Defense Logistics Agency Annual Financial Report Fiscal Year 2007

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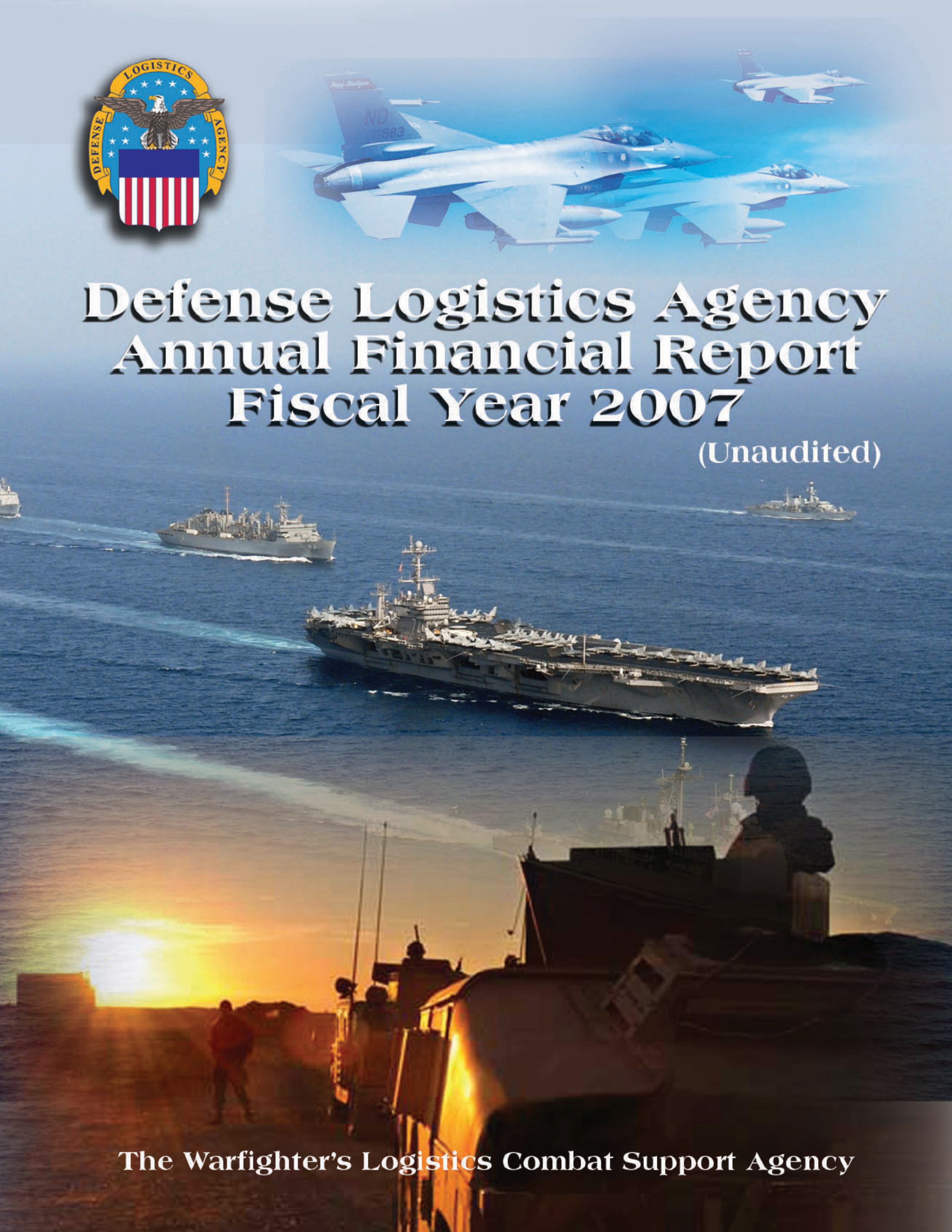

The Warfighter's Logistics Combat Support Agency

WORKING CAPITAL FUND and GENERAL FUND

Fiscal Year 2007 Annual Financial Report

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Message from the Director

October 2007

Having led the Defense Logistics Agency (DLA) for the past 13 months, I'm convinced that delivering DLA's commitment to the warfighter requires far more effort than successfully managing the Department of Defense's wholesale supplies and suppliers. To continue providing robust logistics support to our customers, we must leverage the capabilities generated through DLA's many transformation initiatives and continue to do so as our missions change and expand. Moving forward with an eye keenly focused on warfighter support, stewardship, growth and development, and leadership we will provide our customers the best possible logistics support at the best possible value. Our competencies and capabilities are being moved closer to the warfighter to provide support at the "point of the spear." Every business process is scrutinized to continually improve our business model to optimize national inventory and reduce costs to our customers. We are working with our customers and partners as we move from wholesale operations to supply chain excellence and lead the military's transformation by sharing our expansive logistics expertise throughout DoD. Using best practices from both government and industry, we will continue to establish and manage a seamless link between Military Service-identified materiel requirements, and the suppliers within the American industrial base who are ultimately filling those requirements. And, we will continue to develop our workforce's technical proficiency and knowledge in response to the wide range of challenges that are associated with supporting America's military forces around the world.

While DLA continues to excel as the Department's Logistics Combat Support Agency, some of DLA's financial data is derived from legacy processes, systems, and sources that cannot yet be audited. In response, we are executing a focused, coordinated, and deliberate process to improve the accuracy, completeness, and reliability of the financial data that will be presented in future financial reports.

The Soldiers, Marines Sailors, and Airmen operating across the globe today require and deserve the finest support, supplies, and materiel we can provide. There isn't another agency out there that can do what DLA does. The commitment of our workforce ensures that our Nation consistently provides America's warfighters with what they need. I am honored and proud to be a member of this team.

R. T. Dail

ROBERT T. DAIL
Lieutenant General, USA
Director

DEFENSE LOGISTICS AGENCY

CONSOLIDATED MANAGEMENT'S DISCUSSION & ANALYSIS

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Description of the Defense Logistics Agency

The Defense Logistics Agency (DLA) is the logistics combat support Agency of the Department of Defense (DoD) and receives its oversight and staff direction from the Deputy Under Secretary of Defense for Logistics and Materiel Readiness. Our primary mission is to provide best value logistics solutions to meet the needs of America's Armed Forces around-the-clock and around-the-world in times of peace, national emergency, and war. Execution of the United States national defense strategy depends on DLA logistics support to feed, clothe, fuel, medicate and treat, and sustain our troops and many of our nation's allies. We support DoD objectives and missions with involvement in the full range of military operations – from participation with multinational forces engaged in large-scale combat operations, peacekeeping efforts, emergency support, and humanitarian assistance to the global war on terrorism.

DLA manages more than 5.2 million items and disseminates logistics cataloging information for most items managed by DLA that support the DoD, other Federal Agencies, and U.S. international partners. Among the materiel we manage are fuel and repair parts for weapon systems as well as food, clothing, and medical supplies needed to deploy and sustain U.S. Forces. We receive, issue, and distribute these items through a network of supply depots and commercial supplier relationships; and through our reutilization and marketing services, we manage DoD programs to reutilize, transfer, donate, or sell surplus and excess materiel and dispose of hazardous materiel. We also administer the DoD document automation and production services.

Our missions have evolved and grown over the past four decades to an extent that if our forces fight with it, wear it, eat it, or burn it as fuel, we probably buy it; warehouse and distribute it; or arrange for its reuse, sale, or disposal after the owner no longer needs it.

Agency Strategic Goals and Strategies

As the Department's sole Logistics Combat Support Agency, we have a pivotal role in delivering the joint logistics capability that optimizes warfighter support; and DLA's ability to deliver the right logistics solution to the American warfighters in every transaction requires supply chain excellence. Consequently, the U.S. military's ability to generate and sustain global combat readiness depends on a supply chain that seamlessly moves DLA-managed materiel from the nation's industrial base to its ultimate user.

To fulfill this mission, DLA will build on its wholesaler excellence. We will leverage the operational efficiencies that will be generated by the Agency's transformational initiatives, such as, the 2005 Base Realignment and Closure (BRAC) decisions and the recently completed Enterprise Business System (EBS) – an end-to-end Enterprise Resource Planning capability managing all of DLA's 5.2 million hardware and troop support items. [NOTE: In prior annual financial reports, EBS was referred to as the Business System Modernization (BSM) program.]

The Defense Logistics Agency FY 07–FY 13 Strategic Plan, promulgated in February 2007, contains four strategic goals and clearly documents and commits DLA's resources and energy to the realization of three new strategic thrusts; each designed to move DLA beyond its traditional wholesaler responsibilities. Those strategic thrusts will: 1) extend Enterprise resources to geographically align with supported activities and capitalize on best value opportunities that improve warfighter readiness; 2) connect warfighter demand with

Our Mission:

To Provide Best Value Integrated Logistics Solutions to America's Armed Forces and Other Designated Customers… in Peace and in War…Around the Clock, Around the World

Our Vision:

Extending the Enterprise Forward to Meet the Needs of the Warfighter
RIGHT ITEM, RIGHT SERVICE, RIGHT PLACE, RIGHT PRICE, RIGHT TIME…EVERY TIME

supply by transforming the Department's demand planning capabilities and the processing of demand signals throughout the supply chain; and 3) deliver supply chain excellence by forging end-to-end logistics solutions that strike the targeted balance among effectiveness, agility, reliability, speed, visibility, and cost. DLA's four strategic goals:

Strategic Goals

- Maximize warfighter potential by extending the Enterprise to provide worldwide response and integrated, best value supplies and services consistently to our customers.
- Continuously improve DLA performance through the development of better processes and business arrangements that reduce cost, increase logistics capabilities, and link customer demands with our supply chains.
- Ensure a diverse, enabled, empowered, and motivated workforce that delivers and sustains supply chain excellence.
- Manage DLA resources for best customer value.

We will achieve these strategic goals through a series of integrated enterprise-wide strategies.

Goal 1. Maximize warfighter potential by extending the Enterprise to provide worldwide response and integrated, best value supplies and services consistently to our customers.

Strategy 1.1. Extend competencies and capabilities closer to the warfighters.

Strategy 1.2. Actively engage the warfighters to better understand their needs and meet their requirements.

Goal 2. Continuously improve DLA performance through the development of better processes and business arrangements that reduce cost, increase logistics capabilities, and link customer demands with our supply chains.

Strategy 2.1. Align demand and supply chain capabilities within the supply chain management model to better support the warfighters and their weapon systems.

Strategy 2.2. Leverage industry capabilities to provide world-class support to the warfighter at the lowest possible cost.

Strategy 2.3. Adopt, institutionalize, and continuously improve best business practices to improve quality and speed and to reduce cycle time and costs, while maintaining the integrity of the procurement process.

Strategy 2.4. Achieve world-class supply chain performance, completing DLA's transition from wholesale to end-to-end supply chain management excellence.

Strategy 2.5. Design, implement, and sustain a best value enterprise Information Technology (IT) environment.

Strategy 2.6. Improve management of DLA's current and future real property.

Strategy 2.7. Implement processes and procedures to support requirements for green procurement.

Goal 3. Ensure a diverse, enabled, empowered, and motivated workforce that delivers and sustains supply chain excellence.

Strategy 3.1. Acquire, develop, and retain, world-class supply chain expertise through a comprehensive talent management program.

Strategy 3.2. Attain and sustain a corporate culture that meets the needs of the warfighter through logistics excellence.

Strategy 3.3. Provide a quality work environment that optimizes employee performance.

Goal 4. Manage DLA resources for best customer value.

Strategy 4.1. Resource DLA's operational strategies.

Strategy 4.2. Minimize total supply chain costs.

Strategy 4.3. Demonstrate stewardship and foster stakeholder trust.

For any enterprise of DLA's size and scope, transformation and organizational evolution generally involves a difficult and complex process that - more often than not - requires an immense expenditure of capital, energy, and effort by all involved. In order to mitigate these challenges while maintaining its focus on its core missions, DLA organized its efforts into 11 distinct transformational initiatives that support the three overarching strategic thrusts. The strategic thrusts provide the initiatives with a coherent focus and objective, ensuring that individual initiatives do not lose sight of the strategic picture even as they remain fixed upon their unique missions. The 11 transformational initiatives are individual programs for executing Enterprise change and are focused on improving DLA: the quality of its services, the scope of its mission, and the efficiency with which it operates to meet the needs of the warfighter while providing the best value for the taxpayer. The FY 2008 Roadmap will be published and distributed in the fall of 2007. DLA's strategic thrusts and transformation initiatives are identified and summarized below:

Extend the Enterprise

- **Customer Facing** is a multi-phase effort to co-locate DLA personnel and Agency capabilities with the Military Services and Combatant Commanders (COCOMs). This initiative is delivering on DLA's strategy to provide DLA's customers with direct access to the Agency's competencies and capabilities.

- **Base Realignment and Closure (BRAC) 2005** decisions will expand DLA's current capabilities and extend those capabilities forward to the Military Services' industrial maintenance depots.

- **Joint Regional Inventory Materiel Management (JRIMM)** is designed to improve warfighter support by: 1) establishing a single warehousing/distribution hub in each region; 2) minimizing all other storage sites within a region; 3) eliminating duplicate inventories; 4) maximizing utilization of the DLA Strategic Distribution Platforms (SDP); 4) reducing the number of times that materiel is handled; and 5) consolidating regional transportation management.

- **National Inventory Management Strategy (NIMS)** is an initiative that streamlines and improves consumable item management by affording the Military Services the opportunity to eliminate their unnecessary inventory investment in DLA-managed parts. This allows the merger of DLA wholesale and Military Service retail inventories into a single national inventory whose total cost is less than the sum of the individual stockpiles.

- **Global Stock Positioning (GSP)** is the strategy to position materiel around the globe in advance of customer requirements. It is designed to appropriately balance material availability with investment, storage, and distribution costs.

Connect Warfighter Demand with Supply

- **Supplier Relationship Management (SRM)** is an initiative to build collaborative alliances with key suppliers in order to ensure materiel availability, quality and value for those DLA-managed items vital to warfighter support. SRM also provides the capability to evaluate and manage supplier performance. Other long-term benefits of SRM include:1) reduced vendor delivery times; 2) inventory savings; 3) collaborative communication between DLA, its customers, and suppliers; and 4) leveraged buying power for DoD.

- **Industrial Product-Support Vendor (IPV)**, formerly known as Integrated Prime Vendor, is an initiative to migrate the management and requisitioning of consumable spare parts – industrial hardware, such as rivets, screws, and o-rings - used at Military Service maintenance facilities from individual service-managed programs to contractor-provided support. These parts are stored in bins at or near the point of use on production lines.

- **Integrated Data Environment (IDE)/Global Transportation Network Convergence (IGC)** is a system-of-systems partnership initiative that will provide a single point of access to decision support related data and information within DLA and the United States Transportation Command (USTRANSCOM), and between DLA/USTRANSCOM and external systems. The convergence of these two programs will create a single face to DoD systems that require access to common and authoritative data, business standards, and information from DLA and USTRANSCOM.

Deliver Supply Chain Excelence

- **Common Food Management System (CFMS)** is a joint initiative between DLA and the Military Services to replace the Military Services' individual food management systems with a single, cross-service system that also allows service members to purchase food at any of the Military Services' dining facilities and will result in an end-to-end logistics solution for the worldwide DoD subsistence supply chain.

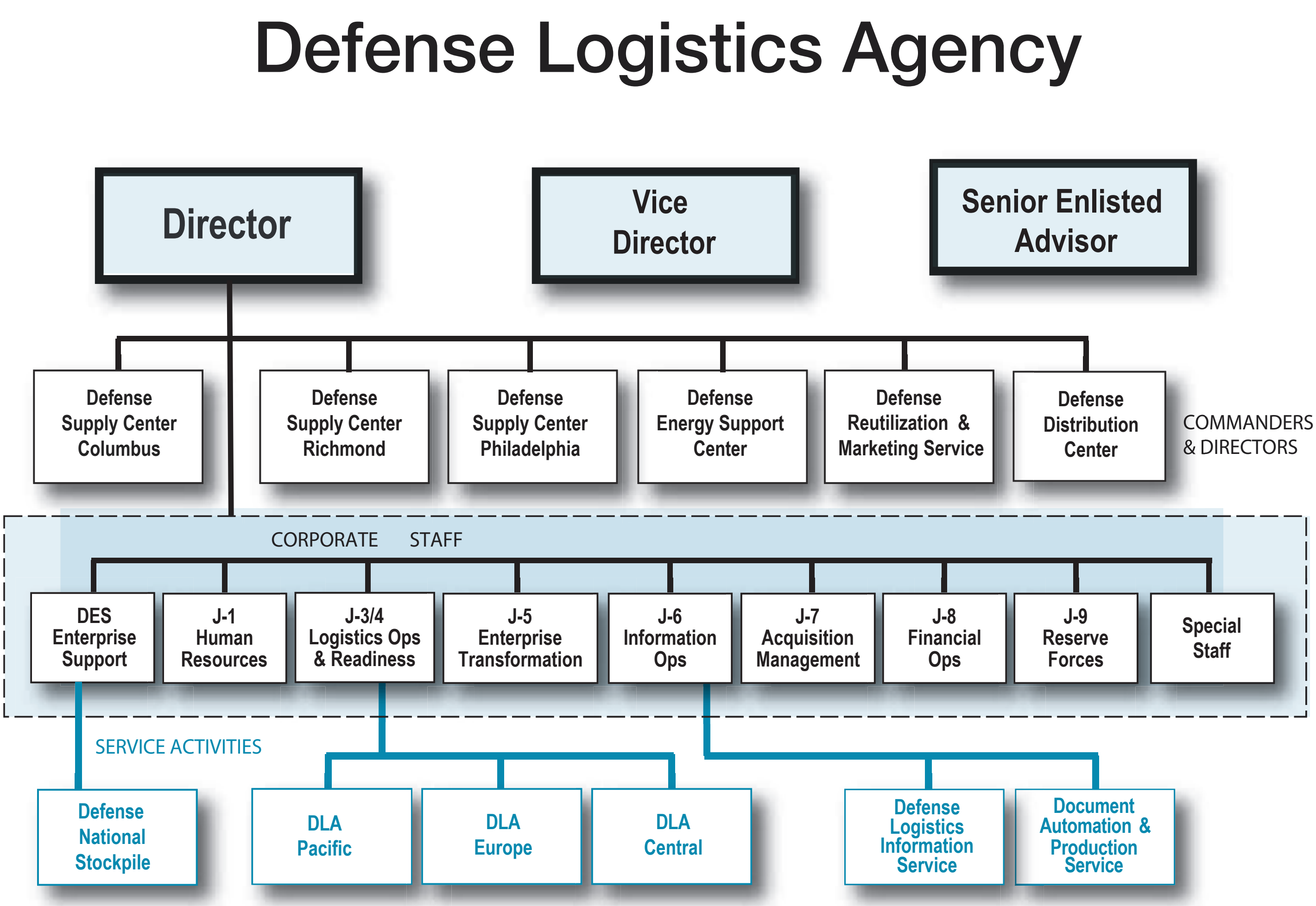
- **Reutilization Modernization Program (RMP)** is a DLA initiative to update its disposal business processes and replace the current Defense Reutilization and Marketing Service (DRMS) inventory management information technology (IT) systems. RMP will integrate the DLA Enterprise Business System (EBS), Distribution Standard System, and other Commercial-Off-the-Shelf (COTS) / Government Off-the-Shelf (GOTS) programs into a single IT system, while re-engineering the DRMS business processes.

- **Enterprise Business Systems (EBS)** is an initiative to establish a DLA-wide Enterprise Resource Planning (ERP) environment that integrates nearly every Agency system and process into a single system that combines software programs for many diverse activities, such as materiel management, order fulfillment, procurement, financials, payroll, and human resources. EBS will be the key enabler for DLA's new business model, allowing the Agency to reengineer its business processes quickly and efficiently to improve overall effectiveness.

Organization

DLA maintains a global presence and accomplishes its mission with approximately 21,000 civilian personnel, 454 active duty personnel, and 756 reserve personnel. Despite our significant mission expansion over the past 46 years, our workforce is now at the smallest level since 1963. Agency leaders are committed to the continuous assessment and transformation of our organizational culture, size,

Our organizational structure is depicted below:



structure, and alignment through enterprise integration and partnering with the private sector. These efforts will enable us to implement an enterprise business model and develop, deploy, and execute an improved set of corporate business processes and strategies. By organizing as a single, integrated business enterprise, we will be in position to focus more efficiently and effectively on supporting the DoD's supply chain, enhancing the Armed Forces' readiness, and providing for the warfighter during contingency operations. We are proactive in our approach to serving those who depend on us for their mission needs; and we constantly meet face-to-face with our customers to determine their requirements and how we can best fulfill them.

DLA's core functions are directed or supported by:

- **Human Resources (J-1)** provides a full range of civilian human resources services for the DLA civilian and military workforce. J-1 conducts these services from its customer support offices located in Columbus, OH and New Cumberland, PA; a centralized military personnel support organization located at HQ DLA in Fort Belvoir, VA; and the DLA Training Center, which provides training support to its workforce - located in Columbus, OH.

- **Logistics Operations and Readiness (J-3/4**) is responsble for the end-to-end supply chain management of DLA's eight supply chains, providing logistics and materiel process management policy, guidance, oversight, and monitoring of supply chain performance. J-3/4 is the principal strategic, operational, and tactical planner for DLA business operations, championing best business practices, and value-added logistics solutions for the warfighter. It serves as the Agency's focal point for customer support, engaging customers around the world, understanding their needs, and translating those needs back to the rest of DLA to maximize the Agency's logistics capability. J-3/4 oversees the daily operation of the DLA Logistics Field Activities. In addition, J-3/4 has primary responsibility for DLA Base Realinment and Closure (BRAC) implementation.

- **Strategic Planning and Enterprise Transformation (J-5)** is DLA's Strategy Management Office, responsible for Agency strategic planning and overall management of enterprise transformation programs. The Director, J-5 communicates and executes the DLA Director's vision and senior leadership's strategies and objectives for attainment of that vision through the DLA Strategic Plan, the Balanced Scorecard, and the DLA Business Plan while aligning with the DoD Risk Score-card and the President's Management Agenda. J-5 is the Director's agent for leading disciplined execution of the strategic change management structure. J-5 ensures horizontal integration and execution of strategy by sponsoring cross-functional processes and collaboration forums for enterprise decision-making.

- **Information Operations (J-6)** is DLA's knowledge broker, and is responsible for providing comprehensive, best practice technological support to the DoD/DLA logistics community, resulting in the highest quality of information systems, efficient and economical computing, data management, electronic commerce, and telecommunication services. The Director, J-6, is responsible for the development and compliance of information technology (IT) policy; the development of IT plans and strategies; and the establishment of IT standards, processes, and measurements. The Director, J-6, also serves as the Agency's Chief Information Officer. Information Operations includes oversight of two field activities: the Defense Logistics Information Service and the Document Automation and Production Service.

- **Acquisition Management (J-7)** is responsible for the development, application, and oversight of DLA acquisition policy, plans, programs, operations, and functional systems.

- **Financial Operations (J-8)** is led by the Agency's Chief Financial Officer and - as the financial management process owner - is the single spokesperson on financial management matters with external organizations. J-8 is responsible for designing, implementing, and executing standard financial processes across the Agency, while determining financial services' resource requirements and performance targets and establishing financial core competency requirements.

- **Joint Reserve Force (JRF) (J-9)** supports DLA with trained, ready, and available reservists, of all reserve components, for contingency operations, peacetime contributory support, wartime surge support, and planning support. Further, J-9 advises the Director, DLA, on the planning and application of JRF support in accordance with DoD and Military Service readiness and activation policies.

- **DLA Enterprise Support (DES)** provides corporate policy, program, and world-wide operational support in the areas of enterprise contracting, environment, safety and occupational health, installation management, public safety, morale welfare and recreation (MWR), and multimedia for DLA. In addition, DES provides operational support to the Headquarters (HQ) DLA (Andrew T. McNamara Complex) building for facilities, security, MWR operations, and Information Technology (IT) contract support for corporate and base contract support for DLA activities in the Washington, DC metropolitan area.

Defense Working Capital Fund

The Defense-wide Working Capital Fund (DWCF) is the primary source of financing for DLA operations. During FY 2007, DLA executed a total budget program of more than $37.2 billion. The four DLA activity groups funded by the DWCF - and included in these statements - are supply management, distribution, reutilization and marketing, and document automation and production. Each year, DLA either obtains or returns funds to the DWCF and other DoD appropriations.

The following activity groups are financed by customer orders and direct appropriations through the DWCF:

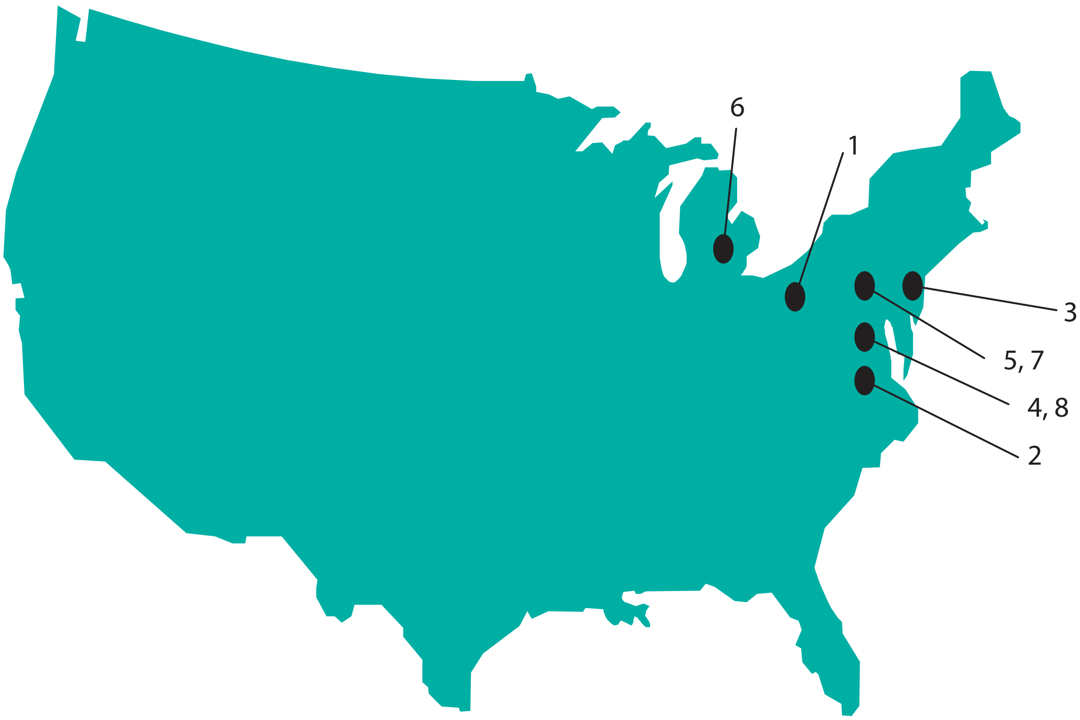
Supply Management: The Supply Management activity group provides customer support through its management of logistics processes. This includes centralized management of logistics catalog information, energy, repair parts, operating supply items, food, pharmaceuticals, medical and surgical supplies, construction materiel and equipment, and clothing and textiles. Supply Management operates through three supply centers located in Columbus, OH; Richmond, VA; and Philadelphia, PA; and the Defense Energy Support Center located at Fort Belvoir, VA. The Supply Management activity group is the largest of our business areas. It makes up about 96% of the assets, 85% of the liabilities, and 93% of revenue and costs on the financial statements.

