2021

Defense Logistics Agency Fiscal Year 2021 Agency Financial Report

Transaction Fund (Unaudited)

◄ Arctic Strategy

Army paratroopers hold onto a rope secured to the back of a small-unit sustainment vehicle during a skijoring exercise at Joint Base Elmendorf-Richardson, Alaska, Jan. 27. Photo Credit: Alejandro Peña/Air Force

▼ Signaling Soldier

A Marine with the 24th Marine Expeditionary Unit provides fresh water to a child during an evacuation at Hamid Karzai International Airport, Kabul, Afghanistan, Aug. 20. Photo Credit: Sgt. Samuel Ruiz/Marine Corps

▲ Aircraft Lines

Air Force aircraft assigned to the 354th Fighter Wing and the Alaska Air National Guard's 168th Wing line up in formation at Eielson Air Force Base, Alaska, Dec. 18, 2020. Photo Credit: Air Force Senior Airman Keith Holcomb

► Exercise Prep

Marines prepare for an exercise at Vaziani Training Area, Georgia, Oct. 18, 2020. Photo Credit: Marne Corps Sgt. Devin Andrews

About the Agency Financial Report

The Defense Logistics Agency (DLA) Transaction Fund (TF) Agency Financial Report (AFR) provides financial and summary performance results enabling the President, Congress, and the American people to assess its accomplishments, and to understand its financial results and operational functions. The AFR consists of DLA TF financial statements and other reports. The principal financial statements[1] have been prepared to report the financial position and results of DLA TF's operations. The principal financial statements and accompanying notes have been prepared from the books and records of DLA TF using guidance from the following applicable laws and regulations for which DLA TF is unable to provide assurance:

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

All information within this report pertains to DLA TF unless specifically noted otherwise. DLA TF's financial results are unaudited because there are limitations to underlying processes and internal controls that support the principal financial statements. DLA TF continues to implement processes and system improvements addressing these limitations. The AFR consists of three primary sections:

Management's Discussion and Analysis (Unaudited)

This section provides a high-level overview of DLA TF, including DLA's history, mission, and organizational structure; DLA TF's overall performance related to its strategic goals and primary objectives; financial analysis; management's assurance on internal controls; system analysis; compliance with laws and regulations; and forward-looking information.

Financial Section (Unaudited)

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

Other Information (Unaudited)

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

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

Defense Logistics Agency

FY 2021 | Transaction Fund

Mission Prep

New Jersey National Guard soldiers and airmen arrive near the Capitol to set up security positions in Washington, D.C., Jan. 12, 2021. National Guard soldiers and airmen from several states have traveled to Washington to provide support to federal and district authorities leading up to the 59th presidential inauguration.

Photo Credit: Air National Guard Master Sgt. Matt Hecht

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

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Message from the Director

On behalf of the Defense Logistics Agency (DLA), I'm pleased to present the Fiscal Year (FY) 2021 Agency Financial Report. This year, the first of October is not only the beginning of a new fiscal year – it's also the anniversary of DLA's founding in 1961. For over six decades, DLA has served the Warfighter, developing into a dynamic and forward-leaning agency with vast capabilities, fueled by a dedicated and mission-focused workforce. We are "Forged by History, Focused on the Future," and proud to serve as the Nation's Combat Logistics Support Agency.

DLA continued to fulfill our key mission to deliver readiness and lethality to the Warfighter Always and to provide support to our Nation through quality, proactive global logistics. Among the FY21 highlights, DLA's Medical Surgical Prime Vendor Program received the Best-in-Class designation from the Office of Management and Budget having achieved a 3% cost avoidance. DLA's Industrial Hardware Supply Chain completed its transformational initiative alignment ahead of schedule, creating increased effectiveness in logistics support, increased efficiencies through reduced material and operating costs, and improved pricing. DLA quickly acted to support Operation ALLIES REFUGE with food, fuel, clothing, and medicine. The agency continued to support efforts to combat the COVID-19 pandemic by managing, tracking, and distributing personal protective equipment and vaccines to overseas military service members and families and to other Department of Defense customers. DLA supported relief efforts for natural disasters, including from Hurricanes Henri and Ida, flooding in Tennessee, and wildfires in California.

The Agency launched a refreshed Strategic Plan (2021-2026) that reflects current challenges. To deliver world-class support to the Warfighter while maintaining fiscal accountability, DLA is committed to five key lines of effort and three critical capabilities.

This year, our Independent Public Accounting (IPA) firm, Ernst and Young, LLP, issued a Disclaimer of Opinion on DLA's Transaction Fund (TF) Financial Statement. Information obtained through this report will be extremely valuable in our ongoing efforts to improve all aspects of DLA TF operations. The IPA reported material weaknesses in key areas involving policies and procedures, critical asset accounting procedures, financial information systems and reporting, and completeness of records. DLA also continues to identify material weaknesses in those areas.

DLA's roadmap to an unmodified audit opinion in the foreseeable future is focused on process improvements, strengthened financial management, and improved monitoring and oversight. DLA will review audit results, identify root causes of conditions, prioritize resources, and develop corrective action plans. This effort will rely on establishing firm internal controls throughout every process, which will better position the agency to address risks effectively and efficiently. In the future, we'll focus on financial and operational system upgrades, reengineering end to end processes, identifying risks, designing and testing controls, and prioritizing remediation efforts. In addition, DLA is reviewing all aspects of OMB Circulars A-123, Management's Responsibility for Enterprise Risk Management and Internal Control and A-136, Financial Reporting Requirements, to incorporate necessary enterprise-wide operational and financial reporting process changes that will ensure our financial statements are complete, accurate and reliable.

DLA CONTINUED TO FULFILL OUR KEY MISSION TO DELIVER READINESS AND LETHALITY TO THE WARFIGHTER ALWAYS AND TO PROVIDE SUPPORT TO OUR NATION THROUGH QUALITY, PROACTIVE GLOBAL LOGISTICS.

In DLA's Diamond Anniversary year, I am proud of our history. From its earliest days, DLA's mission, "…to provide effective logistics support to the operating forces of our military services and do so at the lowest possible cost to the taxpayer," has been our focus. With this report, we reaffirm our commitment to supporting our Warfighters and our Nation through efficient and accountable resource management and making strides toward stronger fiscal transparency and performance.

WARFIGHTER ALWAYS!

M.C. SKUBIC
VADM, SC, USN
Director

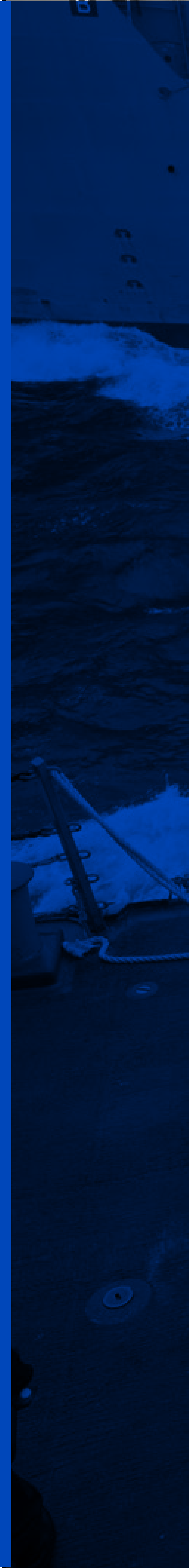
SECTION 1

Management's Discussion and Analysis (Unaudited)

Replenishment-at-Sea ▶

Sailors aboard the Arleigh Burke-class guided-missile destroyer USS Roosevelt (DDG 80) receive pallets of food stores during a replenishment-at-sea with the dry cargo ship USNS William McClean (T-AKE 12), April 1, 2021. Roosevelt, forward-deployed to Rota, Spain, is on its second patrol in the U.S. Sixth Fleet area of operations in support of regional allies and partners and U.S. national security interests in Europe and Africa.

Photo Credit: U.S. Navy - Mass Communication Specialist 2nd Class Andrea Rumple



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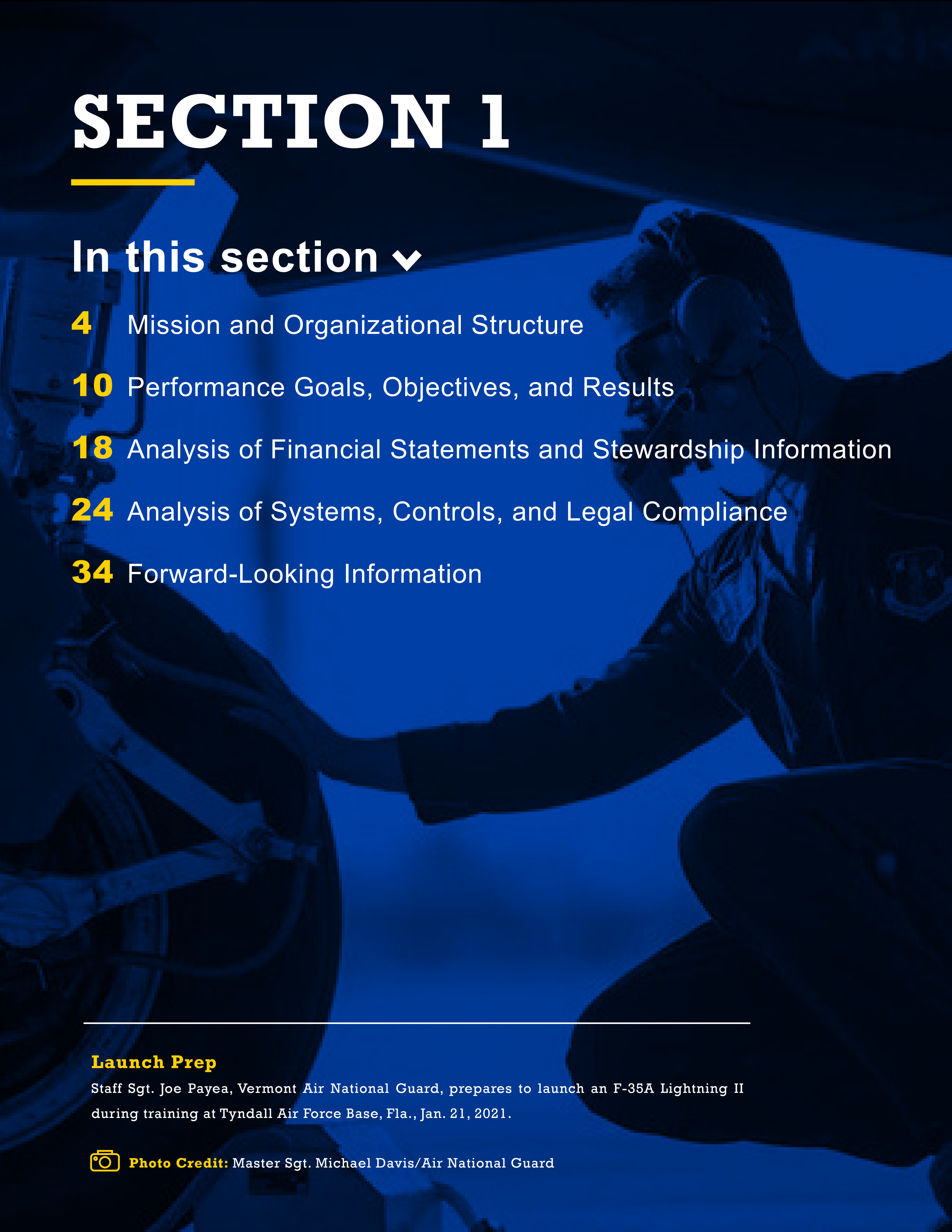


SECTION 1

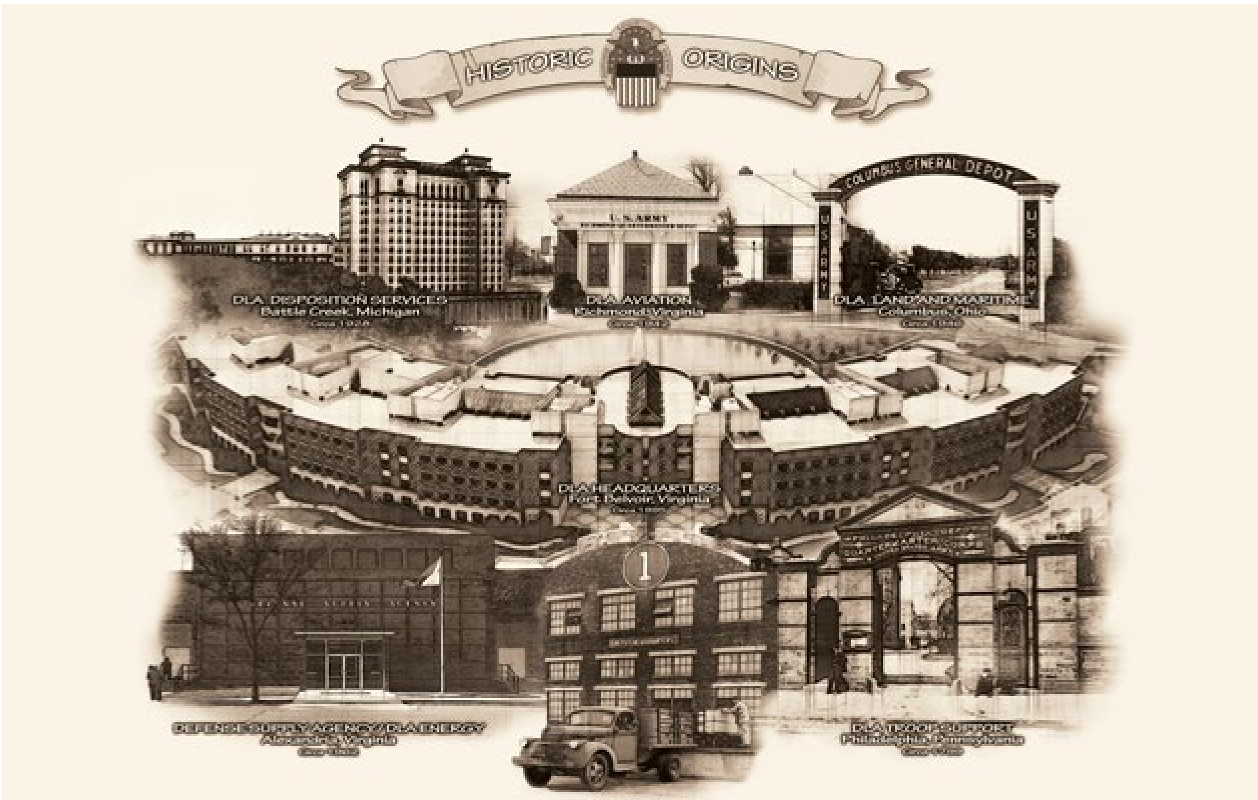
In this section

Launch Prep

Staff Sgt. Joe Payea, Vermont Air National Guard, prepares to launch an F-35A Lightning II during training at Tyndall Air Force Base, Fla., Jan. 21, 2021.

Photo Credit: Master Sgt. Michael Davis/Air National Guard

Mission and Organizational Structure



As the Nation's combat logistics support agency, the Defense Logistics Agency manages the global supply chain – from raw materials to end user to disposition – for the Army, Marine Corps, Navy, Air Force, Space Force, Coast Guard, 11 combatant commands, other Federal agencies, and partner and allied nations.

Forged by History, Focused on the Future:
A Short History of the Defense Logistics Agency

The origins of DLA date back to World War II when America's military buildup required the rapid procurement of vast amounts of munitions and supplies. After the war, a commission headed by former President Herbert Hoover recommended the central management of items common to more than one military service. The Department of Defense (DoD) responded by assigning procurement responsibilities to individual services. The Army became the military's sole buyer of food, clothing, general supplies, and construction supplies; the Navy purchased medical supplies, petroleum, and industrial parts for every service; and only the Air Force provided airlift services.

Although centralizing wholesale stocks, this "single manager" system did not provide the uniform methods recommended by the Hoover Commission. Each single manager operated under its own rules, giving customers as many sets of procedures as there were managers. On October 1, 1961, Secretary of Defense Robert McNamara eliminated this complexity by forming the Defense Supply Agency (DSA). Beginning operations on January 1, 1962, DSA saved money by employing fewer people and keeping less inventory.

DSA faced its first real-world test one year after formation. Restricted to the continental United States, it was perfectly positioned to respond to Soviet Premier Nikita S. Khrushchev's placement of nuclear missiles on Cuba. The agency supported the military during the crisis by supplying fuel and photographic film and the Nation after it, by providing fallout shelter material.

DSA grew substantially following the Cuban Missile Crisis. In 1963 and 1964, it assumed control of additional warehouses and supply centers. In 1965, it consolidated contract management offices under its Headquarters (HQ). Through its Defense Contract Administration Services (DCAS), DSA oversaw most of the Nation's defense contractors, as well as companies manufacturing items for the National Aeronautics and Space Administration (NASA).

The war in Vietnam also fueled DSA's growth. In the summer of 1965, the clothing and textile supply chain doubled its employees to produce enough warm-weather uniforms and jungle boots for the 44 battalions deployed by President Lyndon B. Johnson. Warehouses also increased hiring, adding shifts so they could operate on a 24-hour schedule. When the subsistence supply chain received permission to establish offices in the Pacific, it increased its numbers as well.

DSA received additional responsibilities Outside the Continental United States (OCONUS) in the last years of the war. In 1972, it started conducting property disposal overseas and oversaw the worldwide procurement, management, and distribution of bulk petroleum. In 1973, it began providing food to mess halls and commissaries in Europe. At the same time, the Agency became involved in foreign military sales (FMS). The weapon systems America sold to partner nations needed repair parts, and DSA was the logical provider.

On January 1, 1977, the Department of Defense recognized this expanded mission by renaming DSA the Defense Logistics Agency. Over the next decade and a half, the retitled Agency demonstrated its acquisition prowess by acquiring meals, ready-to-eat; filling the Nation's Strategic Petroleum Reserve; and providing parts for the F-16 Fighting Falcon, the most-manufactured fighter jet in history. Parts production reached all-time highs with the Reagan buildup of the 1980s. In 1986, DLA grew in purpose and scope when Congress designated it a combat support Agency. In 1988, it became even more important to DoD when the General Services Administration (GSA) transferred strategic materials oversight to it. The following year, the Department consolidated nearly all contract administration activities under the Agency. To handle the increased workload, DLA elevated DCAS to a command: the Defense Contract Management Command.

The Agency continued to reorganize in the 1990s. In April 1990, it began overseeing the services' distribution depots. This mission eventually became the responsibility of DLA Distribution. In March 1993, the Agency reengineered its HQ so only 6 organizations, rather than 42, reported directly to the Director. In 1995, as a result of Base Realignment and Closure (BRAC) 88, DLA HQ moved from Cameron Station, VA, to Fort Belvoir, VA. In the mid-1990s, as a result of BRAC 93, the Agency merged its Defense Electronic Supply Center in Dayton, OH, with its Defense Construction Supply Center in Columbus, OH. It called the consolidated center Defense Supply Center Columbus. As part of the same BRAC, the Defense Personnel

History of **DLA**

1961

The Defense Supply Agency is established.

1965

Active combat units deploy to Vietnam. By 1969, more than 500,000 U.S. troops in the country.

1977

DSA is redesignated the Defense Logistics Agency in recognition of its broadened mission responsibilities.

1986

The Goldwater-Nichols Reorganization Act designates DLA a combat support agency.

1988

DLA assumes management of the nation's strategic stockpile from the General Services Administration and Federal Emergency Management Agency. Headquarters and Defense Fuel Supply personnel learn that they will be moving from Cameron Station to Fort Belvoir.

Support Center collocated with Defense Industrial Supply Center in northern Philadelphia to form Defense Supply Center Philadelphia. Finally, Defense Printing Services, renamed Defense Automated Printing Service, transferred to the Agency in October 1996.

The DLA rose to meet new challenges in the new millennium. The Agency responded rapidly to terrorist attacks in 2001, providing logistical support to multiple commands in Operation ENDURING FREEDOM. Beginning that year, DLA supported the conflict by processing more than 6.8 million requisitions worth more than $6.9 billion, providing $21.2 million in humanitarian support, and supplying in excess of 2.3 billion U.S. gallons of fuel. To sustain service members fighting Operation IRAQI FREEDOM, DLA processed 6.4 million requisitions worth more than $6.89 billion, provided 180.5 million field meals, supplied nearly 2.0 million humanitarian daily rations, and sourced more than 3.0 billion U.S. gallons of fuel.

The DLA supported humanitarian and relief missions in addition to military operations in the twenty-first century. In August 2005, it offered food, fuel, and housing to the many Louisianians displaced by Hurricane Katrina. In October and November of 2012, it offered the same services to victims of Hurricane Sandy, one of the worst weather events to strike the eastern coast of the United States. In September 2014, it helped the U.S. Agency for International Development combat the deadly Ebola virus in West Africa, not only providing material but also developing the sustainment footprint. In the later part of the decade, DLA delivered disaster relief to Haiti and the Southeastern U.S., sustained Iraqi and Syrian refugees, helped the U.S. Forest Service fight fires, and provided resources to secure the Nation's southern border.

Since early 2020, DLA has supported the Nation's efforts to fight COVID-19, its most-sustained non-military mission in 60 years. Through the Federal Emergency Management Agency (FEMA), Department of Health and Human Services (HHS), U.S. Army Corps of Engineers (USACE), and military hospitals, the Agency provided personal protective equipment (PPE), ventilators, food, construction material, and repair parts. Among those DLA helped were inhabitants of hard-hit cities, residents of assisted-living facilities, and school children. In addition to supplying mass quantities of scarce goods at low prices, the Agency developed domestically sourced face masks, used additive manufacturing to produce face shields, and tracked PPE data for the entire Federal government. Starting in December 2020, it began distributing vaccines to the military's overseas locations.

