbursement to DOL	9,530	13,217	22,747
Custodial Liabilities	4,513	-	4,513
Employer Contribution and Payroll Taxes Payable	23,832	-	23,832
Total Intragovernmental Other Liabilities	**53,708**	**13,217**	**66,925**
Non-Federal			
Accrued Funded Payroll and Benefits	249,086	-	249,086
Advances from Others	6,922	-	6,922
Contract Holdbacks	-	18	18
Employer Contribution and Payroll Taxes Payable	-	-	-
Contingent Liabilities	6,126	-	6,126
Total Non-Federal Other Liabilities	**262,134**	**18**	**262,152**
Total Other Liabilities	**$ 315,842**	**$ 13,235**	**$ 329,077**

	2018		
	Current	Non-Current	Total
Intragovernmental			
Advances from Others	$ 363,680	$ -	$ 363,680
Judgment Fund Liabilities	192	-	192
FECA Reimbursement to DOL	9,159	14,172	23,331
Custodial Liabilities	2,752	-	2,752
Employer Contribution and Payroll Taxes Payable	21,288	-	21,288
Total Intragovernmental Other Liabilities	**397,071**	**14,172**	**411,243**
Non-Federal			
Accrued Funded Payroll and Benefits	238,785	-	238,785
Advances from Others	11,891	-	11,891
Contract Holdbacks	-	18	18
Employer Contribution and Payroll Taxes Payable	113	-	113
Contingent Liabilities	927	8,386	9,313
Total Non-Federal Other Liabilities	**251,716**	**8,404**	**260,120**
Total Other Liabilities	**$ 648,787**	**$ 22,576**	**$ 671,363**

Intragovernmental Advances from Others represent advances from FEMA related to hurricane relief efforts. Any unused funds will be returned to FEMA. Non-Federal Advances from Others represent advances from employees and others.

Judgment Fund Liabilities represent amounts paid by Treasury on behalf of DLA WCF for the settlement of legal contingent liabilities.

FECA Reimbursement to the DOL represents the accrued FECA liability paid by DOL but not yet reimbursed by DLA WCF.

Custodial Liabilities represent liabilities for collections reported as non-exchange revenues where DLA is acting on behalf of another Federal entity.

Employer Contributions and Payroll Taxes Payable represents 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 represent salaries, wages, leave, and other compensation earned by employees but not yet disbursed.

Non-Federal Advances from Others represent liabilities for collections received to cover future expenses or acquisition of assets.

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

Contingent Liabilities is a loss determined to be probable and the amount is estimable based on the outcome of an uncertain future event. The current portion is related legal contingencies. The non-current portion is related to contract financing payments.

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

Note 11: Environmental and Disposal Liabilities (Unaudited)

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

	2019	2018
Environmental and Disposal Liabilities		
Other Accrued Environmental Liabilities—Non-BRAC:		
Environmental Corrective Action	$ 391,872	$ 350,888
Environmental Closure Requirements	786,586	1,079,772
Asbestos	93,781	77,297
Total Environmental and Disposal Liabilities	**$ 1,272,239**	**$ 1,507,957**

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

In FY2019, DLA WCF utilized the Remedial Action Cost Engineering and Requirements (RACER) software to generate the FY2020 CTC estimates of anticipated future costs. Cost estimates related to environmental sites under DLA Energy management were generated for 5,754 sites; 73 sites associated with corrective action costs, 3,335 sites associated with closure costs, and 2,346 sites associated with asbestos clean-up costs. Cost estimates related to environmental sites under Non-Energy management were generated for 1,011 sites; one site with corrective action costs, 71 sites with closure costs, and 939 sites with asbestos clean-up costs.

In FY2018, DLA WCF utilized the RACER software to generate the FY2019 CTC estimates of anticipated future costs. Cost estimates related to environmental sites under DLA Energy management were generated for 7,244 sites; 72 sites associated with corrective action costs, 4,207 sites associated with closure costs, and 2,965 sites associated with asbestos clean-up costs. Cost estimates related to environmental sites under Non-Energy management were generated for 1,906 sites; one site associated with corrective action costs, 117 sites associates with closure costs, and 1,788 sites associated with asbestos clean-up costs. The latest available version of RACER was used to prepare the FY2018 estimates which reflects a FY2017 cost basis since no RACER version was released in FY2018. As a result, an inflation factor was applied to escalate estimates from an FY2017 to FY2018 cost basis.