Distribution: The Distribution activity group provides a single, unified materiel distribution system for DoD. In addition to its primary mission of receiving, storing, and issuing materiel worldwide, distribution depots perform other functions that include - but are not limited to - providing refrigerated storage, cylinder refurbishment, tent repair, medical unit assemblies, kitting, and set assembly or disassembly. The Distribution activity group is under the control of the Defense Distribution Center in New Cumberland, PA, and includes 26 subordinate distribution centers located throughout the United States, Europe, Southwest Asia, and the Pacific region.

Reutilization and Marketing: The Reutilization and Marketing activity group supports and coordinates the disposal of excess and surplus property within DoD. Property not reutilized within DoD is available for transfer to other Federal agencies or for donation to authorized non-profit organizations, state governments, and local governments. Property not reused, transferred, or donated is either sold to the public on a competitive basis or disposed of in an environmentally safe manner. A critical part of the Reutilization and Marketing mission is to arrange for the worldwide disposal of hazardous waste in compliance with law and regulation. The activity group accomplishes its mission from a Headquarters in Battle Creek, MI, and 104 Defense Reutilization and Marketing Offices located on military installations around the world.

Document Automation & Production: The Document Automation & Production Service (DAPS) activity group provides printing, duplicating and document automation services within DoD. This mission encompasses the full range of automated services to include: document workflow conversion, electronic storage and output, and distribution of hard copy and digital information. DAPS' focus is on enabling customers to transition from hardcopy to digital/electronic-based document management. DAPS manages its worldwide mission through its headquarters in Mechanicsburg, PA, and a network of 187 production facilities.

DEFENSE LOGISTICS AGENCY ACTIVITY GROUP PRINCIPAL LOCATIONS



1. Defense Supply Center Columbus (DSCC)
2. Defense Supply Center Richmond (DSCR)
3. Defense Supply Center Philadelphia (DSCP)
4. Defense Energy Support Center (DESC)
5. Defense Distribution Center (DDC)
6. Defense Reutilization and Marketing Service (DRMS)
7. Document Automation & Production Service (DAPS)
8. Defense Logistic Agency Headquarters (DLA HQ)

General Funds and Transaction Fund

DLA also received about $652.9 million in General Funds direct appropriations, which accounted for approximately 2% of DLA's total budget program for FY 2007. These appropriations included: Operation and Maintenance (O&M), Research, Development, Test and Evaluation (RDT&E), Military Construction (MILCON), Procurement, Family Housing Construction, Family Housing O&M and Family Housing Improvement Fund.

The DLA O&M appropriation, $350.8 million, funded two distinct groups: Other Logistics Services (OLS) and Other Logistics Programs (OLP). The OLS group included approximately 30 programs and incurred $285.2 million in costs associated with the DLA logistics mission, such as: Price Comparability, Warstoppers, Hard Copy Map Function, Unemployment, Morale Welfare & Recreation, and Disaster Relief Blankets. In addition, OLS included programs added by either the DoD or Congress, such as Logistics Transformation. The OLP group consisted of approximately eight program offices for which DLA either provided administrative support or had program oversight, such as the Defense Property Accountability System and the Continuity of Operations Program.

The DLA RDT&E appropriation, $216.2 million, primarily supported two types of efforts: Advanced Technology Development (Logistics Research and Development Technology Demonstration and Defense Microelectronics Equipment) and Operational System Development (Industrial Preparedness/Manufactured Technology and Logistics Support Activities).

The DLA MILCON appropriation, $71.8 million, funded major construction projects to replace, renovate, or build new facilities. The Army Corps of Engineers and Naval Facilities Engineering Command are the primary design and construction agents for this program.

The DLA Procurement appropriation, $11.9 million, funded the purchase of mission essential equipment, including automated data processing, telecommunications equipment, microelectronics equipment, and passenger carrying motor vehicles.

The DLA Family Housing O&M appropriation, $1.3 million, supported an inventory of 201 units located at the Defense Supply Center, Richmond, VA (31), the Distribution Depot Susquehanna, PA (140), and the Distribution Depot San Joaquin, CA (30). DLA's Family Housing program consisted of routine operation requirements including management and utility costs, carpet and linoleum replacement, painting, and replacement of appliances. In addition, $0.9 million was made available for several Family Housing Construction projects, which are large-scale renovations and unit replacements.

DLA also manages the National Defense Stockpile Transaction Fund, a separate revolving fund that strives to provide the safe, secure, and environmentally sound stewardship for strategic and critical materiel in the United States National Defense Stockpile. The Transaction Fund and related financial events are not accounted for in these financial statements, but are embedded in the DoD Agency-wide financial statements.

Financial Condition

The financial statements have been prepared to report the financial position and results of operations for DLA, pursuant to the requirements of Title 31, United States Code, Section 3515(b).

While the statements were prepared from the books and records of DLA in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

To the extent possible, the financial statements were prepared in accordance with federal accounting standards. At times, the Department is unable to implement all elements of the standards due to financial management systems limitations. The Department continues to implement system improvements to address these limitations. There are other instances when the Department's application of the accounting standards differs from the auditor's application of the standards. In those situations, the DoD has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent. The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

The Defense Working Capital Fund (DWCF) is a revolving fund that fosters a demand-driven cost-based relationship between customers (primarily the military operating forces) and suppliers (the DoD's business-driven support organizations). In this capacity, the operations of a DWCF activity are financed with the funded orders placed by its customers and satisfied by that activity. The expected outcome of this relationship is the effective and efficient delivery of goods and services. Since the financial structure of the DLA DWCF allows for the identification of the cost to produce goods and services and subsequently set prices, the customer can use both pricing and delivery information in its decision-making process. This visibility also enables DLA managers to use performance measures to ensure that the activities operate consistent with budget execution targets, address program requirements, and foster productivity improvements.

The DLA DWCF finished FY 2007 with total assets valued at approximately $21.1 billion and liabilities of $3.4 billion from the Consolidated Balance Sheet and a net operating gain of slightly less than $600 million on program costs of approximately $35.6 billion and revenues of approximately $36.1 billion from the Consolidated Statement of Net Cost.

The General Funds are appropriated by Congress which also grants authority to the Office of the Secretary of Defense (OSD) and its components to obligate funds and pay for goods and services from their annual budgets. After funds are appropriated, apportioned by OMB, and allotted by the OSD, the funds may be used to acquire goods and services.

The DLA General Funds are comprised of Operation and Maintenance (O&M); Research, Development, Test and Evaluation (RDT&E); Military Construction (MILCON); Procurement; Family Housing Construction; Family Housing O&M; and Family Housing Improvement Fund. Both detail and summary level financial reports are available to provide the information necessary to make suitable management decisions pertaining to the allocation and use of General Funds.

The DLA General Funds finished FY 2007 with total assets valued at approximately $1.1 billion and liabilities of almost $300 million from the Consolidated Balance Sheet.

Systems, Controls, and Auditability

The Defense Logistics Agency (DLA) senior management evaluated the system of internal accounting and administrative controls in effect during the fiscal year and as of the reporting period of July 1, 2006 through June 30, 2007. This evaluation was done in accordance with guidance provided by OMB Circular A-123, "Management's Responsibility for Internal Control," dated August 5, 2005, as implemented by DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," dated January 4, 2006, and DoD Comptroller guidance, "FY 07 Guidance for the Preparation of the Statement of Assurance (SOA)," dated November 2006. The OMB guidelines were issued in conjunction with the Comptroller General of the United States, as required by the "Federal Managers' Financial Integrity Act of 1982." Included was an evaluation of whether the system of internal accounting and administrative controls for DLA complies with standards prescribed by the Comptroller General.

There are three objectives of DLA's system of internal accounting and administrative controls. The first is to provide reasonable assurance that obligations and costs comply with applicable laws. The second is to provide reasonable assurance that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation. Finally, the third is to provide reasonable assurance that revenue and expenditures applicable to Agency operations are properly recorded and accounted for, to permit the preparation of reliable accounting, financial, and statistical reports, and to maintain accountability over assets.

The results indicate that the DLA system of internal accounting and administrative controls, in effect during the FY 2007, taken as a whole, complies with the requirement to provide reasonable assurance that the objectives mentioned above were achieved.

Systems

For most of its history, DLA performed its complex, worldwide logistics mission with strong command and control lines along multiple business segments and programs. Over time, this led to "stovepipe" organizations that developed their own automated management (legacy) information systems and accounting processes.

While these business practices worked well to serve the customer, they also produced a fragmented and very complex set of accounting processes and financial systems. Often these business practices applied accounting methods and systems differently to account for essentially the same types of transactions. As part of our logistics transformation initiatives, we will dramatically improve the accuracy, timeliness, and relevance of the financial management data maintained in our logistics systems.

The Defense Finance and Accounting Service (DFAS) prepared the FY 2007 DLA financial statements from available automated finance, accounting, and feeder systems (such as acquisition, logistics, and personnel systems) and manual processes. Since most of these automated systems were designed decades before the current Federal accounting standards were developed, it is difficult to collect the data needed to prepare financial statements that comply with Federal standards. Additionally, there is often insufficient documentation available to show how financial transactions are processed through those systems. These factors make it impractical to audit the financial statements and for DLA to demonstrate a high level of internal control and compliance with pertinent financial laws and regulations. Lastly, some data comes from DFAS systems that are not linked with DLA systems and cannot easily pass data among other DFAS systems.

DLA has a multitude of short and long-term efforts designed to fully assess its financial operations and to develop integrated systems and processes that are compliant with Federal system and accounting requirements. Two of our major strategies include:

- An upgrade of the DLA supply chain management system (supply/non-energy) was introduced via the Business Systems Modernization (BSM) initiative. BSM was designed to improve business practices and replace aging legacy logistics systems with commercial-off-the-shelf (COTS) enterprise resource planning software that is compliant with Federal Financial Management Improvement Act (FFMIA) of 1996 requirements. This transformation is expected to reduce costs, eliminate systemic deficiencies, and provide the necessary auditability to demonstrate financial stewardship and pass the scrutiny of financial audits. Fully implemented in December 2006, the system introduced by BSM is currently supporting approximately 5.2 million items of supply and 8,000 users.

- The legacy energy supply chain management system was replaced by BSM-Energy (formerly, the Fuel Automated System (FAS)). FAS was an automated information system designed to support the Defense Energy Support Center (DESC) and the Military Services in performing their respective responsibilities in fuels supply chain management. In December 2003, DLA was directed to converge FAS with the DLA core architecture (introduced via the BSM program). This Energy Convergence Program will fully assess all of DESC's supply chain operations and will develop integrated systems and processes that comply with Federal system and accounting requirements.

Management Controls

The Managers' Internal Control (MIC) Program is fully developed at DLA, and the Headquarters (HQ DLA) Business Offices and Field Activities (FA) have continued to make progress in the expanded reporting of weaknesses and controls. DLA continuously reviews current processes and procedures to ensure existing internal controls are in place, working as intended, or are being enhanced. Each directorate, FA, and major office has a MIC Program Monitor assigned to oversee the program. These monitors are responsible for ensuring that their respective organizations follow the prescribed requirements and regulations, as set forth in OMB, DoD, and DLA guidelines; provide assistance regarding the performance of objective assessments; and report weaknesses and concerns arising from those assessments.

DLA MIC Program Monitors annually review risk areas to determine what should be assessed for the coming fiscal year. The objectives are developed and included in the MIC Program for each HQ DLA Directorate and FA; and all assessments are reviewed and approved by senior management and the MIC Program Team, at both the FA and the HQ DLA levels.

MIC Program performance standards are part of DLA's supervisory/managerial performance plans and include MIC Program responsibilities. As part of the DLA Internal Support Review program, updated status reports on MIC program weaknesses and concerns are addressed on a quarterly basis to the DLA senior leadership.

The DLA Senior Assessment Team (SAT) oversees the OMB Circular A-123, Appendix A requirements for the Agency. Appendix A requires - at a minimum – that DLA report on the effectiveness of the key business process internal controls that significantly affect its financial reporting. DoD determined that limiting assessments to key focus areas, which are material to DoD's financial statements, would be the most economical approach and result in significant improvements for its reporting entities. Accordingly, under the leadership and direction of the SAT and the MIC Program Team, DLA Focus Area Leads are responsible for assessing the effectiveness of internal controls over financial reporting and preparing annual statements of assurance that follow strict rules established by DoD. If material weaknesses are discovered, Focus Area Leads are responsible for developing and executing Corrective Action Plans to resolve them. As such, Corrective Action Plans document and fix material weaknesses in internal controls over financial reporting. Progress in executing Corrective Action Plans are reported to the SAT, DoD, and the DLA Corporate Board through Balanced Scorecard metrics at least quarterly. In addition, Corrective Action Plans are reported to the DoD Financial Improvement and Audit Readiness (FIAR) Directorate, through its web-based FIAR tool.

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

Progressing Toward Auditability

Under the leadership and direction of the DLA Audit Committee, the Auditability Working Group (AWG) and its subordinate Issue Resolution Teams (IRTs) are responsible for creating and implementing strategies that both resolve reported audit findings and, perhaps more importantly, documenting the approaches to maintain and sustain auditability. The AWG and IRTs are comprised of senior managers and personnel representing both DLA and the Defense Finance and Accounting Service (DFAS). Each IRT is led by a member of the DLA Process Owner's (Flag Officer/Senior Executive Service level) staff and is responsible for developing and executing a Detailed Work Plan (DWP) to resolve audit impediments in specific areas. As such, DWPs document DLA's approach to fix audit impediments; contain the actions required to document the processes and related internal controls; and identify the steps required to validate the outcome of the corrective actions and prepare the requisite management assertions. Progress in executing the Financial Improvement Plans (FIPs) and Key Milestones (KMs) that are contained in the DWP is reported monthly to the AWG, bi-monthly to the Audit Committee, and quarterly to the DLA Corporate Board through DLA's Balanced Scorecard metrics. In addition, KMs are reported to the FIAR Directorate through its web-based tool and included in the DoD FIAR Plan – the Department's comprehensive approach to achieve DoD-wide auditability. DLA updates the FIAR tool – on a monthly basis – with the status of its key milestones.

As DLA progresses towards audit readiness, the importance of systems - within the business processes - and the reliance on the controls in and around those systems become more and more apparent. DLA has a complex Financial Systems Architecture comprised of systems owned by separate and autonomous organizations (DLA, Business Transformation Agency, Defense Finance and Accounting Service and other Components). Consequently, ensuring that adequate controls are embedded in and around these systems is a significant task; and because DLA-owned systems are undergoing revolutionary changes (legacy systems were replaced and its enterprise resource planning system, Enterprise Business System, is undergoing a significant software upgrade), control issues are even more difficult to manage. However, DLA is working to ensure that management can assert that no material control weaknesses exist in its systems and that data extractions and system documentation are readily available for auditors. The complexity of the DLA Financial Systems Architecture, the revolutionary nature of the on-going changes to the DLA enterprise resource planning system, and the recent automated control corrective action plans - resulting from OMB-123, Appendix A testing - are a few of the key challenges that DLA will need to be overcome before asserting that the Agency is ready for audit.

Additionally, following months of discussions with the Government Accountability Office and OMB, in mid-FY 2007 the Department revised its audit readiness strategy approach from making Balance Sheet line items auditable to a segmentation approach. DLA is implementing this new approach by identifying each end-to-end business process and assigning those business processes to DLA senior-level executives, the process owners. The business processes identified include: Procure to Pay; Order to Cash; Inventory; Plan to Execution (Budget); Environment Management; Funds Balance With Treasury; Hire to Retire; Property, Plant and Equipment Management; and Record to Report. This approach considers the business processes as an auditor would during a financial statement audit. The IRT structure is being modified to provide support to the various business process owners. An IRT's responsibilities will include creating, reviewing, and revising DWPs - and the embedded KMs and FIPs - to cover the end-to-end business processes.

As of the 3rd Quarter, FY 2007, IRT leads reported that 66 KMs and 182 FIPs are open, tracked, and reported through Balanced Scorecard metrics. Additionally, as a result of testing required by OMB Circular A-123, Appendix A, an additional 111 new FIPs were established to account for the Corrective Action Plans needed to revise or enhance an already existing control, or implement a new control.

Financial Improvement and Audit Readiness (FIAR) Initative

In support of the strategic objective to demonstrate readiness for financial statement audit, DLA continues to execute a comprehensive – yet fluid – approach to achieve auditability. DLA follows the six phase process contained in the DoD Comptroller's Business Rules that culminates with a financial statement audit. The six phases are: 1) Discovery and Correction, 2) Segment Assertion, 3) Audit Readiness Validation, 4) Audit Readiness Sustainment, 5) Financial Statement Assertion, and 6) Financial Statement Audit. DLA is responsible for phases 1, 2, 4, and 5, while the DoD Inspector General is responsible for 3 and 6. During FY 2007, DLA engaged the services of a commercial firm that assisted with implementation of corrective action and preparation of process documentation required by both the DoD Comptroller's Business Rules and the Office of Management and Budget's (OMB) Circular A-123. DLA's plan to achieve auditable financial statements is continually updated/revised as progress is made toward these goals or as circumstances warrant.

Other Accompanying Information

Forward Logistics: Forward Logistics is the net sum of the DLA Enterprise efforts to perform end-to-end supply chain management on the eight DLA supply chains--Aviation, Maritime, Land, Construction & Equipment, Subsistence, Clothing & Textiles, Medical, and Energy. In managing these supply chains, DLA's efforts in FY 2007 focused on supporting two of DLA's Strategic Goals: extending the Enterprise and continuing to improve performance. The Enterprise accomplishments include those outlined in the discussion of Retail Integration, as well as building on/expanding the Customer Demand Collaboration initiative begun under the BSM/EBS program. Looking forward, we see these efforts (retail integration and customer demand collaboration) coalescing into a collaboratively extended supply chain with close involvement of customer requirements generators and ultimate consumers of DLA's goods and services.

Reverse Logistics: Reverse Logistics in DLA consists primarily of two components: the Materiel Returns Program, which equates to the 'Return' process of the Supply Chain Operations Reference Model of supply chain management, and the reutilization services performed by the Defense Reutilization and Marketing Service (DRMS). Under the Materiel Returns Program, customers return materiel that they no longer need to the wholesale supply chain to support a future customer's requirements. These assets, in turn, preclude the need to initiate procurement actions to acquire assets to meet projected requirements, thus improving both the efficiency and effectiveness of supply chain management. The DRMS reutilization mission, which is described in detail separately, primarily involves receiving materiel that is no longer needed by a component of the DoD and making it available to all of the components of the DoD. These efforts optimize the use of materiel that is available for use by the DoD and helps minimize the investment in inventory.

Retail Integration: Retail integration is a transformational program to extend the DLA enterprise closer to the warfighter; and where DLA becomes a manager of complete supply chains – versus a manager of wholesale supplies. Instead of merely operating as a wholesaler, DLA will take supply ownership and management from the factory to the ultimate customer. Using Department-wide initiatives (such as the National Inventory Management Strategy (NIMS), Joint Regional Inventory Materiel Management, Joint Environmental Materiel Management, and the Base Realignment and Closure supply, storage and distribution concepts), DLA will replace distinct wholesale and retail inventories with a national inventory that can be managed in a more integrated manner. Through FY 2007, DLA has rolled-out NIMS to six locations: the Joint Environmental Materiel Management Service Center, Okinawa (June 2002); Naval Station Ingleside, TX (July 2003); Naval Air Station Whidbey Island, WA (August 2005); Naval Air Weapons Station China Lake, CA (February 2006); Marine Corps Air Station Miramar, CA (February 2006); and Naval Auxiliary Landing Field San Clemente, CA (February 2006). NIMS provides better demand visibility, increases supply availability and reduces customer wait-time. As the strategy becomes more fully integrated into our business systems, benefits will include: further reductions to customer wait-times, higher levels of supply readiness, more tailored logistics support solutions, improved inventory and customer demand visibility, greater optimization of the supply chain, better use of available resources (including lower overall DoD inventory and inventory management costs), and a reduction in the Military Services' inventory investments without reducing support.

Executive Agent (EA): An Executive Agent is defined as "The Head of a DoD Component to whom the Secretary of Defense or the Deputy Secretary of Defense has assigned specific responsibilities, functions and authorities to provide defined levels of support for operational missions, or administrative or other designated activities that involve two or more of the DoD Components." The Deputy Secretary of Defense has designated the Director of DLA as the Executive Agent for Subsistence (Class I), Bulk Petroleum (Class III B), Construction and Barrier Materiel (Class IV), and Medical Materiel (Class VIII). Accomplishments by DLA as the Executive Agent are as follows:

- **For Class I (Subsistence):** 1) jointly established supply chain readiness standards and metrics for continuous assessment and reporting of end-to-end supply chain performance based on Mission Essential Tasks of the Defense Readiness Reporting System; 2) engaged the Combatant Commands to optimize sustainment supportability and planning; 3) jointly identified 76 supply chain gaps and seams to be addressed by the EA Working Groups - after conducting a Humanitarian Assistance/ Disaster Relief and Migrant Operation Review of Concept (ROC) drill with the Pacific Command (USPACOM) and the Southern Command (USSOUTHCOM); 4) obtained Joint Subsistence Policy Board approval on proposed resolutions to five supply chain gaps; 5) completed Pre-Pilot Test of the Common Food Management System.

- **For Class III (B) (Bulk Petroleum):** 1) initiated a life-cycle management program for receipt meters procured for tactical locations in the Central Command (USCENTCOM) Area of Responsibility; 2) achieved a common petroleum requirements generation methodology and tool through the Integrated Consumable Item Support system; 3) finalized performance-based joint specifications for tactical fuel bladders (multiple sizes) and assisted in initiating First Article Test (FAT) for the procurement of 210,000 gallon bladders for use by the Military Services; 4) funded FAT for the Tactical Automated Tank Gauge as the community standard for improving inventory measurement in tactical Defense Fuel Supply Points; 5) studied system interfaces and data element utilization for the purpose of simplifying/leveraging single-input information; and 6) developed a Terminal Operation Services basic module to be used as the foundation for fuel terminal contracts established by the Defense Energy Support Center and the Military Services.

- **For Class IV (Construction and Equipment)**: 1) jointly identified supply chain gaps and seams to be addressed by the EA Working Group after conducting a Humanitarian Assistance/Disaster Relief and Migrant Operation ROC drill with USPACOM and USSOUTHCOM; 2) developed a requirements forecasting and management planning concept; and 3) deployed a Troop Support Planner to the USCENTCOM Area of Responsibility.

- **For Class VIII (Medical Materiel):** 1) obtained the Chairman of the Joint Chiefs of Staff's approval for deploying Theater Lead Agents for Medical Materiel (TLAMMs) in the Northern Command (USNORTHCOM) and USSOUTHCOM. TLAMMs are now in all Geographic Combat Commands; 2) conducted a second ROC drill with USPACOM, USNORTHCOM, and USSOUTHCOM; 3) initiated Memorandums of Agreement for Medical Planners in Geographic Combatant Commands; 4) initiated the development of the Functional Executive Agent Medical Support system; 5) established Performance Based Agreements with Navy to improve collaboration/support aboard hospital ships; and 6) completed a study, the Medical Materiel Readiness Assessment II.

Business Systems Modernization (BSM): The re-engineering of DLA's internal materiel management processes to best business practices by replacing decades-old software with commercial-off-the-shelf solutions. BSM was the engine or heart of the transformation. It delivered an integrated set of software applications running on a single hardware platform which Agency transformational initiatives will leverage, as they are developed and deployed. Tangible benefits BSM brings to the warfighter include: improved materiel availability, reduced customer wait time, reduced cost, and improved data integrity.

Enterprise Business System (EBS): DLA's Enterprise Business System (EBS) capabilities will continue to be leveraged as a major transformation initiative. It will expand capabilities and benefits introduced under the Business Systems Modernization (BSM) Program by delivering additional standard systems and business processes through the integration of a family of software applications. The Agency will continue to leverage best practices and its commercially-based Commercial Off-the-Shelf (COTS) infrastructure to enable DLA to extend its EBS capabilities outward throughout the DoD supply chain. EBS will integrate DLA's (previously) program-focused IT initiatives into an enterprise capability-focused solution. Specifically, the Agency will leverage its existing core enterprise architecture components (SAP-based Enterprise Resource Planning (ERP) tool, Distribution Standard System (DSS), and Integrated Data Environment (IDE)) to enable a single, integrated, capability-based system that is accessible and of value to warfighters across the enterprise.

- **Energy Convergence:** As DLA's enterprise is extended across the DoD supply chain, a technology insertion effort is needed to enable the SAP Industry Solution Public Sector and the SAP Industry Solution Oil & Gas solutions to coexist in support of the Defense Energy Support Center (DESC) mission requirements. At the highest level DESC business processes and other DLA supply chain operations appear similar, but at a more detailed level there are significant differences. Energy Convergence will allow DLA to integrate fuels commodity management within the DLA Enterprise Architecture.

- **Enterprise Operational Accounting System (EOAS):** EOAS is a planned post-production enhancement that will add all operational accounting functions into EBS. The result will be an enterprise-wide financial system that complies with federal government accounting standards.

- **eProcurement:** A planned post production enhancement that will integrate the SAP Government Procurement software into EBS, replacing remaining legacy contract writing systems. This initiative will standardize DLA procurement and contract writing capabilities and provide state-of-the-art decision planning tools. It will position the Agency to assume depot level repairable (DLR) procurement responsibility from the services as a result of the latest Base Realignment and Closure (BRAC) recommendations.

- **Distribution Planning and Management System (DPMS):** GOTS/COTS software solution that improves the coordination, visibility, and positioning of supplies and equipments. The result is better management of product movement from vendors to DLA customers and from DLA distribution centers to DLA customers. DPMS provides DLA with the means to continuously collect and access real-time information on the location, movement and status of equipment and supplies. Access to this information facilitates the seamless flow of materiel from the point of origin to the point of consumption.

- **Reutilization Modernization Program (RMP):** DLA's strategy to replace the current Defense Reutilization and Marketing Service (DRMS) information technology (IT) systems with a solution based on best-business practices, COTS, and best of breed software products. RMP will integrate and leverage the DLA Enterprise Business System (EBS) and Distribution Standard System (DSS) to transform the DRMS business area. This integration will incorporate DRMS information needs into the DLA end-state architecture.

