



Defense Logistics Agency **Annual Financial Report** **Working Capital Fund**

Fiscal Year 2017
(Unaudited)





DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND AGENCY FINANCIAL REPORT



DEFENSE LOGISTICS AGENCY

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Defense Logistics Agency Working Capital Fund Fiscal Year 2017 Agency Financial Report

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Message from the Director

MESSAGE FROM THE DIRECTOR DECEMBER 2017

For more than five decades, we have a proud history of providing the right support, to the right place, at the right time, across the globe. Our Nation has a powerful military force, capable of swiftly responding to any challenge, at a moment's notice. Our Soldiers, Marines, Sailors, and Airmen rely on the men and women of the Defense Logistics Agency (DLA) to accomplish their mission. Through continued collaboration and innovation, we continue to be the standard-bearer for joint logistics and acquisition - delivering world-class support to the Warfighter.



Through the issuance of the National Defense Authorization Act of 2010, Congress mandated that the entire Department of Defense assert auditability of its financial statements by the end of Fiscal Year (FY) 2017. Knowing that DLA was up to the challenge, the Agency voluntarily accelerated our audit readiness goal to the end of FY 2015. We are now in the midst of our first enterprise-wide full financial statement audit and stand ready to continue the annual audit cycle; this is not a one-and-done exercise.

We have entered the initial year of audit in FY 2017 and have been advised by the Independent Public Accountant (IPA) of the intent for disclaimer of opinion for the Agency's Working Capital Fund, General Fund and Transaction Fund (TF) financial statements. We have been transparent with our challenge areas and identified material weaknesses and critical corrective action plans where necessary. Each audit report will help DLA build a better foundation and act as iterative stepping stones towards the eventual attainment and sustainment of a clean audit opinion.

While DLA's audit journey is far from over, the Agency has made tremendous strides from audit readiness to audit advancement. As we enter FY 2018, I am confident in our abilities to support our Warfighters and Whole of Government Agencies with reliable financial information and resources while meeting the Department's challenges, no matter how difficult or complex. Our ability to become more effective and efficient with the resources we have is critical to moving forward, especially as we are asked to do more with less. With a solid foundation, an agile, professional workforce, and a constant desire to improve our support to the Warfighter around the globe, we will continue to be the Nation's best Combat Logistics Support Agency. I am proud of where we have come and where we are headed into the future of audit advancement.

A handwritten signature in black ink, appearing to read 'Darrell K. Williams'.

DARRELL K. WILLIAMS
Lieutenant General, USA
Director



Management's Discussion and Analysis

The ***Management's Discussion and Analysis*** is required supplementary information to the financial statements and provides a high-level overview of the Defense Logistics Agency (DLA). This is required per the Office of Management and Budget (OMB) Circular A-136 and Statements of Federal Financial Accounting Standards (SFFAS) No. 15.

The ***Overview*** section describes the DLA's organization, its missions and goals, and provides an overview of our DLA Commands.

The ***Performance Overview*** section provides a summary of each DLA mission, selected accomplishments, key performance measures, and future initiatives to strengthen the DLA's efforts in supporting Department of Defense (DoD) objectives and missions.

The ***Financial Overview*** section provides a summary of DLA's financial data explaining the major sources and uses of funds and provides a quick look at our Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Limitations of Financial Statements.

The ***Management Assurances*** section provides the Director's Assurance Statement related to the Federal Managers' Financial Integrity Act and the Federal Financial Management Improvement Act. This section also describes the DLA's efforts to address our financial management systems to ensure systems comply with applicable accounting principles, standards, requirements, and with internal control standards.

Overview

Our Organization

Mission and Organizational Structure

DLA reports to the Office of the Under Secretary of Defense (OUSD) for Acquisition, Technology and Logistics (AT&L) through the Deputy Under-Secretary of Defense for Logistics and Materiel Readiness. DLA provides support around the clock and around the world to meet the needs of America's Armed Forces and other designated customers in times of peace, national emergency, and war. America's national defense strategy depends on DLA's support to feed, clothe, fuel, medicate, treat, and sustain U.S. and many allied nations' troops. DLA supports DoD objectives and missions with involvement in the full range of military operations from participation with multi-national forces engaged in large-scale combat operations, weapons and spares provisions, peacekeeping efforts, emergency support, to humanitarian assistance.

DLA sources and provides nearly all consumable items used by American military forces worldwide. DLA manages nearly 5.1 million separate line items of inventory for land and maritime parts for weapon systems, fuel, and critical troop-support items involving food, clothing and textiles, medical, industrial hardware, and construction equipment and materiel. Additionally, DLA provides a broad array of associated supply chain services that include storage and distribution; reutilization or disposal of surplus military assets; providing catalogs and other logistics information, services; and, document automation and production services.

DLA's Mission Vision and Values

Mission	Vision	Values
Provide effective and efficient global solutions to Warfighters and our other valued customers	Deliver the right solution on time, every time	Integrity, Resiliency, Diversity, Innovation, Accountability, Excellence

DLA employs approximately 24,700 civilian personnel, 520 active duty military personnel, and 570 reserve personnel who operate a \$42.0 billion global enterprise in 28 countries. DLA manages nine supply chains and supports more than 2,300 weapon systems. The nine supply chains are: DLA Aviation, DLA Land, DLA Maritime, DLA Energy, Subsistence, Medical, Clothing and Textiles, Construction and Equipment, and Industrial Hardware. Agency leaders are committed to the continuous assessment and transformation of the organizational culture, size, structure, and alignment through enterprise integration and partnering with the private sector. Organizing as a single, integrated business enterprise enables DLA to focus on supporting the DoD's supply chains, enhancing the Armed Forces' readiness, and providing for the Warfighter during contingency operations.

This Agency Financial Report (AFR) is prepared for the DLA's Working Capital Fund (WCF). Information is provided for WCF, where applicable, and other information is for the DLA Enterprise-Wide.

WHO'S WHO IN DLA



Figure 1, the DLA Organizational Chart

DLA Major Subordinate Commands (MSCs)

DLA AVIATION, headquartered in Richmond, Virginia, is the primary source for over 1.1 million repair parts and operating supply items for more than 1,340 major weapon systems. The DLA Aviation Supply Chain provides mapping, kitting, chemical, petroleum packaging, gases, and cylinder items to the Military Services. In addition, DLA Aviation provides engineering, sustainability, ozone depleting substances reserve, and industrial plant equipment services.

DLA DISPOSITION SERVICES, headquartered in Battle Creek, Michigan, receives excess, obsolete, and unserviceable (EOU) DoD property, providing ultimate disposition through reutilization, transfer, donation, and sales. In FY 2017, DLA Disposition Services received an estimated \$29.0 billion of EOU inventory, \$1.4 billion was reutilized and issued back to the Military Services. The reutilization of excess property provides the Services an opportunity to get property at no cost. DLA Disposition Services sales generated approximately \$119.0 million of revenue in FY 2017, offsetting operational costs.

DLA DISTRIBUTION, headquartered in New Cumberland, Pennsylvania, is responsible for the receipt, storage, issuance, packing, preservation, and transportation of more than 4 million items worldwide. It operates a network of 26 distribution centers around the world that provide timely and quality support to the Warfighters. Its Global Stock Position Plan ensures rapid distribution of critical military items. DLA Distribution's overseas distribution operations are located in Europe, Middle East, and Pacific Asia regions.

DLA ENERGY, headquartered at Fort Belvoir, Virginia, serves as the DLA's executive agent for the bulk petroleum supply chain. DLA Energy business includes sales of petroleum and aerospace fuels; arranging for petroleum support services; providing facility/equipment maintenance on fuel infrastructure; performing energy-related environmental assessment and cleanup; storage and transportation for bulk and aerospace products; and performing quality surveillance functions for petroleum for the Military Services, as well as for the privatization of their utility systems.

DLA LAND AND MARITIME, headquartered in Columbus, Ohio, is the primary source for over 420,000 repair parts and 1.5 million operating supply items, for land and sea-based weapon systems. The DLA Land and Maritime Supply Chains provide product testing, engineering, and technical support to the Military Services. In addition, the DLA Land and Maritime Supply Chains support Navy Surface and Subsurface and Army and Marine Corps customers through dedicated customer relations while working with numerous suppliers to fulfill requirements for assigned stock classes across the DoD. Furthermore, the DLA Land and Maritime Supply Chains provides logistical services directly to Navy shipyards and Army/United States Marine Corps industrial sites.

DLA TROOP SUPPORT, headquartered in Philadelphia, Pennsylvania, is DLA's lead center for troop and general support. Troop Support is responsible for managing food, clothing, medical supplies, construction and equipment, and general and industrial supplies worldwide. DLA Troop Support has the following Supply Chains: Subsistence, Clothing & Textile, Construction & Equipment, Medical, and Industrial Hardware.

DLA J/D Codes

DLA GENERAL COUNSEL provides legal services and guidance to the DLA Director, senior leadership, and staff.

DLA OFFICE OF THE INSPECTOR GENERAL leverages audit and investigative expertise to provide DLA leadership with timely facts to make informed decisions that improve efficiency, accountability and warfighter support.

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

DLA TRANSFORMATION (DT) manages the Agency's strategic plan, executive governance forums, and the agency-wide deployment of Enterprise Process Management, Continuous Process Improvement (CPI), Enterprise Organizational Alignment, and Enterprise Policy Management programs.

DLA HUMAN RESOURCES (J1) provides the full range of human resources services, both policy and operational, for DLA's civilian and active duty military employees. DLA Human Resources (HR) recruits, hires, trains, and sustains a mission-ready workforce for DLA and our HR customers, using world class policies, processes, programs, and tools.

DLA LOGISTICS OPERATIONS (J3) manages DLA's supply chains by providing logistics and materiel management policy, guidance, oversight, and monitoring of supply chain performance.

DLA INFORMATION OPERATIONS (J6) as DLA's knowledge broker, provides comprehensive, best practice technological support to the DoD/DLA logistics community for information systems; efficient and economical computing; data management; electronic commerce; telecommunication

services; and transaction services. The Director of Information Operations also serves as DLA's Chief Information Officer. J6 manages DLA's Research and Development program.

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

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

DLA JOINT RESERVE FORCE (J9) provides DLA with trained, ready, and available reservists from all Service components for worldwide contingency operations and support of peacetime operations, wartime surge requirements, and logistics planning.



Figure 2, the locations of the major DLA offices

Our Strategic Framework

Agency Goals and Objectives

DLA is committed to achieving significant savings for its customers. In April 2015, the former DLA Director, Lieutenant General Andrew Busch, refreshed the Agency's long-term strategy to concentrate on attaining savings while continuing to identify new opportunities to reduce cost. Our current Director, Lieutenant General Darrell Williams, is updating the Agency's strategic plan to reflect the current environment and anticipates publishing the updated plan near the beginning of FY 2018. DLA's Director's annual guidance is derived from the Agency's long-term strategy and serves to align DLA's support to DLA's goals and objectives. DLA continues to provide world-class support to the Warfighter – delivering the right solution on time, every time – through pursuit of the five goals described in Figure 3: Agency Goals and Objectives, which support the Agency's strategic plan. This report is based on Lieutenant General Busch's strategic plan for the Agency.

Warfighter First: *Deliver innovative and responsive solutions to Warfighters first, DoD components and our other valued customers.*

DLA's top priority is Warfighter support. The current threat environment is complex, and we must be a trusted and responsive partner to the Warfighter as well as one that is able to anticipate changing and future needs. We ensure our organization's goals, processes, and performance are innovative, responsive, and synchronized with the current and future needs of the Warfighters, DoD components, other mission partners, and stakeholders.

People and Culture: *Hire, develop, and retain a high-performing, valued, resilient, and accountable workforce that delivers sustained mission excellence.*

DLA has always been a high-performing organization, and our workforce is our greatest asset. To further increase performance, we use innovative approaches to attract and retain mission-focused people. We foster an environment that unlocks the full potential of our workforce, enabling them to achieve peak performance and meet future challenges. To accomplish this, we continue to attract and hire highly-talented individuals, develop their competencies, and cultivate and retain the next generation of the DLA workforce.

The key to mission success is to continue our focus on people and culture. Our success depends on the readiness of our workforce to meet changing mission requirements in an evolving technological environment.

Partnering with our labor unions to communicate and implement positive change to maintain our standing as an employer of choice is vital to an invigorated, sustained, and resilient workforce.



Figure 3, the Agency Goals and Objectives

Strategic Engagement: *Engage industry and other partners in the delivery of effective and affordable solutions.*

Strong relationships with external partners are vital to achieve DLA's mission. We are, and continue to be, focused on developing innovative business relationships with our industry and DoD partners. We need to engage more closely with industry providers of materiel and to anticipate and meet the demands. As the relationships with our partners deepen, we become more knowledgeable about their strengths, challenges, and priorities. Through this knowledge, we make informed decisions in the development and delivery of the right solutions for our Warfighters. Increased communication and collaboration will benefit DLA, our industry partners, DoD, and, above all, the Warfighters.

Financial Stewardship: *Deliver effective and affordable solutions.*

Providing support to the Warfighter is our top priority. We acquire new capabilities and eliminate non-value-added processes to optimize Warfighter readiness, meet future threats, and reduce their total equipment and system ownership costs. We aggressively drive costs out of operations and materiel acquisitions to ensure an agile capability that can surge as needed to provide global military and humanitarian support.

Accountability is the foundation of good stewardship. We are steadfast in maintaining our financial commitments to our customers while ensuring value, efficiency, and effectiveness in every program. We partner with our customers to improve pricing transparency and to collaboratively develop solutions to minimize costs. We offer more discrete and flexible pricing options to allow customers to select the type of service and performance that best meets their mission and affordability needs.

Process Excellence: *Achieve Enterprise Process Excellence.*

DLA optimizes processes to obtain the most effective and efficient outcome. We obtain this goal through rigorous examination of end-to-end, core, and enabling processes coupled with the use of continuous process improvement tools. The teams are composed of individuals from diverse functional backgrounds to ensure we optimize, standardize, and implement process improvements as well as advance auditability. We achieve Process Excellence by requiring every level of leadership to evaluate, manage, and seek to improve the processes within their scope of responsibility. We systematically reassess and implement Process (Innovation) to reduce costs, increase speed, improve quality, and become a more agile organization. This is accomplished, as appropriate, within each organization and at the enterprise level. Through our governance structure, DLA enables, prioritizes, and integrates process innovation.

Process Excellence encourages simplification, improves performance, and helps DLA better achieve the outcomes Warfighters expect. At its essence, Process Excellence moves beyond the success of achieving and sustaining a positive financial statement audit and optimizes process change to bring forth the most effective and efficient outcomes in support of Warfighters, the Whole of Government, and our Nation. DLA continues to pursue initiatives that improve Warfighter support with even greater fiscal responsibility. To accomplish its strategic goals to support the Warfighter in an evolving environment, DLA established new governance forums to report progress against its goals. Figure 4 depicts how the new structure informs decision makers to enable them to optimize the use of DLA's resources.



Leading and Managing the Agency

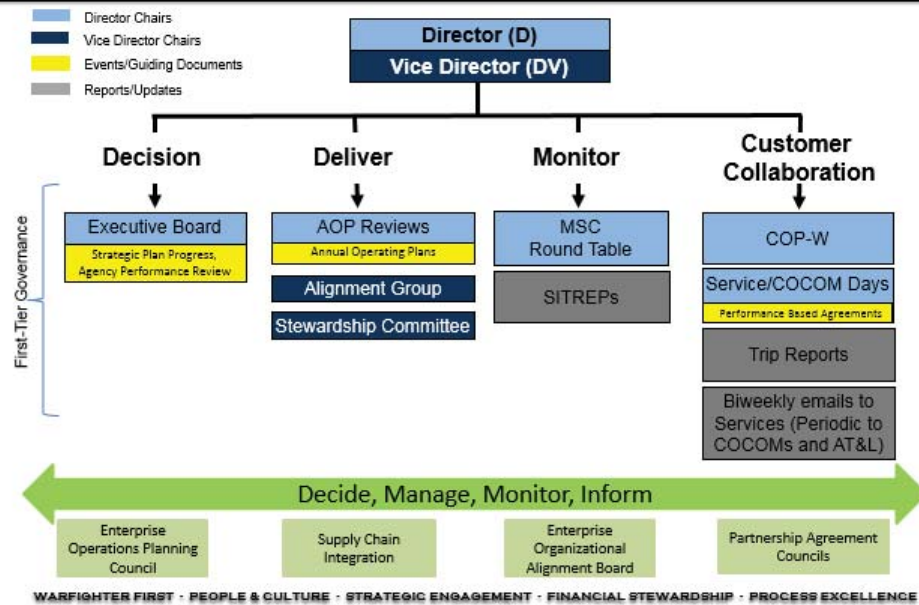


Figure 4, Leading and Managing the Agency

This Program Cost Reduction plan, which uses FY 2014 as the baseline, targeted \$13.1 billion in six years by FY 2019. Figure 5 shows the reductions by operating expenses and costs of materials. Details on the individual MSCs and staff reductions are contained in the individual Agency Operating Plans (AOPs). Please contact DLA at <http://www.dla.mil/AboutDLA/ContactUs.aspx> to request copies of AOPs.

	FY14	FY15	FY16	FY17	FY18	FY19	TOTALS
OSD-C Guidance (DLA Supply Chain Only)							
Operating Cost (\$ Millions)	\$120	\$145	\$171	\$199	\$199	-	\$834
Materiel Cost (\$ Millions)	\$416	\$629	\$850	\$735	\$745	-	\$3,375
TOTAL	\$536	\$774	\$1,021	\$934	\$944	-	\$4,209
Additional Efficiencies (DLA Supply Chain & Energy)							
Operating Cost (\$ Millions)	\$543	\$599	\$646	\$712	\$851	\$597	\$3,948
Materiel Cost (\$ Millions)	\$327	\$336	\$256	\$648	\$1,001	\$2,407	\$4,975
TOTAL	\$870	\$935	\$902	\$1,360	\$1,852	\$3,004	\$8,923
Total Savings							
Operating Cost (\$ Millions)	\$663	\$744	\$817	\$911	\$1,050	\$597	\$4,782
Materiel Cost (\$ Millions)	\$743	\$965	\$1,106	\$1,383	\$1,746	\$2,407	\$8,350
TOTAL	\$1,406	\$1,709	\$1,923	\$2,294	\$2,796	\$3,004	\$13,132
Additional Savings (MEMO)							
SNO - Phase I (Materiel)	\$57	\$58	\$0	\$0	\$0	\$0	\$115
SNO - Phase I (Operating)	\$16	\$20	\$20	\$20	\$21	\$18	\$115
FDTP (Materiel)	\$34	\$16	-\$6	\$0	-\$5	\$96	\$135
Investments (Operating & Materiel)	\$0	\$0	\$0	\$0	\$0	\$63	\$63
TOTAL	\$107	\$94	\$14	\$20	\$16	\$177	\$428
TOTAL SAVINGS	\$1,406	\$1,709	\$1,923	\$2,294	\$2,796	\$3,004	\$13.1B
"13-in-6"							

SNO – Strategic Network Optimization

FDTP – First Destination Transportation & Packaging Initiative

Figure 5, the Program Costs Reduction Targets

Analysis of DLA's Financial Statements and Stewardship Information

The following analysis provides an overview of DLA's funding mechanisms and the information presented in the financial statements and notes.

DLA's Funding Sources

DLA receives funding through its Working Capital Fund (WCF), General Fund (GF), and Transaction Fund (TF). DLA prepares financial statements and notes for the WCF, GF and TF. The WCF Financial Statements are presented only for FY 2017. The Financial Statements and the notes are not presented on a comparative basis because there are known misstatements in the FY 2016 balances that were corrected in FY 17. Therefore, presenting comparative statements would not provide additional value to the reader. The Management Discussion and Analysis (MD&A) covers all three funds due to the interrelationship between the funds.

Working Capital Fund

In FY 2017, the WCF financed \$31.9 billion in operations, making it DLA's primary source of financing for operations. 97 percent of the Agency's budget is resourced through this fund in which the agency's operating expenses are funded by revenues from customer purchases. This financing model identifies the cost to procure goods and services enabling the customer to use pricing and delivery information in its decision-making process. This visibility also supports DLA's performance measures that ensure DLA activities operate consistently within budget execution targets, address program requirements, and foster productivity improvements.

Supply Chain Management

- The WCF Supply Chain Management is DLA's largest business area and accounts for nearly all DLA assets, liabilities, revenues, and costs on its financial statements. It provides customer support through its management of logistical processes. DLA's Supply Chain Management is comprised of the DLA Supply Chain, the DLA Energy, the DLA Distribution Supply Chain, and the DLA Disposition Services Supply Chain.
 - DLA Supply Chains include DLA Aviation, DLA Land and Maritime, and DLA Troop Support. DLA Aviation provides consumable parts and operating supplies for aviation weapons systems. DLA Land and Maritime provides consumable parts and operating supplies for land and sea-based weapon systems. DLA Troop Support includes the following Material Supply Chains: Subsistence, Medical, Clothing and Textiles, Construction and Equipment, and Industrial Hardware.
 - DLA Energy provides comprehensive worldwide energy solutions to the DoD and other authorized customers. DLA Energy serves as the DLA's executive agent for the bulk petroleum supply chain. The DLA Energy business includes sales of petroleum and aerospace fuels; arranging for petroleum and aerospace support services; providing facility/equipment maintenance on fuel infrastructure; performing energy-related environmental assessment and cleanup; coordinating bulk petroleum and aerospace transportation; and performing petroleum quality surveillance functions worldwide. DLA Energy also performs procurement functions for electricity natural gas, and privatization of utility systems for the Military Services.
 - DLA Distribution provides a single, unified materiel distribution system for DoD. It receives, stores, and issues materiel worldwide. Distribution Centers also provide refrigerated storage, cylinder refurbishment, tent repair, medical unit assemblies and kitting including assembly or disassembly.
 - DLA Disposition Services 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 or state 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 DLA Disposition Services mission is to arrange for the worldwide disposal of hazardous waste in compliance with laws and regulations.

DLA Information Operations Document Services

DLA Information Operations Document Services provides printing, duplicating, and document automation services within DoD to include document workflow conversion, electronic storage and output, and distribution of hard copy and digital information.

Performance Overview

The Performance Overview provides a summary of DLA's mission, selected accomplishments, key performance measures, and forward looking initiatives to strengthen the DLA's efforts in achieving a safer and more secure nation. This performance overview encompasses mission activities that are DLA Enterprise-wide.

Performance Management in DLA

Warfighter First

DLA's goal is to deliver innovative and responsive solutions to the Warfighters and our other valued customers. We have achieved considerable success in this area, including supporting Federal Emergency Management Agency (FEMA) with hurricane assistance efforts. We also acquired funding for service material readiness, no-notice deployments in support of Hurricane relief, and collaborated with the Services and other Federal agencies for retail support. Detailed program information is below.

Nuclear Enterprise Support Office: We expanded our support to the Nuclear Enterprise including United States Strategic Command and its Air Force and Navy components. During FY 2017, DLA received an average demand volume increase for nuclear enterprise weapon system of 3 percent with specific weapon systems increasing by 15 percent. Simultaneously, DLA improved material availability to 92 percent. These improvements in support, in an environment of increased demand, can be directly attributed to the Agency's inventory investment and change in DLA Recoupment/Retention policies.

DLA's Center of Planning Excellence: We expanded efforts to anticipate and meet Warfighter requirements through a collaborative planning approach with defined agreements for all Military Services. We made major steps in restructuring the Agency Demand and Supply Planning by automating several processes. As a result, we realized an increase of 17 percent for automated returns, 50 percent in automated disposals, 60 percent in automated recoupments, and a decrease of 37 percent in planner over-procurement workload. This reduces costs and increases efficiency for the Warfighter and other customers.

Retail: We achieved considerable efficiencies by collaborating with the Military Services to bring DLA's strategic advantages to bear on the wholesale-retail interface. Air Force and Navy have implemented DLA's Retail Support Strategy at Air Logistics Centers and Fleet Readiness Centers, and we are working with the Marine Corps and Army on similar measures.

Performance Based Logistics (PBL): We strengthened DLA's Major Development & Acquisition Program role by codifying the DoD acquisition life-cycle process policy. DLA is utilizing this program for the Marine Corps Amphibious Combat Vehicle and the Coast Guard Offshore Patrol Cutter programs. We anticipate savings as these programs expand and as efficient sustainment design becomes the norm. DLA continues development as a Performance Based Logistics Center of Excellence.

Improve Counterfeit Parts Identification; (Prevent Commercial and Government Entity Code (CAGE)) Hopping: Automated processes carry risks and DLA has taken major steps to reduce and mitigate those

risks. DLA improved their ability to identify fraudulent suppliers and counterfeit parts with improved Business Decision Analytics and advanced testing and deoxyribonucleic acid marking.

Whole of Government (WoG): We offered DLA's strategic advantages of buying power and global presence to our WoG partners. This has increased DLA sales by \$7.0 billion, an increase of 7.7 percent from FY 2016 to FY 2017. We are executing initiatives to expand supply chain support through collaborative development. These efforts continue the trend for centralized logistics with significant estimated savings.

DLA Transportation Command (TRANSCOM) (DLA-T): DLA has integrated with and ensured execution of U.S. Transportation Command (USTRANSCOM)/DLA Lines of Effort. We have jointly deployed capabilities for exercises and contingencies, rapidly responded to FEMA requests, including hurricane response and sustained strategic momentum of the Global Distribution Campaign Plan. We continue collaboration on the Distribution Services Initiative to improve support to Foreign Military Sales customers. DLA has also worked to provide USTRANSCOM improved sustainment forecasts, when possible, and to help mitigate missed Required Delivery Dates for surface movement by leveraging the USTRANSCOM Closewatch Dashboard capabilities. Closewatch Dashboard is a system that utilizes 15-years of historical data to estimate route times.

People and Culture

DLA's goal for this year is to hire, develop and retain a high-performing, valued, resilient and accountable workforce.

In FY 2017, DLA was able to achieve the following:

- Implemented DoD Performance Management and Appraisal Program to approximately 24,700 employees across the enterprise;
- Improved hiring timeliness by 5 percent;
- Spearheaded the Agency's culture/climate program addressing challenges respective to organizational effectiveness and climate;
- Executed a 2.5 day leadership development forum for 135 high potential future leaders;
- Implemented a succession management framework to ensure continuity while mitigating knowledge gaps due to personnel attrition of key positions; and,
- Revamped the Human Resources Annual Operating Plan and cascading strategic initiatives.

DLA continues to monitor respective performance metrics and trends to ensure the Agency continues to successfully hire, develop and retain a high-performing workforce.

Strategic Engagement

FY 2017 highlighted our continuous commitment toward increasing efficiency and effectiveness in our service to all DLA stakeholders. A snapshot of our FY 2017 performance is as follows:

- DLA achieved \$2.8 billion in Spend Under Management Tier II or higher in FY 2017 for DLA Transportation & Logistics Service Category as part of the OMB-led Category Management initiative, and also recorded \$7.3 billion in material cost savings through 3rd Quarter, FY 2017 that originated as part of the DLA "Big Ideas" initiative.
- DLA met its FY 2017 competition rate goal of 78 percent with an end of year rate of 78.65 percent. DLA also met its FY 2017 small business of 32 percent and achieved 32.92 percent.
- The Agency continued to make significant gains in Defense Acquisition Workforce Improvement

Act (DAWIA) certification compliance. For FY 2017, the Human Capital Initiative data showed a 97.3 percent DAWIA certification rate for DLA Acquisition Workforce.

- From a contracting perspective, we were resilient in our pursuit towards achieving DLA Contracting Services Office efficiencies through the \$6.0 billion J6 Enterprise Technology Services (JETS) contract that was awarded in 1st Quarter, FY 2017. The JETS contract consolidated Information Technology (IT) support requirements under one contract, increasing DLA's buying power. DLA awarded the indefinite-delivery/indefinite-quantity contract through a competitive procurement process and will obligate defense working capital funds from FYs 2017 through 2025 upon the award of task orders.

Areas for improvement for Strategic Engagement are as follows:

- Since FY 2013, DLA has driven down the average Administrative Lead Time to 12 days for automated awards (from 21 days), to 55 days for small buys < \$150 thousand (from 98 days), and to 230 days for large buys =>\$150 thousand (from 267 days). This continues to be a focus area for achieving greater reductions, along with reductions in Production Lead Time.
- The Government Purchase Card (GPC) compliance goal was 85 percent. DLA had a compliance rate of 72 percent. Corrective measures have been put in place to achieve the 85 percent compliance goal. We anticipate a higher compliance goal in FY 2018.
- DLA continues to improve the On-Time-Delivery (OTD) compliance rate. We ended the year at 90 percent. We will continue focusing on Planned Customer Direct contracts meeting the goal of 100 percent, per Time Definite Delivery Standards, as the current compliance rate, 63.6 percent, fell short of its target, 100 percent.
- Our Military Interdepartmental Purchase Request (MIPR) on-time compliance was not as robust as we expected. We achieved a 70 percent compliance rate against a goal of 95 percent which presents an opportunity for improvement in FY 2018.
- Several areas of process improvements are still ongoing and will continue through FY 2018. These include upgrading the Agency Contract Quality Review process, Contracting Officer Representative Process, and the process of ensuring 100 percent timely completion of internal control testing.

Financial Stewardship

DLA's goal was to deliver effective and affordable financial solutions that support the DLA Strategic Plan, to include better cost visibility to our customers, more customer rate options that better reflect the drivers of cost, and improved analytical capabilities to evaluate new or improved business processes. Additionally, DLA programs and justifies resource requirements to the Office Under the Secretary of Defense, Comptroller (OUSD(C)), execute resources efficiently and effectively, and achieve Net Operating Result (NOR) and cash balance goals. DLA accomplished or made significant progress towards meeting these objectives in FY 2017, as shown below:

- Developed a Cost Reduction Tracking Standard Operating Procedure (SOP) that ensures new business process initiatives are monitored and evaluated throughout the future years defense plan.
- Finalized and socialized the Distribution Business Area Market Basket Pricing initiative with the Military Services and OUSD(C). The proposal is still being evaluated by customers and OUSD(C) for potential modifications.
- Began to automate a budget formulation tool that will reduce manpower necessary to meet OUSD(C) mandated Major Headquarters Activity (MHA) reductions by FY 2020.
- Conducted Cost Summit, DLA/Military Service days, and other forums where DLA cost data and rate justification information was briefed to customers. This information improved transparency and reinforced DLA's reputation as a best value logistics materiel and services

- provider to the Warfighter.
- Responded to Independent Public Accounting firm requests for information in support of DLA financial statement audit and identified key focus areas for FY 2018.

Process Excellence

DLA's goal was to achieve enterprise Process Excellence by focusing on our end-to-end supply chain management, accountability and governance mechanisms, and process improvement initiatives to optimize our performance and provide best value outcomes to our customers.

During FY 2017, we evolved our governance forums to assess opportunities to gain efficiencies and increase effectiveness. We increased our compliance and accountability through policy actions and process documentation in our audit efforts. Finally, we improved support to our customers worldwide through robust process improvement efforts with measureable outcomes. We demonstrated a 24 percent increase in process improvement efforts. Examples include an inspection counts workload reduction in our Distribution Core Processes of 66 percent, a 30 percent improvement in our Delivery Response Time four hour delivery rate, and a 58 percent reduction in open call-outs at the Norfolk Naval Shipyard. We continue to look for opportunities to reduce costs and provide better support to our customers.

In the coming years, we will focus on accountability through improved integration of our business processes, as well as continuously seeking opportunities for innovation and improvement that will ensure we deliver effective, efficient and reliable logistical operations to the our valued customers.

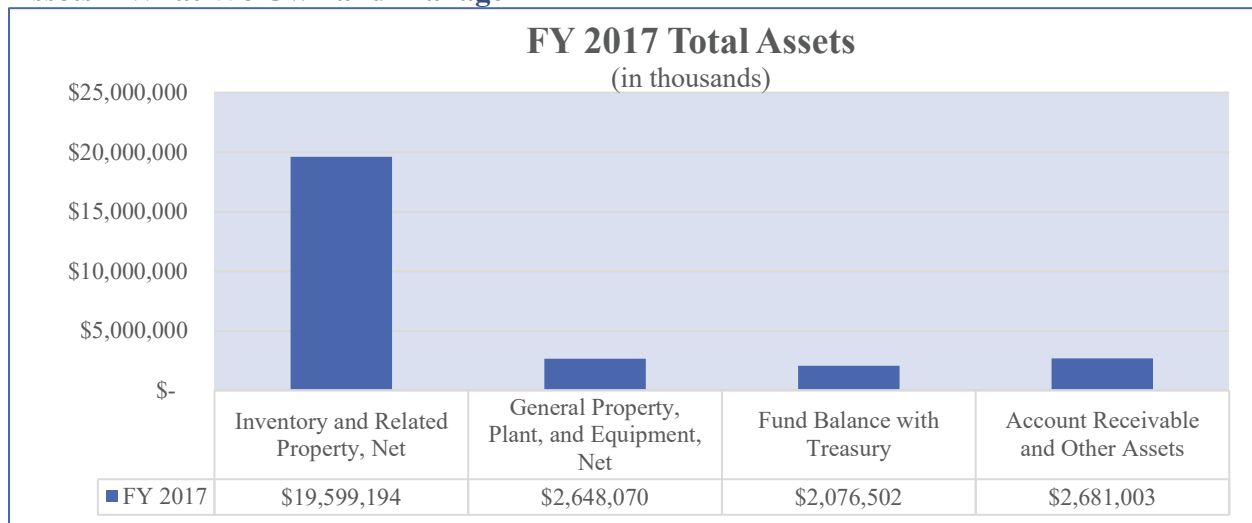
Financial Overview- DLA Working Capital Fund

The Financial Statements presented in this AFR relate solely to DLA's WCF. The Financial Statements for GF and TF are located in their respective AFRs. The WCF's budgetary resources were approximately \$45.6 billion for FY 2017. The budget represents our plan for efficiently and effectively achieving the strategic objectives set forth by Director, Lieutenant General Williams to carry out our mission and to ensure that the DLA manages its operations within the appropriated amounts using budgetary controls. The DLA prepares its Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position on an accrual basis; meaning that economic events are recorded as they occur, regardless of when cash is received or disbursed. These financial statements provide the results of our operations and financial position, including long-term commitments and obligations. Budgetary accounting principles require recognition of the obligation of funds according to legal requirements, which in many cases occurs prior to the occurrence of a transaction under the accrual basis. The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of federal funds, and are reported in the Statement of Budgetary Resources. The financial statements are broken down into three segments: DLA Energy, DLA Supply Chains Management (SCM), and Document Services (DLA Information Operations). DLA SCM in the financial statements encompasses: DLA Aviation, DLA Land, DLA Maritime, DLA Energy, Subsistence, Medical, Clothing, and Textiles, Construction and Equipment, and Industrial Hardware, DLA Distribution, and DLA Disposition Services. Ernst & Young, LLP performed the audit of the WCF's principal financial statements.

Balance Sheet

The Balance Sheet presents the resources owned or managed by the DLA that have future economic benefits (assets) and the amounts owed by DLA that will require future payments (liabilities). The difference between the DLA's assets and liabilities is the residual amount retained by DLA (net position) that is available for future programs and capital investments.

Assets – What We Own and Manage



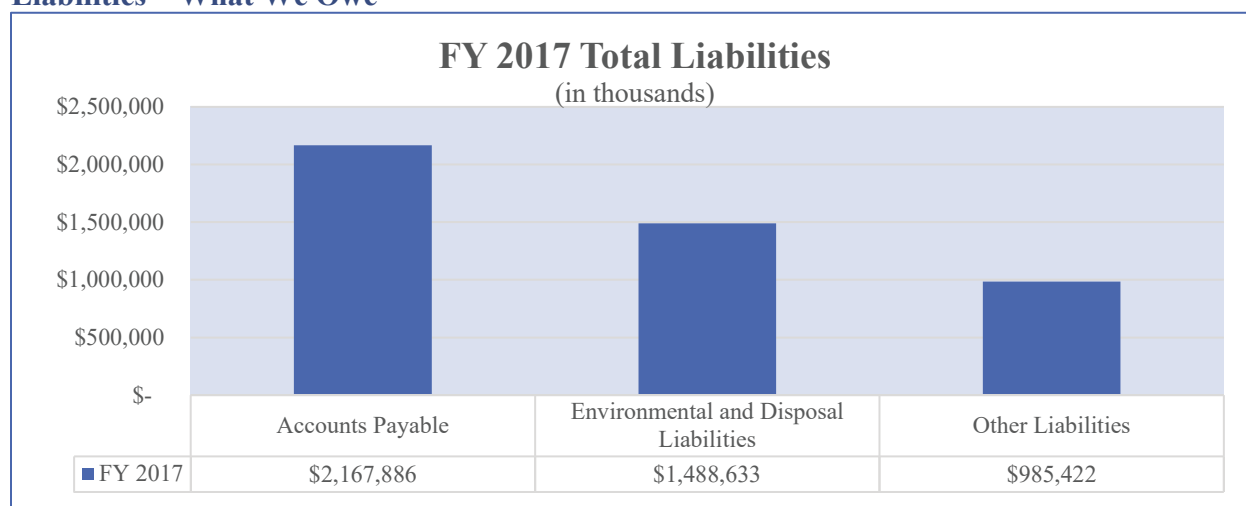
Assets represent amounts owned or managed by the DLA which can be used to accomplish its mission. As of September 30, 2017, the WCF had \$27.0 billion in assets.

Inventory and Related Property is the WCF's largest asset, comprises 72 percent of the total assets. Inventory and Related Property balances are primarily comprised of Supply Chain Management and Energy Management and is categorized into inventory held for sale; inventory reserved for future sale; excess, obsolete, and unserviceable inventory; and inventory held for repair.

General Property, Plant, and Equipment (PP&E), Net is the second largest asset, comprising 10 percent of total assets. The major items in this category include buildings, structures, and facilities, software, general equipment and construction-in-progress. In acquiring these assets, the DLA either spent resources or incurred a liability to make payment at a future date; however, because these assets should provide future benefits to help accomplish the DLA mission, the DLA reports these items as assets rather than expenses. PP&E is recorded at cost, and depreciated over the estimated useful life of the asset. PP&E is presented net of accumulated depreciation.

Other Assets represents 18 percent of total assets, which includes Fund Balance with Treasury (FBWT), Accounts Receivable, and other assets.

Liabilities – What We Owe



Liabilities are the amounts owed: to the public or other federal agencies for goods and services provided but not yet paid for; to DLA employees for wages and future benefits; and for other liabilities. As of September 30, 2017, the WCF reported approximately \$4.6 billion in total liabilities.

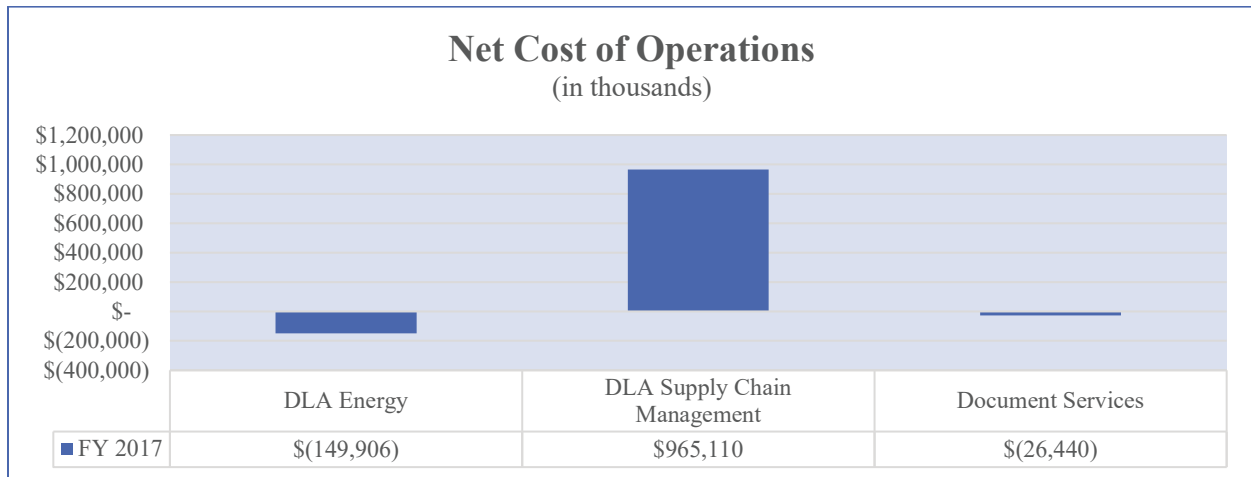
The WCF's largest liability is for *Accounts Payable*, which represents 47 percent of total liabilities and results from amounts owed to other federal agencies and the public for goods and services received by DLA.

Environmental and Disposal Liabilities represent 32 percent of total liabilities, and is comprised of environmental cleanup costs associated with restoration of environmental sites. These environmental sites may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, clean closure of assets, and post-closure costs related to the Agency's operations that result in hazardous waste.