Types of Environmental Liabilities and Disposal Liabilities: The DLA WCF is responsible for the recognition, measurement, reporting, and disclosure of EL not eligible for funding under the

Defense Environmental Restoration Program (DERP), also known as Non-BRAC EL, and Environmental Disposal for General Equipment. Non-BRAC EL are specifically related to past and current installation restoration activities and operations, and closure and disposal of facilities. All clean-up and disposal actions are conducted in coordination with regulatory agencies, other responsible parties, and current property owners. DLA WCF reported EL under Other Accrued EL – Non-BRAC and includes the following line items:

- *Environmental Corrective Action:* EL associated with the cleanup sites not eligible for DERP funding, typically conducted under Resource Conservation and Recovery Act (RCRA) or other Federal or state statutes and regulations.
- *Environmental Closure Requirements:* EL associated with the future closure/decommissioning of facilities on an installation that have environmental closure requirements to include fuel storage tanks and pipelines.
- *Asbestos:* EL associated with the removal, containment, and/or disposal of friable (immediate health threat) and nonfriable (not an immediate health threat): (1) asbestos-containing materials from property, or (2) material and/or property that consists of asbestos-containing material at permanent or temporary closure or shutdown of associated PP&E on Non-BRAC installations.
- *Non-Nuclear Powered General Equipment:* EL resulting from the disposal of non-nuclear powered general equipment. DLA assessed its General Equipment asset inventory and does not have reportable EL for Non-Nuclear Powered General Equipment.

Applicable Laws and Regulations for Cleanup Requirements: The DLA WCF 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 WCF is required to ensure all hazardous substances are removed prior to closing or disposing of assets such as Petroleum, Oil, and Lubricant storage tanks and pipelines.

The DLA WCF is required to comply with the following laws and regulations for Corrective Actions where applicable: the Comprehensive Environmental Response, Compensation, and Liability Act; the Superfund Amendments and Reauthorization Act; the RCRA; and other applicable Federal, State, and local laws and regulations. Required cleanup may at times extend beyond Installation boundaries onto privately owned property or onto sites where DLA WCF is named as a potentially responsible party by a regulatory Agency.

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

The DLA WCF is required to report EL associated with asbestos cleanup in accordance with FASAB *Technical Release 10: Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment*, and FASAB Federal Financial Accounting and Auditing *Technical Release No. 2 Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government.*

Additionally, DLA WCF is required to report EL associated with Non-Nuclear Powered General Equipment, in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*, and Technical Releases 11 and 14 and follow applicable DLA policy and guidance related to PP&E.

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

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

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

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

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

The DLA WCF conducted the annual Roll Forward process in accordance with the DLA EL CTC SOP, the DoD 7000.14-R FMR Volume 4, Chapter 13 – Environmental and Disposal Liabilities

(April 2018), and the OUSD memorandum for Strategy for Environmental & Disposal Liabilities Audit Readiness (September 30, 2015). Based on the results of the annual Roll Forward process, it was determined that material changes to DLA WCF EL occurred between approval of the original EL estimates and the financial reporting date of September 30, 2019. These material changes are included in the EL balance stated above.

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

Unrecognized Costs: The DLA WCF systematically recognizes asset related EL over the useful life of PP&E assets in accordance with DoD FMR Volume 4, Chapter 13, Paragraph 130203 (April 2018). The total recognized Asbestos EL balance is stated above in the footnote and the associated unrecognized Asbestos EL is $1,454 thousands. The total recognized Environmental Closure Requirements EL is stated above in the footnote and the associated unrecognized Environmental Closure EL is $4,755 thousand. DLA has no reportable General Equipment EL. Asset-related EL are amortized based on the useful life of the assets as determined in DoD FMR Volume 4, Chapter 24 – Real Property, Paragraph 240206.B. Table 24-1 (June 2019) DoD Useful Lives for Depreciable Real Property Assets.

Cleanup Costs Associated with Overseas Environmental Liabilities: Total overseas cleanup ELs include 856 environmental closure requirements sites (794 tanks and 62 pipelines) at 84 installations across 18 countries/territories, and two environmental corrective action sites at Royal Air Force Base Mildenhall, England. Additionally, there are 715 buildings/structures with overseas asbestos cleanup-related requirements at 82 installations across 20 countries/territories.