Base Realignment and Closure (BRAC) 2005: DLA is responsible for developing and executing policies and procedures, and in addition manages the implementation of the BRAC 2005 recommendations related to Depot-Level Reparable (DLR) Procurement Management Consolidation (including Consumable Item Transfer (CIT)); Supply, Storage, and Distribution (SS&D) Management Reconfiguration; Commodity Management Privatization; and discretionary location moves. The DLR and CIT realignment will enable DoD to leverage its buying power, promote better materiel prices, and reduce labor and disposal costs by consolidating the management of DLR procurements and most consumable items. By consolidating SS&D functions within DLA, the Department will achieve economies of scale and efficiencies that will make logistics support to the operational forces more effective. Commodity Management Privatization creates long-term contracts with private industry for the inventory management and distribution of all tires, packaged petroleum, oils, lubricants, and compressed gasses used by the DoD. This approach will provide more responsive supply support and eliminate the related excess infrastructure and personnel costs. Lastly, the discretionary location moves include the relocation/realignment of customer service representatives, Document Automation & Production Service offices, Defense Reutilization and Marketing Service activities, and fuel sites in response to other BRAC changes occurring at Military Service locations.

Reservists: Among the manpower available to DLA were 756 reservists - authorized and funded by the Military Services. The reservists are utilized by DLA in a variety of capacities in support of peacetime operations, contingencies, and wartime surges. Since September 11, 2001, the wartime surges were supported with the mobilization of 408 reservists who served a total of 568 tours of duty in support of Operations ENDURING FREEDOM and IRAQI FREEDOM in the Global War on Terrorism. During FY 2007, 50 reservists mobilized and provided support to DLA's three Contingency Support Teams (DCSTs) in Kuwait, Iraq, and Afghanistan, while 15 reservists staffed the Sustainment Division of the U.S. Central Command's Deployment and Distribution Operations Center. Collectively, activated reservists logged more than 27,000 man-days of support to DCSTs, field activities, and headquarters missions. In addition, to those deployed overseas, reservists provided more than 8,000 man-days of operational support to the various stateside DLA activities during their statutory annual training.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Consolidated and Combined Financial Statements

As of and for the Years Ended September 30, 2007 and 2006

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Balance Sheets
As of September 30, 2007 and 2006
(In Thousands)

	2007	2006
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Accounts Receivable (Note 4)	$ 932,515	$ 857,284
Other Assets (Note 5)	124,925	124,925
Total Intragovernmental Assets	1,057,440	982,209
Cash and Other Monetary Assets (Note 6)	7,421	12,100
Accounts Receivable, Net (Note 4)	489,224	570,080
Inventory and Related Property, Net (Note 7)	17,516,903	17,913,093
General Property, Plant, and Equipment, Net (Note 8)	1,938,422	1,920,819
Other Assets (Note 5)	43,629	60,341
TOTAL ASSETS	21,053,039	21,458,642
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	90,388	93,288
Other Liabilities (Notes 12 & 13)	64,757	86,885
Total Intragovernmental Liabilities	155,145	180,173
Accounts Payable (Note 10)	2,751,119	3,032,382
Military Retirement and Other Federal		
Employment Benefits (Note 14)	235,596	253,172
Environmental and Disposable Liabilities (Note 11)	72,644	104,136
Other Liabilities (Notes 12 & 13)	149,449	246,998
TOTAL LIABILITIES	3,363,953	3,816,861
NET POSITION		
Cumulative Results of Operations – Other Funds	17,689,086	17,641,781
TOTAL NET POSITION	17,689,086	17,641,781
TOTAL LIABILITIES AND NET POSITION	$ 21,053,039	$ 21,458,642

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Statements of Net Cost
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 15)

	2007	2006
PROGRAM COSTS		
Gross Costs	$ 35,587,003	$ 35,161,318
(Less: Earned Revenue)	(36,148,078)	(35,759,143)
Net Program Costs	(561,075)	(597,825)
NET COST OF OPERATIONS	$ (561,075)	$ (597,825)

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 16)

	2007	2006
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 17,641,781	$ 16,184,286
Prior Period Adjustments:		
Corrections of Errors (+/-)	-	124,925
Beginning Balances, as adjusted	17,641,781	16,309,211
Budgetary Financing Sources:		
Appropriations used	489,316	681,678
Transfers-in/out without reimbursement (+/-)	(374,904)	16,165
Other Financing Sources:		
Donations and forefeitures of property	2,710	-
Transfers-in/out without reimbursement (+/-)	(782,613)	(109,083)
Imputed financing from costs absorbed by others	151,721	145,986
Total Financing Sources	(513,770)	734,746
Net Cost of Operations (+/-)	(561,075)	(597,824)
Net Change	47,305	1,332,570
Ending Balances	17,689,086	17,641,781
UNEXPENDED APPROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	489,385	2,147,051
Appropriations transferred-in/out (+/-)	-	(1,465,200)
Other adjustments (rescissions, etc.) (+/-)	(69)	(173)
Appropriations used	(489,316)	(681,678)
Ending Balances	-	-
NET POSITION	$ 17,689,086	$ 17,641,781

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

		2007		2006
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources:				
Unobligated balance, brought forward, October 1	$	(30,820)	$	(35,476)
Recoveries of prior year unpaid obligations		438,636		446,035
Budget authority:				
Appropriation		489,385		2,147,051
Contract authority		36,589,729		33,797,628
Spending authority from offsetting collections:				
Earned				
Collected		34,015,324		34,627,477
Change in receivables from Federal sources		47,316		11,761
Change in unfilled customer orders				
Advance received		(95,521)		(11,219)
Without advance from Federal sources		1,893,299		685,356
Subtotal		72,939,532		71,258,054
Nonexpenditure transfers, net, anticipated and actual		(374,904)		(1,449,329)
Permanently not available		(36,059,827)		(36,099,085)
Total Budgetary Resources	$	36,912,617	$	34,120,199

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

	2007	2006
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 36,936,465	$ 34,151,019
Subtotal	36,936,465	34,151,019
Unobligated balance:		
Apportioned	(23,848)	(30,820)
Subtotal	(23,848)	(30,820)
Unobligated balance not available	-	-
Total Status of Budgetary Resources	36,912,617	34,120,199
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	13,840,700	15,342,337
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(5,294,115)	(4,596,998)
Total unpaid obligated balance	8,546,585	10,745,339
Obligations incurred net (+/-)	36,936,465	34,151,019
Less: Gross outlays	(33,377,915)	(35,206,622)
Less: Recoveries of prior year unpaid obligations, actual	(438,636)	(446,035)
Change in uncollected customer payments from Federal sources (+/-)	(1,940,616)	(697,116)
Obligated balance, net – end of period		
Unpaid obligations	16,960,614	13,840,700
Less: Uncollected customer payments from Federal sources (+/-)	(7,234,730)	(5,294,115)
Total unpaid obligated balance, net, end of period	9,725,884	8,546,585
Net Outlays:		
Gross outlays	33,377,915	35,206,622
Less: Offsetting collections	(33,919,803)	(34,616,258)
Net Outlays	$ (541,888)	$ 590,364

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Notes to the Consolidated and Combined Financial Statements

For the Fiscal Year Ended September 30, 2007 and 2006

Note 1. Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Defense Logistics Agency (DLA) Working Capital Fund (WCF), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of DLA in accordance with the Department of Defense (DoD) Financial Management Regulation (FMR), the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible generally accepted accounting principles (GAAP). Effective 4th Quarter, Fiscal Year (FY) 2006, DoD no longer publishes consolidating/combining financial statements. The accompanying financial statements account for all WCF resources for which DLA is responsible unless otherwise noted.

The DLA is unable to fully implement all elements of GAAP and the OMB Circular A-136 due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The DLA has deployed a fully integrated Enterprise Resource Planning (ERP) system to a major portion of its business. The Enterprise Business System (EBS) reached full operational capability in July 2007 and is capable of fully supporting financial transactions and of delivering GAAP financial statements. However, a portion of the information fed to the ERP still derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic 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 GAAP. The DLA continues to implement process and system improvements addressing these limitations.

The DoD currently has several auditor identified financial statement material weaknesses. Of these, the DLA WCF has the following: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Unsupported Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant, and Equipment, (7) Governmental Property and Material in Possession of Contractors, (8) Inventory and (9) Accounts Payable.

B. Mission of the DLA

The DLA's primary mission is to provide best value logistics integrated solutions to meet the needs of America's Armed Forces and other designated customers in peace and in war around the clock, around the world. Support begins with joint planning for parts used in new weapons systems, extends through production and contract support, distribution and warehousing, and concludes with the disposal of materiel that is obsolete, worn out, or no longer needed.

The DLA provides supply support, technical/logistics services and quality support to all branches of the Military and other nonDoD customers. The services provided fall into the following activity groups: Supply Management, Defense Distribution Center (DDC), Defense Reutilization and Marketing Service (DRMS), and Document Automation and Production Service (DAPS). Supply Management is comprised of NonEnergy and Energy. NonEnergy supply is further divided into the following supply chains: Clothing and Textiles, Medical, Subsistence, Construction and Equipment, Aviation, Land, and Maritime.

C. Appropriations and Funds

The DLA WCF receives its appropriations and funds as working capital funds. The DLA uses these appropriations and funds to execute its missions and subsequently report on resource usage.

The DLA WCF received its initial working capital corpus through an appropriation or a transfer of resources from existing appropriations or funds; those capital resources are used to finance the operations and transactions that flow through the fund. The WCF resources the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and are generally available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus and to fund contingency operations and nonbusiness like activities.

The DLA WCF is provided two forms of budgetary authority: contract authority and anticipated reimbursement authority. The DLA's Supply Management, DDC, and DRMS activity groups are provided contract authority for both operations and capital programs. The DAPS activity is provided anticipated reimbursement authority for its operations and contract authority for its capital programs. Contract authority allows for the incurring of obligations prior to receipt of customer orders. In contrast, anticipated reimbursement authority requires the receipt of customer orders prior to incurring obligations. Contract authority must subsequently be liquidated through the receipt of customer orders, appropriations or transfers.

D. Basis of Accounting

For FY 2007, DLA's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DLA's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of DLA's legacy systems were designed to record information on a budgetary basis.

The DoD has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Starting in 2001, DLA undertook a major initiative to implement an ERP system. This effort, known as EBS, became fully operational as of July 2007. The DLA plans to expand EBS, a USSGL compliant system, to all WCF activities. Until all of DLA's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DLA's financial data will be derived from budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DoD identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The DoD is working towards a cost reporting methodology that meets the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government.

E. Revenues and Other Financing Sources

DLA WCF activities recognize revenue from the sale of inventory items and services.

The DLA does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Note 18, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

F. Recognition of Expenses

For financial reporting purposes, DLA's policy requires the recognition of operating expenses in the period incurred. However, because DLA financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue.

G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, DLA cannot accurately eliminate intragovernmental transactions by customer because all of DLA's systems do not track at the transaction level. Generally, seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. IntraDoD intragovernmental balances are then eliminated. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements to ensure accurate intragovernmental information, to include sufficient up-front edits and controls eliminating the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government, and the U.S. Treasury's Federal Intragovernmental Transactions Accounting Policy Guide provide guidance for reporting and reconciling intragovernmental balances. While DLA is unable to fully reconcile intragovernmental transactions with all federal partners, DLA is able to reconcile balances pertaining to Federal Employees' Compensation Act transactions with the Department of Labor and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the U.S. Treasury does not allocate such interest costs to the benefiting agencies.

H. Transactions with Foreign Governments and International Organizations

Each year, DLA sells defense articles and services to foreign governments and international organizations under the provisions of the Arms Export Control Act of 1976. Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the U.S. Government. Payment in U.S. dollars is required in advance.

The DLA's fuel transactions with foreign governments are made under fuel exchange agreements (FEAs). The FEAs, also known as replacement in kind agreements, are international acquisition and cross-servicing agreements established between DLA and the military departments of other nations. The DLA utilizes FEAs to account for fuel provided by foreign militaries to the U.S. Military as well as fuel provided by DLA to other nations. Settlement can be made either in fuel or cash. For cash settlements, the agreements typically call for reciprocal pricing (i.e. prices cannot be more than the participants charge their own military). The DLA charges DoD standard prices to foreign militaries.

I. Funds with the US Treasury

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

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records this information to the applicable fund balance with treasury account. Appropriations are suballocated to DLA by DoD and, as such, are not separately identifiable by the U.S. Treasury. Therefore, differences between U.S. Treasury and the DoD balances are reconciled at the DoD level.

J. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based on the Analysis of Receivables by Age Group method except for the Energy business area which uses the General Reserve method based on bad debt experience. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual at http://www.fms.treas.gov/tfm/vol1/07-03.pdf.

Exchange transactions such as FEAs must be settled through the issuance or receipt of replacement supplies or services within 12 months of the original transaction according to current DoD policy. As the settlement of the exchange transactions is authorized to take up to 12 months, the analysis of the nonfederal accounts receivable balances greater than 180 days old could be distorted. To assist in the analysis, Note 4, Accounts Receivable, separates FEA transaction balances from the remainder of the nonfederal accounts receivable. Currently, upon reconciliation the purchases of fuel from foreign governments are netted against their accounts receivable balances. This methodology is being reviewed during FY 2008 for conformance with GAAP.

K. Inventories and Related Property

The DLA values approximately 71% of its resale inventory using the moving average cost method. An additional 29% (fuel inventory) is reported using the first-in-first-out method.

The DLA manages only military or government specific materiel under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DLA materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DLA holds materiel based on military need and support for contingencies. The DoD does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future sale" based on SFFAS No. 3 definitions, unless otherwise noted.

The DLA recognizes condemned materiel as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned materiel is zero. Potentially redistributed materiel, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by DLA. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. Often, it is more economical to repair these inventory items rather than to procure these items. The DLA often relies on weapon systems and machinery no longer in production. As a result, DLA supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Work in process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead, and other direct costs. Work in process also includes the value of finished products or completed services that are yet to be placed in service and transferred to an asset account.

L. General Property, Plant, and Equipment

In FY 2006, DoD revised the real property capitalization threshold from $100 thousand to $20 thousand. The current $100 thousand capitalization threshold remains unchanged for the remaining General PP&E categories. The DLA has not fully implemented this revised policy due to system and process limitations.

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

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15 thousand, $25 thousand, and $50 thousand for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below $100 thousand was written off of the General Fund financial statements in FY 1998. No adjustment was made for WCF assets that remain capitalized and reported on WCF financial statements. The heritage assets and stewardship land maintained at DLA WCF installations and other related material disclosures are provided in Note 8, General PP&E, Net.

When it is in the best interest of the government, DLA provides government property to contractors to complete contract work. The DLA either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, federal accounting standards require that it be reported on DLA's Balance Sheet.

The DoD is developing new policies and a contractor reporting process for Government Furnished Equipment that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, DLA reports only government property in the possession of contractors that is maintained in DLA's property systems. The DoD has issued new property accountability and reporting requirements that require DLA to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards. The DLA has not fully complied with this revised policy due to system and process limitations.

M. Advances and Prepayments

The DoD's policy is to record advances and prepayments in accordance with GAAP. As such, payments made in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The DLA follows DoD's policy to expense and/or properly classify assets when the related goods and services are received.

N. Leases

The DLA has contracted with a third party to review DLA's leases to determine if they are capital leases. The DLA's effort to identify all lease agreements at our field sites was projected to be completed in the 4th Quarter, FY 2007. As part of our discovery effort, we found that this project was more complex than originally planned. As a result, the project required additional time and funding. After researching all the facts, DLA was able to fully assess and determine the requirements for the lease efforts. The project then began in 4th Quarter, FY 2007 with completion scheduled for 4th Quarter, FY 2008. The DLA is developing guidance which will be issued in a subsequent period to appropriately record capital leases in the financial statements.

O. Other Assets

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on DLA's Balance Sheet.

The DLA 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 may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property are reported as construction in progress. It is DoD policy to record certain contract financing payments as Other Assets.

P. Contingencies and Other Liabilities

The SFFAS No. 5, Accounting for Liabilities of the Federal Government, as amended by SFFAS No. 12, Recognition of Contingent Liabilities Arising from Litigation, defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DLA recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

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

Other liabilities arise as a result of anticipated disposal costs for DLA's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, Accounting for Property, Plant, and Equipment, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon DoD's policy, which is consistent with SFFAS No. 5, Accounting for Liabilities of Federal Government. The DLA has not fully implemented these policies due to system and process limitations.

Q. Accrued Leave

The DLA reports as liabilities civilian earned leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. As a WCF activity, DLA is required to fund civilian accrued annual leave earned but not taken. Sick leave is expensed as taken. The liability reported at the end of the accounting period reflects the current pay rates.

R. Net Position

Net Position consists of cumulative results of operations. Cumulative results of operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfer in and out of assets without reimbursement.

S. Unexpended Obligations

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

T. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in DLA's activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the monthly accounting reports. Intransit payments are those payments that have been made, but have not been recorded in the fund holder's accounting records. These payments are applied to the entities' outstanding accounts payable balance. Intransit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

U. Significant Events

Beginning 4th Quarter, FY 2007, DoD began presenting the Statement of Financing (SOF) as a note in accordance with the OMB Circular A-136. The SOF will no longer be considered a basic statement and is now referred to as "Reconciliation of Net Cost of Operations to Budget."

Note 2. Nonentity Assets

As of September 30	2007		2006	
(Amounts in thousands)				
Nonfederal Assets				
Cash and Other Monetary Assets	$	7,421	$	7,970
Accounts Receivable		3,077		2,481
Total Nonfederal Assets	$	10,498	$	10,451
Total Nonentity Assets	$	10,498	$	10,451

Nonentity accounts are assets for which DLA maintains stewardship and accountability to report, but are not available for DLA's operations.

The Cash and Other Monetary Assets consists of cash collected by the Defense Reutilization and Marketing Service (DRMS) that will be paid to other entities. When DRMS enters into a long-term contract with a buyer purchasing excess/surplus government property or scrap, DRMS requires a prepayment. After contract closeout, any remaining balance is refunded to the sales contractor. Also included are credit card collections that are payable to DRMS' commercial sales partner and the portion of sales proceeds from certain types of property that DRMS is required to return to the Military Services or Defense Agencies that originally owned the property.

The Nonfederal Accounts Receivable consists of interest, penalties, and administrative fees that are related to the nonfederal accounts receivable that have been referred to Defense Finance and Accounting Service debt management for collection. This amount is nonentity because upon collection the amount will be transferred to U.S. Treasury.

Note 3. Fund Balance with Treasury

The U.S. Treasury maintains and reports the Defense Working Capital Fund (DWCF) fund balances at the Treasury Index (TI) appropriation sub-numbered level. Defense Agencies, to include DLA, are included at the TI 97 DWCF appropriation sub-numbered level, an aggregate level that does not provide identification of the separate Defense Agencies by U.S. Treasury. Additionally, while DLA maintains collections and disbursement clearing accounts, those cash balances are transferred to the DWCF cash account on an annual basis. As a result, DLA does not report Fund Balance with Treasury (FBWT) separately. The DLA balance in the DWCF cash account as of the 4th Quarter, FY 2007 is $1.6 billion.

Status of Fund Balance with Treasury

As of September 30	2007		2006	
(Amounts in thousands)				
Unobligated Balance Available	$	(23,848)	$	(30,820)
Obligated Balance not yet Disbursed	$	16,960,614	$	13,840,699
NonFBWT Budgetary Accounts	$	(15,377,069)	$	(12,906,483)
Total	$	1,559,697	$	903,396

Unobligated Balance, Available shows an abnormal balance of $23.8 million. This abnormal balance exists because prior to 4th Quarter, FY 2003, Document Automation and Production Service processed its budgetary reports as if contract authority was used for operating authority. The use of contract authority accounting was determined to be incorrect and an adjustment was made at year end in FY 2003, resulting in an abnormal balance in Unobligated Balance. The abnormal balance is being resolved over time.

The Status of Fund Balance with Treasury reflects the budgetary resources to support the FBWT.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represent adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

NonFBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT. DLA's NonFBWT Budgetary Accounts consist of contract authority, accounts receivable and the accounts for unfilled orders without advance from customers. This category reduces the Status of FBWT.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. There are no restrictions on DLA's unobligated balances.

The DLA's FBWT is zero as the net of DLA's current year disbursements, collections, cash transfers, and appropriations received are transferred to the DWCF cash account. The Total Status of Funds represents what DLA's FBWT would have been if the transfers to the cash account had not taken place.

Disclosures Related to Problem Disbursements

As of September 30	2005	2006	2007	(Decrease)/ Increase from FY 2006 to 2007
(Amounts in thousands)				
Total Problem Disbursements, Absolute Value				
Unmatched Disbursements (UMDs)	$ 70,884	$ 66,862	$ 43,760	$ (23,102)
Negative Unliquidated Obligations (NULO)	564	1,603	2,053	450
In-Transit Disbursements	704,572	328,723	369,941	41,218
Total	$ 776,020	$ 397,188	$ 415,754	$ 18,566

Problem Disbursements are reported as an absolute value amount. Absolute value is the sum of the positive values of debit and credit transactions without regard to the plus or minus signs.

An Unmatched Disbursement occurs when a payment is not matched to a corresponding obligation in the accounting system.

A Negative Unliquidated Obligation occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The Intransits represent the absolute value of disbursements and collections made by a Department of Defense disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

Beginning with 2nd Quarter, FY 2007, intransit disbursements are reported as an absolute value as opposed to net amounts disclosed in prior years. This reporting change applies to amounts in the note schedule for both the current and comparative years.

Note 4. Accounts Receivable

As of September 30	2007			2006
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
Intragovernmental Receivables	$ 932,515	N/A	$ 932,515	$ 857,284
Nonfederal Receivables (From the Public)	$ 514,102	$ (24,878)	$ 489,224	$ 570,080
Total Accounts Receivable	$ 1,446,617	$ (24,878)	$ 1,421,739	$ 1,427,364

Aged Accounts Receivable

As of September 30	2007		2006	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
(Amounts in thousands)				
CATEGORY				
Nondelinquent				
Current	$ 1,079,146	$ 172,862	$ 738,330	$ 185,897
Noncurrent	204,285	132,869	189,408	111,447
Delinquent				
1 to 30 days	$ 56,165	$ 65,901	$ 34,135	$ 93,064
31 to 60 days	25,071	14,014	21,348	23,998
61 to 90 days	36,680	11,864	1,541	52,032
91 to 180 days	26,342	32,215	17,800	42,525
181 days to 1 year	20,120	37,654	23,570	50,526
Greater than 1 year and less than or equal to 2 years	21,649	21,695	19,560	35,725
Greater than 2 years and less than or equal to 6 years	12,324	12,794	10,023	13,480
Greater than 6 years and less than or equal to 10 years	(43)	11	(12)	1,245
Greater than 10 years	0	0	0	1,443
Subtotal	$ 1,481,739	$ 501,879	$ 1,055,703	$ 611,382
Less Supported Undistributed Collections	(8,931)	12,223	(56,447)	(7,871)
Less Eliminations	(217,124)	0	(141,973)	0
Less Other	(323,169)	0	0	0
Total	$ 932,515	$ 514,102	$ 857,283	$ 603,511

Abnormal Balance

Intragovernmental delinquent balance greater than 6 years and less than or equal to 10 years is $42.5 thousand. The credit is for a refund receivable due to a customer that was not posted in the accounting system prior to the conversion of accounting records from our legacy system to the Enterprise Business System.

Nondelinquent Noncurrent Accounts Receivable

Intragovernmental nondelinquent noncurrent accounts receivable of $204.3 million consists of the Heavy Equipment Procurement Program ($127.2 million), Military Interdepartmental Purchase Requests ($15.5 million), and the Department of Defense Electronic Mall credit card collections ($61.6 million). The matching of collections to the billings for these programs is a manual, time intensive process. Historically DLA has found these bills have already been collected, but not yet matched to open receivables. Therefore, for delinquency reporting purposes, these programs are categorized as nondelinquent noncurrent. The DLA and the Defense Finance and Accounting Service Columbus (DFAS--CO) are working to automate this matching process to reduce the noncurrent accounts receivables.

Nonfederal nondelinquent noncurrent accounts receivable of $132.9 million primarily consists of foreign military sales for the Defense Energy Support Center's Fuel Exchange Agreement Program. The normal process for clearing these receivables can take up to 12 months. Refer to Note 1.J, Accounts Receivable, for additional details of this program.

Collection Action for Delinquent Receivables

The DLA and DFAS-CO are working together to ensure timely collection/resolution of delinquent receivables. The DLA's financial systems generate collection letters which DFAS-CO sends to delinquent customers. The DFAS-CO, on behalf of DLA, refers nonfederal receivables that are delinquent over 60 days involving amounts of $600 or more to the Debt Management Office (DMO). The DMO refers those debts exceeding 180 days old to the U.S. Treasury or to the Department of Justice (DOJ) for collection action, as appropriate. Debt returned uncollectible from the U.S. Treasury of $500 thousand or more is referred to the DOJ. Debt returned less than $100 thousand, may be written off by DMO upon notification to fund holder. Write-offs of nonfederal accounts receivable after 2 years are mandatory in most cases unless special circumstances exist. The DLA management researches and continues collection efforts on delinquent intergovernmental customers as appropriate.

Description of "Other" Line

The Other line consists primarily of an adjustment to accounts receivable balances for customer returns that are intransit.

Note 5. Other Assets

As of September 30	2007	2006
(Amounts in thousands)		
Intragovernmental Other Assets		
Other Assets	$ 124,925	$ 124,925
Total Intragovernmental Other Assets	$ 124,925	$ 124,925
Nonfederal Other Assets		
Outstanding Contract Financing Payments	41,597	59,591
Other Assets (With the Public)	2,032	750
Total Nonfederal Other Assets	$ 43,629	$ 60,341
Total Other Assets	$ 168,554	$ 185,266

Description of "Other" Lines

Intragovernmental Other Assets consist of crude oil held by the Department of Energy (DoE) on behalf of the Department of Defense (DoD). The DLA has the right to approximately 6.4 million barrels of crude oil held by DoE on behalf of 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. The 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. To date none of the reserve has been drawn upon, thus the full inventory remains on hand with DoE. See the Energy Policy and Conservation Act (42 USC 6241(d)), Section 161(d) of for further details.

Nonfederal Other Assets (With the Public) consist of prepaid postage and salary advances for civilian employees.

Contract Financing Payments

Contract terms and conditions for certain types of contract financing payments convey certain rights to DLA that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and DLA is not obligated to make payment to the contractor until delivery and acceptance.

The Contract Financing Payment balance of $41.6 million is comprised of $35.6 million in contract financing payments and an additional $6.0 million in estimated future payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 12, Other Liabilities).