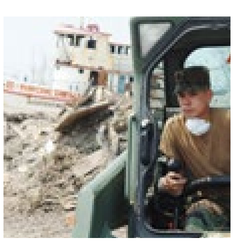
As DLA approaches its 60th anniversary on October 1, 2021, it continues to provide logistics, acquisition, and technical services to DoD and other customers. As it has for sixty years, the Agency adds effectiveness and efficiency to governmental logistics. Forged in history, it remains focused on supporting Warfighters and the Nation they serve.

1993

DLA forms integrated business units for supply management, distribution, and contract management, reducing the number of organizations reporting directly to the DLA director from 42 to 6.

2005

DLA provides support in the wake of Hurricane Katrina.



2012

DLA delivers more than 6.2 million meals, 172,500 blankets, and 14 million gallons of fuel to areas affected by Hurricane Sandy.

2014–15

DLA helps West Africa combat the Ebola virus by providing goods and services in Operation United Assistance.

2020–21

DLA supports efforts to combat the coronavirus by providing personal protective equipment and ventilators to the American people through the Federal Emergency Management Agency and Department of Health and Human Services. It also acts as a purveyor of information, feeds naval crews on lockdown, reutilizes life-saving equipment, and delivers vaccines to the military's overseas locations.

Mission and Vision

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

MISSION

Deliver readiness and lethality to the Warfighter Always and support our Nation through quality, proactive global logistics.

VISION

As the Nation's Combat Logistics Support Agency and valued partner, we are innovative, adaptable, agile, and accountable – focused on the Warfighter Always.

What DLA Does

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

The DLA TF employs approximately 58 civilian personnel, whose labor is paid from DLA TF.

The National Defense Authorization Act (NDAA) is the U.S. Federal law specifying annual budget and expenditures of the DoD.

Fresh Produce

Soldiers assigned to the Arizona National Guard (AZNG) load boxes with fresh produce at a local food bank in Phoenix, Ariz., May 21, 2021. The AZNG continues to support food banks and vaccination sites across the state during this COVID-19 emergency response. Photo By: Army Sgt. Laura Bauer

How DLA TF Accomplishes its Mission

The DLA SM program is a distinct revolving fund which operates under the authority of the Strategic and Critical Materials Stock Piling Act (50 U.S.C. §98, et seq.) (the Act). The mission of the National Defense Stockpile (NDS) program is to provide for the acquisition and retention of stocks of certain S&C materials, and to encourage the conservation and development of sources of S&C materials within the United States. The major activity within the DLA TF is the acquisition and storage of Strategic Materials (SM) as part of managing and operating the Nation's NDS. DLA SM strives to decrease and preclude a dangerous and costly dependency upon foreign sources or a single point of failure for supplies of such materials in times of National Emergency. DLA SM operational goals for the NDS include ensuring efficient and responsible resource stewardship and the highest environmental standards.

Along with providing oversight and acquisition and retention of stockpile materials, DLA SM provides for the conversion and upgrade of stockpile materials to prevent obsolescence, the recycling of strategic materials from end-of-life Government items and disposes of excess stocks for operational funding. DLA SM performs analysis, planning, procurement, and management of materials critical to National security. DLA SM serves clients through a unique combination of technical expertise, global/geopolitical material supply analysis, management of existing critical materials, and broad range tracking of future critical materials.

The DLA SM revenues are generated through auctions to pre-qualified customers of stocks determined excess to DoD needs as determined by Congress through the Annual Sales Plan (ASP) and is the source of funding for operational expenditures and new material acquisitions.

Organizational Chart

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

Figure 1: DLA Organizational Chart

Performance Goals, Objectives, and Results

The DLA has established performance assessments of its programs to evaluate Agency performance and improvement based on the GPRA Modernization Act of 2010. DoD produces an Annual Performance Report (APR) for all its components (including DLA TF) and will include its FY 2021 APR with its FY 2023 Congressional Budget Justification. The APR is located at: https://dam.defense.gov/Publications/Annual-Performance-Plan-and-Performance-Report/.

The Performance Goals, Objectives, and Results within this section are aligned to DLA's 2021-2026 Strategic Plan and provides a summary of DLA's five Lines of Effort (LOEs) and three Critical Capabilities (CCs). These goal-oriented objectives and forward-looking initiatives are designed to strengthen DLA's efforts in sustaining Warfighter readiness and the Nation's responsiveness as described:

Lines of Effort: Key strategic priority used to link multiple objectives that when combined achieve an operational or strategic outcome.

Critical Capabilities: Agency enablers which are essential to accomplishing DLA's strategic objectives and LOEs.

Objectives: Specific goals to be achieved and are the most important actions essential to LOEs and Critical Capabilities – the "how" of the strategy.

The key initiatives that have specific Director's emphasis in DLA's Strategic Plan for 2021-2026 are shown in the LOEs and CCs below.

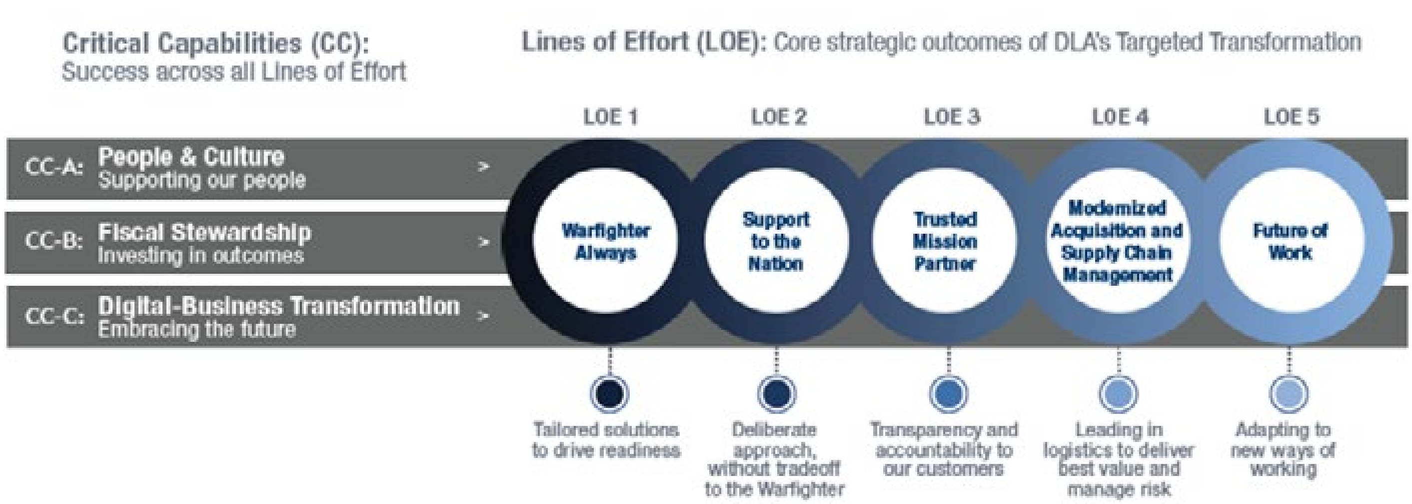


Figure 2: Lines of Effort and Critical Capabilities

The LOEs, CCs and objectives in the section below are derived from DLA's 2021-2026 Strategic Plan; however, there are specific objectives and key performance measures that are applicable to DLA TF and have been identified accordingly below.

LOE 1: WARFIGHTER ALWAYS

Objective 1.1: Improve end-to-end readiness and cost-effectiveness in support of Combatant Commander Campaign Plans and Integrated Contingency Plans in competitive and contested logistics environments

Objective 1.2: Partner with customers at the wholesale and retail levels to address Service-specific challenges and develop solutions

Objective 1.3: Proactively support the DoD Nuclear Enterprise and Space Enterprise

DLA's support to the Warfighter is job one. It's our core strategic priority. We must provide the right support in the right places at the right times.

The Military Services and Combatant Commands have unique needs and capabilities requiring customized solutions.

It's imperative for DLA to make smart, disciplined investments in innovative tailored logistics solutions to increase and sustain weapons system and warfighting readiness – including our Nation's strategic deterrent – to meet today's requirements and prepare for the future fight.

LOE 2: SUPPORT TO THE NATION

Objective 2.1: Implement a deliberate, enterprise-wide approach to Whole of Government support

Capitalizing on our scope, scale and skills in acquisition, storage, distribution, and surge capabilities, the Nation has increasingly called upon DLA to provide Whole of Government support.

DoD is redoubling its commitment to a cooperative, whole-of-nation approach to national security that builds consensus, drives creative solutions to crises, to guarantee that we lead from a position of strength.

As part of this effort, this LOE clarifies a deliberate approach to our Whole of Government mission with no cost trade-off to the Warfighter.

LOE 3: TRUSTED MISSION PARTNER

Objective 3.1: Implement customer-centric performance metrics and predictive problem-solving culture

Objective 3.2: Provide greater financial transparency to customers

Objective 3.3: Provide next generation customer service, including a customer feedback mechanism

Building trust begins with understanding our customers' priorities. Through a collaborative, data-driven problem-solving culture, we will pursue viable solutions to these critical challenges.

DLA will improve trust and transparency by enhancing customer-facing tools and software, formalizing customer feedback and increasing collaboration at all levels. We will align performance metrics and targets to ensure we are accountable to our customers.

LOE 4: MODERNIZE ACQUISITION AND SUPPLY CHAIN MANAGEMENT

Objective 4.1: Expand industry engagement to foster innovation and maximize value for our customers

Objective 4.2: Improve the end-to-end post-award segment to enable collaborative customer support, increase responsiveness, and manage costs

Objective 4.3: Develop a market intelligence capability to manage supply chain risk and drive best value

Objective 4.4: Enhance our acquisition capabilities to improve readiness for contingencies

The global logistics environment is rapidly evolving and increasingly interconnected. DLA must work closely with industry partners to modernize and streamline our acquisition and end-to-end supply chains to deliver increased readiness and maintain our competitive advantage.

Through strong partnerships with our suppliers, and an enhanced focus on market intelligence capabilities, DLA will continue building a diverse, resilient, and agile industrial base to reduce supply chain risk and drive the best value for our customers.

Given the increasing number of global contingencies, this will better position us and our partners to meet the accelerating challenges in an ever-changing world.

At the heart of this LOE is the ability to increasingly harness and analyze business performance data to make informed, risk-based decisions and develop actionable solutions to improve customer outcomes for routine and contingency operations.

LOE 5: FUTURE OF WORK

Objective 5.1: Redefine virtual work models to enable our next generation workforce

Objective 5.2: Assess DLA CONUS facilities footprint to maximize space utilization

Objective 5.3: Build skillsets of the future

The workplace is increasingly virtual, reducing the need for a large physical footprint. Ongoing modernization efforts such as the use of mobile tablets, voice technology, autonomous guided vehicles and other advances to optimize warehouse operations all impact the future of work. DLA will continue adapting to these changes as it attracts and sustains a competitive workforce to drive increased productivity and employee satisfaction.

Creating an optimal work environment for employees that is modern, safe, secure, and well maintained will help increase retention and expand our access to diverse talent pools.

DLA Critical Capabilities

The three Critical Capabilities are fundamental to our successful transformation. They intersect and support the five LOEs with specific underlying objectives, initiatives and metrics.

- **CC-A:** People and Culture
  Supporting our people
- **CC-B:** Fiscal Stewardship
  Investing in outcomes
- **CC-C:** Digital-Business Transformation
  Embracing the future

In these areas, DLA must be ready to act, adapt, reform, and embrace change to improve our organizational efficiency and effectiveness.

Critical Capability A: People and Culture

Objective A1: People

Objective A2: Culture

Our most important asset as an agency is our people. This capability aligns DLA's proven human capital strategies with our mission, LOEs, and objectives.

Our ability to attract, develop, and retain a diverse, skilled, and agile workforce is vital to our continued success.

To achieve a shared vision with the agency's Strategic Plan, all DLA organizations, employees and leaders must work together to fortify the culture, reward high performance, build connections, and prioritize safety of the workforce.

Critical Capability B: Fiscal Stewardship

Objective B1: Auditability

Objective B2: Cost visibility and cash management

Objective B3: Investment to drive efficiency and effectiveness

In an increasingly resource-constrained environment we will drive cost effectiveness while maintaining Service readiness. We must effectively manage our resources while making smart, transformative investments that increase value for our customers and taxpayers.

Through enhanced tools and capabilities, we will improve our cost and cash management for the DLA Transaction Fund.

We will assess our work processes and the effectiveness of current internal controls to provide greater transparency, improve auditability and prevent fraud, waste, and abuse.

Critical Capability C: Digital Business Transformation

Objective C1: Transformational information technology capabilities

Objective C2: Advanced analytics and automation

Objective C3: Cybersecurity

Objective C4: Technology governance

Technology is changing at an exponential rate, generating new possibilities in logistics and customer support. It is also increasing the capabilities of our competitors, the risks to our supply chains and operations.

We are focusing our IT and digital capability investments on key areas that will enable us to enhance performance, reduce costs, and make more predictive and data-driven decisions.

We will transform our systems and processes to improve transparency, reliability, and security for our employees, customers, and suppliers.

We will work internally and with our partners to ensure the agency's network, systems, and data are protected from emerging and complex cyber threats.

Welcome to America

Fort Lee Garrison Command Sgt. Maj. Tamisha Love welcomes an Afghan child to America during reception operations in New Jersey Aug. 5. Photo By: 1st Lt. Tom Burcham IV/Army

Performance Measures (Unaudited)

Performance Measure 1: Sales versus Contract Awards

This performance measure relates to the objectives described above:

Objective B2: Cost visibility and cash management

The DLA SM targets current year sales to equal respective contract awards, as all the contracts signed each year are typically completed that year. SM cash receipts keep the program self-funded, facilitating program operations in current and future years.

The Stockpile Sales Program conducted 45 competitive offerings in FY 2021. The results were 45 sales contracts: 10 more than in FY 2020. FY 2021 contract awards totaled $75.5 million.

Any variances between contract awards and sales are typically due to timing of shipments; if a contract is signed late in the financial period the actual shipment (and the sales recognition) may be delayed until the following period. For the year ending September 30, 2021, sales were higher than contract awards due to shipments relating to contracts that had been awarded late in FY 2020.

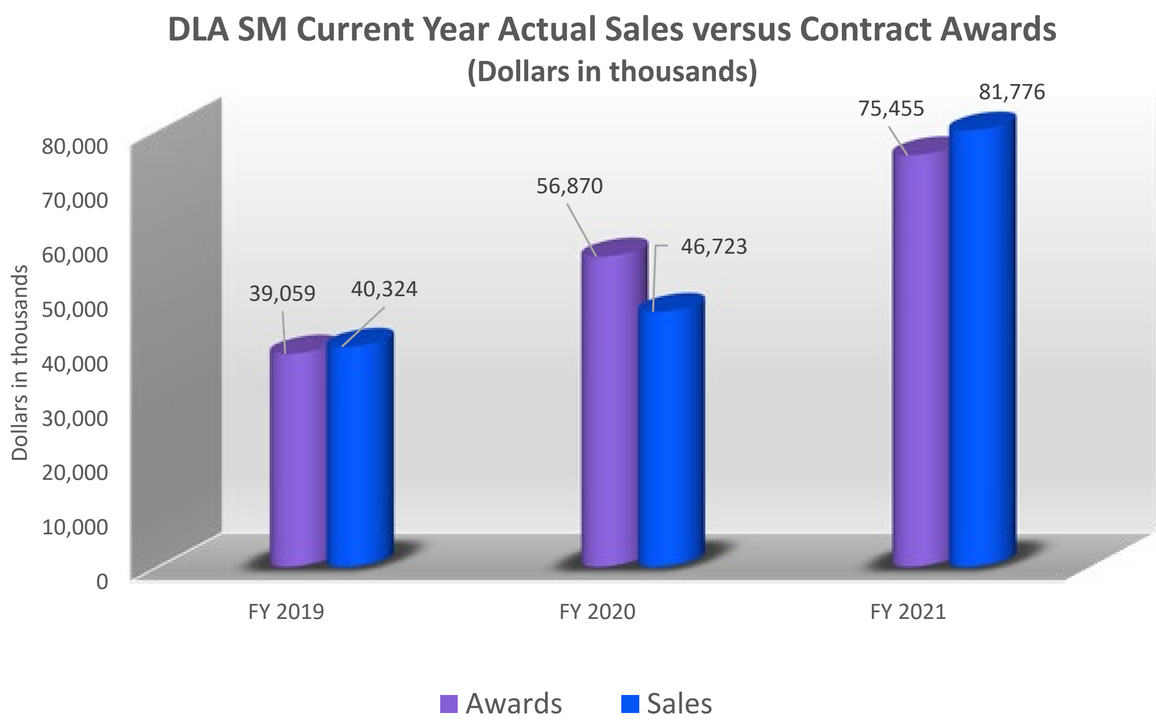


Figure 3: DLA SM Sales and Contract Awards

Performance Measure 2: DLA SM Actual Collections versus Anticipated Collections

This performance measure relates to the objectives described above:

Objective B2: Cost visibility and cash management

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

Through comprehensive analyses and study, all NDS stocks undergo evaluation of need against a stringent set of criteria. The determinations from these analyses may result in authorization by Congress to acquire new materials and deem some current stocks excess. The National Defense Stock Piling Act provides authority for a public competitive sales program, which protects against an avoidable loss to the Government, and avoids undue disruption to the usual markets. The sale of excess stocks requires current existing legislative disposal authority along with an Annual Materials Plan (AMP). Congress typically provides disposal authority via the National Defense Authorization Act. Disposal authority, generally, provides quantity by material but does not always provide for a specific expiration. Additionally, the AMP provides for the ceiling limit quantity of any material sold in a given fiscal year.

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

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

FY 2021 collections totaled $79.0 million, or 94.8% of anticipated collections of $83.3 million. All FY 2021 collections related to FY 2021 sales.

All but two of the DLA Strategic Materials Stockpile Sales Program offerings since April were net 30 days. This translated to awards being made in nearly every offering (45 contacts awarded in 45 offerings) all with values that exceeded minimum pricing tolerances. Basic Ordering Agreement (BOA) sales contracts are fixed price and require payment and removal within 30 days which provides for a quick turn on payment collection.

(continued on next page)

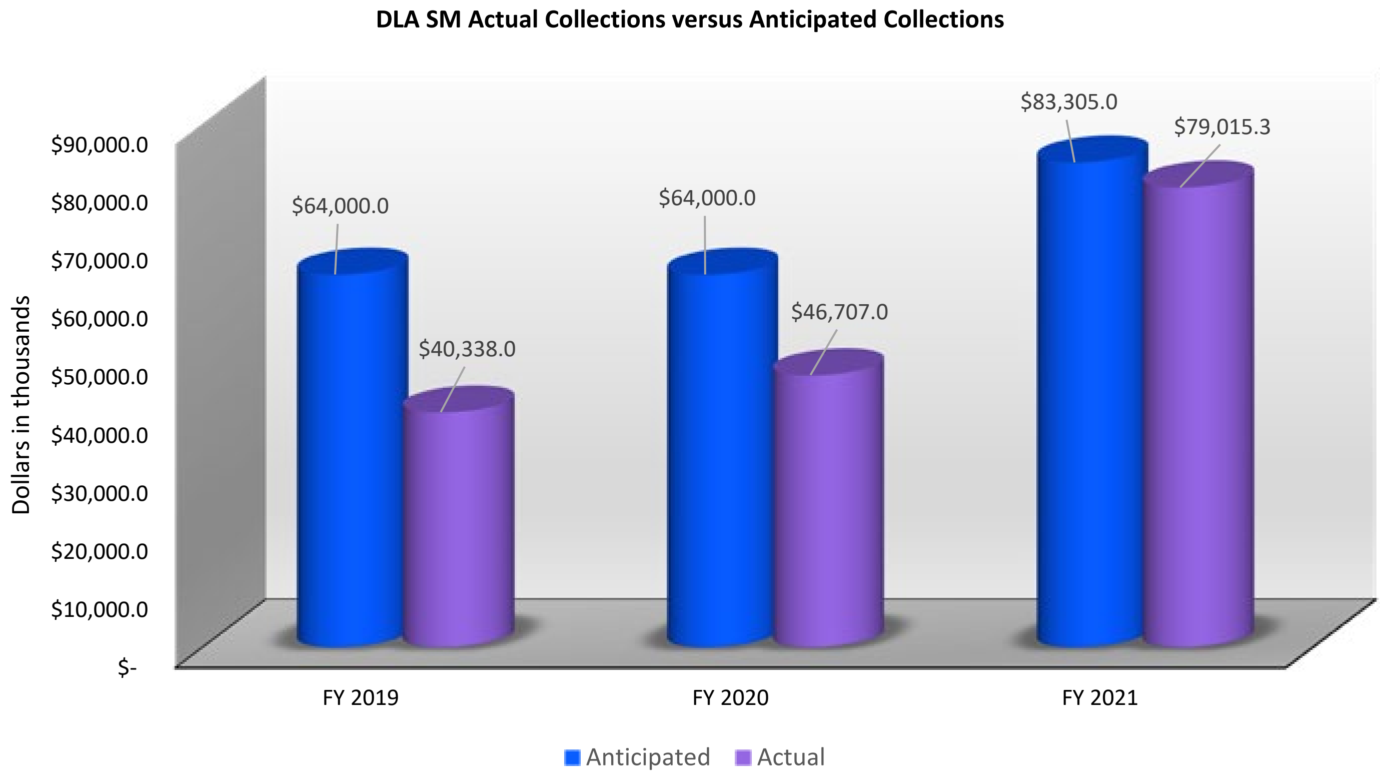


Figure 4: DLA SM Actual Collections versus Anticipated Collections

(From Standard Form 132, *Apportionment and Reapportionment Schedule*)

Securing PPE

Angela Mello, left, a general duty corpsman assigned to Naval Medical Center San Diego, and Navy Ensign. Kaitlyn Leibing, a staff nurse assigned to one of NMCSD's internal medicine wards, don 3D-printed face shields, donated to the hospital by Naval Information Warfare Systems Command, before entering a COVID-19 positive, non-critical patient's room in San Diego, Aug. 4, 2020. Photo By: Navy Petty Officer 3rd Class Jake Greenberg

DLA Roadmap to Auditability

This performance measure relates to the objectives described above:

Objective B1: Auditability

Currently, DLA TF receives a disclaimer of opinion on its financial statements. DLA TF is striving to obtain an unmodified audit opinion from its IPA in the future. Since receiving a disclaimer of opinion each year from FY 2017, DLA TF has taken a two track approach in resolving major impediments in efforts to strive for an unmodified audit opinion: (1) improving the reliability and fair presentation of financial data reported in the AFR by addressing Notice of Findings and Recommendations (NFRs); and (2) developing, improving, and refining the underlying end-to-end processes that support the compilation of the AFR by instilling sound fundamental practices in accordance with U.S. GAAP. The following timeline summarizes the occurrence of events that propelled DLA into a corrective action posture.