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

Note 12: Other Federal Employment Benefits (Unaudited)

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

2019	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	$ 180,535	$ -	$ 180,535
Total Other Federal Employment Benefits	**$ 180,535**	**$ -**	**$ 180,535**

2018	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	$ 201,935	$ -	$ 201,935
Total Other Federal Employment Benefits	**$ 201,935**	**$ -**	**$ 201,935**

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

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

Interest rate assumptions utilized for FY2019 discounting were as follows:

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

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

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

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

Note 13: Commitments and Contingencies (Unaudited)

Accrued and reasonably possible legal, contract financing payment, and environmental contingent liabilities as of September 30, 2019 and 2018, respectively, consist of the following (dollars in thousands):

	2019		
	Accrued Liabilities	Estimated Range of Loss Lower End	Upper End
Legal Contingencies			
Probable	$ 6,126	$ 6,126	$ 6,957
Reasonably Possible		$ 18,042	$ 2,868,438
Contract Financing Payment Contingencies			
Probable	$ -	$ -	$ -
Reasonably Possible		$ -	$ -
Environmental Contingencies			
Probable	$ 1,272,239	$ -	$ -
Reasonably Possible		$ -	$ -

	2018		
	Accrued Liabilities	Estimated Range of Loss Lower End	Upper End
Legal Contingencies			
Probable	$ 927	$ 927	$ 1,840
Reasonably Possible		$ 10,162	$ 2,849,314
Contract Financing Payment Contingencies			
Probable	$ 8,386	$ -	$ -
Reasonably Possible		$ -	$ -
Environmental Contingencies			
Probable	$ 1,507,957	$ -	$ -
Reasonably Possible		$ -	$ -

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

The DLA WCF has accrued contingent liabilities for legal actions where the DLA Office of General Counsel considers an adverse decision probable and the amount of loss is estimable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. DLA WCF records contingent liabilities (refer to Note 10, *Other Liabilities*) within Other Liabilities in the Balance Sheets.

The DLA WCF has an estimated reasonably possible minimum loss contingency of $18.0 million and $10.2 million as of September 30, 2019 and 2018, respectively. 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 WCF's Automated Workflow and Reporting System (AWARS) is used by the DLA Office of General Counsel to assess the outcomes and possible liability amounts of open cases. The AWARS projects a minimum liability of approximately $18.0 million and $10.2 million and a maximum liability of approximately $2.9 billion and $2.8 billion as of September 30, 2019 and 2018, respectively. These cases relate to Employee or Applicant Related and Contract Related matters.

Environmental Contingencies: The DLA WCF has developed a process to identify, estimate, and record contingent EL. The DLA WCF does not estimate a potential range of loss in this process. Where DLA WCF 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 11, *Environmental and Disposal Liabilities*.

Potential Loss Related to Economic Price Clause Contracts: The DLA WCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. DLA WCF has limited automated system processes by which it captures or assesses these potential liabilities; therefore, the amounts reported may not fairly present DLA WCF's total contingent liabilities. Known contingencies that are considered both measurable and probable have been recognized and recorded as liabilities in the Balance Sheets.

Commitments: The DLA WCF does not have obligations related to cancelled appropriations for contractual commitments.

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

Note 14: Exchange Revenue (Unaudited)

The DLA WCF pricing policy for SCM and Energy Management is to seek full cost recovery for products and services provided. These DLA WCF activities maintain the goal to break-even over a single year or two-year period; however, DLA WCF may request a waiver from the OUSD(C) to recover costs beyond the budget year to maintain a stabilized CRR. DLA WCF establishes its selling or standard prices in the budget to ensure sufficient budgetary resources are available to cover costs of operations. The prices are normally stabilized or fixed during execution to mitigate the impact of unforeseen fluctuations. DLA WCF will not change the prices during the fiscal year unless a prior approval from OUSD(C) is received, with the exception of those instances in which the out-of-cycle price changes may be made without OUSD(C) approval.

The DLA Energy Management generally bills its customers using a petroleum standard price mandated by OUSD(C). OUSD(C) establishes the standard price for petroleum and product costs on an annual basis (refer to Note 1.T. related to non-NSN and cost-plus pricing.