Note 6. Cash and Other Monetary Assets

As of September 30	2007	2006
(Amounts in thousands)		
Cash	$ 7,421	$ 12,100
Total Cash, Foreign Currency, & Other Monetary Assets	$ 7,421	$ 12,100

The entire Cash balance is restricted because it consists of prepayments, credit card collections, and sales proceeds that will be paid to other entities. When the Defense Reutilization and Marketing Service (DRMS) enters into a long-term contract with a buyer purchasing excess/surplus government property or scrap, DRMS requires a prepayment. After contract closeout, any remaining balance is refunded to the sales contractor. Also included are credit card collections that are payable to DRMS' commercial sales partner and the portion of sales proceeds from certain types of property that DRMS is required to return to the Military Services or Defense Agencies that originally owned the property.

Note 7. Inventory and Related Property

As of September 30	2007	2006
(Amounts in thousands)		
Inventory, Net	$ 17,516,903	$ 17,904,388
Operating Materials & Supplies, Net	0	8,705
Total	$ 17,516,903	$ 17,913,093

Inventory, Net

As of September 30	2007			2006	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
(Amounts in thousands)					
Inventory Categories					
Available and Purchased for Resale	$ 17,511,043	$ (11)	$ 17,511,032	$ 17,890,803	LAC,MAC
Held for Repair	9,785	(3,914)	5,871	13,585	LAC,MAC
Excess, Obsolete, and Unserviceable	4,926,768	(4,926,768)	0	0	NRV
Total	$ 22,447,596	$ (4,930,693)	$ 17,516,903	$ 17,904,388	

Legend for Valuation Methods:
Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses; NRV = Net Realizable Value; MAC = Moving Average Cost

Restrictions

The DLA has restrictions related to inventory in litigation. Inventory in litigation (condition code L) is materiel held pending litigation or negotiation with contractors or common carriers, and remains in condition code L until negotiated or settled. The balance as of September 30, 2007 for inventory in litigation was $1.5 million.

General Composition of Inventory

The DLA inventory is comprised of NonEnergy Supply and Energy Supply. The NonEnergy inventory supply chains represent commodity based inventory and is reported in Enterprise Business System (EBS). Energy Supply is reported in Business System Modernization - Energy (BSM-E).

NonEnergy Supply consists of Troop and Weapon Systems Support supply chains. Troop Support supply chains includes Clothing and Textiles, Medical, Subsistence, Construction and Equipment. Weapon Systems supply chains include repair parts of Aviation, Land, and Maritime.

Energy Supply consists of: jet fuels, aviation gasoline, automotive gasoline, heating oils, power generation, naval propulsion fuels, lubricants, and missile propellants.

Table 1 displays the total gross value of Available and Purchased for Resale materiel by system.

Table 1 ($ millions)

Systems	Inventory Gross Value	Valuation Method
EBS	$ 12,326.30	Moving Average Cost (MAC)
BSM-E	$ 5,179.60	Transactional First-In, First-Out (FIFO)
Legacy	$ 5.10	Adjusted Latest Acquisition Cost (LAC)
Total	$ 17,511.00	

Changes from Prior Year's Accounting Methods

Prior to 2nd Quarter, FY 2007 inventory for the Document Automation & Production Services (DAPS) was reported as Operating Material & Supplies (OM&S). During 2nd Quarter, FY 2007 a review of the composition and use of the OM&S balance determined that DAPS' OM&S should be classified as inventory. As of 2nd Quarter, FY 2007 it is classified as inventory.

Decision Criteria for Identifying the Category to which Inventory is assigned:

The Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) established a condition code crosswalk as stated in the memorandum, “Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies”, in order to standardize DoD reporting of the categories: serviceable; unserviceable; and excess, obsolete and unserviceable.

Inventory Category	Condition Code
Serviceable	A,B,C,D
Unserviceable	E, F, G, H, J, K, L, M, N, R
Excess, Obsolete, Unserviceable	H, P, S

Minimum Inventory Levels

The DLA has congressionally mandated minimum levels of specific inventory items. These items are not necessarily restricted on use, rather these are mandated minimum levels for DLA, which drive fluctuations in the DLA inventory levels. The Meals Ready to Eat (MRE) have a congressionally mandated level of 5.0 million cases. In addition, MRE have a disaster reserve level of 250 thousand cases for use by the Federal Emergency Management Agency, Department of Homeland Security.

Petroleum inventories are comprised mostly of products with military specification and are stocked primarily to meet wartime operation plans and to ensure that DLA has sufficient stocks in place to minimize any risk to the warfighter. Wartime petroleum requirements are calculated by Military Services and coordinated with Combatant Commanders. The DLA’s Defense Energy Support Center (DESC) then works with the Combatant Commanders to position those stocks where space permits and within the funded volumes. The current wartime stockage objective is 34.5 million barrels (mbbls). Peacetime bulk petroleum inventory requirements are calculated by DESC in accordance with guidelines provided by OUSD(C) and are positioned by DESC prior to placing war reserve inventories. The peacetime objective is 25.7 mbbls. These inventories are not physically segregated in tankage, meaning that wartime (appropriated funded) stocks can be used to meet peacetime (working capital funded) requirement.

Operating Materiels and Supplies, Net

As of September 30	2007			2006	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
OM&S Categories					
Held for Use	$ 0	$ 0	$ 0	$ 8,705	SP, LAC, MAC
Total	$ 0	$ 0	$ 0	$ 8,705	

Legend for Valuation Methods:
Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses; MAC = Moving Average Cost; SP = Standard Price

Prior to 2nd Quarter, FY 2007 inventory for the DAPS was reported as OM&S. During 2nd Quarter, FY 2007 a review of the composition and use of the OM&S balance determined that DAPS’ OM&S should be classified as inventory. As of 2nd Quarter, FY 2007 it is classified as inventory. The DLA has no OM&S inventory.

Note 8. General PP&E, Net

As of September 30	2007					2006
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation / Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
Major Asset Classes						
Buildings, Structures, and Facilities		20 or 40	$ 1,901,969	$ (1,204,611)	$ 697,358	$ 681,921
Software	S/L	2-5 or 10	1,335,625	(473,503)	862,122	707,201
General Equipment	S/L	5 or 10	648,646	(402,611)	246,035	238,386
Construction-in-Progress	N/A	N/A	132,907	N/A	132,907	293,300
Other			0	0	0	11
Total General PP&E			$ 4,019,147	$ (2,080,725)	$ 1,938,422	$ 1,920,819

There are no restrictions on the use or convertibility of general property, plant and equipment (PP&E) except heritage assets.

Heritage Assets and Stewardship Land

Statement of Federal Financial Accounting Standards No. 29, Heritage Assets and Stewardship Land, requires note disclosures for PP&E that are unique because of historical or natural significance; cultural, educational, or artistic (e.g. aesthetic) importance; or significant architectural characteristics. The DLA's policy is to preserve and account for its heritage assets. The DLA's heritage assets consist of a building, a monument, and cemeteries. The DLA has no stewardship land. The DLA's heritage assets are resources that are managed to provide multiple use activities for the public benefit to include compliance with required federal laws, executive orders, Department of Defense policies, final governing standards and other binding agreements.

Buildings & Structures: The Defense Supply Center Richmond (DSCR) operates an early nineteenth century plantation house which also serves as the DSCR Officer's Club. The building is listed in the National Register.

Monuments & Memorials: The DSCR and a local Native American organization jointly established a monument honoring Native American culture.

Cemeteries: DLA has administrative and curatorial responsibilities for two cemeteries located at DSCR.

Assets Under Capital Lease

The DLA is engaged in a long-term comprehensive effort to identify and assess agreements for assets acquired through lease-type arrangements to determine if the leases should be classified as capital or operating. Refer to Note 8, General Property, Plant And Equipment, for further details.

Note 9. Liabilities Not Covered by Budgetary Resources

As of September 30	2007	2006
(Amounts in thousands)		
Intragovernmental Liabilities		
Other	$ 10,120	$ 34,968
Total Intragovernmental Liabilities	$ 10,120	$ 34,968
Nonfederal Liabilities		
Military Retirement and Other Federal Employment Benefits	235,596	253,171
Environmental Liabilities	22,249	87,152
Other Liabilities	17,690	17,752
Total Nonfederal Liabilities	$ 275,535	$ 358,075
Total Liabilities Not Covered by Budgetary Resources	$ 285,655	$ 393,043
Total Liabilities Covered by Budgetary Resources	$ 3,078,298	$ 3,423,818
Total Liabilities	$ 3,363,953	$ 3,816,861

Liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided. The DLA Working Capital Fund current year liabilities not covered by budgetary resources are primarily comprised of actuarial Federal Employees Compensation Act (FECA) benefits. The FECA liability is for actuarial cost projections, and therefore is unfunded.

Description of "Other" Lines

Intragovernmental Liabilities Other primarily consists of accruals for unfunded FECA liability and interest on overdue nonfederal accounts receivable that must be remitted to the U.S. Treasury upon receipt.

Nonfederal Liabilities Other includes accruals for unfunded leave and contingent liabilities for contract financing payments. The DLA began recording an accrual for civilian employee compensatory time and credit hours earned but not used during 3rd Quarter, FY 2006 and later began recording a contingency for contract financing payments during 4th Quarter, FY 2006. The DLA implemented these modifications in accordance with Department of Defense issued guidance.

Military Retirement and Other Federal Employment Benefits

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources are comprised of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities are primarily comprised of $235.6 million for FECA. Refer to Note 14, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Note 10. Accounts Payable

As of September 30	2007			2006
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
Intragovernmental Payables	$ 90,388	$ N/A	$ 90,388	$ 93,288
Nonfederal Payables (to the Public)	2,749,441	1,678	2,751,119	3,032,382
Total	$ 2,839,829	$ 1,678	$ 2,841,507	$ 3,125,670

The DLA's systems do not track all intragovernmental transactions by customer at the transaction level. Therefore, internal Department of Defense buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts payable were adjusted by reclassifying amounts between federal and nonfederal accounts payable.

Note 11. Environmental Liabilities and Disposal Liabilities

As of September 30	2007			2006
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Environmental Corrective Action	$ 10,382	$ 62,262	$ 72,644	$ 104,136
Total Environmental Liabilities	$ 10,382	$ 62,262	$ 72,644	$ 104,136

Environmental Disclosures

The DLA's environmental liabilities (EL) are from current and out-year Remedial Action Cost Engineering & Requirements (RACER) estimates for 247 sites, 214 associated with closure costs, and the remaining 33 are corrected action costs. In August FY 2006, DLA executed the RACER model and it generated the FY 2007 Cost to Complete (CTC) estimates which are an estimation of anticipated costs necessary to complete environmental restoration requirements. The CTC estimates for the first year plus the unliquidated obligations as of year end equal the current liability. All remaining CTC estimates are categorized as noncurrent liabilities.

The DLA has developed a plan for collecting and reporting EL for Non Defense Environmental Restoration Program (NonDERP) contamination at DLA managed installations including government-owned contractor-operated (GOCO) fuel points and for Service-owned and operated fuel terminals where DLA stores fuel. To obtain the Service-owned fuel terminals data, DLA developed an environmental template that will be provided to the Military Services after the Office of the Under Secretary of Defense (Comptroller) resolves real property record inconsistencies between the Military Services and DLA. This template will be used to populate the Environmental Disclosures table and for the reporting of overseas base EL in the 1st Quarter, FY 2008 financial statement.

Applicable Laws and Regulations for Cleanup Requirements

The DLA 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. The DLA is required to follow the Comprehensive Environmental Response, Compensation, and Liability Act; Resource Conservation and Recovery Act; and the Superfund Amendments and Reauthorization Act to clean up contamination on installations managed by DLA in coordination with regulatory agencies. This cleanup may at times extend beyond installation boundaries onto privately owned property and to sites where DLA is named as a potentially responsible party by a regulatory agency.

Types of Environmental Liabilities and Disposal Liabilities

The DLA has cleanup requirements for NonDERP installations. All cleanup is done in coordination with regulatory agencies, other responsible parties, and current property owners.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating Periods

The DLA uses the RACER model, an independently validated model, to estimate environmental costs. The DLA validates the model in accordance with Department of Defense (DoD) Instruction 5000.61 and primarily uses the model to estimate the liabilities based on data received during a preliminary assessment and initial site investigation.

In compliance with accounting standards, DLA is developing a process to capture and expense the costs for cleanup associated with General Property, Plant and Equipment (PP&E). Initial Data on the environmental cost linked to General PP&E was gathered during FY 2006 and is the basis for the development, implementation, and reporting.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, or Applicable Laws and Regulations.

The DLA had changes in estimates resulting from changes in site conditions, changes in recent groundwater modeling data, better site characterization and improved analysis by program managers. The EL are expected to fluctuate due to changes in agreements with regulatory agencies, deflation, inflation, and technology. The FY 2007 CTC has incorporated the DoD inflation factors into the NonDERP closure estimates. The latest version of RACER (2007) was used to rebaseline estimates.

Uncertainty Regarding the Accounting Estimates used to Calculate the Reported Environmental Liabilities.

The EL for DLA are based on accounting estimates and assumptions that are believed to be reasonable based upon information available at the time of the RACER calculation. The actual results may materially vary from the accounting estimates if agreements with the regulatory agencies require different remediation than anticipated at the time of the calculation. The liabilities can be further impacted if further investigation of the environmental sites discloses contamination different than known at the time of the estimate.

Although DLA has instituted extensive internal controls to ensure that these estimates are accurate and reproducible, they are generally considered accurate at +/- 40%. The stated noncurrent liability is an estimate of future liabilities, as the majority of DLA sites will require cleanup for up to 30 years. Estimates for work that are more than 1 to 2 years in the future may be subject to significant change.

Liability for Overseas Bases

In addition to the liabilities reported above, DLA has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The DLA is unable to provide a reasonable estimate at this time because the extent of restoration required is not known.

Note 12. Other Liabilities

As of September 30	2007 Current Liability	2007 Noncurrent Liability	2007 Total	2006 Total
(Amounts in thousands)				
Intragovernmental				
Advances from Others	$ 21,932	$ 0	$ 21,932	$ 18,489
FECA Reimbursement to the Department of Labor	23,802	7,021	30,823	57,043
Other Liabilities	12,002	0	12,002	11,353
Total Intragovernmental Other Liabilities	$ 57,736	$ 7,021	$ 64,757	$ 86,885
Nonfederal				
Accrued Funded Payroll and Benefits	161,665	0	161,665	154,476
Advances from Others	17,578	0	17,578	116,805
Deposit Funds and Suspense Accounts	(55,809)	0	(55,809)	(54,630)
Accrued Unfunded Annual Leave	7,064	0	7,064	6,950
Other Liabilities	11,245	7,706	18,951	23,397
Total Nonfederal Other Liabilities	$ 141,743	$ 7,706	$ 149,449	$ 246,998
Total Other Liabilities	$ 199,479	$ 14,727	$ 214,206	$ 333,883

Abnormal Balance

The Nonfederal Deposit Funds and Suspense Accounts balance reflects an abnormal amount of $55.8 million related to unsupported undistributed collections. This primarily resulted when the Document Automation and Production Service (DAPS) transferred from Navy to DLA in FY 1997. At that time, approximately $45 million in cash related to DAPS business did not transfer to DLA. This issue is pending a decision by the Office of the Under Secretary of Defense (Comptroller).

Description of "Other" Lines

Intragovernmental Other Liabilities include the employer portion of payroll taxes and benefit contributions, such as retirement, including DLA's contribution to the Thrift Savings Plan (a Federal Government sponsored retirement savings and investment plan). Also included are health and life insurance for covered employees, and custodial revenue yet to be transferred to the U.S. Treasury for interest on overdue nonfederal accounts receivables.

Nonfederal Other Liabilities consist of contingent liabilities and contract holdbacks for amounts withheld from contractors pending completion of related payments for open contracts.

Contingent Liabilities

Contingent Liabilities include $6.0 million in estimated future contract financing payments that will be paid to the contractors upon delivery and Government acceptance. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The DLA is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to DLA and the amount of potential future payments is estimable; DLA has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

Note 13. Commitments and Contingencies

The DLA is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests.

The DLA has accrued contingent liabilities for legal actions where DLA's Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The DLA records Judgment Fund liabilities in Note 10, Accounts Payable, and Note 12, Other Liabilities.

The DLA has reasonably possible loss contingencies of $65.0 thousand. This is comprised of one case for $50.0 thousand currently in the Armed Services Board of Contract Appeals; and one U.S. Court case for $15.0 thousand. The Defense Distribution Center is the party in both of these actions. Of the cases reported in DLA's Case Management System, which is used by OGC to project the outcome and value of open cases, the minimum liability is approximately $65 thousand and the maximum is approximately $608 thousand.

The DLA Working Capital Fund (WCF) does not have obligations related to cancelled appropriations for contractual commitments.

Environmental Contingencies

The DLA has developed a process to identify and record contingent environmental liabilities. Where DLA is aware of any pending environmental claims, the appropriate program category will be reported in Note 11, Environmental Liabilities. If the Judgment Fund is responsible for a portion of claims for settlement, an imputed financing amount (i.e. paid on the agency's behalf) will be reflected only for the amount to be paid by the Judgment Fund on behalf of DLA.

Potential Loss Related to Economic Price Clause Contracts

The DLA is involved in litigation in the U.S. Court of Federal Claims regarding the use of economic price adjustment clauses in fuels contracts awarded from 1982 through 1999. The DLA continues to believe that the use of such clauses was proper and in accordance with law. In previous financial statements, DLA reported 27 cases challenging economic price adjustment clauses. The value of these cases was approximately $3 billion, and DLA disclosed the potential liability in the footnotes to the financial statements. Since that time, DLA's OGC has determined an outflow of cash associated with these cases is remote.

In April 2005, the U.S. Court of Appeals ruled in the Tesoro Hawaii and Hermes cases that the Defense Energy Support Center's economic price adjustment clauses are authorized by the Federal Acquisition Regulation. The court's decision is precedent and applies to the remaining 25 cases pending in the U.S. Court of Federal Claims. However, plaintiffs in many of these cases have been pursuing alternative theories, meaning that the cases are not yet finished. In September 2007, the U.S. Court of Appeals upheld the August - September 2006 dismissal of a number of these alternative theories by three U.S. Court of Federal Claim's judges. The U.S. Court of Appeals decision is precedent for other cases and DLA's OGC is waiting to determine whether plaintiffs will continue to pursue the cases.

Refer to Note 12, Other Liabilities, for additional details related to contingencies that are considered both measurable and probable.

Note 14. Military Retirement and Other Federal Employment Benefits

As of September 30	2007				2006
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
(Amounts in thousands)					
FECA	$ 235,596		$ 0	$ 235,596	$ 253,172
Total Other Actuarial Benefits	$ 235,596		$ 0	$ 235,596	$ 253,172
Total Military Retirement and Other Federal Employment Benefits:	$ 235,596		$ 0	$ 235,596	$ 253,172

Actuarial Calculations

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

Actuarial Cost Method and Assumptions

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

- 4.930% in Year 1
- 5.078% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (COLAs) and medical inflation factors (Consumer Price Index Medical (CPIMs)) were applied to the calculation of projected future benefits. These factors were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2007	2.63%	3.74%
2008	2.90%	4.04%
2009	2.47%	4.00%
2010	2.37%	3.94%
2011+	2.30%	3.94%

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

Programs Upon Which Actuarial Calculation are Based (Retirement Systems)

The DLA interacts with, and is dependent upon the financial activities of the Federal Government as a whole. The DLA's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) while the Military Retirement System (MRS) covers military personnel. Additionally, personnel covered by FERS and MRS also have varying coverage under Social Security. The DLA finances only a portion of the civilian pensions. While reporting and funding civilian pensions under CSRS and FERS is the responsibility of Office of Personnel Management, DLA recognizes an imputed expense for the portion of civilian employee pension's benefit on the Statement of Net Cost. The DLA also recognizes corresponding imputed revenue from the civilian employee pension's benefit on the Statement of Changes in Net Position.

Note 15. General Disclosures Related to the Statement of Net Cost

As of September 30	2007	2006
(Amounts in thousands)		
Intragovernmental Costs	$ 1,285,443	$ 2,427,583
Public Costs	34,301,560	32,733,736
Total Costs	$ 35,587,003	$ 35,161,319
Intragovernmental Earned Revenue	$ (30,251,340)	$ (31,276,914)
Public Earned Revenue	(5,896,738)	(4,482,229)
Total Earned Revenue	$ (36,148,078)	$ (35,759,143)
Net Cost of Operations	$ (561,075)	$ (597,824)

Intragovernmental costs and earned revenues are related to transactions made between two reporting entities within the Federal Government. Public costs and earned revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The DLA's systems do not track all intragovernmental transactions by customer at the transaction level. Therefore, internal Department of Defense buyer-side balances are adjusted to agree with internal seller-side balances for revenue. Expenses were adjusted by reclassifying amounts between federal and nonfederal expenses.

The Statement of Net Cost is unique because its principles are driven on understanding the net cost of programs and/or organizations that the Federal Government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

The amounts presented in this statement do not meet accounting standards and are based on budgetary obligations, disbursement and collection transactions, as well as nonfinancial feeder systems, adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

The DLA accounting systems do not capture information relative to heritage assets separately and distinctly from normal operations. Where the DLA was able to separately identify the cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets, the DLA has identified $135 thousand for the fiscal year.

Note 16. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2007		2006	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(Amounts in thousands)				
Errors and Omissions in Prior Year Accounting Reports	$ 0	$ 0	$ 124,925	$ 0
Total Prior Period Adjustments	$ 0	$ 0	$ 124,925	$ 0
Imputed Financing				
Civilian CSRS/FERS Retirement	$ 55,690	$ 0	$ 58,260	$ 0
Civilian Health	93,010	0	87,175	0
Civilian Life Insurance	247	0	237	0
Judgment Fund	2,774	0	314	0
Total Imputed Financing	$ 151,721	$ 0	$ 145,986	$ 0

Imputed Financing

The amounts DLA remits to the Office of Personnel Management (OPM) by and for employees covered by the Civilian Service Retirement System, Federal Employee Retirement System, Federal Employee Health Benefits and Federal Employee Group Life Insurance, do not fully cover the Federal Government's cost to provide these benefits. The financial statements include an imputed cost made to recognize the difference between the government's and DLA's costs of providing these benefits to the employees and contributions made by and for them. The OPM provides the cost factors to Defense Finance & Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) (OUSD (P&R)) and DLA for validation. After validation, OUSD (P&R) provides the imputed costs to the reporting components for inclusion in their financial statements.

The Judgment Fund imputed financing recognizes DLA's expense when unfavorable litigation outcomes occur and settlement payments have been made on DLA's behalf by the U.S. Treasury's Judgment Fund. These imputed payments are nonreimbursable to the Judgment Fund.

Other Disclosures

The $69.0 thousand in Budgetary Financing Sources: Other adjustments (rescissions, etc) is a permanent reduction to unexpended appropriations in Supply Management.

In FY 2007, DLA received $2.7 million of free commodities from foreign governments in support of the Global War on Terror as donated revenue - nonfinancial resources. During FY 2007, $126.0 million in commodities were distributed free of charge to the Military Services, some of which was donated in FY 2006.

Note 17. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2007	2006
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 13,743,356	$ 10,511,696
Available Borrowing and Contract Authority at the End of the Period	0	7,612,368
Total	$ 13,743,356	$ 18,124,064

Abnormal Balance

Unobligated balance brought forward, October 1, 2006, shows an abnormal balance of $30.8 million. This abnormal balance exists because prior to 4th Quarter, FY 2003, Document Automation and Production Service processed its budgetary reports as if contract authority was used for operating authority. The use of contract authority accounting was determined to be incorrect and an adjustment was made at year end in FY 2003, resulting in an abnormal balance in Unobligated Balance. The remaining abnormal balance of $23.8 million is reflected as Unobligated Balance: Apportioned and is being resolved over time.

Apportionment Categories for Obligations

The DLA had apportionment category B reimbursable obligations totaling $36.9 billion.

Other Disclosures

The Statement of Budgetary Resources (SBR) includes intraentity transactions because the statements are presented as combined.

The available Contract Authority at the end of the period is $0.

The DLA received direct appropriations during FY 2007 totaling $489.3 million. Public Law 110-28 provided $471.7 million in supplemental funding. The funding was comprised of $156.3 million received in the DLA NonEnergy Supply to replenish previous cash investments in combat inventory, $296.1 million received in the DLA Energy Supply for increased fuel transportation costs and combat losses, $3.8 million received in the Defense Reutilization and Marketing Service to defray the cost of demilitarization service contracts, and $15.5 million received in the Defense Distribution Center for Theatre Redistribution efforts. An additional $17.6 million in direct appropriations was provided for the Reutilization, Transfer, and Disposal mission and Defense Finance and Accounting Service (DFAS) Financial Systems costs.

During FY 2007, residual FY 2006 supplemental fuel funding, provided to cover fuel customers impacted by increased DoD fuel rates, was reapportioned. The Air Force Working Capital Fund received $262.4 million and the Navy Working Capital Fund received $112.5 million.

There is a difference between the SBR and SF 133, Report on Budget Execution, in the amount of $2.0 million. This is a result of reversals of prior year Contract Disputes Act Judgment Fund data call and DFAS accrual amounts. In 4th Quarter, FY 2006, the amounts were not included in the SF 133 but reflected in the SBR. To avoid an overstatement in FY 2007, the amount is reversed on the SBR, thus creating a difference between the two reports.

This note has been modified to accurately report the remaining available balance of contract authority. Previously, DLA reported the amount of the contract authority that had initially been used and not subsequently replaced by reimbursement or appropriation.

Note 18. Reconciliation of Net Cost of Operations to Budget

As of September 30	2007	2006
(Amounts in thousands)		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations incurred	$ 36,936,465	$ 34,151,019
Less: Spending authority from offsetting collections and recoveries (-)	(36,299,054)	(35,759,410)
Obligations net of offsetting collections and recoveries	637,411	(1,608,391)
Net Obligations	$ 637,411	$ (1,608,391)
Other Resources:		
Donations and forfeitures of property	2,710	0
Transfers in/out without reimbursement (+/-)	(782,613)	(109,083)
Imputed financing from costs absorbed by others	151,721	145,986
Net Other Resources Used to Finance Activities	$ (628,182)	$ 36,903
Total Resources Used to Finance Activities	$ 9,229	$ (1,571,488)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Undelivered Orders (-)	(3,231,660)	2,105,936
Unfilled Customer Orders	1,797,778	674,137
Resources that fund expenses recognized in prior Periods (-)	(76,984)	(160,202)
Resources that finance the acquisition of assets (-)	(26,984,654)	(29,148,247)
Other (+/-)	779,903	109,083
Total Resources Used to Finance Items not Part of the Net Cost of Operations	$ (27,715,617)	$ (26,419,293)
Total Resources used to Finance the Net Cost of Operations	$ (27,706,388)	$ (27,990,781)

Reconciliation of Net Cost of Operations to Budget (Continued):

As of September 30	2007	2006
(Amounts in thousands)		
Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	$ 314	$ 6,950
Increase in environmental and disposal Liability	0	63,724
Other (+/-)	0	128,086
Total Components Requiring or Generating Resources in Future Periods	$ 314	$ 198,760
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 175,395	$ 188,873
Revaluation of assets or liabilities (+/-)	(1,246,091)	(309,084)
Cost of Goods Sold	28,237,383	27,315,970
Other	(21,688)	(1,562)
Total Components not Requiring or Generating Resources	$ 27,144,999	$ 27,194,197
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$ 27,145,313	$ 27,392,957
Net Cost of Operations	$ (561,075)	$ (597,824)

The Reconciliation of Net Cost of Operations to Budget provides information on the total resources used by DLA - both those received through the budget and those received by other means. It reconciles the budgetary obligations incurred to the net cost of operation for a given reporting period. It articulates and details the relationship between net obligations from budgetary accounting and net cost of operations from proprietary accounting.

