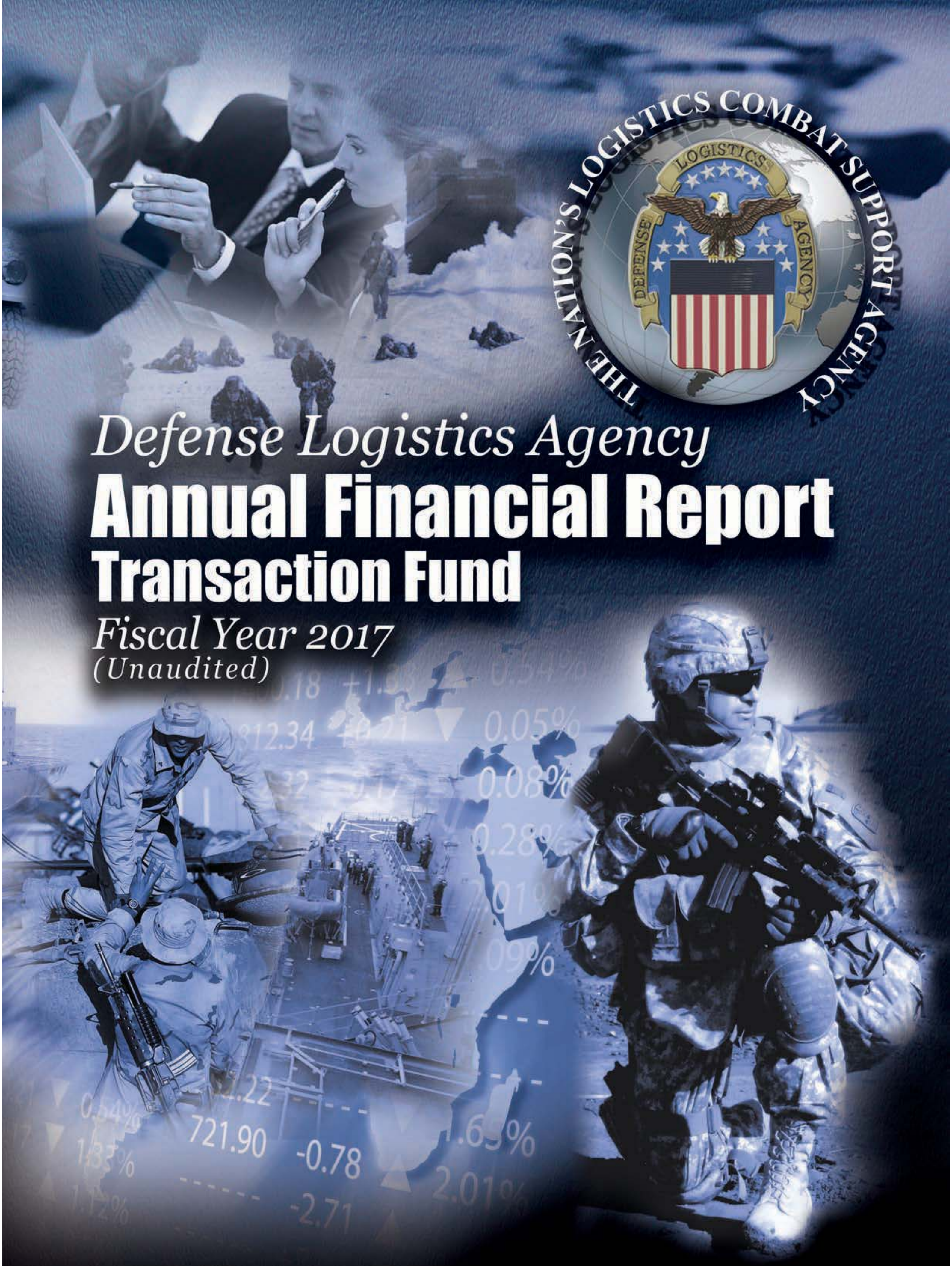

Defense Logistics Agency

Annual Financial Report
Transaction Fund

Fiscal Year 2017
(Unaudited)

DEFENSE LOGISTICS AGENCY TRANSACTION FUND AGENCY FINANCIAL REPORT

DEFENSE LOGISTICS AGENCY
Andrew T. McNamara Building
8725 John J. Kingman Road
Fort Belvoir, VA 22060-6221

Defense Logistics Agency
Transaction Fund
Fiscal Year 2017 Agency Financial Report

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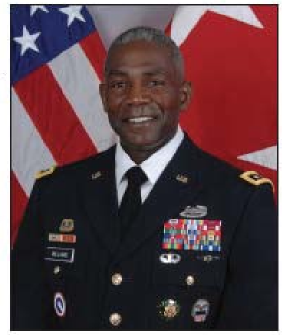
Message from the Director

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.

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. This is required per 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 item 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 Transaction Fund (TF). Information is provided for TF, where applicable, and other information is for the DLA Enterprise-Wide.

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. DLA Finance established Accounting Cycle Offices to support DLA's business processes. The Director of Finance also serves as DLA's Chief Financial Officer.

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.

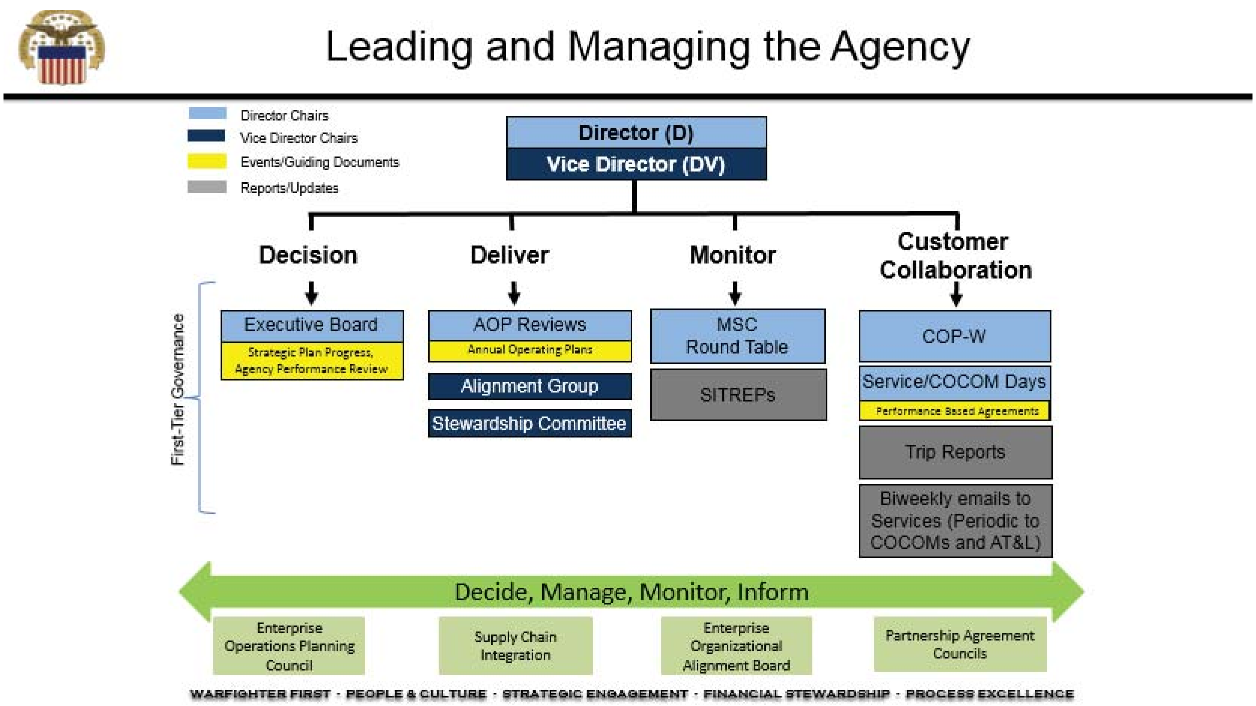


Figure 4, Leading and Managing the Agency

Strategic Materials Overview

DLA Strategic Materials (SM) is the operational arm that manages the National Defense Stockpile (NDS). In accordance with 50 U.S.C. § 98 et seq., the mission of NDS is to protect against a costly dependence upon foreign and single points of supply for strategic and critical materials needed in times of national emergency. Effectively managing and maintaining the nation's stockpile of strategic and critical materials, ensuring efficient resource stewardship and the highest environmental standards is paramount to DLA Strategic Materials operational goals.