Other Liabilities, comprising 21 percent of the WCF's liabilities, includes amounts due to the Other Federal Employment Benefits and other liabilities.

Statement of Net Cost (SNC)

Net cost of operations represents the difference between the costs incurred and revenue earned by WCF programs.



DLA Energy, represents negative 19 percent of the WCF's net cost and includes operations related to the sale and management of jet fuel, gasoline, heating oil, diesel, naval propulsion fuel, lubricants, and missile propellants. DLA SCM represents 122 percent of total net costs and includes operations related to Troop Support, and Weapon Systems Support supply chains. Document Services represents negative 3 percent of total net costs and includes operations related to automated document production, printing services, digital conversion, and document storage. Both DLA Energy and Document Services earned more revenue than costs incurred. Troops support includes Subsistence, Medical, Clothing, and Textiles, Construction and Equipment, and Industrial Hardware. Weapon support includes DLA Aviation, DLA Land, and DLA Maritime.

During FY 2017, the WCF earned approximately \$41.4 billion in exchange revenue. Exchange revenue arises from transactions in which the WCF provides and the other party receives value and that are directly related to WCF operations.

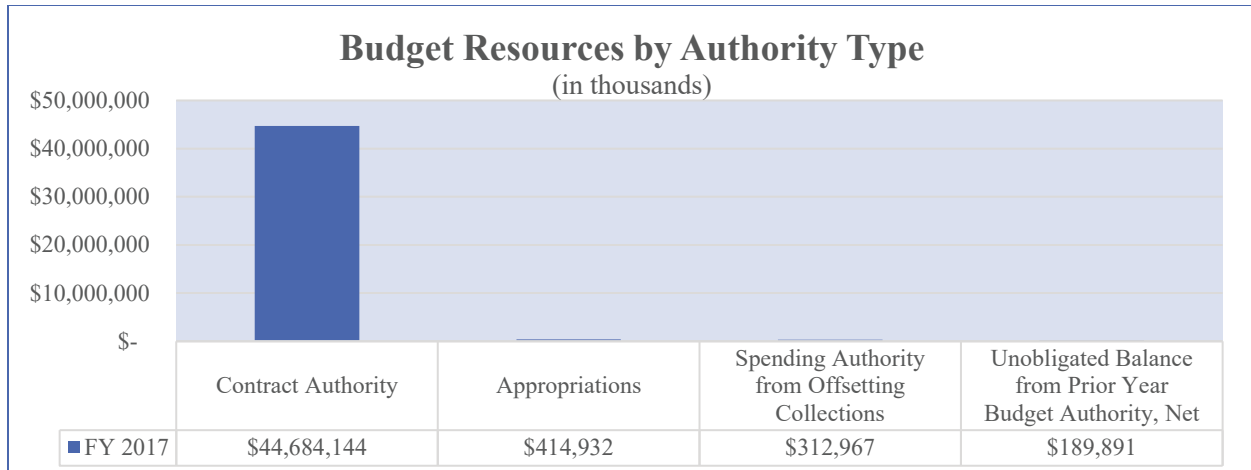
Statement of Changes in Net Position (SNCP)

Net position represents the accumulation of revenue, expenses, budgetary, and other financing sources since inception, as represented by WCF's balances for cumulative results of operations on the Statement of Changes in Net Position. Financing sources increase net position and include, but are not limited to, appropriations and user fees. The net costs discussed in the section above as well as transfers to other agencies decrease net position. For FY 2017, total net position is \$22.4 billion.

Statement of Budgetary Resources (SBR)

This statement provides information on the status of the approximately \$45.6 billion in budgetary resources available to the WCF during FY 2017.

The authority was derived from appropriations of \$414.9 million, \$189.9 million in authority carried forward from FY 2016, \$44.7 billion in contract authority, and \$312.9 million in collections.



As of September 30, 2017, \$534.9 million of the \$45.6 billion was not yet obligated. The \$534.9 million represents apportioned funds available for future use. Of the total budget authority available, the WCF incurred a total of \$45.1 billion in obligations from salaries and benefits, purchase orders placed, contracts awarded, or similar transactions. These obligations will require payments during the same or future period.

Limitations of Financial Statements

The principal financial statements were prepared to report the financial position and results of operations of WCF, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements were prepared from DLA's books and records in accordance with the formats prescribed by the OMB Circular No. A-136, the statements are in addition to the financial reports used to monitor and control budgetary resources.

To the extent possible, the financial statements were prepared in accordance with Federal accounting standards. At times, the DLA is unable to implement all elements of the standards due to financial management systems limitations. The DLA continues to implement system improvements to address these limitations.

DLA and the Defense Finance and Accounting Service (DFAS) prepared the FY 2017 WCF financial statements from available automated finance, accounting, and feeder systems (such as acquisition, logistics, and personnel systems) and manual processes. Due to system deficiencies, there are limitations in collecting the data needed to prepare financial statements that comply with Federal standards. To prepare the financial statements, DFAS made numerous adjustments during the compilation process in an attempt to overcome these deficiencies.

Other Key Regulatory Requirements

See the Other Information section for Prompt Payment Act and Debt Collection Improvement Act of 1996.

Management Assurances

The following section provides an overview of DLA's Management's Assurances related to FY 2017.



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

July 21, 2017

MEMORANDUM FOR SECRETARY OF DEFENSE

THROUGH: UNDER SECRETARY OF DEFENSE (ACQUISITION, TECHNOLOGY, AND LOGISTICS)

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act (FMFIA) for Fiscal Year 2017

As Director of the Defense Logistics Agency (DLA), I recognize that DLA is responsible for managing risks and maintaining effective internal control to meet the objectives of Sections Two and Four of the FMFIA of 1982. DLA conducted its assessment of risk and internal control in accordance with the Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. Based on the results of the assessment "*Internal Control Evaluation –Management Control Testing*" (Attachment 1), DLA can provide a modified statement of reasonable assurance that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2017. Detail for the 16 material weaknesses and four non-conformances are reported in the "*Material Weaknesses and Corrective Action Plans Template*" (Attachment 3) and *Risk Management Template*" (Attachment 4). "*Significant Managers' Internal Control Program Accomplishments*" (Attachment 2) and "*Reportable Anti-Deficiency Act Violations Template Response*" (Attachment 5) (support the complete assertion package).

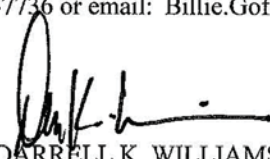
DLA conducted its assessment of the effectiveness of internal controls over operations in accordance with the FMFIA and the OMB Circular No. A-123. "*Internal Control Evaluation Management Control Testing*" section provides specific information on how DLA conducted this assessment (Attachment 1). Based on the results of the assessment, DLA can provide a modified statement of reasonable assurance, except for the five material weaknesses reported in the "*Material Weaknesses and Corrective Action Plans Template*" (Attachment 2) that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2017.

DLA conducted its assessment of the effectiveness of internal controls over reporting (including external financial reporting) in accordance with OMB Circular No. A-123, Appendix A. "*Internal Control Evaluation Management Control Testing*" section provides specific information on how the DLA conducted this assessment (Attachment 1). Based on the results of this assessment and the intent to Disclaim by Ernst & Young, Independent Public Accounting firm, DLA is unable to provide assurance that internal control over operations, reporting, and compliance (including external financial reporting) were operating effectively due to material weaknesses identified for the Working Capital Fund and General Fund as of June 30, 2017.

DLA can provide a modified statement of reasonable assurance that internal controls over operations, reporting, and compliance for the Transaction Fund were operating effectively as of September 30, 2017. Detail for the 11 material weaknesses reported can be found in the “*Material Weaknesses and Corrective Action Plans Template*” (Attachment 2).

DLA also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with Federal Financial Management Improvement Act (FFMIA) of 1996 (Public Law 104-208) and OMB Circular No. A-123, Appendix D. “*Internal Control Evaluation – Management Control Testing*” section provides specific information on how DLA conducted this assessment (Attachment 1). Based on the results of this assessment, DLA can provide a modified statement of reasonable assurance, except for the **four** system non-conformance that the internal controls over the financial systems are in compliance with the FFMIA and OMB Circular No. A-123, Appendix D, as of June 30, 2017. Detail for the **four** non-conformances reported can be found in the “*Material Weaknesses and Corrective Action Plans Template*” (Attachment 2).

Point of contact for this action is Ms. Billie Sue Goff, Financial Compliance & Audit Readiness Operations, (703) 767-7736, DSN 427-7736 or email: Billie.Goff@dla.mil.



DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Attachments:
As stated

cc:
OUSD Comptroller, Financial Improvement and Audit Readiness
OUSD Deputy Chief Management Officer



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

JUL 14 2017

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY


SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act
For Fiscal Year 2017

Each Enterprise Business Process Owner is responsible to provide the Defense Logistics Agency (DLA) Director their informed judgement as to the overall adequacy and effectiveness of internal controls within their respective business processes related to operations, reporting, and compliance. DLA Finance recognizes the responsibility for establishing and maintaining effective internal controls to meet the objectives of the Federal Managers' Financial Integrity Act. DLA Finance assessed risk management and internal controls, in accordance with Office of Management and Budget Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, Appendix A, and Government Accountability Office Standards for Internal Control (**TAB A**). Based on the results of this assessment, DLA Finance is unable to provide assurance that internal control over operations, reporting, and compliance was operating effectively due to the material weaknesses identified for the Working Capital Fund (WCF) and General Fund (GF).

DLA Finance can provide a modified statement of reasonable assurance that internal controls over operations, reporting and compliance were operating effectively for the Transaction Fund (TF). Details of Financial Reporting/Financial System Material Weaknesses, Financial Reporting/Financial System Corrective Action Plans and Milestones are provided at (**TAB B**).

Ernst & Young (EY), Independent Public Accounting Firm, notified the Department of Defense Office of Inspector General of the intent to issue a disclaimer of opinion of the WCF and GF Fiscal Year 2017 Financial Statement (**TAB C**). EY is auditing DLA's Transaction Fund for Fiscal Year 2017 and, as of the date of this report, DLA has not received any TF observations from EY.

Point of contact for this action is Mr. Damon Hawkins, Chief, Financial Compliance, (703) 767-6607 or email: Damon.Hawkins@dla.mil.


Gretchen V. Anderson
Director, DLA Finance
Chief Financial Officer

Attachments as stated

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires federal agencies to implement and maintain financial management systems that comply substantially with:

- Federal financial management system requirements;
- Applicable federal accounting standards; and,
- The U.S. Standard General Ledger at the transaction level.

In assessing compliance with FFMIA, the DLA uses the OMB guidance and considers the results of the Office of Inspector General's annual financial statement audits and Federal Information Security Modernization Act (FISMA) compliance reviews. As reported in the CFO's Management Assurance Statement, significant system improvement efforts are underway to modernize, certify, and accredit all financial management systems to conform to government-wide requirements.

DLA has developed and is implementing an Enterprise FFMIA Concept of Operations (CONOPs) that addresses critical activities towards achieving FFMIA compliance. The key components of the CONOPs include an FFMIA implementation approach, with a governance structure, roles and responsibilities to manage requirements, and activities for systems, controls, and processes. Additional activities include assessing OMB Circular A-123 test results to identify potential gaps in FFMIA compliance; continuous monitoring and reporting mechanisms to replace annual system testing (to provide an early warning for potential FFMIA compliance issues and inform the enterprise risk management process); and an annual FFMIA assessment and reporting process to support the DLA's Statement of Assurance. Over the next fiscal year several actions will be addressed to support the implementation of the FFMIA Enterprise CONOPs. These activities include establishing, maintaining and communicating policy, training and SOPs relating to OMB Circular A-123 and FFMIA. The approach includes the implementation of the FFMIA Monitoring Continuum, which encompasses ERM, Financial Risk Management (FRM), risk-based testing, data profiling and monitoring, and core operational activities that impact financial systems and processes. A key element will be the establishment of a charter governing the relationship between the CFO and the Chief Information Officer (CIO) defining the communication between J8 and J6.

Financial Management Systems

DLA Information Operations (J6) is the DLA knowledge broker, providing comprehensive, best practice Information Technology support to the DoD/DLA Logistics Business Community, resulting in the highest quality information systems, customer support, efficient and economical computing, data management, electronic business, telecommunication services, key management, and secure voice systems for DOD, DLA, and geographically separated operating locations. J6 endeavors to improve the control posture of systems and processes by testing and correcting deficiencies to ensure that DLA's systems are compliant with Federal system security and accounting requirements.

J6 conducts annual internal reviews of the effectiveness of the DLA internal controls over financial systems. J6 is able to provide modified assurance (with deficiencies noted) that the internal controls over the financial systems as of June 30, 2017 are in compliance with the FFMIA and OMB Circular A-123.

Additionally, J6 reviewed audit results from the current financial statement audit to make corrections and improvements as needed. Any deficiencies identified are aligned to the appropriate Corrective Action Plans (CAPs) issued for the Enterprise control areas to ensure they are addressed in a consistent and coordinated manner. Systems include:

- Defense Automatic Addressing System (DAAS)
- Defense Agencies Initiative (DAI)

- Defense Medical Logistics Standard Support – Wholesale (DMLSS-W)
- DoD Electronic Mall/FedMall (DoD EMALL/FedMall)
- Distribution Standard System (DSS)
- Employee Activity Guide for Labor Entry (EAGLE)
- Enterprise Business System (EBS)
- Electronic Document Access (EDA)
- Fuels Manager Defense (FMD)
- Invoice, Receipt Acceptance, and Property Transfer (iRAPT)
- Subsistence Total Order and Receipt Electronic System (STORES)

Federal Information Security Modernization Act of 2014

The Federal Information Security Modernization Act of 2014 (FISMA) provides a framework for ensuring effectiveness of security controls over information resources that support federal operations and assets, and provides a statutory definition for information security. FISMA requires the head of each agency to "implement policies and procedures to cost-effectively reduce information technology security risks to an acceptable level." J6 is the accountable entity within DLA to perform FISMA assessments and reporting.

FISMA reporting is conducted on an annual basis and covers all operating environments of DLA's authorized systems and applications, and also requires management to review the compliance of key security personnel with their training requirements. The compliance targets of FISMA reviews are tracked and monitored in Cyberscope, an automated tool that is mandated for use across the Federal Government. The Chief Information Officer (CIO) reviews and signs the FISMA results, which are then rolled up at the Department of Defense level for reporting purposes.

Anti-Deficiency Act (ADA)

DLA WCF has two formal investigations on-going for potential ADA violations. As required by the Department of Defense Financial Management Regulations (FMRs), DLA notified the Office of the Undersecretary of Defense Comptroller (OUSDC) of the result of the preliminary investigations of these cases. The formal investigations will be completed during FY 2018 and, if required, provided to OUSDC for further legal review and processing.



Financial Information

The Financial Information section demonstrates our commitment to effective stewardship over the funds DLA receives to carry out its mission, including compliance with relevant financial management legislation. It includes the Working Capital Fund (WCF) **Financial Statements**: Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources, as well as the accompanying **Notes to the Financial Statements**. It also includes the **Independent Auditors' Report** on the DLA's Financial Statements and accompanying Notes, provided by Ernst & Young, LLP.

MESSAGE FROM THE CHIEF FINANCIAL OFFICER
DECEMBER 2017

DLA's Fiscal Year 2017 Annual Financial Report (AFR) is our principal statement of financial accountability to the Department of Defense. Accountability represents the foundation of stewardship and DLA remains committed to ensuring value, efficiency, and effectiveness in every program. This section of the AFR provides detailed information about DLA's financial statements, and gives a comprehensive view of DLA's financial activities.




DLA received a Disclaimer of Opinion on the Agency's Working Capital Fund financial statements, which means the auditor conducted audit procedures on the statements but was unable to express an opinion on them. This was attributed to DLA's departures from generally accepted accounting principles and insufficient audit evidence supporting accounting assertions. We view this Disclaimer of Opinion as an opportunity that will continue to shape our way forward. Each Independent Public Accountant audit report will help DLA build a better financial reporting foundation and provide a stepping stone towards a clean audit opinion. In the coming years, each audit will help measure the effectiveness and efficiency of our business processes, systems, and controls as we incorporate a standard of continuous improvement.

DLA's new audit phase, Audit Advancement, represents our ongoing audit sustainment efforts. Audit Advancement is not merely a financial management focus; it encompasses every organization at DLA. We have taken a holistic, risk-based look at the maturity of our enterprise, and have identified remediation focus areas to address material weaknesses. The key areas we will focus on for the Working Capital Fund are Fund Balance with Treasury, Inventory, and General Property, Plant, and Equipment.

DLA's mission is constantly evolving and challenging us to find innovative solutions. As the new Chief Financial Officer at DLA, I am committed to assisting DLA to reach this goal.

Winston Churchill once said, "Success is not final, failure is not fatal: it is the courage to continue that counts." The road ahead may be long, but I have full confidence DLA will meet the challenge. We are confident we have the right team in place to continue our forward progress toward an unmodified audit opinion, and look forward to working with the DLA enterprise on this endeavor.


GRETCHEN V. ANDERSON
Director, DLA Finance
Chief Financial Officer

Introduction

The principal financial statements included in this report are prepared pursuant to the requirements of the Government Management Reform Act of 1994 (Pub. L. 103-356) and the Chief Financial Officers Act of 1990 (Pub. L. 101-576), as amended by the Reports Consolidation Act of 2000 (Pub. L. 106-531), and the DLA Financial Accountability Act of 2004 (Pub. L. 108-330). Other requirements include the OMB Circular No. A-136, Financial Reporting Requirements, as amended. The responsibility for the integrity of the financial information included in these statements rests with the management of DLA. Ernst and Young, LLP performed the audit of the DLA's WCF principal financial statements. The Independent Auditors' Report accompanies the principal financial statements. This report reflects FY 2017 information only. Comparative statements are not presented because there are known misstatements in the FY 2016 balances that were corrected in FY 17. Therefore, presenting comparative statements would not provide additional value to the reader.

The DLA's WCF principal financial statements consist of the following:

1. The **Balance Sheet** presents those resources owned or managed by the DLA that represent future economic benefits (assets), amounts owed by DLA that will require payments from those resources or future resources (liabilities), and residual amounts retained by DLA comprising the difference (net position) as of September 30, 2017.
2. The **Statement of Net Cost** presents the net cost of DLA operations for the fiscal year that ended on September 30, 2017. DLA net cost of operations is the gross cost incurred by DLA less any exchange revenue earned from DLA activities and any gains or losses from assumption changes on pensions, other retirement benefits, and other post-employment benefits.
3. The **Statement of Changes in Net Position** presents the change in the DLA's net position resulting from the net cost of DLA operations, budgetary financing sources, and other financing sources for the fiscal year that ended on September 30, 2017.
4. The **Statement of Budgetary Resources** presents how and in what amounts budgetary resources were made available to the DLA during FY 2017, the status of these resources at September 30, 2017, the changes in the obligated balance, and outlays of budgetary resources for the fiscal year that ended on September 30, 2017.
5. The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the financial statements as of September 30, 2017.

Financial Statements

**Department of Defense
Defense Logistics Agency-Working Capital Fund
Balance Sheet
As of September 30, 2017
(In Thousands)**

	Unaudited 2017
ASSETS	
Intragovernmental	
Fund Balance with Treasury (Note 3)	\$ 2,076,502
Accounts Receivable	1,876,269
Other Assets (Note 4)	123,306
Total Intragovernmental Assets	\$ 4,076,077
Accounts Receivable, Net	638,525
Inventory and Related Property, Net (Note 5)	19,599,194
General Property, Plant, and Equipment, Net (Note 6)	2,648,070
Other Assets (Note 4)	42,903
TOTAL ASSETS	\$27,004,769
Stewardship Property, Plant, and Equipment (Note 7)	
LIABILITIES	
Intragovernmental:	
Accounts Payable	\$ 197,469
Other Liabilities (Note 10)	504,991
Total Intragovernmental Liabilities	\$ 702,460
Accounts Payable	1,970,417
Environmental and Disposal Liabilities (Note 9)	1,488,634
Other Liabilities (Note 10)	270,067
Other Federal Employee Benefits (Note 12)	210,364
TOTAL LIABILITIES	\$ 4,641,942
COMMITMENTS AND CONTINGENCIES (NOTE 11)	
NET POSITION	
Unexpended Appropriations	\$ 377,800
Cumulative Results of Operations	21,985,027
TOTAL NET POSITION	\$22,362,827
TOTAL LIABILITIES AND NET POSITION	\$27,004,769

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency-Working Capital Fund
Statement of Net Cost
For the period ended September 30, 2017
(In Thousands)

	Unaudited 2017
Gross Program Costs (Note 13)	
Energy	
Gross Cost	\$ 11,466,090
Less Earned Revenue	(11,615,996)
Net Cost	<u>(149,906)</u>
Supply Chain Management	
Gross Cost	30,562,336
Less Earned Revenue	(29,597,226)
Net Cost	<u>965,110</u>
Document Services	
Gross Cost	237,054
Less Earned Revenue	(263,494)
Net Cost	<u>(26,440)</u>
Net Cost of Operations-WCF	
Total Gross Cost	42,265,480
Less Earned Revenue	(41,476,716)
NET COST OF OPERATIONS	<u><u>\$ 788,764</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistic Agency-Working Capital Fund
Statement of Changes in Net Position
For the period ended September 30, 2017
(In Thousands)

	Unaudited 2017
Cumulative Results of Operations	
Beginning balances	\$ 22,283,281
Budgetary Financing Sources:	
Appropriations used	37,132
Nonexchange revenue	23,849
Other Financing Sources:	
Transfers-in/out without reimbursement	(2,236)
Imputed financing from costs absorbed by others	123,686
Other	308,079
Total Financing Sources	490,510
Net Cost of Operations	(788,764)
Net Change	(298,254)
Cumulative Results of Operations	21,985,027
Unexpended Appropriations	
Beginning Balance	-
Budgetary Financing Sources	
Appropriations transferred-in/out	414,932
Appropriations used	(37,132)
Total Budgetary Financing Sources	377,800
Total Unexpended Appropriations	377,800
Net Position	\$22,362,827

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency- Working Capital Fund
Statement of Budgetary Resources
For the period ended September 30, 2017
(In Thousands)

	Unaudited 2017
BUDGETARY RESOURCES	
Unobligated Balance Brought Forward, October 1	\$ 151,256
Recoveries of Unpaid Prior Year Obligations	7,183,044
Other Changes in Unobligated Balance	<u>(7,144,409)</u>
Unobligated Balance From Prior Year Budget Authority, Net	189,891
Appropriations	<u>414,932</u>
Contract Authority (Note 14)	44,684,144
Spending Authority From Offsetting Collections	<u>312,967</u>
TOTAL BUDGETARY RESOURCES	<u>\$ 45,601,934</u>
STATUS OF BUDGETARY RESOURCES	
New Obligations and Upward Adjustments (Note 15)	\$ 45,067,054
Unobligated Balance, End of Year:	
Apportioned, Unexpired Accounts	<u>484,050</u>
Unexpired Unobligated Balance, End of Year	534,880
Total Unobligated Balance, End of Year	<u>534,880</u>
TOTAL BUDGETARY RESOURCES	<u>\$ 45,601,934</u>
CHANGE IN OBLIGATED BALANCE	
Unpaid obligations:	
Unpaid Obligations, Brought Forward, October 1	\$ 17,502,763
New Obligations and Upward Adjustments	45,117,884
Outlays, Gross	<u>(35,539,619)</u>
Recoveries of Prior Year Unpaid Obligations	<u>(7,183,044)</u>
Unpaid Obligations, End of Year	19,897,984
Uncollected payments:	
Uncollected payments From Federal	(9,763,620)
Sources, Brought Forward, October 1	
Change in Uncollected Payments, Federal Sources	<u>543,142</u>
Uncollected Payments From Federal Sources, End of the Year	<u>(9,220,478)</u>
Obligated Balance, Start of Year, Net	<u>\$ 7,739,143</u>
Obligated Balance, End of Year, Net	<u>\$10,677,506</u>

The accompanying notes are an integral part of these statements

Department of Defense
Defense Logistics Agency- Working Capital Fund
Statement of Budgetary Resources
For the period ended September 30, 2017
(In Thousands)

	Unaudited 2017
Budget Authority and Outlays, Net:	
Budget Authority, Gross	\$ 45,412,043
Actual Offsetting collections	(35,735,342)
Change in Uncollected Payments, Federal Sources	543,142
Budget Authority, Net	<u>10,219,843</u>
 Outlays, Gross	 \$ 35,539,619
Actual Offsetting Collections	(35,735,342)
Agency Outlays, Net	<u>\$ (195,723)</u>

The accompanying notes are an integral part of these statements

Notes to the Financial Statements

Note 1. Summary of Significant Accounting Policies - Unaudited

A. Reporting Entity

Created in 1961, the Defense Logistics Agency (DLA) is the Department of Defense's (DoD) largest logistics combat support agency, with the mission to provide effective and efficient global solutions to warfighters and our valued customers around the clock, around the world in time of peace, national emergency, and war.

The DLA is responsible for contracting, purchasing, storing and distributing most of the consumable, expendable and reparable items for DoD. Its primary purpose is to meet the logistics requirements of the armed forces for food, clothing, fuel, repair parts and other items.

To accomplish these responsibilities, DLA has a staff of about 24,700 personnel conducting the following missions:

- Contracting for material across the supply classes of food, textiles, energy products, medical material and equipment, construction material, industrial hardware, personal demand items and major end items and repair parts
- Worldwide distribution
- Logistics and staff planning support to DoD's geographic combatant commands
- Disposal of surplus or excess materiel from the military services

The DLA has the following MSCs that execute the mission to provide supply and logistics service support and are DLA's major revenue generators:

- DLA SCM includes:
 - DLA Troop Support- consists of five commodities:
 - Subsistence- food support for the military all over the world.
 - Clothing and Textile Supply Chain- clothing, textiles and equipment to U.S. service members, other federal agencies and partner nations.
 - Construction and Equipment- construction materials, heavy equipment, tactical gear, firefighting equipment, minerals and precious metals to wood products, imaging and information equipment.
 - Industrial Hardware- industrial items such as screws, nuts, and bolts, typically referred to as bench stock or repair parts.
 - Medical Supply Chain- medical and pharmaceutical supplies.
 - DLA Aviation- provides repair parts for aviation weapons systems.
 - DLA Land and Maritime- provides repair parts for ground-based and maritime systems.
 - DLA Distribution- provides storage and distribution solutions, transportation planning, logistics planning and contingency operations as well as operating a global network of 34 distribution centers.
 - DLA Disposition Services- disposes of excess property by reutilization, transfer and demilitarization; and conducts environmental disposal and reuse
- DLA Energy- provides petroleum products/lubes, Sustainment, Restoration & Modernization, transportation, alternative fuel/renewable energy, aerospace energy, fuel quality/technical support, natural gas and electricity.
- DLA Information Operations Document Services- provides automated document production, printing services, digital conversion and document storage.

B. Basis of Presentation

The accompanying financial statements present the financial position, net cost of operations, changes in net position, and budgetary resources of DLA Working Capital Fund (WCF) in accordance with the form and content requirements of the Office of Management and Budget (OMB) Circular No. A-136 except as described in the following paragraph. The financial statements have been prepared from the books and records of DLA WCF, and do not include the DLA Transaction Fund or DLA General Fund, which are reported in separate financial statements. Transactions and balances among the DLA's components and other DoD organizations have been adjusted in the consolidated presentation of the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position. Eliminating adjustments are based on the information provided by the seller/service provider unless a waiver is obtained. A waived entity is a DoD reporting entity believed to have its buyer-side data more complete, accurate, and supported than the associated seller-side data. Currently, DLA WCF is a non-waived entity. The elimination adjustments for accounts payable and expenses, unless otherwise specified, are based on seller's accounts receivable and revenue records. The Statement of Budgetary Resources is presented on a combined basis, as required by OMB Circular No. A-136. Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernible.

The DLA financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of DLA's MSCs and Headquarters activities. Some of the sub-entity level trial balances may reflect known abnormal balances, however, at the consolidated DLA level these abnormal balances may not be evident. This may increase the likelihood that DLA may not detect system errors or business process deficiencies in a timely manner. Disclosures of abnormal balances are in the applicable notes, but only to the extent that the abnormal balances are evident at the consolidated level.

The DLA WCF is unable to fully prepare these financial statements in conformity with U.S. Generally Accepted Accounting Principles (U.S. GAAP) due to limitations of the financial and nonfinancial management systems and processes that currently support the DLA WCF financial statements. These systems are designed to maintain accountability over assets, liabilities and budgetary resources, rather than preparing financial statements in accordance with U.S. GAAP.

The DLA is continuing the actions required to bring its financial and nonfinancial systems and processes into compliance with U.S. GAAP. Until all DLA financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by U.S. GAAP, DLA continues to implement interim mitigation processes to address these limitations. In addition, DLA is remediating deficiencies found in all end-to-end business process cycles pertaining to reconciliations and adequacy of the supporting documentation identified through audits and other compliance reporting.

Currently, the DLA WCF identified the following non-U.S. GAAP accounting practices or policies that impact DLA's financial statements:

- Fund Balance With Treasury (FBWT) – DLA is not able to identify its undistributed collections and disbursements in a timely manner because DLA shares a Treasury Index (TI)-97 with Other Defense Organization for Treasury reporting. (See Note 1. F. Fund Balance with Treasury).
- Accounts Receivable (Fuel Exchange Agreement (FEA)) - Posting logic issues exist in the FEA business process. The current practice of netting accounts receivable and accounts payable for FEA individual sales and purchase transactions resulted in an overstatement in each of these accounts.

A mitigation strategy has been put in place to post a quarterly journal voucher to reverse these transactions until a systemic solution can be implemented. In addition, budgetary entries are not adjusted when the netting of individual sales and purchases transactions occurs. Currently, a journal voucher is processed to adjust the budgetary consumption to correct the budgetary to proprietary variance that occurs when the accounts receivable and accounts payable are adjusted.

- Inventory:
 - Excess, Obsolete and Unserviceable (EOU) Transfer-in – DLA Disposition Services values all EOU transferred from the military services at net realizable value. In EBS the asset is recorded incorrectly as a gain upon receipt rather than a transfer-in.
 - DLA does not properly account for inventory provided to vendors against contracts and work orders for manufacturing and assembly. These items should be initially accounted for as Raw Material, and then as Inventory Work in Process. In addition, DLA does not properly account for additional inventory costs in the manufacturing and assembly process.
 - DLA did not properly implement the Statement of Federal Financial Accounting Standard (SFFAS) 48 to establish the beginning balance for FY 2017 (See Note 5).
 - Customer Direct - In recording Customer Direct transactions, DLA combines the purchase from the vendor and the cost of goods sold into a single entry in its Enterprise Business System (EBS) that does not include the receipt or issuance of inventory.
- General Property, Plant and Equipment (PP&E):
 - DLA is unable to determine the valuation of real property and general equipment assets previously transferred from the Military Services.
 - We inaccurately reported aged Construction in Progress (CIP) balances creating misstatements on the balance sheet. DLA began remediating the CIP process in FY 2017.
- Leases – DLA does not currently report capital and operating leases in its financial statements. DLA initiated an Agency-Wide business event assessment for the financial recognition of leases that will conclude in FY 2018 (See Note 1. J.).
- Accounts Payable – Negative payable occurs when a payment is made outside of EBS prior to the goods receipts being posted in EBS. This results in an understatement of current year expenses and payables, and an overstatement of undelivered orders. Monthly, a journal voucher is prepared to properly record the accounting entries.
- Unfilled Customer Orders - The DLA does not have the proper policy and procedures to reconcile the Unfilled Customer Orders from the EBS trial balance to the transaction detail.
- Undelivered Orders - The DLA does not have the proper policy and procedures to reconcile the Undelivered Orders from the EBS trial balance to the transaction detail.

C. Basis of Accounting

The DLA uses the accrual basis of accounting to prepare the Balance Sheet, Statement of Net Cost and Statement of Changes in Net Positions. U.S. GAAP encompasses both accrual and budgetary transactions. Under accrual accounting, revenues are recognized when earned and expenses are recognized when incurred. The Statement of Budgetary Resources is prepared using a budgetary basis of accounting and complies with legal requirements on the use of federal funding.

The DLA WCF is in the process of establishing the inventory balances using “deemed cost” as defined in SFFAS 48, “Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials”.

DLA WCF did not make an unreserved assertion in the application of SFFAS 48 (See Note 1.B and Note 5). In addition, DLA WCF plans to initiate the implementation of SFFAS 50 “Establishing Opening Balances for General Property, Plant, and Equipment” in FY 2018 (See Note 6).

D. Appropriations and Funds

The DLA WCF received its initial corpus through an appropriation from the Defense Wide Working Capital Fund (DWWCF) and a transfer of resources from existing appropriations or funds. The corpus financed initial operations to obtain goods and services sold to customers on a reimbursable basis to maintain the corpus.

The DWWCF (Treasury Account Symbol (TAS) 97X4930.5)) consists of six activity groups. DLA WCF operates three of the six activity groups which include: DLA SCM, DLA Energy, and DLA Document Services. Defense Finance and Accounting Service (DFAS) and the Defense Information Systems Agency (DISA) operate the other three activity groups. As a result, DLA shares TAS 97X4930.5 with DFAS and DISA; however, each agency receives their own separate Annual Operating Budget. The Office of the Under Secretary of Defense (Comptroller) uses a data element referred to as a ‘limit’ to differentiate the various Other Defense Organizations under TI-97. DLA uses limits assigned to the TI-97 organizations to track spending at a level below the TAS level.

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

The DLA Document Services receives spending authority from offsetting collections for its operation program; and contract authority for its capital program. Spending authority requires the receipt of customer orders prior to incurring obligations. The spending authority from offsetting collections comes from other federal agencies which funds reimbursable activities performed by the DLA Document Services on their behalf.

E. Nonentity Assets

Non-entity assets are assets that DLA holds on behalf of another federal agency or a third party and are not available for DLA to use in its normal operations. DLA’s non-entity assets mainly consist of Interest Receivable from customers due to late payments.

F. Fund Balance with Treasury

The DLA WCF does not maintain cash in commercial bank accounts, but rather in U.S. Treasury Accounts. The disbursing offices of DFAS, the U.S. Army Corps of Engineers, and the Department of State’s financial service centers process DLA’s cash collections, disbursements, and adjustments.

Undistributed disbursement and collections represent the amounts that have been reported to Treasury, but have not yet been posted to DLA’s general ledger. Undistributed amounts can be a result of timing, invalid line of accounting, and invalid TAS information. Undistributed can be supported or unsupported. Supported undistributed amounts are those with supporting documentation. Unsupported undistributed amounts are amounts that are not yet reconciled and not yet researched to obtain supporting documentation.

The DLA is not able to reconcile its FBWT ending balances in the general ledger directly to the U.S. Treasury balances due to the noted material weaknesses. DLA 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. Adjustments for both supported and unsupported undistributed disbursements and collections are applied to reduce differences of accounts payable and receivable balances between DLA and Treasury's accounts.

G. Accounts Receivable, Net

Accounts receivable consists of amounts owed to the DLA WCF by other federal agencies and the public. Amounts due from federal agencies are considered fully collectible.

Intragovernmental receivables include sales from petroleum products from DLA Energy, weapon system repair parts from DLA Aviation and DLA Land and Maritime, food and medical supplies from DLA Troop Support. DLA Direct sale of materials are from DLA stock to the customer. Customer Direct sales are from the vendor directly to the customer.

Nonfederal receivables (from the public) are presented in the Balance Sheet net of an allowance for loss on uncollectible accounts based on the Analysis of Receivables by Age Group Method. DLA WCF calculates its non-federal accounts receivable allowance for doubtful accounts using the estimated allowance percentages applied to 90-day intervals of the non-federal aged receivables categories. The allowance for doubtful accounts is calculated based on the aged accounts receivable balances from the preceding month, with the exception of FEA accounts receivable. The timing of FEA settlements occur at intervals prescribed in the FEA (See Note 1. B and 1.V). The nonfederal aged accounts receivable over two years are fully allowable.

The total Accounts Receivable, Net consists of Gross Accounts Receivable of \$2,895,550 thousand and the allowance for estimated uncollectible of \$380,756 thousand.

The DLA WCF does not have the proper policy and procedure to address the following areas:

- Adequate policies and procedures to review aged intragovernmental receivables, including assessing collectability.
- Process to review the assignment of "Dunning" codes in order to accurately maintain a complete population of intra-governmental and non-federal accounts receivable.
- Validate the accounts receivable and revenue balances associated with manual adjustments.

H. Inventory

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

- Inventory Held for Current Sale - Inventory that is in the process of production for sale or to be consumed in the production of goods for sale or in the provision of services for a fee. In this category, the inventories primarily include petroleum and aerospace products from DLA Energy, weapon system repair parts from DLA Aviation and DLA Land and Maritime, and food and medical supplies from DLA Troop Support. DLA uses Moving Average Cost (MAC) method to value inventory Held for sale. The MAC is calculated each time inventory is purchased dividing the total cost of units available by the number of total units available.
- Inventory Held in Reserve for Future Sale - Inventory that is maintained and not readily available in the market or because there is more than a remote chance that they will eventually be needed (although not necessarily in the normal course of operations). Similar to the Inventory Held for

Sale, the inventories primarily include weapon system repair parts from DLA Aviation and DLA Land and Maritime, and food and medical supplies from DLA Troop Support. DLA uses MAC method to value Inventory Held in Reserve for Future Sale.

- Excess, Obsolete and Unserviceable (EOU) Inventory – Excess inventory exceeds management requirements to meet the DLA’s mission. Obsolete inventory is no longer useful because of obsolescence. Unserviceable inventory is damaged inventory that is more economical to dispose of than to repair. DLA values EOU inventory at its expected Net Realizable Value (NRV) using: 1) a NRV factor based on the methodology identified in DoD FMR 7000.14-R Volume 4, Chapter 4, for materiel turned in to DLA Disposition for disposal, 2) the average sales price per unit sold per material for scrap items, or 3) the fair value rates associated with the inventory condition code as described in DoD FMR Volume 15 Chapter 7, for items that are held by DLA SCM that have not been turned over to DLA Disposition Services for disposal.
- Inventory Held for Repair - Inventory that is damaged and requires repair to make it suitable for sale, which includes consumable spare, repair parts and repairable items. Inventory Held for Repair is valued using the allowance method as described in SFFAS 3, Accounting for Inventory and Related Property; and DoD FMR, Volume 4, Chapter 4. Inventory Held for Repair is valued at MAC less an allowance for the estimated repair cost. The allowance is calculated based on 2% of the total value of Inventory Held for Repair.

The DLA WCF does not have the proper policy and procedure to address the following areas:

- Appropriate classification and accurate recording of inventory quantities and values in the financial statements.
- Reconciliation of inventory balances between the accountable property system of record and Financial Accounting system.
- Adequate policy, procedure and implementation of methods used to estimate net realizable value for EOU, and allowance for inventory held for repair.
- Effective design and implementation of inventory count procedures.
- Availability of evidential matter to support underlying transactions.

I. General Property, Plant and Equipment

The DLA WCF General PP&E consists of buildings, structures, linear structures, internal use software (IUS), IUS under development, CIP, and general equipment that are used to facilitate the Agency’s mission. The land that these assets reside on is not owned by DLA. DLA uses the straight-line (SL) method to calculate and accumulate depreciation/amortization expenses. The SL method is based on the acquisition cost and depreciated/amortized over the asset’s useful life.

The DLA WCF General PP&E assets are capitalized at historical acquisition cost, except as noted in Note 6, when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the \$250 thousand threshold. The PP&E assets acquired prior to October 1, 2013 were capitalized at various thresholds and are carried at the remaining net book value.

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

The DLA WCF reports Real Property (RP) that DLA does not own, but property where DLA receives the primary economic benefit from the utilization of the Real Property. The primary economic benefit is derived when DLA WCF is using 90% or more of the physical capacity of the Real Property to conduct

its operations, carry out its programs, and execute its mission. DLA WCF is also responsible for sustainment of this property.

The DLA was determined to be the financial reporting organization (FRO) for a large number of real property transfers from the military services. Due to insufficient supporting documentation, DLA is not able to confirm it's FRO status.

The DLA WCF does not have the proper policy and procedure to address the following areas:

- Inaccurate reporting of the aged CIP balance on the financial statements.
- Inconsistent grouping of assets.
- Physical inventory of real property.
- Appropriate capitalization of IUS.
- Recording of IUS assets in the appropriate accounting period.
- Confirmation of quantity and value related to real property and general equipment transfers.

In addition, noted weaknesses in the current accounting system preclude DLA from providing a complete and accurate listing of additions and disposals for real property and general equipment.

J. Leases

The DLA initiated an Agency-Wide business event assessment for the financial recognition of leases during FY 2017 that will conclude in FY 2018. This assessment may result in the reporting of leases, or lease-like activities inclusive of service contracts.