Due to DLA's financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data is a previously identified deficiency.

The reconciliation requires that adjustments be processed because of imbalances between the budgetary and proprietary amounts recorded in DLA's accounting systems. The balancing entries for DLA include adjustments with an absolute value of $6.7 million to Resources That Finance the Acquisition of Assets, $0.6 million to Other Components Not Requiring or Generating Resources and $14.3 million to Revaluation of Assets or Liabilities lines. These adjustments were required in order to bring the reconciliation into agreement with the Statement of Net Cost (SoNC).

The following note schedule lines are presented as combined instead of consolidated due to intraagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts

- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

The $107.4 million change between 4th Quarter, FY 2007 and 4th Quarter, FY 2006 in Liabilities Not Covered by Budgetary Resources on the Balance Sheet (Note 9) differs from the $0.3 million amount reported as of 4th Quarter, FY 2007 in Components Requiring or Generating Resources in Future Period on this note schedule. The $107.1 million difference is comprised of a $77.0 million decreases in the future funded liabilities and $30.1 million decrease from reclassifying environmental liabilities from uncovered to covered.

In FY 2007, DLA received $2.7 million of free commodities from foreign governments in support of the Global War on Terror as donated revenue nonfinancial resources. During FY 2007, $126.3 million in commodities were distributed free of charge to the Military Services, some of which was donated in FY 2006.

Other Disclosures

Resources used to Finance Items not part of Net Cost of Operations: Other. This amount mainly consists of end of quarter fund balance with treasury (FBWT) that is transferred to Defense Working Capital Fund (DWCF) component level, where the DWCF FBWT is managed.

Components Requiring or Generating Resources in Future Period: Other. This amount consists of contingent legal liabilities that are considered probable.

Components Not Requiring or Generating Resources: Other. This amount is comprised of changes in the allowance for bad debt, miscellaneous expenses that did not require budgetary resources and to record the note schedule to SoNC budgetary adjustment.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Required Supplementary Information

for the Years Ended September 30, 2007 and 2006

HERITAGE ASSETS

For the Years Ended September 30, 2007 and 2006

Categories	Measure Quantity	As of 10/01/06	Additions	Deletions	As of 9/30/07
Buildings and Structures	Each	1	-	-	1
Cemeteries	Site	2	-	-	2
Museums	Each	-	-	-	-
Monuments and Memorials	Each	1	-	-	1

Stewardship Land and Heritage Assets

The DLA reports insignificant restrictions on the use or convertibility of general PP&E for heritage assets associated with the Department of Historical Preservation under the state and other minor restrictions as such by the installation host(s) where DLA is a tenant activity through real-estate agreements and Interdepartmental Service Support Agreements. The DLA has no stewardship land.

Buildings & Structures

Executive Order 11593 from the United States Department of the Interior, Heritage Conservation and Recreation Service entered Bellwood, Chesterfield County, Virginia in the National Register. Operated by the Defense Supply Center - Richmond (DSCR), the Bellwood home is an early nineteenth century plantation house highlighted by slender columns extending up two stories; it also serves as the DSCR Officer's Club. (Cultural)

Cemeteries

The DSCR has established a cemetery to re-inter African American remains unearthed during the construction of a child development center. (Cultural)

The DSCR has established a cemetery for the Gregory Family. The family owned the property prior to the acquisition of the property by the Government. (Cultural)

Monuments & Memorials

The DSCR jointly established a monument honoring Native American culture with a local Native American organization. (Cultural)

During the 4th Quarter FY 2007, DLA expensed approximately $135,000 in the Statement of Net Cost for the costs of acquiring, constructing, improving, reconstructing, or renovating heritage assets.

Note: Financial information pertaining to Multi-Use Heritage Assets is included on the Balance Sheet.

REAL PROPERTY DEFERRED MAINTENANCE

As of September 30, 2007
(In Thousands)

Property Type		FY 2007			
	Restoration Prior	Annual Sustainment			Restoration Ending
		Required	Actual	Difference	
Buildings and Structures	$245,000	$495,000	$399,000	$96,000	$341,000

FY 2007 sustainment requirements for DLA originate from the DOD Facilities Sustainment Model (FSM). The requirements and funding encompass facilities funded from the Operations & Maintenance appropriation, Defense-wide Family Housing appropriations, the Defense-wide Working Capital Fund, and from Non-Appropriated Funds. Accuracy of data above is dependent upon information collected and recorded in the FSM. The FSM captures and presents data specific to trends, reductions and requirements imposed by Base Realignment and Closure (BRAC) activity.

Property Type	Annual Deferred Sustainment Trend				
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Buildings and Structures	$293,443	$239,953	$219,430	$245,000	$341,000

The majority of the facilities for which the Agency is responsible for sustaining or restoring and modernizing are not under DLA's direct operational control, e.g. fuel storage and handling facilities.

Actual cumulative sustainment spending through the end of the 4th Quarter, FY 2007 was $399 million. The increase in facilities maintenance spending reflects requirements associated with increased troop support and additional costs incurred due to ongoing BRAC efforts.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Supply Management Activity Group Overview

Supply Management Activity Group

The Supply Management Activity Group consists of three supply centers, one support center, two service centers, and several support organizations. The supply centers are located at the Defense Supply Center Columbus (DSCC) in Columbus, OH; the Defense Supply Center Richmond (DSCR) in Richmond, VA; and the Defense Supply Center Philadelphia (DSCP) in Philadelphia, PA. DLA supports its Military Service customers by managing supply chain business processes that ensure worldwide logistics support is provided at the right time, to the right place, and consistently at the best value in peacetime, emergency, and wartime scenarios. Each supply center acts as a supply chain lead for one or more commodity groups. Each commodity group contains common suppliers, similar items, and to some extent, similar customers. They are formed to improve alignment with industry and customers. The seven supply chains at these three centers include: aviation, land, and maritime (associated with weapon system spare parts and related consumable materiel), construction and equipment, food, clothing and textiles, and medical. The Defense Energy Support Center (DESC), which is located at Fort Belvoir, VA, purchases, manages, positions, and sells fuel to the Military Services and provides centralized energy supply chain support to meet the energy needs of the military installations. The service centers are: the Defense Logistics Information Service, located in Battle Creek, MI, which manages the Federal Supply Catalog System and provides logistics information products and services for all military and civilian activities; and the Defense Automatic Addressing System Center, located in Dayton, OH, which provides support to DLA's logistics mission by editing and routing electronic logistics transactions (including maintaining the addresses of customers and suppliers); maintaining network interoperability for the logistics community; and conducting special services and reports. During FY 2007, DLA supported more than 1,300 different weapon systems; managed fuel that generated net sales of 132.8 million barrels; and received a daily average of 104,566 requisitions that led to a daily average of 3,890 contracts awarded. By year's end, there were than 9,469 civilian, 308 active duty military, and 229 military reserve personnel that supported this business area. The Supply Management Activity Group generated revenue which totaled about $33.7 billion during FY 2007. This is an increase of more than $1.1 billion from the previous year.

Mission

The Supply Management Activity Group's mission is to provide materiel and logistics services that support peacetime and combat operations, combat preparedness, emergency support, and humanitarian aid. These services include the integrated materiel management of more than 5.2 million national stock numbered items that support the eight separate supply chains. The support requirements are dynamic, and DLA continues to adjust its approach in response to evolving changes in national priorities, requirements of the Military Services, technology, and the commercial marketplace.

The primary logistics functions include:

- **Supply-chain integration and inventory management;**
- **Transportation management (shared with the Distribution Activity Group);**
- **Technical management, which guarantees product quality and proper pricing of materiel;**
- **Procurement management, ensuring DoD gets the best value;**
- **Logistics data and information collection, management, and distribution and providing for the integration and availability of this information; and**
- **Logistics management process and processing of logistics and standard Military Logistics Systems transactions**

Strategic Goals

The long-term goals of the Supply Management Activity Group are consistent with those in the DLA Strategic Plan. By achieving these goals, DLA will ensure that the supplies and services required by its customers are procured and delivered in the most effective and efficient manner and that these services reflect the customers' concerns for timeliness, quality, and cost. These goals will be achieved through a series of supporting strategies and executed primarily by the supply centers.

Program Initiatives and Accomplishments

Supplier Relationship Management (SRM): SRM is a major transformation effort which encompasses all of the Agency's supplier facing initiatives. The focus of SRM is to transition from managing supplies to managing suppliers as a means to better serve the warfighter. When established, these enhanced relationships between DLA and its suppliers will allow the Agency to achieve the underlying goal of having the "right item, right service, right place, right time...every time." Consequently, SRM will affirm DLA as an integral partner in the end-to-end supply chain that links our suppliers to our customers. Detailed below are some of the key initiatives within SRM including Strategic Materiel Sourcing (SMS), Strategic Supplier Alliances (SSAs), Supply Chain Alliances (SCAs), and Performance-Based Logistics (PBL):

- **Strategic Materiel Sourcing (SMS):** SMS focuses on stratifying and satisfying customer driven high demand and readiness hardware items – 304,010 of the more than 3 million hardware items managed by DLA - through long-term agreements. While the targeted SMS items make up only about 10% of the DLA managed hardware items, they account for over 80% of its hardware procurement actions and sales. The primary performance measurement of the SMS program is inventory savings. Since the inception of this program, DLA has realized over $216 million in one-time inventory savings. DLA currently has a total of 131,444 items under SMS long-term agreements. These agreements include Prime Vendor Agreements, Corporate Contracts, and standard Long-Term Contracts (LTCs).

- **Strategic Supplier Alliances (SSAs):** SSAs are long-term partnerships - formed with DLA's key suppliers - that allow the Agency and the supplier to work together by sharing information and jointly working problem areas. The result is added value for both parties and improved support to the warfighters. There are currently 28 SSAs and each one is assigned to a Supplier Relationship Manager, whose primary responsibility is the maintenance and success of the partnership. Significant savings have been realized by reducing lead-times and lowering prices. For example, in one partnership, Administrative Lead Time (ALT) was reduced, on average, by almost 71% compared to pre-SSA performance with on-time delivery that exceeds 98%. Similar results occurred with the other SSAs.

- **Supply Chain Alliances (SCAs):** SCAs are alliances with key suppliers who provide items that have lower customer demand and readiness impact. Generally, these alliances do not require the high level of interaction and management attention that are received for SSAs. Additionally, SCAs can be formed with competitive suppliers, something not possible with SSAs. However, while SCAs require less involved relationships, they still further the goals of the SRM initiative and add value to both DLA and the supplier. To date, DLA has formed SCAs with 20 suppliers, six of which were signed in FY 2007.

- **Performance-Based Logistics (PBL):** PBLs are: 1) the preferred contract method to support weapon systems; 2) mandatory for all new major systems and for fielded Acquisition Category (ACAT) I and II systems; and 3) expected to increase support to warfighters through increased materiel availability, improved reliability, and enhanced obsolescence management. DLA sold $149 million worth of materiel in FY 2007 through its PBL partnerships. The majority of these sales were obtained from commercial vendors (who were awarded Service PBL contracts and utilized DLA as a source of supply for consumable items).

Chemical Management Services (CMS): Championed by the Assistant Deputy Under Secretary of Defense for Supply Chain Integration - CMS is a DoD enterprise-wide and cradle-to-grave initiative designed specifically to manage hazardous materiel (hazmat), reduce associated hazmat management and disposal costs, and enable DLA to get closer to its customers. It is a strategic, long-term relationship where either the service provider or supplier manages a customer's chemical-related services. While initially developed to meet the needs of Military Service industrial complexes, CMS is fully capable of managing hazmat down to the tactical retail levels, and will incorporate the best business practices of DLA's Tailored Prime

Vendor initiatives. These best business practices will also include many of those developed and used to execute the National Inventory Management Strategy, Joint Environmental Materiel Management System, and the Base Realignment and Closure supply, storage, and distribution concepts. The pilot sites for this initiative are the 76th Maintenance Wing (76th MXW) and Navy Strategic Communication Wing - one (SCW-1) located at Tinker Air Force Base, Oklahoma City - Air Logistics Center, with start-up estimated for the third quarter FY 2008. After the "Proof of Concept" is demonstrated, the intent is to extend the program throughout the Tinker base and then to all DoD customers within the region. DLA will provide the contract and contract management oversight for this initiative, and as the strategy becomes more fully integrated into our business models, benefits will include reduced wait times for customers, higher levels of DLA supply readiness, more effective and efficient tailored logistics support solutions, better inventory visibility, a more optimized supply chain, and reduced waste/disposal cost. Consequently, these benefits will produce significant cost savings and better utilization of hazmat resources.

Customer Support Modules (CSM)/Customer Outreach: DLA uses SAP Customer Support Modules tools and processes in its Customer Outreach Management effort to more deliberately understand warfighter needs and meet customer expectations. DLA began using these standard Enterprise-wide tools and processes for account management, opportunity management, and customer outreach in March 2006. In the following month, analytics and service modules were configured and deployed. System enhancements were periodically deployed during the remainder of 2006 and 2007. These improvements included improved program reporting, customer outreach, account management, opportunity management, and service capabilities. In total - 1,800 DLA employees use the system and processes to perform customer outreach, manage accounts and customer support opportunities, provide customer service, as well as take advantage of the integrated analytics capability that provides reports for each process. CSM reached full operational capability in July 2007.

Client-level Survey: The 2007 client-level survey will be fielded in fall 2007 to evaluate the warfighters' assessment of DLA goods and services and provide feedback for the continued improvement in the delivery of those goods and services. The survey focuses on the opinions of upper-echelon clients – those with the officer rank of O-6 and above – by evaluating enterprise partnerships, reputation and brand. The first client-level survey - conducted in April 2006 - yielded insights centering on successes and opportunities for improvement. Specifically, the survey revealed that the overall client-level satisfaction was at 67%, which is consistent with results for similar respondents in the larger overall customer satisfaction survey – conducted in May 2005. Additionally, 86% of respondents indicated they would recommend DLA to another unit or colleague. Warfighters cited that the Agency strengths were: delivering well on its commitments; maintaining a relatively good reputation; and providing valuable support. However this initial client-level survey also revealed a number of customer concerns. These concerns were reviewed by the DLA Customer Assessment Integrated Process Team which grouped them into six "themes for action." These themes serve as the focus points for developing and instituting fixes:

- Partnering and understanding customers' missions;
- Dealing with customers proactively;
- Responding to and routing calls and other contacts;
- Better promoting DLA's capabilities;
- Improving timeliness of support; and
- Better promoting the value DLA brings

Both the DLA field commands and Headquarters have taken action to respond to these concerns.

Program Performance Indicators

In December 2006, DLA finalized the transition of data from its legacy system (Standard Automated Materiel Management System - SAMMS) to the Enterprise Business System (EBS). This transition enables DLA management greater access to more timely, complete, accurate, and reliable performance and financial data. Consequently, the following metrics are or will soon be available for management decision-making:

- **Perfect Order Fulfillment (POF)**– as a draft interim metric - was developed and deployed, and is being tested in coordination with the Marine Corps. POF measures the percentage of orders shipped on time and delivered in full with no product quality or pricing issues. This will be the overarching metric to measure how well DLA supported its customer – the warfighter. We expect a final POF metric to be fully developed and deployed during FY 2009.

- **Demand Planning Accuracy (DPA)** measures the degree of accuracy of a demand forecast compared to the actual demand. It is first calculated at the lowest level of detail, the Demand Forecasting Unit (DFU), comprised of a customer and an item of supply. The DFU can be rolled up to compute the DPA for the various and significantly larger customer groups (such as an Enterprise, a Demand Chain, a Customer, etc.). Currently, DPA is measured in "lags" or forecasted ahead for set periods of time (both at one month and at six months). Plans include measures for two, three, and twelve month lags as well. Increased demand planning accuracy should result in better customer support and lower inventory investments and holding costs. To this end, DLA is pursuing both top down and bottom up approaches. The most recent DPA for Lag 1 for August 2007 was 28.41%; the management objective was 40%.

- **Sales Orders** are the number of customer orders (requisitions) received and are an indicator of workload. The number of sales orders for FY 2006 was slightly more than 33.6 million and for FY 2007 the number was almost 40.9 million - representing a 21.6% increase.

- **Attainment to Plan (ATP)** identifies the percentage of Purchase Requests and Stock Transport Orders (DLA-owned stock redistribution orders) generated through the supply planning process which meet criteria for quantity, quality, and timeliness. A failure of one or more of these criteria indicates that a problem exists within the supply chain. An increase in ATP demonstrates that supply plans are more reliable and lower safety stock levels (smaller inventory investments) may be possible. Implemented in July 2007 the ATP during the fourth quarter was 74%. The management objective is 91% ATP for FY 2008 and the long-term management objective is 99%. Our analyses of the contributing factors leading to extended lead times, and of ATP by vendor will be completed by the end of October 2007. In addition, management oversight will ensure that Supply Planners are actively working their inventory exceptions and reviews to ensure that PRs are prioritized by the Required Award Date.

- **Purchase Requests (PRs) On Hand** are the number of PRs in process, but not yet awarded. This metric grew significantly - to nearly 240,000 - in the early part of the fiscal year as DLA rolled business from its legacy system, the Standard Automated Materiel Management System, to the Enterprise Business System concurrent with a surge in customer demands. In response to this rise, DLA developed and promulgated productivity goals for the Hardware, Construction & Equipment, and Clothing & Textile Supply Chains to mobilize their available assets to arrest the rise and gradually reduce the number of PRs On Hand to a manageable level. After peaking near 260,000, the overall PRs on Hand have remained relatively stable (near that number) through the end of the fiscal year. Aggressive efforts to reduce these numbers targeted on low value PRs are the first order of action for FY 2008.

- **Percentage of PRs Exceeding Required Award Date (RAD)** is determined by the number of PRs that have not been awarded within the required contract award date relative to the total number of PRs On Hand. The DLA management objective is to have no more than 20% of its PRs exceeding the RAD. Significant increases throughout the fiscal year in receipt of customer demands exceeded the capacity of the Supply Chains to award contracts. Consequently, by the end of the fiscal year, roughly 60% of the PRs exceeded the RAD. As the Supply Chains make progress in reducing their PRs on Hand, the percentage shows downward trends.

- **Administrative Lead Time (ALT)** is the total time between DLA receipt of a customer order/planned requirement to the Contract Award Date. ALT is weighted to compensate for quantities of single-item orders. The observed ALT for the enterprise has steadily improved throughout the year to from a high of 43.26 days in October 2006 to 33.19 days by the end of the fiscal year. As the Supply Chains make progress in reducing their PRs on Hand, the ALT should continue to trend downward in 2008.

- **Production Lead Time (PLT)** is the total time between the receipt of award by the vendor to either DLA's or the customer's receipt of a quality product. PLT is weighted to compensate for quantities of single-item orders. The observed PLT for the enterprise improved steadily throughout the year - from a high of 61.44 in October 2006 to 54.01 by the end of the fiscal year.

- **Net Operating Result** compares business results to the business plan for revenues, expenses and gains or losses.
- **Gross Sales at Standard Price** is the revenue generated by the sale of materiel.
- **Obligations and Cash Performance** measure funds execution and cash position relative to the budgets and plans.

Financial Performance Measures

DLA establishes its prices predicated on three primary factors: 1) its current financial position, as determined by the Accumulated Operating Result (AOR); 2) its projected cash position relative to the stated objective; and 3) the estimated expenses that will be incurred to generate the estimated revenue. It is Agency policy to set prices that achieve an AOR of zero over the long-term and maintain cash balances that preclude an Anti-Deficiency Act violation. In addition, not all costs attributed to the business are recovered by the business - imputed costs, depreciation expenses applied to investments funded from General Fund accounts, and the recording of revenue that is for non-expense items (peacetime inventory augmentation, mobilization inventories, and adjustments to the cash position). The Results section below more fully describes DLA achievement during FY 2007.

DLA measures the effectiveness of program budgeting and execution with unit cost performance measures. The following table depicts the Supply Management unit cost results for the fuel supply chain:

Unit Cost Results	FY 07 Goal	FY 07 Actual
Product Cost Per Barrel of Fuel	$79.33	$84.35
Non -Product Cost per Barrel of Fuel	$8.60	$8.05
Total Cost per Barrel of Fuel	$87.93	$92.40

The total cost per barrel of fuel is comprised of the composite product cost (the acquisition cost of a barrel of petroleum product sold) and the non-product cost (operations costs for fuel services, transportation, storage, and overhead). This total unit cost ended the year over plan by $4.47 (a 5.1% increase) due to sales that were 76 thousand barrels higher than the planned sales of 132.7 million barrels and a composite refined product cost of $84.35 ($5.02 per barrel higher than the planned cost). This composite product cost included a purchase of 6.74 million barrels of Kuwait fuel priced at $39.00 per barrel. Without this specially-priced fuel, the product cost would have been $86.72 per barrel. Higher product costs are market driven. The non-product cost decrease was due primarily to lower actual labor, facility maintenance, and terminal operations expenditures than planned.

The following table depicts the Supply Management unit cost result for the non-energy supply chains:

Unit Cost Results	FY 07 Goal	FY 07 Actual
Non-Energy	$.95	1.04

The Non-Energy unit cost was $1.04, which exceeded the plan by $.09. The actual unit cost was higher than the plan primarily due to a process change that requires obligation of funds when customers place orders with our prime vendors, leaning forward efforts, and an additional end of year purchase to buy components and tray packs for a new item, Unitized Group Rations-Express.

DLA also measured and monitored financial performance of its Non-Energy business segment by comparing the Cost Recovery Rate (CRR) approved in the budget to that which was executed. The CRR is a composite rate that is calculated by dividing its related operating costs by the cost of goods sold; and is used as an aggregate measurement of the costs that DLA incurred to generate a level of sales. The long-term financial goal is to achieve a break-even budget-related accumulated operating result. DLA's composite FY 2007 CRR goal was 14.4%. The actual CRR was 14.1%, which was 0.3% lower than the FY 2007 President's Budget and is attributed to greater than expected Net Sales at the end of the fiscal year and focused efforts to reduce operating costs.

FINANCIAL RESULTS

The Supply Management Net Cost of Operations, which includes costs (military construction depreciation, imputed expenses, and accounting adjustments) not recovered by the Defense-wide Working Capital Fund, reflects a gain of approximately $832 million. The increase is primarily attributable to the Energy business segment where both sales price and sales quantity to federal customers increased. Additionally, revenue grew in the Non-energy area due to greater demand by the Military Services.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Supply Management

Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2007 and 2006

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Consolidated Balance Sheets
As of September 30, 2007 and 2006
(In Thousands)

	2007	2006
ASSETS (Note 2)		
Intragovernmental:		
Accounts Receivable (Note 4)	$ 876,414	$ 697,942
Other Assets (Note 5)	124,925	124,925
Total Intragovernmental Assets	1,001,339	822,867
Accounts Receivable (Note 4)	482,581	567,335
Inventory and Related Property (Note 7)	17,511,771	17,904,388
General Property, Plant and Equipment (Note 8)	1,265,784	1,262,816
Other Assets (Note 5)	41,838	60,049
TOTAL ASSETS	20,303,313	20,617,455
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	10,087	42,167
Other Liabilities (Note 12 and Note 13)	13,148	16,799
Total Intragovernmental Liabilities	23,235	58,966
Accounts Payable (Note 10)	2,595,024	2,832,801
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 14)	36,608	37,380
Environmental Liabilities (Note 11)	72,645	104,135
Other Liabilities (Note 12 and Note 13)	134,070	234,993
TOTAL LIABILITIES	2,861,582	3,268,275
NET POSITION		
Cumulative Results of Operations	17,441,731	17,349,180
TOTAL NET POSITION	17,441,731	17,349,180
TOTAL LIABILITIES AND NET POSITION	$ 20,303,313	$ 20,617,455

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Consolidated Statements of Net Cost
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 15)

	2007	2006
PROGRAM COSTS		
Gross Costs	$ 32,842,943	$ 31,945,957
(Less: Earned Revenue)	(33,674,612)	(32,536,251)
Net Program Costs	(831,669)	(590,294)
NET COST OF OPERATIONS	$ (831,669)	$ (590,294)

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 16)

	2007	2006
Beginning Balances	$ 17,349,180	$ 16,274,118
Budgetary Financing Sources:		
Appropriations used	470,050	654,901
Transfers-in/out without reimbursement	(374,904)	15,246
Other Financing Sources:		
Donations and forfeitures of property	2,710	-
Transfers-in/out without reimbursement	(923,586)	(270,383)
Imputed Financing Sources	86,612	85,004
Total Financing Sources	(739,118)	484,768
Net Cost of Operations	(831,669)	(590,294)
Net Change	92,551	1,075,062
Ending Balances	17,441,731	17,349,180
UNEXPENDED APROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	470,119	2,120,101
Appropriations transferred-in/out (+/-)	-	(1,465,200)
Other adjustments (rescissions, etc.)	(69)	-
Appropriations used	(470,050)	(654,901)
Ending Balances	-	-
NET POSITION	$ 17,441,731.00	$ 17,349,180.00

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

	2007	2006
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Recoveries of prior year unpaid obligations	$ 438,475	$ 446,034
Budget Authority:		
Appropriations received	470,119	2,120,101
Contract Authority	34,623,573	31,051,479
Spending authority from offsetting collections:		
Earned		
Collected	31,967,505	31,471,504
Change in receivables from Federal sources	147,012	(52,541)
Change in unfilled customer orders		
Advance received	(98,363)	(13,757)
Without advance from Federal sources	1,917,961	742,063
Subtotal	69,027,807	65,318,849
Nonexpenditure transfer, net, anticipated and actual	(374,904)	(1,450,247)
Permanently not available	(34,467,805)	(33,263,156)
Total Budgetary Resources	34,623,573	31,051,480
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	34,623,573	31,051,480
Total Status of Budgetary Resources	34,623,573	31,051,480
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	13,127,305	14,384,387
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(4,944,936)	(4,255,413)
Total unpaid obligated balance	8,182,369	10,128,974
Obligations incurred net (+/-)	34,623,573	31,051,480
Less: Gross outlays	(31,171,049)	(31,862,528)
Less: Recoveries of prior year unpaid obligations, actual	(438,475)	(446,034)
Change in uncollected customer payments from Federal sources (+/-)	(2,064,973)	689,521
Obligated balance, net – end of period		
Unpaid obligations	16,141,354	13,127,304
Less: Uncollected customer payments from Federal sources (+/-)	(7,009,909)	(4,944,935)
Total unpaid obligated balance, net, end of period	9,131,445	8,182,369
Net Outlays:		
Gross outlays	31,171,049	31,862,528
Less: Offsetting collections	(31,869,142)	(31,457,747)
Net Outlays	$ (698,093)	$ 404,781

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Distribution Activity Group Overview

Distribution Activity Group

The Distribution Activity Group operates through the Defense Distribution Center (DDC) headquartered in New Cumberland, PA, and 26 subordinate distribution centers located throughout the United States, Europe, Pacific and Southwest Asia. The group's mission is to manage the receipt, storage, and issuance of DoD materiel. It may deliver that materiel to customers collocated on a base or to far-off ships, posts, and repair facilities. The activity group uses contracts with commercial sources to transport items from DLA-owned warehouses directly to customers worldwide. Some distribution centers are highly automated facilities that were specifically designed to provide global support for general commodities; while others fill customer requirements on a regional basis or may provide global support for materiel that requires special equipment, facilities, or training. For example, one distribution center - with nine subordinate satellite operations - provides global support for all map distribution requirements. The distribution centers maintain the accountable inventory records and are responsible for preserving about $96 billion (at selling price) in DoD materiel, representing over 3.5 million items. In addition, they processed 23 million receipt and issue transactions during FY 2007 and their business services generated almost $1.4 billion in revenue. By year's his activity group employed approximately 7,129 civilian, 137 active duty, and 179 reserve military personnel.