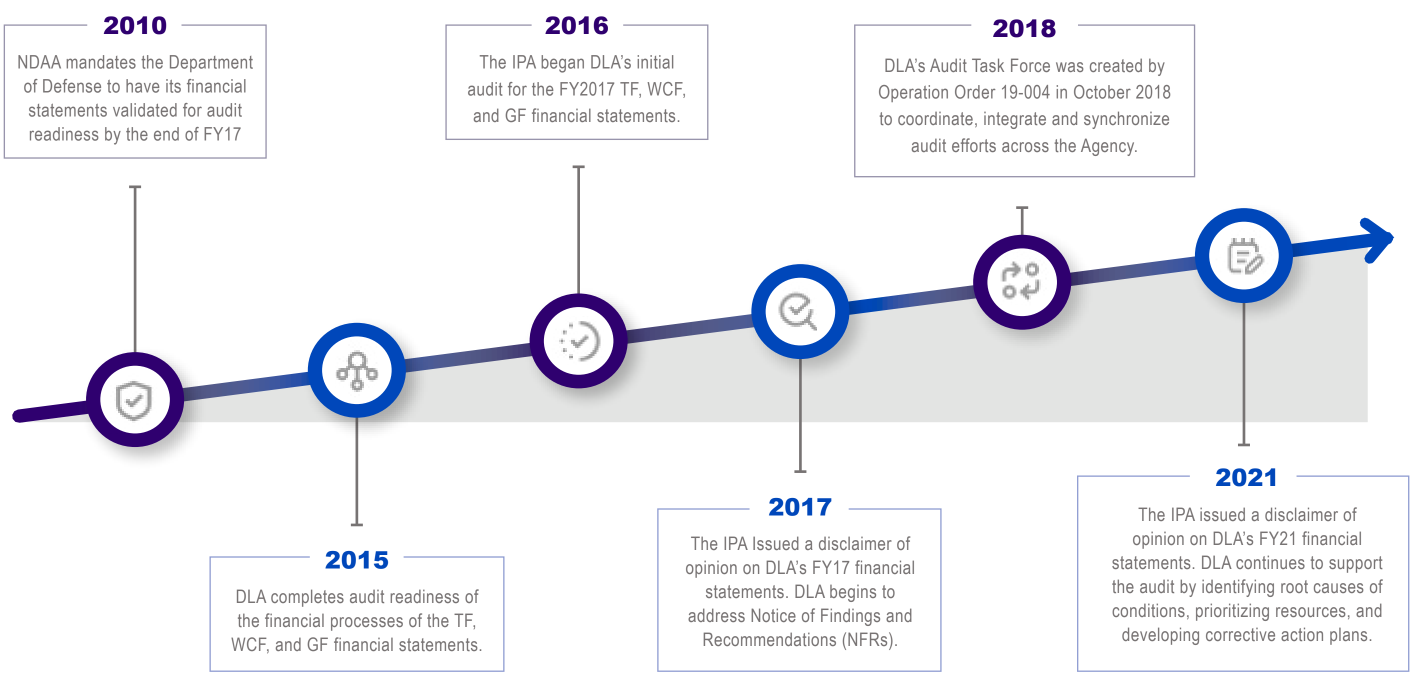


Figure 5: DLA Auditability Timeline

Analysis of Financial Statements and Stewardship Information

This analysis presents a summary of DLA TF's financial position and results of operations and addresses the major changes and the related activity in the amounts of assets, liabilities, net position, cost, revenue, budgetary resources, and obligations.

Overview of Financial Position

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

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

A summary of DLA TF's changes in key financial measures for FY 2021 and FY 2020 is presented in the following Analysis of Key Financial Measures. The table represents the assets on hand to pay liabilities, and the corresponding net position. The net cost of operations is the gross costs of executing DLA TF programs, less earned revenue. The Financial Results Summary section also includes an explanation of significant changes for each DLA TF financial statement.

Air Force, Army Joint Petroleum Training

Senior Master Sgt. Paul Franklin, 302nd Logistics Readiness Squadron fuel shop noncommissioned officer in charge, prepares a group of 59th Quartermaster Company Army petroleum systems technicians to enter a C-130 aircraft Jan. 29, 2021, at Peterson Air Force Base, Colorado. Photo By: Tech. Sgt. Justin Norton

Changes In Key Financial Measures

As of and for the Years Ended September 30, 2021 and 2020 (dollars in millions)

Condensed Principal Financial Statements

Financial Condition	**FY 2021** (Unaudited)	**FY 2020[2] As Restated** (Unaudited)	**Increase/Decrease $**	**Increase/Decrease %**
Fund Balance with Treasury	$ 313.6	$ 280.7	$ 32.9	11.7%
Inventory and Related Property, Net	809.4	740.4	69.0	9.3%
General PP&E, Net and Other Assets	1.7	2.3	(0.6)	(26.1%)
TOTAL ASSETS	**$ 1,124.7**	**$ 1,023.4**	**$ 101.3**	**9.9%**
Accounts Payable	$ 1.1	$ 5.1	$ (4.0)	(78.4%)
Environmental and Disposal Liabilities	9.8	11.1	(1.3)	(11.7%)
Federal Benefits and Other Liabilities	2.7	6.3	(3.6)	(57.1%)
TOTAL LIABILITIES	**$ 13.6**	**$ 22.5**	**$ (8.9)**	**(39.6%)**
TOTAL NET POSITION (ASSETS LESS LIABILITIES)	**$ 1,111.1**	**$ 1,000.9**	**$ 110.2**	**11.1%**
Total Gross Cost	$ 141.3	$ 105.0	$ 36.3	34.6%
Less: Total Earned Revenue	(251.0)	(65.9)	(185.1)	280.9%
NET COST OF OPERATIONS	**$ (109.7)**	**$ 39.1**	**$ (148.8)**	**(380.6%)**

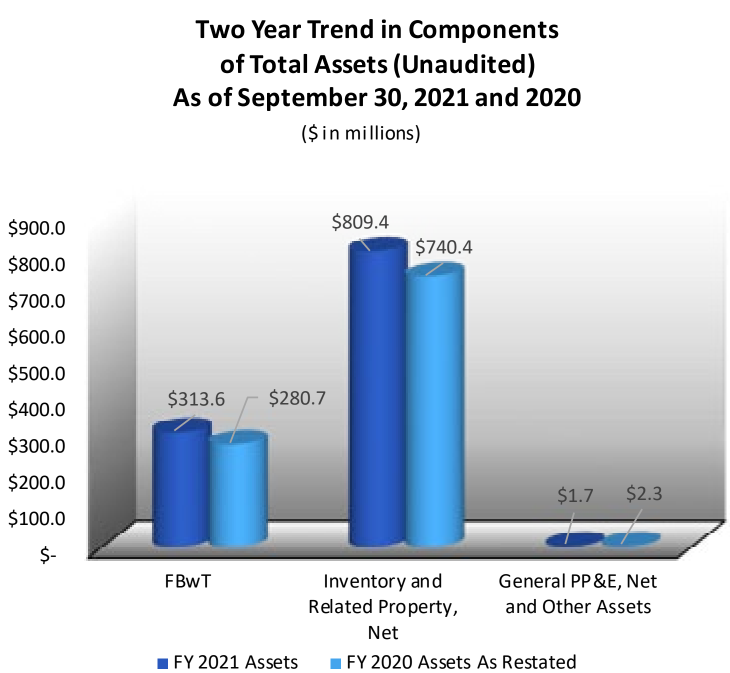
Figure 6: Changes In Key Financial Measures

[2] In FY 2021, DLA TF restated its FY 2020 financial statements to correct errors in the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position. Additionally, the FY 2020 Balance Sheet was reclassified to conform to the FY 2021 financial statement presentation requirements in accordance with OMB Circular No. A-136, *Financial Reporting Requirements.*

Financial Results Summary

Assets - What DLA TF Owns and Manages

Assets represent materials owned and managed by DLA TF that can be used to accomplish its mission as the Nation's Combat Logistics Support Agency and consist of Fund Balance with Treasury, Inventory and Related Property, Net, and General PP&E, Net and Other Assets. The DLA TF's largest asset is Inventory and Related Property, Net, which represent $809.4 million or 72.0% of Total Assets as of September 30, 2021. DLA TF FBwT increase of $32.9 million or 11.7% from September 30, 2020 was primarily attributed to improved collections and higher demand of supplies as the global markets and economy reopened following the COVID-19 shutdown in FY 2020.



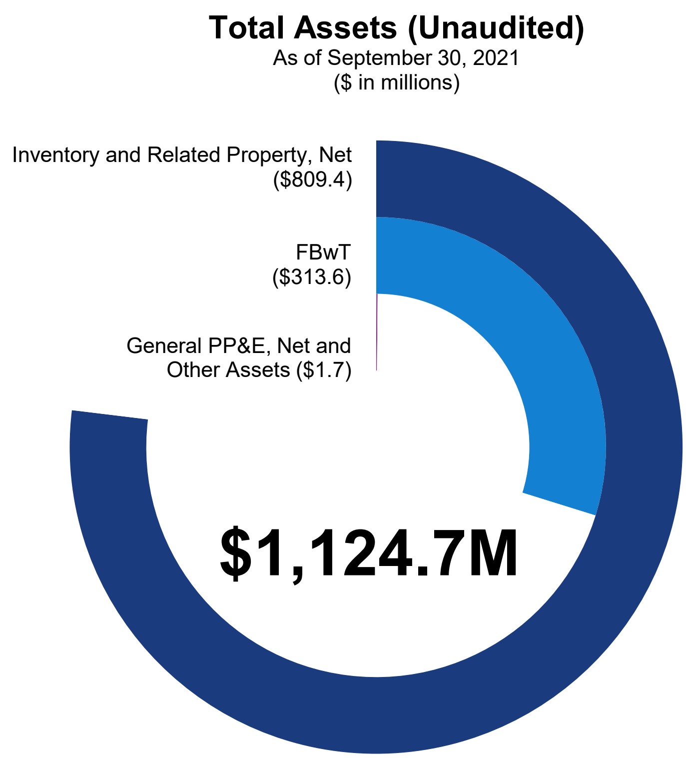
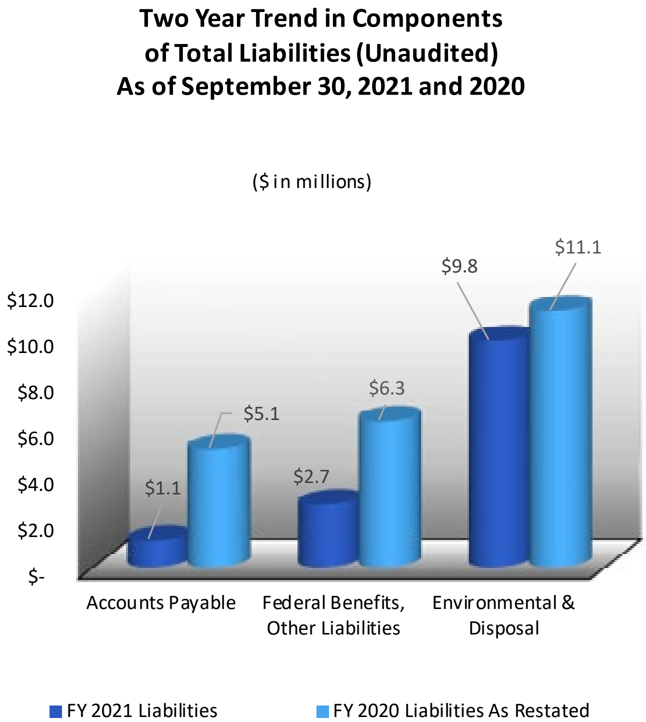


Figure 7: Total Assets by component as of September 30, 2021 and 2020.

Liabilities - What DLA TF Owes

Liabilities are the amounts owed (1) to Federal and public entities (Other than Intragovernmental) for goods and services provided but not yet paid; (2) to DLA TF employees for wages and future benefits; (3) for Environmental and Disposal Liabilities (EL); and (4) for Other Liabilities. The largest liability as of September 30, 2021 was EL, which was associated with restoration of environmental sites on real property that DLA TF does not own but has received funds to execute and manage. The EL balance of $9.8 million represented 72.1% of Total Liabilities as of September 30, 2021. Federal Benefits and Other Liabilities of $2.7 million represented 19.9% of Total Liabilities.



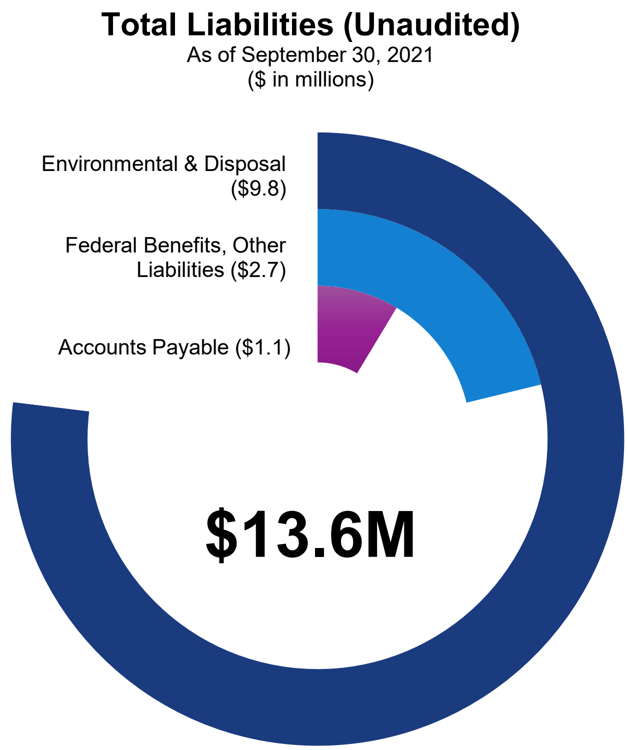


Figure 8: Total Liabilities by component as of September 30, 2021 and 2020.

Net Position - What DLA TF has Done Over Time

Net position represents primarily the accumulation of revenue and expenses, as represented in DLA TF balances reflected in the Statements of Changes in Net Position. DLA TF Net Position consisted of Cumulative Results of Operation of $1,111.1 million as of September 30, 2021 and $1,000.9 million as of September 30, 2020.

Budgetary Activity - DLA TF Budgetary Resources and Obligations

The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds. The budget represents the plan for efficiently and effectively achieving the strategic objectives to carry out the mission and to ensure that DLA TF manages its operations within the appropriated amounts using budgetary controls. Two key components of budgetary activity include Budgetary Resources and Obligations. Budgetary resources are funds available to DLA TF to incur obligations, to pay for goods and services, and to sell products to customers. Obligations are balances for which there has been legally binding action during the year.

For the year ended September 30, 2021, Total Budgetary Resources were $309.5 million and Obligations were $47.8 million. Total Budgetary Resources increased by $44.0 million or 16.6% due to an increase in sales as the global markets and economy reopened following the COVID-19 shutdown in FY 2020.

Net Cost of Operations - DLA TF Net Operating Results

The DLA TF Statements of Net Cost reports one program: Operations, Readiness, and Support. Net Cost of Operations totaled ($109.7) million for the year ended September 30, 2021 and $39.1 million for the year ended September 30, 2020. Net Cost of Operations decreased ($148.8) million, or over (380.6%) due to Total Earned Revenue exceeding Total Gross Cost. The net decrease in Net Cost of Operations was primarily due to an increase in sales as the global markets and economy reopened following the COVID-19 shutdown in FY 2020.

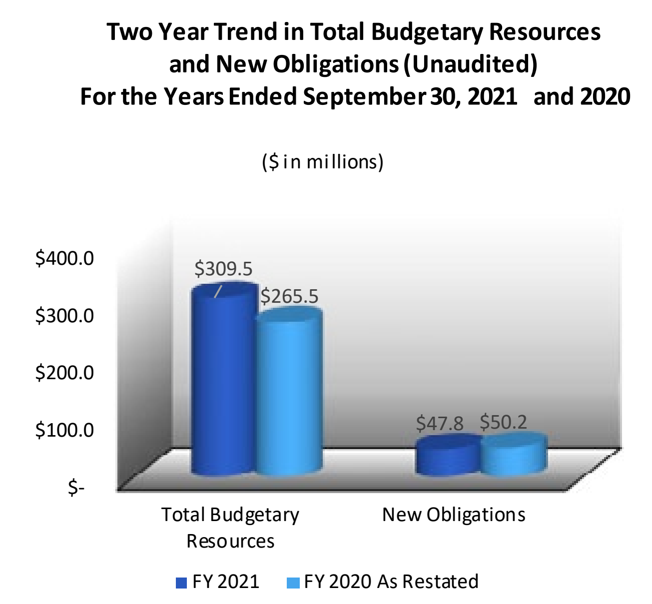


Figure 9: Total Budgetary Resources and New Obligations for year ended September 30, 2021 and 2020.

Limitations of the Financial Statements

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

The DLA TF is unable to fully implement all elements of U.S. GAAP as promulgated by the Federal Accounting Standards Advisory Board (FASAB) and the form and content requirements for Federal government entities specified by OMB Circular A-136, and other authoritative guidance. This is due to financial and nonfinancial management system limitations, as well as limitations on the underlying processes that support the principal financial statements. DLA TF derives reported values and information for major asset and liability categories largely from nonfinancial systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with U.S. GAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by U.S. GAAP, and most of the financial management systems used by DLA TF were designed to record information on a budgetary basis.

The DLA continues to address IT and financial audit NFRs to strengthen system controls, and financial and regulatory compliance with corrective action plans that include developing requests for systems changes. DLA has begun planning and defining requirements for a major system upgrade to the 4th version of System Applications and Products (SAP's) Data processing Enterprise Resource Planning (ERP) Business Suite 4 SAP HANA (SAP S/4HANA). SAP S/4 will provide enhanced reporting of financial information on the full accrual accounting basis and streamline data between IT systems, which DLA continues to consolidate and rationalize through the migration of major legacy systems

The DLA TF continues to develop, improve, and refine the underlying financial and nonfinancial end-to-end processes and systems that support the compilation of the financial statements and notes in accordance with U.S. GAAP as promulgated by FASAB and other Federal regulations. DLA TF continues to implement interim mitigation processes to address known limitations; additionally, DLA TF is remediating material weaknesses to the financial statement preparation process. DLA TF has several corrective actions underway intended to improve the underlying systems, business processes and internal controls.

The financial statements should be read with the realization that they are for a component of the U.S. Government.

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

Water Works

Army Sgt. 1st Class Glenn Malo and Sgt. Jorge Mercado prepare a water buffalo at Fort Bliss. N.M., Sept. 3, 2021. The Defense Department is providing support for Afghan evacuees. Photo By: Army Sgt. Briaira Tolbert

Analysis of Systems, Controls, and Legal Compliance

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

Management Assurances

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

SEP 30 2021

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER OF THE DEPARTMENT OF DEFENSE

SUBJECT: Annual Statement of Assurance Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2021

As Director of the Defense Logistics Agency (DLA), I recognize DLA is responsible for managing risks and maintaining effective internal controls to meet the objectives of Sections 2 and 4 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. DLA conducted its assessment of risk and internal control in accordance with the OMB Circular No. A-123, "Management's Responsibility for Enterprise Risk Management and Internal Control"; and the Green Book, GAO-14-704G, "Standards for Internal Control in the Federal Government." This internal review also included an evaluation of the internal controls around our Security Assistance Accounts (SAA) activities. Based on the results of the assessment, DLA is unable to provide assurance that internal controls over operations, reporting, and compliance are operating effectively as of September 30, 2021.

DLA conducted its assessment of the effectiveness of internal controls over operations in accordance with OMB Circular No. A-123, the GAO Green Book, and the FMFIA. The Summary of Management's Approach to Internal Control Evaluation provides specific information on how DLA conducted this assessment. This internal review also included an evaluation of the internal controls around our Security Assistance Accounts (SAA) activities. Based on the results, DLA is unable to provide assurance that internal controls over operations and compliance are operating effectively as of September 30, 2021.