For the year ended September 30, 2019 and 2018, DLA WCF recognized other accounting gains of approximately $2.3 billion and $2.0 billion, respectively, and losses of approximately $2.5 billion and $2.0 billion, respectively, derived from supply chain activities involving MAC updates, receipts without purchase orders, NRV updates, and disposal of demilitarized property.

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

Note 15: Inter-Entity Cost (Unaudited)

Goods and services are received from other Federal entities at no cost or at a cost less than the full cost to the providing Federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by DLA WCF are recognized as imputed cost in the Statements of Net Cost, and are offset by imputed revenue in the Statements of Changes in Net Position. Such imputed costs and revenues relate to employee benefits and claims to be 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 WCF financial statements.

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

Note 16: Undelivered Orders (Unaudited)

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

	2019	2018
Intragovernmental		
Unpaid	$ 1,507,992	$ 1,321,181
Total Intragovernmental	**1,507,992**	**1,321,181**
Non-Federal		
Unpaid	21,631,576	20,567,816
Prepaid/Advanced	86,173	78,827
Total Non-Federal	**21,717,749**	**20,646,643**
Total Undelivered Orders	**$ 23,225,741**	**$ 21,967,824**

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

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

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

Note 17: Contributed Capital (Unaudited)

For the years ended September 30, 2019 and 2018, DLA WCF received additional funding through DoD reprogramming actions of $548.0 million and $631.0 million, respectively.

Note 18: Reconciliation of Net Cost to Net Outlays (Unaudited)

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

	2019		
	Intra-governmental	Non-Federal	Total
NET COST	**$ (32,696,615)**	**$ 32,568,734**	**$ (127,881)**
Components of Net Cost That are Not Part of Net Outlays			
PP&E Depreciation	-	(236,482)	(236,482)
PP&E Disposal and Revaluation	-	(815,474)	(815,474)
Cost of Goods Sold	(5,942,040)	(28,234,408)	(34,176,448)
Offset to Capitalized Assets	-	87,558	87,558
Net Gains	-	593,856	593,856
Increase/(Decrease) in Assets:			
Account Receivable	211,786	(25,598)	186,188
Other Assets	-	(1,040)	(1,040)
(Increase)/Decrease in Liabilities:			
Accounts Payable	(18,314)	355,822	337,508
Salaries and Benefits	865	(10,188)	(9,323)
Environmental and Disposal Liabilities	-	235,719	235,719
Other Liabilities	343,454	29,555	373,009
Other Financing Sources:			
Federal employee retirement benefit costs paid	(185,607)	-	(185,607)
Total Components of Net Cost That are Not Part of Net Outlays	**(5,589,856)**	**(28,020,680)**	**(33,610,536)**
Components of Net Outlays That are Not Part of Net Costs			
Acquisition of Inventory	200,565	34,624,912	34,825,477
Other	3,238	(3,900)	(662)
Total Components of Net Outlays That are Not Part of Net Costs	**203,803**	**34,621,012**	**34,824,815**
NET OUTLAYS	**$ (38,082,668)**	**$ 39,169,066**	**$ 1,086,398**
Outlays, Net, Statement of Budgetary Resources			**1,108,011**
Reconciling Difference			**$ (21,613)**

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

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

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

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

Required Supplementary Information

Deferred Maintenance and Repairs

The DLA WCF owns and manages five stewardship properties to support its mission. The maintenance and repair needs of these assets are identified primarily through the condition assessment process. Maintenance and repairs that were not performed when they should have been or were scheduled and delayed for a future period are considered Deferred Maintenance and Repairs.

M&R Policies. Installation Management – Installation & Equipment (DM-I) manages only the DLA Non-Energy portion of the Sustainment, Restoration and Maintenance (SRM) program. DM-I continues to conduct condition assessments of DLA non-Energy facilities using the U.S. Army Corps of Engineer Sustainment Management System (SMS) BUILDER. The use of the reported SMS application was mandated by the OUSD memorandum dated September 10, 2013 and will result in the generation of a consistent and uniform Facility Condition Index (FCI) for Non-Energy DLA facilities. M&R policies do not include Energy deferred maintenance and repairs.