The evidential matter used for this assessment include Contracts, Performance Work Statements, Memorandum of Understanding/Memorandum of Agreement/Inter-Service Support Agreement, property records, payment records. Additional procedures include business event walkthrough meetings, follow on discussions and property, plant and equipment questionnaires. As the assessment progresses, if a lease is determined to be in place for recognition purposes, an additional assessment will be done to determine if the lease is: 1) Operating – Non-Reportable; 2) Operating – Reportable; or 3) Capital Lease.

To date this assessment has indicated that the majority of DLA's leases are for copiers, multi-functional devices, equipment, warehouse/storage facilities, ocean vessels and vehicles that do not meet the capitalization threshold and are non-reportable operating leases with cancellation clauses and/or terms of 12 months or less.

K. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DLA's policy is to record advances or prepayments. As such, payments made in advance of the receipt of goods and services are reported as other assets on the Balance Sheet.

L. Other Assets

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

The DLA Energy's Strategic Petroleum Reserve consist of crude oil held by the Department of Energy (DoE) on behalf of the DoD. 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, therefore the full inventory remains on hand with DoE.

The DLA SCM conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DLA may provide financing payments. The Federal Acquisition Regulations, Part 32, defines contract financing payments as, “authorized disbursements to a contractor prior to acceptance of supplies or services by the Government”. Contract financing payments clauses are in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

M. Accounts Payable

Accounts Payable includes amounts owed to federal and nonfederal entities for goods and services received by DLA. DLA WCF estimates and records accruals when service and goods are performed or received.

N. Commitments and Contingencies

The DLA recognizes contingent liabilities in the DLA's balance sheet and statement of net costs when they are probable and the loss can be reasonably estimated. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury.

The DLA WCF discloses the contingent liabilities in Note 11 of the Financial Statements when the condition for liability recognition does not exist but there is a reasonable possibility that the loss may occur. DLA does not disclose contingent liabilities where the loss is considered as remote.

The DLA is responsible for accurate reporting of the environmental expense and liabilities for the real property and/or equipment that it records and reports on its financial statements as assets, regardless of ownership. DLA identifies and estimates accrued Environmental Liabilities (EL) through its annual Cost-to-Complete process. DLA's accrued EL are comprised of environmental cleanup costs associated with restoration of environmental sites on real property that it does not own but has received appropriated funds to execute and manage. These environmental sites may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, clean closure of assets, and post-closure costs related to the Agency's operations that result in hazardous waste. Due to noted deficiencies, DLA is not able to reconcile the population of real property assets that encompass the environmental sites closure and asbestos liabilities (See Note 9).

O. Payroll, Annual and Sick Leave Accruals

Accrued payroll consists of salaries, wages, and other compensation earned by employees but not yet disbursed. The liability is estimated for reporting purposes based on historical pay information.

The DLA accrues the cost of unused annual leave, including restored leave, compensatory time, and credit hours as earned and reduces the accrual when leave is taken. The DLA accrued leave amounts upfront based on accrued leave reported in the Defense Civilian Payroll System.

P. Federal Employee Benefit

The Federal Employees' Compensation Act (FECA) is administered by the U.S. Department of Labor (DOL) to provide disability and medical benefits to covered federal employees injured on the job or who have occupational illness, and the survivor's benefit for employee whose death is attributable to a job-related injury or occupational illness. The DOL bills the DLA annually as claims are paid, and DLA in turn accrues a liability to recognize the future payments. Payment on these bills is deferred for two years to allow for funding to go through the budget process. Similarly, employees that the DLA terminates without cause may receive unemployment compensation benefits under the unemployment insurance program also administered by the DOL that is billed to each agency quarterly for paid claims. In addition, DLA records estimates for the FECA actuarial liability using the DOL's FECA bill.

Q. Pension Benefits

The DLA's civilian employees may participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), depending on when they started working for the federal government. Additionally, personnel covered by FERS, also have varying coverage under Social Security. DLA finances only a portion of the civilian pensions. While reporting and funding civilian pensions under CSRS and FERS are the responsibility of the Office of Personnel Management, DLA recognizes an imputed expense for the portion of civilian employee pension's benefit on the Statement of Net Cost. DLA also recognizes corresponding imputed revenue from the civilian employee pension's benefit on the Statement of Changes in Net Position.

R. Revenues

The DLA WCF classifies revenues as either exchange revenue or non-exchange revenue. Exchange revenues arise when DLA provides goods or services to the public or the Federal entities at a price. These revenues are presented on the Statement of Net Cost and serve to offset the costs of these goods and services. DLA WCF activities recognize the revenue from the sale of petroleum products from DLA Energy, weapon system repair parts from DLA Aviation and DLA Land and Maritime, food and medical supplies from DLA Troop Support, or from the reimbursements for good and services provide to DoD activities, other Federal agencies and the public. Prices set for products and services offered through the DLA WCF are intended to recover the full costs (actual cost, plus administrative fees) incurred by these activities.

Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public. DLA WCF non-exchange primarily consists of interest penalty collection from DLA's vendors. These revenue are presented on the Statement of Change in Net Position and recognize as part of budgetary financing sources.

S. Net Position

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

Unexpended appropriations represent the amounts of budget 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 between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

T. Other Financing Sources

The DLA WCF other financing sources, occasionally, come from congressional appropriations. The funds come in as a no-year appropriation and are recognized as a financing source when used. The other financing sources include transfers of assets from other government entities, and imputed financing with respect to costs subsidized by other Federal entity for employees' life insurance and pension benefits.

DLA recognizes the costs incurred by the DLA but financed by other entities on behalf of the DLA as imputed financing. DLA WCF recognizes the following imputed costs: (1) employee pension, post-retirement health, and life insurance benefits; (2) post-employment benefits for terminated and inactive employees to include workers compensation under the Federal Employees' Compensation Act; and (3) losses in litigation proceedings.

U. Transactions with Foreign Governments and International Organizations

The DLA sells defense articles and services to foreign governments and international organizations under the provisions of the Arms Export Control Act of 1976. The DLA's fuel transactions with foreign governments are made under the Arms Export Control Act of 1976 program, via direct sales and under the FEA program. The FEAs, are international acquisition and cross-servicing agreements established between DLA and the military departments of other nations. 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.

The FEA sale transactions settle on a periodic basis as prescribed in the FEA. Upon settlement with the foreign country, the purchases of fuel from foreign governments (FG) net against sales to the FG. 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 military service components).

V. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates and assumptions include, but are not limited to, contingent liabilities, judgment fund, environmental liabilities, allowance for doubtful account and allowance for Inventory Held for Repair at the date of the financial statements. The actual result from the reported amounts and expenses during the reporting period may differ from these estimates.

W. Significant Events

During 2nd Quarter, FY 2017, a tornado damaged a DLA Distribution Depot located in Albany, Georgia. DLA Distribution Depot Albany, Georgia is the primary source of wholesale and retail storage location for secondary repair parts and expendables. The Depot was closed for approximately 8 days while damage assessments and remediation was performed. Damage was assessed at approximately \$40.0 million.

Note 2. Nonentity Assets - Unaudited

Nonentity Assets at September 30, 2017, consisted of the following (in thousands):

	2017
Nonfederal Assets	
Accounts Receivable	\$ 6,685
Total Nonfederal Assets	\$ 6,685
Total Nonentity Assets	\$ 6,685
Total Entity Assets	\$ 26,998,084
Total Assets	\$ 27,004,769

As of September 30, 2017, DLA has \$6.7 million in nonentity assets due to Interest, Administrative Fees, and Penalties and Fines Receivables.

Note 3. Fund Balance with Treasury - Unaudited

Fund Balance with Treasury at September 30, 2017, consisted of the following (in thousands):

	2017
Fund Balances	
Revolving Funds	\$ 2,076,502
Total Fund Balances	\$ 2,076,502
Status of Fund Balance with Treasury Unobligated Balance	
Unobligated	
Available	\$ 534,880
Obligated Balance not yet Disbursed	19,847,153
Other Budgetary FBWT	(18,305,531)
Total	\$ 2,076,502

The Status of Fund Balance with Treasury reflects the budgetary resources to support FBWT. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

Unobligated Balance, classified as available, represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations.

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

Other Budgetary FBWT reduces the Status of FBWT. This amount includes the remaining budgetary resources accounts such as contract authority and unfilled customer orders.

In FY 2017, the adjustment to FBWT for undistributed transactions was \$ 70,970,269.

Note 4. Other Assets - Unaudited

Other Assets at September 30, 2017, consisted of the following (in thousands):

	2017
Intragovernmental Other Assets	
Other Assets	\$123,306
Total Intragovernmental Other Assets	\$123,306
Nonfederal Other Assets	
Outstanding Contract Financing Payments	\$ 42,861
Advances and Prepayments	42
Total Nonfederal Other Assets	\$ 42,903
Total Other Assets	<u>\$166,209</u>

Other Information:

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 Federal Government. The Federal 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.

Outstanding Contract Financing Payments includes \$37.8 million in contract financing payments and \$5.1 million in estimated future payments to contractors upon delivery and government acceptance of a satisfactory product (See Note 10).

Note 5. Inventory, Net - Unaudited

Inventory and Related Property, Net at September 30, 2017, consisted of the following (in thousands):

	2017		
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net Valuation Method
Inventory Categories			
Held for Sale	\$19,022,675	-	\$19,022,675 MAC
Held for Repair	97,742	(1,955)	95,787 MAC
Excess, Obsolete, and Unserviceable	480,732	-	480,732 NRV
Total	<u>\$19,601,149</u>	<u>(1,955)</u>	<u>\$19,599,194</u>

Legend for Valuation Methods:

NRV = Net Realizable Value

MAC = Moving Average Cost

Other information:**Deemed Cost Adjustment**

In FY 2016, DLA WCF began applying the Statement of Federal Financial Accounting Standards (SFFAS) No. 48, Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials. In accordance with SFFAS No. 48, DLA WCF applied an alternative valuation method, known as deemed cost, to establish opening balances for inventory. Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances. Deemed cost is an acceptable valuation method for opening balances of inventory when a reporting entity is presenting financial statements, or one or more line items addressed by, following U.S. GAAP promulgated by the Federal Accounting Standards Advisory Board (FASAB) either: (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such U.S. GAAP-based financial statements without use of the alternative valuation method. In applying deemed cost, DLA used a combination, of the following valuation methods as prescribed in SFFAS No. 48:

(1) Standard price (selling price) - the latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.

(2) Latest Acquisition Cost – a method that where all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use.

Accounting adjustments were made to the DLA WCF's inventory valuation as a result of the application of SFFAS No. 48. These accounting adjustments were recognized in FY 2016 and 2017.

The DLA did not make an unreserved assertion of SFFAS No. 48. DLA processed the updates to its inventory values in EBS in two stages. In the first stage, DLA updated the inventory values for all National Item Identification Numbers (NIINs) with unit prices above \$25,000 on September 30, 2016. In the second

stage, DLA updated the inventory values for all NIINs with unit prices below \$25,000 on or after October 1, 2016.

The DLA identifies inventory categories and condition codes based on DoD Financial Management Regulation Volume 4, Chapter 4, paragraph 040304G “Relationship of General Ledger Inventory Accounts to Logistic Supply Condition Codes.

The Excess, Obsolete, and Unserviceable inventory is valued at its expected net realizable value. The difference between the carrying amount of the inventory before identification as excess, obsolete or unserviceable and its expected net realizable value is recognized as a loss or gain.

Minimum Inventory Levels

The DLA maintains mandated minimum levels of specific inventory items. These items are not necessarily restricted for use; rather these are mandated minimum levels for DLA that drive fluctuations in the DLA inventory levels.

The Meals Ready to Eat (MRE) has a congressionally mandated level of 5.1 million cases.

Petroleum minimum inventory levels are mandated by the Joint Chiefs of Staff and 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 developed by Military Services and coordinated with Combatant Commanders. DLA Energy then works with the Combatant Commanders to position those stocks. The current wartime stockage objective is 34.5 million barrels (mbbls). Peacetime bulk petroleum inventory requirements are calculated by DLA Energy in accordance with guidelines provided by Office of the Under Secretary of Defense (Comptroller), and are positioned by Energy. The peacetime objective stockage is 18.5 mbbls.

For FY 2017, The DLA Supply Chain Management (SCM) recorded \$134.3 million inventory in litigation that is not available for sale or use.

Note 6. General Property, Plant and Equipment, Net - Unaudited

General Property, Plant, and Equipment at September 30, 2017, consisted of the following (in thousands):

	2017				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Buildings, Structures, and Facil.	S/L	20 or 40	\$ 6,280,827	\$ (4,194,978)	\$2,085,849
Software	S/L	2-5 or 10	713,026	(486,675)	226,351
General Equipment	S/L	5 or 10	667,168	(502,270)	164,898
Construction-in- Progress	N/A	N/A	170,972	N/A	170,972
Total General PP&E			\$ 7,831,993	\$ (5,183,923)	\$2,648,070

S/L= Straight Line

N/A = Not Applicable

In FY 2016, the DLA WCF applied SFFAS 35, which has since been rescinded and replaced with SFFAS 50. The previous method allowed the agency to use Deflated Plant Replacement Value for deemed cost in establishing opening balances in the absence of auditable historical costs for Real Property Valuation. Review and analysis of these assets were performed to ensure asset records agreed to the allowable or derived supporting documentation. This analysis resulted in adjustments to both acquisition cost and accumulated depreciation. DLA has not made an unreserved assertion of SFFAS 50 but plans to initiate the implementation in FY 2018.

The DLA WCF determines the useful life of its PP&E using the asset classification and the type of assets (i.e. building, structure, linear structure, improvement, etc.) based on DoD guidance.

Note 7. Stewardship Property, Plant and Equipment - Unaudited

Stewardship Property, Plant and Equipment (PP&E) are assets with properties that resemble those of the General PP&E that are traditionally capitalized in the financial statements. Due to the nature of these assets, however, valuation is difficult and matching costs with specific periods is not meaningful. Stewardship PP&E includes heritage assets. Heritage assets are items of historical, natural, cultural, educational, or artistic significance, (e.g., aesthetic) or items with significant architectural characteristics. Heritage assets are expected to be preserved indefinitely. In the case where a heritage asset serves both a heritage function and general government operations, the asset is considered a multi-use heritage asset. Multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements.

The DLA heritage assets have no impact on DLA's ability to complete its ongoing mission. The DLA's policy is to preserve and account for its heritage assets. There are no restrictions on the use or convertibility of General PP&E except for heritage assets. The DLA's heritage assets consist of a building, a monument, and cemeteries. 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, governing standards and other binding agreements.

The DLA heritage assets at Richmond are components of the original Bellwood plantation which was sold to the Department of the Army in 1941 when the Installation was first created. Bellwood sits on a 23-acre parcel of land in the southeast corner of the larger 527-acre Defense Supply Center Richmond, a secure military facility located at 8000 Jefferson Davis Highway. As such, it is integral to the history of both the region and Army, and by extension, to DLA. It is a National Historic property and is listed on the National Register of Historic Places. Use of the main building as an Officers' Club has made it the social center of the installation.

The DLA has four heritage assets that include: (1) an early nineteenth century plantation house which the Defense Supply Center Richmond (DSCR) operates and serves as the DSCR Officer's Club and is listed in the National Register, (2) a Native American monument which was jointly established by DSCR and a local Native American organization to honor Native American culture, and (3) two cemeteries located at DSCR which DLA has administrative and curatorial responsibilities. The Bellwood Club, Gregory Cemetery and African American Cemetery were acquired as part of land purchase for the base.

Note 8. Liabilities not Covered by Budgetary Resources - Unaudited**Intragovernmental Liabilities**

Other	\$ 18,003
Total Intragovernmental Liabilities	\$ 18,003

Nonfederal Liabilities

Other Federal Employment Benefits	\$ 210,364
Environmental and Disposal Liabilities	1,465,343
Other Liabilities	25,463
Total Nonfederal Liabilities	\$ 1,701,170
Total Liabilities Not Covered by Budgetary Resources	\$ 1,719,173
Total Liabilities Covered by Budgetary Resources	\$ 2,922,769
Total Liabilities	\$ 4,641,942

Intragovernmental Liabilities: Other consists of accruals for current year FECA liability based on DOL records.

Nonfederal Liabilities: Other generally consists of contingent legal liabilities.

Total Liabilities Covered by Budgetary Resources includes \$23,290 (in thousands) of Environmental and Disposal Liabilities.

Note 9. Environmental and Disposal Liabilities - Unaudited

Environmental Liabilities at September 30, 2017, consisted of the following (in thousands):

	2017
Environmental Liabilities--Nonfederal	
Other Accrued Environmental Liabilities—Non-BRAC	
Environmental Corrective Action	\$ 241,483
Environmental Closure Requirements	1,165,576
Asbestos	81,575
Total Environmental Liabilities	\$ 1,488,634

The DLA's Environmental Liabilities (EL) are comprised of two primary elements: (1) existing obligations supporting the Defense Working Capital Fund environmental restoration programs, and (2) anticipated future costs necessary to complete the environmental restoration requirements at DLA's Energy and Non-Energy environmental sites. In FY 2017, DLA utilized Version 11.4 of the Remedial Action Cost Engineering and Requirements (RACER) software to generate the fiscal year (FY) 2018 Cost to Complete (CTC) estimates of anticipated future costs. Cost estimates related to DLA Energy were generated for 7,295 sites; 4,300 sites associated with closure costs, 71 sites associated with corrective action costs and 2,924

sites associated with asbestos costs. Cost estimates Non-Energy related were generated for 1953 sites; 118 sites associated with closure costs, one site associated with corrective action costs and 1,834 sites associated with asbestos costs.

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. DLA is required to comply with the following laws and regulations where applicable: The Comprehensive Environmental Response, Compensation, and Liability Act; the Superfund Amendments and Reauthorization Act ; the Resource Conservation and Recovery Act; the Clean Water Act; and other applicable Federal, State, interstate, and local laws and regulations. Required cleanup may at times extend beyond Installation boundaries onto privately owned property, and onto sites where DLA is named as a potentially responsible party by a regulatory agency. Additionally, DLA is required to report EL associated with asbestos cleanup in accordance with FASAB Technical Release 10: Implementation Guidance on Asbestos Clean-up Costs Associated with Facilities and Installed Equipment, and FASAB Federal Financial Accounting and Auditing Technical Release No. 2 Determining Probable and Reasonable Estimable for Environmental Liabilities in the Federal Government.

Types of Environmental Liabilities and Disposal Liabilities

The DLA is responsible for clean-up requirements for Non-BRAC Installations. All clean-up 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 WCF uses the RACER software to estimate future environmental costs. The RACER Steering Committee ensures that the software is validated, verified, and accredited in accordance with DoD Instruction 5000.61. OSD is working with the RACER steering committee and stakeholders to identify improvements to RACER functionality, auditability, and documentation. Additionally, DLA utilizes historical user-defined costs to estimate future environmental costs.

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

The primary change in site level estimate from the previous CTC occurred in the FY 2018 CTC and can be attributed to the increase in Non-BRAC Corrective Actions due to new requirements to achieve site closure at the San Pedro Fuel Tank Farm. Additionally DLA's Non-BRAC Closure costs increased due to changes to the EBS tanks and pipelines inventory data combined with changes to Remedial Action Cost Engineering Requirements (RACER®) 11.4 unit costs. Non-BRAC Asbestos clean-up costs decreased due to an overall decrease of 510 buildings/structures in the EBS buildings and structures inventory. Year-to-year fluctuations in DLA's ELs are expected due to changes in agreements with regulatory agencies, deflation, inflation, and technology. The latest version of RACER was used to prepare the estimates.

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

The cost estimates produced through the CTC process are considered accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the

estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

DLA has instituted extensive controls to ensure that these estimates are accurate and reproducible. Due to the inherent uncertainty involved with environmental contamination and associated remedial actions, RACER, as a parametric cost estimating tool, is used as a preliminary order of magnitude estimate. The stated total liability includes prior year obligations and the estimate of future costs necessary to complete the environmental restoration requirements.

In FY 2017, DLA implemented the Roll Forward process bridging the timing gap between the completion of the annual CTC estimates and September 30, 2017 to determine if any significant changes to environmental liabilities have occurred during that timeframe. Based on the results of the roll forward process, it was determined that there were significant changes to environmental liabilities between the completion of the annual CTC process and September 30, 2017. These changes are summarized in the table below (in thousands):

DWCF Roll Forward Adjustments			
Fund & Program	Category	Material Change	Cost Change
Corrective Action	Changes to Site Requirements	Operations and maintenance (O&M) in FY18 at San Pedro Fuel Depot Tank Farm Area was funded in FY17.	\$ (1,695)
Closures	Changes to Site Requirements	Changes to inventory including addition of assets, removal of assets and changes to asset properties created a material change.	\$ (2,609)
Asbestos	Changes to Site Requirements	Changes to the Building and Structures inventory resulted in an overall decrease in assets resulting in a material cost change.	\$ (4,616)

This process is in accordance with OSD memorandum for Strategy for Environmental & Disposal Liabilities Audit Readiness (September 30, 2015).

Additionally, in FY 2017, DLA implemented the EL Site Identification (ID) process that reviews the Environmental Event Repository and evaluates each event for Out Year EL potentiality for use in the annual CTC and EL financial reporting. During the FY 2017 Site ID Process, sites were identified as Potential Out Year ELs due to the lack of sufficient information/data or pending additional corrective or closure actions. These sites will be re-evaluated during the next Site ID process to determine if any changes have taken place and sufficient information/data is available to create an estimate of future costs that would be included in the Defense Working Capital Fund EL.

Unrecognized Costs

DLA systematically recognizes Asbestos and Closure liabilities over the useful life of assets in accordance with Volume 4, Chapter 13, and paragraph 130202. The total recognized Asbestos liability is stated above and the unrecognized Asbestos liability is \$16,900 (in thousands). The total recognized Closure liability is stated above and the unrecognized Closure liability is \$59,883 (in thousands). These liabilities are amortized based on the useful life of the assets as determined in DoD FMR Volume 4, Chapter 6, Section 060205.J. Table 6-1 DoD Recovery Periods for Depreciable General PP&E Assets.

Cleanup Costs Associated with Asbestos

The DLA's total environmental liability for asbestos related clean-up reported above is \$81,574 (in thousands). Cost estimates were generated for each asset by applying DLA's agency-specific asbestos abatement cost factor to the square footage of each asset, resulting in asset-specific asbestos-related estimates. DLA's agency-specific asbestos abatement cost factor was developed from asbestos surveys for the DLA host installations. For more detailed information on the development of the DLA agency-specific asbestos abatement cost factor, refer to the DLA Asbestos Cost-Factor Methodology and Calculation document dated August 1, 2016.

DLA calculated the future cost associated with asbestos EL utilizing the agency specific asbestos abatement cost factor and DLA's Enterprise Business Solution (EBS) real property records in compliance with the Department of Defense (DoD) Strategy for Environmental & Disposal Liabilities Audit Readiness (September 2015). Cost estimates related to DLA asbestos EL were generated by multiplying the gross square footage of 4,758 DLA buildings and structures by the agency-specific asbestos abatement cost factor of \$1.25 per gross square foot. Additionally, applicable RACER location modifiers and Professional Labor Management were factored on an asset by asset basis followed by systematic recognition of the liability over the remaining useful life of the asset in accordance with DoD FMR Volume 4 Chapter 13 (December 2011).

Cleanup Costs Associated with Overseas EL

Total overseas cleanup ELs include 1,232 environmental closure sites (1,087 tanks and 145 pipelines) at 59 installations across 25 countries/territories, and two environmental corrective action sites at Royal Air Force Base Mildenhall, England. In addition, there are 1,198 buildings/structures with asbestos cleanup-related requirements at 71 installations across 32 countries/territories.

Note 10. Other Liabilities - Unaudited

Other Liabilities at September 30, 2017, consisted of the following (in thousands):

	2017		
	Current Liability	Noncurrent Liability	Current Liability
Intragovernmental			
Advances from Others	\$ 452,857	\$ -	\$ 452,857
Judgment Fund Liabilities	10	-	10
FECA Reimbursement to the Department of Labor	10,418	14,400	24,818
Custodial Liabilities	6,684	-	6,684
Employer Contribution and Payroll Taxes Payable	20,622	-	20,622
Total Intragovernmental Other Liabilities	\$ 490,591	\$ 14,400	\$ 504,991
Nonfederal			
Accrued Funded Payroll and Benefits	\$ 236,221	\$ -	\$ 236,221
Advances from Others	1,339	-	1,339
Contract Holdbacks	-	28	28
Employer Contribution and Payroll Taxes Payable	1,941	-	1,941
Contingent Liabilities	25,462	5,076	30,538
Total Nonfederal Other Liabilities	\$ 264,963	\$ 5,104	\$ 270,067
Total Other Liabilities	\$ 755,554	\$ 19,504	\$ 775,058

During 4th Quarter, FY 2017 DLA provided assistance in hurricane relief efforts to protect the lives and safety of those in the affected areas of the US, Gulf Coast, Puerto Rico and Virgin Islands. DLA received a \$452.9 million advance from FEMA related to these efforts. DLA is supporting FEMA and other government entities for hurricanes Harvey, Irma & Maria consisted of fuel, MREs, equipment, water and other supplies.

Note 11. Commitment and Contingencies - Unaudited**CONTINGENCIES:**

The DLA is a party in various administrative proceedings and legal actions related to claims for environmental damages, equal opportunity matters, and contractual bid protests. DLA has accrued contingent liabilities for legal actions where the 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 maybe payable from the U.S. Treasury Judgment Fund. DLA records contingent liabilities in Note 10, Other Liabilities.

Reasonably Possible Likelihood of an Adverse Outcome

The DLA has an estimated reasonably possible minimum loss contingency of \$10.6 million. DLA's Automated Workflow and Reporting System (AWARS) is used by OGC to assess the outcomes and possible liability amounts of open cases. The AWARS projects a minimum liability of approximately

\$10.6 million and a maximum liability of approximately \$26.4 million. The minimum level decreased in FY 2017 due to changes in the cases pending. Cases for which legal counsel are able to make a determination that an adverse outcome is reasonably possible and the possible financial outflow is measurable, are reported as reasonably possible for financial reporting purposes.

Environmental Contingencies

The DLA has developed a process to identify and record contingent environmental liabilities. Where DLA is aware of probable and measurable future outflow of resources due to a past event or exchange transaction, the appropriate program category will be reported in Note 9, Environmental Liabilities and Disposal Liabilities.

Potential Loss Related to Economic Price Clause Contracts

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

COMMITMENTS:

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

Note 12. Other Federal Employment Benefits - Unaudited

Other Federal Employment Benefits at September 30, 2017, consisted of the following (in thousands):

	2017		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	\$ 210,364	\$ -	\$ 210,364
Total Other Benefits	\$ 210,364	\$ -	\$ 210,364
Total Other Federal Employment Benefits:	<u>\$ 210,364</u>	<u>\$ -</u>	<u>\$ 210,364</u>

Actuarial Calculations

The DLA actuarial liability for workers' compensation benefits is developed by the Department of Labor's (DOL) Office of Workers' Compensation Programs (OWCP) 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:

Year 1: 2.218% 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. The actual rates for these factors for the charge back year (CBY) 2016 were also used to adjust the methodology's historical payments to current year constant dollars. The compensation COLAs and CPIMs used in the projections for various CBY were as follows:

CBY	COLA	CPIM
2017	N/A	N/A
2018	1.22%	3.20%
2019	1.35%	3.52%
2020	1.59%	3.80%
2021	1.99%	3.99%
2022	2.26%	3.91%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions; (2) a comparison of the percentage change in the liability amount by the agency to the percentage change in the actual incremental payments; (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2016 to the average pattern observed during the most current three charge back years; and (4) a comparison of the estimated liability per case in the 2016 projection to the average pattern for the projections of the most recent three years.

The cost model used for the estimated actuarial liability is updated only at the end of each fiscal year.

Note 13. Cost and Exchange Revenue – Unaudited

General Disclosures Related to the Statement of Net Cost at September 30, 2017, consisted of the following (in thousands):

	2017
Energy	
Intragovernmental Costs	\$ 265,129
Public Costs	11,200,961
Total Costs	<u>\$ 11,466,090</u>
Intragovernmental Earned Revenue	\$ (8,889,726)
Public Earned Revenue	(2,726,270)
Total Earned Revenue	<u>\$ (11,615,996)</u>
Total Net Costs	<u><u>\$ (149,906)</u></u>
 Supply Chain Management	
Intragovernmental Costs	\$ 1,449,690
Public Costs	29,112,646
Total Costs	<u>\$ 30,562,336</u>
Intragovernmental Earned Revenue	\$ (24,404,514)
Public Earned Revenue	(5,192,712)
Total Earned Revenue	<u>\$ (29,597,226)</u>
Total Net Costs	<u><u>\$ 965,110</u></u>
 Document Services	
Intragovernmental Costs	\$ 66,836
Public Costs	170,218
Total Costs	<u>\$ 237,054</u>
Intragovernmental Earned Revenue	\$ (263,056)
Public Earned Revenue	(438)
Total Earned Revenue	<u>\$ (263,494)</u>
Total Net Costs	<u><u>\$ (26,440)</u></u>
 Consolidated	
Intragovernmental Costs	\$ 1,781,655
Public Costs	40,483,825
Total Costs	<u>\$ 42,265,480</u>
Intragovernmental Earned Revenue	\$ (33,557,296)
Public Earned Revenue	(7,919,420)
Total Earned Revenue	<u>\$ (41,476,716)</u>
Total Net Costs	<u><u>\$ 788,764</u></u>

Intragovernmental costs and revenue represents transactions made between two reporting entities within the Federal Government. Nonfederal costs and revenues are exchange transactions made between the reporting entity and a Nonfederal entity.

The DLA's Enterprise Business System (EBS) does not track intragovernmental transactions by customer at the transaction level. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between federal and nonfederal expenses.

Note 14. Available Contract Authority, End of Period - Unaudited

The amount of available contract authority at the end of the period is \$44.7 billion.

Note 15. Apportionment Categories of new obligations and upward adjustments: Direct vs. Reimbursable Obligations - Unaudited

The DLA WCF only had Reimbursable Obligations Incurred in Category B this reporting period. Category A and Category B did not contain Obligations Exempt from apportionment. The table below summarizes the apportionment categories. The summation of the categories is equivalent to the New Obligations and Upward Adjustments Line on the Statement of Budgetary Resources (in thousands):

	Category B
Direct Obligations Incurred	\$ 37,132
Reimbursable Obligations Incurred	\$ 45,029,922
Total	\$ 45,067,054

Note 16. Undelivered Orders at the End of the Period - Unaudited

The Net Amount of Budgetary Resources Obligated for Undelivered Orders at the end of the period is \$17.5 billion.

Note 17. Reconciliation of Net Cost of Operations to Budget - Unaudited

Reconciliation of Net Cost of Operations at Budget at September 30, 2017, consisted of the following (in thousands):

	2017
Resources Used to Finance Activities:	
Budgetary Resources Obligated:	
Obligations incurred	\$ 45,117,884
Less: Spending authority from offsetting collections and recoveries	(42,375,243)
Obligations net of offsetting collections and recoveries	2,742,641
Net obligations	\$ 2,742,641
Other Resources:	
Transfers in/out without reimbursement	\$ (2,236)
Imputed financing from costs absorbed by others	123,686
Other	308,079
Net other resources used to finance activities	429,529
Total resources used to finance activities	\$ 3,172,170
Resources Used to Finance Items not Part of the Net Cost of Operations:	
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:	
Undelivered Orders	\$ (3,731,159)
Unfilled Customer Orders	(336,390)
Resources that fund expenses recognized in prior Periods	(48,162)
Resources that finance the acquisition of assets	(26,063,005)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:	
Other	(305,843)
Total resources used to finance items not part of the Net Cost of Operations	\$ (30,484,559)
Total resources used to finance the Net Cost of Operations	\$ (27,312,389)

Reconciliation of Net Cost of Operations at Budget at September 30, 2017, consisted of the following (in thousands): (Continued)

Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:

Components Requiring or Generating Resources in Future Period:	
Increase in exchange revenue receivable from the public	(252,258)
Other	52,608
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ (199,650)

Components not Requiring or Generating Resources:	
Depreciation and amortization	\$ 1,657,492
Revaluation of assets or liabilities	(2,134,178)
Other	
Cost of Goods Sold	28,742,696
Other	34,792
Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ 28,300,802

Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	\$ 28,101,152
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Net Cost of Operations	\$ 788,764
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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 operations 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.

All mandatory reconciliations are cleared before financial statements can be released to the customer. Due to the DLA's financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. DLA WCF adjusted the note schedule in the amount of \$488.0 million to bring it into balance the Net Costs of Operations on the Statement of Net Costs, Statement of Net Position and Note 17. The adjustment is reported in Other Components Not Requiring or Generating Resources.

Below are the primary business events comprised in the lines titled, “Other”

Resources Used to Finance Activities, Other includes:

DLA SCM:

- Offset to non-entity accrued collections to record an allowance for accounts receivable with Supreme Food Service.
- Offset to non-entity collections to account for penalties, fines and administrative fees, related to Supreme Food Service.

Components Requiring or Generating Resources in Future Period, Other includes:

DLA Energy:

- Future funded expenses, adjusting Environmental Liabilities cleanup costs in the Enterprise Business System.

Components not Requiring or Generating Resources, Other includes:

DLA Energy:

- Cost capitalization offset primarily related to CIP for Minor Construction, Petroleum Minor Construction Operations, and Non-Information Technology.
- Bad Debt Expense to establish an allowance for loss on accounts receivables, interest, penalties, and administrative fees.
- Other Expenses Not Requiring Budgetary Resources-Performance Metric Indicator 3, to balance the Reconciliation of Net Cost of Operations to Budget with the Statement of Net Cost and the Statement of Changes in Net Position.

DLA SCM:

- Cost capitalization offset related to CIP for DLA Headquarters – Minor Construction, and DLA Distribution – Automated Data Processing Information Technology.
- Bad Debt Expense, primarily to record an allowance for accounts receivable Supreme Food Service for DLA Distribution, Garrison Feeding Division.
- Other Expenses Not Requiring Budgetary Resources-Performance Metric Indicator 31, to balance the Reconciliation of Net Cost of Operations to Budget schedule with the Statement of Net Cost and the Statement of Changes in Net Position.

Required Supplementary Information

Deferred Maintenance and Repairs

DLA presents deferred maintenance and repairs as of the end of the fiscal year in accordance with SFFAS No. 42, Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32. Maintenance and repairs are activities directed toward keeping fixed assets in an acceptable condition. Activities include preventive maintenance; replacement of parts, systems, or components; and other activities needed to preserve or maintain the asset. Deferred maintenance and repairs are activities that were not performed when they should have been, or that were scheduled to be performed but were delayed for a future period.

Deferred maintenance and repair amounts represent the cost to restore an asset's condition so that the asset provides acceptable services and achieves its expected life. Mission performance metrics reports, scorecards, and historical records are used as objective evidence of deficiencies in deferred maintenance and repairs. Project management reviews of the inputs are conducted to identify maintainability and reliability, labor costs, design costs, technical expertise required, organizational reparability, organizational spares availability, and opportunities to use spare parts from property that may be retired.

Defining and Implementing Maintenance and Repairs Policies. The DLA measures deferred maintenance and repairs for each class of asset using condition assessments performed at least once every five years. These assessments include surveys, inspections, operating evaluations, regional strategic assessments, facility quality ratings, and consolidated support function plans.

Deferred maintenance and repair procedures are performed for capital and non-capital accountable personal and real property, capitalized stewardship PP&E including multi-use heritage assets—such as buildings and structures, memorials, and recreational areas—as well as inactive and excess property that is not required to fulfill the Component missions, or have been withdrawn from operational service. Most of these assets have been fully depreciated. The condition of the assets included in these assessments ranges from good to poor. Components identify maintenance not performed as scheduled and establish future performance dates.

The DLA allows Components the flexibility to apply industry standard methods commensurate with each asset's condition and usage, unless more thorough procedures are mandated by federal, state, or local codes. Components estimate the cost to address deferred maintenance and repair deficiencies using construction, maintenance, and repair cost data available through the Components' real property structure.

Ranking and Prioritizing Maintenance and Repair Activities. DLA ranks and prioritizes deferred maintenance and repair activities based on mission criticality to the operations of DLA and legal requirements, as well as the condition of the asset. Deferred maintenance and repair projects are prioritized among other activities as part of the DLA Strategic Play and annual capital budgeting processes.

Factors Considered in Setting Acceptable Condition. Acceptable condition is primarily prescribed by the facility condition assessments or other similar methodology. The condition assessment process includes factors such as asset age, operating environment, inventory levels, threat vulnerability, and current condition as determined by physical inspection, operating environment, and maintenance and repair history of the asset under assessment. The Agency also considers federal requirements (including OMB's Federal Real Property Profile), accessibility, mission criticality, and needs.

Heritage Assets Excluded under Deferred Maintenance and Repairs. The DLA possesses certain types of heritage assets that are not reported in deferred maintenance and repairs. These heritage assets include artifacts, artwork, display models, and sunken vessels and aircraft that have deteriorated through damage due to moving and transportation, storage or display, or environmental degradation.

Significant Changes from Prior Year. As of September 30, 2017, \$466.2 million in deferred maintenance and repairs for active assets was estimated to return active real property assets to acceptable operating condition.

Deferred maintenance and repairs for FY 2017, by asset class, consisted of (in thousands):

Real Property Deferred Maintenance and Repairs			
	1. Plant Replacement Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage (Required Work / Plant Replacement Value)
Active Real Property			
Category 1: Buildings, Structures, and Linear Structures (Enduring Facilities)	\$37,282.60	\$466.00	1.2%
Category 2: Buildings, Structures, and Linear Structures (Heritage assets)	\$2.70	\$0.20	7.0%
Inactive Real Property			
Category 3: Buildings, Structures, and Linear Structures (Excess Facilities or Planned for Replacement)	\$595.80	\$13.60	2.3%

Independent Auditors' Report



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

December 12, 2017

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

SUBJECT: Transmittal of the Disclaimer of Opinion on the Defense Logistics Agency
Working Capital Fund Financial Statements and Related Footnotes for FY 2017
(Project No. D2016-D000FE-0209.000, Report No. DODIG-2018-054)

We contracted with the independent public accounting firm of Ernst & Young to audit the Defense Logistics Agency (DLA) FY 2017 Working Capital Fund Financial Statements and related footnotes as of September 30, 2017, and for the year then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. The contract required Ernst & Young to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008. Ernst & Young's Independent Auditor's Reports are attached.

Ernst & Young's audit resulted in a disclaimer of opinion. Ernst & Young could not obtain sufficient, competent evidential matter to support the reported amount within the DLA financial statements. As a result, Ernst & Young could not conclude whether the financial statements and related footnotes were fairly presented in accordance with accounting principles generally accepted in the United States of America. Accordingly, Ernst & Young did not express an opinion on the DLA FY 2017 Working Capital Fund Financial Statements and related footnotes.

Ernst & Young's separate report on "Internal Control over Financial Reporting" discusses eight material weaknesses related to DLA's internal controls over financial reporting. Ernst & Young's report also includes a significant deficiency related to financial reporting. Ernst & Young's additional report on "Compliance and Other Matters Based on an Audit of the Financial Statements Performed" discusses four instances of noncompliance with applicable laws and regulations.

In relation to the contract, we reviewed Ernst & Young's report and related documentation and discussed the audit results with Ernst & Young representatives. Our review, as differentiated from an audit conducted in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the DLA's FY 2017 Working Capital Fund Financial Statements and related footnotes, conclusions about the effectiveness of internal control, conclusions on whether the DLA's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the DLA complied with laws and regulations.

Ernst & Young is responsible for the attached reports, dated December 12, 2017, and the conclusions expressed in these reports. However, our review disclosed no instances in which Ernst & Young did not comply, in all material respects, with GAGAS.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945.



Lorin T. Venable, CPA

Assistant Inspector General

Financial Management and Reporting

Attachments:

As stated



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Report of Independent Auditors

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

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Working Capital Fund of the Defense Logistics Agency (“DLA”), which comprise of the balance sheet as of September 30, 2017, and the related statements of net costs, changes in net position, and combined statement of budgetary resources for the year ended September 30, 2017, and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

The Department of Defense, including DLA, continues to have unresolved accounting issues and material weaknesses in internal controls that cause DLA to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on DLA’s financial statements as a whole for the year ended September 30, 2017.

Disclaimer of Opinion

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



Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Financial Information and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise DLA's basic financial statements. The Other Financial Information, as identified on DLA's Agency Financial Report Table of Contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Other Financial Information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in an engagement to perform an audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Other Financial Information.

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



Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated December 12, 2017 on our consideration of DLA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering DLA's internal control over financial reporting and compliance.