DLA conducted its assessment of the effectiveness of internal controls over reporting (including internal and external financial reporting) in accordance with OMB Circular No. A-123, Appendix A. The Summary of Management's Approach to Internal Control Evaluation, provides specific information on how DLA conducted this assessment. This assessment also included an evaluation of the internal controls around our Security Assistance Accounts (SAA) activities. Based on the results, DLA is unable to provide assurance that internal controls over reporting (both internal external reporting) as of September 30, 2021, and compliance are operating effectively as of September 30, 2021.

DLA also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with FMFIA and OMB Circular No. A-123, Appendix D. The Summary of Management's Approach to Internal Control Evaluation provides specific information on how DLA conducted this assessment. This internal review also included an evaluation of the internal controls around our Security Assistance Accounts (SAA) activities. Based on the results, DLA is unable to provide assurance that the internal controls over the financial systems are in compliance with the FMFIA, Section 4; Federal Financial Management Improvement Act (FFMIA) of 1996, Section 803; and OMB Circular No. A-123, Appendix D, as of September 30, 2021.

DLA has conducted an assessment of entity-level controls including fraud controls in accordance with the Green Book, OMB Circular No. A-123, the Payment Integrity Information Act of 2019, and GAO Fraud Risk Management Framework. This internal review also included an evaluation of the internal controls around our Security Assistance Accounts (SAA) activities. Based on the results of the assessment, DLA is unable to provide assurance that entity-level controls including fraud controls are operating effectively as of September 30, 2021.

DLA is reporting that no Anti-Deficiency Act (ADA) violation has been discovered/identified during our assessments of the applicable processes.

If there are any questions regarding this Statement of Assurance for FY 2021, my point of contact for this action is Erich Gabris and can be reached at (571) 431-9621 or erich.gabris@dla.mil.

for

M. C. SKUBIC
VICE ADMIRAL, SC, USN
Director

Summary of Internal Control Assessment

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

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

Federal Managers' Financial Integrity Act

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

The evaluation of internal controls extends to every responsibility and activity undertaken by DLA and applies to program, administrative, operational controls, and financial reporting. Furthermore, the concept of reasonable assurance recognizes that: (1) the cost of internal controls should not exceed the expected benefits and (2) the benefits include reducing the risk associated with failing to achieve the stated objectives. Errors or irregularities may occur and not be detected because of inherent limitations in any system of internal control, including those limitations resulting from resource constraints, congressional restrictions, and other factors. The projection of any system evaluation to future periods is subject to risks that procedures may be inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate. Based on the preceding description, DLA is providing a statement of no assurance.

DLA considered the five components and seventeen principles defined by the GAO Green Book to conclude its determination of statement of no assurance. Based on the standards, DLA identified gaps in Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. The Risk Assessment component evaluates the risk facing the entity as it seeks to achieve its objectives and provides the basis for developing appropriate risk responses. Within this component, gaps exist in fraud risk management. Furthermore, DLA lacks sufficient policies and procedures to achieve the control activities principles. The Information and Communication component lacks data quality that affects external communication and the financial statement audit. The lack of assessments also identified the need for improvements in remediation and timeliness of response to internal control failures. Therefore, the overall operating effectiveness of DLA's system of internal control is insufficient to support reasonable assurance.

The DLA SOA package only includes self-identified material weaknesses and significant deficiencies for internal DoD reporting; however, the financial statement audit NFRs continue to be monitored by management. The audit related ICOR and ICOFS material weaknesses that have not yet been remediated are reported in the Summary of Financial Statement Audit and Management Assurances Other Information (OI) section. DLA's SOA Package FY 2021 Material Weaknesses and Significant Deficiencies template included a total of three ICOR-O material weaknesses.

Effectiveness of Internal Control over Operations (FMFIA § 2)	
Material Weaknesses	Corrective Action Summary
Supply Operations: Lack of policy and procedures in place over the management and oversight of First Article Test Exhibits	The DLA will establish and implement policies and procedures for identified areas, train affected personnel on new procedures, and conduct compliance reviews, tests of design, and tests of effectiveness for internal controls.
Business Process Controls: Lack of procedures over the scrap management program	The DLA Disposition Services will perform a risk assessment (to include fraud risks), define, develop, and publish policy and procedures and controls to correct OCONUS Scrap Program.
Contract Administration: Non-verification of supplier invoices	The DLA will perform an analysis, develop and update policies and procedures, test controls, and conduct implementation procedures to remediate the deficiencies associated with this finding.

The DLA is working to improve the documentation around DLA's end-to-end business processes and has not performed full-scale OMB Circular A-123 internal control testing during FY 2021 in order to self-identify and track ICOR and ICOFS material weaknesses that remain unremediated from the FY 2020 SOA package.

To address these deficiencies, the DLA Enterprise Risk Management (ERM) Program Management Office (PMO), led by DLA's Chief Risk Officer, maintain oversight of the full spectrum of DLA's risk portfolio and key internal controls across all organizational and business aspects. This oversight enables DLA to integrate the diverse groups performing elements of risk management and internal control activities under a single umbrella with the goal of improved mission delivery, reduced costs, and response actions focused on key risks to DLA's mission. DLA continues to build the institutional capacity to execute an effective OMB Circular A-123 Program and demonstrates measurable progress that includes:

- Publishing two comprehensive manuals, DLAM 5010.40 Risk Management (Vol I) and Internal Control (Vol II) that provide the concepts for implementing and executing an effective A-123 program;

- Publishing DLA's Fraud Risk Management Strategy, that defines the framework to protect our agency's assets and resources from fraud, waste, and, abuse;

- Conducting a Fraud Risk Maturity Assessment across major DLA programs to identify and build upon activities to mitigate the risks of fraud, waste, abuse, and mismanagement;

- Performing regular reviews of ERM and A-123 efforts and work products through a robust, multi-layered ERM governance structure, including a Senior Management Council (SMC) to identify, escalate, and respond to risks in a methodical way and implement internal controls in the high priority areas;

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

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

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

The DLA's Summary of Financial Statement Audit and Management Assurances for SOA package and audit related material weaknesses are presented in the OI section of this report.

Federal Financial Management Improvement Act

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

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

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

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

FFMSR:

High-risk factors that indicate non-compliance in this area include: the disclaimer of opinion on the FY 2020 financial statements; and material weaknesses over internal controls over reporting and information system non-compliance related to financial system security were reported in FY 2020 and FY 2021 in areas that corresponded to FFMSRs.

Federal Accounting Standards[4]:

High-risk factors that indicate non-compliance in this area include: the disclaimer of opinion on the FY 2020 financial statements and material weaknesses over internal controls over reporting reported by DLA in FY 2020 and FY 2021 in areas that related to compliance with Federal accounting standards.

USSGL at the Transaction Level:

High-risk factors that indicate non-compliance in this area include the disclaimer of opinion on the FY 2020 financial statements and material weaknesses over internal controls over reporting reported in FY 2020 and FY 2021 in areas that related to implementation of the USSGL at the transaction level.

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

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

FFMIA Section 803(a) Requirement	Remediation Activities	Target Date	Responsible Offices
Federal Financial Management System Requirements	The DLA will continue to develop and document policies, procedures, and controls in order to comply with standards, laws, and regulations that promote reliable financial reporting and effective and efficient operations.	FY 2022 - FY 2023	• Finance • Information Operations • Acquisition • Logistics Operations
Federal Accounting Standards Advisory Board (FASAB)	The DLA will continue to perform a root cause analysis to identify underlying issues as well as develop and document policies, procedures, and controls to maintain accounting data to permit reporting in accordance with U.S. GAAP as established by the FASAB.	FY 2022 - FY 2023	• Finance • Information Operations • Acquisition • Logistics Operations
USSGL at the Transaction Level	To reduce the material risks of procedural and posting logic deficiencies and achieve compliance with applicable accounting regulations, DLA will identify non-compliant areas with a financial impact in processes across the enterprise. This approach will include creating and updating policies, procedures and internal controls, as well as requesting the implementation of system changes to address underlying errors in the systemic posting logic.	FY 2022 - FY 2023	• Finance • Information Operations • Acquisition • Logistics Operations

Compliance with Laws and Regulations

Anti-Deficiency Act

The Anti-Deficiency Act (ADA) Title 31 U.S.C. §1341, prohibits Federal employees from obligating funds in excess of an appropriation or before funds are available, or from accepting voluntary services. As required by the ADA, DLA TF notifies all appropriate authorities of any potential ADA violations. At this time, there are no known or potential ADA violations for DLA TF.

The DLA TF has funds control policies to monitor and track commitments, expenditures, and obligations to ensure amounts do not exceed available authority, in compliance with the ADA. DLA TF is continuously evaluating the existing processes and controls to identify areas of improvement.

Digital Accountability and Transparency Act of 2014

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

In FY 2021, DLA completed a comprehensive Data Quality Plan (DQP) in accordance with OMB Memorandum M-18-16, Appendix A to OMB Circular A-123, *Management Reporting of Data and Data Integrity Risk*. This plan leverages several well-established processes to monitor and improve procurement data quality and sets forth the DLA process for reviewing, monitoring, and reporting the required data, as well as how DLA will continue to improve the process. During FY 2021, DLA began implementation of its DQP and executed test plans to assess controls impacting data quality in the core financial system, EBS.

The DLA is unable to provide assurance over compliance with the DATA Act.

Debt Collection Improvement Act of 1996

For the purpose of administrative offset, the Debt Collection Improvement Act of 1996 requires Federal Agencies to refer legally enforceable, past due, non-tax debts to the Secretary of the Treasury after 180 days. Section 5 of the Digital Accountability and Transparency Act of 2014 amended the Debt Collection Improvement Act of 1996 to reduce the time period to 120 days.

Accordingly, at the end of each fiscal quarter, the Defense Finance and Accounting Service (DFAS) prepares the Treasury Report on Receivables (TROR) to notify the Secretary of the Treasury of receivables due from the public aged more than 120 days.

In FY 2021, DLA TF had no delinquent debt to report to Treasury and noted no instances of noncompliance with the Debt Collections Improvement Act.

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

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

The DLA is unable to provide assurance over compliance with the PPA.

Government Charge Card Abuse Prevention Act of 2012

The Charge Card Abuse Prevention Act (Charge Card Act) requires Agencies to establish and maintain safeguards and internal controls for purchase cards, travel cards, integrated cards, and centrally billed accounts. Furthermore, the Charge Card Act requires Agencies to report purchase card violations, and the Inspector General to conduct periodic risk assessments of government charge card programs. DLA is unable to provide assurance over compliance with the Charge Card Act but has multiple layers of processes and controls in place to identify fraudulent purchases.

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

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

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

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

During FY 2021, there were no instances of fraud identified as a result of reviews or audits.

Financial Systems

Financial Systems Strategy

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

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

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

Financial Management Systems Framework

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

Future Financial Management Systems Framework

The DLA has begun migrating the existing SAP Enterprise Resource Planning (ERP) application environment to SAP's Secure HANA Cloud (SHC) platform. DLA has also begun the process for migrating the core financial management system, SAP ECC 6.0 to SAP S/4HANA in SAP's SHC. These migrations will provide an improved cyber security posture as well as enhanced capabilities for accounting and financial reporting and improved auditability.

The DLA is in the first year of a two phased ERP Migration. Phase 1 is ERP Migration to Cloud (M2C) and during this phase all applications that are within the EBS accreditation boundary will be migrated to SAP's Secure HANA Cloud platform. Phase 1 is scheduled to be completed by February 2022. Phase 2 is ERP Migration to Standard (M2S) – SAP S/4HANA in SAP's SHC. Phase 2 has four sub-phases: Business Transformation Study (BTS), Business Process Engineering/Laws Regulations and Policy (BPR/LRP) Analysis, Requirements Development, and Execution.

The BTS was performed to identify opportunities to de-customize and adopt standard SAP S/4HANA capability. DLA will conduct BPR/LRP analysis to identify and challenge DoD LRPs that impede the ability to adopt standard capability. DLA will consider BPR to use standard capability to the maximum extent possible to reduce cost, streamline business processes to adopt industry best practices, and allow for better innovation going forward. Phase 2 is scheduled to be completed by the fourth quarter of FY 2027.

The DLA will also be implementing system changes to meet the requirements of Treasury's G-Invoicing system. G-Invoicing will help address government-wide accounting elimination problems by ensuring trading partners have the same information for intragovernmental transactions. The G-Invoicing required use date for Federal Program Agencies (FPAs) for new orders has been delayed from June 2021. The mandated implementation deadline of October 2022 for new orders includes orders with a period of performance beginning October 1, 2022, or later. FPAs must implement G-Invoicing for "In-Flight" orders by October 2023. The mandated implementation deadline of October 2023 for "In-Flight" orders includes the conversion of orders with an open balance and a period of performance extending beyond September 30, 2023.

The implementation of DoD SLOA will improve interoperability between DoD business systems and provide better end-to-end funds traceability and eliminations reporting to enable successful audits in DoD.

Helping Hands

U.S. Marines, along with British and Turkish forces assist a child during an evacuation at Hamid Karzai International Airport, Kabul, Afghanistan, Aug. 20, 2021. U.S. service members are assisting the Department of State with a non-combatant evacuation operation (NEO) in Afghanistan. Photo By: Marine Corps Staff Sgt. Victor Mancilla

Forward-Looking Information

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

An Ever-Changing Workforce

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

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

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

Technology is the third external factor. COVID-19 has accelerated the use of digital technology and has changed the way work is being performed. More work is being performed virtually rather than on site or in person. DLA developed a COVID-19 Vaccine Questionnaire that will replace the manual email and spreadsheet tracking currently being performed. The Department of Defense expanded efforts to gather data as it relates to COVID-19 vaccinations to better focus vaccine supply availability. As a result, DLA would like to ascertain the percentage of the workforce that has been vaccinated against COVID-19. This information will be used to aid in distribution at locations with shortfalls and assist in prioritizing Agency/DoD vaccination efforts. DLA must recruit, develop, and sustain a workforce that is technically proficient and agile to adopt emerging technologies, which requires innovative human capital management strategies.

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

The DLA has a critical mission to support the Military Services, Combatant Commands, and other Federal Agencies; that includes supporting our Nation's response to COVID-19. The key to DLA's success is its people, and while DLA will respond professionally and swiftly to mission requirements related to COVID-19, DLA will also take necessary steps to protect and inform our workforce. The workforce that has been designated as "mission-critical onsite," must come into their respective workplace throughout the crisis to continue DLA's vital work of supporting Warfighters and the whole-of-government response to the pandemic. This includes deploying overseas; executing our wholesale distribution operations; supporting our Disposition Services customers; enabling our Service customers at shipyards, readiness centers, and depots; keeping our installations safe and secure; performing necessary IT "touch labor"; issuing Common Access Cards (CACs) and fingerprinting new employees; performing classified work; and many other functions requiring physical presence. As an employer, DLA will follow DoD policies and guidelines in taking any actions to address or mitigate the threat posed by COVID-19. This includes disseminating official information by appropriate public or military health authorities, leveraging workplace policies and flexibilities designed to protect our workforce, and activating "continuity of operations" plans should it become necessary. In response to both Families First Coronavirus Response Act (FFCRA) and American Rescue

Plan (ARP), DLA added new leave codes so employees will be able to record excused absences for virus prevention or for care of self or family members with COVID-19. Each DLA major population center has its own plan for returning employees to the workplace, all based on common guidance for a condition-based, deliberate, and safe return. Different locations will go through the various phases on different timelines accounting for local conditions. DLA is monitoring workforce availability and conducting site capability and capacity assessments. DLA will continue to encourage completion of COVID-19 worksite related trainings and to develop methods to effectively hire and onboard personnel with a plan for virtual training and orientation.

External Threats

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

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

In addition, DLA continuously reviews its strategy to meet global mission requirements as prescribed by DoD. DLA developed a 2021-2026 Strategic Plan and amended the plan in April 2021 to meet the evolving requirements of the Warfighter and the nation with a targeted transformative approach encompassing the most critical priorities for the next five years. DLA's Strategic Plan reaffirms and extends DLA's commitment to Warfighter readiness and lethality and to self-accountability. The plan describes five LOEs and three CCs that DLA leverages to provide global, end-to-end supply chain solutions: Warfighter Always, Support to the Nation, Trusted Mission Partner, Modernized Acquisition and Supply Chain Management, Future of Work, People and Culture, Fiscal Stewardship, and Digital-Business Transformation. Each LOE or CC has specific objectives.

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

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

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

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

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

Technological Advancement and Initiatives

As part of the 2021-2026 Strategic Plan, DLA has the Digital-Business Transformation. Digital-Business Transformation focuses on IT and digital capability investments on key areas that will enable DLA to enhance performance, reduce costs, and make more predictive and data-driven decisions. This will transform systems and processes to improve transparency, reliability, and security for DLA's employees, customers, and suppliers. DLA data assets include supply chain, acquisition, personnel, information management, and financial data, along with the infrastructure and exchanges that move it. Looking forward, effective data management will enable DLA to develop data and analysis as a service for its business users to facilitate access to it as well as data-driven decisions.

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

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

DLA Energy Commander Visits Texas Aerostat Site

Defense Logistics Agency Energy Commander Air Force Brig. Gen. Jimmy Canlas and a team from DLA Energy Aerospace visited the Tethered Aerostat Radar System site at El Indio, Texas, Sept. 29. The balloons, technically known as aerostats, are filled with DLA Energy Aerospace helium and are operated by U.S. Customs and Border Protection. They are equipped with an array of high-powered surveillance and communications equipment. Photo courtesy of DLA Energy Aerospace.. Photo By: DLA Energy Aerospace

SECTION 2

Financial Section (Unaudited)

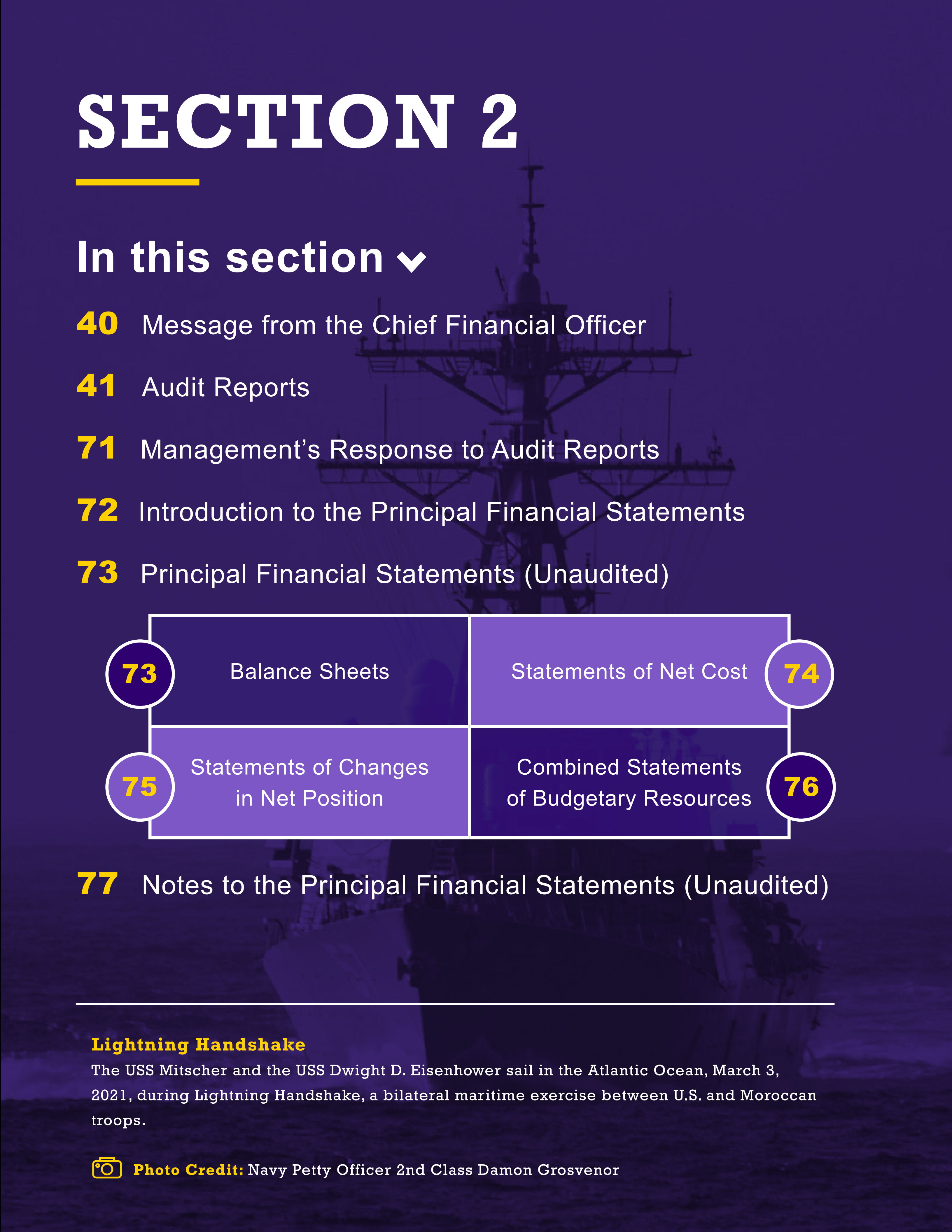
Corps Cover ▶

Marine Corps officer candidates receive uniform items upon arriving at Officer Candidates School at Marine Corps Base Quantico, Va., Sept. 13, 2021.