Fiscal year (FY) 2017 saw improved market conditions supporting the sales program for excess NDS stocks. Revenues are generated through competitive public sales of materials deemed excess to NDS needs in order to finance operational expenditures and new material acquisitions. The Stockpile Transaction Fund is a revolving account that supports the operation of the NDS.

Beginning in FY 2014, Congress granted authority for the procurement of $41.0 million in new strategic and critical material stocks for the NDS. This represented the first new acquisition authority for NDS stocks since mid-1990. The multi-year authority (FYs 2014-2019) continued to be executed in FY 2017 with approximately $4.5 million obligated for options under existing contracts. All six materials authorized for acquisition via the FY 2014 National Defense Authorization Act (NDAA) are on contract with significant portions of inventories already received. Congressional authority to procure an additional seven materials was granted in the FY 2017 NDAA in the amount of $55.0 million. All newly authorized materials are in process for acquisition with four scheduled for award in FY 2017. Current acquisition authorizations stand at $96.0 million, and an FY 2018 legislative request has been submitted for another three materials valued at $9.0 million.

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 footnotes for the WCF, GF and TF. The TF 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 2017. Therefore, presenting comparative statements would not provide additional value to the reader. The Management Discussion & Analysis (MD&A) covers all three funds due to the interrelationship between the funds.

National Defense Stockpile

DLA manages the DLA Strategic Materials program, which is a separate revolving fund with approximately $1.1 billion in assets. The DLA Strategic Materials program operates under the authority of the Strategic and Critical Materials Stock Piling Act (50 United States Code (U.S.C.) §98, et seq.). Under the Act, strategic critical materials are stockpiled, in the interest of national defense, to preclude a dangerous and/or costly dependence upon foreign or single source suppliers. DLA Strategic Materials’ Stockpile Manager administers the acquisition, storage, management, and disposal of the stockpile. The FY 2017 NDAA authorized the Stockpile Manager to acquire materials determined to be strategic and critical to meet defense, industrial, and essential civilian needs of the United States. The legislation further provided authority to dispose of certain materials, with proceeds to be deposited in the Fund to finance future Stockpile operating costs and procurement of replenishment materials. It also terminated the transfer of revenues from the sale of NDS materials to fund specific Congressionally earmarked programs. Even with this legislation, the program's Transaction Fund faces a longer-term problem funding operating costs and procuring sufficient material to satisfy requirements outlined in the Annual Materials Plan (AMP). Per the Act (50 U.S.C. 98h-2(a)), on January 15, 2017, DLA Strategic Materials delivered to the Congress, *The Strategic and Critical Material Requirements Report for 2017*. This bi-annual report informs Congress and the DoD on materiel Supply Chain vulnerabilities and potential materials shortfalls under approved national emergency planning scenarios.

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

Strategic Materials (SM) maintains a stockpile of ready materials suitable for defense. SM reviews its materials annually and initiates material upgrades as needed in order to ensure that our stockpiled materials are synchronized with the current and future needs of the Warfighters and DoD. In support of this goal, DLA Strategic Materials has initiated several material upgrade programs during FY 2017. Specific projects are listed below.

Tin Remelt Project: In a joint project with Rock Island Arsenal (U.S. Army), DLA Strategic Materials oversaw the reprocessing of 170,000 pounds of tin. This effort has resulted in improved quality and grade of the tin making it well-suited for future needs and more stable for long-term storage.

Beryllium Conversion Project: A multi-year conversion project of beryllium billets, used as feedstock for producing high purity beryllium powder, continued in FY 2017. This powder metallurgy is considered a preferred form for immediate infusion into the defense industrial base for the production of end-use items.

People and Culture

DLA's goal for this year is to hire, develop and retain a high-performing workforce. In FY 2017, DLA Strategic Materials was able to achieve the following:

- Implemented DoD Performance Management and Appraisal Program for all of our employees;
- Continued monthly Employee Appreciation Awards (EAA) to extend the organization's gratitude to employees who have gone above and beyond in their job performance.
- Continued our monthly Employee Appreciation Meetings to communicate issues of importance throughout the organization, increase employee morale, and congratulate EAA winners.
- Executed a one day Managers Meeting for all HQ and Depot managers.
- Ensured all processes and procedures were followed in the hiring process.

Strategic Engagement

FY 2017 highlighted our continuous commitment toward increasing efficiency and effectiveness in our service to all DLA stakeholders. In FY 2017, DLA Strategic Materials saw their first successful accomplishments from the authority granted in the FY 2014 NDAA for the recycling and recovery of strategic materials from government sources. Germanium and various high-grade nickel-bearing alloys were recovered to the NDS. These materials are now stored at DLA Strategic Materials inventory locations and are available to mitigate critical material shortfalls.

Germanium Recycling Project: Germanium is used either as metal or in combination with other transparent materials to construct night-vision and thermal targeting systems, used in aircraft targeting pods (right) and land vehicles. As components are reconditioned and withdrawn from service, germanium has been accumulating at various military installations. It is recognized that germanium is a critical material that should not be discarded, but a viable recovery process did not exist. Working via joint recycling partnerships with the U.S. Army, the U.S. Navy, and the U.S. Air Force, components are disassembled and demilitarized, pieces of germanium are recovered, and radioactive thorium optical coatings are removed (under an NRC license). After confirmation, items surveys, are packaged and shipped to the NDS depot in Hammond, IN.

Strategic Materials Recycle and Recovery Program: Superalloys are used in jet turbine engines, such as the F-16 engine. Prior practice has been to demilitarize and dispose of these alloy parts using public auction services such as Government Liquidators. As DLA became aware of the loss of strategic materials through this process, hot engine parts were held back and are now recovered via joint recycling partnerships, and incoming shipment rates have increased to over 60,000 pounds per month. With participants from DLA Distribution, DLA Disposition Services, and the U.S. Air Force, process improvements continue to be made and the overall program efficiency continues to improve.

Financial Stewardship

- Strategic Materials accomplishments in the Financial Stewardship area were: Responded to Independent Public Accounting firm requests for information in support of DLA financial statement audit and identified key focus areas for FY 2018.
- Manage the sales of excess stockpile materials to create opportunities to reduce lease payments at unmanned storage locations.
- Replace lighting at the Hammond Indiana Depot with energy efficient LED lighting.

Process Excellence

DLA Strategic Materials optimizes processes to obtain the most effective and efficient outcome for its long-term environmental remediation projects and storage of environmentally sensitive materials. Program discussion follows.

Somerville Remediation Program: Like many DoD sites, most DLA Strategic Materials depots date back to the mid-1900s and predate many major US environmental laws and regulations. Some of the historical practices of material storage and handling would not be considered current best practices, and unfortunately allowed chemical constituents to leach out of our materials into soil and water. FY 2017 saw significant progress in developing a Feasibility Study (FS) to inform environmental remediation decision-making at Somerville, NJ where DLA Strategic Materials maintained material stockpiles for several decades. The site will be returned to the General Services Administration once remediation is completed.

Mercury Transfer and Long Term Storage Program: DLA Strategic Materials maintains a large stockpile of high grade mercury. Mercury is a potent neurotoxin with a wide range of well-documented impacts to human health, wildlife, and the environment. The mercury inventory was consolidated at Hawthorne, NV in FY 2010 and has been undergoing a multi-year repackaging effort since FY 2016. In FY 2017, approximately 200 metric tons of mercury were safely repackaged into state-of-the-art containers for long-term safe and secure storage. Since inception, over 393 metric tons of mercury have been repackaged without incident.