Mission

The mission of the Distribution Activity Group is to provide the full range of distribution services and information enabling a seamless, tailored worldwide DoD distribution network that delivers effective, efficient and innovative support to the Combatant Commands, the Military Services, and other Agencies during peace and war. The distribution network ensures that America's Warfighters receive competitively priced and best value distribution services by providing "around the clock - around the world" world-class service. The Distribution Activity Group is also responsible for the DLA transportation management functions which supports all shipments, both first and second destination.

Strategic Goals

The strategic goals established by the Distribution Activity Group are consistent with those contained in the DLA Strategic Plan. These goals are achieved through a series of supporting strategies that will:

- Increase our reliability and value coupled with a faster response time to our customers by continuously improving and reengineering business practices;
- Provide best-value solutions to our customers by continuously evaluating our activities and implementing changes, as necessary, to ensure efficient and effective distribution operations; and
- Reduce under-utilized infrastructure by eliminating unnecessary storage capacity.

Program Initiatives and Accomplishments

Infrastructure Cost Reduction through A-76 Cost Comparisons: In FY 1998, DDC began the process of competing DLA depots with private industry. The goal of these competitions is to reduce operating costs either by reengineering existing depot business processes or by inserting the market forces of competition into the distribution functions. As of the end of FY 2007, twelve sites have been competed, with the government retaining depot operations at five sites, while the other seven were contracted with private industry. The estimated long-term (FY 1998 - FY 2013) net savings from these twelve competitions is in excess of $560 million. In addition to these competitions, selected installation services support functions at the Defense Distribution Depot San Joaquin CA (DDJC) and the Defense Distribution Depot Susquehanna PA (DDSP) underwent public/private competitions, also following the guidelines of OMB Circular A-76. While a commercial firm won the DDJC competition and began work in March 2007, the federal workers at the DDSP were awarded the performance decision as a Most Efficient Organization (MEO) and will begin full performance in October 2007.

Domestic Disaster Support: As part of the DLA Domestic Disaster Plan to support the Federal Emergency Management Agency (FEMA) the DDC developed distribution initiatives to maintain 100% In-Transit Visibility of DLA shipped supplies using satellite tracking capability. DDC established a Defense Transportation Tracking System account to track DDC booked DLA shipments from the commercial vendor and/or distribution center to the FEMA, drop-off destination. The DDC also established a Deployable Distribution Depot, with positions battle-rostered and available to respond to domestic disaster situations in CONUS. This response will be in concert with the coordinated requirements and capabilities of both FEMA and the U.S. Northern Command (USNORTHCOM).

Foreign Disaster Support: Plans for expanding Deployable Distribution Depot capabilities for world-wide use are being considered. Conceptually, this would require a combination of functions and capabilities of both a Theater Distribution Center and those of a DLA fixed base forward stocking site to meet contingency needs and priorities. Those needs and priorities would include wholesale support services, as well as materiel visibility.

Theater Consolidation and Shipping Points (TCSP)–Kuwait, Europe, and Korea: In FY 2006, DLA accepted the transfer of the Army Theater Distribution Center (TDC) in Kuwait at Camp Arifjan and established the Theater Consolidation and Shipping Point (TCSP-Kuwait). TCSP-Kuwait is the primary conduit for sustaining theater operations by rapidly consolidating or segregating shipments from multiple sources and then preparing and forwarding those shipments directly to the customer. Key features of TCSP-Kuwait include the capability to maintain visibility of the transportation control number and asset control. Collectively, these features will allow for the movement of pelletized materiel directly from the receiving dock to the shipping dock. The ability to “cross-dock” eliminates the need for any storage or staging and facilitates an efficient transition from inbound to outbound operations. At the request of the Army, DLA established TCSP-Europe (located at Defense Distribution Depot Europe) in September 2006. TCSP-Europe’s mission is to rapidly segregate, sort, and consolidate multiple consignee shipments from a range of sources and then deliver those supplies to the customer. These efforts provide both effective and efficient support to the warfighters throughout Europe, Africa, and the Middle East. Thus far, this mission has reduced cost by 20% with a 40% reduction in redundant hub and spoke distribution systems. Based on the successes achieved by both the Kuwait and European operations, DLA is negotiating with the Pacific Command to establish a TCSP-Korea.

Deployment Distribution Operations Center (DDOC) Pilot Project: DLA partnered with the United States Transportation Command, the Joint Munitions Command, and the United States Central Command to establish the DDOC pilot project. The DDOC is a cross-command, cross-Service team that focuses on integrating movement of DLA and Military Service sustainment cargo, deploying forces and equipment, and managing in-theater stocks. The goal is to optimize the use of personnel and equipment (aircraft, Materiel Handling Equipment, etc.) by improving asset visibility and sustaining pipeline velocity, using Department of Defense transportation assets.

Defense Logistics Management System (DLMS): The two Strategic Distribution Platforms (DDSP and DDJC) implemented DLMS on 1 July 2007. Consequently, DDC’s performance metrics will change how Hi-Priority and Routine receipts and shipments are processed. These changes – to include importing the metrics that are focused on customer outputs - will enable the DDC to further optimize the distribution network and provide flexibility in processing orders that are tailored to the customer’s needs. To ensure that its customer needs are understood and fully met, the DDC is actively engaged with DLA’s National Account Managers, Customer Facing Personnel, and Account teams.

Distribution Planning and Management System (DPMS): DPMS is a DLA transformational initiative to improve the management of product movements from vendors and distribution centers to customers. The DPMS program reached full operational capability at the end of FY 2006 and has resulted in better coordination, visibility, and precise stock positioning. Since February 2007, all OCONUS shipments are being processed by DPMS; and as of June 2007, 11% of all DLA product movement contracts were awarded to DPMS vendors. By August 2008, the use of DPMS will be mandatory for all new DLA product movement contracts.

Enterprise-wide Transportation System: DLA will achieve economies and efficiencies by consolidating and centralizing the management and services for seven of its eight supply chains (Energy has transportation requirements unique to its supply chain). When completed near the end of FY 2007, this system will establish a single point of contact for vendors, supply chain representatives and eventually the carriers. It will improve the reliability and predictability of transportation delivery time and other services by standardizing business practices and driving down transportation lead time.

Defense Transportation Coordination Initiative (DTCI): DTCI is a Continental United States (CONUS) freight initiative that focuses on reducing cycle time and improving predictability through optimization and increased coordination. DTCI will provide DoD, DLA and the DDC with greater insight on shipment consolidation and transportation cost reduction opportunities throughout the DoD transportation enterprise. This initiative contributes to the DoD goal to integrate the Department's logistics to make it more responsive to warfighter readiness while achieving greater efficiency. In August 2007 a contract was awarded for the selection of a nationwide transportation coordinator. DTCI is anticipated to be rolled out to DDC Distribution Centers during FYs 2008 and 2009.

Augmentation of Passive Radio Frequency Identification (RFID) Portals: The DDC installed passive radio frequency identification portals across its global logistics network. The current initiative to expand DDC's existing passive RFID infrastructure will bring DDC into compliance with the Department of Defense policy to make DoD distribution centers capable of receiving passive RFID tags as suppliers begin tagging their products in compliance with acquisition regulations. All 19 of DDC's distribution centers in the continental United States were equipped with RFID portals by September 2006. Portal installation at DDC's seven overseas sites was complete during FY 2007.

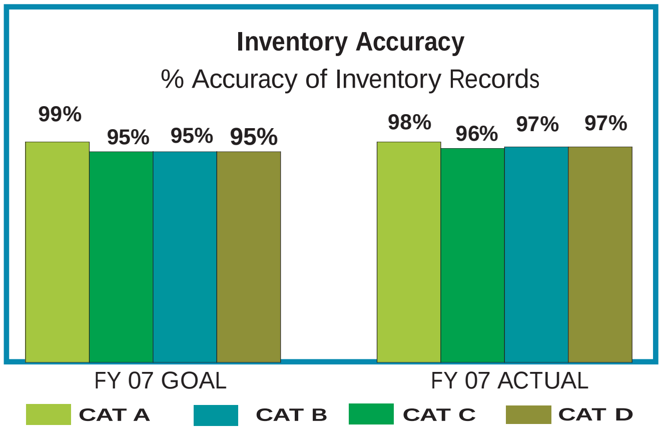
Integrated Data Environment (IDE) / Global Transportation Network (GTN) Convergence (IGC): IGC is a DLA and United States Transportation Command (USTRANSCOM) system-of-systems partnership initiative that will provide a single point of access to decision support related data and information within DLA and USTRANSCOM and between DLA/USTRANSCOM and external systems. The convergence of these two programs will create a single face to systems requiring access to common and authoritative data, business standards, and information from DLA and USTRANSCOM. GTN is the current transportation information system that warehouses and integrates information from multiple transportation, distribution and supply systems, and provides the capability to track passengers and cargo moving through the Defense Transportation System (DTS). IDE is a net-centric, service-oriented data capability that provides access to supply chain and transportation data across the DLA and USTRANSCOM landscape. IGC allows the legacy components of GTN to be retired and the newer ones to be expanded.

Program Performance Indicators

Inventory Record Accuracy: This performance metric measures the accuracy of inventory records using statistical sampling techniques, which are performed semi-annually. Starting in FY 1999, DLA incorporated established DoD stratification and tolerance levels into the inventory sampling methodology. The DoD plan takes into consideration item characteristics such as dollar value and provides a means to focus resources commensurate with the significance of the errors found.

The FY 2007 goals for inventory accuracy were: 99% for items in the high dollar strata (Category A) and 95% for the remaining three strata. Our record accuracy for the high dollar Category (A) was 98%; Category (B) was 96%; Category (C) was 97%; and Category (D) was 97%.

Category A:	Unit Price > $1,000
Category B:	Unit of Issue Not Equal to Each OR On-Hand Balance > 50 AND Extended Dollar Value < $50,000 OR Activity > 50 per year
Category C:	On-Hand Balance < 50 AND Date of Last Inventory > 24 Months
Category D:	All Others



The FY 2007 performance sample inventory shows that goals were met in three of the four inventory accuracy categories. However, the Category "A" (high dollar value items) goal was not reached because an insufficient number of sample inventories were performed. In FY 2008 DDC will institute an aggressive schedule for the conduct of sample inventories for Category "A" items at each of its Distribution Centers. The DDC is also providing continuous training in the related distribution responsibilities and processes, as well.

Maintaining Process Performance: All performance metrics were within the DLA goals and the continued operational streamlining and reengineering of the workplaces had a positive impact on performance:

	FY 07 Goal	FY 07 Actual
High Priority Requisitions (Shipped in)	1 Day	0.7 Day
Routine Requisitions (Shipped in)	1 Day	1 Day
New Procurement Receipts (Stored in)	1 Day	0.7 Day
Customer Returns (Stored in)	3 Days	2.1 Days
Denial Rate (Ordered Materiel Unavailable)	0.5%	0.45%
Location Accuracy (Materiel locations verified)	99.5%	99.8%

By exceeding the standards for processing both High Priority and Routine requisitions, the DDC continued to provide timely, quality support to its customers. The operational support provided to both the Central Command and the Military Service Maintenance Depots was instrumental in maintaining the high state of combat equipment readiness experienced during FY 2007. In addition to timely delivery of materiel, the DDC continues to exceed the goals for processing receipts and inventory integrity. This ensures that America's warfighters continue to get the right item at the right price at the right time...every time.

Financial Performace Measures

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

Unit Cost Results	FY 07 Goal	FY 07 Actual
UnitCost-Total Composite Processing Rate	$21.82	$23.93
Unit Cost-Covered Storage	$3.12	$3.83

The Unit Cost-Total Composite Processing Rate measures processing costs (direct, indirect, and applied overhead) relative to the number of line items (receipts and issues) processed.

The Unit Cost-Covered Storage measures the costs (direct, indirect, and applied overhead) to provide covered storage to the cubic footage used.

Actual processing unit cost was above goal by $2.11. Actual processing workload was 22.7 million lines or 0.6 million lines less than our original FY 2007 estimate. Actual processing cost (without Second Destination Transportation) was $543 million, or $72.7 million above plan.

Actual covered storage unit cost was higher than the goal due to a reduced level of covered storage workload. Actual covered storage workload was 73 million cubic feet or 14 million cubic feet less than the 87 million cubic feet that was forecasted. Actual storage costs were $318 million or $9 million less than the $309 million budgeted due to decreased facility maintenance obligations.

Financial Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of expenses over revenue of approximately $203 million. This loss was primarily related to the processing business where workload declined significantly below forecasted levels. Because of the fixed and overhead components, the business area could not fully reduce costs enough to offset the decline in revenue caused by lower workload.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Distribution

Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2007 and 2006

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Consolidated Balance Sheets
As of September 30, 2007 and 2006
(In Thousands)

	2007	2006
ASSETS (Note 2)		
Intragovernmental:		
Accounts Receivable (Note 4)	$ 50,813	$ 156,040
Total Intragovernmental Assets	50,813	156,040
Accounts Receivable, Net (Note 4)	1,409	871
General Property, Plant, and Equipment, Net (Note 8)	600,165	580,574
Other Assets (Note 5)	131	176
TOTAL ASSETS	652,518	737,661
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	62,854	30,477
Other Liabilities (Notes 12 & 13)	25,092	43,792
Total Intragovernmental Liabilities	87,946	74,269
Accounts Payable (Note 10)	53,475	89,253
Military Retirement and Other Federal		
Employment Benefits (Note 14)	172,078	186,714
Other Liabilities (Notes 12 & 13)	49,506	49,045
TOTAL LIABILITIES	363,005	399,281
NET POSITION		
Cumulative Results of Operations – Other Funds	289,513	338,380
TOTAL NET POSITION	289,513	338,380
TOTAL LIABILITIES AND NET POSITION	$ 652,518	$ 737,661

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Consolidated Statements of Net Cost
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 15)

	2007	2006
PROGRAM COSTS		
Gross Costs	$ 1,599,309	$ 2,564,380
(Less: Earned Revenue)	(1,395,873)	(2,550,372)
Net Program Costs	203,436	14,008
NET COST OF OPERATIONS	$ 203,436	$ 14,008

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 16)

	2007	2006
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 338,380	$ 83,128
Budgetary Financing Sources:		
Appropriations used	15,500	25,000
Transfers-in/out without reimbursement	341,500	-
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(251,961)	196,871
Imputed financing from costs absorbed by others	49,529	47,389
Total Financing Sources	154,568	269,260
Net Cost of Operations (+/-)	203,436	14,008
Net Change	(48,868)	255,252
Ending Balances	289,512	338,380
UNEXPENDED APPROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	15,500	25,000
Appropriations used	(15,500)	(25,000)
Ending Balances	-	-
NET POSITION	$ 289,513	$ 338,380

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

		2007		2006
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources:				
Budget authority:				
Appropriation	$	15,500	$	25,000
Contract authority		1,622,228		2,452,624
Spending authority from offsetting collections:				
Earned				
Collected		1,447,433		2,482,910
Change in receivables from Federal sources		(104,934)		69,683
Change in unfilled customer orders				
Without advance from Federal sources		(28,977)		(53,160)
Subtotal		2,951,250		4,977,057
Nonexpenditure transfers, net, anticipated and actual		341,500		-
Permanently not available		(1,670,522)		(2,524,433)
Total Budgetary Resources	$	1,622,228	$	2,452,624

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

	2007	2006
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 1,622,228	$ 2,452,624
Total Status of Budgetary Resources	1,622,228	2,452,624
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	473,195	721,862
Less: Uncollected customer payments		
from Federal sources, brought forward, October 1	(264,147)	(247,623)
Total unpaid obligated balance	209,048	474,239
Obligations incurred net (+/-)	1,622,228	2,452,624
Less: Gross outlays	(1,548,435)	(2,701,292)
Change in uncollected customer payments		
from Federal sources (+/-)	133,910	(16,523)
Obligated balance, net – end of period		
Unpaid obligations	546,987	473,195
Less: Uncollected customer payments		
from Federal sources (+/-)	(130,236)	(264,147)
Total unpaid obligated balance, net, end of period	416,751	209,048
Net Outlays:		
Gross outlays	1,548,436	2,701,292
Less: Offsetting collections	(1,447,433)	(2,482,910)
Net Outlays	$ 101,003	$ 218,382

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Defense Reutilization and Marketing Activity Group Overview

Defense Reutilization and Marketing Activity Group

The Defense Reutilization and Marketing Activity Group operates through the Defense Reutilization and Marketing Service (DRMS), headquartered in Battle Creek, MI, and 104 Defense Reutilization and Marketing Offices (DRMOs) located on military installations throughout the world. The group's mission is to coordinate the reuse of excess and surplus DoD property. DRMOs receive, classify, segregate, demilitarize, account for, and dispose of excess materiel in accordance with all applicable laws and regulations. The reutilization of excess materiel by DoD customers reduces their need to purchase new materiel. In FY 2007, materiel with an acquisition value of $25 billion was turned in to DRMS, and $2.2 billion was reutilized within DoD. DRMS also oversees the demilitarization and disposal of the remaining property through transfers, donations, and sales, or its ultimate disposal - as in the case with hazardous waste. The business services provided by this activity group generated revenues of approximately $253 million in FY 2007. By year's end, this activity group employed 1,276 civilian, 9 active duty, and 228 reserve military personnel.

Mission

The mission of the Defense Reutilization and Marketing Activity Group is to manage the reutilization, transfer, donation, and sale of military personal property as well as the disposal of hazardous waste items no longer needed for national defense. The DRMS mission must be accomplished in a manner that safeguards national security in a cost efficient and operationally effective manner, conserves valuable resources, and protects the environment.

Strategic Goals

The strategic goals established by the Reutilization and Marketing Activity Group are consistent with the goals contained in the DLA Strategic Plan. These goals are achieved through a series of supporting objectives and initiatives designed to improve and reengineer business practices to ensure efficient, effective, and best-value operational support.

The DoD disposal business model calls for a balance between maximizing the use of property with an absolute requirement to prevent it from getting into the hands of unauthorized recipients. Accordingly, DRMS' goals are to continue to provide quality support to the warfighter, mitigate risks to national security by strengthening the disposal process and inventory accountability, and ensure taxpayer dollars are spent appropriately. DRMS is committed to eliminating the release of potentially harmful property to the public. DRMS continues to balance the maximum reutilization of property with controls over potential vulnerabilities, even if it results in reduced revenues and increased costs.

In short, DRMS "PROVES" it is the provider of choice for disposal solutions by:

P reventing unauthorized releases;
R eutilizing as much as possible DRMS adds value to the American taxpayer. By ensuring
O defects;
V erifying everything;
E xecuting its operations flawlessly; and
S elling only what should be sold, it protects National Security.

Program Intiatives and Accomplishments

Reduced Concurrent Procurement: Numerous actions were taken to reduce the frequency of DoD organizations procuring the same items they are disposing as excess but still in serviceable condition. Specific actions included:

- Conducted on-going education, training, and working group sessions with senior Military Service representatives to increase reutilization and determine how existing systems can interface with DLA's systems;
- Updated systems to allow DLA activities to automatically match DRMS excess property assets against DLA inventory retention levels;
- Provided electronic notifications to past customers of available property;
- Featured scrolling photographs of high dollar and/or unique good condition items on the DRMS R/T/D website; and
- Implemented an additional 2-day screening opportunity for Local Stock Number and Batch lot property that has been reviewed and cleared for sale at the Controlled Property Centers (CPCs).

These actions resulted in an annual increase of 12% in the acquisition value of excess property reutilized/recouped as compared to FY 2006. Overall the re-utilization rate for the best quality property increased from an average of 12,900 lines per month in FY 2006 to an average of 13,800 lines per month in FY 2007.

Controlled Property Centers (CPCs): The four CPCs receive, thoroughly review, and research property with either specified Local Stock Numbers or property consolidated into batch lots from designated feeder sites. After completing this identification process, the property goes through the appropriate disposition channel to mitigate the release of unauthorized property to the public. During FY 2007, the CPCs received 12,000 batch lots. Of these, 7,300 batch lots were processed, 278,000 lines of property were inspected, and 124,000 lines of property were determined inappropriate for release. Consequently, through CPC processing, 948,000 pieces of property were removed from sale to the public and properly disposed.

Controlled Property Verification Office (CPVO): In a continuous effort to ensure security of the national defense and safeguard the public, the CPVO was established. This office monitors the Commercial Venture (CV) website to determine whether controlled property is being offered for sale. DRMS verification efforts (website reviews by CPVO and contractor, automated integration of disparate databases identifying controlled and sensitive items, and establishing CPCs) successfully removed 4.3 million pieces of property from sales world-wide; approximately 477,000 pieces were removed as a result of its CV website reviews. Additionally, the CPVO submitted approximately 19,000 demilitarization code challenges to the Defense Logistics Information Service Demilitarization Coding Management Office to prevent the unauthorized release of potentially significant military equipment/items. Of these challenges, 13,000 were reviewed and 10,800 were upheld, thus preventing the inappropriate sale of property to the public. Greater emphasis has been placed on reviewing property and identifying controlled items prior to the item being transferred to the sales partner. The CPVO also researches changes to regulations that may affect an assigned demilitarization code and submits a code challenge, as appropriate.

Commercial Venture (CV) Contract Changes: DRMS modified its sales contract to include financial disincentives if unauthorized property is sold to the general public, and incentives for returning all controlled property determined to be unauthorized for sale. Any additional items in the CV possession deemed “unsafe” to sell are also returned to the Government. DRMS measures the CV contractor’s performance through constant reviews and audits of property offered for sale and data reports received from the CV contractors and the CPVO. Results are reported to DRMS management on a monthly basis. Because the CV contractor met the contract incentives, no financial disincentives were levied during FY 2007; while the financial incentives totaled more than $1.8 million for the same period.

Safeguarding Excess/Surplus Property: DRMS will spend almost $2.2 million from FY 2007 – 2011 on a priority basis to upgrade the physical security at DRMOs. Based on the greatest need, seven facility projects totaling almost $0.7 million were executed in FY 2007. Significant changes also were implemented activity group-wide to tighten the walk-in procedures for property removal. Consequently, DRMS ensures that authorization letters and potential screeners are independently verified before property is released and conducts weekly site inspections of contractor facilities where security risks exist.

Most Efficient Organization (MEO): Transition to full MEO status for stock, store and issue functions in the continental United States was completed in July 2006. The stand-up of the MEO has resulted in a reduced organizational and physical infrastructure. The MEO operates 21 fully staffed DRMO warehousing operations compared to 68 prior to MEO implementation.

Vulnerabilities Integrated Process Team (IPT). In July 2006, DRMS initiated a Vulnerability Team Assessment Program to review and identify vulnerabilities and risks throughout all of its disposal operations. The Vulnerability IPT, comprised of nine sub-teams, conducted integrated process reviews and off-site conferences that examined DRMS’ receiving, warehousing, knowledge management, demilitarization, sales, scrap, environmental, recycling control point operations, and reutilization/transfer/donation (R/T/D). Corrective measures include the establishment of the four Controlled Property Centers, a stronger compliance assessment program, and a fully operational "job ready" training program with job ready training standards in place.

Collaborative Efforts Between DRMS and Defense Distribution Center (DDC) to Extend the Enterprise: Because DRMS and DDC have similarities in the stock, store, and issue functions, their joint management team is exploring opportunities to leverage those similarities into a "one stop" shopping experience for acquiring and disposing of surplus and excess property. Utilizing the concepts of Lean Six Sigma, the management team developed a flow chart that mapped the DRMS and DDC value stream to realign the DRMO processes with the current operations within DDC.

Developing Waste Disposal Standards for Iraq: DRMS - working with DoD, U.S., and international regulations and guidance (including tools such as technical guidance documents available from the United Nations Environmental Program's Basel Convention Regional Centers) - is developing waste disposal and treatment standards specific to its operations in Iraq. The goal is to reduce the volume of materiel that DoD must export for disposal and increase opportunities for in-country treatment, including land disposal. These standards should be available for use by 30 October 2007, and will be forwarded to the Multi-National Forces - Iraq for their consideration.

Supporting DRMO Operations in Iraq, Afghanistan, and Kuwait: The Request for Proposal and Statement of Objectives for receipt and distribution functions at the DRMOs in Iraq, Afghanistan, and Kuwait were issued to industry during the second quarter FY 2007. After the contracts are awarded in FY 2008, DRMS will oversee the work performance using Acceptable Performance Levels and metrics to ensure that the contractor meets contract requirements. The contractor's performance data will be monitored and reported in the Contract Performance Assessment Reporting System. Formal report cards will be issued yearly based on input from the customers and DRMS representatives. This effort will improve operations by bringing commercial capability to the DRMO yard, demilitarization capability to the forward operating bases, and scrap removal by contractor.

Enhanced DRMS Intern Program: Faced with an aging workforce, DRMS utilizes an Intern Training Program to ensure that the knowledge base is transferred to a trained employee prior to an individual's retirement. The program includes completion of mandatory formal training courses, on-the-job training, cross training, and rotational training within a 2-year period. Each intern is assigned to one of three disciplines (disposal, environmental, or contracting) with specific program development requirements: the various training courses, prerequisites, and learning objectives. Each intern is also assigned to a targeted position with established progression criteria that must be met prior to assigning the intern to a permanent position. DRMS hired 16 interns in FY 2006 and seven interns in FY 2007.