Photo Credit: Tia Dufour, Marine Corps

SECTION 2

In this section



Lightning Handshake

The USS Mitscher and the USS Dwight D. Eisenhower sail in the Atlantic Ocean, March 3, 2021, during Lightning Handshake, a bilateral maritime exercise between U.S. and Moroccan troops.

Photo Credit: Navy Petty Officer 2nd Class Damon Grosvenor

Message from the Chief Financial Officer

November **2021** (TF)

I am proud to join the Director in issuing our Fiscal Year (FY) 2021 Agency Financial Report (AFR), the fifth Defense Logistics Agency (DLA) has issued since starting the financial statement audit process. DLA Transaction Fund's (TF) FY 2021 AFR highlights certain valuable insights into the overall financial operations, accomplishments, and challenges of the Agency, and this section of the AFR provides a comprehensive view of DLA TF financial activities. DLA remains committed to ensuring value, efficiency, and effectiveness, as well as ensuring outstanding stewardship to protect against fraud, waste, and abuse in every program we manage.

Although DLA received a Disclaimer of Opinion on the Agency's TF financial statements, which denotes that the auditor conducted audit procedures but was unable to express an opinion on the financial statements, DLA continues to make tremendous strides. DLA's continued efforts consist of establishing the framework to correct material weaknesses by reviewing and establishing end-to-end business processes, evaluating operational impacts on the financial statements, identifying the financial statement and financial reporting risks, and designing and implementing the appropriate controls to address those risks.

The DLA enterprise continues to document and evaluate critical processes, identify risks, and develop internal controls to address risks associated with reporting of financial information. Efforts include initiatives to improve budgeting, financial operations, and accounting to enhance the value provided to the Warfighter and our partners. DLA continues to focus efforts and resources towards improving the financial reporting data, upgrading financial and operational systems, concentrating remediation of Notice of Findings and Recommendations in areas with the greatest impact to DLA readiness and lethality, and improved financial data and internal controls with the goal of achieving an unmodified audit opinion. For DLA TF, we are enhancing our internal controls over operations, financial reporting, and financial systems.

As DLA continues to evolve in the audit process, we will continue to learn and use that knowledge to improve and protect our business processes, allowing us to maximize our resources in support of the Warfighter. One of our highest priorities is to provide enhanced financial management and strong governance in support of our goals to identify and address risks, successfully manage challenges including audit findings, and accomplish associated remediation actions necessary to address material weaknesses. Our commitment to fiscal stewardship is paramount in supporting the Warfighter and demonstrates prudent use of the American taxpayer funds entrusted to us.

WARFIGHTER ALWAYS!

J.ARTHUR HAGLER
Director, DLA Finance
Chief Financial Officer

Audit Reports

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

November 8, 2021

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

SUBJECT: Transmittal of the Independent Auditor's Reports on the Defense Logistics Agency National Defense Stockpile Transaction Fund Financial Statements and Related Notes for FY 2021 and FY 2020 (Project No. D2021-D000FE-0059.000, Report No. DODIG-2022-033)

We contracted with the independent public accounting firm of Ernst & Young, LLP (EY), to audit the Defense Logistics Agency (DLA) National Defense Stockpile Transaction Fund (Transaction Fund) Financial Statements and related notes as of and for the fiscal years ended September 30, 2021, and 2020. The contract required EY to provide a report on internal control over financial reporting and compliance with provisions of applicable laws and regulations, contracts, and grant agreements, and to report on whether the DLA's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996. The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018, Volume 1 (Updated, April 2020), Volume 2 (Updated, March 2021), and Volume 3 (Updated, September 2021). EY's Independent Auditor's Reports are attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the DLA Transaction Fund Financial Statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the DLA Transaction Fund FY 2021 and FY 2020 Financial Statements and related notes.

EY's separate report, "Report of Independent Auditors on Internal Control Over Financial Reporting," discusses six material weaknesses related to the DLA's internal controls over financial reporting.[*] Specifically, EY concluded that the DLA did not design or implement effective internal controls to:

- document and validate Inventory balances and transactions;
- reconcile Fund Balance With Treasury;
- support Accounts Payable, expenses, and related budgetary balances;
- review inaccurate financial statement balances and footnote disclosures;
- document end-to-end business processes, monitor internal control risks, and remediate audit findings in a timely manner; and
- ensure the effective design and operation of financial reporting information systems.

EY's additional report, "Report of Independent Auditors on Compliance and Other Matters," discusses two instances of noncompliance with provisions of applicable laws and regulations, contracts, and grant agreements. Specifically, EY's report describes instances in which the DLA's financial management systems did not comply with the Federal Financial Management Improvement Act of 1996 and Federal Managers' Financial Integrity Act of 1982.

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY's representatives. Our review, as differentiated from an audit of the financial statements and related notes in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the DLA Transaction Fund FY 2021 and FY 2020 Financial Statements and related notes. Furthermore, we do not express conclusions on the effectiveness of internal control over financial reporting, on whether the DLA's financial systems substantially complied with Federal Financial Management Improvement Act of 1996 requirements, or on compliance with provisions of applicable laws and regulations, contracts, and grant agreements. Our review disclosed no instances where EY did not comply, in all material

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

respects, with GAGAS. EY is responsible for the attached November 8, 2021 reports, and the conclusions expressed within the reports.

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

Lorin T. Venable

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

Attachments:
As stated

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Report of Independent Auditors

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

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the National Defense Stockpile Transaction Fund of the Defense Logistics Agency (DLA), which comprise the balance sheets as of September 30, 2021 and 2020, and the related statements of net cost and changes in net position and statements of budgetary resources for the years then ended, and the related notes to the financial statements (the financial statements).

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States 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 Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

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

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EY
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Basis for Disclaimer of Opinion

DLA continues to have unresolved accounting issues and material weaknesses in internal controls that cause DLA to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on DLA's financial statements as of and for the years ended September 30, 2021 and 2020.

Disclaimer of Opinion

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

Other Matters

Required Supplementary Information

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

Other Information

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

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

2111-3902072

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Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 8, 2021, on our consideration of DLA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of those reports is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of DLA's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering DLA's internal control over financial reporting and compliance.

Ernst + Young LLP

November 8, 2021

2111-3902072

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States 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. 21-04, *Audit Requirements for Federal Financial Statements,* the financial statements of the National Defense Stockpile Transaction Fund of the Defense Logistics Agency (DLA), which comprise the balance sheet as of September 30, 2021, and the related statement of net cost, statement of changes in net position and statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2021. Our report disclaims an opinion on such financial statements because DLA was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered DLA's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of DLA's internal control. Accordingly, we do not express an opinion on the effectiveness of DLA's internal control. We did not consider all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to preparing performance information ensuring efficient operations.

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a

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material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described below and in Appendix A as items I through VI to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below and in Appendix B as items I and II to be significant deficiencies.

Material Weaknesses

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

I. Inventory – Inventory is comprised of strategic and critical materials that can be used in times of national emergencies. The materials include ores, metals, alloys, chemicals, high-performance fibers and energetics. Policies, procedures and internal controls surrounding documentation of procurements and disbursements, validating the perpetual inventory systems by performing periodic physical counts, accumulating cost of inventory, and supporting inventory balances and transactions all had deficiencies. The combination of these deficiencies in aggregate results in a material weakness in internal control related to inventory. The matters identified related to inventory are further described in Appendix A.

II. Fund Balance with Treasury (FBwT) – FBwT represents the aggregate amount of funds in DLA's account with U.S. Treasury. DLA is unable to reconcile FBwT beginning and ending balances from the general ledger to U.S. Treasury and support the FBwT balance. DLA implemented a process to reconcile the collection and disbursement activity from the general ledger to U.S. Treasury, however, DLA did not implement controls to assess the completeness and accuracy of the source data used in the reconciliation. DLA lacks policies, procedures and controls to evaluate the impact to FBwT for transactions in suspense accounts and the Statement of Differences (SOD). The combination of these deficiencies in aggregate results in a material weakness in internal control related to FBwT. The matters identified related to FBwT are further described in Appendix A.

III. Accounts Payable (AP) and Expense – AP represents the amount owed to third parties by DLA for goods and services received. Expenses are incurred and recognized when DLA obtains services from the public or other federal entities. DLA was unable to support the AP balance, expenses and related budgetary beginning balances. In addition, DLA did not have adequate policies, procedures and internal controls for the procure to pay process, including the process to create and approve obligations and the process to review, record and pay invoices. Furthermore, DLA lacked adequate procedures to record obligations and accrue for liabilities incurred but not paid, and it recorded transactions in the procure to pay process in incorrect periods. The combination of these deficiencies in aggregate results in a material

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weakness in internal control related to AP and expense. The matters identified related to AP and expense are further described in Appendix A.

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

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

VI. Information Systems – Our assessment of DLA's information technology (IT) controls and the computing environment identified deficiencies which, collectively, constitute a material weakness in the design and operation of information systems controls over financial data. Based on our review, we have identified four areas of deficiency which, when aggregated, result in a material weakness. The deficiencies relate to the following four areas:

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

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

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Significant Deficiencies

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

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

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

Management's Response to Findings

DLA's response to the findings identified in our engagement and relevant comments from DLA's management are provided in their accompanying letter dated November 8, 2021. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Ernst & Young LLP

November 8, 2021

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Appendix A – Material Weaknesses

I. Inventory

DLA's inventory is comprised of strategic and critical materials that can be used in times of national emergencies. The materials include ores, metals, alloys, chemicals, high-performance fibers and energetics. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability for all assets for which the agency is responsible. DLA's controls and processes do not exist or are not operating in several significant areas, specifically:

A. **Lack of or Inadequate Policies, Procedures and Controls Over Inventory Processes.** DLA lacks or has inadequate policies, procedures and controls, including the design of controls, over the following:

- **Physical Inventory Counts.** DLA has not adequately designed controls over physical inventory counts. Adjustments for variances identified during the inventory count are not properly evaluated, which includes assessing the impact of the variances to the remaining inventory balance, and are not reviewed for completeness and accuracy. Variance thresholds are established only by using the weight discrepancies without considering the monetary impact. As such, weight discrepancies below the threshold may be a material error and not adjusted in the general ledger and the financial statements.
- **Inventory Recorded in the Appropriate Period.** Policies and procedures are not in place to record transactions in the period that the transaction occurred or to accrue for transactions that occurred but were not posted at period-end. For example, quantity variances identified during the reconciliation of third-party inventory listings to DLA's general ledger system are not recorded in the proper period.

B. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** DLA does not have policies, procedures and controls to effectively implement accounting standards, causing an inaccurate presentation of inventory on the balance sheet and in the related footnote disclosure. Specifically, DLA has neither implemented nor applied the costing and valuation methodologies set forth by Statement of Federal Financial Accounting Standards (SFFAS) No. 3, *Accounting for Inventory and Related Property* and SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*. For example:

- Inventory is valued based on historical cost, unless the carrying amount of the material has suffered a permanent decline in value to an amount less than the cost. DLA does not have defined policies, procedures and controls to determine whether there are permanent declines in value. For example, DLA does not have documentation that describes the valuation process, including the criteria used to determine whether a decline in value is temporary or permanent. In addition, the impairment assessment does not include procedures to perform a periodic review and to document the basis for determining that the benchmarks and inputs used for assessing whether a decline in value has occurred are appropriate.

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- SFFAS No. 3 states that historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. However, DLA records the reconditioning costs associated with the refurbishment of inventory as a period cost rather than capitalized and included as part of the cost to bring the inventory to its current condition. In addition, inventory received from other federal agencies is not properly valued and recorded in accordance with SFFAS No. 3.
- DLA began implementing inventory costing methodologies in accordance with SFFAS No. 48. However, DLA is unable to sufficiently support its application SFFAS No. 48. For example, DLA did not sufficiently document the valuation methods, inputs and assumptions used to determine deemed cost and was unable to provide documentation to support key inputs and assumptions.

Recommendations

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

A. **Lack of or Inadequate Policies, Procedures and Controls Over Inventory Processes.**
- **Physical Inventory Counts.** Design and implement controls over physical inventory counts. The controls should be designed to review adjustments recorded for completeness and accuracy and to assess the monetary impact of variances, individually and in the aggregate across the entire inventory balance.
- **Inventory Recorded in the Appropriate Period.** Design and implement policies and procedures, including controls to process and post transactions to the correct period in the general ledger, and that an accrual is recorded at period-end for transactions that should be posted to reflect recording in the proper period but have not been resolved.

B. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design policies and procedures to implement the accounting standard, SFFAS No. 3 and SFFAS No. 48. The policies and procedures should consider:
- Determining the criteria for when a decline in value should be considered temporary or permanent, how the market value of specific commodities should be selected and performed, and what benchmarks are used to determine market value.
- Ensuring that costs to bring inventory to its current condition, such as reconditioning costs, are properly capitalized.
- Ensuring that inventory received from federal entities is properly valued in accordance with U.S. GAAP.
- Establishing opening inventory balances by valuing inventory using the valuation methodologies provided in SFFAS No. 48, supporting the key inputs and assumptions used in the valuation methodologies with appropriate documentation and verifying that inventory valuation complies with SFFAS No. 3 subsequent to the implementation of SFFAS No. 48.

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II. Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in DLA's account with U.S. Treasury. Treasury's Financial Manual (TFM) Chapter 5100, Section 5130 requires agencies to implement effective and efficient reconciliation processes and perform timely reconciliations. However, deficiencies exist related to DLA's processes of recording and reconciling transactions involving FBwT.

A. **Lack of or Inadequate Documentation of FBwT Accounting Policies, Procedures and Controls.** DLA has not documented the end-to-end process to account for, monitor and report FBwT and FBwT-related transactions. Documentation does not include the process to determine the amounts recorded in suspense accounts and research and resolve differences between U.S. Treasury, disbursing system records and accounting system records on a timely basis (the DoD suspense account contains transactions that are aged more than 60 days).

B. **Lack of Controls for the Reconciliation of FBwT Between the General Ledger and the U.S. Treasury.** DLA lacks or has inadequate controls, including the design of controls, to reconcile FBwT. As a result, DLA is unable to accurately reconcile the beginning and ending general ledger balances to U.S. Treasury.
   - **Collections and Disbursements.** DLA has not effectively designed controls to completely and accurately reconcile collections and disbursement data from the source systems to U.S. Treasury, including controls to reconcile collections and disbursements between the general ledger and Treasury's Secure Payment System (SPS).
   - **Statement of Differences (SOD).** DLA has not effectively designed controls to completely and accurately reconcile FBwT. Specifically, DLA has not demonstrated how the differences included in the SODs were appropriately identified and cleared to the TF. For example, DLA erroneously excluded \$4 million of transactions in the SOD from its opening balance.

C. **Lack of or Inadequate Documentation to Substantiate FBwT.** DLA was unable to provide documentation to support the existence and completeness of FBwT. Specifically, documentation was not available to support the composition of a \$333 million summary journal voucher and demonstrate that the amount is appropriate to include in FBwT.

Recommendations

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

A. **Lack of or Inadequate Documentation of FBwT Accounting Policies, Procedures and Controls.** Finalize the documentation of the end-to-end process for FBwT. The documentation should include the process to perform regular and recurring reconciliations of the suspense account data and the process to research and resolve differences between U.S. Treasury, disbursing system records and accounting system records within a timely basis.

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B. **Lack of Controls for the Reconciliation of FBwT Between the General Ledger and the U.S. Treasury.**
   - **Collections and Disbursements.** Design and implement procedures to assess the completeness and accuracy of the collections and disbursements data from third party systems used in the reconciliation to U.S. Treasury.
   - **SODs.** Design and implement procedures to completely and accurately reconcile FBwT, including demonstrating that the differences included in the SODs associated to the DLA TF are recorded correctly and timely in the general ledger.

C. **Lack of or Inadequate Documentation to Substantiate FBwT.** Develop documentation to support the existence and completeness of FBwT and demonstrate that amounts recorded are appropriate to include in the FBwT balance.

III. Accounts Payable and Expenses

Accounts payable (AP) consists of amounts owed to vendors. Expenses are incurred and recognized when DLA obtains goods and services from the public or other federal entities. Undelivered Orders (UDOs) represent the amount of goods and/or services ordered which have not been received. AP, expenses and UDOs fall within the scope of DLA's procure to pay process. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenses and budgetary transactions applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial reports. Because of the nature of the operations, DLA has a significant volume of transactions to procure goods and services to sell to its customers. Deficiencies exist in DLA's processes for recording and supporting accounts payable, expenses and the related budgetary balances; recording transactions in the proper period; documenting policies, procedures and controls in a sufficient manner; and designing and executing controls over the process to create and approve obligations and to review, record and pay invoices.

A. **Lack of or Inadequate Documentation of UDO, AP and Expenses Accounting Policies, Procedures and Controls.** DLA has not documented the end-to-end processes to account for UDO, AP and expense transactions.
   - **UDO.** The documentation does not include the process to review the validity of significantly aged UDO.
   - **AP.** The documentation does not include the process to evaluate the validity of AP, including significantly aged AP and negative payables; and the process to pay invoices timely or assess interest penalties for late payments in accordance with the Prompt Payment Act.

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B. **Lack of or Inadequate Controls Over UDO, AP, Expenses and Cash Disbursement Processes.** DLA lacks or has inadequate controls, including the design of controls, over the following:

- **UDO.** DLA lacks controls to approve and record obligations in a timely manner; controls to record upward and downward adjustments to UDO accurately and timely; controls to close invalid UDO in a timely manner; and controls to review that the purchase order information is recorded accurately in order to record the obligation in the correct period.
- **Vendor Contracts.** DLA lacks controls to execute contracts in accordance with the Federal Acquisition Regulation (FAR), and record obligations timely for contracts, including Indefinite Quantity Contracts (IQC). For example, IQCs were awarded, and the obligation was not recorded at the contract award date because the IQC did not have a guaranteed minimum at contract award date.
- **AP and Cash Disbursements.** DLA lacks controls to post goods receipts in a timely manner; review invoices prior to payment; and prevent rejected invoices from being paid.
- **Expenses Recorded in the Appropriate Period.** DLA lacks controls to record expense transactions appropriately and accurately in the period that the transaction occurred. As a result, expense transactions were recorded in the incorrect period.
- **Transactions Recorded at the Detailed Level.** DLA lacks controls to comply with the Federal Financial Management Improvement Act (FFMIA), which requires transactions to be recorded at the detailed level. DLA recorded transactions at a summary level for certain budgetary and proprietary accounts. As a result, each summary-level record contained multiple individual transactions. A reconciliation is not performed between detailed transactions posted to the proprietary accounts and the summarized postings to the corresponding budgetary accounts.

C. **Lack of or Inadequate Documentation to Substantiate AP and Expense Transactions.** DLA was unable to provide documentation to support the existence of AP balances, or that expense transactions that occurred are accurately recorded in the financial statements. Specifically, documentation was not available to support the transactions and balances for various accounts, such as accounts payable, negative payables, UDO, and upward and downward adjustments to UDO. For example, DLA was unable to provide sufficient documentation demonstrating that the goods were received for purchase order samples selected.

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** DLA does not have policies, procedures and controls to effectively implement accounting standards. Specifically, DLA has neither implemented nor applied the accounting set forth by SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts* and SFFAS No. 5, *Accounting for Liabilities of the Federal Government.* For example:

- DLA inappropriately expensed costs that should have been capitalized. For example, inventory purchased for resale was inappropriately expensed.

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- DLA processes allow for payment without receipt, thus resulting in a negative payable balance. This occurs when payment is made prior to the goods receipts being posted in the general ledger. This results in an understatement of expenses and payables and a misstatement of UDO.
- AP and accrued liabilities are not recorded appropriately. For example, DLA applied the straight-line method to calculate the accrual amount but did not perform any assessment to determine whether this is an appropriate methodology. Particularly, for Military Interdepartmental Purchase Requests that do not have a fixed monthly cost, the straight-line method is not appropriate.

Recommendations

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

A. **Lack of or Inadequate Documentation of UDO, AP and Expenses Accounting Policies, Procedures and Controls.** Update and finalize the process cycle memoranda that document the end-to-end **processes** for UDO, AP and expenses.
   - **UDO.** The documentation should include the process to review the validity of significantly aged UDO, including a process to write off residual UDO for completed transactions.
   - **AP.** The documentation should include the process to evaluate the validity of accounts payable, including significantly aged AP and negative payables, and the process to pay invoices timely or assess interest penalties for late payments in accordance with the Prompt Payment Act.

B. **Lack of or Inadequate Controls Over UDO, AP, Expenses and Cash Disbursement Processes.**
   - **UDO.** Design and implement controls to approve and record obligations in a timely manner; controls to record upward and downward adjustments to UDO accurately and timely; controls to review and close invalid UDO in a timely manner; and controls to validate that the purchase order information is recorded accurately in order to record the obligation in the correct period.
   - **Vendor Contracts.** Design and implement controls to execute contracts in accordance with the FAR and record obligations timely for contracts, including IQCs. For example, controls that prevent contracts from being completed and executed without the appropriate terms and conditions required by the FAR.
   - **AP and Cash Disbursements.** Design and implement controls to post goods receipts in a timely manner; review invoices prior to payment; and prevent rejected invoices from being processed for payment.
   - **Expenses Recorded in the Appropriate Period.** Design and implement controls to record expense transactions appropriately and accurately in the period that the transaction occurred and controls to monitor expense transactions at or near period-end.

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- **Transactions Recorded at the Detailed Level.** Design and implement controls to comply with the FFMIA and reconcile the transaction-level detail to the summarized postings in each account.