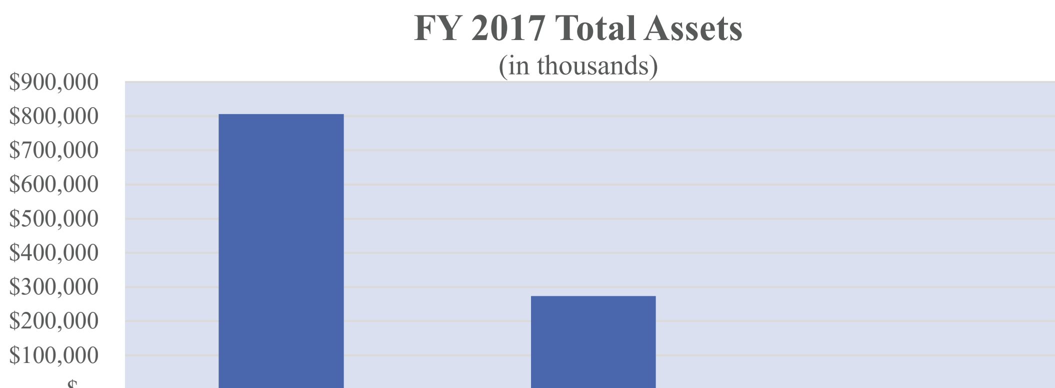
Financial Overview- DLA Transaction Fund

The Financial Statements presented in this AFR relate solely to DLA's TF. The Financial Statements for WCF and GF are located in their respective AFRs. The DLA Strategic Material budgetary resources were approximately $268.0 million 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 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. Ernst & Young, LLP performed the audit of the DLA'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



	Stockpile Material	Fund Balance with Treasury	Other Assets
FY 2017	$806,597	$273,121	$1,696

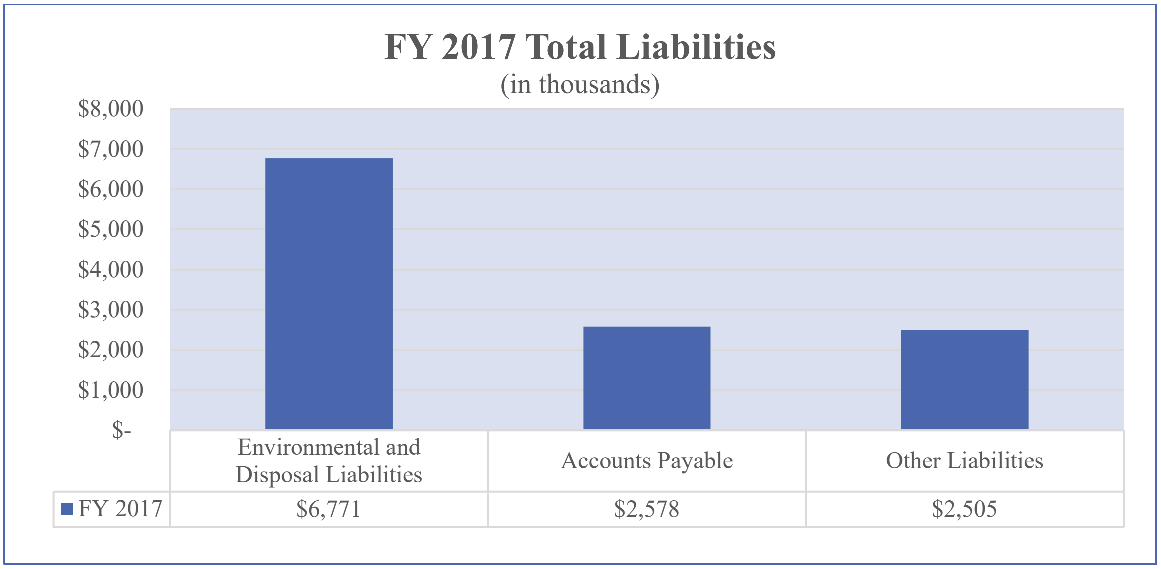
Assets represent amounts owned or managed by the DLA that can be used to accomplish its mission. As of September 30, 2017, the TF had $1.1 billion in assets.

Stockpile Material, Net is the Strategic Material's largest asset that comprises 74 percent of total assets. Inventory balances consists of Stockpile Materials which are strategic and critical materials held due to statutory requirements for use in national defense, conservation, or national emergencies.

Fund Balance with Treasury (FBWT) is the second largest asset, comprising 25 percent of total assets.

Other Assets represents one percent of total assets, which includes General Property, Plant, and Equipment and Accounts Receivable.

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 TF reported approximately $11.9 million in total liabilities of which 8.3 million are liabilities without budgetary resources.

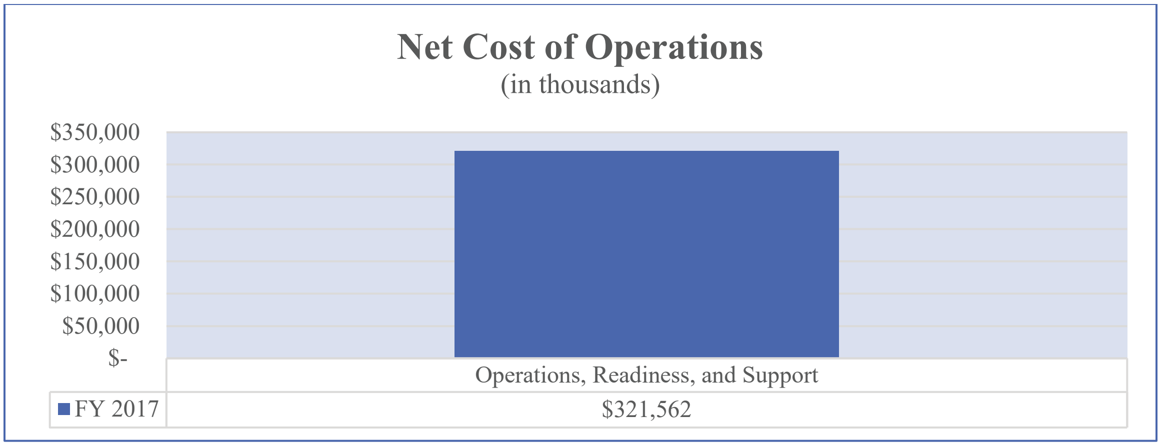
The DLA's largest liability is for *Environmental and Disposal Liabilities*, representing 57 percent of total liabilities. The DLA TF is responsible for clean-up requirements of Non-BRAC Installations in which they have conducted operations, in the past or present.

Accounts Payable represents 22 percent of total liabilities, and results from amounts owed to other federal agencies and the public for goods and services received by DLA.

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

Statement of Net Cost (SNC)

Net cost of operations before gains and losses represents the difference between the costs incurred and revenue earned by TF programs. The DLA TF SNC is reported in one segment: Operations, Readiness, and Support.



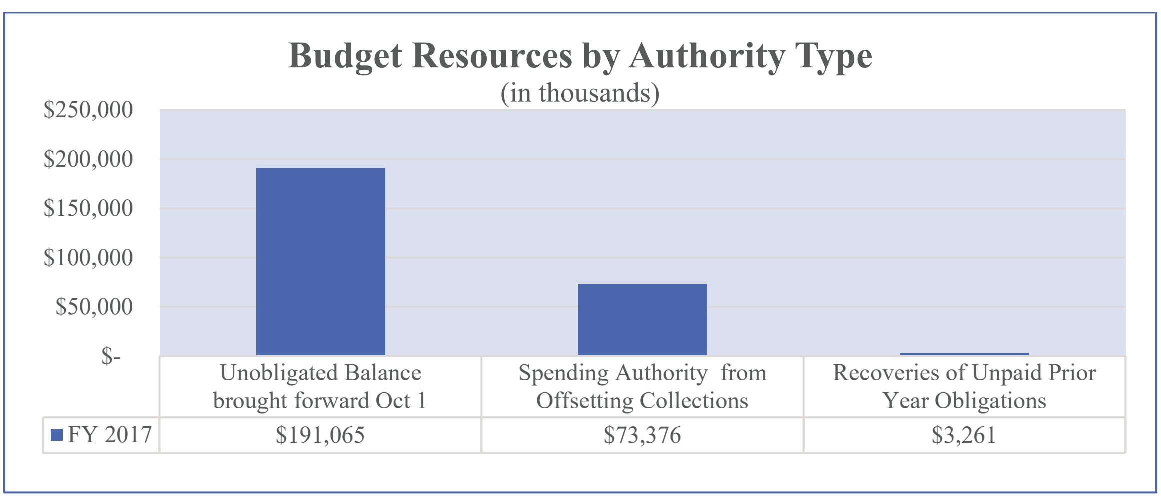
In FY 2017, DLA TF reported approximately $321.6 million in net cost of operations. During FY 2017, TF earned approximately $465.0 million in exchange revenue. Exchange revenue arises from transactions in which the DLA and the other party receive value and that are directly related to DLA operations (See Note 9).