Ernst + Young LLP

December 12, 2017



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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (“OMB”) Bullet No. 17-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund of the Defense Logistics Agency (DLA), which comprise the balance sheet as of September 30, 2017, and the related statement of net cost, changes in net position, and statement of budgetary resources for the fiscal year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 12, 2017. The report states that because of matters described in the Basis for Disclaimer Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on the financial statements as of and for the fiscal year ended September 30, 2017 and the related notes to the financial statements.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered DLA's internal control over financial reporting (“internal control”) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of DLA's internal control. Accordingly, we do not express an opinion on the effectiveness of DLA's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 17-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (“FMFIA”), such as those controls relevant to ensuring efficient operations.

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



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

Material weaknesses

During our audit, we noted the following matters involving internal control over financial reporting and its operation that we consider to be material weaknesses as defined above.

- I. Inventory - Inventory is comprised of items held by DLA for resale or held by DLA on behalf of one of the military services. We found that policies, procedures and controls surrounding documentation of procurements and disbursements, tracking of inventory by owner, challenging the perpetual inventory systems by periodic physical counts, and accumulating cost of inventory all had deficiencies that in combination signified a material weakness in internal control related to inventory. The matters identified related to inventory are further described in Appendix A.
- II. Property, Plant, and Equipment (PP&E) – PP&E includes real property general equipment, internal use software and construction-in-progress. We found that DLA has not completed an analysis of existence and completeness of PP&E records for which they are the FRO, had not completed their process to value PP&E beginning balances, and have weaknesses in the processes of maintaining and reconciling PP&E records. The combination of these findings led us to conclude that there is a material weakness related to PP&E. The matters identified related to PP&E are further described in Appendix A.
- III. Fund Balance with Treasury (FBwT) – DLA is unable to reconcile the FBwT ending balances from general ledger directly to the U.S. Treasury. DLA, in conjunction with DFAS, has implemented the Cash Management Reconciliation (CMR) and Defense Reconciliation Reporting Tool (DRRT) processes as mechanisms to reconcile DLA's general ledger to Treasury. However, these tools have known control deficiencies and reconciling issues within the process. In addition, DLA does not have sufficient policies, procedures or controls in place for the end-to-end FBwT process. These



deficiencies supported a conclusion of a material weakness in FBWT. The matters noted are further described in Appendix A.

- IV. Accounts Receivable (AR) – AR consists of amounts owed to DLA primarily related to resale of goods. We found that DLA was unable to adequately support the balances included in the accounts receivable detail, had not adequately validated or explained the significant balance of aged receivables and did not have adequate procedures to estimate valuation allowances against receivables. The combined effect of these weaknesses led us to conclude there is a material weakness related to accounts receivable. The matters identified related to AR are further described in Appendix A.
- V. Accounts Payable (AP) - AP falls within the scope of DLAs procure to pay process. We found that DLA was unable to adequately support the accounts payable and related budgetary beginning balances, had issues recording transactions in the proper period, and lacked overall policies, procedures, and internal controls in the procure to pay process. This combination of deficiencies is considered to be a material weakness. The matters identified related to AP are further described in Appendix A.
- VI. Financial Reporting – DLA’s financial statement preparation process lacks sufficient, appropriate reviews to identify inaccurate balances on the face of the financial statements as well as completeness and accuracy of disclosures. We considered these deficiencies to be a material weakness. The matters noted are further described in Appendix A.
- VII. Oversight and Monitoring - DLA does not have an effective OMB Circular A-123 program, which impacted DLA’s ability to appropriately identify and address significant risks for all key business processes. DLA has not implemented appropriate internal controls, including the documentation of policies and procedures that describe DLA’s environment related to end-to-end business processes, roles and responsibilities, monitoring of service providers, related parties, systems, risks and controls. DLA’s lack of documented controls prevent the consistent execution and proper review of data/reports used in the execution of key controls, as well as appropriate evidence of management review controls. We consider these overall weaknesses in the internal control structure to be a material weakness. The matters noted are further described in Appendix A.
- VIII. Information Systems – Our assessment of DLA’s IT controls and the computing environment identified deficiencies which collectively constitute a material weakness in the design and operation of information systems controls over financial data. We reviewed each finding individually as well as in aggregate. Based on our review, we



have identified four areas of deficiency which, when aggregated, result in a material weakness. The deficiencies relate to the following four areas:

- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Security management / governance over implementation of security controls

Refer to Appendix A for additional detail in these four areas.

Significant deficiencies

During our audit, we also noted the following matter involving internal control over financial reporting and its operation that we consider to be a significant deficiency, as defined above.

- I. Environmental Liabilities (EL) – Environmental liabilities is comprised of clean-up costs associated with the restoration of sites on real property that DLA manages. The lack of formal policies, procedures and supporting documentation does not allow for DLA to substantiate the completeness and valuation of its EL. The matters identified related to EL are further described in Appendix B.

DLA's Response to Findings

DLA's response to the findings identified in our engagement, as described above, are included in its letter dated December 12, 2017, which has been included at the end of this report. DLA's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.



Purpose of this Report

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

Ernst & Young LLP

December 12, 2017



Appendix A - Material Weaknesses

Inventory

DLA's inventory is comprised of petroleum and aerospace products, weapon system repair parts, food and medical supplies. Inventory also includes material from the military services designated for disposal or reutilization. Control over the inventory process is complex because of the large number of locations in which inventory is stored, the volume of different items held, and the specific requirements imposed by the individual branches of the military service. To meet these challenges DLA must have controls over processes of procurement and introduction of goods into inventory, delivery of goods to customers and periodic reconciliation of goods on hand to accountability and financial records. In our testing we found that DLA's controls and processes did not adequately meet these needs in several significant areas. Specifically:

DLA lacks policies and procedures that adequately describe the end-to-end process to account for and report inventory and inventory-related transactions due to the following:

- DLA inventory process cycle memos, policy memorandum or standard operating procedures do not adequately document the flow of transactions and related internal control activities. Specifically, DLA has not documented the processes related to the significant business activities for acquisition, movement, warehousing, and disposition of inventory, the related risks and the control activities designed to mitigate risk of loss or material misstatement.
- The process documentation does not adequately include a description of inventory financial reporting, inventory records management, physical inventory count policies, accounting for third-party managed inventory and various other business processes.
- The process documentation also does not include the description or significant operating protocols surrounding the inventory reconciliation framework or the annual CFO sample process.

DLA has not appropriately designed controls related to physical counts for the validation of existence and completeness of Distribution inventory due to the following:

- Good practice in inventory cycle count programs is a requirement that all inventory is counted at least once annually. DLA policy requires the physical count of all items on 2 or 5 year cycle depending on inventory value. DLA is not currently in compliance with this policy.
- DLA has instituted an annual statistical sampling count to supplement the cycle counts and mitigate potential weaknesses in the cycle count control. However, the statistical sampling approach was not executed completely and accurately in FY17. The sampling approach



was not designed to include all inventory. In addition, errors identified in the sample were not assessed to determine root cause or projected over the population to determine the potential financial significance of the errors noted over the entire population.

DLA lacks policies and procedures to properly segregate inventory held for others and ensure gains and losses recorded as a result of physical inventory counts are properly assigned to the appropriate owner due to the following:

- DLA does not properly segregate inventory held for others from inventory owned by DLA. As a service to the military, in addition to procuring and holding inventory for the military, it also manages certain inventory procured directly by the military and delivered to DLA. This inventory held on behalf of the military services is not always stored in physically segregated locations and instead is comingled with similar inventory owned by multiple owners.
- DLA's inventory systems track quantities of inventory by owner but does not reconcile those records to the total physical inventory counts on a regular basis.
- DLA policy states that DLA does not accept the risk of loss for inventory held by DLA on behalf of others. However, policies or procedures are not in place to ensure that gain/loss adjustments are appropriately assigned to the appropriate owner. DLA policy states that upon completion of inventory counts, gains and losses are assigned based on a proration methodology. In certain instances, the gains and losses are entirely recorded by DLA, as the manager of the inventory. Gains and losses recorded by DLA for inventory held by DLA on behalf of other does not comply with their policy.
- Policies are not adequate to ensure gains/losses recognized in the financial statements are complete and accurate.

DLA is unable to substantiate the completeness and accuracy of Disposition inventory received from the services due to:

- Inventory physical counts are not required to be performed on all Disposition inventory received from the military services. . DLA policy requires that prior to transferring the inventory into DLA disposition from the military services, a physical count is only performed under specific circumstances. If all of the criteria are not met, a physical count



is not required to be performed. The inventory count policies are not adequate to ensure existence and completeness of all inventory received is recorded appropriately.

DLA is unable to substantiate the existence and completeness of inventory held at third parties due to:

- A detailed listing of all vendors who hold inventory on DLA's behalf was unavailable to the auditors.
- A detailed listing of inventory by vendor that reconciles to the inventory recorded in DLA's general ledger, Enterprise Business System (EBS), was unavailable to the auditors.
- Sufficient evidential matter to support the balances of inventory held at third parties for each vendor was unavailable. Due to the lack of evidential matter, confirmations could not be completed to validate the inventory held at third parties. In addition, differences in inventory balances between the third-party and DLA could not be reconciled due to the lack of evidential matter.

DLA lacks appropriate controls to ensure compliance with and consistent application of DLA Energy policies and procedures.

- DLA policy requires that manual readings of fuel tank levels be obtained by calibrated tape or calibrated rod in the absence of functional automated tank gauging (ATG) systems. DLA does not have processes in place to ensure that manual readings are used for malfunctioning ATGs.
- DLA policy requires that monthly or quarterly ATG verifications are performed. DLA does not perform procedures to monitor and review that field level sites perform the monthly or quarterly verifications.
- DLA policy requires that a work order is submitted for all malfunctioning ATGs to be recalibrated. However, DLA does not have sufficient monitoring controls in place to determine if work orders are completed.

DLA lacks policies and procedures to properly validate in-transit inventory due to the following:

- Policies and procedures are not in place to validate that DLA has accepted title and has the right to record inventory in-transit from procurement.
- In-transit inventory is comprised of inventory that was accepted at the point of origin (FOB shipping point) and in-transit to a DLA destination. We found circumstances wherein inventory was recorded as in-transit from procurement points of origin and has remained in-transit for several fiscal years, including amounts dating back to 2013.



DLA does not have adequate controls to ensure that transactions between the Accountable Property System of Record (APSR) and EBS are posted appropriately due to the following:

- Controls are not in place to prevent users from posting above their approved thresholds nor to review if users posted unauthorized transactions. Transactions posted in the APSR are reconciled to transactions posted in EBS. Errors identified in the data recorded between the systems results in that transaction being flagged. DLA policy requires that the errors are reviewed and corrected by assigned users. Adjustments above a certain dollar threshold are reviewed by a supervisor. However, DLA does not have a process that prevents users from posting adjustments above the threshold or detect that adjustments posted above the threshold were reviewed.
- Controls are not in place to ensure that a review is performed on adjustments that were made to detect whether an unauthorized adjustment was made.

DLA does not have controls to ensure that work-in-process inventory is complete, accurate, appropriately valued and presented due to the following:

- Costing - DLA does not have adequate controls in place to properly value inventory in accordance with Federal Accounting Standards Advisory Board (FASAB) SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*. DLA implemented inventory costing methodologies in accordance with FASAB SFFAS 48 in FY 2016. However, DLA did not completely and accurately value inventory in accordance with SFFAS 48.
 - In applying SFFAS 48, the values assigned for certain inventory items were based on the latest acquisition cost (LAC). The LAC values did not properly consider inventory acquired through the implementation date.
 - Purchase discounts and/or additional costs to get the material to the suitable form and location of its intended use were not considered when calculating the LAC.
- Work in process (WIP) - DLA does not properly account for additional inventory costs associated with WIP inventory while the inventory is in the kitting or assembly process. Inventory items or components are provided to a production facility, for assembly, modification, or to make an end-item. DLA policy is to classify the raw materials provided to a vendor for kitting or assembly as inventory stock on hand until the finished goods are produced and a goods receipt is posted. Upon receipt, the raw materials is decremented and the finished good is recorded. Policies and procedures are not in place to assign and



record all costs, such as the assembly and labor costs, incurred during the kitting or assembly process.

- Inventory Valuation Allowances - DLA lacks policies and procedures to ensure that the valuation of inventory, including excess, obsolete and unserviceable (EOU) inventory; inventory held for repair; inventory held at net realizable value, etc., is in accordance with GAAP due to the following:
 - Inventory Held for Repair:
 - The policy documentation did not sufficiently describe the methodology used to estimate the Allowance for Inventory Held for Repair.
 - The policy did not describe the rationale for adopting the methodology being used and the factors used in the estimation process.
 - EOU:
 - Policies or procedures are not in place to identify and properly value inventory held by third parties which is excess, obsolete, or unserviceable.
 - Adequate controls are not in place to ensure the net realizable value applied to EOU inventory is calculated correctly.

DLA does not have adequate controls in place to ensure the balances at period end are complete and accurate due to the following (Existence and Completeness):

- Policies and procedures are not in place to ensure transactions are appropriately and accurately recorded in the period that the transaction occurred.
- DLA does not have a process to accrue for transactions that occurred but were not posted at period end.
- Internal controls are not in place for detecting and resolving timely the posting errors during the interfaces between the accountable property systems of record (APSR) and the general ledger (EBS).

DLA has not adequately designed controls to ensure that inventory is reconciled between the APSR and EBS on a complete and timely basis.

- DLA does not have adequate processes in place to reconcile inventory balances effectively. DLA utilizes the Inventory Reconciliation Framework (IRF) to reconcile inventory. The IRF compares the inventory quantity balance in EBS to the inventory quantity balance in the Inventory Record Management (IRM)-compliant APSRs. The IRF is comprised of ten tie points of both financial and quantity data. However, the inventory reconciliation for September 30, 2016 was not completed until December 2016. As of December 2016, there were significant unreconciled variances totaling \$858 million. Subsequent to December 2016, additional procedures were performed to reconcile September 30, 2016 inventory



balances, which reduced the unreconciled variance by approximately \$414 million to \$444 million (by March 2017).

- The IRF does not include all appropriate general ledger accounts such as inventory in-transit between storage locations, inventories-stock on hand, etc.
- DLA is unable to substantiate how variances are reconciled. DLA provides the causative and non-causative research worksheet to support how variances are resolved. However, the worksheet is not adequate to support the cause of the variance and how the adjustment properly corrected the variance.

DLA is unable to substantiate that transactions are recorded consistently with Treasury's United States Standard General Ledger (USSGL) accounting transaction definitions and processing rules, and trace transaction detail supporting USSGL accounts to USSGL account codes due to the following:

- DLA does not have sufficient evidential matter that documents the posting logic for inventory transactions (inventory receipts, issues, gains, losses and condition change), including which general account should be used and how the values of each general ledger entry are calculated. DLA utilizes multiple APSRs that transfers financial transactions to the general ledger in EBS. The financial transactions result in adjustments to inventory balances (e.g. inventory receipts, issues, gains, losses, and condition change), which trigger a movement type through an existing interface. The movement types are configured to update the inventory ledger in EBS and the Inventory Stock on Hand general ledger account.
- DLA was unable to provide an accurate mapping of the EBS posting logic to the APSR document identifier codes (DIC) and EBS movement types. DLA's documentation demonstrated the DICs being mapped to several movement types, which resulted in different posting logics being used.
- The posting logic for various inventory transactions does not comply with the guidance outlined in the Treasury Financial Manual such as recoupment from disposal, material transfers, etc. The transactions do not meet the corresponding TFM business events.

DLA does not have adequate controls to ensure that inventory is classified and presented appropriately in the financial statements due to the following:

- Controls are not in place to ensure that inventory balances are appropriately recorded and reported in the financial statements. DLA accounting policy states that Inventory balances are based on the following categories: inventory held for current sale, inventory held for



- future sale, EOU and inventory held for repair. However, DLA lacks policies and procedures to identify excess inventory.
- Controls are not in place to ensure that inventory is assigned to the appropriate condition codes and that the balances in inventory general ledger accounts are complete and accurate. DLA uses the inventory condition codes as the basis to classify inventory between each category.
 - Policies and procedures are not in place to identify and classify inventory as not available for sale for both inventory held by DLA and inventory held at third parties.

DLA is unable to substantiate inventory and inventory-related transactions due to the following:

- DLA is unable to provide evidential matter to support that inventory balances exist or inventory transactions occurred and are accurately recorded in the financial statements. Specifically, documentation was not available to support:
 - Transactions recorded in EBS.
 - Shipping terms for sales transactions to evidence when the title and risk of loss is transferred to the buyer.
 - Transactions were recorded appropriately for transactions where title transfer occurs at origin.
 - Balances recorded in the inventory detail reports from EBS does not reconcile to the site-specific end of month report and component financial statements.
- Policies, procedures and controls are not in place to verify the existence and valuation of the Aerospace inventory as of the balance sheet date. Aerospace inventory is comprised of non-tangible materials such as hypergolic fuels and compressed gases. DLA was unable to provide documentation to substantiate the Aerospace inventory held at any point during the year.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:

- Update and finalize the PCMs that document the end-to-end processes for Inventory, including receiving, distributing, recording, processing and reporting. Process owners review and sign off on the updated PCMs to validate that the PCMs are complete and accurate. The process to update and finalize the PCMs should be included in the Manager's Internal Control Program (MICP).
- Design and implement inventory count policies and procedures for which the following objectives are met:



- Add a requirement to the inventory processes whereby quantities in the perpetual inventory system are supported via physical counts at least once a year either through a wall-to-wall year-end count or adequately designed cycle counts
- Test the effectiveness of the perpetual inventory system by refining the CFO sample inventory count program whereby DLA executes counts on materiel selected using statistical sampling and the errors are appropriately projected to the population, including testing for existence, classification, etc. including the following:
 - Performing procedures to verify that the inventory population used to select the CFO Sample is complete and accurate such as reconciling the population used to the general ledger; verifying that the data include the relevant data fields such as price; etc.
 - Establishing and documenting a policy supporting the methodology used to determine the inventory population (i.e. justify the amounts that are included or excluded from the population)
 - Establishing and documenting a policy supporting the methodology used to calculate the materiality threshold used in the CFO sample count procedures, including the assessment that the materiality thresholds are sufficiently precise and sensitive enough to identify errors at the appropriate level
 - Establishing a policy to evaluate whether the changes in condition code identified during the sample are considered errors since valuation may be impacted
 - Performing adequate research over materiel with zero dollar MAP to record the correct value and to properly classify the material in the appropriate statistical strata in the sample design
 - Establishing and documenting a formal methodology to extrapolate errors and the procedures to extrapolate those errors are supported by evidential matter
 - Establishing a formal policy to validate EBS inventory balances for each sample selection made in the CFO sample.
- Perform a reconciliation of third party managed inventory balances to EBS balances prior to making adjustments from physical inventory counts.
- Design policies and procedures related to inventory held for others to include the following:
 - Policies and procedures to properly identify the inventory owner of the materiel, such as identifying the owner on materiel labels upon receipt
 - Policies and procedures that segregate the inventory by owner, in order for DLA to efficiently and effectively manage DLA-owned inventory and inventory held on behalf of others.



- Policies and procedures to record inventory gains/losses for inventory held on behalf of other to the appropriate owner to properly account for the gains/losses, as well as comply with fiscal law.
- Policies and procedures to ensure compliance with laws and regulations (e.g. Antideficiency Act).
- Design policies and procedures related to S9W inventory receipted by DLA to: Revise TPIC T inventory criteria to include all items received from other services
- Add additional procedures to ensure inventory exists prior to being recorded on DLA's financial statements
- Implement policies and procedures related to inventory held at third parties to ensure the following: A reconciliation is performed on a monthly basis to reconcile detailed inventory balances by vendor to EBS inventory listings, including all variances being investigated
- Evidential matter exists to support the comprehensive listing of vendors and military services which hold DLA owned inventory on behalf of DLA (e.g. An EBS export with vendor plant codes, vendor names, associated balances tied to the MB5L report)
- The names of third party vendors and military service can be cross walked to EBS plant codes
- Evidential matter exists to support EBS plant codes which are mapped to multiple vendors (e.g. an EBS export which lists the plant codes and vendors assigned to each code)
- Evidential matter exists to support individual vendor balances for EBS plant codes which are used for multiple vendors (e.g. an EBS export listing the inventory balance by vendor name).
- Design policies should include procedures to monitor the results of the DFSP's manual measurement to ATG verification. The procedures that were completed to verify the ATG should be documented to demonstrate that the control activity was operating effectively. For sites with out of tolerance ATGs, DLA should track and monitor the recalibration of the ATG system to ensure that the resolution is completed in a timely manner. DLA should also monitor that the site performs manual measurements on out of tolerance tanks during the period the tank is considered out of tolerance.
- Develop and implement comprehensive policies and procedures to review in-transit inventory to ensure balances are complete, accurate, and that DLA owned materiel exists and DLA has rights to the materiel.
 - Establish appropriate policies and procedures that outline the criteria or thresholds that should be used when in-transit inventory transactions during the review process
- Develop and implement policies and procedures to monitor the Major Subordinate Commands' (MSC) compliance with DLA policies.



- Update policies and procedures to properly record the appropriate inventory costs in the general ledger in accordance with the United States Standard General Ledger (USSGL) and SFFAS 3 as follows:
 - Implement a process to track and record additional costs to bring items to their intended form and location to USSGL 152600 and the finished goods
 - Update EBS posting logic to record materiel in the kitting phase(s) of the SPTV process to USSGL 152600
 - Perform a management review of EBS posting logic to ensure compliance with Treasury's Financial Manual
- Design application controls that limits users to postings transactions within their approved thresholds. Further, DLA's inventory process should include procedures to review transactions posted to verify that unauthorized transactions were not posted.
- Evaluate current inventory policies and procedures related to implementation of deemed cost valuation methodologies in accordance with SFFAS 48 and ensure:
 - Documentation outlining the implementation of SFFAS 48 provides a sufficient description of the process, as well as application of SFFAS 48
 - Procedures performed to verify completeness and accuracy of data obtained from iRAPT and EBS are documented
 - Valuation methodologies used is based on the best available information to arrive at an alternate value
 - DLA considers all costs necessary to get an item to a form and location suitable for its intended use when valuing materiel based on LAC
 - DLA has a supportable methodology to value Disposition Services inventory that complies with either SFFAS 48 (when establishing beginning balances) or SFFAS 3 (upon implementing SFFAS 48)
 - DLA establishes and implements policies and procedures to value inventory that comply with SFFAS 3 on a go forward basis
 - Management reviews the implementation methodology to ensure compliance with GAAP.
 - Evidential matter (e.g. policies and procedures) which documents steps taken to ensure consistent application.
- Design policies and procedures related to inventory allowances to include:
 - Documentation describing the methodology and processes used to estimate the allowance for inventory held for repair.
 - Policies and procedures to derive estimates used in the calculation of the repair allowance.
 - Policies and procedures to assess the completeness and accuracy of the data populations.
 - Policies and procedures to document management's review for compliance with generally accepted accounting principles.



- Design the inventory management process and related internal control activities to include procedures to identify excess, obsolete, or unserviceable inventory held at third parties. Further, these procedures should include an analysis to assess the value of the excess, obsolete or unserviceable inventory and record these inventories at the lower of cost or net realizable value.
- For calculating the NRV, design policies and procedures to include the following:
 - Review the methodologies used in the NRV calculation to ensure estimated costs of completion, holding and disposal are complete and accurate.
 - Ensure methodologies used to estimate recoveries from sale of materiel are documented and supported.
 - Have policies and procedures that include standards for maintaining evidential matter to support inputs to the NRV calculation.
 - Consider implementing and documenting a single methodology for all EOU inventory, when appropriate.
 - Implement policies and procedures to ensure the NRV calculation considers data from the most recent fiscal year plus the previous two fiscal years in accordance with the DoD FMR.
 - Implement management review procedures to ensure that the valuation methodology and the application of the methodology is in compliance with GAAP and DoD policies.
- Design policies, procedures, and controls to ensure transactions are processed and posted to the correct period in EBS and that an accrual is recorded at period-end for transactions that should be posted to reflect recording in the proper period but have not been resolved. Furthermore, DLA's inventory process should include policies and procedures to review the remainder of the IRM reports and the IDOC failure review process.
- Design policies and procedures related to timely reconciliation of inventory subsidiary ledgers to EBS to include the following:
 - Policies and procedures to ensure difference reports are reviewed and variances are reconciled or resolved timely.
 - Policies and procedures to adequately support how variances are resolved.
 - Policies and procedures to identify reconciling differences due to timing and ensure adjustments are not processed for variances which self-correct (i.e. timing differences).
 - Policies and procedures to reconcile all inventory GLACs to the sub-ledger.
 - Policies and procedures requiring that items that are removed from the differences report are properly documented and resolved.
 - Policies and procedures to standardize treatment of common errors, unreconciled items, and adjustments to APSRs or EBS.
 - Policies and procedures to assess whether trends exist for various error types, in order to identify and/or resolve systemic issues within business processes.



- Policies and procedures for establish thresholds for variances that require for a review to be performed.
- Ensure evidential matter to support posting logic utilized for recording inventory transactions in EBS includes the following:
 - A system-generated mapping which ties EBS configured posting logic to EBS transaction codes and movement types, TFM transaction numbers, and business events interfaced from APSRs.
 - Clear descriptions of business events and varying circumstances which impact or change the posting logic.
 - Documentation over the process to calculate the dollar value of each general ledger entry.
 - Evidence that a review is performed by management to ensure that the posting logic is in compliance with the TFM.
- Design and implement policies and procedures related to classifying inventory to include the following:
 - The policies and procedures for how Supply Centers should assign inventory items to the appropriate condition code once an SDR is submitted.
 - The policies and procedures for how inventory is identified as excess, obsolete, or unserviceable and how condition codes for such inventory are subsequently updated.
 - The policies and procedures that differentiate inventory items in condition codes A-D that should be accounted under the account Held for Future Sale (1522.0100) and under the account Inventory Stock on Hand (1521.0100).
 - The policies and procedures to properly identify excess inventory.
 - The policies and procedures to monitor and account for DLA-owned inventory sent for repair.
 - The policies and procedures that describe how inventory items are identified for reclassification into Inventory Manufacturing & Fabrication (USSGL 1522.0200).
 - The policies and procedures to review inventory items in suspended inventory condition codes and to evaluate whether the inventory items should remain in the suspended condition code (based on the length of time in the suspended codes).
 - The policies and procedures to describe how long inventory should be stored at a Distribution Center once placed into a suspended condition code.
 - The policies and procedures to tie out the general ledger balances to the condition code reports used in the reclassification process.
 - The policies and procedures to reconcile inventory adjustments recorded during the reclassification process.
- Design policies and procedures in place to ensure that proper evidential matter exists to support inventory transactions related to the Aerospace inventory. Additionally, DLA should have policies and procedures in place that include a process to verify the inventory balance for hypergolic fuels.



- DLA's policies and procedures related to supporting inventory transactions occurred and are accurately recorded in the financial statements should be updated to include:
 - Policies and procedures to ensure evidential matter is maintained to support inventory balances
 - Policies and procedures to standardize data elements included in data extracts from APSRs and EBS
 - Policies and procedures to standardize evidential matter required to support financial events.



Property, Plant and Equipment

Property, Plant, and equipment (PP&E), is comprised of real property, general equipment, internal use software and construction-in-progress (CIP). In this, the initial financial statement audit of DLA, we found that DLA was not able to adequately support the existence, completion or valuation of its PP&E

DLA lacks policies and procedures to properly identify, account for and report real property where DLA is the Financial Reporting Organization (FRO).

- DLA reports real property assets for which DLA is not able to demonstrate that DLA has rights to the asset. The FRO is the entity that has the primary economic benefit and is responsible for programming, budgeting, and executing the sustainment requirements. The FRO is the entity that reports the PP&E in their financial statements. DLA is unable to substantiate that DLA is the FRO for real property assets recorded in the balance sheet and related note disclosure. Supporting documentation, such as lease agreements, memorandum of agreement, or memorandum of understanding, is not available to substantiate that DLA is the FRO, as defined by the Department of Defense

DLA lacks policies, procedures and controls to verify the existence and completeness of real property and internal use software (IUS) due to:

- A physical inventory for real property was not performed in FY17. DLA is in the process of revising its policies and procedures for performing the physical inventory of real property.
- DLA does not have documented policies and procedures in place to perform an inventory of IUS assets on a consistent basis. Unlike performing an inventory of physical assets, the existence of IUS is validated by verifying that the software functionalities and/or objects are still in use. DLA policy requires that the inventory is performed on 10% of the population each month. However, DLA does not comply with the policy on a consistent basis.
- DLA has not designed adequate internal controls to identify when assets are completed and should be placed in service. DLA policy states that IUS assets are recorded as in-service



PP&E upon the completion of the asset. However, DLA does not have a process in place to ensure that completed assets are placed in service in the correct period.

DLA lacks policies and procedures to review the construction-in-progress (CIP) balance and reconcile CIP to assets placed in service due to:

- Approximately \$346 million of the \$438 million of CIP were improperly included in the beginning balance sheet. Completed assets were inappropriately presented as active CIP.
- In addition, CIP assets were recorded in both CIP and real property resulting in duplicate assets being recorded.

DLA is unable to substantiate the existence and completeness of real property assets, such as buildings, linear structures (above and below ground pipelines, bridges, roads, sidewalks, parking lots, etc.), etc. and general equipment assets, such as tank gauging systems, heavy machinery, etc., due to:

- DLA is unable to support the existence and completeness of real property assets. Approximately 10% of the assets tested were improperly included in the real property beginning balance. Additionally, DLA was unable to substantiate whether assets were properly included or excluded (approximately 35% of the assets tested).
- DLA is unable to provide evidence to substantiate the quantity of the linear structures recorded in its financial systems. DLA policy states that the unit of measure of linear structures include square foot, square yard, statute mile, etc. However, DLA is unable to substantiate the values used for the linear structures.
- DLA is unable to support the existence and completeness of general equipment assets. Approximately 10% of our sample was improperly included in the general equipment



beginning balances. In addition, DLA was unable to substantiate whether assets were properly included or excluded (approximately 25% of the assets tested).

DLA is unable to substantiate PP&E transactions, such as PP&E added or disposed of, during the fiscal year due to:

- DLA is unable to provide a complete and accurate population of additions and disposals. The listing did not reconcile to the activity in the financial statements.
- DLA is unable to completely and accurately substantiate the PP&E transactions recorded in EBS. The listing included a significant number of activity that were not valid additions and disposal. DLA was unable to differentiate the valid PP&E transactions in the listing.

DLA lacks formal policies and procedures and related supporting documentation to properly value real property and general equipment in accordance with FASAB SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment* (SFFAS 50) due to:

- DLA was unable to demonstrate that the policies and procedures to value PP&E complied with SFFAS 50. The valuation methodology used to assign values to PP&E was not documented.
- DLA was unable to substantiate the values assigned to its PP&E assets, including substantiating that the application of SFFAS 50 was consistent and appropriate. The documentation was not sufficient to substantiate how the valuation methods were applied to each asset.

DLA was unable to substantiate values assigned to IUS assets are in accordance with FASAB SFFAS 10, *Accounting for Internal Use Software*, due to:

- DLA was unable to substantiate the values assigned to a significant amount of the IUS beginning balance. The documentation was not retained or available to determine whether the values recorded were in accordance with SFFAS 10.
- DLA was unable to substantiate the in-service date of the IUS assets, which is the basis for the asset amortization. The documentation, such as the evidence demonstrating that the asset was tested and accepted, is not retained or available.



DLA was unable to substantiate the values recorded for real property and general equipment in the financial statements.

- Placeholder values were used for real property and general equipment assets (approximately 4,800 assets) resulting in misstatements in the financial statements (i.e. the asset and accumulated depreciation values).
- The valuation procedures for a significant number of real property and general equipment assets (approximately 4,800 assets) have not been completed. To account for these assets, DLA assigned placeholder values to these assets until the valuation process is completed.

DLA has not appropriately designed controls to adequately detect material misstatements in the financial statements.

- DLA has not designed and implemented adequate management review controls, including outlining the specific procedure required to evidence that the controls were performed. DLA's control activities include a significant number of management review controls.

DLA lacks formal policies and procedures to ensure that similar assets are recorded on a consistent basis due to:

- Inconsistencies in the application of the accounting policies does not allow for DLA to ensure that all assets have been properly accounted for and recorded in the financial systems.
- DLA includes equipment, such as generators, with other assets, such as a building, in many instances. However, there are other instances where similar generators are recorded as unique assets.

DLA lacks policies and procedures to identify and assess lease arrangements and to properly account for lease obligations and disclose lease commitments, in accordance with FASAB SFFAS 5, *Accounting for Liabilities of the Government; Capital Leases*, and SFFAS 6, *Accounting for Property, Plant, and Equipment*.

- DLA has not completed procedures to identify all of its leasing arrangements, including assessing whether the leasing arrangements should be accounted for as a capital or operating lease.
- The financial statements do not include disclosures for its policy to account for lease arrangements; any operating lease commitments; and future minimum payments due.



DLA lacks policies and procedures to reconcile the PP&E note disclosure in the financial statements to the underlying financial systems.

- DLA does not have controls in place to reconcile the PP&E note disclosure in the financial statements to the accountable property system of record (APSR).
- There was a material unreconciled difference (approximately \$640 million) between the PP&E note disclosure in the financial statements and the APSR as of September 30.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:

- Develop documentation to substantiate that they are the FRO for the real property assets being recorded in the financial statements. DLA should work with the military services to obtain documentation, such as a lease, an MOA, or MOU, for all of their assets that confirms DLA's financial responsibility of the assets.
- Perform a physical inventory of real property to verify the existence and completion of the accounting records. The procedures should include:
 - Determining a sufficient and reasonable number of locations to perform the physical inventory
 - Confirming 100% of the assets for any location tested instead of selecting a sample from each location
 - Verifying that the real property assets recorded exist;
 - Verifying that DLA is the FRO for all of its real property assets recorded.
- Update the IUS process memos and standard operating procedures to adequately describe the policies and procedures in place to inventory IUS assets.
- Design and implement policies and procedures to include the following:
 - Review the CIP balance on a periodic basis (i.e. monthly or quarterly).
 - Verify the accuracy of the listing of its CIP projects
 - Ensure that all projects included in the balance are active construction projects.
- Design and implement adequate policies and procedures to ensure that all of DLA's general equipment assets are recorded accurately and completely. Specifically, this should include a comprehensive inventory of general equipment assets that includes verifying the completeness of the listing of general equipment assets and verifying that the general equipment assets recorded exist.
- Design and implement policies and procedures that ensures the IUS assets are recorded in the appropriate period. This includes reviewing a complete and accurate list of all projects that have successfully completed end user testing and verifying that the projects have been recorded in EBS as active IUS assets.



- Add a data element in EBS- Financial Accounting (FI) Module to adequately differentiate between assets that have been added to or removed from the capital PP&E population and assets that have changed or assign a unique identifier to each asset to allow a reconciliation to be performed to identify additions and disposals. For example, if the Real Property Unique Identifier (RPUID) value, which is a standard code used to uniquely identify DoD RP assets, was added to all asset records in EBS-FI, it would provide the ability to differentiate between assets that had been added to or removed from the capital PP&E population and assets that have changed. Since RPUIDs are assigned by the military services, if an RPUID has not been assigned, DLA could assign a temporary RPUID with a distinctive number pattern to make it easily identifiable as having a temporary RPUID.
- Design and implement policies and procedures concerning the performance of alternate valuation procedures for its real property. These should include the following components, at a minimum:
 - The process used to complete the DPRV process,
 - How the FAC code is selected for each asset,
 - Ensuring that the correct cost factors were used,
 - How the value was calculated, and
 - Adequate review was performed of the documentation package to ensure the process was completed completely and accurately and is sufficiently supported.
- Design and implement policies and procedures to verify that all of DLA's general equipment assets are valued appropriately and the values assigned to all general equipment assets are substantiated by supporting documentation.
- Document the alternate valuation methodology for general equipment.
- Design and implement policies and procedures to ensure that DLA retains adequate supporting documentation to substantiate the values assigned to each asset. At a minimum, the documentation required should include how the value was determined such as a price list or catalogue excerpt.
- Assign value to all general equipment assets using the alternate valuation method for which DLA does not have evidence of the historical cost.
- Adopt a policy to prospectively capitalize IUS assets, as described in *Statement of Federal Financial Accounting Standards 50: Establishing Opening Balances for General Property, Plant, and Equipment (SFFAS 50)*. SFFAS 50 permits the exclusion of IUS and IUS under development from the opening balance as of the opening balance date.
 - Design and implement policies and procedures to ensure that DLA maintains sufficient supporting documentation to demonstrate that its IUS expenditures are appropriately capitalized, in accordance with SFFAS 10.
- Perform and complete the alternate valuation procedures in accordance with SFFAS 50 for all assets recorded in EBS for which historical costs cannot be determined.
 - Ensure that DLA has adequately documented the methodology used to perform these alternate valuations.



- Ensure that DLA maintains adequate documentation to substantiate the value assigned for each asset valued using alternate valuation procedure.
 - Design and implement policies and procedures to ensure that the performance of review controls are adequately documented and supported by evidential matter.
 - Develop a central repository to retain evidence of control performance and management review.
 - Design and implement policies and procedures that include variance thresholds to ensure that the review of significant financial data is precise.
 - Design and implement policies and procedures that detail the related documentation and evidential matter to be inspected as part of the review.
- Develop and implement policies and procedures outlining how PP&E assets are recorded in the financial system to ensure that similar assets are accounted for consistently.
- Perform an analysis of assets recorded in EBS to determine completeness and accuracy of transitions recorded. Updated the records in EBS as necessary prior to preparation of the financial statements.
- If time constraints prevent DLA from updating the value for each real property asset in EBS prior to the issuance of its financial statements, then DLA should prepare a reconciliation showing the adjustment to the value of each asset that has been made so that the total value of the adjusted real property assets in EBS agrees to the amount reported for real property in FN 10.
- Complete analysis of their leases to determine if DLA has entered into any leasing arrangements that should be accounted for and reported as a capital lease.
 - Design and implement policies and procedures to identify and account for leasing arrangements including whether the leases should be accounted for and reported as capital or operating leases, in accordance with SFFAS 6.20.
 - Develop policies and procedures to review all leasing arrangements to gather the information necessary to prepare and include the required disclosures for capital and operating leases in the financial statements, in accordance with OMB A-136 II.4.9.18.
- Design and implement, as a part of the Manager's Internal Control Program (MICP), a key control to reconcile general ledger detail to the financial statements and related footnotes.



Fund Balance with Treasury

Fund Balance with Treasury represents the aggregate amount of funds in DLA's account with Treasury. Through our audit procedures, we identified deficiencies related to DLA's processes of recording and reconciling transactions involving Fund Balance with Treasury.

DLA is unable to reconcile FBwT from general ledger directly to the U.S. Treasury:

- DLA, in conjunction with DFAS, has implemented the Cash Management Reconciliation (CMR) and Defense Reconciliation Reporting Tool (DRRT) processes as mechanisms to attempt to tie EBS to the Treasury. However, the CMR and DRRT processes are not sufficient to produce a complete and accurate reconciliation of DLA's general ledger to U.S. Treasury. There are known differences between CMR and Treasury. In addition, there are known control deficiencies in the DRRT process.

DLA lacks sufficient policies, procedures and controls around the end-to-end FBwT process:

- DLA has not finalized a FBwT process narrative or systems flow to document the flow of data through DLA and DFAS systems from the initiation of a transaction to reporting in the financial statements, the key stakeholders within the process, or the flow of data between stakeholders. Additionally, DLA has not identified risks and controls for the end-to-end FBwT process.

DLA lacks policies and procedures to properly review cash balances throughout the year to prepare cash projections and determine if DLA has enough cash to meet financial obligations.

- Due to a rescission of unobligated balances from the Department of Defense, Defense Working Capital Fund, approximately \$1 billion was removed from the Working Capital Fund FBwT. DLA did not consider how the rescission would impact their operations, including the ability to pay obligations, in the future.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Work with DFAS to obtain a Service Organization Controls Report for the CMR performed by the Defense Finance Accounting Service in order to obtain assurance on whether the CMR process is complete and accurate.



- Work with DFAS to obtain a Service Organization Controls Report for the Department 97 Report Reconciliation Tool (DRRT) process performed by the Defense Finance Accounting Service -Columbus in order to determine whether the controls in place are operating effectively.
- Work with DFAS to establish a process, including a key control, for DLA to monitor the status of significantly aged unreconciled transactions in both the CMR and DRRT processes on a frequent basis.
- Work with DFAS to create an updated policy and procedure for the DRRT process that addresses issues of maintaining sufficient evidential matter to support ongoing remediation efforts on undistributed transactions.
- Develop policies and procedures to establish DLA's involvement in monitoring undistributed funds and assisting DFAS with the research and the clearing process.
- Finalize a Standard Operating Procedure or Process Cycle Narrative that documents the end-to-end process for FBwT, including the initiation, recording, processing and reporting of FBwT transactions
- Finalize a Standard Operating Procedure or Process Cycle Narrative that documents the policies and procedures that the Defense Logistics Agency has in place to monitor the CMR and DDRT produced by the Defense Finance and Accounting Services. The Standard Operating Procedure or Process Cycle Narrative should include all key controls, process owners, data interfaces and Federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used for the FBWT process.
- Designate a DLA point of contact responsible for overseeing the FBwT process, understanding the complex process flow as well as key risk points as well as communication with DFAS.
- Evaluate current process for determining that DLA has sufficient cash-on-hand to meet current financial obligations.
 - Implement policies and procedures to ensure a review control is in place to perform cash review on a frequent basis.
 - Document policies and procedures to follow if low cash balances are identified and detailed steps to address identified cash issues.
 - Outline required supporting documentation and maintain as part of the review process.