M&R Prioritization. Planning, programming, and execution of DLA Non-Energy SRM program is executed IAW DLAI 4165.02 (dated October 30, 2018) using the following priorities:

a. Life, health, and safety concerns (cannot mitigate)
b. Facilities with an FCI of 60 or less
c. Security deficiencies including cyber security (cannot mitigate)
d. Environmental deficiencies addressing non-compliance (cannot mitigate)
e. Warfighter support facilities (mission failure)
f. Energy conservation projects (as mandated)
g. Other Warfighter support facilities (mission impact)
h. Routine maintenance (no mission impact).

Acceptable Condition Standards. OUSD and DLA consider an asset acceptable when it is in good condition with an assigned minimum FCI of 80.0%. This acceptance criteria is in accordance with the OUSD memorandum dated April 29, 2014, titled Facility Sustainment and Recapitalization Policy. DLA also considers life, health and safety and mission when assessing acceptable conditions. Facilities with an FCI below 60.0% are considered failing facilities whereas facilities with an FCI between 60.0% and 79.0% are in “Poor” condition.

Capitalization of Deferred Maintenance and Repairs. The deferred maintenance and repair information presented relates to assigned use of DoD facilities and is not restricted to capitalized assets.

Asset Exclusions. The deferred maintenance and repair information excludes facilities that have been semi-active, caretaker, outgranted, non-functional, environmental hold status or closed, disposed, excess, surplus, or returned to the Servicing Components.

Deferred Maintenance and Repairs (Cont.)

	Beginning Balance	Ending Balance
Active		
Category 1: Building, Structures, and Linear Structure (Enduring Facilities)	$ 1,086,370	$ 869,643
Category 2: Building, Structures, and Linear Structure (Heritage Assets)	832	1,063
Total Active	**$ 1,087,202**	**$ 870,706**
Inactive and Excess		
Category 3: Building, Structures, and Linear Structure (Excess Facility or Planned for Replacement)	$ -	$ -
Total Inactive and Excess	**-**	**-**
Total Deferred Maintenance	**$ 1,087,202**	**$ 870,706**

Combining Statements of Budgetary Resources

The Combining Statements of Budgetary Resources combines the availability, status, and outlays of DLA WCF's budgetary resources. The following tables provide the Combining Statements of Budgetary Resources disaggregated by DLA WCF activities for the years ended September 30, 2019 and 2018, respectively.

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

	Energy	Supply Chain Management	Document Services	2019 Combined
BUDGETARY RESOURCES				
Unobligated Balance From Prior Year Budget Authority, Net	$ 657,611	$ 824,573	$ 161,022	$ 1,643,206
Appropriations	-	48,096	-	48,096
Contract Authority	15,426,344	34,466,108	-	49,892,452
Spending Authority From Offsetting Collections	-	-	298,191	298,191
TOTAL BUDGETARY RESOURCES	**$ 16,083,955**	**$ 35,338,777**	**$ 459,213**	**$ 51,881,945**
STATUS OF BUDGETARY RESOURCES				
New Obligations and Upward Adjustments	$ 15,991,800	$ 35,139,893	$ 297,356	$ 51,429,049
Unobligated Balance, End of Year:				
Apportioned, unexpired accounts	92,155	198,884	161,857	452,896
Unexpired Unobligated Balance, End of Year	92,155	198,884	161,857	452,896
Total Unobligated Balance, End of Year	92,155	198,884	161,857	452,896
TOTAL BUDGETARY RESOURCES	**$ 16,083,955**	**$ 35,338,777**	**$ 459,213**	**$ 51,881,945**
OUTLAYS, NET				
Outlays, Net	$ (822,455)	$ 1,903,864	$ 26,602	$ 1,108,011
AGENCY OUTLAYS, NET	**$ (822,455)**	**$ 1,903,864**	**$ 26,602**	**$ 1,108,011**