Statement of Changes in Net Position (SCNP)

Net position represents the accumulation of revenue, expenses, budgetary, and other financing sources since inception, as represented by TF's balances in unexpended appropriations and 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 decrease net position. Total net position is $1.1 billion.

Statement of Budgetary Resources (SBR)

This statement provides information on the status of the approximately $267.7 million in budgetary resources available to the TF during FY 2017.



The authority was primarily derived from $191.1 million in authority carried forward from FY 2016, $73.4 million in collections, and 3.3 million in recoveries of unpaid prior year obligations.

As of September 30, 2017, $218.8 million of the $267.7 million was not yet obligated. The $218.8 million represents $18.7 million in apportioned funds available for future use, and $200.1 million in unapportioned and unexpired funds. Of the total budget authority available, the DLA incurred a total of $48.8 million 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 TF, 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, 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 DLA 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.

DLA has several corrective actions underway that are intended to improve the underlying systems, business processes, and internal controls.

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 howthe 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
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 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 Chief Financial Officer'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, 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 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. 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 TF is not aware of any violations of the Anti-Deficiency Act that we must report to the Congress and the President (and provide a copy of the report to the Comptroller General) for the year ended September 30, 2017.

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 Transaction Fund (TF) **Financial Statements**: the 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 Transaction 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 area we will focus on for the Transaction Fund is Stockpile Material.

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

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 Office of Management and Budget (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 TF 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 TF 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-Transaction Fund
Balance Sheet
As of September 30, 2017
(In Thousands)

		Unaudited 2017
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$	273,121
Accounts Receivable		1
Total Intragovernmental Assets	**$**	**273,122**
Accounts Receivable, Net		9
Stockpile Material, Net (Note 3)		806,597
General Property, Plant, and Equipment, Net (Note 4)		1,686
TOTAL ASSETS	**$**	**1,081,414**
LIABILITIES		
Intragovernmental:		
Accounts Payable	$	767
Other Liabilities		241
Total Intragovernmental Liabilities	**$**	**1,008**
Accounts Payable		1,811
Environmental and Disposal Liabilities (Note 6)		6,771
Other Liabilities (Note 7)		791
Other Federal Employee Benefits (Note 8)		1,473
TOTAL LIABILITIES (Note 5)	**$**	**11,854**
COMMITMENTS AND CONTINGENCIES		
NET POSITION		
Cumulative Results of Operations		1,069,560
TOTAL NET POSITION	**$**	**1,069,560**
TOTAL LIABILITIES AND NET POSITION	**$**	**1,081,414**

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency-Transaction Fund
Statement of Net Cost
For the Year Ended September 30, 2017
(In Thousands)

		Unaudited 2017
Gross Program Costs (Note 9)		
Operations, Readiness & Support		
Gross Cost	$	786,607
Less Revenue Earned		(465,045)
Net Cost		321,562
NET COST OF OPERATIONS	**$**	**321,562**

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency-Transaction Fund
Statement of Changes in Net Position
For the Year Ended September 30, 2017
(In Thousands)

	Unaudited 2017
Cumulative Results of Operations	
Beginning balances	$ 1,390,772
Other Financing Sources:	
Imputed financing from costs absorbed by others	351
Other	(1)
Total Financing Sources	350
Net Cost of Operations	321,562
Net Change	**(321,212)**
Cumulative Results of Operations	1,069,560
Net Position	**$ 1,069,560**

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency- Transaction Fund
Statement of Budgetary Resources
For the Year Ended September 30, 2017
(In Thousands)

		Unaudited 2017
BUDGETARY RESOURCES		
Unobligated Balance Brought Forward, October 1	$	191,065
Recoveries of Unpaid Prior Year Obligations		3,261
Unobligated Balance From Prior Year Budget Authority, Net	$	194,326
Spending Authority From Offsetting Collections		73,376
TOTAL BUDGETARY RESOURCES	**$**	**267,702**
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments	$	48,885
Unobligated Balance, End of Year:		
Apportioned, unexpired accounts		18,680
Unapportioned, unexpired accounts		200,137
Total Unobligated Balance, End of Year		218,817
TOTAL BUDGETARY RESOURCES	**$**	**267,702**
CHANGE IN OBLIGATED BALANCE		
Unpaid obligations:		
Unpaid Obligations, Brought Forward, October 1	$	29,902
New Obligations and Upward Adjustments		48,885
Outlays, Gross		(39,722)
Recoveries of Prior Year Unpaid Obligations		(3,261)
Unpaid Obligations, End of Year		35,804
Obligated Balance, Start of Year, Net	**$**	**29,902**
Obligated Balance, End of Year, Net	**$**	**35,804**
Budget Authority and Outlays, Net:		
Budget Authority, Gross		73,376
Actual Offsetting Collections		(64,941)
Budget Authority, Net		**8,435**
Outlays, Gross	$	39,722
Actual Offsetting Collections		(64,941)
Agency Outlays, Net	**$**	**(25,219)**

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

The National Defense Stockpile (NDS) is composed of strategic and critical materials (S&CM) that can be used in times of national emergencies. By Executive Order 12626, the Secretary of Defense is designated as the NDS Manager, with management responsibilities delegated to the Under Secretary of Defense for Acquisition, Technology and Logistics. The operational activities of the NDS are delegated to the Director of the Defense Logistics Agency (DLA). The DLA established Strategic Materials to manage the stockpile program through the NDS Transaction Fund (NDSTF).

The DLA TF is the leading U.S. agency for the analysis, planning, procurement and management of materials critical to national security. The DLA TF mission is to administer the implementation and execution of S&CM policies as set forth by the NDS Manager and to minimize dependence on foreign sources or a single supplier on supply chains of S&CM. Example of S&CM includes but is not limited to:

- Ores
- Metals
- Alloys
- Chemicals
- High-Performance Fibers
- Energetics

B. Basis of Presentation

The accompanying financial statements present the financial position, net cost of operations, changes in net position, and budgetary resources of the DLA Transaction Fund (TF) in accordance with the form and content requirements of 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 TF, and do not include the DLA General or Working Capital funds, which are reported in separate financial statements. Transactions and balances among the Department of Defense (DoD) components have been adjusted in the presentation of the Balance Sheets, Statements of Net Cost, and Statements 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 TF 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. DLA TF is unable to validate the accounts receivable and revenue balances associated with manual adjustments. 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 TF is unable to fully prepare these financial statements in conformity with Generally Accepted Accounting Principles (U.S. GAAP) due to limitations of the financial and nonfinancial management systems and processes that currently support the DLA TF 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 pertaining to reconciliations and adequacy of the supporting documentation identified through audits and other compliance reporting.

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

- 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.

- Stockpile Material - The accounting for the sale of stockpile materials does not comply with the Treasury Financial Manual United States Standard General Ledger. The difference between the sales contract and book value, whether a gain or loss, is recorded in the gain account. The gains and losses should be recorded in separate accounts.