Accounts Receivable

Accounts Receivable (AR) consists of amounts owed to DLA and falls within the scope of DLAs order to cash process. Because of the nature of their services DLA has a significant volume of transactions in the order to cash process. This balance represents a substantial portion of WCF activity that involves receipt of funds by DLA in order to provide inventory to their ultimate consumers. The volume of these transactions makes it a critical function for DLA to properly record and reconcile these transactions to assure timely appropriate recognition of costs to the end users.

DLA lacks policies and procedures to properly identify valid Unfilled Customer Order (UCO) transactions in EBS.

- DLA was unable to provide the supporting UCO detail that reconciles to EBS. Further, DLA was unable to provide documentation to support the activity in EBS.
- DLA is unable to substantiate the existence and completeness of UCO transactions in EBS due to an interface error between the module and EBS. Additionally, DLA does not have sufficient policies and procedures in place to identify, research and resolve unreconciled amounts.
- Policies and procedures are not in place to review the validity of significantly aged UCOs. Policies and procedures are not in place to ensure that inconsistencies in UCOs are identified and reviewed and dated orders are investigated.
- DLA does not have policies and procedures in place to identify and validate significantly aged UCO transactions balances that have been transferred from legacy systems into EBS.

DLA lacks policies and procedures to properly verify the existence of receivables.

- DLA is unable to trace customer payments to outstanding receivables. Detailed transaction data in EBS is unable to be matched to the activity in the Fund Balance with Treasury to substantiate the existence of the receivable.
- Receivables includes a significant amount of aged receivables (greater than 180 days). Policies and procedures are not in place to evaluate the collectability and payment authorization for significantly aged accounts receivable. DLA does not review aged



intragovernmental receivables sufficiently for management to assert that the receivable exists.

- DLA does not review, reconcile or clear negative accounts receivable balances in a consistent manner.
- DLA does not have policies and procedures in place to identify and validate significantly aged AR transactions balances that have been transferred from legacy systems into EBS.

DLA is unable to provide supporting documentation to substantiate the federal (intragovernmental) and non-federal (public) accounts receivable balances due to:

- DLA is unable to determine a complete and accurate listing of intragovernmental and public accounts receivable to properly present accounts receivable in the financial statements.

DLA does not have formal policies and procedures in place to account for the Allowance for Doubtful Accounts due to:

- DLA does not have sufficient written policies and procedures in place to document their process for the calculation and posting of the Allowance for Doubtful Accounts. Additionally, DLA has not identified key internal controls in regards to the process.

DLA lacks policies, procedures and controls to properly account for and report financial transactions during emergency management situations and disaster relief efforts.

- DLA did not accurately record payments received in advance in the financial statements.
- DLA did not accurately record revenue for goods and services provided for disaster relief in the financial statements.

DLA is unable to substantiate the occurrence and completeness of sales revenue due to:

- DLA's is unable to provide supporting documentation that can substantiate revenue recorded occurred and is complete.
- Supporting documentation consists of screen shots from EBS and other internal financial systems that do not evidence that the sales transaction occurred with a third-party.
- Additionally, DLA is unable to provide accurate customer statements in a timely manner.



DLA lacks policies and procedures to properly record sales and receivable transactions in the correct accounting period due to:

- A significant number of transactions were unable to be posted in the correct accounting period. Approximately 50% of the transactions tested were not supported or were inappropriately recorded in the fiscal year.

DLA does not have controls in place to reconcile postings and tie points between budgetary and proprietary transaction level detail.

- DLA has posting logic errors in EBS and its feeder systems causing budgetary and proprietary accounts to not reconcile at the detail level.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:

- Continue to investigate and attempt to resolve the legacy posting differences between the EBS general ledger and the EBS Sales and Distribution (S&D) module. Create standard operating procedures for the reconciliation of the EBS trial balance and EBS S&D module and associated adjusting JV to ensure properly designed reconciliations are performed in a timely manner.
- Establish and implement the policies and procedures to review the aging of UCO balances. DLA should perform and document procedures to assess the validity of the UCO balances. This assessment should include the DLA's policies regarding cancelling invalid orders, management's key assumptions regarding UCOs, and an evaluation of the reasonableness of these key assumptions.
- Implement a process to review the DLA's aged transactions throughout the Order to Cash process to validate that the population of transactions within EBS is valid and complete. Perform a data cleanse of EBS to remove any data that is incorrect, incomplete, improperly formatted or duplicated.
- Develop policies and procedures to perform detailed reconciliations of large ongoing customer balances for both federal and public account holders. The reconciliation should include beginning balance, period sales, period collections, credits and returns, and adjustments, with an ending balance tied to the quarterly A/R aging. Attempt to push forward a coordinated DoD process to manage and exchange detail level exchange data for TI-97 collections. Attempt to push forward an expanded coding structure in order for all



Other Defense Organizations (“ODO’s”) each have their own unique identifying code in Fund Balance with Treasury transaction detail.

- Establish and implement policies and procedures to adequately review aged intragovernmental receivables, including assessing collectability. DLA should consider (a) the age of the receivable, (b) the federal agency’s payment history, (c) the federal agency’s ability to pay using appropriated monies, and (d) the probable recovery amounts relating to the federal agency. Establish and implement a policy that when DLA has determined it is more likely than not (greater than 50%) these intragovernmental receivables will not be totally collected, the gross amount of their intragovernmental receivables should be reduced to its net realizable value and record a corresponding loss due to uncollectible amounts.
- Analyze current controls in the O2C process as a part of DLA’s Manager’s Internal Control Program (MICP). Perform an analysis of the current negative receivable balances to validate and correct negative receivable balances, as needed. Implement additional internal controls that entails DLA Management performing a periodic review of negative customer account balances for each major revenue stream in the Working Capital Fund.
- Implement a process to review the assignment of “Dunning” codes as part of DLA’s customer management policies to validate the completeness and accuracy of the federal verses public outstanding accounts receivable as presented on the DLA’s financial statements.
- Develop and maintain internal control documentation relating to the WCF non-federal AR Allowance estimation process. The documentation should include the initiation of the estimate, the recording and processing of the estimate and the reporting of the loss to the General Ledger. Additionally, the documentation should include the journal entries recorded throughout the WCF Allowance process. DLA’s management should consider including documentation relating to the following:
 - The financial statement risks relating to the process
 - General Ledger accounts relating to the process
 - Key controls relating to the process, including management’s review of the allowance estimate
 - Control Type, Frequency and Specific Process Owners relating to these key controls
 - Identification of information Systems relating to these key controls

Additionally, DLA’s documentation of these key controls relating to the collectability of their non-federal receivables should include consideration of the following:

- The age of the receivables, understanding the entity’s customary terms of sales, the conditions under which goods may be returned and how collections and credit memos are applied to outstanding balances



- The soundness of DLA's credit granting and collection procedures, including any of DLA's credit limits
- Collection experience subsequent to the balance sheet date
- Historical bad debt experience
- Comparative statistics for the current period and prior periods, such as the relationships of accounts written off and the allowance and provision for doubtful accounts to trade receivables and sales
- Conditions and trends in the industry and the economy in general
- Develop policies, procedures and controls around financial reporting requirements during emergency management situations, including disaster relief efforts. Ensure these policies include acceptable deviations from the normal business process, documentation requirements and timelines for completion.
- Perform an analysis of transactions posted in the general ledger in FY18 related to the disaster relief efforts and ensure amounts are recorded in the appropriate period.
- Implement processes and procedures to manage and maintain evidential matter relating to DLA's AR and sales transactions. DLA should maintain and manage supporting evidential matter in a way allowing for the documentation to be readily available for examination. DLA should maintain and manage sufficient detailed customer statements to adequately substantiate the AR balances recorded.
- Implement a process to manage and maintain evidential matter relating to DLA's sales transactions. DLA should maintain and manage supporting evidential matter in a way allowing for the documentation to be readily available for examination. Extend the close time within EBS and implement additional policies and procedures for monitoring of sales transactions at year-end.
- Analyze and investigate the known budgetary to proprietary tie point variances related to AR and Revenue at a business process level to determine the root cause. DLA should assess their current policies and procedures around the budgetary to proprietary reconciliations including the design of key controls in the process. DLA should design a control that focuses on addressing the root cause of the variances in order to resolves current underlying issues as well as prevent future variances from occurring.



Accounts Payable

Accounts Payable (AP) falls within the scope of DLAs procure to pay process. Through our audit procedures, we identified deficiencies in DLA processes for recognizing and supporting accounts payable and the related budgetary balances, recording transactions in the proper period and documenting policies, procedures and controls in a sufficient manner.

DLA is unable to substantiate Accounts Payable and Undelivered Orders:

- Supporting documentation was not provided to substantiate the samples tested from the following accounts:
 - Accounts Payable
 - Negative Payables
 - Undelivered Orders, Unpaid
 - Undelivered Orders, Paid
- Goods and/or services received as of year-end were not recorded as an expense/asset and not applied to the Undelivered Order balance.

DLA does not have policies and procedures in place to manage stale payables/obligations:

- A timely review and monitoring is not performed for the following account balances:
 - Negative Payables – There is a significant number of aged transactions that may no longer be valid.
 - AMMA Payables – Transactions are not properly cleared from the account resulting in transactions that are recorded in the account that have been paid and completed in prior years.
 - Undelivered Orders (UDO), Unpaid – Approximately \$701 million (or 5 percent of the total) in UDOs that had no activity (payables, expenses, outlays) for at least two years.

DLA does not adhere to the Treasury Financial Manual USSGL Posting Logic:

- A general ledger account is inappropriately being used to track accounts payable activity. DLA uses Negative Payables to track outstanding goods receipt and to prevent inventory from showing as available for distribution when the items are not physically available. The related posting logic is not recording assets or expenses at the appropriate point in time. In



addition, an Undelivered Order, Paid is recorded for these transactions, but they the proprietary entry for the payment made in advance is not recorded.

DLA does not comply with the Federal Financial Management Improvement Act due to the following:

- Transactions were not recorded at the detailed transaction level. DLA recorded transactions at a summary level for certain budgetary and proprietary accounts. As a result, each EBS summary level record contains multiple individual transactions.
 - Transactions are posted in detail to the Fund Balance with Treasury (FBwT) account (general ledger account 1010), but summarized when posting to the other proprietary and budgetary accounts. A reconciliation is not performed to ensure that all detailed transactions posted to the FBwT agree to the summarized postings to the corresponding budgetary general ledger accounts.
 - Additionally, budgetary accounts (obligations, expenses, payables) are not tied to the FBwT transactions and are posted in summary within the general ledger.

DLA does not have controls that are operating effectively in the accounts payable process:

- Controls for the proper approval of invoice; receiving reports; and purpose, time and amount for the following accounts were not operating effectively: Account Payable, Negative Payables, and Expense accounts.
- Control for the government purchase card expenditure approval due to the following was not operating effectively. The Approving/Billing Official (A/BO) has the ability to approve the monthly statement in US Bank Access Online and certify that statement for payment without any secondary review. When the government purchase card holder (GPCH) is not available to reconcile purchase card transactions to the statement, the A/BO has the authority to perform the reconciliation and prepare the form 1901 (Request for Purchase). Also, the A/BO can approve the GPC monthly bill in U.S. Bank Online for payment.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Evaluate current policies and procedures against practices in the field to identify the root cause of DLA not being able to provide sufficient, appropriate evidential matter related to



accounts payable and undelivered orders samples. Identify key gaps and inconsistencies in current procedures versus field implementation.

- Based on the evaluation, perform updates to identified policies, procedures, desk guides, and/or accounting manuals to completely and accurately reflect current key procure to pay processes as well as provide clarification/updates to areas where differences between policy and implementation are noted.
- Consider providing trainings and implementation guidance on any current and/or new/updated procedures where issues were noted to ensure consistent application of procedures including:
 - Ensure procure to pay process owners' document detailed explanation (i.e. cause, impact) for discrepancies or missing documentation.
 - Ensure documentation standards are clear including supporting documentation that is complete, accurate, and prepared timely.
 - Ensure process owners understand key supporting documentation.
- Consider increasing communication between DLA HQ and process owners to ensure sufficient, complete documentation is provided as part of documentation requests.
- After processes have been evaluated and procedures have been updated, as needed, implement and/or strengthen review procedures to ensure transactions are recorded accurately, timely and process owners can obtain and provide supporting documentation for the transactions.
- Write off residual accounts payable for paid and completed transactions. EY recommends that DLA removes activity from the general ledger detail that were completed in prior years. DLA should monitor the UDO balances and identify stale UDOs for de-obligation. DLA should examine account balances on the balance sheet and statement of budgetary resources to determine the magnitude of aged balances by account.
- Perform an analysis of transactions posted at or near year-end to determine the overall significance of the issue across all general ledger accounts. Based on this analysis, perform corrective action on incorrect transactions, as necessary.
- Implement and/or enhance DLA's year-end process, including key controls, for monitoring potential business events that will need to be entered into the general ledger prior to year-end close.
- Update policies and procedures to document year-end processes for identifying, monitoring and recording transactions prior to financial statement close.
- Discontinue the use of the negative payable account. In addition, DLA should develop, test, and implement a process to ensure that all transactions related to proper recording and reporting for expenses and inventory items are in compliance with the TFM USSGL postings at the transaction level. This would include developing an entity wide standard process and procedure of identifying the financial events that requires the recognition of an account payable based on standard accounting guidance (Ex. Treasury FMS USSGL



guidance - Recognition of a Liability). EY further recommends, that once the new procedures are in place, stakeholders are educated on the new process. EY further recommends that any process, procedure, or policy documentation for accounts payable be updated to reflect the use of the asset or expense accounts instead of the negative payable accounts.

- Implement and maintain financial management systems that comply substantially with Federal financial management systems requirements and the United States Government Standard General Ledger at the transaction level. DLA should establish a process that reconciles the transaction level detail to the summarized postings in each account.
- Update existing internal control documentation to accurately describe the Procure to Pay process and identify key internal controls over financial reporting.
- Monitor, review, and validate whether controls are operating effectively on an on-going basis related to the Procure to Pay process.
- Update existing internal control activities to produce evidence that the control occurred (e.g. signature) after the control is executed in the Procure to Pay process.
- Implement limiting the A/BO to one key role to either approving GPC purchases on DLA form 1901 or approving payments of the GPC monthly bill in U.S. Bank Online. If DLA is unable to properly segregate the duties, DLA should require a secondary reviewer as a mitigating factor to approve the monthly bill or approving the form 1901.



Financial Reporting

Financial Reporting encompasses all aspects of operations affecting DLA's ability to produce reliable financial statements and disclosures. This process starts with establishing an effective governance structure to identify and assess risk and continues with developing a control environment that is effective and efficient to manage identified risks. Through our audit procedures, we identified a number of deficiencies in DLA processes related to the accumulation and presentation of their financial position and results of operations.

DLA does not have sufficient policies and procedures in place around the implementation and monitoring of EBS:

- DLA is unable to adequately demonstrate that business events are linked to the correct posting logic.
 - In DLA's posting logic reference book, which was manually generated, there are multiple scenarios associated with same transaction description and SAP T-Code (i.e. EBS doc type).
 - In DLA's posting logic reference book, there is no attribute or data field to indicate the type of transaction posting in the Enterprise Business System (EBS). Therefore, DLA is unable to crosswalk the reference book to the EBS.
 - DLA is unable to produce a posting logic directly from EBS
- DLA does not have any monitoring or review controls in place to ensure that EBS posting logic is configured in accordance with the USSGL.
- DLA has not completed mapping all funds centers used in EBS to the respective MSC.

DLA does not have sufficient controls in place to validate that EBS proprietary general ledger accounts agree to budgetary accounts:

- DLA has known reconciliation issues between budgetary and proprietary tie points. Based on walkthrough procedures performed, EY noted that the DFAS posts an unsupported quarterly JV in Defense Departmental Reporting System (DDRS) to ensure DLA's budgetary accounts reconcile to the proprietary accounts.
- DLA has known tie-point variances between proprietary and budgetary FBWT.
- DLA has known tie-point variances between proprietary and budgetary AR and Revenue.
- DLA has known tie-point variances between proprietary and budgetary AP and Expense.

DLA does not have sufficient controls in place around the quarterly reconciliation of EBS to the financial statements:



- DLA does not perform a sufficient Unadjusted Trial Balance (UTB) to Adjusted Trial Balance (ATB) reconciliation.
 - DLA uses data pulled out of DDRS as a starting point for the crosswalk instead using data directly pulled from EBS.
 - DLA lacks controls to validate the completeness and accuracy of the data and reports used to create the reconciliation.
 - Lack of master listing of files used and the purpose of each file within the reconciliation.
 - Lack of a review to ensure that feeder files and adjustments are valid and agree to supporting documentation.
- DLA does not perform the quarterly UTB to ATB reconciliation in a timely manner.
 - DLA does not perform the reconciliation until after the quarter-end as well as fiscal year-end has been closed.
 - Per SOP, DFAS should provide DLA with the data files needed for the reconciliation 5 days after quarter/year-end close. However, the reconciliation is completed approximately two months subsequent to quarter-close.

DLA does not perform a sufficient review of quarterly adjustments and JVs made by DFAS:

- DLA does not have a comprehensive listing of adjustments that occur in DDRS including:
 - The source of each file and parameters to generate the files
 - The required files or reports needed from DFAS to support each adjustment as well as the parameters of each file or report
 - The rationale or business purpose for each adjustment and the evidential matter to support the amounts
- DLA does not review each type of adjustment and feeder files to determine completeness, accuracy, validity and impact of information posted to DLA's financial statements.
 - In several cases, prior year adjustments were used in the reconciliation of the DDRS-B unadjusted trial balance (UTB) to the DDRS-B adjusted trial balance (ATB) that did not have evidence of review by DLA.
 - Trial balance input adjustments occurred during the interface of DDRS-B to DDRS-AFS that were not reviewed by DLA.
- DLA relies on DFAS to make various adjustments that are maintained within DDRS-B versus making the corrective updates within EBS.
 - Within the quarterly reviews, prior year adjustments were used as offsetting entries to current year adjustments.
- DLA does not perform a reconciliation in a timely manner to allow for adjustments to be reviewed prior to the generation of the financial statements.
- DLA is currently remediating the trading partner elimination process to be completed in FY 2018. EY noted the following during FY 2017:



- Supporting documentation to reconcile the variances between DLA and trading partners is not obtained timely.
- DLA relies on contractor maintained software tools to determine the balances for trading partners. There is no evidence that DLA assesses the completeness or accuracy of data input or output from this tool.
- Adjustments made to Accounts Receivable, Accounts Payable, Revenue, Expenses and undisbursed funds are not appropriately supported.
- DFAS performs quarterly elimination adjustments to DLA financial statements for both waived and non-waived entities
 - EY noted that there is not a complete reconciliation at the agreement level to the trading partner adjustments that are being made. Trading partner adjustments are recorded in DDCRS-AFS as “top-side” adjustments and are identified as “unsupported” by DFAS.

During EY’s review of the Q3 and Q4 FY17 financial statements and footnote disclosure, we determined that level of review performed was insufficient to detect and correct misstatements in the financials and related disclosures:

- Inaccurate balances reported in the financial statements and notes
 - Gross costs did not accurately foot on that statements
 - Balances per the Notes do not consistently agree to the balances on the Statements.
 - In footnote 10, Property, Plant and Equipment (PP&E), the Construction-in-Progress (CIP) balance was incorrectly stated at \$432 million when DLA determined most of these projects to be inactive.
 - Supporting documentation did not adequately support the balances recorded in the Notes.
- Lack of complete and accurate disclosures
 - Note 1 Significant Accounting Policies (SAP) did not completely and accurately summarize the accounting principles and methods of applying those principles.
 - Note 1 SAP did not appropriately disclose management’s judgements relevant to valuation, recognition, and allocation of assets, liabilities, expenses and revenues.
 - Note 1 SAP did not sufficiently describe changes or non-compliance in GAAP reporting.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:



- Evaluate EBS posting logic and evidential matter to ensure system posting logic is configured in compliance with USSGL and DOD SFIS.
- Evaluate EBS system capabilities and provide a system-generated mapping report which ties EBS configured posting logic to EBS transaction codes and movement types and USSGL/DOD transaction numbers
- Document clear descriptions of business events and varying circumstances that impact or change the posting logic
- Document transaction description based on the EBS doc type to identify the type of transactions within EBS universe of transactions.
- Implement monitoring or review control to ensure EBS transactions are being posted as intended.
- Complete the mapping of EBS fund centers to MSCs.
- Update policies and procedures for assigning and managing fund centers in EBS.
- Analyze and investigate the known budgetary to proprietary tie point variances at a business process level to determine the root cause.
- Assess current policies and procedures around the budgetary to proprietary reconciliations including the design of key controls in the process. DLA should design a control that focuses on addressing the root cause of the variances in order to resolve current underlying issues as well as prevent future variances.
- Evaluate the current process for creating UTB to ATB:
 - Identify areas to create efficiencies through automating the process.
 - Consider other reconciliation options to design a reconciliation that is performed in conjunction with the production of the DDRS-AFS trial balance and not subsequent to the production.
 - Consider the design of the reconciliation and ensure data is being pulled from the proper sources to ensure completeness and accuracy of data interfaces.
 - Consider documenting the list of reports generated by DFAS and the specific parameters used to generate the reports
- As a part of the Managers Internal Control Program (MICP), assess the risks associated with the process to generate the financial statements including the complexity, extent of manual processes, decentralization and reliance on third party data. Based on the assessed risks, determine if sufficient policies, procedures and controls are in place to address risks related to the compilation of the financial statements.
- Evaluate the current support agreement with DFAS to determine if agreement sufficiently documents roles, responsibilities, communications and timelines needed to support DLA's reconciliation requirements.
- Evaluate the policies and procedures in place over the financial reporting process including the specific roles of DLA and DFAS related to journal vouchers, adjustments and eliminations recorded by DFAS:



- Document the list of reports generated by DFAS and the specific parameters used to generate the reports
- Include a control(s) for reviewing all the files that are used to adjust the ending balances within EBS in the creation of the adjusted trial balances.
- Document the business need for adjustments and the appropriate evidential matter required to support adjustments
- Evaluate current quarterly adjustments and prior year adjustments to determine which of those recorded in DDRS-B could be eliminated by making the adjustment within EBS.
- Evaluate trading partner adjustments, prioritize based on dollar value and risk and begin a reconciliation process at the agreement level.
- Implement additional controls for agreement level reconciliations with DLA trading partners and develop a process for resolving differences at the agreement level in a timely manner.
 - Evaluate system capabilities to include recording and monitoring transactions at the trading partner and agreement level
- Finalize updated policies and procedures for identifying, researching and reconciling variances between DLA general ledger data and trading partners. Include considerations for:
 - Review of appropriate classification between federal and non-federal
 - Review impact on both proprietary and budgetary general ledger accounts
- Work with DFAS and OSD as necessary to continue to resolve issues with trading partners at the Department level.
- Evaluate all components of OMB-136 and determine if disclosures are complete, accurate and compliant. Incorporate updates to footnotes as necessary.
- Re-assess review controls associated with the financial statement review process and consider including:
 - A review of revised OMB-136 requirements to ensure updated guidance is evaluated and incorporated in a timely manner.
 - Other reviews by business process areas to ensure disclosures are complete, accurate and compliant. These reviews should ensure that footnote disclosure are consistent with business activity occurring throughout the year.
 - An assessment of current checklists used in the financial reporting process to determine if checklists need to include enhanced review procedures.



Oversight and Monitoring

Oversight and monitoring relates to DLA's lack of establishment and implementation of a sufficient control environment, enterprise-wide.

DLA Lacks a sufficient control environment related to Internal Controls over Financial Reporting including a sufficient A-123 program:

- A sufficient risk assessment, performed at the appropriated level, related to reporting such as documenting the complexity of programs, accounting estimates, related party transactions, and extent of manual processes.
- An evaluation of fraud risks and the approach to implement financial and administrative control activities to mitigate identified material fraud risks.
- A finalized policy or procedure to develop and implement ERM and internal control, including anti-deficiency act reporting, that includes the appropriate documentation requirements that are necessary as a part of an effective internal control system.

DLA lacks sufficient policies and procedures around financial reporting including:

- Sufficient written policies and procedures do not exist related to Management Review Controls for the Financial Reporting Process. The identified management review controls do not accurately describe the procedures performed to detect or correct an error.
- Policies or procedures are not in place to verify the accuracy and completeness of system generated reports used in the execution of controls.

DLA does not perform sufficient oversight and monitoring of service organization control reports:

- DLA has not associated each relevant Complementary User Entity Controls (CUECs) to specific DLA controls.
- DLA has not identified specific DLA compensating controls for DFAS controls deemed ineffective in the DFAS SOC 1 report.
- DLA has unresolved control gaps relate both to addressing control issues identified in the DFAS SOC report as well as with DLA's CUECs
- DLA's evaluation was not performed by the subject matter experts in a timely manner. As of May 21, 2017, the SMEs had not reviewed the evaluation and the controls identified as possible mitigating controls.



Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Continue to design and implement DLA SOA policy at all levels throughout the organization and emphasize the importance of the Manager's Internal Control Program (MICP) from DLA leadership. This will help bring visibility, education and support to the program from across the organization.
- Ensure DLA SOA policy includes proper detail and guidance for conducting the risk assessment process, including:
 - all aspects of the risk management process are reviewed at least once a year;
 - risks themselves are subjected to review with appropriate frequency; and
 - provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed
- Identify, document and communicate MICP roles and responsibilities. Ensure proper groups and personnel are involved at the appropriate levels to produce the most results based, cost effective control environment.
- Develop, document and maintain supporting documentation as a part of the MICP and for the Statement of Assurance as evidence that DLA developed management control plans, performed risk assessments, performed ongoing monitoring, developed corrective action plans and tracked progress towards remediation for each separate fund
- Provide formal training and guidance, on an annual basis, to those involved in the MICP to ensure roles, responsibilities and objectives are properly understood, carried out in a timely manner, and executed consistently across the organization.
- Increase the resources dedicated to the A-123 program, as needed, to completely execute all aspects of the program requirements on an on-going basis.
- Utilizing the updated risk assessment, DLA should design and implement a control testing strategy appropriate to address the risks.
- DLA should evaluate the current review controls identified to operate over an entire process:
 - Evaluate single controls to determine if multiple controls actually exist in the process
 - Assess control descriptions to ensure they are documented completely including how the control is applied, who is responsible, how frequently it is performed, and how the control is evidenced.
- Evaluate the current policies and procedures for evaluating information produced by the entity.
 - Foot system generated financial reports
 - Perform a tie-out of system generated reports to the trial balance



- Verify that the parameters used to generate the reports or data are appropriate
- Judgmentally select a sample of transactions or balances in the report and validate that the transactions are accurate.
- Implement a process to identify, monitor and maintain related parties and material related party transactions. Additionally, management should perform a review of these sales transactions on a regular basis and disclose any material related party transactions in the notes to their financial statements.
- DLA should develop and maintain internal control documentation relating to the identification of related parties and related party transactions.
- DLA should analyze if current policies and procedures are sufficient for the process and update if necessary.
 - Ensure that appropriate personnel are involved in the process
 - Evaluate that proper roles and responsibilities are identified and communicated
 - Ensure timelines are defined
- DLA should determine if controls need to be established for the SOC 1 review process and ensure controls are properly identified, designed and operating effectively
- DLA should associate specific DLA controls to CUECs as well as DFAS controls determined to be ineffective.



Financial Information Systems

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

Our assessment of the Information Technology ("IT") controls and the computing environment identified deficiencies in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate.

The deficiencies relate to the following areas:

- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Security management / governance over implementation of security controls

(a) Access controls / user access

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

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

- Access was not restricted to authorized users and was not assigned in accordance with the principle of least privilege.
- Lack of monitoring and auditing security violations and sensitive user activities, including activities of privileged users logs were not documented, not being performed, or not configured appropriately within systems.



- Lack of enforcement for concurrent session limits and session inactivity parameter documentation.
- Lack of enforcement for procedures related to establishing new users, monitoring unused IDs, locked IDs, terminated users, or access re-certifications.
- Lack of policies and procedures for account authorization, provisioning, and termination.

(b) Configuration management / change controls

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

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

- Inability to identify all application changes made to production during the audit period.
- Lack of monitoring and recording of changes made to applications by DLA management.
- Users have access privileges enabling them to bypass the configuration management process and make changes directly to production.
- Testing of new changes does not include documentation of review and approval per DLA policies.
- Emergency changes may be implemented prior to approval.

(c) Segregation of duties ("SoD") controls

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

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

- DLA management did not identify segregation of duties conflicts that consider both IT and business process roles and activities across DLA-owned applications.



- Application program management has not completely identified sensitive (financial transactions) roles in order to identify and implement appropriate segregation of duties.
- Segregation of Duties review within the user provisioning process is not performed consistently across all applications.
- Administrator and super user privileges are not restricted through user groups and permissions. In some cases, users can create and assign roles to themselves roles including DISA administrators.
- Business end users have access to roles intended for IT privileged users.

(d) Security Management / governance over implementation of security controls

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures and controls implement the entity-wide policy. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

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

- Service Organization Control (SOC) reports are not reviewed, specifically, to assess Complementary User Entity Controls (CUECs). In addition, SLAs with DISA are not reviewed and updated in a timely manner.
- Lack of application specific access control policies/procedures to consider unique business rules/processes, roles and responsibilities, and technologies.
- System Security Plans (SSPs) do not reflect the existing IT controls environment or include all requirements of DoDI 8510.01.
- Security controls were not assessed or tested within required timeframes, including inherited controls from DISA.
- DLA does not perform complete risk assessments on an annual basis to facilitate identification of new threats and vulnerabilities.

Recommendations:

DLA should implement controls to address deficiencies in access controls, configuration



management, segregation of duties, and security management procedures to include:

Access controls / user access / segregation of duties

- Restrict access to authorized users in accordance with least privilege principles.
- Document and follow procedures related to user account management and segregation of duties.
- Implement stronger security controls and restricting user access to programs and data to the minimum level required by the user's responsibilities, to include encrypting sensitive data.
- Identify sensitive business transactions in application business and privileged roles, segregate these roles and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.

Configuration management / change controls

- Identify and monitor applications changes made in the production environment.
- Segregate developers' access to the development and production environments.
- Review, approve, and monitor application changes completeness and accuracy, including emergency changes.

Security Management / governance over implementation of security controls

- Implement stronger security controls to improve the security documentation and testing of applications.
- Establish a process to evaluate and incorporate service providers' CUECs into security documentation and the current application control environment.



Appendix B - Significant Deficiency

Environmental Liabilities

Environmental Liabilities (EL) is comprised of clean-up costs associated with the restoration of sites on real property that DLA manages.

DLA lacks policies and procedures in place to reconcile EL associated with its real property, such as tanks and pipelines, to the real property, such as tanks and pipelines, reported in its financial systems.

- DLA is unable to substantiate that a reconciliation is performed to verify that the tanks and pipelines used to estimate the EL is complete and accurate. Environmental regulations require that environmental restoration procedures be performed when a tank or pipeline is permanently placed out of service. In order to appropriately determine the existence and completeness of EL, the tanks and pipelines reported as real property assets should be considered.
- DLA is unable to substantiate the existence, completeness and obligation of EL. As previously reported, DLA does not have policies and procedures to identify the real property assets for which DLA is the FRO which does not allow DLA to demonstrate their obligation to perform the environmental remediation for the real property asset.

DLA is unable to substantiate the cost to complete estimates for environmental liabilities.

- Policies and procedures are not in place that adequately demonstrates the methodology used to derive the estimate was appropriate.
- The supporting documentation does not appropriately substantiate the estimate for the cost to complete the clean-up and restoration.

DLA is unable to substantiate the program management cost estimates for environmental liabilities.

- Policies and procedures not in place that adequately documents the methodology used to derive the estimate.
- The supporting documentation does not appropriately substantiate the estimate for the program management costs.

DLA has not appropriately designed controls to adequately detect material misstatements in EL.

- Controls are not designed to verify the completeness and accuracy of the system generated reports or data used in executing the control activity. DLA's EL control activities,



including deriving the EL estimates, are dependent upon system-generated reports or data produced by information systems.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:

- Design and implement policies and procedures to ensure that a reconciliation is performed between the tanks and pipelines in the environmental closure liabilities estimate and the PP&E listings in EBS. The differences between the two listings should be investigated to assess whether the environmental closure liabilities is complete and accurate.
- Design and implement policies and procedures to ensure that process for preparing the cost to complete estimate is adequately documented and sufficiently describes the methodology used to derive the estimate.
- DLA should include procedures to verify that the supporting documentation used to derive the estimate properly reconciles to the cost to complete estimate.
- DLA should adequately document the qualifications of the specialist used in deriving the estimate to ensure and demonstrate that the specialists have the necessary competence, capabilities, and objectivity.
- Design and implement policies and procedures that adequately describe the process for preparing the estimate of the EL PM costs. The description should include sufficient detail for a reviewer to understand the process and evaluate whether the process used is reasonable and consistent with the policy.
- Implement policies and procedures to verify that the system generated reports or data used in the performance of the control is complete and accurate such as:
 - Foot system generated inventory reports;
 - Perform a tie-out of the system generated reports to the trial balance;
 - Verifying that the parameters used to generate the reports or data are appropriate
 - Judgmentally selecting a sample of transactions or balances in the report and validating that the transactions are accurate.



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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (“OMB”) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund of the Defense Logistics Agency (“DLA”), which comprise of the balance sheet as of September 30, 2017, and the related statement of net costs, changes in net position, and combined statement of budgetary resources for the year ended September 30, 2017, and the related notes to the financial statements and have issued our report thereon dated December 12, 2017. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2017 and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 17-03, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (“FFMIA”) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to DLA.

The results of our tests of compliance with laws and regulations described in the second paragraph of this report disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 17-03, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.



FFMIA

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

(a) Federal financial management system requirements

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

(b) Noncompliance with applicable federal accounting standards

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

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

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

FMFIA

Federal Managers' Financial Integrity Act ("FMFIA") requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control.

The DLA was not able to provide evidence that they are in compliance with significant aspects of



Circular A-123, which implemented FMFIA. The DLA provided a FY 2017 Statement of Assurance, however there was not sufficient evidence that each process identified by DLA fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level. Based on the evidence received, EY notes that DLA has an A-123 testing strategy, however DLA is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

DLA's Response to Findings

Our Report on Internal Control dated December 12, 2017 includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance with FFMA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from DLA's management responsible for addressing the noncompliance are provided in their letter dated December 12, 2017. We did not audit management's comments and accordingly, we express no opinion on them.

Purpose of this Report

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

Ernst & Young LLP

December 12, 2017

Management's Response to Auditors' Report



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

DEC 12 2017

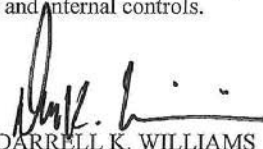
MEMORANDUM FOR DEPARTMENT OF DEFENSE OFFICE OF THE INSPECTOR
GENERAL

SUBJECT: Fiscal Year (FY) 2017 Financial Statement Audit – Working Capital Fund

Thank you for the opportunity to comment on the Independent Auditors' report on the audit of the Defense Logistics Agency's (DLA) FY 2017 financial statements. We agree with the Independent Public Accountant's (IPA) conclusions for the DLA inaugural Financial Statement Audit. This initial audit has provided us with a valuable independent view of our current financial operations. We concur with the reported findings as presented by the IPA.

For FY 2017, the engagement with the IPA was a positive partnership that facilitated an effective and efficient audit. The IPA's continual updates to our management team provided on-going insight during the audit. We are committed to resolving the material weaknesses and strengthening internal controls around DLA's operations.

I look forward to working collaboratively with the Office of the Inspector General and the IPA to strengthen DLA financial management and internal controls.


DARRELL K. WILLIAMS
Lieutenant General, USA
Director



Other Information

The ***Other Information*** section contains information on the Summary of Financial Statement Audit and Management Assurances, Improper Payments, Fraud Reduction Report, and Other Key Regulatory Requirements.

Summary of Financial Statement Audit and Management Assurances

Table 1 and Table 2 below provide a summary of the financial statement audit results and management assurances for FY 2017.

Table 1: FY 2017 Summary of the Financial Statement Integrated Audit Results

Audit Opinion	Disclaimer				
Restatement	No				
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Reporting	0	1	0	0	1
IT Controls & System Functionality	0	1	0	0	1
Property, Plant & Equipment	0	1	0	0	1
Inventory	0	1	0	0	1
Fund Balance with Treasury	0	1	0	0	1
Oversight and Monitoring	0	1	0	0	1
Accounts Payable	0	1	0	0	1
Accounts Receivable	0	1	0	0	1
Total Material Weaknesses	0	8	0	0	8

Table 2. Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Modified					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
FR&R - Unresolved variances for key reconciliations		1				1
FR&R - Period-end Close review process requires improvement		1				1
FR&R - Timely compilation of Annual Financial Report and components		1				1
FR&R - The B2P reconciliations for the Working Capital Fund (WCF) are not performed on a timely basis and include cumulative differences with incomplete or unsupported explanations	1					1
FR&R – The Eliminations issue was identified while performing period-end close procedures.	1					1
FR&R –Lack of Evidential matter.	1		1			
FR&R –DFAS Account Maintenance & Control (AM&C) and Departmental Reporting (DR) prepare Journal Vouchers (JVs) for variances cannot be reviewed and approved by DLA J85 timely.	1		1			
A2R – An effective, consistently applied physical inventory process is not in place to ensure recorded real property assets exist and that real property records are complete	1					1

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Modified					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
A2R – An effective, consistently applied standardized process is not in place to ensure recorded real property assets are supported by adequate evidential matter for valuation and recording of real property records.	1					1
A2R – There are discrepancies between recorded asset balances and documentation supporting asset acquisition costs and place in service date. Specifically, no standardized process exist to ensure that capitalized costs are captured, tracked and recorded correctly for IUS projects that meet the capitalization threshold	1		1			
P2S – Inventory Reconciliation Framework Design and Implementation	1					1
FBWT – DLA is unable to provide sufficient, competent evidential documentation to support undistributed collection items	1					1
FBWT – DLA is unable to provide sufficient, competent evidential documentation to support undistributed disbursement items	1					1
FBWT – Standard processes for the FBWT reconciliation process were not fully documented	1					1
FBWT – Identified variances between Treasury records and DLA's accounting records are not being reconciled on a timely basis.	1		1			
Total Material Weaknesses	12	3	4			11

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Modified					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Risk of HAZMAT materiel not being segregated properly by Hazardous class caused by inadequate knowledge of HAZMAT segregation requirements or inadequate compliant storage space resulting in a potential safety hazard	1				1	
Certain items within Medical Supply Chain are critical for war readiness. However there are cases where the item (e.g. Antidote Treatment Nerve Agent Autoinjector, 2-PAM Atropine, or key ingredients of these items are provided by a sole source	1					1
Controls over the processing of Product Quality Deficiency Reports (PQDRs) were found to be ineffective in DODIG Report		1				1
Two rental and seven tenant locations do not have valid real property agreements that establish DLA rights and obligation for occupying the real property		1				1
Customers are not verifying receipt of material. Therefore, the Agency is not able to process supplier invoices in accordance with financial regulations	1					1
Risk of shipping wrong item to a Foreign Military Customer caused by not verifying and validating materiel at pack process resulting in loss of accountability and potential consequences to the Agency	1		1			

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Modified					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Risk of shipping wrong item to Foreign Military Customer caused by second verifier validating materiel at the pack process resulting in loss of accountability and potential consequences to Agency	1		1			
Distribution Standard System for DLA Disposition Services implementation has been incomplete and resulted in several financial and operational weaknesses	1		1			
Lack of a reconciliation between Fuels Manager Defense (FMD), Wide Area Workflow (WAWF) and Enterprise Business System (EBS).	1		1			
Total Material Weaknesses	7	2	4		1	4

Compliance with Federal Managers Financial Integrity Act (FMFIA § 4)						
Statement of Assurance	Federal Systems comply, except for instances of non-compliance, or do not comply with financial management system requirements.					
Non-Compliance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Security Management: <ul style="list-style-type: none"> • System Security Plan conformance and completeness across financial systems • Policies and procedures out of date or not approved • Monitoring of service provider and demonstrating evidence of complementary User Entity Control completion 	1					1
Access Controls: <ul style="list-style-type: none"> • Coverage and details within Account Management Policy – Increase stringency in areas of risk • Financial system Compliance with Account Management Policy – ensure all systems are in alignment to policy • Alignment of Provisioning Tools with Account Management Policy – ensure tools that support account request and approval of user roles. • Clarify T-code alignment to role in system – identify business and IT functions within systems that are higher risk or critical to both financial reporting and IT system management 	1					1

Compliance with Federal Managers Financial Integrity Act (FMFIA § 4)						
Statement of Assurance	Federal Systems comply, except for instances of non-compliance, or do not comply with financial management system requirements.					
Non-Compliance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Segregation of Duties: <ul style="list-style-type: none"> Issues with Firefighter roles – ensure Firefighter roles are provisioned only when needed and activity is promptly reviewed to ensure Firefighter roles are provisioned only when needed and activity is promptly reviewed to ensure Fighter use was appropriate Segregation of Duties in SDLC 	1					1
Contingency Planning: <ul style="list-style-type: none"> DMLSS-W COOP environment – ensure COOP environment is established and tested regularly 	1					1
Total Non-Compliances	4					4

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)		
FFMIA Fundamentals	Agency	Auditor
Federal Financial Management Requirements	No lack of compliance noted, or Lack of compliance noted	Lack of compliance noted
Applicable Federal Accounting Standards	No lack of compliance noted, or Lack of compliance noted	Lack of compliance noted
USSGL at the Transactional Level	No lack of compliance noted, or Lack of compliance noted	Lack of compliance noted

DLA management evaluated the system of internal controls in accordance with the guidelines identified in OMB Circular A-123 “*Management’s Responsibility for Enterprise Risk Management and Internal Control*” and DODI 5010.40 “*Managers’ Internal Control Program Procedures*”. The results indicate that the system of internal controls of DLA, in effect as of the date of this memorandum, taken as a whole, complies with the requirement to provide reasonable assurance that the Strategic objectives were achieved. This position on reasonable assurance is within the limits described within guidance. Using the following process, DLA evaluated its system of internal control.