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

D. **Lack of Policies, Procedures and Controls to Effectively Implement Accounting Standards.** Design and implement policies and procedures to record expenses incurred in the proper period and to properly classify costs and payables in accordance with SFFAS No. 1, SFFAS No. 4 and SFFAS No. 5.

IV. Financial Reporting

Financial reporting encompasses all aspects of operations affecting DLA's ability to produce reliable financial statements and disclosures. This process starts with establishing an effective governance structure to identify and assess risk and continues with developing a control environment that is effective and efficient to manage identified risks. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. However, deficiencies exist in DLA's processes related to the accumulation and presentation of their financial position and results of operations.

A. **Lack of or Inadequate Documentation of Financial Reporting and Budgetary Processes.** DLA has not documented the end-to-end processes to account for funds management. The documentation does not sufficiently include a description of the process to record budget authority, the transfer process, and the Treasury warrant process.

B. **Lack of Controls Over Compliance with the TFM United States Standard General Ledger (USSGL).** DLA does not have controls to configure the general ledger posting logic to be compliant with the USSGL and apply TFM updates timely, nor does it have controls to link business events to the correct posting logic. As a result, transactions are not recorded appropriately. For example, DLA inappropriately uses a general ledger account (negative payables) to track payments made without goods received and inappropriately combines entries to record the movement of budgetary funds through the apportionment and allotment process, which should be recorded separately. As a result, DLA did not implement the FY 2021 TFM update to add USSGL account 425400 – Reimbursements and Other Income Earned – Collected From Non-Federal Sources during FY 2021. In addition, the posting logic for various inventory transactions, such as goods being sold and returned into inventory, do not meet the corresponding TFM business events.

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C. **Lack of or Inadequate Controls Over Financial Reporting Processes**. DLA lacks or has inadequate controls, including the design of controls, over the following:

- **Beginning Balances for Budgetary Accounts.** DLA does not have controls to verify the accuracy of the beginning balances for budgetary accounts, such as the Total Actual Resources Collected account.
- **Trading Partner Transactions.** DLA does not have controls in place to validate and reconcile trading partner eliminations. Adjustments made to accounts receivable, accounts payable, revenue, expenses and undisbursed funds are not appropriately supported. A complete reconciliation is not performed at the agreement level to the trading partner adjustments that are being made. As a result, trading partner adjustments are recorded in the Defense Departmental Reporting System (DDRS) as "top-side" adjustments and are identified as "unsupported" by DFAS.
- **Contingent Liabilities.** DLA does not have adequate controls to identify and account for contingent legal liabilities that should be recorded or disclosed in the financial statements.
- **Leases.** DLA has not established a policy, including controls, to account for its leasing arrangements, nor has it completed an assessment whether the leasing arrangements should be accounted for as a capital or an operating lease set forth by SFFAS No. 5, *Accounting for Liabilities of the Government;* and SFFAS No. 6, *Accounting for Property, Plant and Equipment*. As a result, the financial statements do not include disclosures for DLA's policy to account for lease arrangements, any operating lease commitments and future minimum payments due.
- **Financial Statement Close Process.** DLA does not have adequately designed controls around the annual close and reconciliation processes, such as the following: the monthly or quarterly reconciliation between the unadjusted trial balance (UTB) and the adjusted trial balance (ATB) is not performed sufficiently and timely and does not consider system generated JVs; the information used in the reconciliation of UTB to ATB is not complete and accurate; and the review of the procedures performed during the financial statement close process is not adequate. In addition, DLA has not designed processes or controls to implement new accounting standards. As a result, DLA has not implemented accounting standards such as SFFAS No. 49, *Public-Private Partnerships: Disclosure Requirements.*
- **Budgetary to Proprietary Tie Points.** DLA does not have adequately designed controls around the tie-point process. There are reconciliation issues between the budgetary and proprietary tie points. As a result, DFAS records unsupported monthly and quarterly JVs in the general ledger and Defense Departmental Reporting System (DDRS) to reconcile DLA's budgetary accounts to the proprietary accounts.
- **Monthly or Quarterly JV Adjustments.** DLA does not have controls to review and approve JV adjustments recorded in the general ledger and DDRS by DLA and DFAS for completeness, accuracy and validity. As a result, a comprehensive listing of adjustments made is not maintained to allow DLA to determine the appropriateness of each JV adjustment, including those recorded by their service provider.

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- **Financial Statement Review Process.** The level of review of the financial statements and footnote disclosures was insufficient to detect and correct misstatements in the financial statements and related disclosures. As a result, inaccurate balances and disclosures were reported in the financial statements and notes. For example, line items are not appropriately classified between federal and with the public; supporting documentation did not support the balances recorded in the notes; and the financial statements are not prepared in conformity with U.S. GAAP as described in Note 1, Significant Accounting Policies, which did not sufficiently describe changes or noncompliance in U.S. GAAP reporting.
- **Transactions Recorded Using Elevated Privileges.** DLA does not have controls to review and approve transactions recorded with elevated access privileges. There were more than 19,000 transactions recorded, totaling approximately $250 million using user roles with elevated access privileges.

D. **Lack of or Inadequate Documentation to Substantiate Budgetary Amounts.** DLA was unable to provide documentation to support the existence and completeness of Total Actual Resources Collected and Unapportioned Authority. Specifically, documentation was not available to support the composition of a $333 million summary journal voucher and demonstrate that the amount is appropriate to include in Total Actual Resources Collected and Unapportioned Authority. In addition, DLA is unable to provide detailed listings for budgetary accounts at the purchase order (PO) or sales order (SO) level that reconcile to the general ledger, such as delivered and undelivered orders and unfilled customer orders.

Recommendations

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

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

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

C. **Lack of or Inadequate Controls over Financial Reporting Processes.**
- **Beginning Balances for Budgetary Accounts.** Design and implement control activities to accurately state the beginning balance for carryforward budgetary accounts.
- **Trading Partner Transactions.** Design and implement controls to perform a reconciliation at the agreement level to validate trading partner eliminations, which includes identifying, researching and resolving variances between DLA general ledger data and trading partners.

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- **Contingent Liabilities.** Design and implement controls related to claims and litigation to identify, estimate, record and disclose contingent liabilities in the financial statements.
- **Leases.** Design policies and procedures to implement the appropriate accounting standards, specifically SFFAS No. 5 and SFFAS No. 6. The policies and procedures should establish an accounting policy to identify and account for leasing arrangements, including whether the leases should be accounted for and reported as capital or operating leases in accordance with SFFAS No. 5 and SFFAS No. 6. In addition, include the required disclosures for capital and operating leases in the financial statements in accordance with OMB A-136.
- **Financial Statement Close Process.** Develop and implement controls around the annual close and reconciliation process, which includes a complete, accurate and timely reconciliation of the UTB to the ATB and processes and controls to analyze the impact of and implement new accounting standards, as appropriate.
- **Budgetary to Proprietary Tie Points.** Design and implement controls to reconcile budgetary to proprietary tie points and investigate variances.
- **Monthly or Quarterly Journal Voucher Adjustments.** Design and implement controls to review and approve JV adjustments recorded in the general ledger and DDRS by DLA and DFAS for completeness, accuracy and validity prior to posting.
- **Financial Statement Review Process.** Design and implement controls to sufficiently review the quarterly and annual financial statements and disclosures; to detect and correct misstatements; and to review that the financial statements and disclosures are complete and prepared in accordance with U.S. GAAP.
- **Transactions Recorded Using Elevated Privileges.** Design and implement controls to review and approve transactions recorded with elevated access privileges to assess for completeness, accuracy and validity. The review and approval should be performed by authorized individuals such as financial management.

D. **Lack of or Inadequate Documentation to Substantiate Budgetary Amounts.** Develop documentation to support the existence and completeness of budgetary amounts and demonstrate that these amounts are appropriate to include in the balance. Develop and implement procedures to generate complete and accurate listings of budgetary accounts at the PO and SO level that reconcile to the general ledger.

V. Oversight and Monitoring

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

A. **Lack of or Inadequate Documentation Around the OMB A-123 Program**. DLA has not documented the end-to-end process to oversee and monitor the enterprise-level risks and controls, including their OMB A-123 program. Specifically, DLA has not performed and documented a sufficient risk assessment at the enterprise and business process level to assess

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and document reporting matters, such as the complexity of programs, accounting estimates, related party transactions and extent of manual processes; a complete and accurate population of its assessable units, business processes and relevant controls that are responsive to and mitigate risks, including fraud risks; and an assessment and plan for timely remediation of audit findings.

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

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

Recommendations

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

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

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

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

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VI. Information Systems

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

We have noted progress in DLA's ability to define the IT risks relevant to the financial statement audit, configuration changes to the entity level tool for managing approvals required for initial access to DLA financially significant systems, and monitoring of an IT service provider. However, several repeat control deficiencies in the design and operation of financially significant information systems controls continue to remain unresolved.

The deficiencies relate to the following areas:

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

Access Controls

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

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

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

- For a selection of users of financially significant applications, access is not restricted to authorized users with a business need, is not reviewed and documented prior to provisioning, and is not assigned in accordance with the principle of least privilege.
- For a selection of account management controls for financially significant applications, user access and activity are not monitored and tracked for routine access recertification, revalidation of privileged access, and terminated or inactive users.
- For a selection of audit logging controls for financially significant applications, audit logs, security violations, and sensitive user activity are not tracked, monitored, resolved, or configured appropriately within systems.

Configuration Management

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

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

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

- For a selection of changes to one financially significant application, both routine and emergency changes are not reviewed, approved, and tested in a non-production environment prior to release. The impact and functionality of configuration changes are not assessed prior to implementation.
- For one financially significant application, system configurations, baseline code, and production environments are not monitored and inspected for unauthorized changes.
- For one financially significant application, users have access privileges enabling them to bypass the configuration management process and make changes directly to production.

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Segregation of Duties Controls

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

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

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

- Segregation of duties within the user provisioning process is not completed consistently across financially significant applications. Management does not identify segregation of duties conflicts that consider both IT and business process roles and activities. Conflicting roles are not inspected and rationalized prior to provisioning.
- Application program management has not completely identified sensitive (financial transactions) roles in order to identify and implement appropriate segregation of duties.

Security Management/Governance Over Implementation of Security Controls

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

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

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

- SOC 1 reports are not monitored and reviewed to assess CUECs, including validation of whether management's internal controls relevant to the CUECs, are designed, implemented, and operating effectively.

Recommendations

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

Access and Segregation of Duties Controls

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

Configuration Management

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

Security Management/Governance Over Implementation of Security Controls

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

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Appendix B – Significant Deficiency

I. Revenue

Revenue arises when DLA provides goods to the public. The amounts of these transactions make it critical for DLA to properly record and reconcile these transactions to ensure timely, appropriate recognition of costs to the end users. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that revenues applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial reports and maintain accountability of assets.

A. **Improper Revenue Recognition in Accordance with Accounting Standards.** DLA lacks policies, procedures and controls that are intended to properly document and review relevant facts and apply the appropriate revenue accounting under SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, which impacted the revenue and gross cost accounts on the statements of net cost. DLA misapplied the revenue recognition accounting principles set forth by SFFAS No. 7. Specifically:
   - **Gross versus net.** Exchange revenue is recorded net of cost of goods sold at the transaction level. DLA records manual adjustments to present revenue and cost of goods sold on a gross basis on the statements of net cost.

Recommendations

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

A. **Improper Revenue Recognition in Accordance with Accounting Standards.** Design and implement revenue recognition policies, procedures and controls in accordance with SFFAS No. 7. The policies should include considering the appropriate relevant facts to determine that revenue and costs of goods sold are properly recorded and presented in the financial statements.

II. Environmental Liabilities

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

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

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Recommendations

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

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

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States 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. 21-04, *Audit Requirements for Federal Financial Statements,* the financial statements of the National Defense Stockpile Transaction Fund of the Defense Logistics Agency (DLA), which comprise the balance sheet as of September 30, 2021, and the related statement of net cost, statement of changes in net position and statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2021. Our report disclaims an opinion on such financial statements because DLA was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of DLA, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the financial statements, as well as the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 21-04, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

Our Report on Internal Control Over Financial Reporting dated November 8, 2021, includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, and our recommendations to the specific issues presented.

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As referenced in the Fiscal Year (FY) 2021 DLA Statement of Assurance, DLA provides no assurance that the internal controls over operations, financial systems, reporting and compliance are operating effectively in compliance with the Federal Managers' Financial Integrity Act (FMFIA), Section 4; FFMIA of 1996, Section 803; and OMB Circular No. A-123.

FFMIA

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

(a) Federal financial management system requirements

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

(b) Noncompliance with applicable federal accounting standards

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

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

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

FMFIA

Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Government Accountability Office's (GAO's) *Standards*

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for Internal Control in the Federal Government (commonly referred to as the "GAO Green Book") issued under the authority of FMFIA, establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring. To determine if an entity's internal control system is effective, the Green Book requires management to assess the design, implementation and operating effectiveness of the five components of the entity's internal control system.

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

DLA was not able to provide evidence that they are in compliance with significant aspects of OMB Circular A-123, which implemented FMFIA. DLA provided a FY 2021 Statement of Assurance, however there was not sufficient evidence that DLA fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level for each process identified. DLA provided evidence demonstrating that DLA has started to implement a testing strategy, however, DLA is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

Management's Response to Findings

DLA's response to the findings identified in our engagement and relevant comments from DLA's management responsible for addressing the noncompliance are provided in the accompanying letter dated November 8, 2021. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Ernst & Young LLP

November 8, 2021

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Management's Response to Audit Reports

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

NOV 0 8 2021

MEMORANDUM FOR DEPARTMENT OF DEFENSE OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Fiscal Year (FY) 2021 Financial Statement Audit – Transaction Fund

Thank you for the opportunity to comment on Ernst & Young, LLP's Independent Auditor Reports on the Defense Logistics Agency's (DLA), Transaction Fund (TF) financial statements for Fiscal Year 2021. We acknowledge and concur with the material weaknesses and the disclaimer of the opinion.

DLA is in the process of refining our audit strategy, prioritizing our resources toward remediation of critical conditions that are material to our financial statements, with a focus on improving the internal control environment. We acknowledge the material weaknesses identified in Ernst & Young, LLP's Report on Internal Control over Financial Reporting and the control deficiencies outlined therein that impact financial reporting. We will continue working to resolve all the conditions identified in the Notice of Findings and Recommendations through proper root cause analysis and detailed closure packages and Corrective Action Plans. The Agency will continue to make this effort a priority with the goal of making positive progress toward a favorable financial statement audit opinion.

We welcome and appreciate the due diligence of Ernst & Young, LLP, and the efforts and partnership provided by your office as we continue to improve our control environment as part of our overall effort to serve as a beacon for fiscal stewardship within the Department in support of the Warfighter Always!

M. C. SKUBIC
Vice Admiral, SC, USN
Director

Introduction to the Principal Financial Statements

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

The DLA TF financial statements consist of the following:

The Balance Sheets present those resources owned or managed by DLA TF that represent future economic benefits (assets), amounts owed by DLA TF that will require payments from those resources or future resources (liabilities), and residual amounts retained by DLA TF comprising the difference (net position) as of September 30, 2021 and 2020.

The Statements of Net Cost present the net cost of DLA TF operations for the years ended September 30, 2021 and 2020. DLA TF's net cost of operations is the gross cost incurred by DLA TF activities, less any exchange revenue earned and inter-entity eliminations from DLA TF activities.

The Statements of Changes in Net Position present the change in DLA TF's net position resulting from the net cost of DLA TF's operations, budgetary financing sources, and other financing sources for the years ended September 30, 2021 and 2020.

The Statements of Budgetary Resources present how and in what amounts budgetary resources were made available to DLA TF, the status of these resources, and the net outlays of budgetary resources for the years ended September 30, 2021 and 2020.

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

One Aircraft,Two Missions

A C-17 Globemaster III awaits take-off Jan. 28, 2021, at Travis Air Force Base, California. The C-17 was part of a mission to transport 35,950 pounds of firefighting equipment and personal protective equipment to Guatemala and Ramstein Air Base, Germany, respectively. Photo Credit: U.S. Air Force, Senior Airman Christian Conrad

Defense Logistics Agency - Transaction Fund
BALANCE SHEETS
As of September 30, 2021 and 2020
(dollars in thousands)

	Unaudited FY 2021	Unaudited FY 2020 As Restated
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$ 313,633	$ 280,730
Total Intragovernmental	**313,633**	**280,730**
Other than Intragovernmental		
Accounts Receivable	4	38
Inventory and Related Property, Net (Note 3)	809,312	740,427
General Property, Plant and Equipment, Net (Note 4)	797	1,019
Advances and Prepayments	915	1,155
Total Other than Intragovernmental	**811,028**	**742,639**
TOTAL ASSETS	**$ 1,124,661**	**$ 1,023,369**
LIABILITIES (Note 5)		
Intragovernmental		
Accounts Payable	$ 762	$ 1,505
Other Liabilities (Note 6)	282	371
Total Intragovernmental Liabilities	**1,044**	**1,876**
Total Other than Intragovernmental		
Accounts Payable	321	3,609
Environmental and Disposal Liabilities (Note 7)	9,800	11,115
Federal Employee Benefits Payable (Note 6)	2,172	2,790
Advances from Others and Deferred Revenue	-	2,795
Other Liabilities (Note 8)	262	299
Total Other than Intragovernmental Liabilities	**12,555**	**20,608**
TOTAL LIABILITIES	**13,599**	**22,484**
Commitments and Contingencies (Note 9)		
NET POSITION		
Cumulative Results of Operations - Funds from Other than Dedicated Collections	1,111,062	1,000,885
TOTAL NET POSITION	**1,111,062**	**1,000,885**
TOTAL LIABILITIES AND NET POSITION	**$ 1,124,661**	**$ 1,023,369**

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - Transaction Fund
STATEMENTS OF NET COST
For the Years Ended September 30, 2021 and 2020

(dollars in thousands)

	Unaudited FY 2021	Unaudited FY 2020 As Restated
Operations, Readiness & Support		
Gross Cost	$ 141,358	$ 104,972
Less: Earned Revenue	(251,047)	(65,824)
Net Cost	**(109,689)**	**39,148**
NET COST OF OPERATIONS	**$ (109,689)**	**$ 39,148**

The accompanying notes are an integral part of these statements.

Food Pantry
Arizona National Guard service members prepare and distribute groceries for area residents at a food pantry in Snowflake, Ariz., June 22, 2021. The Arizona National Guard activated more than 800 Arizona guardsmen to support food banks during the COVID-19 emergency response. Photo By: Air Force Tech. Sgt. Dillon Davis, Air National Guard

Defense Logistics Agency - Transaction Fund
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30, 2021 and 2020
(dollars in thousands)

	Unaudited FY 2021		Unaudited FY 2020 As Restated	
Cumulative Results of Operations				
Beginning Balance	$	1,000,885	$	1,039,538
Imputed Financing		488		495
Net Cost of Operations		**(109,689)**		**39,148**
Net Change in Cumulative Results of Operations		**110,177**		**(26,983)**
Cumulative Results of Operations: Ending Balance		**1,111,062**		**1,000,885**
TOTAL NET POSITION	**$**	**1,111,062**	**$**	**1,000,885**

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - Transaction Fund

STATEMENTS OF BUDGETARY RESOURCES

For the Years Ended September 30, 2021 and 2020

(dollars in thousands)

	Unaudited FY 2021	Unaudited FY 2020
BUDGETARY RESOURCES		
Unobligated Balance From Prior Year Budget Authority, Net	$ 229,822	$ 214,702
Spending Authority From Offsetting Collections	80,850	50,755
TOTAL BUDGETARY RESOURCES	**$ 310,672**	**$ 265,457**
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments	$ 48,953	$ 50,248
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	44,743	56,934
Unapportioned, Unexpired Accounts	216,976	158,275
Unexpired Unobligated Balance, End of Year	**261,719**	**215,209**
Total Unobligated Balance, End of Year	**261,719**	**215,209**
TOTAL BUDGETARY RESOURCES	**$ 310,672**	**$ 265,457**
OUTLAYS, NET		
Outlays, Net	$ (32,903)	$ 6,588
AGENCY OUTLAYS, NET	**$ (32,903)**	**$ 6,588**

The accompanying notes are an integral part of these statements.

Notes to the Principal Financial Statements (Unaudited)

Note 1: Summary of Significant Accounting Policies (Unaudited)

A. Reporting Entity

Created in 1961, DLA is a component of the U.S. DoD and reports to the OUSD for Acquisition and Sustainment through the Assistant Secretary of Defense for Sustainment. DLA provides material and services to components of DoD (including the U.S. Army, Navy, and Air Force), other Federal Agencies, and public entities. DLA accomplishes its mission and goals through the operations of the DLA WCF, DLA GF, and DLA TF. These financial statements and accompanying notes herein only refer to the activities of DLA TF.

The NDS (commonly known as DLA TF) is composed of S&C materials authorized for use during times of National Emergencies. Initially authorized by the Strategic and Critical Materials Stock Piling Act of 1946, the NDS is a physical reserve of definite quantities of S&C materials, owned by the U.S. government, authorized for use during times of National Emergencies. Executive Order 12626, issued February 25, 1988, designated the Secretary of Defense as the NDS Manager. The Secretary of Defense delegated the management responsibilities to the OUSD for Acquisition and Sustainment through the Assistant Secretary of Defense for Sustainment. The operational activities of the NDS are delegated to the Director of DLA.