- Leases – DLA does not currently report capital and operating leases in its financial statements (See Note 1. I.). DLA initiated an Agency-Wide business event assessment for the financial recognition of leases that will conclude in fiscal year (FY) 2018.

- 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. In FY 2016, the TF initiated the application of SFFAS 48, Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials.

D. Appropriations and Funds

Congress established in the Treasury of the United States a revolving fund account known as the NDSTF to be used to fund all operations of the NDS. The DLA TF operates under the authority of the Strategic and Critical Materials Stock Piling Act (50 United States Code §98, et seq.). The Act provides that strategic and critical materials are stockpiled in the interest of national defense to preclude a dangerous and costly dependence upon foreign or single sources of supply in times of national emergency. The DLA TF receives an annual apportionment from OMB to administer the acquisition, storage, management, and disposal of the stockpile.

E. Fund Balance with Treasury

The DLA TF funds are maintained in the U.S. Treasury account established as the NDSTF. The Defense Finance and Accounting Service Disbursing Office in Columbus Ohio processes cash collections, disbursements, and adjustments. Third party direct cite transactions may also process to the NDSTF. The U.S. Treasury records transactions affecting the NDSTF Fund Balance with Treasury (FBWT) account. On a monthly basis, the NDSTF FBWT balance is reviewed and adjusted to agree with the U.S. Treasury accounts.

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 Treasury Account Symbol 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 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.

F. Accounts Receivable

Accounts Receivable consists of sales offerings to customers who have been prequalified by DLA to purchase material in a particular offering. The basic ordering agreements for all material require customer payment within the contract period, typically 30 days, and prior to the shipment of materials. The existing accounts receivable balance is current. The DLA TF generally does not have uncollectable receivables and therefore, does not establish an Allowance for Estimated Uncollectibles. If required, the Direct Write-off Method will be used for uncollectible receivables.

G. Stockpile Material

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

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

- Stockpile Materials Held For Sale: This Stockpile Material is comprised of Ores, Metals, Alloys, Chemicals, High-Performance Fibers, and Energetics that is used to maintain the stockpile materials that have been authorized for sale. The materials authorized for sale is valued using the same basis used before they were authorized for sale. Any gain (or loss) upon sale must be recognized as a gain (or loss) at that time.

Both stockpile materials classifications are valued at historical cost, also known as Actual cost (AC). Lower of Cost or Market (LCM) valuation is used when AC is lower than market value.

Accounting adjustments were made to the DLA TF's Stockpile Materials valuation as a result of the application of SFFAS 48. These accounting adjustments were recognized in FY 2016 and subsequent accounting adjustments were recognized in FY 2017 in the gain/loss accounts.

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

- Accurate recording of inventory quantities and values in the financial statements.
- Sufficient policy and procedure over the inventory valuation process.

H. General Property, Plant and Equipment

The DLA TF General Property Plant & Equipment (PP&E) consists of general equipment used to facilitate the Agency's mission. DLA uses the straight-line (SL) method to calculate and accumulate depreciation expenses. The SL method is based on the acquisition cost and depreciated over the asset's useful life.

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

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

I. 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.

DLA's assessment of the evidentiary matter includes contracts, Performance Work Statements, Memorandum of Understanding/Memorandum of Agreement/Inter-Service Support Agreement, property records and payment records. To date, this assessment has indicated that the majority of DLA TF leases are for warehouse/storage facilities and buildings that do not meet the capitalization threshold and are non-reportable operating leases, as they are GSA Occupation Agreements with cancellation clauses and/or terms of 12 months or less. 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.

J. 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 assets on the Balance Sheet.

K. Accounts Payable

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

L. Commitments and Contingencies

The DLA recognizes Contingent Liabilities in the DLA's Balance Sheet and Statement of Net Cost 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 TF discloses the Contingent Liabilities in Note 7 of the financial statements when the condition for liability recognition do 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. The DLA identifies and estimates accrued Environmental Liabilities through its annual Cost-to-Complete process. DLA's accrued Environmental Liabilities 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.

M. Payroll, and Annual 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.

N. Federal Employment Benefit

The Federal Employees' Compensation Act (FECA), administered by the U.S. Department of Labor (DOL), provides 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 the 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, which DOL bills each agency quarterly for paid claims.

O. 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**.**

P. 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.

Q. Other Financing Sources

The DLA TF financing sources are generated through the sales to the public of stockpile materials that have been deemed excess to the needs of the stockpile. Materials are offered for sale on the open market and are awarded through competitive bidding. DLA TF recognizes gains for the difference between the sales value and book value of the stockpile materials. Sale proceeds are deposited to the NDSTF.

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

R. 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. The DLA TF uses estimates for environmental liabilities. The actual result from the reported amounts and expenses during the reporting period may differ from these estimates.

Note 2. Fund Balance with Treasury - Unaudited

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

	2017
Fund Balances	
Revolving Funds	$ 273,121
Total Fund Balances	$ 273,121
Status of Fund Balance with Treasury	
Unobligated	
Available	$ 18,680
Unavailable	$ 218,638
Obligated Balance not yet Disbursed	$ 35,803
Total	$ 273,121

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 is classified as available or unavailable and 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 yet paid.

In FY 2017, the adjustment to FBWT for undistributed transactions was $613,495.

Note 3. Stockpile Materiel, Net – Unaudited

Stockpile Material, Net at September 30, 2017, consisted of the following (in thousands):

	2017	
	Stockpile Materiel, Net	Valuation Method
Stockpile Materiel Categories		
Held for Sale	$ 19,618	AC, LCM
Held in Reserve for Future Use	786,979	AC, LCM
Total	$ 806,597	

Legend for Valuation Methods

AC = Actual Cost

LCM = Lower of Cost or Market

Other information:

The estimated market value for Stockpile Materials Held for Sale is $35,211 (in thousands).

In FY 2016, DLA TF started applying the SFFAS 48, Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials. In accordance with SFFAS 48, DLA TF 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 generally accepted accounting principles (GAAP) promulgated by the 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 GAAP-based financial statements without use of the alternative valuation method. The DLA TF used the fair value method as prescribed by SFFAS 48, which is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The DLA TF recorded accounting adjustments as a result of the application of SFFAS 48. These accounting adjustments were recognized in FY 2017 gain/loss accounts.

Note 4. General Property, Plant, and Equipment, Net – Unaudited

General Property, Plant, and Equipment, Net 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					
General Equipment	S/L	5 or 10	$ 2,337	$ (651)	$ 1,686
Total General PP&E			$ 2,337	$ (651)	$ 1,686

Legend for Valuation Methods:

S/L = Straight Line

Note 5. Liabilities not covered by Budgetary Resources - Unaudited

Liabilities Not Covered By Budgetary Resources, Net at September 30, 2017, consisted of the following (in thousands):

	2017
Intragovernmental Liabilities	
Other	$ 35
Total Intragovernmental Liabilities	35
Nonfederal Liabilities	
Other Federal Employment Benefits	$ 1,473
Environmental and Disposal Liabilities	6,172
Other Liabilities	604
Total Nonfederal Liabilities	8,249
Total Liabilities Not Covered by Budgetary Resources	8,284
Total Liabilities Covered by Budgetary Resources	3,570
Total Liabilities	$ 11,854

Intragovernmental Liabilities Other consists of FECA Liability and Other Unfunded Employment Related Liability.

Nonfederal Liabilities Other consists of unfunded annual leave owed to civilian employees.

Total Liabilities Covered by Budgetary Resources includes $598 thousands of Environmental and Disposal Liabilities.

Note 6. Environmental and Disposal Liabilities - Unaudited

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

	2017
Environmental Liabilities--Nonfederal	
Other Enviromental liabilities	$ 6,771
Total Environmental Liabilities	$ 6,771

The DLA TF Environmental Liabilities (EL) for the NDSTF are comprised of two primary elements: (1) existing obligations supporting Non-BRAC Corrective Action costs, Non-BRAC Closure Requirement costs, including site-related and Program Management costs, and (2) anticipated future cost to complete (CTC) environmental restoration requirements at DLA TF environmental sites. DLA utilized the Remedial Action Cost Engineering & Requirements (RACER) software to generate the fiscal year (FY) 2018 CTC estimates of anticipated future costs. Cost estimates were generated for six Non-BRAC Corrective Action sites and seven Non-BRAC Closure Sites.