Understanding the criteria to assess the effectiveness of DLA’s internal control is the cornerstone to develop an effective assessment approach. DLA began its assessment with a review of its entity level controls. Entity level controls refer to the elements of internal control that have an overarching or pervasive effect on the Agency. These controls are the foundation for DLA’s overall control environment and support internal control activities at the assessable unit/end-to-end process level. Weaknesses or deficiencies at the entity level are generally systemic and may require several weeks or months to remediate. The control environment is the foundation for all other components of internal control..

The governance structure of DLA integrates a system by which business is directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants within DLA, such as the Executive Board, Alignment Group, Stewardship Committee, and program working groups, managers, and stakeholders who spell out the rules and procedures for making decisions on DLA business affairs. By establishing this governance structure DLA provides a structure to make decisions, set objectives, and the means of attaining those objectives and monitoring performance. The implementation of the OMB Circular A-123 program process for managements’ responsibility for risk management and internal controls incorporates a structured process with key players who evaluate risk response and internal controls. The Stewardship Committee aids the agency Director and Executive Board in fulfilling Agency Financial Stewardship. The Stewardship Committee /Senior Assessment Team provides oversight of OMB Circular A-123 activities reported to OUSD(C). The Stewardship Committee is the governance structure for Enterprise Risk Management (ERM), Internal Controls, and subsumes Audit Committee responsibilities. The OMB Circular A-123 team consists of Stewardship Committee, Enterprise Business Process Cycle Owners (EBCO), Headquarter J/D Code Organization, MSC Director/Commander and their sub-organizations. Process Cycle Integrators (PCIs) for the EBCO coordinates with Assessable Unit Managers (AUMs) and Process Health Leads to ensure proper documenting of business processes that support operational, administrative, system, and financial events to assess controls and improve efficiency

in agency mission execution.

DLA must be aware of and deal with the risks we face. To elevate awareness in risk management and establish a risk mitigation strategy, the Risk Profile (RP) is the basis for developing internal control assessments. DLA's approach of controlling risk does not necessarily seek to eliminate the risk, but attempts to reduce risk and monitor its impact on completing mission objectives. The first steps in risk management are to develop awareness, expertise, and alignment. The below DLA RP depicts Enterprise Risks and associated vulnerabilities, as recognized by Senior Leadership, conveyed through the Chief Risk Officer for the Agency, through the Enterprise Risk Management Program Lead and Risk Managers throughout DLA. It is the top-down perspective to DLA's top-down and bottom-up approach to Risk Management. The eleven Enterprise Risks fall into seven overarching categories: Support to Operations, Information Technology Management, Inventory Management, Procurement and Acquisition, Financial Management, Human Resources Management, and Security and Force Protection. The bottom-up perspective is documented in Local Risk Profiles (LRPs), submitted by DLA Assessable Units. LRPs tie Enterprise Risks to local issues. LRPs ascertain the risk driver, category, impact, end-to-end business process, and strategic objectives associated with each risk at the local level.

Internal Controls over Operations (ICO) is evaluated based on the vulnerabilities identified in the DLA RP where the agency chooses to further evaluate the risk mitigation strategies. Leadership identifies the need for further assessment of the risk response (accept, avoid, mitigate, transfer) to gain further trust in the process or processes' controls that would mitigate the risk to an acceptable level. Assessments conducted may follow the Financial Improvement Audit Readiness (FIAR)/OMB Circular A-123 methodology (discovery, corrective action, assertion/evaluation, validation, and audit) or may utilize a self-report assessment process.

Internal Controls over Reporting (ICOR) assessments are determined through risk assessments relevant to Auditability. DLA Financial Policy Compliance Division takes lead on determining financial risk impacts and process evaluations that will impact the financial statement audit. Results from FY 2017 internal control testing and substantive testing identified material weaknesses and significant deficiencies in several processes captured above in the ICOR tables. DLA continues to monitor and reassess end-to-end processes to determine corrective action plans that will provide greater assurance on the effectiveness of the processes that impact the financial statement audit.

Internal Controls over Financial System (ICOFS) evaluations are done through assessments; DLA considered performance data and compliance indicators in forming an overall assessment of compliance for the agency. DLA J6 conducted an internal review of the effectiveness of the DLA internal controls over financial systems. J6 is able to provide modified assurance (with deficiencies noted) that the internal controls over the financial systems as of June 30, 2017 are in compliance with the Federal Financial Management Improvement Act (FFMIA) and OMB Circular A-123. Appendix D. Compliance testing is complete for all five Enterprise Control Families, examining control attributes at the Enterprise and application level within the scope of eleven Financially Relevant Systems. J6 reviewed audit results from the current financial statement audit to report the status controls that the IPA reviewed. As of June 2017, additional information from the financial statement audit led to the determination that J6 would provide modified assurance in the Enterprise Control Areas.

As prescribed in the General Accounting Office "*Green Book*" and in accordance with OMB Circular A-123, management evaluated its internal control system by assessing whether the 17 principles that represent the requirements necessary to support the five internal control components are designed, implemented, and operating together in an integrated manner. In FY 2017, DLA conducted Entity Level Controls (ELC) Interviews with EBCOs (senior leadership) to assess operational stewardship, decision-making awareness and establishing DLA's structure, policies, procedures, processes, and activities have a pervasive impact

not only on DLA's control system but DLA's mission accomplishment. Due to the revised OMB Circular A-123's focus on Management's Responsibility for proactive Enterprise Risk Management, DLA FY 2017 ELC interviews focused specifically on Risk Assessment and Monitoring components.

Table 3 Summarizes financial statement audit material weaknesses in internal controls as well as planned corrective actions.

Table 3: FY 2017 Internal Control Over Financial Reporting Corrective Actions

FY 2017 Internal Control Over Financial Reporting Corrective Action Summary	
Material Weakness	Correction Action Summary
FR&R - Unresolved variances for key reconciliations	DLA is in process of improving existing reconciliations by training employees on new procedures for identifying root causes, developing the appropriate corrective actions, and monitoring the performance of the processes.
FR&R - Period-end Close review process requires improvement	DLA is developing processes, updating standard operating procedures, training employees on new procedures, and monitoring the performance of the new standardized process.
FR&R - Timely compilation of Annual Financial Report and components	DLA is updating standard operating procedures and implementing a monitoring process to ensure the timely compilation of AFR.
FR&R - The B2P reconciliations for the Working Capital Fund (WCF) are not performed on a timely basis and include cumulative differences with incomplete or unsupported explanations	DLA is performing root cause analysis on existing variances to determine applicable corrective actions and updating standard operating procedures to monitor the timely resolution of variances.
FR&R – The Eliminations issue was identified while performing period-end close procedures.	DLA is validating the existing trading partner derivation rules and analyzing existing open transactions to identify the proper trading partner codes.
FR&R –Lack of Evidential matter.	DLA is focusing on fully implementing records management, employee's awareness and compliance, and management's review of properly stored evidential matter.
FR&R –DFAS Account Maintenance & Control (AM&C) and Departmental Reporting (DR) prepare Journal Vouchers (JVs) for variances cannot be reviewed and approved by DLA J85 timely.	DLA is implementing a monitoring process to ensure JVs are reviewed and processed in a timely manner.

FY 2017 Internal Control Over Financial Reporting Corrective Action Summary	
Material Weakness	Correction Action Summary
P2S – Inventory Reconciliation Framework Design and Implementation	The IRM Reconciliation Framework Design and Implementation subsumed all of the material weaknesses identified to the left into one corrective action process. DLA identified insufficient oversight and policy for Inventory Records Management. DLA has begun steps to create a standardized process for timely reconciliation process that will be repeatable, sustainable and establish supportable beginning balances.
FBWT – DLA is unable to provide sufficient, competent evidential documentation to support undistributed collection items	DLA, in collaboration with DFAS, has developed a plan of action and milestones to resolve aged undistributed collections within the prescribed timeline of 60 days.
FBWT – DLA is unable to provide sufficient, competent evidential documentation to support undistributed disbursement items	DLA and DFAS are researching such collections and disbursements recorded. Working in collaboration a POAM and corrective action has been established to identify erroneous disbursements and make correction in a timely manner. System changes are being made to facilitate automated corrective actions.
FBWT – Standard processes for the FBWT reconciliation process were not fully documented	To prove corrections have taken place evidential documentation is being reconciled and filed to support transactions executed.
FBWT – Identified variances between Treasury records and DLA's accounting records are not being reconciled on a timely basis.	Established tiger team to address unreconciled transactions, documented current processes at DFAS-IN for WCF, TF, and GF, assisted OSD and DFAS in performing root cause analysis and corrective actions for variances, and redesigned and implemented processes.
A2R – An effective, consistently applied physical inventory process is not in place to ensure recorded real property assets exist and that real property records are complete	Complete quarterly physical inventories, document discrepancies, conduct internal control testing, and analyze results for closure
A2R – An effective, consistently applied standardized process is not in place to ensure recorded real property assets are supported by adequate evidential matter for valuation and recording of real property records.	Conduct Substantive Testing, analyze test results, and evaluate closure

FY 2017 Internal Control Over Financial Reporting Corrective Action Summary	
Material Weakness	Correction Action Summary
A2R – There are discrepancies between recorded asset balances and documentation supporting asset acquisition costs and place in service date. Specifically, no standardized process exist to ensure that capitalized costs are captured, tracked and recorded correctly for IUS projects that meet the capitalization threshold	Performed data cleansing on existing assets and assets under construction, conducted an inventory of existing assets and deactivated assets no longer in use, developed standardized processes and incorporated into an SOP, and provided key control training to process owners.

Internal Control over Operations (ICO)

DLA began FY 2017 with a review of its high-risk areas. The Agency determined its Enterprise Risk Profile through a top-down and bottom-up approach that included gathering details through the DLA Enterprise Risk Management Community of Practice and senior leadership engagement to determine the final profile. This provided a portfolio view of risk and vulnerabilities that was cross-walked to specific processes and test plan scopes used by the enterprise to provide detail on the mitigation strategy for each risk. Using the Government Accountability Office's Standards for Internal Control in the Federal Government (the "Green Book"), DLA cross-walked the control environment detail to the Committee of Sponsoring Organizations of the Treadway Commission framework and developed an information sheet that supported the Green Book's 17 Components of Internal Control. Figure 6 below shows DLA evaluated 79 processes, with only three failures. The failures have plans of action and milestones for corrective action and monitoring.



Figure 6; the FY 2017 ICO Control Evaluation

Internal Control over Reporting (ICOR)

DLA provided a modified Statement of Assurance (SOA) that, as of July 21, 2017, its ICOR was operating effectively, with the exception of the identified material weaknesses. DLA remains vigilant in assessing its internal controls, continues to address all of its weaknesses efficiently and effectively, and is committed to resolving them in a timely manner. As part of the Audit Advancement effort, DLA evaluated the control environment for financial reporting and financial system compliance. During the FY, DLA identified and corrected five material weaknesses over financial reporting. Figure 7: FY 2017 ICOR Control Evaluation, shows the ICOR controls evaluated.

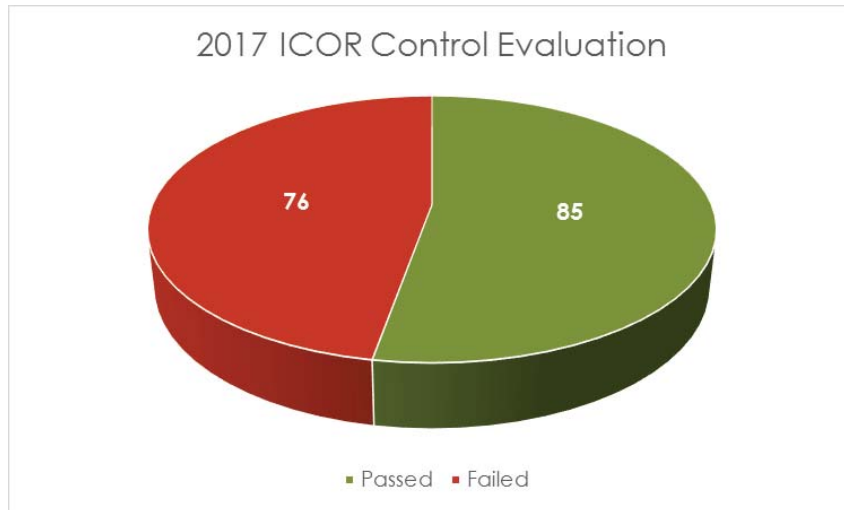


Figure 7; the FY 2017 ICOR Control Evaluation

The details of DLA's material weaknesses, as well as status of corrections and estimated completion timeframes, are included in the DLA's complete SOA.

Improper Payments Elimination and Recovery Improvement Act (IPERIA)

The DoD FMR 7000-14-R, Volume 4, Chapter 14, defines improper payments as “any payment that should not have been made or was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements.” In accordance with the Improper Payments Information Act (IPIA) of 2002 (Public Law (P.L.) 107-300); Improper Payments Elimination and Recovery Act (IPERA) of 2010 (P.L. 111-204); Improper Payment Elimination and Recovery Improvement Act of 2012 (IPERIA) (P.L.112-248); Executive Order 13520, Reducing Improper Payments, issued November 20, 2009; and Appendix C of Office of Management and Budget (OMB) Circular No. A-123, Defense components are required to report the status of improper payments and recovery of these improper payments to the President and Congress.

On October 7, 2016, DoD administered a remediation plan enterprise wide to ensure placement of front-end internal controls to minimize the potential for travel pay improper payments and to take prudent actions to detect, correct or recover improper payments. In compliance with the remediation plan, DLA's CFO submitted the DLA Travel Remediation Plan to the OUSD(C), which was approved in January 2017. The plan mandates the following:

- Automated courseware and delivery of annual training for DLA appointed Defense Travel System (DTS) Approving Officials (AOs), to include FMR directed Certifying Officer Legislation Training; Programs & Policies - U.S. Government Rental Car Program; and Program & Policies – Travel Policies, specifically suggested by the DoD Inspector General (IG). The DTS AOs are required to take annual refreshers on all three courses and must complete all three to obtain a new Approving Official permission appointment.
- Monthly, DLA Travel Compliance Team performs a Post Payment Review (PPR), with the criteria of 15 percent random sampling of DTS paid vouchers, all paid vouchers greater than \$2,500, and 100 percent of all Senior Executive Service (SES)/General Officer (GO)/Finance Officer (FO) paid vouchers for the detection of improper payments. Any findings for the SES/GO/FO, Director DLA Human Resources will open initial communications, and all findings are addressed to the appointed DTS Approving Official with specific area of concern. Recommendations are made for remediation and confirmation actions occur to ensure corrective steps take place. DLA Travel Compliance Team memorialized both the review findings and review results for publication.
- Enhance DLA's Travel Compliance initiatives by remediating erroneous claims and amending vouchers ahead of the Defense Finance and Accounting Service's PPR. DLA's Compliance Review provides assurance by reviewing paid travel claims for compliance with applicable laws and regulations.
- Post Payment Review (PPR) Overview identifies the outcome of the DLA PPR review results. The DFAS standardized areas of audit are used, capturing the number of errors and the value of those errors DLA has identified. DLA continues to demonstrate that “receipts”, invalid or missing continues to be the highest of concern. This is consistent with what is reported by DFAS at the Departmental levels. This PPR is informational in nature, and is updated monthly and released to all DLA AO's and Senior Leaders.

The following charts provide information on DLA's PPR data, OSD performance data and OMB performance data.

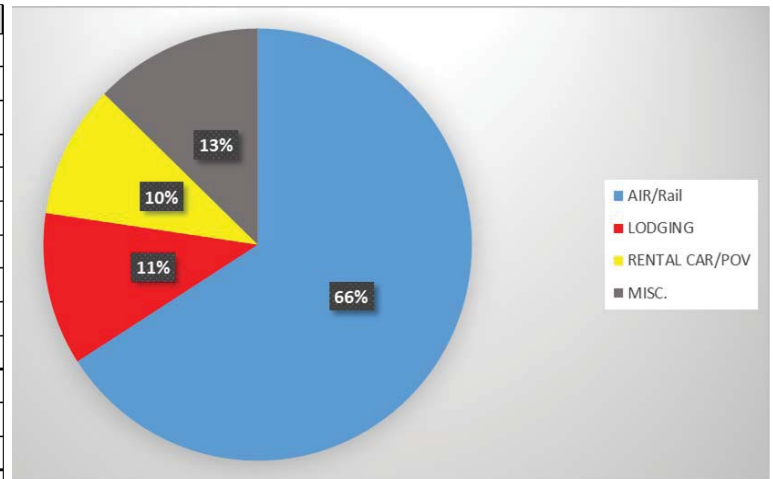
DLA Post Payment Review (PPR) Data:

DLA Goal: Monthly Audit Performed – Paid Vouchers

- 15% Random
- 100% Disbursements \$2,500 or over
- 100% All SES/GO
- 86% or above (OMB measurement) = **GREEN**
- 85% or below (OMB measurement) = **RED**

83%

FLAGGED ERROR DESCRIPTION	# ERRORS	ERROR \$ VALUE
Air/Rail – Receipt MISMATCH	54	\$10,274.32
Air/Rail – Invalid Receipt	75	\$62,287.62
Air/Rail – Missing Receipt	159	\$164,509.85
Lodging – Receipt MISMATCH	57	\$8,953.94
Lodging – Invalid Receipt	8	\$4,387.48
Lodging – Missing Receipt	40	\$25,431.45
Duplicate/Dual Lodging - Paid Incorrectly	1	\$315.24
Lodging Tax – Paid Incorrectly (CONUS)	16	\$1,145.50
Lodging Tax – Paid Incorrectly (OCONUS)	14	\$825.48
Mileage/Taxi – Incorrect/Undaimed	7	\$1,240.71
Parking Fee – Paid Incorrectly	22	\$2,154.66
Rental Car – Receipt MISMATCH	13	\$1,134.80
Rental Car – Invalid Receipt	58	\$17,758.31
Rental Car – Missing Receipt	11	\$3,941.85
Rental Car – Unauthorized Expenses Paid	101	\$7,673.92
MISC. Non-Reimbursable Expenses	48	\$9,827.21
Constructive Cost – CTW box not checked	15	\$10,778.44
Per Diem – M&IE Rate Paid Incorrectly	17	\$4,992.75
Registration/Conference Fee – Paid Incorrectly	8	\$4,319.11
Flat Rate Paid Incorrectly	6	\$15,800.21
TOTAL	730	\$357,752.85



Error Type	%	\$	#
AIR/Rail	66%	\$237,071.79	288
LODGING	11%	\$41,059.09	136
RENTAL CAR/POV	10%	\$33,904.25	212
MISC.	13%	\$45,717.72	94
Total	100%	\$357,752.85	730

*Note - Data is reported two months in arrears.

DLA Reduce Improper Payments Data:

OSD Goal: Reduce Improper Payments

- Value of Improper Payments vs. Value of Sample Population
- 4.46% or below = **GREEN**
- 4.47% or above = **RED**
- FY 2017 DLA Overall = **GREEN**
- DLA: Continue to Communicate and Educate DLA DTS AOs

4.06%

Month	Total Sample \$	Total IP \$	%
Oct-16	\$ 802,117.10	\$ 26,188.45	3.26%
Nov-16	\$ 927,961.04	\$ 23,547.90	2.54%
Dec-16	\$ 874,880.22	\$ 26,541.48	3.03%
Jan-17	\$ 447,476.49	\$ 21,724.99	4.86%
Feb-17	\$ 776,633.95	\$ 26,232.55	3.38%
Mar-17	\$ 1,255,026.59	\$ 60,214.41	4.80%
Apr-17	\$ 1,205,769.01	\$ 59,934.93	4.97%
May-17	\$ 1,408,921.59	\$ 53,188.68	3.78%
Jun-17	\$ 1,070,169.36	\$ 58,505.71	5.47%
Jul-17	DTS Failure: Sub Docs Unrecoverable		N/A
Aug-17			
Sep-17			
Total	\$ 8,768,955.35	\$ 356,079.10	4.06%

*Note - Data is reported two months in arrears.

DLA Prompt Collection Data:

OMB Goal: Prompt Collections of DUE US

- 86% or above = **GREEN**
- 85% or below = **RED**
- FY 2017 DLA Overall = **RED**
- DLA: Travel Remediation - Day 16 DUE US Implementation Plan

97%

FY17	Total DTS Vouchers	Sample DTS Vouchers Audited	% of Population Reviewed	Policy Compliant Vouchers	%	Non-Compliant Vouchers	Total Errors	%	Monetary	Monetary Voucher Count	Debt Satisfied	Due Process	Reconciled	Outstanding	% of Recovery
Oct-16	1981	327	17%	276	84%	51	52	16%	\$ 1,644.29	18	\$ 1,108.40	\$ -	\$ 535.89	\$ -	100%
Nov-16	2249	372	17%	321	86%	51	62	14%	\$ 1,842.33	23	\$ 1,077.35	\$ -	\$ 764.98	\$ -	100%
Dec-16	2090	355	17%	307	86%	48	64	14%	\$ 3,756.83	17	\$ 2,910.67	\$ -	\$ 169.04	\$ 677.12	82%
Jan-17	1436	244	17%	213	87%	31	34	13%	\$ 2,610.29	11	\$ 2,393.51	\$ -	\$ 216.78	\$ -	100%
Feb-17	2171	354	16%	280	79%	74	89	21%	\$ 5,748.82	39	\$ 2,887.59	\$ -	\$ 2,861.23	\$ -	100%
Mar-17	2762	457	17%	362	79%	95	143	21%	\$ 5,217.80	44	\$ 2,267.45	\$ 242.20	\$ 2,708.15	\$ -	95%
Apr-17	2240	370	17%	302	82%	68	84	18%	\$ 11,338.38	24	\$ 1,923.13	\$ 103.05	\$ 9,272.69	\$ 39.51	99%
May-17	2769	463	17%	386	83%	77	98	17%	\$ 8,069.22	31	\$ 5,298.78	\$ 49.32	\$ 2,684.68	\$ 36.44	99%
Jun-17	2501	414	17%	335	81%	79	104	19%			DTS Failure: Sub Docs Unrecoverable				N/A
Jul-17	0	0	0%	0	0%	0	0		DTS Failure: Sub Docs Unrecoverable				\$ -	\$ -	N/A
Aug-17															
Sep-17															
YTD:	20199	3356	17%	2782	83%	574	730	17%	\$ 40,227.96	207	\$ 19,866.88	\$ 394.57	\$ 19,213.44	\$ 753.07	97%

*Note - Data is reported two months in arrears. (See additional notes on next page)

DLA Prompt Collection (ALL DLA/DTS Debt Management Monitor Collections). DLA currently RED 81%

** NOTE: these are not PPR inclusive – these can be self-reported in addition to other means of review outside of random testing; proving DLA is tracking and reporting – holding to the OMB reporting standards.

DLA Goal: Prompt Collections of DUE US

- 86% or above = **GREEN**
- 85% or below = **RED**
- FY 2017 DLA Overall = **RED**
- DLA: Measure by Following OMB Goal

81%

Organization	FY 16 Debt Balance	FY 17 Debt Value	FY16 and FY17 Total Debt Value	Open Debt Vouchers (cumulative)	Open Due US	Debt Paid	DLA DMM Recovery Rate
ACQUISITION (J7)	\$ 108.50	\$ 1,798.95	\$ 1,907.45	1	\$ 1,369.00	\$ 538.45	28%
AVIATION	\$ 7,673.62	\$ 18,837.87	\$ 26,511.49	1	\$ 27.15	\$ 26,484.34	100%
D-GROUPS	\$ 23.55	\$ 2,912.99	\$ 2,936.54	1	\$ 11.29	\$ 2,925.25	100%
DISPOSITION	\$ 10,274.73	\$ 3,689.80	\$ 13,964.53	7	\$ 1,936.38	\$ 12,028.15	86%
DISTRIBUTION	\$ 53,364.33	\$ 18,807.72	\$ 72,172.05	17	\$ 14,188.75	\$ 57,983.30	80%
DPAS	\$ -	\$ -	\$ -	0	\$ -	\$ -	0%
DSPO	\$ -	\$ -	\$ -	0	\$ -	\$ -	0%
ENERGY	\$ 8,513.17	\$ 21,063.98	\$ 29,577.15	6	\$ 6,736.24	\$ 22,840.91	77%
FINANCE (J8)	\$ 46.20	\$ 2,353.89	\$ 2,400.09	0	\$ (0.00)	\$ 2,400.09	100%
HUM RSC (J1)	\$ 15,551.10	\$ 5,512.81	\$ 21,063.91	2	\$ 14,644.96	\$ 6,418.95	30%
INFO OPS (J6)	\$ 3,683.60	\$ 5,013.00	\$ 8,696.60	4	\$ 498.74	\$ 8,197.86	94%
INSTL SPPT	\$ 6,374.41	\$ 14,930.09	\$ 21,304.50	6	\$ 2,028.15	\$ 19,276.35	90%
JOINT RSRV (J9)	\$ -	\$ -	\$ -	0	\$ -	\$ -	0%
LAND & MARI	\$ 75.00	\$ 6,434.55	\$ 6,509.55	4	\$ 1,502.60	\$ 5,006.95	77%
LOG OPS (J3/4)	\$ 1,181.92	\$ 14,693.18	\$ 15,875.10	2	\$ 515.60	\$ 15,359.50	97%
STRAT MAT	\$ -	\$ 1,119.95	\$ 1,119.95	0	\$ -	\$ 1,119.95	100%
STRAT P&P (J5)	\$ -	\$ -	\$ -	0	\$ -	\$ -	0%
TROOP SPPT	\$ 4,001.11	\$ 8,083.12	\$ 12,084.23	3	\$ 535.88	\$ 11,548.35	96%
	\$ 110,871.24	\$ 125,251.90	\$ 236,123.14	54	\$ 43,994.74	\$ 192,128.40	81%

*Note - Data is reported two months in arrears.

Fraud Reduction Report

Pursuant to OMB Circular A-136 and the Fraud Reduction and Data Analytics Act of 2015 (Public Law 114-186, 31 USC 3321), DLA began to build the Fraud Framework by identifying the high risk areas within our business. Fraud, Waste, Abuse, and Mismanagement (FWAM) poses a significant risk to DLA in the execution of business practices and our mission. Risks include procurement process illegalities such as bribery, kickbacks, collusive bidding, false or inflated billing claims, shell companies, and product/labor substitution. Fraud also includes asset misuse/misappropriation, cash embezzlement, property theft, and falsified entitlement/expense reimbursement claims. Fraud creates significant cost and reputation risk to DLA.

DLA developed the ERP utilizing a top-down/bottom up perspective provided to senior leadership for a portfolio view of DLA risks. Information gathered from the local risks identified by the Major Subordinate Commands and Headquarters Directorates enabled the identification of vulnerabilities to mission accomplishment. These risks were ranked and rated utilizing a likelihood and impact rate scale to determine high risk areas. From this ERM methodology, DLA created a risk profile in FY 2015. The requirement to conduct the identification of fraud risks specifically is evolving within DLA. To build the Fraud Framework DLA looked at business vulnerabilities. As the premier agency that procures, manages, stores, and distributes almost every consumable item the military needs to operate our focus began with customer support. To do business with DLA, customers are required to complete specific criteria that must be met and internal controls are put in place to protect the Warfighter interests and provide accountability and transparency to our stakeholders.

DLA has specific guidance in place to standardize the “how to do business” with us and also the control environment that makes sure those that do business with us are cleared to engage in our secure environment. Policies and procedures are in place to establish compliance with laws and regulations for employees to follow in the execution of their daily responsibilities and for business partners to employ in gaining opportunity to work with DLA to support our mission – “Warfighter First”.

Risk and control assessments plays a pivotal role in audit sustainment, audit advancement, fraud detection, and fraud deterrence. We began our journey with specifying a high-level financial reporting objective and sub-objectives related to preparing financial statements and disclosures. In doing so, we identified significant financial statement accounts based on the risk of material misstatement. Then for each account or disclosure, we identified relevant financial reporting assertions. In addition, we identified underlying transactions, events and processes supporting the respective accounts and disclosures. As part of this risk and controls process we are expanding our Fraud Framework in 2018 to include a more detailed fraud response plan.

DLA provides worldwide logistics support in both peacetime and wartime to America’s Military Services as well as civilian agencies and foreign countries. DLA Logistics Information Service has sole responsibility for assigning and maintaining the CAGE Code Master File. The CAGE Code is a five position code that identifies contractors doing business with the Federal Government, NATO member nations, and other foreign governments. The CAGE Code is used to support a variety of mechanized systems throughout the government and provides for a standardized method of identifying a given facility at a specific location. The code may be used for a facility clearance, a pre-award survey, automated Bidders Lists, identification of Debarred Bidders, fast pay processes, etc. Registration in the Central Contractor Registration database is required prior to the award of any contract, basic agreement, blanket ordering agreement or blanket purchasing agreement unless the award results from a solicitation issued on or before May 31, 1998. Having a CAGE Code alone is no longer sufficient to qualify a contractor to do business with The Federal Government.

The DLA Enterprise External Business Portal provides industry and military service personnel with centralized access to DLA Business Services. Systems accessed through the portal include: Engineering Support Activities, Data Demand Exchange/Customer Collaboration, Installation Support (Real Property), Disposition Services, Energy Commodity Support, and the Enterprise Data Warehouse (EDW). Access is controlled by Information Technology Directorate where the Automated Management Provisioning System is the single point of entry into approvals for requests to do business with DLA. To do business you are required to complete specific criteria that must be met and these internal controls are put in place to protect the criticality of business we do and the security of the Warfighter first.

As part of the Agency's risk associated with our end-to-end processes (Procure to Pay, Order to Cash, Plan to Stock, Acquire to Retire, Hire to Retire, Budget to Execute, Financial Reconciliation and Reporting, Fund Balance with Treasury, and Environmental Liabilities Management) business cycles have internal controls in place that support our mitigation strategies and help DLA detect or prevent fraud. Under the purview of the DLA Finance Directorate, Financial Compliance and Policy Division monitors and reports on risk mitigation strategies as part of the annual Statement of Assurance. Process documentation, testing, risk identification, and process control gaps are identified and corrective actions implemented to mitigate risk in our business processes. In accordance with OMB Circular A-123 guidance several areas have internal controls in place to mitigate fraud risk, such as payroll, contracting, and purchase and travel cards.

Metrics are developed and reported to the Director through our Annual Operating Plan (AOP) and Strategic Plan Implementation Guidance as mechanisms to monitor the achievement of the goals and objectives of the DLA's Strategic Plan. Placing performance metrics in our control environment allows for continues monitoring and reporting on our success. It also highlights the need for improvements in DLA's internal controls environment. This drives proactive instead of reactive responses.

DLA's Office of Inspector General (OIG) provides the arm of investigations and response in FWAM. The DLA OIG considers it mission essential to establish an effective means of identifying those areas where processes and controls have been found vulnerable to fraud. Combatting FWAM requires an active collaborative effort. While the DLA OIG operates independently, it relies upon the continuous support from mandated partnerships with Defense Criminal Investigative Services, Department of Defense (DoD) Inspector General (IG), and meaningful relationships with other DoD Inspectors General offices and their associated criminal investigative agencies. The support provided by these entities allows the DLA OIG to collaborate on investigative and audit efforts as well as receive operational support. In the process of combating FWAM, the DLA OIG aligns its performance measures with the DLA Director's priorities to improve organizational effectiveness and efficiency, and remain committed to providing value to the agency. DLA OIG leverages subject matter experts within and outside of DLA in combatting FWAM.

The DLA OIG Investigations Division (ID) conducts preliminary and administrative IG investigations of matters of interest to the DLA Director and DLA senior leadership. When an ID investigation develops credible information to believe criminal activity has occurred, and the severity of that activity may need to be referred for prosecution if it is substantiated, the investigation is coordinated with and referred to a Federal, Defense, State, or local Law Enforcement Agency.

The DLA Enterprise Hotline Program is intended to provide DLA personnel with an alternative communication mode to report suspected fraud, waste, abuse, and mismanagement without fear of reprisal. DLA Hotline complaints are received through a web portal, email, phone or fax. Complaints are received, considered, coordinated as appropriate with General Counsel, and then referred to ID or to the appropriate senior leadership point of contact for either information or action. When investigations are required in support of an action referral, an examining official is appointed. Completion Reports are received and reviewed by the Hotline Program Manager (PM) before distribution, if required. The DLA Hotline PM acts as the liaison with the DoD Hotline Program.

The Agency has made significant strides to incorporate all the GAO Federal Internal Control Standards. However, specifically around principle eight - Assess Fraud Risk – two areas of the seven require greater emphasis in 2018; risk factors and response to fraud.

Other Key Regulatory Requirements

Prompt Payment Act

The Prompt Payment Act requires federal agencies to make payments to vendors for supplies and services by the payment due date. Computation of the payment due date is specific to the type of service or product provided. In general, most payments are made within 30 days. However, there are some exceptions. For example, contracts with suppliers of meat, fresh and frozen fish products, poultry and egg products payment will be made as close as possible to but no later than, seven calendar days from the date of delivery of the product.

DLA is strongly committed to supporting small business growth and has taken steps to ensure that the Federal Government promptly and efficiently pays small businesses. As part of this commitment, OMB issued Memorandum M-11-32, “Accelerating Payments to Small Businesses for Goods and Services,” in FY 2011. This outlines the Executive Branch policy that, to the full extent permitted by law, by agencies shall accelerate payments to small business contractors with the goal of making payments within 15 days of receipt of relevant documents.

If a payment is late, an interest payment is due to the vendor and is made without the vendor having to request the interest payment. Interest is computed using the daily rate of interest (established by the Secretary of Treasury) multiplied by the principle amount times the number of days paid late.

OSD has established an interest penalties performance target of \$90 dollars per million.

Debt Collection Improvement Act (DCIA)

In compliance with the DCIA of 1996, DLA manages its debt collection activities under the DCIA regulation. The DLA’s Accounts Receivable policies, in accordance with the DoD FMR, provide guidance for the collection, referral, reporting and write-off of non-tax debts. DLA coordinates with the DFAS, which then refers valid and legally enforceable delinquent public receivables to Treasury. This in accordance with the DCIA and the Digital Accountability and Transparency Act of 2014.

Audit Advancement

Prior to February 2012, DLA organizations were mission-focused and concentrated on supporting the Warfighter; however, the end-to-end processes were not centrally managed nor focused on the elements necessary to pass and sustain an audit. The establishment in March 2012 of the Audit Readiness Program Management Team (PMT), led by a member of the Senior Executive Service, demonstrated Leadership’s commitment to audit readiness and reduce overall risks to the agency, thereby providing better support to the Warfighter.

The OUSD (Comptroller) Financial Improvement and Audit Readiness (FIAR) Directorate manages the DoD FIAR Plan and develops and issues the FIAR Guidance that defines DoD’s goals, priorities, strategy, and methodology to achieve audit readiness. The guidance describes the roles and responsibilities of reporting entities and service providers and the processes they should follow to achieve audit readiness. This guidance is updated periodically to remain current with DoD’s priorities and align with all applicable Federal and Departmental financial management requirements. On September 30, 2015, DLA asserted that our Agency was audit ready for all fund accounts. Since DLA reached its goal of assertion and to better reflect where DLA is in the audit process, the audit readiness initiative was changed from audit readiness to the Audit Advancement.

DLA established a rigorous enterprise Audit Advancement strategy, program infrastructure, and governance structure that were managed centrally with full Agency support and clear accountabilities at the

senior level. The governance included a Stewardship Committee, centralized PMT, the Audit Leadership Integration (ALI) Team, Business Cycle Teams (BCTs) led by senior executives at DLA Headquarters known as Enterprise Business Cycle Owners (EBCOs), Major Subordinate Command (MSC) representatives, and PMT.

The Stewardship Committee serves primarily to support the EBCOs in fulfilling their stewardship responsibilities by identifying and removing obstacles to stewardship and by elevating audit advancement related processes and concerns. Collectively, the Stewardship Committee makes decisions and builds consensus to improve business operations; recommends resourcing to help ensure compliance with existing laws, regulations, policies, and standards; reviews enterprise-wide audit advancement milestones and progress; reviews audit advancement-related obstacles and significant risks to DLA, and decides how to overcome them; and sets the “tone at the top” for free and open exchange of audit advancement-related information.

The Business Cycle and MSC representatives work with the EBCOs and MSC Commanders to help ensure execution of their respective team’s audit advancement responsibilities, and identify and resolve impediments to the Agency’s auditability at each ALI meeting. This group provides the PMT a forum to communicate program guidance and assignment details to the Business Cycle and MSC representatives in a scheduled manner; advise on potential resolutions and strategize on implementation approaches to agreed-upon resolutions; and foster open audit advancement-related communication among the various teams.

The ALI Team is chaired by the OMB CircularA-123 Program Manager and meets weekly with the Process Cycle Integrators, Process Owners, and MSC Process Health representatives to discuss and provide updates on Audit Advancement initiatives and issues.

DLA designed a sustainment plan to ensure it has the skills and/or capabilities to train and transition the DLA workforce to prepare for audit and sustain these new practices into the future. DLA has the necessary processes, controls, data, system, and human capital capabilities in place (including audit infrastructure, manual and system internal control testing protocols, and management oversight) to sustain audit advancement solutions within the business processes throughout the Agency and with the Agency’s service providers.

DLA’s Audit Advancement program identified and established processes and controls to withstand an audit for full enterprise-wide auditability and to integrate financial management with DLA’s programs and operations. The readiness of DLA’s key systems, particularly EBS, is a critical element of DLA achieving audit success, given the size, complexity, volume of transactions, geographic dispersion of its operations, and highly automated business processes with its customers.

J6 focused on IT General Controls affecting auditability for DLA-owned and DLA-managed systems whereby DLA performs the role of a service provider to its customers. Certain system components are operated by DLA on behalf of other entities and DLA has demonstrated through service provider focused audits that it has adequately designed controls that operate effectively.

The Audit Response and Sustainment Team serves as Audit Liaison in responding to external Services Organizations financial statement audit requests. The team meets daily with the PCI, Process Owners, and MSC representatives to assign and discuss audit requests for evidential matter from the Independent Public Auditor (IPA).

The IPA, Ernst & Young was selected and arrived in August 2016. The IPA Report is enclosed in the Financial Section of the AFR. DLA will use the report as a baseline to improve financial statements.

Supply Chain Management Overview



Supply Chain Management Mission

The SCM mission, through DLA WCF 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 to sustain the 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. This section of this report will detail the SCM mission at DLA.

The SCM's primary logistics functions include: Supply Chain Integration and Inventory Management, specifically:

- Transportation management;
- 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,
- Logistics management and processing standard Military Logistics Systems transactions.