The DLA SM program is a distinct revolving fund which operates under the authority of the Strategic and Critical Materials Stock Piling Act (50 U.S.C.) §98, et seq. Under the Act, critical materials are stockpiled in the interest of National defense to preclude a dangerous and/or costly dependence upon foreign or single source suppliers. The NDS Manager administers the acquisition, storage, management, and disposal of the stockpile. The NDAA authorized the NDS Manager to acquire materials determined to be strategic and critical to meet defense, industrial, and essential civilian needs of the U.S. The legislation further provided authority to dispose of certain materials, with proceeds deposited in the fund to finance future stockpile operating costs and procurement of replenishment materials.

B. Basis of Presentation and Accounting

Basis of Presentation and Accounting: The DLA TF fiscal year ends September 30. The accompanying financial statements account for all resources for which DLA TF is responsible. These financial statements present the financial position, results of operations, changes in net position, and budgetary resources of DLA TF, as required by the CFO Act of 1990, expanded by the GMRA of 1994, and other applicable legislation. The financial statements are prepared from the books and records of DLA TF in accordance with U.S. GAAP promulgated by the FASAB[5] and presented in the format prescribed by the OMB Circular A-136, except as identified in Note 1.C., *Departures from U.S. GAAP*, and in the following paragraphs.

The DLA TF financial statements reflect both accrual and budgetary accounting transactions, except as identified in Note 1.C., *Departures from U.S. GAAP*. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash. Budgetary accounting is based on concepts set forth by OMB Circular A-11, Preparation, Submission, and Execution of the Budget, as amended which provides instructions on budget execution. Budgetary accounting is designed to recognize the budgetary resources and the related status of those budgetary resources, including the obligation and outlay of funds according to legal requirements, which in many cases is made prior to the occurrence of an accrual-based transaction. Budgetary accounting is essential for compliance with legal constraints and controls over the use of Federal funds.

However, DLA TF is unable to fully prepare financial statements in conformity with and implement all elements of U.S. GAAP (refer to Note 1.C., *Departures from U.S. GAAP*), the form and content requirements for Federal government entities specified by OMB Circular A-136, due to limitations of financial and

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

nonfinancial management processes and systems that support the financial statements. In addition, the financial management systems used by DLA TF are unable to meet all full accrual and budgetary accounting requirements as many of the financial and nonfinancial feeder systems and processes were not designed to collect and record financial information on the full accrual accounting basis as required by U.S. GAAP. These systems were designed to support reporting requirements for maintaining accountability over assets, reporting the status of Federal appropriations, and recording information on a budgetary basis, rather than preparing financial statements in accordance with U.S. GAAP.

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

Statements of Budgetary Resources: The budgetary accounting concepts are recognized in the Statements of Budgetary Resources. The Statements of Budgetary Resources present; (1) budgetary resources for the fiscal year; (2) status of those budgetary resources (includes obligated[6] amounts and unobligated[7] amounts for the fiscal year); and (3) Outlays[8], Net for the fiscal year, which is comprised of Outlays less Offsetting Receipts (cash transactions). DLA TF's budgetary resources[9] include unobligated balances of resources from prior years and new resources, consisting of spending authority from offsetting collections.

Intragovernmental and Other than Intragovernmental Transactions:

Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, distinguishes between Intragovernmental and Other than Intragovernmental assets and liabilities. Intragovernmental assets and liabilities arise from transactions among Federal entities. Intragovernmental assets are claims other Federal entities owe to DLA TF. Intragovernmental liabilities are claims DLA TF owes to other Federal entities, whereas Other than Intragovernmental assets and liabilities arise from transactions with public entities. The term public entities encompass domestic and foreign persons and organizations outside the U.S. Government. Other than Intragovernmental assets are claims of DLA TF against public entities. Other than Intragovernmental liabilities are amounts that DLA TF owes to public entities.

The DLA TF engages in transactions with other DoD and Federal entities that generate inter-DoD and intragovernmental balances; however, DLA TF is unable to reconcile and resolve differences between balances and transactions with other DoD and Federal entities in accordance with OMB Circular A-136 requirements and Treasury Financial Manual (TFM), Volume I, Part 2, Chapter 4700, *Federal Entity Reporting Requirements for the Financial Report of the United States Government*.

The process is not fully implemented (refer to Note 1.C., *Departures from U.S. GAAP*, related to Intragovernmental/Intra-departmental and Other than Intragovernmental Transactions).

Intra-departmental Transactions: DoD reporting entities reconcile with their trading partners at the detail transaction level. Detail transactions provide support for reported balances requiring elimination with trading partners. DLA TF is ultimately responsible for the accuracy of its trading partner data and initiating actions to reconcile balances with its trading partners; however, DLA TF is unable to resolve the reconciling differences in amounts reported for the buyer/seller transactions reciprocal category with Other Defense Organizations (ODOs), (refer to Note 1.C., *Departures from U.S. GAAP*, related to Intragovernmental/Intra-departmental and Other than Intragovernmental Transactions). A DoD reporting entity unable to provide detail transactions at the appropriate time of the financial statement reporting cycle must adjust its balance to match the seller's or buyer's supportable data.

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

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

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

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

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

Use of Estimates: The DLA TF management has made certain estimates and assumptions when reporting assets, liabilities and expenses and disclosures in the notes. DLA TF's estimates are based on historical experience, current events and other assumptions that are believed to be reasonable under the circumstances. However, uncertainties associated with these estimates exist and actual results may differ from these estimates; Significant estimates reported in the financial statements include: (1) environmental and disposal liabilities and (2) Federal Employees' Compensation Act (FECA) actuarial liability as of the date of these financial statements.

C. Departures from U.S. GAAP

Financial management systems and operations continue to be evaluated and modified as DLA TF strives to remediate its material weaknesses and record and report its financial activity in accordance with U.S. GAAP. Therefore, DLA TF is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with U.S. GAAP. However, due to the financial management systems and operational limitations, the known departures from U.S. GAAP described below have been identified that impact DLA TF financial statements although other departures from U.S. GAAP may exist that have not been identified.

Definition of Reporting Entity: The DLA TF has not completed analyzing material applicable business relationships with other organizations to identify consolidation entities, disclosure entities, or related parties in accordance with SFFAS 47, *Reporting Entity* (effective FY2018). As a result, DLA TF is unable to determine if there are consolidation entities that are required to be consolidated and disclosed in DLA TF financial statements or disclosure entities and related parties where the nature and magnitude of such relationships are required to be disclosed in a Disclosure Entities and Related Parties note to the financial statements.

Statements of Net Cost: The DLA TF does not have policies and compliant processes in place to present its major program costs aligned with DLA TF mission and goals by responsibility segments in accordance with SFFAS 4, *Managerial Cost Accounting Concepts and Standards*, and OMB Circular A-136.

Intragovernmental/Intra-departmental and Other than Intragovernmental Transactions (Note 1.B.): The DLA TF does not have compliant processes in place to properly report and distinguish between intragovernmental, intra-departmental, and Other than Intragovernmental transactions in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*.

Inter-Entity Cost (Note 1.S.): The DLA TF does not have compliant processes in place to recognize all significant inter-entity costs related to inputs of its goods or services provided to entities for a fee or user charge in accordance with SFFAS 55, *Amending Inter-Entity Cost Provisions*, (effective FY 2019). Generally, the fees and user charges should recover the full costs of those goods and services. Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold.

Fund Balance with Treasury (Note 1.F. and Note 2): The DLA TF is not able to account for Fund Balance with Treasury (FBwT) in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, due to its inability to identify and reconcile beginning balances and unknown entity transactions in DoD Statement of Differences to determine if they impact TF FBwT balances.

Accounts Receivable, Revenue, and Gains (Notes 1.G, 1.H., and 1.S.): The DLA TF does not have policies and compliant processes in place to recognize gains in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. DLA TF improperly recognized gains when: (1) acquiring purchased stockpile materials and receiving upgraded and/or reconditioned stockpile materials and (2) making adjustments in FY 2021 to the value of its stockpile materials for which it did not have sufficient evidential matter to support the historical cost in accordance with SFFAS 3 (refer to Note 1.C., *Departures from U.S. GAAP*, related to Inventory and Related Property, Net.)

Inventory and Related Property, Net (Note 1.H. and Note 3): The DLA TF does not have policies and compliant processes in place to account for stockpile materials in accordance with SFFAS 3, *Accounting for Inventory and Related Property*, and SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. Furthermore, DLA

TF has not completed establishing beginning balances for stockpile materials using deemed cost and has not made an unreserved assertion as permitted by SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials* (effective FY 2017). More specifically:

Inventory Quantities: The DLA TF does not have proper policies and procedures to record inventory quantities in the proper period and to sufficiently support the existence and completeness of the inventory quantities recorded;

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

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

Stockpile Materials Valuation: The DLA TF does not have proper policies and procedures over the inventory valuation process. During FY 2021, DLA TF made adjustments to the value of its stockpile materials for which it did not have sufficient evidential matter to support the historical cost in accordance with SFFAS 3. Most adjustments were made utilizing fair market value prices as of September 30, 2020. The adjustments recognized a gain or a loss for each inventory item. These adjustments were not made in accordance with U.S. GAAP. The results are an overstatement to total gross cost and total earned revenue reported in the Statements of Net Cost and a misstatement to Inventory and Related Property, Net reported in the Balance Sheets.

Inventory Restatement: DLA TF made adjustment to Stockpile Materials inventory related to weight reverification activity from FY 2020. However, these adjustments could not all be attributed to FY 2020 activity as some of the adjustments were related to weight reverification activity performed in fiscal years prior to FY 2020. In addition, DLA could not provide sufficient support for the adjustments recorded. The adjustments recognized a gain or a loss for each inventory item. The results are an overstatement to total gross cost and total earned revenue reported in the Statements of Net Cost for FY 2020.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Advances and Prepayments; Accounts Receivable, Revenue, and Gains; and Accounts Payable, Expenses, and Undelivered Orders; and Note 12, *Restatements of the FY 2020 Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position.*)

Leases (Note 1.J.): The DLA TF does not have polices and compliant processes in place to identify, evaluate, record, and report capital and operating leases in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*, SFFAS 6, *Accounting for Property, Plant, and Equipment,* and SFFAS 10, *Accounting for Internal Use Software* (IUS). As such, DLA TF does not have any capital or operating leases reported or disclosed as of the date of these financial statements.

Advances and Prepayments (Note 1.K. and Note 1.M.): The DLA TF does not have compliant processes in place to properly report Advances and Prepayments in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities* (refer to Note 1.C., *Departures from U.S. GAAP*, related to Inventory and Related Property, Net; and Note 12, *Restatements of the FY 2020 Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position.*)

Accounts Payable, Expenses, and Undelivered Orders (Notes 1.M. and 1.T.; Note 3; Note 5; Note 6; and Note 10):

The DLA TF does not have policies and compliant processes in place to account for accounts payable, expense accruals, and the related UDO's in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*, and SFFAS 5, *Accounting for Liabilities of the Federal Government*. More specifically:

Negative Payable: The DLA TF processes allow for payment to be made prior to the goods receipts being posted in the accounting system. Given that DLA does not post goods receipts timely, and that the posting of goods receipts triggers the recognition of expense and accounts payable, these processes result in negative balances existing in accounts payable (refer to Note 1.C., *Departures from U.S. GAAP*, related to Inventory and Related Property, Net);

Expenses: The DLA TF improperly recognized expenses when: (1) acquiring stockpile materials; (2) receiving upgraded and/or reconditioned stockpile materials; and (3) improperly recognized loses when adjusting the value of its stockpile materials, resulting in an overstatement of expenses. In addition, DLA is unable to support historical costs; therefore, cost of goods sold is not properly recognized (refer to Note 1.C., *Departures from U.S. GAAP*, related to Inventory and Related Property, Net); and

Undelivered Orders: The DLA TF does not have sufficient policies and procedures in place to record obligations at the time contracts are awarded. In addition, DLA TF is unable to support the UDO balance in the accounting system.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Inventory and Related Property, Net; and Note 12, Restatements of the FY 2020 Balance Sheet, *Statement of Net Cost, and Statement of Changes in Net Position*).

Environmental and Disposal Liabilities (Notes 1.L. and 1.N.; Note 7; and Note 9): The DLA TF does not have policies and compliant processes in place to reconcile asset listings to the amounts recorded for EL related to cleanup, asset closure, and asbestos associated with general PP&E, in accordance with SFFAS 5, Accounting for Liabilities of the Federal Government; SFFAS 6, Accounting for Property, Plant, and Equipment, and Federal Financial Accounting and Auditing Technical Release 2, Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government (refer to Note 1.C., *Departures from U.S. GAAP*, related to Commitments and Contingencies).

Commitments and Contingencies (Notes 1.L. and 1.N.; Note 7; and Note 9): The DLA TF did not complete its assessment of commitments and contingencies in accordance with SFFAS 5, *Accounting for Liabilities of The Federal Government*, and SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation*: An Amendment of SFFAS 5, *Accounting for Liabilities of the Federal Government* (refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities).

Reconciliation of Net Cost to Net Outlays (Note 11): The DLA TF does not have an established policy for the reconciliation of net cost to net outlays in accordance with SFFAS 53, *Budget and Accrual Reconciliation*. DLA TF is also unable to fully prepare reconciliation of net cost to net outlays in conformity with U.S. GAAP due to limitations of financial and nonfinancial management processes and systems that support the underlying financial information (refer to Note 1.B., *Basis of Presentation and Accounting*).

Public-Private Partnerships: The DLA TF has not completed analyzing all applicable business relationships to determine if these arrangements or transactions indicate the existence of Public-Private Partnerships (P3) relationships, risk-sharing arrangements or transactions lasting more than five years between public and private sector entities, in accordance with SFFAS 49, *Public-Private Partnerships*: Disclosure Requirements, (effective FY 2019). As a result, DLA TF is unable to determine the nature of such partnerships and related Federal funding amounts required to be disclosed in a P3 note to the financial statements, if applicable.

D. Pronouncements Recently Issued but Not Yet Effective

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

FASAB Statement No	SFFAS 54	SFFAS 57 (paragraphs 3 – 8, 11, and 12)
FASAB Standard	Leases: An Amendment of SFFAS 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 6, *Accounting of Property, Plant, and Equipment*	Omnibus Amendments FY 2019
Adoption Required in FY	Deferred to FY 2024	Effective FY 2024

SFFAS 58, ***Deferral of the Effective Date of SFFAS 54, Leases***, defers SFFAS 54, ***Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment*** until FY 2024; earlier implementation is not permitted. SFFAS 54, revises the current Federal financial reporting standards for lease accounting and requires that Federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. SFFAS 57, *Omnibus Amendments 2019*, amends certain references to leases affected by SFFAS 54, as well as other minor changes in order to improve clarity of existing statements.

E. Funding Sources

The DLA TF receives annual apportionments of spending authority from offsetting collections from OUSD based on expected sales of materials that have been deemed excess to the needs of the Stockpile. The proceeds from the sale of materials are DLA TF's major source of authority used to fund operations. The funds in the revolving fund do not expire but remain available for the NDS subject to Congressional and OUSD approval as part of the annual apportionment process.

F. Fund Balance with Treasury

The DLA TF does not maintain cash in a commercial bank, but rather in the U.S. Treasury. DLA TF's FBwT includes the amount available for DLA TF to pay current liabilities and finance authorized purchases, except as restricted by law. The disbursing offices of DFAS, the U.S. Army Corps of Engineers, GSA, and the Department of State's financial service centers process DLA TF's cash collections, disbursements, and adjustments.

The DLA TF is the only agency using Treasury Account Symbol (TAS) 97X4555, the National Defense Stockpile Transaction Fund, which allows DLA to identify the transactions belonging to this fund. On a monthly basis, DLA TF adjusts its FBwT account balance to bring its cash balance in agreement with the U.S. Treasury cash balance reported on the Central Accounting and Reporting System (CARS). The adjustments represent the undistributed disbursements and collections amounts that have been reported to Treasury, but have not yet been posted to DLA TF's accounting system. Undistributed amounts can be a result of timing, invalid line of accounting, and invalid Treasury Account Symbol (TAS) information, and unsupported and unreconciled differences.

The DLA TF's accounting service provider, DFAS, uses U.S. Treasury suspense accounts to hold transactions temporarily prior to identifying the correct appropriation. Suspense account items represent the amounts that are reported to U.S. Treasury at the Treasury Index (TI) Level (TI-17, TI-21, T-57, T-97), but have not yet been classified to a DLA TF TAS. The transactions in suspense accounts include unidentified collections, disbursements, and Intragovernmental Payment and Collection transactions at month end. DFAS researches suspense transactions in each TI to post them against the appropriate line of accounting. The current balances for DLA TF suspense transactions are derived from the DFAS suspense Account Universe of Transactions (UoT).

U.S. Treasury also compares DoD's FBwT reported by DFAS with comparable data submitted by financial institutions and U.S. Treasury Regional Financial Centers and notifies DoD of differences in collection and disbursement data on the Statement of Differences (SOD) report. DFAS reviews the SOD report to research and resolve differences. The current balances for DLA TF SOD transactions are derived from DFAS management analysis and the SOD UoT.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Fund Balance with Treasury and Note 2, *Fund Balance with Treasury*.)

G. Accounts Receivable

Accounts receivable represents amounts due to DLA TF from public sources. DLA's accounts receivable arises from sales of stockpile materials.

The DLA TF customers remit payments in advance before material is shipped. There are instances when, the material delivered to the customer is in excess of the amount paid for in advance by the customer. When this occurs, DLA TF establishes an accounts receivable for the amount of material delivered in excess of the advance payment received. These amounts are minimal and historically are collected within 30-60 days. The risk of uncollected receivable is minimal; therefore, DLA TF does not establish an allowance for doubtful accounts.

(continued on next page)

H. Inventory and Related Property, Net

The DLA TF's Inventory and Related Property, Net includes stockpile materials, which are categorized as;

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

Stockpile Materials Held in Reserve for Future Use: Stockpile materials held in reserve for future use is comprised of S&C materials held due to statutory requirements for use in National defense, conservation, or National Emergencies. The S&C materials are not held with the intent of selling in the ordinary course of business; and

Stockpile Materials Valuation: Both stockpile materials classifications are valued at historical cost. They are recorded as assets when acquired and recorded as expenses when sold.

(Refer to Note 1.C., *Departures from U.S. GAAP,* related to Accounts Receivable, Revenue, and Gains, Accounts Payable, Expenses, and Undelivered Orders, and Inventory and Related Property, Net, and Note 3, *Inventory and Related Property, Net.*)

I. General Property, Plant and Equipment, Net

The DLA TF's General Property, Plant and Equipment (PP&E) consists of general equipment used to facilitate the Agency's mission. DLA TF uses the Straight-Line (S/L) method to calculate and record depreciation expense. The S/L method is based on the acquisition cost and expensed over the asset's useful life in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*.

Capitalization Threshold: The DLA TF's General PP&E assets are recorded at the historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the $250,000 capitalization threshold.

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

Depreciation Method and Useful Life:

Asset Classes	Depreciation Method	Useful Life (Years)
General Equipment	S/L	5 or 10

(Refer to Note 4, *General Property, Plant and Equipment, Net.*)

J. Leases

As of the date of these financial statements, DLA TF has not completed the process of developing policies and procedures to identify, evaluate, record, and report capital and operating leases in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 6, *Accounting for Property, Plant, and Equipment*, (refer to Note 1.C., *Departures from U.S. GAAP*, related to Leases).

K. Advances and Prepayments

Advances represent cash outlays to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Prepayments represent payments made by a federal entity to cover certain periodic expenses before those expenses are incurred.

When advances are permitted by law, legislative action, or presidential authorization, DLA's policy is to record advances or prepayments. DLA recognizes advance payments made for stockpile materials before the goods are provided by the contractor.

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

L. Commitments and Contingencies

In accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government, as amended by SFFAS 12, Recognition of Contingent Liabilities Arising from Litigation*, DLA TF recognizes contingent liabilities in DLA TF's Balance Sheets and Statements of Net Cost when the loss is determined to be probable and reasonably estimable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury. DLA TF evaluates all contingent liabilities based on three criteria: probable, reasonably possible, and remote.

The DLA TF recognizes that the estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recorded. If no amount within the range is a better estimate than any other amount, the minimum amount of the range is recorded and the range and a description of the nature of the contingency are disclosed.

The DLA TF records an accrual for contingent liabilities if it is probable and reasonably estimable and discloses those contingencies that are reasonably possible in Note 9, *Commitments and Contingencies*, of the financial statements. DLA TF does not disclose or record contingent liabilities when the loss is considered remote.

For matters where DLA Counsel is unable to express an opinion regarding the likely outcome of the case and an estimate of the potential liability cannot be made, the total amount claimed against the government is classified as “Reasonably Possible” and disclosed if available.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities and Commitments and Contingencies; Note 7, *Environmental and Disposal Liabilities*; and Note 9, *Commitments and Contingencies*.)

M. Liabilities

Liabilities represent probable and measurable future outflows of resources as a result of past transactions or events and are recognized when incurred, regardless of whether there are budgetary resources available to pay the liabilities. However, liabilities cannot be liquidated without legislation providing resources and legal authority (refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses, and Undelivered Orders and Advances and Prepayments, Note 5, *Liabilities Not Covered by Budgetary Resources*, and Note 6, *Other Liabilities*.)

Liabilities Covered and Not Covered by Budgetary Resources: Liabilities covered by budgetary resources include those liabilities for which Congress appropriated funds and are otherwise available to pay amounts due as of the Balance Sheet dates. Liabilities not covered by budgetary resources are amounts owed in excess of available, congressionally appropriated funds and, therefore, no budgetary resources are available to pay amounts due as of the Balance Sheet dates (refer to Note 5, L*iabilities Not Covered by Budgetary Resources*).