Applicable Laws and Regulations for Cleanup Requirements
The DLA TF is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other prior activities, which may have created a public health or environmental risk. DLA TF is required to comply with the following laws and regulations where applicable: The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA); the Superfund Amendments and Reauthorization Act (SARA); the Resource Conservation and Recovery Act (RCRA); the Clean Water Act; and other applicable Federal, State, interstate, local laws, and regulations. Required clean up 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.

Types of Environmental Liabilities and Disposal Liabilities
The DLA TF is responsible for clean-up requirements of Non-BRAC Installations in which they conduct their operations, in the past or present. All cleanup is conducted 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 TF 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 Department of Defense 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 total DLA TF Non-BRAC CTC increased 13.9 percent for the FY 2018 CTC from the prior year's CTC. This increase can be primarily attributed to the addition of a remedial investigation and a supplemental excavation in FY 2047 at the Wenden Depot Right of Way Manganese Storage Area site. These tasks were determined by the program manager as required tasks to achieve site close-out under the 30 year look ahead for locations in continuous operations with no closure plans. Year-to-year fluctuations in DLA TF'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 the Program Managers to make reasonable professional judgments and assumptions 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 TF, along with 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 to determine if any significant changes to EL occurred as of September 30, 2017 since the completion of the annual CTC estimates in July 2017. If significant changes exist, they are included in the EL balance as of September 30, 2017. For FY 2017, it was determined that there were no significant changes to DLA TF EL between the completion of the annual CTC process and September 30, 2017 in accordance with OSD memorandum for Strategy for Environmental & Disposal Liabilities Audit Readiness (September 30, 2015).

Each year, DLA TF undergoes the EL Site Identification (ID) process that reviews the Agency's Environmental Event Repository and evaluates each event for EL potentiality for use in the annual CTC and EL financial reporting. During the FY 2018 Site ID Process, the sites identified as Potential 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 are available to create an estimate that would be included in the TF EL.

Note 7. Other Liabilities - Unaudited

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

	2017		
	Current Other Liabilities	Noncurrent Other Liabilities	Total Other Liabilities
Intragovernmental			
FECA Reimbursement to the Department of Labor	$ 139	$ 35	$ 174
Employer Contribution and Payroll Taxes Payable	67	-	67
Total Intragovernmental Other Liabilities	206	35	241
Nonfederal			
Accrued Funded Payroll and Benefits	186	-	186
Accrued Unfunded Annual Leave	605	-	605
Total Nonfederal Other Liabilities	791	-	791
Total Other Liabilities	$ 997	$ 35	$ 1,032

Note 8. Other Federal Employment Benefits - Unaudited

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

	2017	
	Liabilities	Unfunded Liabilities
Other Benefits		
Federal Employees Compensation Act (FECA)	$ 1,473	$ 1,473
Total Other Benefits	1,473	1,473
Total Other Federal Employment Benefits:	$ 1,473	$ 1,473

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%

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 by DOL 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 9. Cost and Exchange Revenue - Unaudited

Program Costs at September 30, 2017, consisted of the following (in thousands):

		2017
Operations, Readiness & Support		
Gross Cost		
Intragovernmental Cost	$	9,092
Nonfederal Cost		777,515
Total Cost		786,607
Earned Revenue		
Nonfederal Revenue		(465,045)
Total Revenue		(465,045)
Total Net Cost	**$**	**321,562**

Other Information
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.

The nonfederal cost includes $734.0 million losses due to a reversal of a deemed cost adjustment for FY 2017 beginning Strategic Material balances. Since the adjustments were also made in DLA's EBS, a reversal is required to eliminate duplication. The reversal is posted to the current year losses, as the original gains from the deemed cost adjustment occurred in FY 2016. Similarly, the nonfederal revenue includes $435 million gains due to the deemed cost adjustments related to SFFAS 48. As a result, the amounts of losses and gains reported on Statement of Net Cost are higher than they would be during the normal course of business.

Note 10. Apportionment Categories of New Obligations and Upward Adjustments: Direct vs. Reimbursable Obligations – Unaudited

The DLA TF recorded $48.9 million for Apportionment Category B - Reimbursable Obligations Incurred. Category B did not contain any Direct Obligations Incurred or Obligations Exempt from Apportionment.

Note 11. Undelivered Orders at the End of the Period - Unaudited

The Net Amount of Budgetary Recourses Obligated for Undelivered Orders at the end of the period is $32.9 million.

Note 12. Reconciliation of Net Cost of Operations to Budget – Unaudited

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

		2017
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations incurred	$	48,885
Less: Spending authority from offsetting collections and recoveries		(68,203)
Obligations net of offsetting collections and recoveries		(19,318)
Net obligations	$	(19,318)
Other Resources:		
Imputed financing from costs absorbed by others	$	351
Other		(1)
Net other resources used to finance activities		350
Total resources used to finance activities	$	(18,968)
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	$	(6,379)
Unfilled Customer Orders		(6)
Resources that fund expenses recognized in prior Periods (-)		(12)
Total resources used to finance items not part of the Net Cost of Operations	$	(6,397)
Total resources used to finance the Net Cost of Operations	$	(25,365)
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 annual leave liability	$	80
Increase in exchange revenue receivable from the Public		19
Other		369
Total components of Net Cost of Operations that will Require or Generate Resources in Future Periods	$	468

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

Components not Requiring or Generationg Resources in Future Period		
Depreciation and amortization	$	(348)
Revaulation of assets or liabilites		346,807
Total Components of Net Cost of Operations that will not Require or Generate Resources	$	346,459
Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	$	346,927
Net Cost of Operations	**$**	**321,562**

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.

Primary business events comprised in the lines titled, "Other":

Components Requiring or Generating Resources in Future Period, Other is primarily comprised of Future Funded Expenses, related to environmental liabilities; and changes in actuarial liability estimates for FY 2017. Per OMB guidance, the Department of Labor sends each reporting entity preparing financial statements actuarial liability estimates for future worker's compensation benefits amounts. These amounts include both current year and prior year. Under the CFO Act each reporting entity should include their portion of the actuarial liability for Workers' Compensation Benefits as liability on the Audited Financial Statements.

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 National Defense Stockpile Transaction Fund Financial Statements and Related Footnotes for FY 2017 (Project No. D2016-D000FE-0210.000, Report No. DODIG-2018-053)

We contracted with the independent public accounting firm of Ernst & Young to audit the Defense Logistics Agency (DLA) FY 2017 National Defense Stockpile Transaction 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 National Defense Stockpile Transaction Fund Financial Statements and related footnotes.

Ernst & Young's separate report on "Internal Control over Financial Reporting" discusses six material weaknesses related to DLA's internal controls over 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 National Defense Stockpile Transaction 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

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 National Defense Stockpile Transaction 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 National Defense Stockpile Transaction Fund of the Defense Logistics Agency (DLA), which comprise of the balance sheet as of September 30, 2017, and the related statements 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 statements, but not for the purpose of expressing an opinion on the effectiveness of DLA's internal control. Accordingly, we do not express an opinion on the effectiveness of DLA's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 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* over financial reporting 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. GAAP such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

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 is comprised of strategic and critical materials that can be used in times of national emergencies. The materials include ores, metals, alloys, chemicals, high-performance fibers, energetics, etc. We found that policies, procedures and controls surrounding documentation of procurements and disbursements, 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. Fund Balance with Treasury – 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 Defense Reconciliation Reporting Tool (DRRT) process as a mechanism to reconcile DLA's general ledger to Treasury. However, this tool has 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.