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

	Energy	Supply Chain Management	Document Services	2018 Combined
BUDGETARY RESOURCES				
Unobligated Balance From Prior Year Budget Authority, Net	$ 18,520	$ 307,800	$ 170,730	$ 497,050
Appropriations	760,562	75,863	-	836,425
Contract Authority	17,922,019	34,355,783	-	52,277,802
Spending Authority From Offsetting Collections	650	-	292,293	292,943
TOTAL BUDGETARY RESOURCES	**18,701,751**	**$ 34,739,446**	**$ 463,023**	**$ 53,904,220**
STATUS OF BUDGETARY RESOURCES				
New Obligations and Upward Adjustments	$ 17,838,828	$ 34,414,873	$ 333,881	$ 52,587,582
Unobligated Balance, End of Year:				
Apportioned, unexpired accounts	862,923	324,573	129,142	1,316,638
Unexpired Unobligated Balance, End of Year	862,923	324,573	129,142	1,316,638
Total Unobligated Balance, End of Year	862,923	324,573	129,142	1,316,638
TOTAL BUDGETARY RESOURCES	**$ 18,701,751**	**$ 34,739,446**	**$ 463,023**	**$ 53,904,220**
OUTLAYS, NET				
Outlays, Net	$ 1,141,886	$ (30,569)	$ 2,453	$ 1,113,770
AGENCY OUTLAYS, NET	**$ 1,141,886**	**$ (30,569)**	**$ 2,453**	**$ 1,113,770**

3

Other Information (Unaudited)

SECTION 3 – OTHER INFORMATION (UNAUDITED)

The Army's newest food truck stopped at DLA Troop Support in Philadelphia. This is one of six state-of-the-art food trucks purchased by DLA Troop Support for the Army's Joint Culinary Center of Excellence.

IN THIS SECTION

Other Information (Unaudited)

Forgone Revenue

At 9:32 a.m. July 16, 1969, Apollo 11 launched from Florida, taking commander Neil Armstrong, lunar module pilot Buzz Aldrin and command module pilot Michael Collins on a mission for the history books – a mission to become the first humans to land on another celestial body. DSA in Cameron Station – the predecessor Agency of DLA Energy – supplied the rocket fuel and other space-related items including liquid hydrogen, cryogenic valves and helium storage tanks for the mission.

DLA provides a fuel service to both military and public entities. The price for fuel supplied is determined by OUSD(C). Often, DLA prices do not match market prices, and therefore DLA incurs a loss in terms of forgone revenue. Forgone revenue denotes the difference between earnings actually achieved and earnings that could have been achieved with the absence of specific fees, expenses, or lost time. DLA Energy did not incur forgone revenue from fuel sales for the years ended September 30, 2019, 2016 and 2015. The demand for the quantity of petroleum products did not change as a result of the difference in price. DLA WCF does not track forgone revenue for the SCM and Document Services activity groups. In addition, the forgone revenue, disclosed below, is presented on a net basis.

Energy Forgone Revenue (dollars in thousands)

	FY2019	FY2018	FY2017	FY2016	FY2015
Forgone Revenue					
Energy	-	$(1,305,045)	$ (882,729)	-	-
Total Forgone Revenue	-	$(1,305,045)	$ (882,729)	-	-

Management Challenges

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

August 1, 2019

MEMORANDUM FOR LTG DARRELL K. WILLIAMS, DIRECTOR, DLA

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

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

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

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

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

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

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

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

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

WILLIAM A. RIGBY
Inspector General

Summary of Financial Statement Audit and Management Assurances

The audit reports on the FY2019 and FY2018 DLA WCF financial statements identified 8 and 8 material weaknesses respectively for DLA WCF. Table 1 below provides a summary of the financial statement audit results for FY2019 and FY2018. Although the material weaknesses overall are not resolved, DLA is continuing to develop CAPs to resolve specific findings associated with the material weaknesses.

Table 1: FY2019 Summary of the Financial Statement Audit					
Audit Opinion	**Disclaimer**				
Restatement	**No**				
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Inventory	1	-	-	-	1
Property, Plant & Equipment	1	-	-	-	1
Fund Balance with Treasury	1	-	-	-	1
Accounts Receivable and Revenue	1	-	-	-	1
Accounts Payable and Expenses	1	-	-	-	1
Financial Reporting	1	-	-	-	1
Oversight and Monitoring	1	-	-	-	1
Information Systems	1	-	-	-	1
Total Material Weaknesses	**8**	**-**	**-**	**-**	**8**

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

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

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

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

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

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

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

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

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

Payment Integrity

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

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

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

Fraud Reduction Report

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

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

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

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

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

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

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

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

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

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Appendix A: Summary of FMFIA Definitions and Reporting

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

Category	Definition	Reporting
	d. Internal Control Over Compliance: A material weakness in internal control over compliance is a condition where management lacks a process that reasonably ensures preventing a violation of law or regulation that has direct and material effect on financial reporting or significant effect on other reporting or achieving Agency objectives.	