Program Performance Indicator

Reutilization/Transfer/Donation (R/T/D) rate: This indicator represents the aggregate number of line items of the property reutilized, transferred, and donated expressed as a percentage of the total line items disposed. The indicator applies to the available assets that are economically reused. It addresses disposal via reutilization by another defense customer, transfer to another Federal Agency, or donation to an eligible state or local government or to a non-profit organization. R/T/D dispositions, as a percentage of total dispositions, indicate support provided to DoD, Federal government, and state and local agencies. Customer utilization of these programs increases troop readiness, avoids new procurement costs, and provides needed items to agencies at no cost. In FY 2007, DRMS successfully reutilized, transferred, or donated over 192,500 line items of excess property for an R/T/D rate of about 17%, which exceeded the goal of at least 15%.

- Operations Enduring Freedom and Iraqi Freedom Reutilization: Total reutilization supporting these two contingencies surpassed 74,000 line items with a value of $528.2 million. Examples of the types of items issued in support of these operations include vehicles, tanks, trucks, and body armor.

- Computers for Learning: DRMS is responsible for overseeing the transfer of computers to schools in support of the DoD's Computers for Learning Program. In FY 2007, over 4,300 schools participated in the program, and computers worth over $23 million in acquisition value were transferred.

R/T/D will continue to increase as a percentage of total dispositions by:

- Marketing high dollar, good condition items through scrolling photographs on the R/T/D website. In FY 2007, DRMS received 308 requisitions for property with an original acquisition value of $22.9 million.
- Pushing (to past customers) inventory alerts of the availability of same/similar items that they previously purchased. In FY 2007, DRMS received over 7,000 requisitions for property with an original acquisition value of $86 million.
- Implementing changes that will improve the information on available property. This includes providing more photographs on the web and writing better descriptions of the property.
- Working closely with DLA and DoD supply centers to fill backorders and new purchase requests.
- Establishing and implementing automated tools that will provide priority screening for item managers.
- Testing initiatives to provide automatic notification to item managers of high dollar value, best condition items received.
- Testing longer screening timeframes for higher quality property.
- Promoting the additional 2-day screening opportunity for Local Stock Number items and batch lots that were previously screened and cleared for sale. In FY 2007, DRMS received 434 requisitions for property with an original acquisition value of $129,000.

FINANCIAL PERFORMANCE MEASURES

We measure the effectiveness of program budgeting and execution with unit cost performance measures. Cost is defined as obligations incurred in support of or attributed to the service performed. DRMS is measured on five unit cost goals:

- Receiving
- Reutilization/Transfer/Donation (R/T/D)
- Useable Sales
- Hazardous Waste (HW) Disposal
- Recycling/Disposal.

These measures recognize that all property received incurs processing costs; that certain types of excess property require costly special handling, such as demilitarization, without generating any economic return to DoD; and that partnerships with the private sector incur cost to the government. The DRMS unit cost structure is flexible to remain viable during periods of significant process changes. The table below depicts the unit cost results for each category.

Finacial Performance Measures	FY 07 Goal	FY 07 Actual
Cost incurred per line item of useable property received – Receiving	$25.394	$34.165
Cost incurred per line item – Reutilization/Transfer/ Donation (R/T/D)	$253.851	$195.618
Cost incurred per line item – Useable Sales	$30.502	$28.678
Cost incurred per pound – Hazardous Waste Disposal	$0.186	$.195
Cost incurred per pound – Recycling/Disposal	$.044	$.052

The Receiving unit cost goal is based on the total cost associated with the stock, store, and issue (logistics) of usable property divided by the number of line items of usable property received.

The FY 2007 Useable Property Received unit cost was higher than the plan by 34%. There were 3.3 million line items actually received versus 4 million line items planned (an 18% decrease).

Based on the BRAC recommendations, DRMS anticipated line items of dormant stock to be transferred from DDC in FY 2007, but this is rescheduled to FY 2008. In addition, the cost of processing workload was higher than planned.

The Reutilization/Transfer/Donation unit cost goal is calculated from the total cost associated with reutilizing, transferring, and donating excess personal property divided by the line items of property disposed via R/T/D. The unit cost for R/T/D was 23% lower than planned. Actual line items disposed by R/T/D were 193,000 versus 210,000 line items planned. DRMS instituted more rigorous property accountability requirements in response to Government Accountability Office concerns. More property was downgraded to scrap and less entered the R/T/D path of disposal. Additionally, total costs associated with R/T/D were decreased for similar property-related reasons, as more items were determined to be scrap and did not go into the R/T/D area.

Useable Sales unit cost goal is calculated from all costs associated with the public sales of surplus useable personal property divided by the number of line items of property sold. The unit cost for Useable Sales was 6% below the goal in FY 2007. The majority of useable property is sold through a Commercial Venture partnership; and while there only 362,804 line items sold versus 699,700 line items planned for sale (a 48% decrease), there was an even greater decrease in cost (more than 51%).

The Hazardous Waste (HW) Disposal unit cost goal is calculated from the non-contract costs associated with environmentally regulated disposal of HW divided by the number of pounds of HW disposed. The unit cost for HW Disposal was above plan due primarily to decrease in workload (207 million pounds disposed versus 230 million pounds planned). The disposal workload was under plan by 10% due to a decrease of HW property turned over to DRMS (some of this decrease may be the result of the "greening efforts" of the Military Services).

The Recycling/Disposal (R/D) unit cost goal is calculated from the cost of either storing in a landfill or destruction of those non-hazardous items, including property that requires demilitarization and scrap, that remain at the end of the disposal process as well as the cost of all recycling processes divided by the number of pounds of property disposed. The actual R/D unit cost for FY 2007 was 18% higher than planned. This is attributed to the increased efforts of the Controlled Property Centers (CPCs) to ensure no unauthorized property is released to the public. As a result of these efforts, more property was downgraded to scrap and destroyed.

FINANCIAL RESULTS

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess expenses of over revenue of approximately $67.1 million.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Reutilization and Marketing

Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2007 and 2006

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Consolidated Balance Sheets
As of September 30, 2007 and 2006
(In Thousands)

	2007	2006
ASSETS (Note 2)		
Intragovernmental:		
Accounts Receivable (Note 4)	$ 417	$ (33)
Total Intragovernmental Assets	417	(33)
Cash and Other Monetary Assets (Note 6)	7,421	7,971
Accounts Receivable, Net (Note 4)	5,075	1,641
General Property, Plant, and Equipment, Net (Note 8)	62,217	66,878
Other Assets (Note 5)	164	118
TOTAL ASSETS	75,294	76,575
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	12,401	16,218
Other Liabilities (Notes 12 & 13)	24,918	23,697
Total Intragovernmental Liabilities	37,319	39,915
Accounts Payable (Note 10)	31,189	37,804
Military Retirement and Other Federal Employment Benefits (Note 14)	17,162	18,799
Other Liabilities (Notes 12 & 13)	21,242	20,694
TOTAL LIABILITIES	106,912	117,212
NET POSITION		
Cumulative Results of Operations – Other Funds	(31,618)	(40,637)
TOTAL NET POSITION	(31,618)	(40,637)
TOTAL LIABILITIES AND NET POSITION	$ 75,294	$ 76,575

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Consolidated Statements of Net Cost
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 15)

	2007	2006
PROGRAM COSTS		
Gross Costs	$ 319,970	$ 298,076
(Less: Earned Revenue)	(252,889)	(316,180)
Net Program Costs	67,081	(18,104)
NET COST OF OPERATIONS	$ 67,081	$ (18,104)

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 16)

	2007	2006
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ (40,637)	$ (38,425)
Budgetary Financing Sources:		
Appropriations used	3,766	1,777
Transfers-in/out without reimbursement (+/-)	(341,500)	900
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	403,453	(31,366)
Imputed financing from costs absorbed by others	10,380	8,373
Total Financing Sources	76,099	(20,316)
Net Cost of Operations (+/-)	67,080	(18,104)
Net Change	9,019	(2,212)
Ending Balances	(31,618)	(40,637)
UNEXPENDED APPROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	3,766	1,950
Other adjustments (rescissions, etc.) (+/-)	-	(173)
Appropriations used	(3,766)	(1,777)
Ending Balances	-	-
NET POSITION	$ (31,618)	$ (40,637)

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

	2007	2006
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ -	$ -
Budget authority:		
Appropriation	3,766	1,950
Contract authority	341,104	290,405
Spending authority from offsetting collections:		
Earned		
Collected	249,060	321,589
Change in receivables from Federal sources	3,825	(5,508)
Change in unfilled customer orders		
Advance received	3,701	2,341
Without advance from Federal sources	41	(3,663)
Subtotal	601,497	607,114
Nonexpenditure transfers, net, anticipated and actual	(341,500)	900
Permanently not available	81,107	(317,609)
Total Budgetary Resources	$ 341,104	$ 290,405

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

	2007	2006
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 341,104	$ 290,405
Total Status of Budgetary Resources	341,104	290,405
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	123,408	128,319
Less: Uncollected customer payments		
from Federal sources, brought forward, October 1	(2,219)	(11,391)
Total unpaid obligated balance	121,189	116,928
Obligations incurred net (+/-)	341,104	290,405
Less: Gross outlays	(318,480)	(295,317)
Change in uncollected customer payments		
from Federal sources (+/-)	(3,866)	9,172
Obligated balance, net – end of period		
Unpaid obligations	146,032	123,408
Less: Uncollected customer payments		
from Federal sources (+/-)	(6,085)	(2,219)
Total unpaid obligated balance, net, end of period	139,947	121,189
Net Outlays:		
Gross outlays	318,480	295,316
Less: Offsetting collections	(252,761)	(323,930)
Net Outlays	$ 65,719	$ (28,614)

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Document Automation & Production Service Activity Group – Overview

Document Automation & Production Service

The Document Automation & Production Service (DAPS) is responsible for printing, duplicating, and document automation programs. This responsibility encompasses the full range of automated services to include: document workflow conversion, electronic storage and output, and distribution of hard copy and digital information. DAPS provides time sensitive, competitively priced, high quality products and services that are either produced in-house or procured through the Government Printing Office. DAPS manages its mission through a headquarters, located in Mechanicsburg, PA, and a worldwide network of 187 production facilities. During FY 2007, DAPS earned approximately $824.7 million in revenue and employed 730 civilians at year-end. Major customers were: Air Force (23%), Navy (28%), Army (21%), Defense Agencies (22%), and non-DoD customers (6%).

Mission

The mission of DAPS is to provide best value document automation and management services in support of America's Armed Forces and Federal Agencies. DAPS' value to DoD is characterized by two elements. First, DAPS provides a full portfolio of best value document services ranging from traditional offset printing, through on-demand output, to online document services and workflow. Second, DAPS actively functions as a transformation agent moving DoD towards the use of online documents and services. These services include building libraries of digital documents to permit online access, providing multifunctional devices (that print from networks, copy, fax and scan) in customer workspaces, and converting paper documents to target digital formats.

Strategic Goals

DAPS is committed to the following goals:

- Serving as a major catalyst in transforming business by revolutionizing document automation services;
- Rapidly utilizing technology for agile and responsive internal business solutions;
- Aggressively pursuing partnerships with government, industry, and suppliers;
- Ensuring the DAPS workforce is enabled to deliver and sustain world-class performance;
- Striving to reduce costs, simplify orgational structure, eliminate unnecessary facilities, and ensure that equipment and personnel are commensurate with the workload; and
- Aligning our processes to focus on improving the quality of our products and services while meeting or exceeding our customers' delivery requirements.

Program Initatives and Accomplishments

Distribute and Print Service is a DAPS fielded readiness enhancement service that supports the Air Force Materiel Command's requirement for "hard copy" printed technical manuals and other related documents. The Air Force maintains a library of 130,000 technical manuals that are comprised of more than 13 million pages and are needed by as many as 10,000 users. Under this service, the Air Force provides the print order, distribution list, and digital files of the required technical documents; and DAPS forwards these files to the most strategically located of its 175 worldwide production facilities - where they are printed and either shipped to or picked up by the customer.

Financial Document Workflow (FDW) is a certified DAPS fielded system capable of creating, approving, storing, managing, and routing financial documents through its automated workflow. FDW allows users to process a variety of financial documents in a uniform, auditable manner, in some cases without requiring any manual handling. FDW reduces financial document creation time by approximately 50 percent.

Program Performance Indicators

Conversion to Digital Format: This performance metric measures the number of pages that were converted to digital format during the year. Conversions are accomplished either in-house or by contract and include hardcopy to digital, system output to digital, and from one form of digital to another. Actual production of 38.3-

million pages was 42% below the goal to convert 66.4 million pages. The primary reason for the below plan result was a decrease in the number of procurement solicitation pages processed through Procurement Gateway.

Product Rework: In-house rework percentage is used to measure the quality of delivered products. This performance metric is calculated by dividing revenue lost from orders not accepted by the total in-house production revenue. During FY 2007, DAPS achieved a rework percentage of 0.25, exceeding its goal of 0.27%.

Customer Satisfaction: This performance metric measures satisfied customers as the percentage of customers ranking DAPS performance as “satisfied” or “very satisfied.” DAPS uses a survey professionally prepared and administered by an independent commercial entity to determine an overall customer satisfaction rating. DAPS achieved a customer satisfaction rating of 97% for FY 2007, exceeding its goal of 90%.

On-Time Delivery (In-house Production): This performance metric measures the timeliness of customer order completion. The performance metric is calculated by dividing the total number of orders filled on time by a DAPS owned and operated production facility (in-house) by the total number of orders filled by these facilities. DAPS achieved an on-time delivery rate of 99.22%, exceeding its goal of 98%.

Financial Performance Measures

In addition to program performance measures, DAPS measures the effectiveness of program budgeting and execution with a unit cost performance measure. It measures the total units produced relative to the total cost to produce those items.

Unit Cost Results	FY 07 Goal	FY 07 Actual
Unit Cost per In-House Production Unit	.0559	.0451

DAPS produced 7% more in-house units than planned (2,819 million actual versus 2,638 million planned); and actual in-house costs were almost 14% lower than planned ($127.3 million actual versus $147.4 million planned). By incurring significantly less cost, while producing slightly fewer units, DAPS was able to better its unit cost goal by more than 19%.

Financial Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of expenses over revenue of less than $77,000.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

Document Automation & Production Service

Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2007 and 2006

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Document Automation & Production Service

Consolidated Balance Sheets
As of September 30, 2007 and 2006
(In Thousands)

	2007	2006
ASSETS (Note 2)		
Intragovernmental:		
Accounts Receivable (Note 4)	$ 4,871	$ 3,334
Total Intragovernmental Assets	4,871	3,334
Cash and Other Monetary Assets (Note 6)	-	4,129
Accounts Receivable, Net (Note 4)	159	233
Inventory and Related Property, Net (Note 7)	5,132	8,705
General Property, Plant, and Equipment, Net (Note 8)	10,258	10,551
Other Assets (Note 5)	1,495	(3)
TOTAL ASSETS	21,915	26,949
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	5,048	4,428
Other Liabilities (Notes 12 & 13)	1,598	2,596
Total Intragovernmental Liabilities	6,646	7,024
Accounts Payable (Note 10)	71,429	72,524
Military Retirement and Other Federal Employment Benefits (Note 14)	9,748	10,278
Other Liabilities (Notes 12 & 13)	(55,369)	(57,734)
TOTAL LIABILITIES	32,454	32,092
NET POSITION		
Cumulative Results of Operations – Other Funds	(10,539)	(5,143)
TOTAL NET POSITION	(10,539)	(5,143)
TOTAL LIABILITIES AND NET POSITION	$ 21,915	$ 26,949

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation & Production Service

Consolidated Statements of Net Cost
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 15)

	2007	2006
PROGRAM COSTS		
Gross Costs	$ 824,783	$ 352,905
(Less: Earned Revenue)	(824,706)	(356,338)
Net Program Costs	77	(3,433)
NET COST OF OPERATIONS	$ 77	$ (3,433)

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Document Automation & Production Service

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 16)

	2007	2006
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ (5,143)	$ (9,611)
Beginning Balances, as adjusted	(5,143)	(9,611)
Budgetary Financing Sources:		
Transfers-in/out without reimbursement (+/-)	-	19
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(10,518)	(4,204)
Imputed financing from costs absorbed by others	5,199	5,220
Total Financing Sources	(5,319)	1,035
Net Cost of Operations (+/-)	77	(3,433)
Net Change	(5,396)	4,468
Ending Balances	$ (10,539)	$ (5,143)

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation & Production Service

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

	2007	2006
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ (30,820)	$ (35,476)
Recoveries of prior year unpaid obligations	161	-
Budget authority:		
Contract authority	2,824	3,118
Spending authority from offsetting collections:		
Earned		
Collected	351,327	351,474
Change in receivables from Federal sources	1,413	129
Change in unfilled customer orders		
Advance received	(859)	197
Without advance from Federal sources	4,274	115
Subtotal	358,979	355,033
Nonexpenditure transfers, net, anticipated and actual	-	19
Permanently not available	(2,607)	6,114
Total Budgetary Resources	$ 325,713	$ 325,690

The accompanying notes are an integral part of these statements.

UNAUDITED

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation & Production Service

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 17)

	2007	2006
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 349,561	$ 356,510
Subtotal	349,561	356,510
Unobligated balance:		
Apportioned	(23,848)	(30,820)
Subtotal	(23,848)	(30,820)
Total Status of Budgetary Resources	325,713	325,690
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	116,792	107,766
Less: Uncollected customer payments		
from Federal sources, brought forward, October 1	(82,813)	(82,570)
Total unpaid obligated balance	33,979	25,196
Obligations incurred net (+/-)	349,561	356,510
Less: Gross outlays	(339,950)	(347,485)
Less: Recoveries of prior year obligations, actual	(161)	-
Change in uncollected customer payments		
from Federal sources (+/-)	(5,687)	(243)
Obligated balance, net – end of period		
Unpaid obligations	126,242	116,791
Less: Uncollected customer payments		
from Federal sources (+/-)	(88,501)	(82,813)
Total unpaid obligated balance, net, end of period	37,741	33,978
Net Outlays:		
Gross outlays	339,950	347,485
Less: Offsetting collections	(350,468)	(351,670)
Net Outlays	$ (10,518)	$ (4,185)

The accompanying notes are an integral part of these statements

DEFENSE LOGISTICS AGENCY

GENERAL FUND

Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2007 and 2006

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Balance Sheets
As of September 30, 2007 and 2006
(In Thousands)

	2007	2006
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 725,689	$ 783,763
Accounts Receivable (Note 4)	17,933	7,945
Total Intragovernmental Assets	743,622	791,708
Accounts Receivable, Net (Note 4)	268	365
General Property, Plant, and Equipment, Net (Note 6)	394,730	426,606
Other Assets (Note 5)	-	562
TOTAL ASSETS	1,138,620	1,219,241
LIABILITIES (Note 7)		
Intragovernmental:		
Accounts Payable (Note 8)	9,173	3,781
Other Liabilities (Note 10)	5,694	5,274
Total Intragovernmental Liabilities	14,867	9,055
Accounts Payable (Note 8)	8,024	12,390
Military Retirement and Other Federal Employment Benefits (Note 11)	6,223	6,787
Environmental and Disposable Liabilities (Note 9)	263,625	246,088
Other Liabilities (Note 10)	3,682	3,296
TOTAL LIABILITIES	296,421	277,616
NET POSITION		
Unexpended Appropriations – Other Funds	689,926	780,802
Cumulative Results of Operations – Other Funds	152,273	160,823
TOTAL NET POSITION	842,199	941,625
TOTAL LIABILITIES AND NET POSITION	$ 1,138,620	$ 1,219,241

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Statements of Net Cost
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 12)

	2007	2006
PROGRAM COSTS		
Gross Costs	$ 704,110	$ 377,072
(Less: Earned Revenue)	(54,132)	(26,845)
Net Program Costs	649,978	350,227
NET COST OF OPERATIONS	$ 649,978	$ 350,227

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 13)

	2007	2006
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 160,824	$ (116,351)
Budgetary Financing Sources:		
Appropriations used	737,875	628,586
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(98,526)	(71,901)
Imputed financing from costs absorbed by others	2,078	2,205
Other (+/-)	-	68,513
Total Financing Sources	641,427	627,403
Net Cost of Operations (+/-)	649,978	350,228
Net Change	(8,551)	277,175
Ending Balances	152,273	160,824
UNEXPENDED APPROPRIATIONS		
Beginning Balances	780,802	688,786
Budgetary Financing Sources:		
Appropriations received	646,322	745,191
Appropriations transferred-in/out (+/-)	11,012	(8,266)
Other adjustments (rescissions, etc.) (+/-)	(10,335)	(16,322)
Appropriations used	(737,875)	(628,586)
Total Financing Sources	(90,876)	92,017
Net Change	(90,876)	92,017
Ending Balances	689,926	780,803
NET POSITION	$ 842,199	$ 941,627

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 14)

	2007	2006
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 192,244	$ 160,922
Recoveries of prior year unpaid obligations	15,209	48,770
Budget authority:		
Appropriation	646,322	745,191
Spending authority from offsetting collections:		
Earned		
Collected	13,297	20,470
Change in receivables from Federal sources	9,807	6,907
Change in unfilled customer orders		
Without advance from Federal sources	3,813	-
Subtotal	673,239	772,568
Nonexpenditure transfers, net, anticipated and actual	11,012	(8,266)
Permanently not available	(10,336)	(16,321)
Total Budgetary Resources	$ 881,368	$ 957,673

The accompanying notes are an integral part of these statements.

UNAUDITED

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006
(In Thousands) (See Note 14)

	2007	2006
Status Of Budgetary Resources:		
Obligations incurred:		
Direct	$ 634,841	$ 738,065
Reimbursable	26,541	27,363
Subtotal	661,382	765,428
Unobligated balance:		
Apportioned	185,686	108,488
Subtotal	185,686	108,488
Unobligated balance not available	34,300	83,757
Total Status of Budgetary Resources	881,368	957,673
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	599,813	512,378
Less: Uncollected customer payments		
from Federal sources, brought forward, October 1	(8,296)	(1,389)
Total unpaid obligated balance	591,517	510,989
Obligations incurred net (+/-)	661,382	765,428
Less: Gross outlays	(718,368)	(629,221)
Less: Recoveries of prior year unpaid obligations, actual	(15,209)	(48,770)
Change in uncollected customer payments		
from Federal sources (+/-)	(13,620)	(6,907)
Obligated balance, net – end of period		
Unpaid obligations	527,619	599,813
Less: Uncollected customer payments		
from Federal sources (+/-)	(21,916)	(8,296)
Total unpaid obligated balance, net, end of period	505,703	591,517
Net Outlays:		
Gross outlays	718,368	629,221
Less: Offsetting collections	(13,295)	(20,470)
Net Outlays	$ 705,073	$ 608,751

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY

GENERAL FUND

Notes to the Consolidated and Combined Financial Statements

As of and for the Years Ended September 30, 2007 and 2006

Note 1. Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Defense Logistics Agency (DLA) General Fund (GF), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of DLA in accordance with the Department of Defense (DoD), Financial Management Regulation (FMR), the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible generally accepted accounting principles (GAAP). Effective 4th Quarter, Fiscal Year (FY) 2006, DoD no longer publishes consolidating/combining financial statements. The accompanying financial statements account for all resources for which DLA is responsible, unless otherwise noted.

Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernable.

The DLA is unable to fully implement all elements of GAAP and the OMB Circular A-136 due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The DLA has deployed a fully integrated Enterprise Resource Planning (ERP) system to a major portion of its business. The Enterprise Business System (EBS) reached full operational capacity in July 2007 and is capable of fully supporting financial transactions and of delivering GAAP financial statements. However, a portion of the information fed to EBS still derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic 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 GAAP. The DLA continues to implement process and system improvements addressing these limitations.

The DoD currently has several auditor identified financial statement material weaknesses. Of these the DLA GF has the following: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Unsupported Accounting Entries, (4) Fund Balance with Treasury (FBWT), (5) Environmental Liabilities, (6) General Property, Plant, and Equipment, and (7) Accounts Payable.

B. Mission of the DLA

The DLA's primary mission is to provide best value logistics integrated solutions to meet the needs of America's Armed Forces and other designated customers in peace and in war around the clock, around the world. Support begins with joint planning for parts used in new weapons systems, extends through production and contract support, distribution and warehousing, and concludes with the disposal of materiel that is obsolete, worn out, or no longer needed.

The DLA provides supply support, technical/logistics services and quality support to all branches of the Military and other nonDoD customers. The services provided fall into the following activity groups: Supply Management, Defense Distribution Center (DDC), Defense Reutilization and Marketing Service (DRMS), and Document Automation and Production Service (DAPS). Supply Management is comprised of NonEnergy and Energy. NonEnergy supply is further divided into the following supply chains: Clothing and Textiles, Medical, Subsistence, Construction and Equipment, Aviation, Land, and Maritime.

C. Appropriations and Funds

The DLA GF receives its appropriations and funds as general funds. The DLA uses these appropriations and funds to execute its missions and subsequently report on resource usage.

General funds are used for financial transactions funded by congressional appropriations including personnel, operation and maintenance; research and development; procurement; and military construction accounts.

The Operation and Maintenance appropriation finances Other Logistics Services, Other Logistics Programs, and environmental programs.

The Research, Development, Test, and Evaluation (RDT&E) appropriation finances the development of major upgrades that increase the performance of existing systems, the purchase of test articles, and the developmental testing and/or initial operational test and evaluation prior to system acceptance.

The Procurement Defense-Wide appropriation finances mission essential equipment, including automated data processing, telecommunications equipment and passenger carrying vehicles that afford a high degree of efficiency, effectiveness, and productivity in the accomplishment of DLA's logistics mission.

The Military Construction (MILCON) appropriation finances the construction of facilities to support DLA's logistic support mission to include DoD fuel infrastructure projects (strategic refueling mission, environmental concerns, and fuel operations). The DLA suballots MILCON funds to certain entities such as the U.S. Army Corps of Engineers (USACE) for the execution of specific authorized programs.

The Family Housing appropriation finances the routine operations, maintenance and construction improvements of 201 military family housing units. Routine operation and maintenance includes management costs, utility costs and cyclical maintenance such as painting and renovations.

D. Basis of Accounting

For FY 2007, DLA's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DLA's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of DLA's legacy systems were designed to record information on a budgetary basis.

The DoD has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Starting in 2001, DLA undertook a major initiative to implement an ERP system. This effort, now known as EBS, became fully operational as of July 2007. The DLA plans to expand EBS, a USSGL compliant system, to all GF appropriations except for MILCON and a small portion of RDT&E funding. Until all of DLA's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DLA's financial data will be derived from budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DoD identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon performance measures as required by the Government Performance and Results Act. The DoD is working towards a cost reporting methodology that meets the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government.