III. 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.

IV. 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.

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

VI. 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.

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 strategic and critical materials that can be used in times of national emergencies. The materials include ores, metals, alloys, chemicals, high-performance fibers, energetics, etc. Control over the inventory process is complex because of the number of locations in which inventory is stored, and the volume of different items held. 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 has not appropriately designed controls related to physical counts for the validation of existence and completeness of inventory due to the following:

- DLA has not performed physical counts of its stockpile inventory since the materials were acquired, which could date back many decades. The policies and procedures to count and verify the individual lots is not adequate to substantiate the existence and completeness of inventory. Inventory is maintained in bulk piles or in containers (drums, pallets, etc.) and grouped in lots. The material is valued based on weight. DLA performs physical counts through visual inspections of materials. Materials are not moved or weighed to complete the count and inspection. In some instances, only the perimeter of the lot can be counted and inspected, with the results being extrapolated over the entire lot.

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

- Policies or procedures are not in place to ensure that adjustments to record a permanent decline (impairment) in the material is recorded in the correct period. DLA's policy is to determine whether an impairment exists on a quarterly basis. The assessment is made after the close of the reporting. As a result, an impairment that existed at period-end is not appropriately reflected in the correct period.
- Policies or procedures are not in place to ensure all transactions are appropriately and accurately recorded in the period that the transaction occurred. DLA does not accrue for

inventory receipts that have not been processed in DLA's general ledger system, Enterprise Business System (EBS).

DLA does not have adequate policies, procedures and controls to ensure that inventory is properly valued in accordance with Federal Accounting Standards Advisory Board (FASAB) SFFAS 3, *Accounting for Inventory and Related Property*.

- Policies or procedures are not in place that describes the valuation process. The policies and procedures does not describe the criteria used to determine whether a decline in value is temporary or permanent.
- The controls are not designed to ensure that the application of the valuation methodology is consistent and in accordance with SFFAS 3. The design of the review controls is not sufficiently precise such that the review activity is defined, including outlining the criteria used in the performance of the review; defining anomalies that should be investigated; etc. Inventory is valued based on historical cost or market, unless the carrying amount of the material has suffered a permanent decline in value to an amount less than the cost. On a quarterly basis, an assessment is made to determine whether there are permanent declines in value.

DLA does not have policies and procedures in place to ensure that transactions are recorded consistently with the Treasury Financial Manual's United States Standard General Ledger (USSGL) accounting transaction definitions and processing rules, and trace transaction detail supporting USSGL accounts to USSGL account codes.

- The posting logic for transactions to issue material does not comply with the guidance outlined in the Treasury Financial Manual (TFM). DLA issues material on a periodic basis and the transaction is recorded in EBS accordingly. Adjustments to inventory balances (e.g. inventory receipts, issues, gains, losses, etc.) trigger a movement type through an existing interface. The movement types are configured to update the inventory ledger in EBS and the Inventory general ledger account. The business events recorded in EBS are not properly linked to the correct posting logic as established by the TFM.

Recommendations

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

- DLA's inventory process should include 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.

- DLA's inventory process should include policies, procedures, and controls to periodically verify the existence, completeness and valuation of the stockpile material and any inventory movements (additions, sales, and transfers). These procedures may include:
    - Selecting a statistical sample of stockpile materials to verify the existence and completeness (weight) of each sample to establish beginning balances and selecting a limited sample on a periodic basis (i.e. annual basis) to verify the weight of each sample.
    - Preparing a rollforward schedule to show the beginning balance, additions, sales, transfers, and ending balance of stockpile materials in the current fiscal year.
- DLA should update policies and procedures related to valuing inventory to include:
    - A defined process to determine when a decline in value should be considered temporary or permanent.
    - A defined process to determine how the review of the market value of specific commodities should be selected and performed.
- DLA's EBS posting logic and evidential matter to support the posting logic should include the following:
    - Updates to transactions noted above to ensure compliance with TFM
    - A system-generated mapping report which ties EBS configured posting logic to EBS transaction codes and movement types and TFM transaction numbers
    - Clear descriptions of business events and varying circumstances that impact or change the posting logic
    - Design and implement formal policies and procedures that outline the procedures required to review for compliance with the TFM, including adequately documenting and supporting through evidential matter that adequate review procedures were performed.

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 support the FBWT balances recorded in EBS:

- DLA was unable to provide adequate supporting documentation for the beginning balance probe sample.

DLA is unable to reconcile FBWT in EBS to Treasury at the transaction level:

- DLA, in conjunction with DFAS, has implemented the DRRT process as a mechanism to attempt to reconcile EBS transaction detail to the U.S Treasury. However, the DRRT process is not sufficient to produce a complete and accurate reconciliation of DLA's general ledger to U.S. Treasury.
  - DLA nor DFAS are able to provide supporting documentation for undistributed collections and disbursements identified through the DRRT process.
  - Proper controls do not exist to match accounts receivable and accounts payable balances to undistributed funds identified in the DRRT Report in a timely manner.

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

- DLA does not have a policy or procedure in place to document controls at DLA related to the DRRT process, or to document the end-to-end process for FBwT. DLA has not developed and finalized a DLA 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.

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 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 the DRRT process 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.
- Continue 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.

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:
  - Negative Payables
  - Downward adjustment
- 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.
  - Undelivered Orders (UDO), Unpaid – Approximately $2.8 million in UDOs that 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 the proprietary entry for the payment made in advance is not recorded.

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

- 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(s) of conditions. 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.
- EY recommends that DLA 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 deobligation. DLA should examine their 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.
- EY recommends that DLA 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.
- EY recommends that DLA 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 process and identify key internal controls over financial reporting.
- Monitor, review, and validate whether controls are operating effectively on an on-going basis.
- Update existing internal control activities to produce evidence that the control occurred (e.g. signature) after the control is executed.

- DLA should 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 control in place to ensure that EBS posting logic is configured in accordance with the USSGL and that transactions are posting accordingly.

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 JVs in Defense Departmental Reporting System (DDRS) to ensure DLA's budgetary accounts reconcile to the proprietary accounts.

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 a 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.

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
  - Line items were not appropriately broken out between federal and non-federal

- 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 conditions described 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.
- Analyze and investigate the known budgetary to proprietary tie point variances at a business process level to determine the root cause.
- 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.
- 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.

Building a better working world

- 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:
  - 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 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 were 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
    - Asses 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 the agency 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 and documentation of session inactivity parameters.
- 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.

(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.
- 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 NIST 800-53.
- 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.

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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 National Defense Stockpile Transaction 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 FFMIA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from DLA's management responsible for addressing the noncompliance are provided in 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 – Transaction Fund

Thank you for the opportunity to comment on the Independent Auditors' report on the audit of the Defense Logistics Agency's (DLA) FY 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 faciliated 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
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
Total Material Weaknesses	**0**	**6**	**0**	**0**	**6**

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 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**			
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	**7**	**3**	**3**			**7**

Compliance with Federal Managers Financial Integrity Act (FMFIA § 3)						
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: • 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: • 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 § 3)						
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: • 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: • 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 choses 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.

FY 2017 Internal Control Over Financial Reporting Corrective Action Summary	
Material Weakness	**Correction Action Summary**
FR&R - Timely compilation of Annual Financial Report (AFR) and components	DLA is updating standard operating procedures and implementing a monitoring process to ensure the timely compilation of AFR.
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.
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.

Internal Control over Operations (ICO)

DLA began Fiscal Year (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 5 below shows, DLA evaluated 79 processes, with only 3 failures. The failures have plans of action and milestones for corrective action and monitoring.

Figure 5; shows the FY 2017 ICO Control Evaluation

Internal Control over Reporting (ICOR)

DLA provided a modified Statement of Assurance 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 Sustainment effort, DLA evaluated the control environment for financial reporting and financial system compliance. During the fiscal year, DLA identified and corrected 5 material weaknesses over financial reporting. As shown on the next page, Figure 6, shows the ICOR controls evaluated.