Strategic Goals

The long-term goals of DLA's SCM 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 that encompasses the DLA's entire supplier facing initiatives. The focus of SRM is to forge new relationships and enhance the quality of existing business relationships. 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 affirms 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

- **Strategic Sourcing (SS):** SS focuses on stratifying and satisfying customer driven high demand and readiness hardware items through long-term contracting coverage and process improvements. Over 177,300 of the 5.1 million hardware items managed by DLA are through long-term agreements. Long-term contract items made up 77.9 percent of DLA spend in FY 2017 YTD.
- **Warstopper Program:** This program recognizes that peacetime demand for certain items is inadequate to sustain an industrial base sufficient for readiness and mobilization. Extra preparedness measures are required for those items, and critical industrial capabilities must be preserved to support the Agency's readiness and sustainment requirements. In most cases, the Warstopper Program preserves essential production capability by investing in industry responsiveness to a projected surge requirement without purchasing, storing, and managing a finished goods inventory. This concept applies to items such as chemical protective suits, nerve agent antidote auto-injectors, MRE, and tray pack assemblies. The most recent Return on Investment (ROI) analysis for the program indicates that from 1993 through 2016 the Warstopper program has offset over \$6 billion in War Reserve Material purchases – a ROI of 7:1. DLA expects a similar ROI on the \$46.8 million Warstopper investments to be made in FY 2018.

- **Strategic Supplier Alliances (SSAs):** SSAs are long-term partnerships formed with DLA's key suppliers, allowing 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 24 SSAs and each is assigned to a Supplier Relationship Manager whose primary responsibility is the maintenance and success of the partnership. There are no plans at this time to add additional SSAs.
- **Supply Chain Alliances (SCAs):** An outgrowth of the SSA initiative, SCAs are alliances with key suppliers who provide both sole source and competitive items. SCAs further the goals of the SRM transformation effort by adding value to both DLA and the supplier. DLA has formed SCAs with 13 suppliers. Several SCAs were dropped over the last year. There are no plans at this time to add additional SCAs. To assist all suppliers with their operational planning, DLA provided them with a tool, the Supplier Requirements Visibility Application, which forecasts 24 months of requirements for both competitive and sole source items. This initiative is essential in achieving the DLA objective of linking supply with demand.

EBS Customer-Relationship Management (CRM): DLA uses standard Enterprise-wide automated management tools and processes to more deliberately understand Warfighter needs and meet customer expectations. In March 2006, DLA began using these EBS CRM tools and processes for account management, opportunity management, and customer outreach. In the following month, analytics and service modules were configured and deployed. EBS CRM reached full operational capability in July 2007. In March 2008, EBS CRM was extended to our Supplier Operations business area in order to capture life-cycle documentation of customer issues such as expedite requests. Approximately 5,400 DLA employees now use the system. EBS CRM system enhancements continually improve program reporting, customer outreach, account management, opportunity management and various other service capabilities. Examples of recent and on-going improvements include:

- Continuing to increase business area focus within DLA's Customer Interaction Center for documentation of customer issues within CRM Service Management (e.g., acquired new mission supporting customer inquiries/requests on the Wildland Fire Protection Program). Daily emergency requisition requests are tracked and forwarded to be included in DLA J3's daily Executive Summary.
- Conducting a CPI initiative on the uniform use of CRM's Service Management process to provide lifecycle documentation on customer inquiries/requests.
- Implementing CRM Service Management to support documentation of customer service requirements with our Fleet Readiness Centers as well in support of Marine Corps Logistics Base, Albany, Georgia and Marine Corps Logistics Base, Barstow, California.
- Expanding CRM process areas within DLA Disposition Services business area. These enhancements include: new functionality implemented to give Sales Contracting Officers the ability to see available disposable material at all locations supporting public offerings and increased sales.
- Continuing to track external customer survey responses resulting from EBS through CRM Service Management's automatic distribution of survey requests based on customer transactional inquiries/requests. This provides a customer experience pulse check on a specific service incident.

Program Performance Indicators

The key program performance indicators described below are included as components of DLA's Enterprise Data Warehouse (EDW) and are tracked closely by the Agency. The display of metrics data in the EDW provides DLA management with access to timely, complete, accurate, and reliable performance and

financial data. Metrics are reviewed at the DLA Executive Board on a monthly basis and during the J3 Agency Performance Review. In addition, these metrics are key elements in DLA's Performance Based Agreements (PBAs) with the Military Services and are jointly reviewed with them to collaboratively evaluate DLA's performance.

MA is used to identify performance issues within the logistics pipeline. As such, MA is DLA's overarching metric. MA is used to identify the capability of DLA to immediately issue materiel, both stocked and vendor-supplied, in response to customer requisitions. MA has a direct impact on DLA's operational performance and metrics such as total and aged backorders, timeliness and inventory efficiency. MA is reported as a percent of orders that are immediately issued out of the total number of orders received in the given time period of interest. DLA's overall MA for FY 2016 was 96.3 percent, and as of FY 2017 was 96.1 percent. The hardware portion of DLA's business performed at 90.3 percent in FY 2016, and was at 89.3 percent as of the end of FY 2017, which is below the Director's established goal of 91.0 percent. The supply chains have action plans in place for improving their supply chain MA throughout the FY 2018, which includes agile procurement and maintaining accurate stockage levels while balancing costs. The FY 2018 goals will likely remain unchanged from FY 2017 levels.

Total Backorder Index and Aged Backorders reflect gaps in DLA's ability to fill or satisfy customer order requirements in a timely manner and are used to measure the number of orders received that have not been fulfilled by DLA by a particular date of interest. The total Backorders index measures customer orders which are in a backorder status for material that DLA can act upon to expedite the fill while controlling for daily average order volume, as high order volumes tend to create more backorders if MA is kept constant. Filtering logic is in place to exclude select open orders that automatically go into unfilled order status as part of the process of filling the order. The total Backorders index and the number of Backorders that are currently over 180 days old (referred to as "aged Backorders") are measured. Due to backorders creating a failure for MA, the two metrics are typically correlated—a high level of Backorders generally corresponds to a lower MA. For FY 2017, the total backorder index measured 3.56 across the Agency, with 103,681 backorders falling in the aged category. For hardware, the total backorder index was at 10.56 against a Director established goal of 10.30. The aged category for hardware measured at 72,465 against a Director established goal of 62,800.

Order Response Time (ORT) measures the responsiveness to Air Logistics Center customer demands for DLA items. Included in each month's population are Air Force Maintenance document orders created in the reporting month, both filled and remaining on backorder at month end. Age is determined from Julian date in the Maintenance document through issue date (date stock is located on base). Cancellations are removed from the population at month end. The management objective is 95.0 percent of all orders for stable demand received in a reporting month to be filled within two days. Each ALC's ORT is computed using the same logic, methodology, and data source Center of Parts Activity. Reporting methodology was changed in December 2016 to focus on stable demand items, versus the older logic that looked at all items. Performance as of August 2017 was at 94.8 percent. The primary degrader for ORT not meeting the 95 percent goal is work on the KC-135 Stratotanker. (Note: ORT reporting lags one month, August data most recent available at time of publication.)

Procurement Productivity measures the Supply Chains response to Purchase Requests (PRs) by awarding either contracts or Purchase Orders and maintaining an acceptable level of backlog, PRs in process. This process includes manual awards, automated awards, placing delivery orders on existing Long Term Contracts and cancellations, as measured against the number of PRs in process. During FY 2016 the number of PRs in process increased from 121,137 as of October 1, 2016 to 135,738 as of September 30, 2017.

- **Time to Award Goals**

- Awards without Buyer assist tracks all Simplified Acquisition Procedure (SAP) awards processed by the automated evaluation system with no human intervention. The Time to Award goal is 12 days for FY 2017. In FY 2016, the automated ALT measured 12 days across the enterprise.
- Manual (SAP) Awards with Buyer Assist tracks all SAPs processed only by human intervention. The Time to Award goal is 50 days for Land & Maritime and 55 days for Troop Support and Aviation in FY17. In FY17, the Manual SAP with buyer assist was 57 days, which is down from 74 days in FY16. A change in logic for Manual (SAP) awards in FY 2017 excluded any awards from the ALT calculation that exceeded 180 days.
- Long Term Contract (LTC) Awards with Certified Cost and Pricing Data (CCPD)
 - This metric tracks LTCs and Large Awards with CCPD. The time to award goal is 285 days for FY 2017 (Aviation and L&M only). For FY 2017 YTD, L&M was at 372 days and Aviation was at 340 days.
 - This metric tracks LTCs and Large Awards without CCPD. The Time to Award goal is 195 days for FY 2017. For FY 2017 YTD Troop Support was at 110 days, Aviation 224 days and L&M was 229 days.
- On Time Delivery (OTD)
 - This metrics tracks the timeliness of supplier performance in providing material by the scheduled delivery date in the contract. The metric is tracked at the MSC level. The OTD goals are: Aviation – 90 percent, Troop Support – 90 percent and L&M – 93 percent. For FY 2017 YTD, Aviation was at 88.32 percent, Troop Support at 89.98 percent and L&M at 92.19 percent. The OTD rates are through August 2017 as the data runs one month in arrears. End of FY17 OTD will be available November, 10 2017.

Long Term Contracts (LTCs) Administration: LTCs are flexible vehicles that remove workload from buyers’ desks and provide documented, reduced administrative and production lead times. These reduced lead times allow DLA to reduce inventory investments. The metric used is the LTC Obligation Rate.

LTC Obligation Rate: Measures the overall success at maintaining coverage and selecting the correct items, and in the right quantities, to be placed on LTC as a percent of total obligations made against items on LTCs during the fiscal year. The FY 2017 Year to Date (YTD) LTC contract obligations rate was 77.9 percent. The DLA Headquarters (HQ) continues to track strategic opportunity initiatives established by the MSCs.

Financial Performance Measures

The DLA measures the effectiveness of program budgeting and execution with unit cost performance measures. Unit cost is a ratio that relates resources to outputs produced. The aim of unit cost is to directly associate total cost to work or output.

The following table depicts the SCM unit cost result for the DLA Materiel Supply Chains (Non-Energy), DLA Distribution and DLA Disposition Services, and DLA Materiel Supply Chains (Energy):

Unit Cost Results	FY 2017 Goal	FY 2017 Actual
DLA Materiel Supply Chains	\$1.03	\$1.03
DLA Distribution –Processing	\$37.87	\$39.36
DLA Distribution – Covered Storage	\$7.71	\$7.58
DLA Disposition Services – Per Line Item	\$52.16	\$74.46
DLA Disposition Services – Per Pound	\$0.10	\$0.18

Unit Cost Results	FY 2017 Goal	FY 2017 Actual
Energy Unit Cost per barrel sold	\$101.03	\$152.60
Petroleum Product Cost per barrel	\$65.12	\$76.33

Financial Results

DLA evaluates financial results based on the solvency of the Defense-Wide WCF's cash position and the ability to meet intended Operating Results (ORs) for the FY. DLA policy is to set prices that achieve an Accumulated Operating Result of zero over the long-term and maintain cash balances sufficient to preclude an ADA violation.

Overall, the Agency had negative Operating Result of \$172.3 million at the end of September 2017. The primary drivers for the OR financial loss is higher operating expenses for DLA Information Operations, lower storage and processing workload for Distribution, lower sales proceeds for DLA Disposition, and higher fuel product cost for DLA Energy (partially offset by higher sales for DLA Energy.) The Agency's cash balance of \$2,076.5 million at the end of September 2017 is due to collecting on customer sales for DLA Energy and for DLA SCM, and unexpended appropriations (Overseas Contingency Operations and Request for Additional Appropriations); partially offset by materiel disbursements for DLA SCM and for DLA Energy; and disbursements for DLA Information Operations.

(\$ in millions)	NOR	Net Outlays
DLA Energy	\$ (296.90)	\$ 1,516.20
DLA SCM	\$ 111.30	\$ 355.90
DLA Information Operations Document Services	\$ 13.40	\$ 204.40
DLA WCF	\$ (172.30)	\$ 2,076.50

DLA Distribution Overview



DLA Distribution

As a DLA MSC, DLA Distribution is the leading provider of global distribution support to America's military including receiving, storing and issuing supplies as well as providing other tailored services to increase Warfighter readiness.

DLA Distribution offers best value supply chain solutions through a broad range of services including storage, distribution, customized kitting, specialized packaging as well as transportation support and technology development. We are connected directly with our operational and industrial partners and integral to the success of our National Military Strategy.

Highly skilled employees provide timely distribution services to customers around the globe. In FY 2017, DLA Distribution processed over 14.2 million receipts and issues supporting customer operations worldwide, including support to combat operations, humanitarian assistance missions, WoG partners and a multitude of military exercises.

Mission

The mission of DLA Distribution is to be the global distribution service provider for the DoD and valued customers.

Strategic Goals

DoD is scaling down operations overseas and drastically reducing costs. As a result, DLA's sales and workload have decreased from its peak several years ago. DLA Distribution is faced with the challenges in this new environment. DLA Distribution will continue to focus on providing effective and efficient distribution services which will provide best value support to the Warfighter by supporting the Director's five Goal Areas:

1. Warfighter First
2. People and Culture
3. Strategic Engagement
4. Financial Stewardship
5. Process Excellence

Program Initiatives and Accomplishments

DLA Distribution's approach will meet agreed upon customer requirements within FY 2017 resource constraints. The DLA Director's Strategic Plan, Audit Readiness/ Sustainment, Process Excellence, and CPI will serve as the foundation of how we will strengthen ourselves to build our enabling Storage and Distribution (S&D) foundation of people, processes and technology to create an effective, efficient distribution organization that provides best value to the Warfighter. DLA Distribution will execute the approach through five goal areas that combine to reach our four end states:

Meet Customer Requirements:

- End-state: Executing the mission to achieve negotiated customer requirements.
- Rationale: To remain relevant as the DoD's S&D provider of choice, DLA Distribution must meet our customer's requirements in order to allow them to perform their worldwide missions.
- Measures of success: Achieve 80 percent amber and green status network-wide on monthly assigned Acceptable Performance Levels within budgeted resources.

Optimize Total Supply Chain Costs:

- End-state: All decisions are evaluated by considering total supply chain costs and potential savings (e.g. transportation, material processing, maintenance, supplies, personnel, inventory, and

acquisition).

- Rationale: DLA Distribution has the expertise to effectively optimize the supply chain for our customers.
- Measures of success: Optimize supply chain cost by \$39.5 million (internal cost + external cost) while demonstrating that best value decisions are reached.

Resilient Organization:

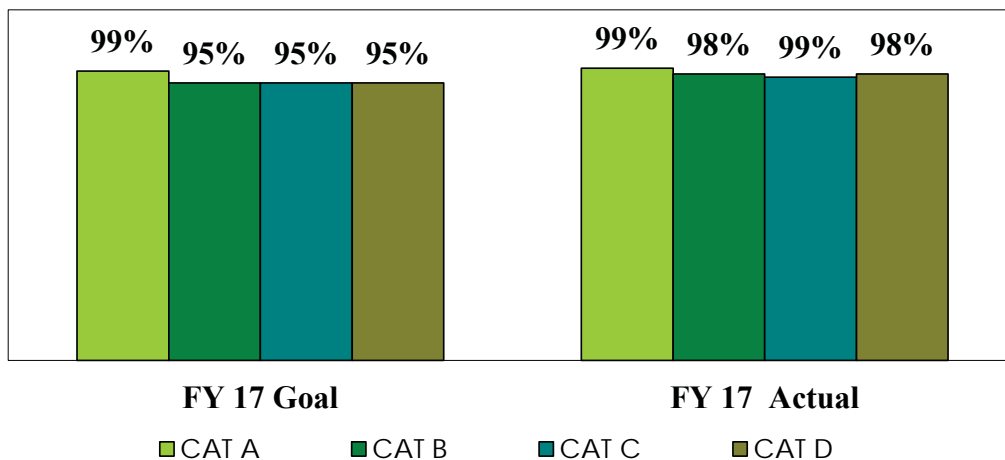
- End-state: Flexible, responsive, recoverable, and able to quickly adapt to changing business environments while achieving outstanding results.
- Rationale: Creating and maintaining a resilient organization will match the workforce's output with its capability.
- Measures of success: Increase deployable readiness, create a problem solving culture, reduce absenteeism, and increase individual productivity.

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 2017 goals for inventory accuracy were: 99 percent for items in the high dollar strata (Category A) and 95 percent for the remaining three strata.

INVENTORY ACCURACY: % Accuracy of Inventory Records



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 2017 performance sample inventory shows that the goals were met or exceeded in all inventory accuracy categories. In FY 2017, DLA Distribution continued an aggressive schedule for the conduct of

sample inventories for all categories of materiel at each of its Distribution Centers. Further, DLA Distribution is providing continuous training in the related distribution responsibilities and processes.

Workload Processing: DLA Distribution strives to continuously maintain performance of key indicators, utilizing the least amount of resources to provide the best value to our customers. Our receipt, issue and denial rate performance can be viewed on the next pages:

Performance Indicators	FY 2017 Goal (Average Days or Hours)	FY 2017 Actual (Average Days or Hours)
RECEIPT INDUCTION:		
• New Procurement Tailgate to Induction	24 hours	12.32 hours
• Customers Returns Tailgate to Induction	120 hours	53.58 hours
• RDOs Tailgate to Induction	48 hours	35.63 hours
• STOs Tailgate to Induction	48 hours	22.25 hours
RECEIPT STOW:		
• New Procurement Induction to Stow	7 days	2.28 days
• Customers Returns Induction to Stow	10 days	5.87 days
• RDOs Induction to Stow	10 days	4.26 days
• STOs Induction to Stow	10 days	3.48 days
ISSUES:		
• High Priority Requisitions	1 day	1.02 days
• Routine Requisitions	3 days	1.83 days
• Routine Military Service Redistributions	3 days	2.37 days
• Routine DLA Redistributions	5 days	2.51 days
• Dedicated Truck (percent shipped by Next Scheduled Departure Date)	85%	87.71%
DENIALS:		
Denial Rate: percentage of issues unavailable for orders due to material shortage against the total number of issues made.	0.45%	0.35%

DLA Disposition Services Overview



15 Countries ... 42 States ... 103 Locations

DLA Disposition Services

DLA Disposition is located in Battle Creek, Michigan. Its mission includes receiving excess, obsolete, and unserviceable (EOU), DoD property, providing ultimate disposition through business process, which include reutilization, transfer, donation, and sales. In FY 2017, DLA Disposition Services received an estimated \$29 billion of EOU inventory, \$1.4 billion was reutilized back within DoD as cost avoidance. DLA Disposition Services Sales business processes generated approximately \$119.0 million of revenue in FY 2017 offsetting operational costs.

Mission

Provide effective and efficient global solutions to the Warfighters and our other valued customers.

Strategic Goals

As we look to the future, we will continued to align our efforts and help achieve DLA's mission, strategic goals and objectives as stated in the DLA Disposition Services FY 2017 AOP. In order to ensure alignment, the Disposal Services Directors developed action based, annual plans that were tailored to the tactical level (Area Manager/Site Lead) and incorporated the dynamics of their operating environment. The plans included specific, measurable actions that address implementation of standardization, desk top guides, production efficiencies, customer training/engagement and improving culture. Plans were briefed during the Senior Leadership Summit in October 2016 and tracked quarterly through FY 2017. Our plan was established with high marks in order to meet the challenging year. FY 2018 will have continuation of some efforts in the prior year, and some new efforts we are prepared to conquer. We will continue to align our efforts and help achieve DLA's mission, strategic goals and objectives as stated in the DLA Director's Strategic Plan.

Program Initiatives and Accomplishments

Warfighter First

Joint Force Integrated Expeditionary Capability: In accordance with the DLA Director's Strategic Plan to enhance the DLA Rapid Deployment Initiative, as well as be able to respond to Global Response Force and Homeland Defense /Defense Support of Civil Authorities) requirements, DLA Disposition Services continues to refine and upgrade its Joint Force Integrated expeditionary capabilities. An expeditionary force, consisting of 290 required military reservists and 133 designated Expeditionary Civilians – Emergency Essential personnel, provided the nucleus to deploy and employ Disposition Services capabilities across the full spectrum of military operations. The expeditionary force includes standardized expeditionary equipment sets with additional equipment augmentation as mission requires, coordinated and oversaw the execution of operational contract to best deliver property disposal and customer support during military operations.

Expeditionary Exercises: DLA Disposition Services continued to refine its expeditionary capabilities. This effort is centered on staffing, equipping, and training an integrated and ready expeditionary force that best supports current and future contingency operational requirements. A key component to achieving and maintaining this capability was through exercising the expeditionary force. DLA Disposition Services conducted its fourth annual Oversees Contingency Readiness Training (OCORT) field exercise in June 2017, the capstone of the expeditionary force-training continuum. OCORT has evolved from round robin, instructor led training to a live field exercise that supports customers in Michigan. This year, OCORT teamed with the joint exercise Turbo Distribution (TD), which tested joint port opening capabilities at Battle Creek Air National Guard Base, deploying personnel, equipment, and cargo in support of an overseas military operation. The DLA Rapid Deployment Team (RDT)-Gold, with follow on DLA Support Team (cells), DLA Distribution Deployable Depot, and DLA J631 Contingency Information Technology Support

Teams also participated in TD and OCORT. This is a major step towards DLA exercising an agency expeditionary workforce with respective functional capabilities, and furthers the DLA Director's Rapid Deployment Initiative delivering integrated and responsive enterprise support to combatant commands and warfighters employed in military operations.

Network Optimization: : The effort is designed to increase the effectiveness, efficiency, and resources required to properly execute the property disposal process, while simultaneously optimizing and standardizing the customer experience. Analysis was accomplished through identification of site locations, suite of services per location, and transportation networks to support the revised network. This effort is working in conjunction with other efforts, such as full time employee management plans, Distribution/Disposition Services Consolidation efforts, process standardization, and inventory management.

DLA Disposition Services Network Optimization team completed initial CONUS network optimization analysis and planning in FY 2016. Implementation of Phase I human capital assessment was completed in April 2017. Phase II, the strategic realignment of the work load, human capital and resources began in July 2017. The transition will be performed over four sub phases with a completion date of October 1, 2018.

CRM: In FY 2016 DLA Disposition Services developed a monthly customer survey process. We set a goal to maintain a 90 percent customer satisfaction rate and 16 percent response rate. In FY 2017, the Customer Engagement Strategy (CES) was expanded to include documentation of G15 level and higher customer visits. The results for FY 2017 are:

- The customer satisfaction rate ended with an overall satisfaction rate of 93 percent, consistently exceeding the 90 percent goal each month.
- The survey response rate ended with an overall response rate of 18 percent, well above the 16 percent goal.

Support Army Divestiture: As the Army continues to draw down to a force structure of 980,000 Soldiers, reducing excess inventory has been a primary initiative. DLA Disposition Services continues to support numerous divestiture efforts in 2017 by disposing of excess property, which included Army Materiel Command's Continuous Reduction of Army Property (excess supply depot inventory of mostly Class VII major end items), Depot Disposals of Army Secondary Items, and final Unit Reuse and Equipping Working Group surge efforts at major Army installations. Additionally, Army Divestiture included Legacy High Mobility Multi-Purpose Wheeled Vehicles (HMMWVs) Divestiture, disposal of 60,000 excess weapons at Anniston Army Depot - all while continuing disposal processing for other Master Divestiture List items and routine attrition of property.

From the legacy HMMWV divestiture, over 8,867 HMMWVs have been divested since April 26, 2016, with the majority being disposed through DLA Disposition Services. As of September 30, 2017, only 282 legacy HMMWVs remain to be divested. The Army is also working towards the divestment of 25,334 legacy radios and 12,351 (DEMIL C and D) Movement Tracking Systems; as of September 30, 2017, 2,968 legacy radios and 5045 Movement Tracking Systems remain to be divested.

Strategic Engagement

Law Enforcement Support Office (LESO): LESO conducts program management on behalf of OSD, as delegated by DLA in accordance with (IAW) Section 1033 of the FY 1997 National Defense Authorization Act and 10 United States Code 2676a. LESO transfers excess DoD personal property to Law Enforcement Agencies (LEAs), with a priority to counter-drug and counterterrorism agencies in coordination with the Office of National Drug Control Policy, OSD, Department of Justice and additional regulatory guidance defined in the Defense Materiel Disposition Manual (DoD 4160.21-M).

LESO Customer Support-Strategic Partnerships: LESO transferred \$370.0 million (original acquisition value) of property to LEAs, comprised of 18,851 line items. This total increased from the prior fiscal year by 16 percent in acquisition value and 13 percent in requisitions. LESO briefed at the Police Securities Expo, Airborne Law Enforcement Association, and the National Tactical Officers Association to share information about the LESO program, the rules, and knowledge of potential excess property. This has had a positive impact on the abilities of the law enforcement community to requisition and properly maintain property through the program.

LESO Program Compliance-Property Accountability: Program Compliance Reviews are a regulatory requirement conducted biannually for each participating state (50), territory (3), and the District of Columbia. LESO conducted 16 reviews in FY 2017.

Financial Stewardship

Price Reductions in Awarded Contracts: DLA Disposition Services substantially revamped the Contract Line Item Number structure for HW disposal contracts. The resultant contracts paralleled commercial practices by providing better-detailed waste descriptions and pricing per container size, rather than pounds. This reflected the true HW treatment and disposal market, reducing risk to the Contractor without transferring risk to the customer, generating more interest and competition in solicitations, and ultimately reducing disposal costs to the warfighter.

Improved Acquisition Execution: Small Business goal achievement is a priority of Disposition Services; we exceeded the Small Business goal of 53.90 percent by over 8 percent. During FY 2017, 91 percent of solicitations issued for long term contracts were set aside for small business. This dedication to maximize support to small business will continue to produce favorable results for the next five years.

Usable Property Sales Term Contract: In 2014, CONUS usable property was split into two separate commodity streams to better align with industry and maximize revenue. The Commercial Venture 4 Rolling Stock (CV4R) contract manages the sale of rolling stock property. The rolling stock contract provides Disposition Services with 75.29 percent of the gross sales proceeds once the contractor re-sells the property. The contract consistently returns revenue 400 percent greater than previous contracts. Strict national security measures are in place for these contracts prior to releasing property to the public. All property controlled or expected to be controlled is added to a "Do Not Sell" list. This list is provided to the contractors so they can systemically remove property from their marketing website or retrieve items in their inventory for return to DLA Disposition Services. In addition, DLA Disposition Services has usable sales in both Europe and Pacific regions. In total, the FY 2017 worldwide sales revenue was approximately \$119 million, of which the CV4R contract contributed \$55 million.

Process Excellence

Targeted Program Oversight: DLA Disposition Services has a rigorous Compliance Assistance Program designed to evaluate the effectiveness and compliance with existing regulations and policy. This ensures our internal controls are in place and working, and identifies areas in need of improvement or controls. The

program consists of Self-Assessments (SA) and Effectiveness Reviews (ER). Each level of oversight has specific elements designed to provide a comprehensive review:

- **SAs:** SAs are completed twice annually, (192 assessments) to assess on performance against specific regulations. Through sampling and review of documentation and inventory, SA results provide management a measure of overall compliance with existing regulations and procedures. SAs also provide a learning opportunity by requiring self-conducted compliance checks on those areas considered most important to DLA Disposition Services.
- **ERs:** ERs are independent reviews of field sites' effectiveness and compliance with existing operational and environmental regulations and policies. The reviews are tailored to focus on specific DLA Disposition Services performance areas and provide a comprehensive evaluation by reviewing processes, documentation, and inventory. Sites receiving ERs are provided minimal advance notice in order to provide DLA Disposition Services a better indicator of compliance and sustained performance. Baseline ERs are also conducted at sites that have new leadership. ER Teams are comprised of personnel from DLA Headquarters, Disposition Services, and field sites. At the conclusion of each ER, an Out-Brief provides the results, impact, and recommended corrective actions to the DLA Disposition leadership. These out-briefs provided visibility of significant issues early in the assessment process ensuring expeditious resolution. In FY 2017, DLA Disposition Services conducted 26 ERs and follow-up reviews at 17 initial visits, 5 no notice and 4 follow up visits to sites that did not meet standards during the initial ER.
- **Standardization Working Group:** Office-level Standard Operating Procedures (oSOP) documents local processes including systematic procedures for carrying out a specific DLA Instruction. These documents detail routine or repetitive activities by an office, section, division, warehouse, etc. The number of oSOP's approved in FY 2017 was 33 with another 44 being finalized.
- **Controlled Property Verification Office (CPVO):** The CPVO maintains oversight of the DLA Disposition Services' Nuclear Weapons Related Material (NWRM)/Nuclear Enterprise (NE) Programs, Local Stock Number (LSN) Verification processes, and continually refines their internal processes designed to review items turned in to the DLA Disposition Services through a multi-pronged series of evaluations that begins at initial receipt and concludes just prior to the sales contractor placing the item up for auction. On a weekly basis, the CPVO provides the DoD Demilitarization (DEMIL) Coding Management Office (DDCMO) all National Stock Numbers (NSNs) that have been received into the DLA Disposition Services' network with a DEMIL Code of B or Q to validate the assigned Federal Logistics Information System (FLIS) DEMIL code. This DEMIL Verification at Receipt (DVR), as it is known, resulted in the evaluation of almost ten thousand NSNs by the DDCMO and effected change to 8,621 NSNs (87.00 percent). The CPVO further reviewed approximately 1.5 million NSNs at receipt and submitted 9,545 DEMIL code challenges to the DDCMO with an approval rate of 99.08 percent resulting in 9,458 DEMIL code changes in FLIS. The CPVO evaluates all usable sales delivery orders, worldwide, on a weekly basis to identify and remove controlled/restricted property. The CPVO analyzed over 240K items and removed 3,572 controlled items from the Sales process prior to transfer to the Sales contractors. As a final safeguard to mitigate the risk of inadvertently releasing controlled property to the public, the CPVO conducts a review of the sales partner's inventory just prior to being offered to the public via a process referred to as the Q-Tool. The CPVO reviewed over 500 thousand NSNs and over 100 thousand LSNs in the Q-Tool resulting in identification and return of 536 controlled/restricted items including 135 recoupments of NE assets and 85 HMMWVs that required key points removed such as antenna mounts, deep water fording kits and armored doors. The CPVO maintains several

automated research applications and EBS business rules that identify controlled property for all Disposition Services field sites. These applications include the Controlled Property Research Tool, and the Do Not Sell List, which is distributed to the sales contractors to establish and maintain their own internal quality assurance processes to prevent the release of controlled property to the public.

- **Local Stock Number (LSN) Verification:** DLA Disposition Services conducted LSN verification at 14 sites primarily to mitigate the risk of inadvertently releasing/mishandling controlled property in the sales process. LSN verification also aids the Reutilization program when the LSN is researched and re-identified to a valid NSN. Analysis indicates that an NSN is 500 percent more likely to be effectively reutilized than if the item remained as an LSN. In FY 2017, the sites performing LSN verification reviewed over 38.5 thousand lines of property that had been turned in to DLA Disposition Services as an LSN and cross-referenced 1,560 lines to valid NSNs. Analysis of these cross-referenced NSNs indicates that 817 lines of property were ineligible for release outside of DoD.
- **Nuclear Weapons Related Material (NWRM):** DLA Disposition Services is responsible for the identification and management of NWRM and other controlled property categories including, but not limited to, F-14 components, body armor, military camouflage clothing and controlled laboratory equipment. During FY 2017, DLA Disposition Services J-312 conducted five NWRM tests with the intent of assessing the DLA Disposition Services NWRM receipt procedures from physical receipt and induction to the Commander's Critical Incident Reporting requirements. All tests were resolved successfully and resulted in only minor improvements to the NWRM oSOP. Additionally, a Request for Change to the Distribution Standard System (DSS) was created to improve NWRM notifications during the DSS query process. Once implemented, this RFC will incorporate improvements that include dual verification requirement, banner messages that clearly identify an NWRM has been received/researched, and email notifications to the DLA Disposition Services NWRM team when an NWRM NSN is queried in DSS. These changes significantly enhance the existing DSS and EBS business rules, email notification process and messages already applied to every receipt at DLA Disposition Services.
- **Research and Development:** DLA Disposition Services developed a SOP for its Research and Development Program that is linked to Defense Logistics Agency J6 program in 2017. Disposition Services completed three Small Business Innovation Research projects this year in conjunction with DLA J3 and J6 program managers. These initiatives focused on warehouse safety, improved warehouse operations, and optimization of DLA Disposition Services, Representatives, in the field.
- **CPI:** Disposition Services CPI program energized CPI and Lean Six Sigma programs, both at HQ and at field sites, across the Enterprise. Disposition Services developed a sustainable CPI program with the assistance of trained Master Black Belt, Black Belts, and Green Belts to support and mentor CPI projects and events. CPI projects approved in FY 2017 include the 2-Step "Put-Away" process and containerization for stowing, Photos at Receiving and Indexing for Reutilization, Transfer, Donation and Sales, Customer Wait Time. Additionally, a series of site optimization projects helped Disposition Services realize increased efficiency in its receiving and warehousing operations.

Program Performance Indicators

Reutilization/Transfer/Donation (R/T/D): Number of items reutilized, transferred, and donated measures RTD performance. The indicator applies to the available assets that are economically reused. R/T/D 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 2017, DLA Disposition Services successfully reutilized, transferred or donated over 187 thousand line items of excess property; valued at over \$2.5 billion.

Humanitarian Assistance/Disaster Relief: DLA Disposition Services supported humanitarian assistance and disasters at home and abroad. In FY 2017, DLA Disposition Services issued 401 line items with a value of \$9.1 million to DOD Humanitarian Assistance Program, and 4,131 line items with a value of over \$38.2 million to the U.S. Agency for International Development, and provided 292 line items with a value of \$16.3 million in support to Hurricanes Harvey and Irma.

DLA Information Operations Document Services Overview



DLA Information Operations Document Services

DLA Information Operations Document Services 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. DLA Information Operations Document Services provides time sensitive, competitively priced, high quality products and services that are either produced in-house or procured commercially. DLA Information Operations Document Services manages its mission through a headquarters, located in New Cumberland, PA, and a worldwide network of 132 production facilities. During FY 2017, DLA Information Operations Document Services earned \$165.9 million in revenue and employed 592 civilians at year-end. Major customers were: Navy/Marines (37.07 percent), Defense Agencies (32.44 percent), Army (17.62 percent), Air Force (12.17 percent) and non- DoD customers (0.69 percent).

Mission

The mission of DLA Information Operations Document Services is to provide best value document automation and management services in support of America's Armed Forces and Federal Agencies. DLA Information Operations Document Services' value to DoD is characterized by two elements. First, DLA Information Operations Document Services 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, DLA Information Operations Document Services 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

DLA Information Operations Document Services 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 business relationships with government, industry, and suppliers;
- Ensuring DLA Information Operations Document Services workforce is enabled to deliver and sustain world- class performance;
- Striving to reduce costs, simplify organizational structure, eliminate unnecessary facilities, and ensure that equipment and personnel are commensurate with workload; and,
- Aligning processes to focus on improving the quality of products and services while meeting or exceeding customers' delivery requirements.

Program Initiatives and Accomplishments

DLA Information Operations Document Services is teaming with DLA Aviation, DLA Distribution and National Geospatial-Intelligence Agency (NGA) to establish a New Model for Map Support Office (MSO) at Naval Air Station North Island, San Diego. The new model will be patterned after the Ft. Bragg model that is already in operation. To support the DOD map mission, DLA is establishing a new model of MSO for the customer mission, including critical deployment requirements, contingency stock, and customer training in support of the various Navy and Marine commands located on the West Coast. The new model will ensure that shelf stock will exactly compliment maps available from print-on-demand.

DLA Information Operations Document Services began Phase III of its partnership with National NGA. Phase III of the implementation commenced in June 2016 and involves the partnership between NGA and the Department of Transportation Federal Aviation Administration (FAA). NGA will be taking the

responsibility for the FAA National Aeronautical Navigation Products (FAA/AeroNav) products. This includes Visual Flight Rules and Instrument Flight Rules (IFR) charting products, Airport/Facility Directory all of which are critical to the safety of air navigation. The majority of the products are critical to flight safety, and are time-sensitive in accordance with the international Aeronautical Information Regulation and Control cycle. DLA Information Operations Document Services will accomplish this workload using a combination of in-house capability and contract support. The transition of the first of three contracts to DLA Document Services is scheduled to be accomplished by December 2019. The remaining two contracts will be completed by December 2021.

DLA Information Operations Document Services entered final phase of scanning for detainee records. We are working on a multiyear project to create a digital, indexed source of intelligence records for the U.S. Army Office of the Provost Marshal General (OPMG). We are also scanning and storing the 10-12 million pages for records from Operation Enduring Freedom, Operation Iraqi Freedom, and Guantanamo Bay, Cuba. Converting these records to digital format will help OPMG maintain accountability and availability of the records. As the records are scanned and stored, DLA Information Operations Document Services is conducting a 100 percent quality review of all records to ensure accuracy, completeness, readable resolution, and accurate cross-referencing, and has secured handling of the documents.

DLA Information Operations Document Services successfully completed the fourth year of end of year output for the DFAS. We printed the entire workload of tax related documents to include W-2s, the Retiree Account Statements (RAS), the Annuitant Account Statements, and Affordable Care Act (ACA) Statements for all military/civilian employees both active and retired. This was produced on a very aggressive schedule, as we were challenged to complete over 20 million units within 60 days, December through January.

DLA Information Operations Document Services exceeded expectations of DoD CIO Office during output for Office of Personnel Management (OPM) Breach Notification Letters when completing over 20.1 million letters back in 2015. Since that timeframe, DoD CIO Office has reached out to reproduce additional letters that pertain to breaches regarding personnel records and background investigation records, personnel affected by these breaches have ten years to request additional information.

Program Performance Indicators

Quality of Products and Services: This performance metric measures customer satisfaction with quality of finished product as a percentage of customers ranking DLA Information Operations Document Services quality performance as “satisfied” or “very satisfied.” We used a survey, professionally prepared and administered by an independent entity, to determine quality of finished product rating. This survey was not conducted in FY 2017, but the same or similar survey method will be used in FY 2018. In FY 2017, quality of products and services was measured by customer’s feedback to management as well as our customer kudos.

Customer Satisfaction: This performance metric measures customer satisfaction as the percentage of customers ranking DLA Information Operations Document Services performance as “satisfied” or “very satisfied.” We used a survey, professionally prepared and administered by an independent entity, to determine an overall customer satisfaction rating. This survey was not conducted in FY 2017 but the same or similar survey method will be used in FY 2018. In FY 2017, customer satisfactions was measured by customer’s feedback to management as well as our customer kudos.

DLA Energy Overview



DLA Energy

DLA Energy is organized to work with customers and suppliers to accomplish all areas of its mission. Bulk Petroleum Products and Bulk Petroleum Supply Chain Services provide procurement and distribution of military specification petroleum products, the majority of DLA Energy's business. Direct Delivery Fuels manages commercial fuels that are delivered directly from the contractor to the customer. Defense Fuel Support Point Management manages fuel terminal and storage operations, including government-owned, contractor-operated and contractor-owned, contractor-operated facilities.

Outside of petroleum, installation energy provides support for natural gas, coal, renewable energy, electricity and energy savings performance contracts. Utility services manages the utility services contracting mission supporting the utility privatization programs of service partners. The Aerospace Energy Business Unit provides propellants, cryogenics and gases in support of weapon systems and space programs. Quality and technical support energy business unit provides quality assurance over the life-cycle for petroleum and aerospace products and services.

Mission

The mission of DLA Energy is to provide the DoD and other government agencies with comprehensive energy solutions in the most effective and efficient manner possible.

Strategic Goals

As an organization, DLA Energy continues to evolve, improve, and expand its business scope and reach. DLA Energy continues to introduce new concepts that will drive organizational and strategic transformation, modernization, and resiliency. This is critical in order to sustain our position as DoD's go-to source for innovative energy solutions.

DLA Energy's strategic priorities are directly aligned with and support the five goal areas of the DLA Director's Strategic Plan -Warfighter First, People and Culture, Strategic Engagement, Financial Stewardship, and Process Excellence. Through established goals and objectives, we will continue to assess developing capabilities and technologies; strengthen and optimize our supply chain through collaborative and committed partnerships with our customers; and lower long-term warfighter risk by ensuring reliable, effective, and efficient solutions.

Program Initiatives and Accomplishments

DLA Energy had approximately \$9.5 billion in sales and issued a total of 4.1 billion gallons of fuel in FY 2017. DLA Energy accomplished the following:

- Develop a Global Petroleum Distribution Plan that will assist the joint petroleum community in prioritizing resources to modify the petroleum distribution supply chain.
- Completed control testing, appraised DLA Energy's Process Cycle Memorandums (PCMs), complied with IPA's requests, and conducted Audit Readiness site visits.
- Published Change 1 to the MIL-STD-3004D (DoD Standard Practice Quality Assurance/Surveillance for Fuels, Lubricants and Related Products). The document provides guidance for quality requirements to assure product arrives to our customer on specification.
- Completed Phase I of the National Jet Fuels Combustion Program (NJFCP) with partial R&D funding and program management assistance from DLA Energy's Energy Readiness Program (ERP). The NJFCP is a Federal Aviation Administration led interagency and commercial industry group which aims to develop combustion models to reduce expense, time and alternative fuel volume requirements.
- Managed 15 million Megawatts of electricity valued at over \$900 million under contracts at

multiple locations providing customers with an estimated savings of more than \$300 million annually.