E. Revenues and Other Financing Sources

The DLA receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The DLA recognizes revenue as a result of costs incurred for goods or services provided to other federal agencies and the public. Full cost pricing is DLA's standard policy for services provided as required by OMB Circular A-25, User Charges. The DLA recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The DLA does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Note 12, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because DLA's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue.

G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, DLA cannot accurately eliminate intragovernmental transactions by customer because all of DLA's systems do not track at the transaction level. Generally, seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. IntraDoD intragovernmental balances are then eliminated. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements to ensure accurate intragovernmental information, to include sufficient up-front edits and controls eliminating the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government and the U.S. Treasury's Federal Intragovernmental Transactions Accounting Policy Guide provide guidance for reporting and reconciling intragovernmental balances. While DLA is unable to fully reconcile intragovernmental transactions with all federal partners, DLA is able to reconcile balances pertaining to Federal Employees' Compensation Act transactions with the Department of Labor and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the U.S. Treasury does not allocate such interest costs to the benefiting agencies.

H. Funds with the US Treasury

The DLA's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the USACE, and the Department of State's financial service centers process the majority of DLA's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and the USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records this information to the applicable FBWT account. Differences between DLA's recorded balance in FBWT accounts and U.S. Treasury's FBWT accounts sometimes result, and are subsequently reconciled.

I. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based on the Analysis of Receivables by Age Group method. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures. These procedures are defined in the Intragovernmental Business Rules published in the Treasury Financial Manual and are available for download at http://www.fms.treas.gov/tfm/vol1/07-03.pdf.

J. General Property, Plant, and Equipment

In FY 2006, the DoD revised the real property capitalization threshold from $100 thousand to $20 thousand. The current $100 thousand capitalization threshold remains unchanged for the remaining General PP&E categories. The DLA has not fully implemented this revised policy due to system and process limitations.

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

General PP&E previously capitalized at amounts below $100 thousand was written off General Fund financial statements in FY 1998.

K. Advances and Prepayments

The DoD's policy is to record advances and prepayments in accordance with GAAP. As such, payments made in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The DLA follows DoD's policy to expense and/or properly classify assets when the related goods and services are received.

L. Other Assets

Other assets include those assets, such as civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on DLA's Balance Sheet.

The DLA 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 may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property are reported as construction in progress. It is DoD policy to record certain contract financing payments as Other Assets.

M. Contingencies and Other Liabilities

The SFFAS No. 5, Accounting for Liabilities of the Federal Government, as amended by SFFAS No. 12, Recognition of Contingent Liabilities Arising from Litigation, defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DLA recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

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

Other liabilities arise as a result of anticipated disposal costs for DLA's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, Accounting for Property, Plant and Equipment, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon DoD's policy, which is consistent with SFFAS No. 5, Accounting for Liabilities of Federal Government. The DLA has not fully implemented these policies due to system and process limitations.

N. Accrued Leave

The DLA reports as liabilities civilian earned leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. Sick and other types of nonvested leave are expensed as taken. The liability reported at the end of the accounting period reflects the current pay rates.

O. Net Position

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

Unexpended appropriations represent the amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative results of operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfer in and out of assets that were not reimbursed.

P. Unexpended Obligations

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

Q. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in DLA's activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the monthly accounting reports. Intransit payments are those payments that have been made but have not been recorded in the fund holder's accounting records. These payments are applied to the entities' outstanding accounts payable balance. Intransit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

R. Significant Events

Beginning 4th Quarter, FY 2007 the Department began presenting the Statement of Financing (SOF) as a note in accordance with OMB Circular A-136. The SOF will no longer be considered a basic statement and is now referred to as Reconciliation of Net Cost of Operations to Budget.

Note 2. Entity Assets

As of September 30	2007	2006
(Amounts in thousands)		
Total Entity Assets	$ 1,138,620	$ 1,219,241
Total Assets	$ 1,138,620	$ 1,219,241

Note 3. Fund Balance with Treasury

As of September 30	2007		2006	
(Amounts in thousands)				
Fund Balances				
Appropriated Funds	$	725,689	$	783,763
Total Fund Balances	$	725,689	$	783,763
Fund Balances Per Treasury Versus Agency				
Fund Balance per DLA		725,689		783,763
Reconciling Amount	$	(725,689)	$	(783,763)

The DLA shows a reconciling net difference of $725.7 million with U.S. Treasury. The U.S. Treasury maintains and reports fund balances at the Treasury Index appropriation level. Defense Agencies, to include DLA, are included at the Treasury Index 97 appropriation level, an aggregate level that does not provide identification of the separate Defense Agencies. As a result, the U.S. Treasury does not separately report an amount for DLA and, therefore, the entire DLA Fund Balance with Treasury (FBWT) amount is reflected as a reconciling amount.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represents adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Status of Fund Balance with Treasury

As of September 30	2007		2006	
(Amounts in thousands)				
Unobligated Balance				
Available	$	185,686	$	108,487
Unavailable		34,300		83,758
Obligated Balance not yet Disbursed		527,619		599,814
NonFBWT Budgetary Accounts		(21,916)		(8,296)
Total	$	725,689	$	783,763

The DLA's Status of Fund Balance with Treasury reflects the budgetary resources to support the FBWT.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

NonFBWT Budgetary Accounts represents adjustments to budgetary accounts that do not affect FBWT. DLA's NonFBWT Budgetary Accounts consist of unfilled customer orders without advance and accounts receivables. This category reduces the Status of FBWT.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. There are no restrictions on DLA's unobligated balances.

Disclosures Related to Problem Disbursements

As of September 30	2005	2006	2007	(Decrease)/ Increase from FY 2006 to 2007
(Amounts in thousands)				
Total Problem Disbursements (Absolute Value)				
Unmatched Disbursements (UMDs)	$ 28	$ 163	$ 674	$ 511
Negative Unliquidated Obligations (NULO)	6	50	55	5
In-Transit Disbursements	3,410	6,837	11,066	4,229
Total	$ 3,444	$ 7,050	$ 11,795	$ 4,745

Problem Disbursements are reported as an absolute value amount. Absolute value is the sum of the positive values of debit and credit transactions without regard to the plus or minus signs.

An Unmatched Disbursement occurs when a payment is not matched to a corresponding obligation in the accounting system.

A Negative Unliquidated Obligation occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The Intransits represent the absolute value of disbursements and collections made by a Department of Defense disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

Beginning with 2nd Quarter, FY 2007, intransit disbursements are reported as an absolute value as opposed to net amounts disclosed in prior years. This reporting change applies to amounts in the note schedule for both the current and comparative years.

Note 4. Accounts Receivable

As of September 30	2007			2006
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
Intragovernmental Receivables	$ 17,933	N/A	$ 17,933	$ 7,945
Nonfederal Receivables (From the Public)	268	0	268	365
Total Accounts Receivable	$ 18,201	$ 0	$ 18,201	$ 8,310

Aged Accounts Receivable

As of September 30	2007		2006	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
(Amounts in				
CATEGORY				
Nondelinquent				
Current	$ 17,917	$ 186	$ 10,754	$ 365
Delinquent				
1 to 30 days	$ 16	$ 1	$ (2,810)	$ 0
31 to 60 days	0	73	0	0
61 to 90 days	0	2	0	0
91 to 180 days	0	0	0	0
181 days to 1 year	0	5	0	0
Subtotal	$ 17,933	$ 267	$ 7,944	$ 365
Less Supported Undistributed Collections	0	1	0	0
Total	$ 17,933	$ 268	$ 7,944	$ 365

Abnormal Balance

The Intragovernmental delinquent receivable balance as of 4th Quarter, FY 2006 reflects an abnormal balance of $2.8 million in the 1 to 30 day aging category. During September 2006, the Defense Finance and Accounting Service (DFAS) billed and collected approximately $312 thousand for the Defense MicroElectronics Activity sales. However, this collection was inadvertently keyed as a $3.1 million collection. This resulted in a negative Accounts Receivable balance of $2.8 million (the difference between the recorded amount and the actual collection). The DLA took appropriate action to correct the error during 1st Quarter, FY 2007.

Collection Action for Delinquent Receivables

Intragovernmental delinquent receivables balance as of 4th Quarter, FY 2007 is $16 thousand for the 1 to 30 day aging category. This balance resulted from an administrative error which prevented the collection from being posted correctly due to a lack of supporting documentation. The DLA and DFAS, which provides accounting functions for DLA, resolved the issue by obtaining the necessary documents in October 2007 after 4th Quarter close.

Nonfederal delinquent receivables balance as of 4th Quarter, FY 2007 is $81 thousand. The delinquent debt represents refund receivables for duplicate payments to vendors and over payments to travelers. Approximately $76 thousand is being recouped by internal offset where the overpayment will be deducted from a future invoice received from the vendor. The remaining $5 thousand has been referred to the Debt Management Office in accordance Department of Defense Financial Management policy and procedures.

Note 5. Other Assets

As of September 30	2007	2006
(Amounts in thousands)		
Nonfederal Other Assets		
Outstanding Contract Financing Payments	$ 0	$ 550
Other Assets (With the Public)	0	12
Total Nonfederal Other Assets	$ 0	$ 562
Total Other Assets	$ 0	$ 562

Note 6. General PP&E, Net

As of September 30	2007					2006
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
Major Asset Classes						
Construction-in-Progress	N/A	N/A	$ 394,730	$ N/A	$ 394,730	$ 426,606
Total General PP&E			$ 394,730	$ 0	$ 394,730	$ 426,606

The DLA General Fund (GF) General Property, Plant and Equipment (PP&E) consists of only construction in progress (CIP). The CIP is funded by the Military Construction (MILCON) and Family Housing appropriations. The CIP account is used to accumulate the costs of real property assets under construction until the construction is completed and the assets are available for use. These costs include direct labor, direct material and overhead, as well as engineering and design costs. When construction is completed and the constructed asset is available for use, the asset is transferred from the DLA GF CIP account to the appropriate Service's General PP&E account.

For MILCON projects, DLA transfers resources to the U.S. Army Corps of Engineers, Navy Facilities Engineering Command, and the Air Force to manage and execute construction projects. These agencies maintain CIP accounts for each construction project they are managing and are responsible for facilitating the transfer of completed assets to the applicable real property account.

Note 7. Liabilities Not Covered by Budgetary Resources

As of September 30	2007		2006	
(Amounts in thousands)				
Intragovernmental Liabilities				
Other	$	4,967	$	5,132
Total Intragovernmental Liabilities	$	4,967	$	5,132
Nonfederal Liabilities				
Accounts Payable		2,256		2,090
Military Retirement and Other Federal Employment Benefits		6,223		6,787
Environmental Liabilities		243,664		204,824
Other Liabilities		2,218		2,413
Total Nonfederal Liabilities	$	254,361	$	216,114
Total Liabilities Not Covered by Budgetary Resources	$	259,328	$	221,246
Total Liabilities Covered by Budgetary Resources	$	37,093	$	56,370
Total Liabilities	$	296,421	$	277,616

Liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided. The DLA General Fund current year liabilities not covered by budgetary resources are primarily comprised of environmental liabilities. These environmental liabilities are estimates related to future events, and therefore are unfunded.

Description of "Other" Lines

Intragovernmental liabilities other primarily consist of the 4th Quarter, FY 2007 estimated unemployment compensation.

Nonfederal liabilities other consist of accruals recorded by DLA for unfunded leave due to civilian employees. It also includes the unpaid portion of compensatory time and credit hours not taken, but earned by employees who are entitled to compensation. The DLA began recording an accrual for civilian employee compensatory time and credit hours earned but not used during 3rd Quarter, FY 2006 in accordance with Department of Defense guidance.

Military Retirement and Other Federal Employment Benefits

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources are comprised of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities are primarily comprised of Federal Employees Compensation Act benefits for $6.2 million. Refer to Note 11, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures

Note 8. Accounts Payable

As of September 30	2007			2006
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
Intragovernmental Payables	$ 9,173	$ N/A	$ 9,173	$ 3,781
Nonfederal Payables (to the Public)	8,024	0	8,024	12,390
Total	$ 17,197	$ 0	$ 17,197	$ 16,171

The DLA's systems do not track all intragovernmental transactions by customer at the transaction level. Therefore, internal Department of Defense buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts payable were adjusted by reclassifying amounts between federal and nonfederal accounts payable.

Note 9. Environmental Liabilities and Disposal Liabilities

As of September 30	2007			2006
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Environmental Liabilities--Nonfederal				
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 29,761	$ 186,685	$ 216,446	$ 197,765
Environmental Corrective Action	16	11,518	11,534	11,534
Installation Restoration Program	15,444	20,201	35,645	36,789
Total Environmental Liabilities	$ 45,221	$ 218,404	$ 263,625	$ 246,088

Environmental Disclosures

The DLA's environmental liabilities (EL) are from current and out-year Remedial Action Cost Engineering & Requirements (RACER) estimates for 508 sites, 344 active and 164 Base Realignment and Closure (BRAC). In August FY 2006, DLA executed the RACER model and it generated the FY 2007 Cost to Complete (CTC) estimates which are an estimation of anticipated costs necessary to complete environmental restoration requirements. The CTC estimates for the first year plus the unliquidated obligations as of year end equal the current liability. All remaining CTC estimates are categorized as noncurrent liabilities.

The DLA has developed a plan for collecting and reporting EL for Non Defense Environmental Restoration Program (NonDERP) contamination at DLA managed installations including government-owned contractor-operated (GOCO) fuel points and for Service-owned and operated fuel terminals where DLA stores fuel. To obtain the Service-owned fuel terminals data, DLA developed an environmental template that will be provided to the Military Services after the Office of the Under Secretary of Defense (Comptroller) resolves real property record inconsistencies between the Military Services and DLA. This template will be used to populate the Environmental Disclosures table and for the reporting of overseas base EL in the 1st Quarter, FY 2008 financial statement.

Applicable Laws and Regulations for Cleanup Requirements

The DLA 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. The DLA is required to follow the Comprehensive Environmental Response, Compensation, and Liability Act; Resource Conservation and Recovery Act; and the Superfund Amendments and Reauthorization Act to clean up contamination on installations managed by DLA in coordination with regulatory agencies. This cleanup may at times extend beyond installation boundaries onto privately owned property and to sites where DLA is named as a potentially responsible party by a regulatory agency.

Types of Environmental Liabilities and Disposal Liabilities

The DLA has cleanup requirements for Defense Environmental Restoration Program (DERP) sites at active installations, Base Realignment and Closure (BRAC) installations, and sites at active installations that are not covered by DERP. All cleanup is done in coordination with regulatory agencies, other responsible parties, and current property owners.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating Periods.

The DLA uses the RACER model, an independently validated model, to estimate environmental costs. The DLA validates the model in accordance with Department of Defense (DoD) Instruction 5000.61 and primarily uses the model to estimate the liabilities based on data received during a preliminary assessment and initial site investigation.

In compliance with accounting standards, DLA is developing a process to capture and expense the costs for cleanup associated with General Property, Plant and Equipment (PP&E). Initial Data on the environmental cost linked to General PP&E was gathered during FY 2006 and is the basis for the development, implementation, and reporting.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, or Applicable Laws and Regulations.

The DLA had changes in estimates resulting from changes in site conditions, changes in recent groundwater modeling data, better site characterization and improved analysis by program managers. The EL are expected to fluctuate due to changes in agreements with regulatory agencies, deflation, inflation, and technology. The FY 2007 CTC has incorporated the DoD inflation factors into the NonDERP closure estimates. The latest version of RACER (2007) was used to rebaseline estimates.

Uncertainty Regarding the Accounting Estimates used to Calculate the Reported Environmental Liabilities.

The EL for DLA are based on accounting estimates and assumptions that are believed to be reasonable based upon information available at the time of the RACER calculation. The actual results may materially vary from the accounting estimates if agreements with the regulatory agencies require different remediation than anticipated at the time of the calculation. The liabilities can be further impacted if further investigation of the environmental sites discloses contamination different than known at the time of the estimate.

Although DLA has instituted extensive internal controls to ensure that these estimates are accurate and reproducible, they are generally considered accurate at +/- 40%. The stated noncurrent liability is an estimate of future liabilities, as the majority of DLA sites will require cleanup for up to 30 years. Estimates for work that are more than 1 to 2 years in the future may be subject to significant change.

Liability for Overseas Bases

In addition to the liabilities reported above, DLA has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The DLA is unable to provide a reasonable estimate at this time because the extent of restoration required is not known.

Note 10. Other Liabilities

As of September 30	2007			2006
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Intragovernmental				
FECA Reimbursement to the Department of Labor	$ 582	$ 171	$ 753	$ 888
Other Liabilities	4,941	0	4,941	4,386
Total Intragovernmental Other Liabilities	$ 5,523	$ 171	$ 5,694	$ 5,274
Nonfederal				
Accrued Funded Payroll and Benefits	$ 390	$ 0	$ 390	$ 0
Accrued Unfunded Annual Leave	2,218	0	2,218	2,413
Other Liabilities	1,074	0	1,074	883
Total Nonfederal Other Liabilities	$ 3,682	$ 0	$ 3,682	$ 3,296
Total Other Liabilities	$ 9,205	$ 171	$ 9,376	$ 8,570

Description of “Other” Lines

Intragovernmental Other Liabilities consists primarily of amounts for unfunded unemployment compensation not covered by the current year’s budget authority.

Nonfederal Other Liabilities is comprised of contract holdbacks related to Operations and Maintenance and Military Construction projects managed by the U.S. Army Corps of Engineers. Contract holdbacks are withheld from contractors pending completion of related payments for open contracts.

Note 11. Military Retirement and Other Federal Employment Benefits

As of September 30	2007 Present Value of Benefits	2007 Assumed Interest Rate (%)	2007 (Less: Assets Available to Pay Benefits)	2007 Unfunded Liability	2006 Present Value of Benefits
(Amounts in thousands)					
FECA	$ 6,223		$ 0	$ 6,223	$ 6,787
Total Other Actuarial Benefits	$ 6,223		$ 0	$ 6,223	$ 6,787
Total Military Retirement and Other Federal Employment Benefits:	$ 6,223		$ 0	$ 6,223	$ 6,787

Actuarial Calculations

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

Actuarial Cost Method and Assumptions

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

- 4.930% in Year 1
- 5.078% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (COLAs) and medical inflation factors (Consumer Price Index Medical (CPIMs)) were applied to the calculation of projected future benefits. These factors were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2007	2.63%	3.74%
2008	2.90%	4.04%
2009	2.47%	4.00%
2010	2.37%	3.94%
2011+	2.30%	3.94%

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

Programs Upon Which Actuarial Calculation are Based (Retirement Systems)

The DLA interacts with, and is dependent upon the financial activities of the Federal Government as a whole. The DLA's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) while the Military Retirement System (MRS) covers military personnel. Additionally, personnel covered by FERS and MRS also have varying coverage under Social Security. The DLA finances only a portion of the civilian pensions. While reporting and funding civilian pensions under CSRS and FERS is the responsibility of Office of Personnel Management, DLA recognizes an imputed expense for the portion of civilian employee pension's benefit on the Statement of Net Cost. The DLA also recognizes corresponding imputed revenue from the civilian employee pension's benefit on the Statement of Changes in Net Position.

Note 12. General Disclosures Related to the Statement of Net Cost

As of September 30		2007		2006
(Amounts in thousands)				
Intragovernmental Costs	$	130,994	$	239,667
Public Costs		573,116		137,406
Total Costs	$	704,110	$	377,073
Intragovernmental Earned Revenue		(22,323)		(15,339)
Public Earned Revenue		(31,809)		(11,506)
Total Earned Revenue	$	(54,132)	$	(26,845)
Net Cost of Operations	$	649,978	$	350,228

Intragovernmental costs and earned revenues are related to transactions made between two reporting entities within the Federal Government. Public costs and earned revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The DLA's systems do not track all intragovernmental transactions by customer at the transaction level. Therefore, internal Department of Defense buyer-side balances are adjusted to agree with internal seller-side balances for revenue. Expenses were adjusted by reclassifying amounts between federal and nonfederal expenses.

The Statement of Net Cost is unique because its principles are driven on understanding the net cost of programs and/or organizations that the Federal Government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

The amounts presented in this statement do not meet accounting standards and are based on budgetary obligations, disbursement and collection transactions, as well as nonfinancial feeder systems, adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

Note 13. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2007		2006	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(Amounts in thousands)				
Civilian CSRS/FERS Retirement	$ 935	$ 0	$ 1,072	$ 0
Civilian Health	1,138	0	1,127	0
Civilian Life Insurance	5	0	5	0
Total Imputed Financing	$ 2,078	$ 0	$ 2,204	$ 0

Imputed Financing

The amounts DLA remits to the Office of Personnel Management (OPM) by and for employees covered by the Civilian Service Retirement System, Federal Employee Retirement System, Federal Employee Health Benefits and Federal Employee Group Life Insurance, do not fully cover the Federal Government's cost to provide these benefits. The financial statements include an imputed cost made to recognize the difference between the government's and DLA's costs of providing these benefits to the employees and contributions made by and for them. The OPM provides the cost factors to Defense Finance & Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) (OUSD (P&R)) and DLA for validation. After validation, OUSD (P&R) provides the imputed costs to the reporting components for inclusion in their financial statements.

Other Disclosures

The $10.3 million in Other adjustments (rescissions, etc) are permanent reductions to unexpended appropriations in Operations and Maintenance, Research, Development, Test & Evaluation and Military Construction.

Note 14. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2007	2006
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 510,628	$ 585,269

The DLA apportionment categories for obligations incurred are Category A direct and reimbursable obligations and Category B direct obligations. The table below summarizes the apportionment categories

($ millions)	Category A	Category B	Totals
DirectObligations			
Incurred	380.6	254.3	634.9
Reimbursable Obligations			
Incurred	26.5	0.0	26.5
Total	407.1	254.3	661.4

Other Disclosures

The Statement of Budgetary Resources (SBR) includes intraentity transactions because the statements are presented as combined.

To improve financial reporting, during FY 2006 DLA began using financial data from source system for financial reporting. Previous reports were derived from other budgetary systems. As a result of the revised process, a $33.6 million adjustment was required in 4th Quarter, FY 2007 to bring the SBR and SF-133 total actual resources collected carried forward balance in to agreement. The FY 2007 yearend closing entries will eliminate future differences.

Note 15. Reconciliation of Net Cost of Operations to Budget

As of September 30		2007		2006
(Amounts in thousands)				
Resources Used to Finance Activities:				
Budgetary Resources Obligated:				
Obligations incurred	$	661,382	$	765,428
Less: Spending authority from offsetting collections and recoveries (-)		(42,126)		(76,147)
Obligations net of offsetting collections and recoveries		619,256		689,281
Net Obligations	$	619,256	$	689,281
Other Resources:				
Transfers in/out without reimbursement (+/-)		(98,526)		(71,901)
Imputed financing from costs absorbed by others		2,078		2,204
Net Other Resources Used to Finance Activities	$	(96,448)	$	(1,184)
Total Resources Used to Finance Activities	$	522,808	$	688,097
Resources Used to Finance Items not Part of the Net Cost of Operations:				
Undelivered Orders (-)		74,642		(104,434)
Unfilled Customer Orders		3,815		0
Resources that fund expenses recognized in prior Periods (-)		(924)		(41,952)
Resources that finance the acquisition of assets (-)		(158)		0
Other (+/-)		98,526		3,389
Total Resources Used to Finance Items not Part of the Net Cost of Operations	$	175,901	$	(142,997)
Total Resources used to Finance the Net Cost of Operations	$	698,709	$	545,100

Reconciliation of Net Cost of Operations to Budget (Continued):

As of September 30	2007	2006
(Amounts in thousands)		
Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	$ 0	$ 32
Increase in environmental and disposal Liability	17,537	0
Other (+/-)	166	3,061
Total Components Requiring or Generating Resources in Future Periods	$ 17,703	$ 3,093
Components not Requiring or Generating Resources:		
Revaluation of assets or liabilities (+/-)	7,492	29,587
Other	(73,926)	(227,552)
Total Components not Requiring or Generating Resources	$ (66,434)	$ (197,965)
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$ (48,731)	$ (194,872)
Net Cost of Operations	$ 649,978	$ 350,228

The Reconciliation of Net Cost of Operations to Budget provides information on the total resources used by DLA - both those received through the budget and those received by other means. It reconciles the budgetary obligations incurred to the net cost of operation for a given reporting period. It articulates and details the relationship between net obligations from budgetary accounting and net cost of operations from proprietary accounting.

Due to DLA's financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data is a previously identified deficiency.

The reconciliation requires that adjustments be processed because of imbalances between the budgetary and proprietary amounts recorded in DLA's accounting systems. The balancing entries for DLA include adjustments with an absolute value of $0.6 million to Other Components Not Requiring or Generating Resources and $5.5 million to Revaluation of Assets or Liabilities lines. These adjustments were required in order to bring the reconciliation into agreement with the Statement of Net Cost.

The following note schedule lines are presented as combined instead of consolidated due to intraagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

The $38.1 million change between 4th Quarter, FY 2007 and 4th Quarter, FY 2006 in Liabilities Not Covered by Budgetary Resources on the Balance Sheet (Note 7) differs from the $17.7 million amount reported as of 4th Quarter, FY 2007 in Components Requiring or Generating Resources in Future Period on this note schedule. The $20.4 million difference is comprised of a $0.9 million decreases in the future funded liabilities and $19.5 million decrease from reclassifying environmental liabilities from uncovered to covered.

Other Disclosures

Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations: Other. This line consists of transfers out of Construction in Progress (CIP) to the appropriate Services upon completion.

Components Requiring or Generating Resources in Future Period: Other. This line consists primarily of future funded expense for reestablished accounts payable for a cancelled appropriation.

Components Not Requiring or Generating Resources: Other. This line consists primarily of operating expenses that were reclassified as CIP.

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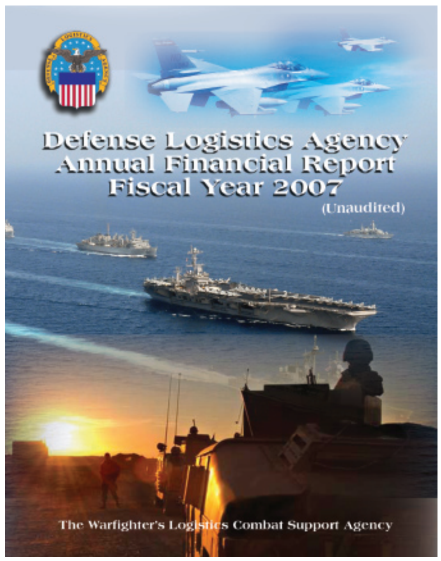
Defense Logistics Agency



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Fiscal year 2007