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

DLA MAJOR SUBORDINATE COMMANDS

The following are DLA WCF MSCs:

DLA TROOP SUPPORT, headquartered in Philadelphia, Pennsylvania, is DLA's lead center responsible for managing food, clothing, medical supplies, C&E, and general and industrial supplies worldwide. Troop Support delivers optimal, global supply chain solutions to Warfighters and other valued partners through five LOEs: Warfighter First, Global Posture, Strong Partnerships, Whole of Government, and Always Accountable. DLA Troop Support accomplishes these missions through the following Supply Chains: Subsistence, C&T, C&E, Medical, and IH

DLA Troop Support delivers optimal, global supply chain solutions to enable ready, lethal Warfighters and other valued partners through five diverse supply chains: subsistence; C&T; C&E; medical and IH.

DLA LAND AND MARITIME, headquartered in Columbus, Ohio, is the primary source for repair parts for DoD weapon systems. DLA Land and Maritime supply chains support U.S. Army, U.S. Navy Surface and Subsurface, and U.S. Marine Corps customers through dedicated customer relations, while working with numerous suppliers to fulfill requirements for assigned stock classes across the DoD. Furthermore, DLA Land and Maritime supply chains provide logistical services directly to Army and Marine Corps industrial sites and Navy shipyards.

DLA AVIATION, headquartered in Richmond, Virginia, is the primary source for repair parts and operating supply items for 1,838 major weapon systems. The DLA Aviation supply chain provides mapping, kitting, chemical, petroleum packaging, gases, and cylinder items to the military services. In addition, DLA Aviation provides engineering, sustainability, ozone-depleting substances reserve, and industrial plant equipment services.

DLA ENERGY, headquartered in Fort Belvoir, Virginia, serves as DLA's executive agent for the bulk petroleum supply chain. DLA Energy's business includes:

- Selling petroleum and aerospace fuels,
- Arranging for petroleum support services,
- Providing facility/equipment maintenance on fuel infrastructure,
- Performing energy-related environmental assessment and cleanup,
- Storing and transporting for bulk and aerospace products, and
- Performing quality functions for petroleum in support of the military services, as well as for the privatization of their utility systems.
- Provides Installation Energy products and Utility Services

DLA DISTRIBUTION, headquartered in New Cumberland, Pennsylvania, is responsible for the receipt, storage, issuance, packing, preservation, and transportation of items worldwide. It operates a network of distribution centers around the world that provide timely and quality support to the Warfighters. Their Global Stock Position Plan ensures rapid distribution of critical military items. DLA Distribution's overseas distribution operations are located in Europe, Middle East, and Pacific Asia regions.

DLA DISPOSITION SERVICES, headquartered in Battle Creek, Michigan, has 1,328 civilians and 13 active duty military in a global network of 103 field locations in 16 countries, 2 territories, and 41 states. DLA Disposition Services receives EOU DoD property and provides ultimate disposal services through reutilization, transfer, donation, and sales. Property not reutilized within DoD is available for transfer to other Federal agencies or for donation to authorized non-profit organizations or state and local governments. Property not reused, transferred, or donated is either competitively sold or disposed of in an environmentally safe manner. DLA Disposition Services also arranges for the worldwide disposal of hazardous waste in compliance with laws and regulations.

Appendix C: Abbreviations & Acronyms

ADA	Anti-Deficiency Act
AFR	Agency Financial Report
APR	Annual Performance Report
AWARS	Automated Workflow and Reporting System
BRAC	Base Realignment and Closure
C&E	Construction and Equipment
C&T	Clothing and Textiles
CAP	Corrective Action Plans
CBY	Charge Back Year
CC	Critical Capabilities
CCMD	Combatant Command
CFO	Chief Financial Officer
CIO	Chief Information Officer
CIP	Construction-in-Progress
CMR	Cash Management Report
COLA	Cost-of-Living Adjustments
COTS	Commercial off-the-shelf
CPIM	Consumer Price Index Medical
CRR	Cost Recovery Rate
CTC	Cost-to-Complete
CUEC	Complementary User End Controls