- Expanded renewables solutions; awarded the Army's first hybrid renewable energy contract for Fort Hood, Texas. The project will provide the installation with 65 Megawatts of alternating current from an on-site solar system and an off-site wind facility.
- Awarded the largest Energy Savings Performance Contract for the Oklahoma City Air Logistics Complex at Tinker Air Force Base. The \$243 million facility modernization project will save at least \$20 million annually in energy and operational costs over the 25-year life of the contract.

DLA Land and Maritime Overview



DLA Land and Maritime

DLA Land and Maritime is the headquarters for DLA's Land and Maritime Supply Chains with over 2,500 employees in more than 30 locations around the world. It manages 1.9 million items, and supports more than 13,000 customers throughout the military services, civil agencies and other DoD organizations. DLA Land and Maritime awards nearly 550,000 contracts annually, supports more than 2,000 weapon systems, and handles 9 million orders annually, with FY 2016 sales topping \$3.4 billion.

The DSCC installation operated by DLA Land and Maritime and DLA Installation Support Columbus leverages the resources of state, federal and defense organizations such as the Ohio National Guard, the Veterans Administration Clinic, and the DFAS, which are collocated on or near the site. DSCC installation activities focused on sustained and timely warfighter support, strategic engagement and workforce development throughout FY 2017 to provide supply chain logistics excellence.

DLA Land and Maritime's mission is to provide worldwide logistical support to its customers - the Military Services. Land and Maritime directly supports Navy Surface and Subsurface, and Army and Marine Corps customers through dedicated customer relations while working with numerous suppliers to fulfill requirements for assigned stock classes across the DoD. Furthermore, DLA Land and Maritime provides logistical services directly to Navy shipyards and Army/USMC industrial sites.

DLA Land and Maritime continues to demonstrate its enviable operational capability as it pushed its myriad performance benchmarks even higher relative to other DLA field activities. While incorporating the strategic guidance from the DLA Director, Land and Maritime's performance metrics validated the organization's total commitment to its Warfighter support mission.

The successful accomplishment of this mission requires a well-trained, diverse workforce and a professional culture that supports high expectations.

Mission

To provide effective and efficient global solutions to Warfighters and our other valued customers.

Strategic Goals

The overall goal of DLA Land and Maritime is to provide world class support to our military and other customers in a fiscally responsible manner while maintaining a sharp focus on the culture and development of our associates. DLA Land and Maritime reflects these ideals by giving top priority to the Warfighter. Focus is placed on providing a more robust menu of services and streamlined processes to do so in a more efficient manner, all while achieving programmed cost and Full Time Equivalent (FTE) savings across the Future Years Development Plan.

- **Warfighter First:** DLA Land and Maritime provides a continuous focus on the Warfighter, which is evident in the close relationships we have fostered with our Military Services. We continue to mature those relationships, with a focus on innovation, collaboration and responsiveness. Our operating plan covers a full spectrum of support initiatives that address the needs of Warfighters – within operational units, at the weapons system support level and those at the industrial depots. We develop and refine tools that allow us to better anticipate, assess, and meet current and future Warfighter requirements, improve collaboration with our customers at all levels, and positively impact their mission readiness.
- **People and Culture:** Teamwork and commitment to our customers, our Agency and ourselves is embedded in the culture within DLA Land and Maritime. The continued development of this world

class workforce will be based on mentoring, training, job enrichment, and health and wellness opportunities offered throughout the year.

- **Strategic Engagement:** The tenets of Better Buying Power encourage collaboration with industry to identify and integrate innovative solutions into Government practices. DLA Land and Maritime will continue to foster strategic relationships with industry through Captains of Industry (COI) forums; Training, Knowledge, Opportunities seminars; and other vendor outreach events. Leveraging strategic relationships to maintain a responsive, agile and viable industrial base is vital to DLA Land and Maritime's continued success of providing world class customer support.
- **Financial Stewardship:** DLA Land and Maritime executes 100 percent of the annual operating budget judiciously. FTE management will be a crucial component to right-sizing the workforce to accomplish vital business events. Complete and proper utilization of materiel and operations authority will satisfy customer requirements while maintaining critical financial metrics such as net operating result (NOR), cash and inventory levels leading DLA Land and Maritime to an auditable environment.
- **Process Excellence:** Audit Readiness highlighted the importance of well-defined and documented processes throughout every aspect of the organization. DLA Land and Maritime continues its journey toward Process Excellence by empowering the workforce to develop more efficient and effective methods of providing warfighter support.

Program Initiatives and Accomplishments

Warfighter First

Forward Stocking. DLA Land and Maritime works with Military Services' counterparts to re-examine forward stocking for critical weapon systems (e.g. Patriot or Terminal High Altitude Area Defense) or systems that have increased theater footprint and achieve greater than 85 percent fill rates for the expanded forward stocking objectives.

DLA Land and Maritime continues sustainment of 100 percent stock on-hand for ballistic missile defense, patrol craft and mine countermeasure forward stocking NIIN.

DLA Land and Maritime is expected to identify additional forward stocking items for existing critical weapons systems and new weapons systems by the end of FY 2017 and meet fill rate objectives.

Retail Integration. DLA Land and Maritime continues to refine retail processes and offer targeted solutions to better support industrial customers. DLA Land and Maritime dedicates people, processes, and tools to create retail efficiencies, refine metrics, and support customer outcomes to include order response time.

DLA Land and Maritime actively participates in the DLA Headquarters sponsored Semi-Annual Total Retail Sustainment Review (STAR) to address strategic, operational, and tactical issues at our retail sites.

Through STAR, DLA Land and Maritime is expected to enhance the understanding of retail processes and incorporate best practices at five retail locations to improve customer support. DLA Land and Maritime is also expected to identify gaps and seams in existing distribution, planning, order fulfillment, procurement, and technical/quality processes.

Nuclear Enterprise. In support of DLA's Nuclear Enterprise Lines of Effort, DLA Land and Maritime will fully implement the Director's Intent & Guidance by resourcing, organizing and executing all tasks as described in the Nuclear Enterprise Operation Order (OPORD). DLA Land and Maritime will remain

committed to enhanced Nuclear Enterprise support and fully responsive to the Nuclear Enterprise customer material requirements.

DLA Land and Maritime is expected to meet or exceed current performance based agreements (PBA) MA targets for the Navy Nuclear Enterprise (21N, 02N, 23N), execute and track all targeted Nuclear Enterprise investments, and comply with the Nuclear Enterprise OPORD.

People and Culture

Workforce Competencies. Through the People and Culture Directorate partnered with J1, J3, J7 and Functional Community Managers DLA Land and Maritime works to foster a DLA workforce that demonstrates the competencies needed to meet current mission requirements and is engaged in professional development to meet future challenges.

DAWIA, Lifecycle Logistics, and Continuous Learning Points (CLP) completions are being tracked through collaboration with Directorates. Partnerships with the Training Council and Executive Training Committee, and the use of employees Individual Development Plans (IDP) will define and project future workforce competency training requirements.

DLA Land and Maritime is expected to have 90 percent of the workforce in credentialed positions compliant or on track with mandatory certification requirements along with 95 percent of IDPs approved.

Leader Competencies. Through the People and Culture Directorate partnered with DLA J1, DLA Land and Maritime defines, administers, coordinates, and recommends opportunities to bolster leadership competencies. The focus is managing in a modern, diverse workplace environment. These opportunities inform each supervisor IDPs, vertically create a Directorate plan for areas of improvement, and create a horizontal plan for DLA Land and Maritime leadership that is used to strengthen competencies throughout the organization.

DLA Land and Maritime is expected to have supervisors and managers complete 90 percent of CLP requirements for professional development to meet current and future challenges.

Diversity and Inclusion. DLA Land and Maritime leverages our Diversity through strong Equal Employment Opportunity (EEO) Special Emphasis Programs and inclusionary management behavior and practices. DLA Land and Maritime trains the workforce on EEO, Diversity, Inclusion, and Reasonable Accommodations to consciously foster a cohesive, tolerant and resilient workforce.

DLA Land and Maritime offers Alternative Dispute Resolution 100 percent of the time to resolve employment disputes. DLA Land and Maritime processes formal EEO discrimination complaints on average under the 180 day statutory timeline and under 360 days when an amendment is made to a formal complaint.

DLA Land and Maritime is expected to increase diversity in at least two of our underrepresented categories and process EEO discrimination complaints on time 95 percent of the time.

Strategic Engagement

Performance Based Logistics (PBL). DLA Land and Maritime developed a plan for implementing performance-based strategic initiatives and executed the plan according to established acquisition milestones. DLA Land and Maritime Identified critical sub-systems or components and spare/repair item groups that may have PBL, Performance Based Agreement, or Long Term Contract (LTC) potential in new

weapons systems.

DLA Land and Maritime explored collaboration opportunities in Navy, Army and United States Marine Corps (USMC) PBLs, including exploration of opportunities to enter life cycle processes before the sustainment phase.

DLA Land and Maritime is expected to utilize COI and other venues to finalize three to five business relationships with Acquisition Category and/or sole source original equipment manufacturer programs to add PBL like features into contracts by December 2017.

Process Excellence

CPI: DLA Land and Maritime increased the maturity of the CPI program by adhering to our robust idea generation, control compliance and governance plan. DLA Land and Maritime coached and trained newly certified Green Belts across DLA Land and Maritime organization. DLA Land and Maritime continues to support and lead enterprise initiatives.

DLA Land and Maritime participates in the enterprise CPI community and adopts best practices from CPI offices around the agency. DLA Land and Maritime provides tracking and increases the number of local projects in the CPI administrative project and event repository. DLA Land and Maritime is achieving the FY 2017 enterprise-wide CPI metrics by continued consolidated program management.

DLA Land and Maritime is expected to hold at least one internal Green Belt training and certify at least 10 additional Green Belts, complete at least 12 local lead projects, and achieve DLA HQ CPI metrics.

Program Performance Indicators

Important Program Performance Indicators for DLA Land and Maritime are provided below:

MA measures the immediate availability of DLA Land and Maritime managed material, both that are stocked by and shipped through the DLA Distribution Depots, as well as that are provided by partnerships with suppliers/vendors through long-term contracts and prime vendor arrangements. MA is a legacy metric (formerly called Supply Availability) traditionally of interest to customers. MA is reported as a percentage of orders that are issued at the time of receipt as compared to the total number of orders received in the given time period. The DLA Land and Maritime goal for MA is 90 percent.

Total and Aged Backorders reflects gaps in DLA Land and Maritime's ability to fill or satisfy customer order requirements in a timely manner. Backorders, Actionable Backorders, and Actionable Unfilled Orders are generally synonymous terms that have been used to describe the same population over time. Unfilled Orders (UFOs) may be used to describe a larger set of orders, all orders in a BB, BV, BZ, or BD status, regardless of "actionable" status. The total number of all Backorders, the number of Backorders that are currently over 180 days in age (i.e., aged Backorders), and the number of Backorders that are currently over three years old are tracked and evaluated. Because Backorders create a failure in material support, MA and BOs are typically tracked and reported in tandem.

On-Hand Purchase Request (PR) Aging measures the age of all open PRs from the date they were created and as compared a goal of 50 to 65 days for small PRs and 175 to 190 days for large PRs. Automated Award percentages, Long Term Contract Utilization, and Time to Award are all Procurement-related metrics tracked in the monthly Agency Performance Review.

On-Time Delivery (OTD) measures Purchase Orders that have matured past the Contract Delivery Date without delivery to the customer. This impacts the ability of the Agency to respond timely to demands. OTD is critical to the effectiveness of the planning process. If Contract Delivery Dates provided in the system are unreliable, stock levels will not be optimized leading to the inefficient use of Obligation Authority. DLA Land and Maritime's goal for OTD is 93 percent, which leads the DLA.

Long Term Contracts (LTCs) Administration: LTCs provide efficiencies that reduce buyer workload. More specifically, if constructed and administrated appropriately, they reduce administrative burden, which decreases Production Lead Times. The metric currently used is LTC Obligation Rate.

DLA Aviation Overview



DLA Aviation

DLA Aviation, a DLA MSC, supports 2,200 weapon systems as the military's primary source for more than 1.02 million repair parts and operating supply items with FY 2017 annual sales valued at \$5.2 billion. In FY 2017, DLA Aviation's dedicated team of over 3,000 professionals served over 11,919 customers, processed over 2.9 million customer orders for all Military Services and conducted business with 4,291 suppliers.

DLA Aviation is responsible for supply at six major industrial maintenance, repair, and overhaul facilities, and for storage operations at three. Our five depot-level repairable (DLR) procurement organizations executed contract actions valued at more than \$3.3 billion.

DLA Aviation delivers unique customer support capabilities through its Industrial Plant Equipment Services (IPES/IPE) and Mapping Customer Operations Divisions. IPES operates the only industrial plant equipment management facility and maintenance depot in the Federal Government dedicated to procuring, rebuilding, retrofitting, and repairing metalworking machinery for the DoD and other Federal agencies. Mapping Customer Operations provide exceptional supply and demand chain support by providing aeronautical, digital, hydrographic, and topographic maps to geospatial intelligence customers.

Mission

DLA Aviation mission is to provide effective and efficient global airpower solutions to Warfighters and our other valued customers

Strategic Goals

DLA Director's Strategic Plan for FYs 2015-2022 contains the five goals that represent the foundational catalysts that are necessary and relevant to the Agency's mission.

- **Warfighter First:**
DLA Aviation plays a pivotal role in supporting Warfighter readiness. We pride ourselves in delivering innovative and responsive customer-focused solutions. DLA Aviation will continue to develop the close relationships it has established with the Military Services and our other customers. We will put their operational readiness concerns first through tailored weapon system product support strategies.
- **People and Culture:**
DLA Aviation is committed to hiring, developing, and retaining a high-performing, valued, resilient, and accountable workforce that delivers sustained mission excellence. We take pride in our efforts to continuously improve our culture and create a work environment where team member contributions are valued. We will empower and equip our employees with the tools they need to excel in providing world-class customer support and to balance the demands of the job with those at home.
- **Strategic Engagement:**
We will improve our performance through engagement with industry and our partners in the delivery of effective and affordable solutions. We will focus on strategic contracting and tactical multi-year contracting efforts that will improve our customer's readiness posture as well as increase Aviation's performance. We will develop innovative performance-based solutions that create synergy with our Service counterparts and incentivize industry to improve their products and service and in turn share the rewards.

- **Financial Stewardship:**

DLA Aviation is committed to continuous improvement of its core processes and enablers, covering all the processes and tools that enable us to provide the customer what it wants, when it wants it, in the right quantity, and with the right quality. DLA Aviation is constantly pursuing effectiveness and efficiency in its planning, technical/quality, procurement, order management, and CRM processes to be good stewards of tax-payer dollars.

- **Process Excellence:**

DLA Aviation views Process Excellence as a major contributor to performance. Process streamlining, process standardization, root cause analysis, and other continuous process improvement initiatives allow DLA Aviation to deliver on the promises we've made to our customers.

These goals also represent our commitment to ensuring our agility and responsiveness to the current and emerging needs and expectations of Warfighters and our other valued customers and stakeholders. DLA Aviation focuses on those key initiatives that align with and significantly contribute towards achievement of DLA's Goals and Objectives.

Program Initiatives and Accomplishments

Performance Based Agreements:

Establish, then meet or exceed all Service - DLA Performance Based Agreement (PBA) metrics requirements for FY 2017:

- In concert with J3, develop a PBA construct that shows linkages and impacts to industrial readiness outcomes (October 2016).
- Maintain communications battle rhythm with Strategic Suppliers and key Service customers to build trust and ensure transparent flow of performance end states.

Develop and pursue three to five business relationships that add PBL-like features into contracts targeting tailored service driven sustainment challenges. Specifically, in support of the KC-46, F/A-18, H-53, and F-15 Programmed Depot Maintenance (PDM). Execute contracts in accordance with program management milestones that drive to award by end of FY 2017.

Forward Stocking: Achieve 85 percent fill rate in support of the Pacific Air Forces by January 2017 and sustain that performance throughout the remainder of FY 2017. In addition, during FY17, work with Combatant Commanders, Service counterparts and the Center of Planning Excellence to re-examine forward stocking for critical weapon systems, reset allowances and execute procurement to support new levels by October 17.

Material Delay: component repair across all Military Services:

- Establish production based goals by October 2016.
- Implement action plans developed by the Navy Material Delay CPI Event in accordance with Joint Plan of Actions and Milestones (POAM).
- Drive Air Force Industrial Support Activity Material Delay CPI efforts leveraging Navy CPI outcomes and develop POAM by January 2017. Execute to POAM timelines for remainder of FY 2017.
- Measure and achieve material delay goals by the end of FY 2017.

Army Retail Support - Execute two lines of effort:

- Meet/exceed milestones to drive successful transition from Technical Engineering and Logistics Support Services to organic support by the end of FY 2017.

Implement AF IPV III - Meet milestones and ensure a smooth transition from IPV II.

DLA's Nuclear Enterprise Lines of Effort:

- Finish executing the FY 2016 Nuclear Enterprise planned investments by October 2016 while maintaining 95 percent or above Material Availability (MA) overall.
- Develop investment and execution plan to achieve 95 percent or above O1F CFM MA:
 - Execute O1F CFM MA investments according to milestones.
 - Support the PDM plan in FY 2017 by planning and executing to achieve PDM DEVPAC supportability.
 -

Climate Culture:

Develop and implement culture climate survey action plans to specifically target improving trust, transparency, communication, and performance across DLA Aviation:

- Develop plans across the enterprise by the first quarter FY 2017.
- Monitor plan execution throughout the fiscal year ended September 30, 2017.

Accomplishments:

- DLA Aviation added 20,041 NIINs to LTC during FY 2017, this projects to a \$217.3 million Savings over next five years.
- DLA Aviation's Small Business awards during FY 2017 projects to \$59.5 million Savings over next five years.
- The Aviation Strategic Sourcing Population Goal was to add 8,791 LTCs for the fiscal year. We have exceeded this goal as we achieved 12,445 total awards for the fiscal year.
- DLA Aviation made steady progress in reducing the number of PRs on Hand > 180 days. Since January 2017, we reduced small PRs in the aged category by 34 percent and large PRs by 29 percent.
- DLA Aviation reached its goal of having less than 10 percent of awards greater than 180 days, Aviation ended September at 9 percent which was fiscal year low.
- DLA Aviation obligated \$1.4 billion to small business. This is 22.9 percent of total obligations of \$6 billion.
- Contract dollars for Women-Owned Small Business (WOSB), Historically Underutilized Business, Small Disadvantaged Business and 8(a) program are the highest in five year with increased set aside dollars in all subcategories.
- Aviation achieved an average 92 percent Material Availability (MA) rate for industrial support
- Aviation produced a fiscal year average MA of 88.4 percent despite a 9 percent increase in demands. August 2017 marked an all-time high month with over 282 thousand orders.

Program Performance Indicators

The key program performance indicators described below are included as components of DLA Aviation.

Material Availability (MA) is used to identify performance issues within the logistics pipeline. As such, MA is Aviation's overarching metric. MA is used to identify the capability of DLA Aviation to immediately issue materiel, both stocked and vendor-supplied, in response to customer requisitions. MA has a direct impact on operational performance and metrics such as total and aged backorders, timeliness and inventory efficiency. MA is reported as a percent of orders that are immediately issued out of the total number of orders received in the given time period of interest. DLA Aviation's overall goal for MA 90 percent.

Total and Aged Backorders reflect gaps in our ability to fill or satisfy customer order requirements in a timely manner and are used to measure the number of orders received that have not been fulfilled by Aviation by a particular date of interest. Total Backorders are customer orders which are in a backorder status for material that Aviation can act upon to expedite the fill. There is filtering logic in place that excludes select open orders that automatically go into Unfilled Order (UFO) status as part of the process of filling the order. The total number of all Backorders, the number of Backorders that are currently over 180 days old (referred to as “aged Backorders”), and the number of Backorders that are currently over 3 years old are measured. Because backorders create a failure for MA, the two metrics are typically correlated—a high level of backorders generally corresponds to a lower MA.

On-Hand Purchase Request (PR) Aging measures the age of all open PRs from their creation date against a standard of 50 to 65 days for small PRs and 175 to 190 days for large PRs. Automated Award percentages, Long Term Contract Growth Projections, and Time to Award are all related metrics reviewed in the Agency Performance Review.

Order Response Time (ORT) measures the Supply Chain responsiveness to customer demands for DLA items. Age is determined from Julian date in Maintenance document through issue date (date stock is located on base). Any cancellations are removed from population at month end. Management objective is 92 percent of orders received in a reporting month are filled within two days.

Long Term Contracts (LTCs) Administration: LTCs are flexible vehicles that remove workload from buyers’ desks and provide documented, reduced administrative and production lead times. These reduced lead times allow Aviation to reduce inventory investments. The metric used is the LTC Obligation Rate.

DLA Troop Support Overview



DLA Troop Support

DLA Troop Support is one of six DLA MSCs, which operates five separate and distinct supply chains: Subsistence, Clothing & Textiles, Construction & Equipment, Medical, and Industrial Hardware. With FY 2017 sales of \$15.6 billion, DLA Troop Support accounts for approximately one-third of all DLA sales.

Staffing includes 2,227 civilians, 70 active duty military personnel and 55 reservists.

DLA Troop Support provides a wide variety of essential items to members of the armed forces and other federally funded agencies, including operational rations and fresh foods, utility and dress uniforms, headgear, footwear, personal protective equipment, heraldic, tents and shelters, force protection items, diving gear, safety and rescue equipment, fire and emergency services equipment, storage, heating, ventilation and air conditioning (HVAC) equipment, plumbing, heavy equipment, metals and lumber, targets for training, pharmaceuticals, medical/surgical and medical equipment items, medical capital equipment, and consumable repair parts.

Using LTCs, tailored logistics support programs, prime vendor relationships, and traditional contracts, DLA Troop Support procured over 3 million items and processed 31 million orders from about 47,000 customers in FY 2017 for Warfighters serving around the globe. The Philadelphia-based MSC also oversees two forward-based commands, DLA Troop Support Europe, Africa, and DLA Troop Support Pacific, headquartered in Germany and Hawaii respectively, as well as forward-based offices throughout the continental U.S. Through this forward presence, DLA Troop Support embeds employees in the continental U.S. and overseas with customers and key industry partners to personally ensure we meet or exceed the needs of our service members.

Mission

DLA Troop Support provides effective and efficient support to our customers and Warfighters with subsistence, clothing/textile, construction and engineer equipment, medical supply, and hardware solutions in order to allow them to achieve their global missions.

Strategic Goals

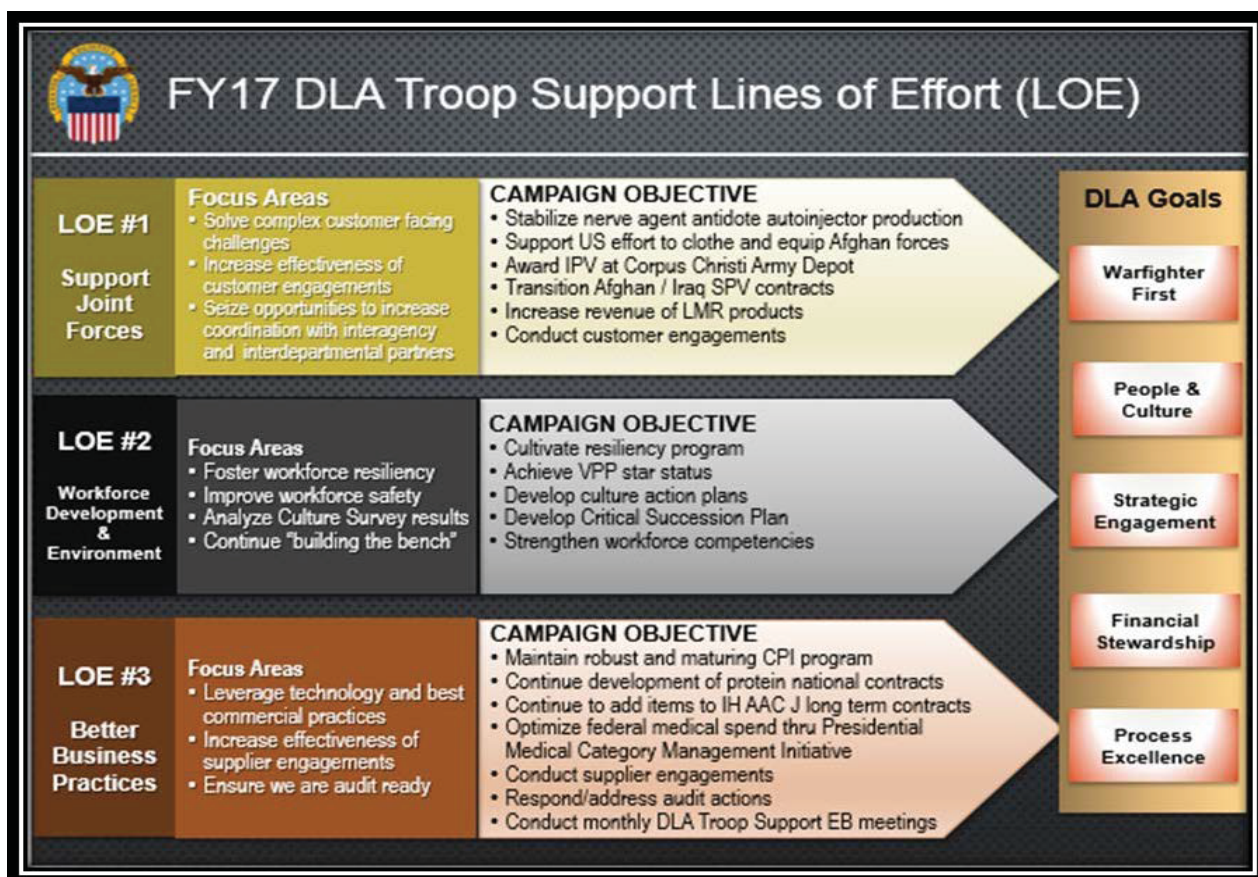
DLA Troop Support's strategic goals align with the agency's goals outlined in the DLA Strategic Plan 2015-2022.

- Warfighter First- DLA Troop Support has a number one focus of ensuring the Warfighter has everything needed to complete the mission. We strive to provide the right item and to ensure the item is received in a timely manner. We do this by remaining in constant contact with the Military Services and in consistent communication with industry. We take pride in offering the most innovative and responsive solutions for the customer.
- People and Culture- DLA Troop Support employees are the heart of the organization. We continue our commitment to hiring, developing and retaining high performing employees who are resilient and dedicated to deliver mission excellence. We foster a culture where the workforce feels valued and instrumental in the organization's overall success.
- Strategic Engagement- DLA Troop Support will continue the positive relationships with our industry partners and stakeholders. We understand that our mission cannot be accomplished without a stable and viable industry base. We are committed to working with our strategic partners to pursue innovative, effective and affordable solutions for the Warfighter and other customers.
- Financial Stewardship- DLA Troop Support highly regards our fiduciary responsibility of being good stewards of tax-payer dollars. Through continuous process improvements of our acquisition processes and standard operating procedures we will continue to find ways to provide both effective and efficient support to the Warfighter.

- Process Excellence- DLA Troop Support will build on its successes in Stewardship Excellence and Audit Readiness by instilling a culture of Process Excellence through EPM. Process Excellence means much more than just achieving a positive financial statement audit; it ensures effective and efficient outcomes to the Warfighter, the WoG and our nation. DLA Troop Support sustains Process Excellence by ensuring processes are well-documented and controlled, but also by fostering a culture of CPI.

Program Initiatives and Accomplishments

The DLA Troop Support commander's Lines of Effort reflect the local initiatives with specific deliverables for FY 2017.



Warfighter Support

- **Support U.S. effort to clothe and equip Afghan forces** - DLA Troop Support is working with the Combined Security Transition Command-Afghanistan and the U.S. Army Security Assistance Command to provide clothing and equipment for the Afghan National Army and the Afghan National Police.
- **Award IPV contract at Corpus Christi Army Depot** - Establish a new Corpus Christi Army Depot IPV contract to manage all benchstock items.

People and Culture

- **Develop Culture Action Plans** - Administer a culture survey every 18 months; analyze scores, and employee feedback for improvement opportunities. Using both a "vertical" (supply chain focused)

and “horizontal” (common to all of DLA Troop Support) approach, take action on key issues to improve DLA Troop Support’s culture and organizational performance.

- **Cultivate Resiliency Program** - Fortify resiliency within DLA Troop Support workforce by helping employees develop a set of fundamental coping skills that will make them more effective in their professional and personal lives. Resiliency leads to better work/life balance, a more enjoyable work environment, increased satisfaction in daily life, lower personal stress, and the ability to recover quickly from setbacks or crisis.
- **Build the Bench** - Build a diverse, sustainable, well-rounded, high-potential cadre of leaders who inspire workforce confidence and productivity. Build this talent pipeline through mentoring, succession planning, developmental experiences, recruiting and retention, and training.

Strategic Engagement

- **Routinely Conduct Supplier Engagements** - Routinely conduct supplier engagements (e.g., Captains of Industry (COI) and other venues) and utilize feedback to meet organizational goals, objectives, and priorities.
- **Conduct Monthly DLA Troop Support Executive Board Meeting** - Conduct monthly DLA Troop Support Executive Board meetings with senior leadership to track AOP progress and report quarterly.

Financial Stewardship

- **Decrease Direct Material Cost** – Troop Support has garnered significant savings for the customer by:
 - Reverse auctions
 - Commercial-type contract terms
 - Substantial industry partnerships, such as COI
 - Performance Based Logistics (PBL) and Prime Vendor contracts
 - Significantly reduce lead times
 - Increase small business opportunities
- **Reduce Inventory** – in order to avoid excessive spending and lingering inventory, DLA Troop Support implemented an inventory reduction initiative using the following:
 - Review and adjust strategic requirements
 - Right size inventories
 - Leverage commercial supply chains without redundancy
 - Improve planning and forecast accuracy

Process Excellence

- **Respond and address audit actions** –DLA Troop Support Process Compliance Directorate’s Audit Readiness Division will provide an assessment of all key internal controls and if a deficiency or risk/vulnerability is identified, the team will work with the particular office to develop and implement a CAP. CPI will be utilized to support these efforts. The AR team will then track the CAP status and conduct testing to support the closure of the CAP.
- **Maintain a robust and maturing CPI program** – The organization’s CPI division is responsible for providing DLA Troop Support employees training, mentoring and coaching for Lean Six Sigma projects. Lean Six Sigma projects apply methodology and analytical tools to optimize efficiency and effectiveness within the organization. The CPI team strives to foster opportunities to realize process improvement across the organization by lending the expertise of organic Black Belt and Green Belt certified CPI practitioners to facilitate projects and initiatives through J5 or locally.

ACCOMPLISHMENTS

- Corpus Christi Army Depot Industrial Product Support Vendor contract awarded. This award supports comprehensive bench stock requirement resulting in a 99.5 percent fill rate to customers with approximately 12,000 items supported.
- Leadership Academy training program to train, inform and prepare employees for future leadership positions. Pillars of the training curriculum include; leadership development, employee management/development and SCM.
- Partnership developed with the Veterans' Administration and the Department of Health and Human Services to establish a substantial acquisition strategy for generic pharmaceuticals. This collaboration resulted in the Office of Federal Procurement Policy government-wide approval of the DLA Medical Category Management Concept of Operations and saved the Defense Health Agency over \$150 million.
- Ensured the award of multiple contracts for operational rations assemblers for MREs and Humanitarian Daily Rations. Assemblers are able to order directly off DLA Troop Support contracts for component items, thus taking advantage of leveraged buying power and eliminating Government Furnished Material thereby reducing inventory costs and eliminating monthly reconciliation requirements.
- Utilized the Better Buying Power initiative, to realize savings of \$1.9 million in negotiated lower pharmaceutical Prime Vendor distribution fees, \$95 million through large program efficiencies in the Construction & Equipment supply chain and \$188 million through vendor and customer collaboration for the Subsistence and Clothing & Textiles supply chains.
- Achieved operational excellence with the reduction of Unliquidated Obligations (ULOs) resulting in a 41 percent decrease in ULOs and \$600 million improvement in Obligation Authority.

Program Performance Indicators

- MA measures the immediate availability of DLA Troop Support managed material, both stocked and vendor-supplied, to respond to customer requisitions. MA is one of DLA Troop Support's key metrics to determine success. MA is reported as a percentage of orders that are issued at the time of receipt as compared to the total number of orders received in the given time period. The individual MA goals for DLA Troop Support's five distinct supply chains are as follows:
 - Subsistence – 99.0 percent
 - Clothing and Textiles – 95.0 percent
 - Construction and Equipment – 90.0 percent
 - Medical – 99.0 percent
 - Industrial Hardware – 93.0 percent
- Total and Aged Backorders reflects gaps in DLA Troop Support's ability to fill or satisfy customer order requirements in a timely manner. The total number of all Backorders, the number of Backorders that are currently over 180 days in age (i.e., aged Backorders), and the number of Backorders that are currently over three years old are tracked and evaluated.
- On-Hand PR Aging measures the age of all open PRs from the date they were created and as compared a goal of 50 to 65 days for small PRs and 175 to 190 days for large PRs. Automated Award percentages, LTC Utilization, and Time to Award are all Procurement-related metrics tracked in the monthly Agency Performance Review .

- Fill Rates is the percentage of the total quantity of the items ordered which are shipped within a particular amount of time. DLA Troop Support Fill Rate goals vary depending on the supply chain.



Acronym List

Acronyms	
AERO/NAV	Aeronautical Navigation
DoD	Department of Defense
DoD EMALL	DOD Electronic Mall
A2R	Acquire to Retire
ADA	Anti-Deficiency Act
AFR	Agency Financial Report
ALC	Air Logistics Center
ALI	Audit Leadership Integration
AO	Approving Officer
AOP	Annual Operating Plan
AT&L	Acquisition, Technology, and Logistics
AUM	Assessable Unit Manager
AWARS	Automated Workflow and Reporting System
B2P	Budgetary to Propriety
BCT	Business Cycle Team
BO	Backorders
CAGE	Commercial and Government Entity Code
CAP	Corrective Action Plan
CBY	Charge Back Year
CCPD	Certified Cost and Pricing Data
CES	Customer Engagement Strategy
CIO	Chief Information Office
CIP	Construction in Progress
CLP	Continuous Learning Points
CMR	Cash Management Review
COI	Captains of Industry
COLA	Cost of Living Adjustment
CONOPS	Concept of Operations
CONUS	Continuous United States
CPI	Continuous Process Improvement
CPIM	Consumer Price Index Medical
CPVO	Controlled Property Verification Office
CRM	Customer Relationship Management
CSRS	Civil Service Retirement System
CTC	Cost to Complete
CV4R	Commercial Venture 4 Rolling Stock

DAAS	Defense Automatic Addressing System
DAI	Defense Agencies Initiative
DAWIA	Defense Acquisition Workforce Improvement Act
DCIA	Debt Collection Improvement Act
DDCMO	Coding Management Office
DEMIL	Demilitarization
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DLA	Defense Logistics Agency
DLA-T	DLA-Transcom
DLR	Depot-Level Repairable
DMLSS-W	Defense Medical Logistics Standard Support – Wholesale
DoE	Department of Energy
DOL	Department of Labor
DPRV	Deflated Plant Replacement Value
DSCR	Defense Supply Center Richmond
DSS	Distribution Standard System
DTS	Defense Travel System
DV	Vice Director
DVR	Verification at Receipt
DWWCF	Defense Wide Working Capital Fund
EAGLE	Employee Activity Guide for Labor Entry
EBCO	Enterprise Business Cycle Owner
EBS	Enterprise Business System
EDA	Electronic Document Access
EDW	Enterprise Data Warehouse
EEO	Equal Employment Opportunity
EL	Environmental Liabilities
EM	Evidential Matter
EOU	Excess, Obsolete, and Unserviceable
ER	Effectiveness Reviews
ERM	Enterprise Risk Management
ERP	Energy Readiness Program
FAA	Federal Aviation Administration
FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance With Treasury
FDTP	First Destination Transportation & Packaging Initiative
FEA	Fuel Exchange Agreement
FECA	Federal Employees Compensation Act

FEMA	Federal Emergency Management Agency
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FG	Foreign Government
FIAR	Financial Improvement Audit Readiness
FISMA	Federal Information Security Modernization Act
FLIS	Federal Logistics Information System
FMD	Fuels Manager Defense
FMFIA	Federal Manages' Financial Integrity Act of 1982
FMR	Financial Management Regulation
FMS	Foreign Military Sales
FO	Financial Officer
FR&R	Financial Reporting & Reconciliation
FRM	Financial Risk Management
FRO	Financial Reporting Organization
FTE	Full Time Equivalent
FWAM	Fraud, Waste, Abuse, and Mismanagement
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principle
GF	General Fund
GO	General Officer
GPC	Government Purchase Card
HMMWVs	High Mobility Multi-Purpose Wheeled Vehicles
HQ	Headquarters
HR	Human Resources
HVAC	Heating, Ventilation and Air Conditioning
HW	Hazardous Waste
IAW	In Accordance With
ICO	Internal Control over Operations
ICOFS	Internal Control over Financial Systems
ICOR	Internal Control over Reporting
ID	Identification/Investigations Division
IDP	Individual Development Plans
IFR	Instrument Flight Rules
IG	Inspector General
IPA	Independent Public Accountant
IPERA	Improper Payments Elimination and Recovery Act
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPES/IPE	Industrial Plant Equipment Services

IPIA	Improper Payments Information Act
IPV	Industrial Product-Support Vendor/Integrated Prime Vendor
iRAPT	Invoice, Receipt Acceptance, and Property Transfer
IT	Information Technology
IUS	Internal Use Software
JETS	J6 Enterprise Technology Services
L&M	Land and Maritime
LEAs	Law Enforcement Agencies
LESO	Law Enforcement Support Office
LOE	Line of Effort
LRP	Local Risk Profile
LSN	Local Stock Number
LTC	Long Term Contract
MA	Material Availability
MAC	Moving Average Cost
MBBLS	Millions Barrels
MD&A	Management Discussion & Analysis
MHA	Major Headquarters Activity
MIPR	Military Interdepartmental Purchase Request
MRE	Meals Ready to Eat
MSC	Major Subordinate Command
MSO	Map Support Office
NE	Nuclear Enterprise
NGA	National Geospatial-Intelligence Agency
NIIN	National Item Identification Number
NJFCP	National Jet Fuels Combustion Program
NOR	Net Operating Results
NRV	Net Realizable Value
NSN	National Stock Number
NWRM	Nuclear Weapons Related Material
O&M	Operations and Maintenance
OCONUS	Outside the Continuous United States
OCORT	Oversees Contingency Readiness Training
OGC	Office of General Counsel
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OPMG	Office of the Provost Marshal General
OPORD	Operation Order

OR	Operating Results
ORT	Order Response Time
OSD	Office of the Secretary of Defense
oSOP	Office-level Standard Operating Procedures
OTD	On Time Delivery
OUSD	Office of the Under Secretary of Defense
OUSD(C)	Office of the Under Secretary of Defense Comptroller
OWCP	Office of Workers' Compensation Programs
P2S	Plan to Stock
PBA	Performance Based Agreements
PBL	Performance Based Logistics
PCI	Process Cycle Integrators
PCM	Process Cycle Memorandums
PDM	Programmed Depot Maintenance
PM	Program Manager
PMT	Program Management Team
POAM	Plan of Actions and Milestones
PP&E	Property, Plant, and Equipment
PPR	Post Payment Review
PQDR	Product Quality Deficiency Report
PR	Purchase Request
R/T/D	Reutilization/Transfer/Donation
RACER	Remedial Action Cost Engineering and Requirements
RAS	Retiree Account Statements
RDT	Rapid Deployment Team
RFC	Request for Change
ROI	Return on Investment
RP	Real Property/Risk Profile
S&D	Storage and Distribution
SA	Self-Assessment/Supply Availability
SAP	Simplified Acquisition Procedure
SBR	Statement of Budgetary Resources
SCA	Supply Chain Alliance
SCM	Supply Chain Management
SES	Senior Executive Service
SFFAS	Statement of Federal Financial Accounting Standards
SL	Straight-line
SNC	Statement of Net Cost
SNCP	Statement of Changes in Net Position

SNO	Strategic Network Optimization
SOP	Standard Operating Procedure
SRM	Supplier Relationship Management
SS	Strategic Sourcing
SSA	Strategic Supplier Alliance
STAR	Semi-Annual Total Retail Sustainment Review
STORES	Subsistence Total Order and Receipt Electronic System
TAS	Treasury Account Symbol
TD	Turbo Distribution
TF	Transaction Fund
TI	Treasury Index
UFOs	Unfilled Orders
ULOs	Unliquidated Obligations
USC	United States Code
USMC	United States Marine Corps
USSGL	United States Standard General Ledger
WCF	Working Capital Fund
WoG	Whole of Government
WOSB	Women-Owned Small Business

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