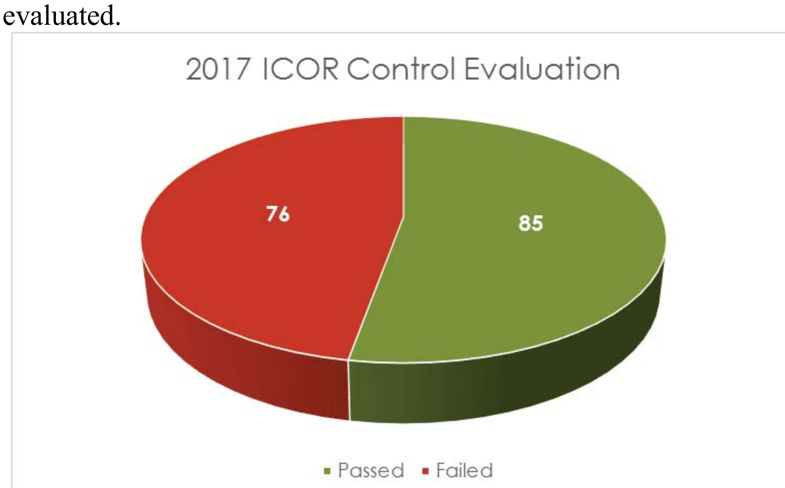


Figure 6; shows the FY 2017 ICOR Control Evaluation

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

Improper Payments Elimination and Recovery Improvement Act (IPERIA)

The Department of Defense Financial Management Regulation (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 Department-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 Chief Financial Officer submitted the DLA Travel Remediation Plan to the Office of the Secretary of Defense, Comptroller, 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 Financial Management Regulation (FMR) directed Certifying Officer Legislation Training; Programs & Policies - U.S. Government Rental Car Program; and Program & Policies – Travel Policies, specifically suggested by the Department of Defense Inspector General. 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.

- 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.

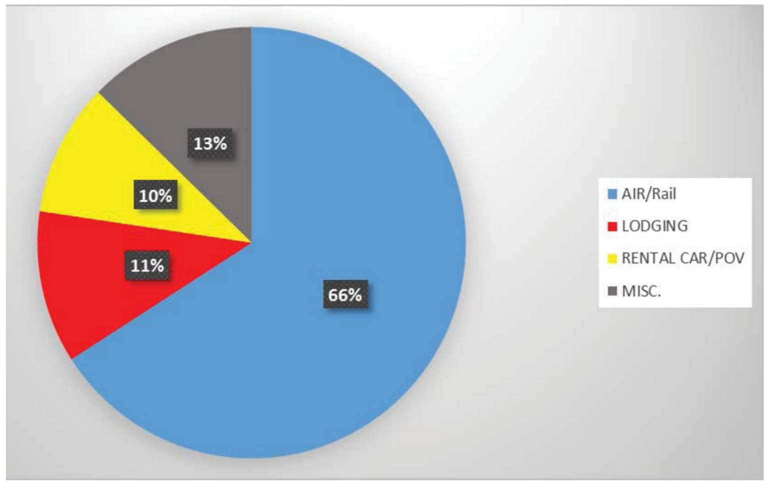
DLA Post Payment Review (PPR) Data:

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/Unclaimed	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:

97%

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

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 Enterprise Risk Profile 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 Enterprise Risk Management 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 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, reporting on our success and need for improvements in DLA's internal controls environment. This drives proactive instead of reactive responses.

DLA's Office of Inspector General 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 Office of Inspector General (OIG) Investigations Division (ID) conducts preliminary and administrative Inspector General (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 Department of Defense Hotline Program.

The Agency has made significant strides to incorporate all the Government Accountability Office 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

In compliance with the Debt Collection Improvement Act of 1996 (DCIA), the DLA manages its debt collection activities under the DCIA regulation. The DLA's Accounts Receivable policies, in accordance with the DoD Financial Management Regulation, provide guidance for the collection, referral, reporting and write-off of non-tax debts. The 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.

Acronym List

Acronyms	
A2R	Acquire to Retire
AC	Actual Cost
AFR	Agency Financial Report
ALI	Audit Leadership Integration
AMP	Annual Materials Plan
AO	Approving Officials
AT&L	Acquisition, Technology, and Logistics
AUM	Assessable Unit Manager
BCT	Business Cycle Team
CAGE	Commercial and Government Entity Code
CBY	Charge Back Year
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CIO	Chief Information Office
COLA	Cost of Living Adjustment
CONOPS	Concept of Operations
CONUS	Continental United States
CPI	Continuous Process Improvement
CPIM	Consumer Price Index Medical
CSRS	Civilian Service Retirement System
CTC	Cost to Complete
DAAS	Defense Automatic Addressing System
DAI	Defense Agencies Initiative
DAWIA	Defense Acquisition Workforce Improvement Act
DCIA	Debt Collection Improvement Act
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DLA-T	DLA Transportation Command
DMLSS-W	Defense Medical Logistics Standard Support – Wholesale
DNA	Deoxyribonucleic acid
DoD	Department of Defense
DoD EMALL	DOD Electronic Mall
DOL	Department of Labor
DSS	Distribution Standard System
DTS	Defense Travel System
DV	Vice Director
EAGLE	Employee Activity Guide for Labor Entry
EBCO	Enterprise Business Cycle Owner
EBS	Enterprise Business System

EDA	Electronic Document Access
EDW	Enterprise Data Warehouse
EL	Environmental Liabilities
ELC	Entity Level Controls
EOU	Excess, Obsolete, Unserviceable
FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
FECA	Federal Employees Compensation Act
FEMA	Federal Emergency Management Agency
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FIAR	Financial Improvement Audit Readiness
FISMA	Federal Information Security Modernization Act
FMD	Fuels Manager Defense
FMR	Financial Management Regulation
FMS	Foreign Military Sales
FO	Finance Officer
FR&R	Financial Reporting and Reconciliation
FTE	Full Time Equivalent
FWAM	Fraud, Waste, Abuse, and Mismanagement
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GF	General Fund
GO	General Officer
GPC	Government Purchase Card
HR	Human Resources
ICO	Internal Control over Operations
ICOFS	Internal Control over Financial Systems
ICOR	Internal Control over Reporting
IG	Inspector General
IPERA	Improper Payments Elimination and Recovery Act (IPERA)
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Info Act
iRAPT	Invoice, Receipt Acceptance and Property Transfer
IT	Information Technology
JETS	J6 Enterprise Technology Services
LCM	Lower of Cost or Market
LRP	Local Risk Profiles
MD&A	Management Discussion & Analysis
MHA	Major Headquarters Activity

MIPR	Military Interdepartmental Purchase Request
MSC	Major Subordinate Command
NATO	North American Treaty Organization
NDAA	National Defense Authorization Act
NDS	National Defense Stockpile
NDSTF	National Defense Stockpile Transaction Fund
OCONUS	Outside the Continental United States
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
OTD	On-Time Delivery
OUSD	Office of the Under Secretary of Defense
OUSD (C)	Office of the Undersecretary of Defense, Comptroller
OWCP	Office of Workers' Compensation
P2S	Plan to Stock
PBL	Performance-Based Logistics
PM	Program Manager
PMT	Program Management Team
PP&E	Property, Plant, and Equipment
PPR	Post Payment Review
PQDR	Product Quote Deficiency Reports
RACER	Remedial Action Cost Engineering & Requirements
RCRA	Resource Conservation and Recovery Act
RP	Risk Profile
S&CM	Strategic & Critical Materials
SARA	Superfund Amendments and Reauthorization Act
SBR	Statement of Budgetary Resources
SCNP	Statement of Changes in Net Position
SES	Senior Executive Service
SFFAS	Statement of Federal Financial Accounting Standards
SL	Straight Line
SNC	Statement of Net Cost
STORES	Subsistence Total Order and Receipt Electronic System
TF	Transaction Fund
TRANSCOM	Transportation Command
USC	United States Code
USSTRATCOM	United States Strategic Command
USTRANSCOM	Unites States Transportation Command
WCF	Working Capital Fund
WoG	Whole of Government

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