DAI	Defense Agencies Initiative
DATA Act	Digital Accountability and Transparency Act of 2014
DCAS	Defense Contract Administration Services
DCIA	Debt Collection Improvement Act of 1996
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DLA	Defense Logistics Agency
DM-I	Installation Management - Installation & Equipment
DoD	Department of Defense
DoDIG	Department of Defense Office of Inspector General
DoE	Department of Energy
DOL	Department of Labor
DRRT	Department 97 Report Reconciliation Tool
DSA	Defense Supply Agency
DSS	Distribution Standard System
DWWCF	Defense Wide Working Capital Fund
EBS	Enterprise Business System
ECC	Enterprise Resource Planning Central Component
EL	Environmental and Disposal Liabilities
EOU	Excess, Obsolete, and Unserviceable

ERM	Enterprise Risk Management
FASAB	Federal Accounting Standards Advisory Board
FBwT	Fund Balance with Treasury
FCI	Facility Condition Index
FEA	Fuel Exchange Agreement
FECA	Federal Employees' Compensation Act
FEMA	Federal Emergency Management Agency
FFMIA	Federal Financial Management Improvement Act of 1996
FFMSR	Federal Financial Management System Requirements
FMFIA	Federal Managers' Financial Integrity Act of 1982
FMR	Financial Management Regulation
FRDAA	Fraud Reduction and Data Analytics Act of 2015
FRO	Financial Reporting Organization
FSCM	Financial Supply Chain Management
FY	Fiscal Year
GAO	U.S. Government Accountability Office
GMRA	Government Management Reform Act of 1994
GPC	Government Purchase Card
GSA	General Services Administration
IAW	In Accordance With
ICO	Internal Control over Operations
ICOR	Internal Control over Reporting
IH	Industrial Hardware
IP	Improper Payments
IPA	Independent Public Accountant
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPERIA	Improper Payments Elimination and Recovery Improvement Act of 2012
IPIA	Improper Payments Information Act of 2002
IT	Information Technology

IUS	Internal Use Software
J/D	Staff Directors and Field Activity Commanders
JLEnt	Joint Logistics Enterprise
LESO	Law Enforcement Support Office
LOE	Lines of Effort
MAC	Moving Average Cost
MOCAS	Mechanization of Contract Administration Services
MSC	Major Subordinate Commands
NDAA	National Defense Authorization Act
NFR	Notice of Findings and Recommendations
NRV	Net Realizable Value
NSN	National Stock Numbers
NWRM	Nuclear Weapon Related Material
OCONUS	Outside the Continental United States
ODO	Other Defense Organizations
OI	Other Information
OIG	Office of the Inspector General
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
OUSD	Office of the Under Secretary of Defense
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
P3	Public-Private Partnership
PP&E	Property, Plant and Equipment
PPA	Prompt Payment Act
R&D	Research and Development
RACER	Remedial Action Cost Engineering and Requirements
RCRA	Resource Conservation and Recovery Act
SAP	Systems Applications and Products
SCM	Supply Chain Management

SFFAS	Statement of Federal Financial Accounting Standards
SFIS	Standard Financial Information Structure
SFP	Standard Fuel Price
SLOA	Standard Line of Accounting
SMS	Sustainment Management System
SOA	Statement of Assurance
SOC	Systems and Organization Control
SOP	Standard Operating Procedure
SRM	Sustainment, Restoration and Maintenance
TAS	Treasury Account Symbol
TFM	Treasury Financial Manual
TNC	Treasury Nominal Coupon
U.S.	United States
U.S. GAAP	U.S. Generally Accepted Accounting Principles
UCO	Unfilled Customer Order
UDO	Undelivered Orders
USC	U.S. Code
USSGL	U.S. Standard General Ledger
WCF	Working Capital Fund

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

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

DLA supports troops around the world, including in Dakar, Senegal, where Navy Lt. Cmdr. Kara Sartain teaches children how to salute while they tour the USNS Carson City July 7, 2019, during an Africa Partnership Station deployment. The ship is deployed to the Gulf of Guinea to demonstrate progress through partnerships and U.S. commitment to West African countries.

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