Current and Noncurrent Liabilities: The DLA TF discloses its other liabilities between current and noncurrent liabilities in accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities*. The current liabilities represent liabilities that DLA TF expects to settle within 12 months of the Balance Sheet dates. Noncurrent liabilities represent liabilities that DLA TF does not expect to be settled within 12 months of the Balance Sheet dates (refer to Note 8, *Other Liabilities*).

Accounts Payable: Accounts Payable includes amounts owed but not yet paid to Intragovernmental and Other than Intragovernmental entities for goods and services received by DLA TF. DLA TF estimates and records accruals when services are performed or goods are received. DLA TF also accrues liabilities incurred at month-end but not yet recorded using data from Third Party Payment Systems, and estimates of costs incurred when goods or services received but not invoiced.

Advances from Others and Deferred Revenue: Advances from Others and Deferred Revenue are cash received in advance of goods or services that have not been fully rendered.

N. Environmental and Disposal Liabilities

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

The DLA TF is responsible for accurate reporting of EL and expenses for the real property and/or equipment that it records and reports in its financial statements as assets, regardless of ownership by any Federal Agency. DLA TF identifies and estimates accrued EL through its annual cost-to-complete (CTC) process. DLA TF’s accrued EL comprises of environmental cleanup costs associated with restoration of environmental sites on real property that it does not own, but has received budget authority to execute and manage. These environmental sites may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, clean closure of assets, and post- closure costs related to the Agency’s operations that result in hazardous waste.

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

and Note 9, *Commitments and Contingencies*.)

O. Payroll and Annual Leave Accruals

Accrued payroll consists of salaries, wages, and other compensation earned by employees, but not yet disbursed as of the Balance Sheet dates. DLA TF accrues the cost of unused annual leave, including restored leave, compensatory time, and credit hours as earned and reduces the accrual when leave is taken. The payroll and annual leave accrual liability is accrued based on the latest pay period data for reporting purposes (refer to Note 8, *Other Liabilities*).

P. Federal Employee Benefits Payable

The FECA (Public Law 103-3) provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from DLA TF for these paid claims. The FECA liability consists of two elements.

The first element, accrued FECA liability, is based on actual future payments for claims paid by DOL but not yet reimbursed by DLA TF. DLA TF reimburses DOL for claims as funds are appropriated for this purpose. In general, there is a one to two- year period between payment by DOL and reimbursement to DOL by DLA TF. As a result, DLA TF recognizes an intragovernmental liability, not covered by budgetary resources, for the claims paid by DOL that will be reimbursed by DLA TF. (refer to Note 5, *Liabilities Not Covered by Budgetary Resources*, and Note 6, *Federal Employee Benefits Payable and Related Other Liabilities.*)

The second element, actuarial FECA liability, is the estimated liability for future payments and is recorded as an other than Intragovernmental liability, not covered by budgetary resources. The actuarial FECA liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. DOL determines the actuarial FECA liability annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value.

The methodology for billable projected liabilities includes, among other things: (1) an algorithmic model that relies on individual case characteristics and benefit payments (the FECA Case Reserve Model) and (2) incurred but not reported claims were estimated using historical incurred benefit liabilities and payments. (refer to Note 5, *Liabilities Not Covered by Budgetary Resources* and Note 6, *Federal Employee Benefits Payable and Related Other Liabilities.*)

Q. Pension Benefits

Based on the effective Federal government start date, DLA TF's civilian employees participate in either the Civil Service Retirement System (CSRS), a defined benefit plan, or the Federal Employees Retirement System (FERS), a defined benefit plan and contribution plan. The employee pension benefit is managed at the OUSD level. The measurement of the service cost requires the use of an actuarial cost method and assumptions. The Office of Personnel Management (OPM) administers these benefits and provides the factors that DLA TF applies to calculate and recognize imputed costs, as reported in its Statements of Net Cost, and a corresponding imputed revenue in the Statements of Changes in Net Position. DLA TF is not responsible for and does not report CSRS or FERS assets, accumulated plan benefits, or liabilities applicable to its employees. OPM is responsible for and reports these amounts.

R. Net Position

Net position is the residual difference between assets and liabilities and consists of cumulative results of operations. Cumulative results of operations consist of the net difference since inception between: (1) expenses and losses; (2) revenue and gains; and (3) other financing sources (refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivable, Revenue, and Gains, Inventory and Related Property, Net, and Accounts Payable, Expenses, and Undelivered Orders)

S. Revenue and Other Financing Sources

Exchange and Non-exchange Revenue: The DLA TF classifies revenue as either exchange revenue or non- exchange revenue. Exchange revenue arises when DLA TF sells the materials that have been deemed excess to the needs of the Stockpile. The proceeds from the sale of materials are DLA TF's major financing source and are used to fund the operation. In addition, materials are offered for sale on the open market and are awarded through competitive bidding.

Non-exchange revenue is derived from the government's sovereign right to demand payment, such as specifically identifiable, legally enforceable claims. Non-exchange revenue is considered to impact the cost of operations and is reported in the Statements of Changes in Net Position as a financing source. For the years ended September 30, 2021 and 2020, respectively, DLA TF does not have activity related to non-exchange revenue.

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

Imputed Financing and Imputed Cost: In certain cases, DLA TF receives goods and services from other Federal entities at no cost or at a cost less than the full cost to the providing entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by DLA TF are recognized as imputed cost in the Statements of Net Cost and are offset by imputed financing in the Statements of Changes in Net Position. DLA TF recognizes the following imputed cost and related imputed financing: (1) employee benefits administered by the OPM (i.e., retirement, health, life insurance benefits); and (2) claims settled by the Treasury Judgment Fund in accordance with SFFAS 55, *Amending Inter-Entity Costs Provisions*.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Inter-Entity Cost, Accounts Receivable, Revenue, and Gains and Inventory and Related Property, Net.)

T. Expenses

Expenses are recognized when there are outflows, usage of assets, or incurrences of liabilities (or a combination) from carrying out activities related to DLA TF's program and missions, for which benefits do not extend beyond the present operating period. For financial reporting purposes, operating expenses are recognized in the period incurred (refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payable, Expenses, and Undelivered Orders).

U. Reclassifications

The FY 2020 Balance Sheet was reclassified to conform to the FY 2021 financial statement presentation requirements in accordance with OMB Circular A-136, as amended, and included changes in the presentation to: Note 5, *Liabilities Not Covered by Budgetary Resources*; Note 6, *Federal Employee Benefits Payable and Related Other Liabilities*; Note 8, *Other Liabilities*; and Note 11, *Reconciliation of Net Cost to Net Outlays*. The reclassifications had no effect on total assets, liabilities, or net position.

DLA Distribution Delivers Johnson & Johnson Vaccines to Overseas Troops

Johnson & Johnson vaccines are packaged for shipping to overseas troops from Defense Logistics Agency Distribution Susquehanna, Pennsylvania, March 12, 2021, as part of the federal response to COVID-19. Photo Credit: Matthew Mahoney, DLA Distribution Public Affairs

Note 2: Fund Balance with Treasury (Unaudited)

Fund Balance with Treasury as of September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

	FY 2021	FY 2020
Status of Fund Balance with Treasury		
Unobligated Balance:		
Available	$ 44,743	$ 56,934
Unavailable	238,999	182,133
Obligated Balances Not Yet Disbursed	29,891	41,663
Total Fund Balance with Treasury	**$ 313,633**	**$ 280,730**

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

Unobligated Balance - Available includes the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations and can be used for future obligations.

Unobligated Balance - Unavailable includes the cumulative amount of unapportionment and sequestrated funds not available for obligation from offsetting collections.

Obligated Balances not yet Disbursed includes funds that have been obligated for goods and services not received and those received but not paid.

Non-budgetary FBwT consists of FBwT in unavailable receipt accounts and clearing accounts that do not have budgetary authority and non-budgetary FBwT such as non-fiduciary deposit funds. As of September 30, 2021 and 2020, DLA TF does not have a balance for non-budgetary FBwT.

Other Information includes the following tables summarizing the undistributed collections and disbursements between U.S. Treasury and DLA TF as of September 30, 2021 and 2020, respectively:

All Aboard

Marines board the USS Lewis B. Puller from an inflatable boat during visit, board, search and seizure training in the Persian Gulf, March 19, 2021. Photo By: Marine Corps Sgt. Sarah Stegall

FY 2021 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)			
Transaction Type	**Treasury Balance based on CARS**	**DLA TF Trial Balance**	**Balances Not Yet Recorded in DLA Accounting System - Undistributed**
Collections	$ 83,052	$ 83,052	$ 0
Disbursements	$ 46,111	$ 46,203	$ (92)

FY 2020 Adjustments of Undistributed Collections and Disbursements (dollars in thousands)			
Transaction Type	**Treasury Balance based on CARS**	**DLA TF Trial Balance**	**Balances Not Yet Recorded in DLA Accounting System - Undistributed**
Collections	$ 45,467	$ 49,502	$ (4,035)[10]
Disbursements	$ 56,092	$ 56,221	$ (129)

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

[10]As of September 30, 2021 and 2020, respectively, DLA TF recorded $0.0 million and $4.0 million, respectively as a Statement of Difference. The Statement of Difference adjustment represents a DLA Fund Balance with Treasury balance at Treasury but not reflected on DLA's Line of Accounting, and also not reflected in DLA's trial balance.

Note 3: Inventory and Related Property, Net (Unaudited)

Inventory and Related Property, Net as of September 30, 2021 and 2020, respectively, include stockpile materials and consist of the following (dollars in thousands):

	Valuation Method	FY 2021	FY 2020 As Restated
Inventory and Related Property, Net			
Stockpile Materials Held for Sale	HC	$ 10,143	$ 17,391
Stockpile Materials Held in Reserve for Future Use	HC	799,169	723,036
Total Inventory and Related Property, Net		**$ 809,312**	**$ 740,427**

HC = Historical Cost[11]

Stockpile Materials Held for Sale is comprised of materials deemed to be excess and have been identified for disposal based on the annual sales plan. The Stockpile Materials Held for Sale in FY 2021 includes Ores, Metals, Minerals, and Alloys. As of September 30, 2021 and 2020, Stockpile Materials Held for Sale estimated selling price is $16.5 million and $18.9 million, respectively.

Stockpile Materials Held in Reserve for future use consist of a variety of industrial commodities including base and minor metals, ferrous and non-ferrous ores, metal powders and mercury.

Based on the Mercury Export Ban Act that was signed into law on October 14, 2008, Federal Agencies are prohibited from conveying, selling or distributing metallic mercury that is under their control or jurisdiction. This includes stockpiles held by DoD. Beginning January 1, 2013, United States Federal Agencies are prohibited from the export of metallic mercury.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivable, Revenue; Accounts Payable, Expenses, and Undelivered Orders; and Gains, and Inventory and Related Property, Net.)

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

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

General Property, Plant and Equipment, Net as of September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

FY 2021			
	Acquisition Value	Accumulated Depreciation	Net Book Value
Major Asset Class:			
General Equipment	$ 2,337	$ (1,540)	$ 797
Total General Property, Plant and Equipment, Net	**$ 2,337**	**$ (1,540)**	**$ 797**

FY 2020			
	Acquisition Value	Accumulated Depreciation	Net Book Value
Major Asset Class:			
General Equipment	$ 2,337	$ (1,318)	$ 1,019
Total General Property, Plant and Equipment, Net	**$ 2,337**	**$ (1,318)**	**$ 1,019**

The table below discloses activity for General Property, Plant and Equipment, Net as of September 30, 2021 and 2020 (dollars in thousands):

	FY 2021	FY 2020
General Property, Plant and Equipment, Net - Beginning Balances	**$ 1,019**	**$ 1,242**
Depreciation Expense	(222)	(223)
General Property, Plant and Equipment, Net - Ending Balances	**$ 797**	**$ 1,019**

Preparing the Workspace

Air Force Staff Sgt. Vittoria Gonzalez and Air Force Staff Sgt. Ayanna Blanco, aerospace medical technicians assigned to the 161st Medical Squadron, prepare a workspace to be used for the administration of the COVID-19 vaccine at Cesar Chavez Cultural Center in San Luis, Arizona, March 30, 2021. Photo By: Army Sgt. Laura Bauer

Note 5: Liabilities not Covered by Budgetary Resources (Unaudited)

Liabilities not Covered by Budgetary Resources as of September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

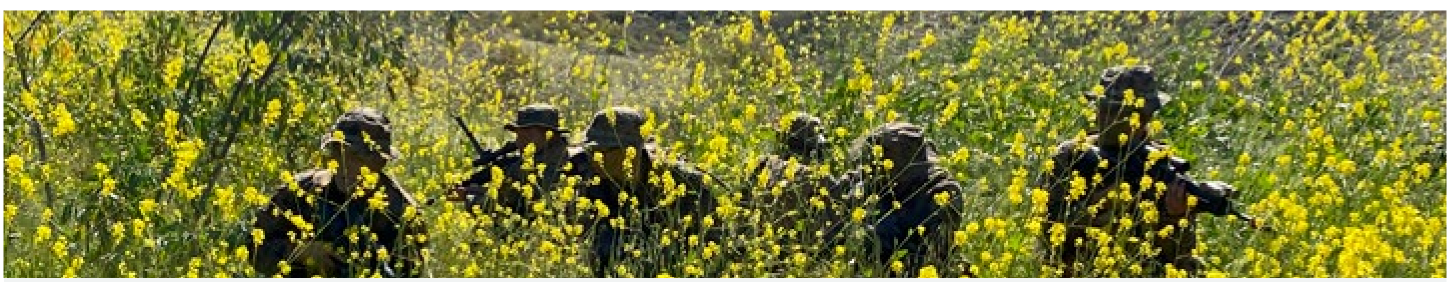
	FY 2021	FY 2020 As Restated
Intragovernmental Liabilities		
Other Liabilities	$ 180	$ 271
Total Intragovernmental Liabilities	**180**	**271**
Other than Intragovernmental Liabilities		
Environmental and Disposal Liabilities	6,658	6,662
Federal Employee Benefits Payable	2,172	2,790
Total Other than Intragovernmental Liabilities	**8,830**	**9,452**
Total Liabilities not Covered by Budgetary Resources	**9,010**	**9,723**
Total Liabilities Covered by Budgetary Resources	**4,589**	**12,761**
Total Liabilities	**$ 13,599**	**$ 22,484**

Other Liabilities (Intragovernmental) include the accrued FECA liability paid by DOL but not yet reimbursed by DLA TF.

Environmental and Disposal Liabilities (Other than Intragovernmental) consist of probable and reasonably estimable future outflow or expenditure of resources that exist as of the financial reporting date for environmental cleanup costs resulting from past transactions or events. As of September 30, 2021 and 2020, the total liabilities covered by budgetary resources for environmental and disposal liabilities consist of $3.1 million and $4.5 million, respectively.

Federal Employee Benefits Payable (Other than Intragovernmental) are comprised of the current year FECA actuarial liability based on DOL records, and current year unfunded annual leave earned by civilian employees but not yet paid. Unfunded annual leave includes restored leave, compensatory time, and credit hours as earned.

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Payables, Expenses, and Undelivered Orders and Accounts Receivable, Revenue, and Gains; Note 6, *Federal Employee Benefits Payable and Related Other Liabilities*; Note 7, *Environmental and Disposal Liabilities*; and Note 9, *Commitments and Contingencies*.)



Field Figures

Marines participate in a patrolling session during the Infantry Marine Course at Marine Corps Base Camp Pendleton, California, March 31, 2021. The 14-week pilot course was designed to create better trained and more lethal entry level infantry Marines prepared for near-peer conflicts. Photo By: Marine Corps Sgt. Jeremy Laboy

Note 6: Federal Employee Benefits Payable and Related Other Liabilities (Unaudited)

Federal Employee Benefits Payable and Related Other Liabilities as of September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

FY 2021						
		Liabilities		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
Intragovernmental Other Liabilities						
Employer Contribution and Payroll Taxes Payable	$	102	$	(102)	$	0
Unfunded FECA Liability		180		-		180
Total Intragovernmental Other Liabilities	**$**	**282**	**$**	**(102)**	**$**	**180**
Other than Intragovernmental Federal Employee Benefits Payable						
Actuarial FECA Liability	$	1,459	$	-	$	1,459
Accrued Unfunded Annual Leave		713		-		713
Total Other than Intragovernmental Federal Employee Benefits Payable	**$**	**2,172**	**$**	**-**	**$**	**2,172**

FY 2020						
		Liabilities		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
Intragovernmental Other Liabilities						
Employer Contribution and Payroll Taxes Payable	$	100	$	(100)	$	0
Unfunded FECA Liability		271		-		271
Total Intragovernmental Other Liabilities	**$**	**371**	**$**	**(100)**	**$**	**271**
Other than Intragovernmental Federal Employee Benefits Payable						
Actuarial FECA Liability	$	2,010	$	-	$	2,010
Accrued Unfunded Annual Leave		780		-		780
Total Other than Intragovernmental Federal Employee Benefits Payable	**$**	**2,790**	**$**	**-**	**$**	**2,790**

Employer Contributions and Payroll Taxes Payable (Intragovernmental) are the employer portion of payroll taxes and benefit contributions for health benefits, retirement, life insurance and voluntary separation incentive payments.

Unfunded FECA Liability (Intragovernmental) include the accrued FECA liability paid by DOL but not yet reimbursed by DLA TF.

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

Accrued Unfunded Annual Leave (Other than Intragovernmental) includes restored leave, compensatory time, and credit hours as earned.

(Refer to Note 5, *Liabilities Not Covered by Budgetary Resources.*)

Note 7: Environmental and Disposal Liabilities (Unaudited)

Environmental and Disposal Liabilities as of September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

		FY 2021		FY 2020
Environmental and Disposal Liabilities				
Environmental Corrective Action	$	9,717	$	11,037
Environmental Closure Requirements		83		78
Total Environmental and Disposal Liabilities	**$**	**9,800**	**$**	**11,115**

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

In FY 2021 and FY 2020, DLA TF utilized the Remedial Action Cost Engineering and Requirements (RACER) software to generate the CTC estimates of anticipated future costs. CTC cost estimates were generated for 14 sites: seven sites with environmental corrective action costs and seven sites with environmental closure requirements costs. In FY 2021 and FY 2020, there were no PP&E transfers impacting the E&DL balance for TF.

Types of Environmental and Disposal Liabilities: The DLA TF is responsible for the recognition, measurement, reporting, and disclosure of EL not eligible for funding under the Defense Environmental Restoration Program (DERP), also known as Non-BRAC EL, and Environmental Disposal for General Equipment. Non-BRAC EL are specifically related to past and current installation restoration activities and operations, and closure and disposal of Property, Plant and Equipment. All cleanup and disposal actions are done in coordination with regulatory Agencies, other responsible parties, and current property owners.

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

Environmental Corrective Action includes EL associated with the cleanup sites not eligible for DERP funding, typically conducted under the Resource Conservation and Recovery Act (RCRA) or other Federal or state statutes and regulations; and

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

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

Applicable Laws and Regulations for Cleanup Requirements: The DLA SM is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other prior activities, which may have created a public health or environmental risk. DLA SM is required to comply with the following laws and regulations for corrective action where applicable: The Comprehensive Environmental Response, Compensation, and Liability Act; the Superfund Amendments and Reauthorization Act; RCRA; and other applicable Federal, State, and local laws and regulations. Required cleanup may at times extend beyond DLA SM operational site boundaries onto adjacent property or onto other sites where DLA SM is named as a potentially responsible party by a regulatory Agency. DLA TF reports corrective action-related EL in accordance with SFFAS 5, *Accounting for Liabilities of the Federal Government,* and Federal Financial Accounting Technical Release 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government.*

The DLA SM is also required to ensure all hazardous substances are removed prior to closing or disposing of Property Plant, and Equipment assets such as Petroleum, Oil, and Lubricant (POL) storage tanks and General Equipment in accordance with applicable Federal, State, and local laws and regulations. DLA TF reports EL associated with closures of Property Plant, and Equipment in accordance with SFFAS 5, *Accounting for*

Liabilities of the Federal Government, SFFAS 6, *Accounting for Property, Plant, and Equipment,* Federal Financial Accounting and Auditing Technical Release 11, I*mplementation Guidance on Cleanup Costs Associated with Equipment, and* Federal Financial Accounting and Auditing Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, and Equipment.*

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

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

Revised CTC estimates and prior year obligations are reported in the balances as of September 30. As of the reporting date, no material changes in total estimated cleanup costs were identified through the roll forward review due to changes in laws, technology, or plans. In addition, DLA SM is not aware of any changes to estimates that would result from inflation, deflation, technology, plans, and/or pending changes to applicable laws and regulations. The cost estimate changes from prior periods are primarily driven by remediation activities and operations, as evidenced by UDOs; there are minor adjustments for inflation or other similar administrative costs throughout the fiscal year. EL estimates will be reevaluated each year and may change in the future due to changes in laws and regulations, changes in agreements with regulatory Agencies, and advances in technology.

Uncertainty Regarding the Accounting Estimates Used to Calculate the Reported Environmental and Disposal Liabilities: The stated total TF EL includes prior year obligations and the estimates of future costs necessary to complete requirements. DLA SM has instituted extensive controls to ensure that these estimates are accurate and reproducible. The cost estimates produced through the EL process are considered accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. Actual results may materially vary from the accounting estimates if agreements with regulatory Agencies require remediation or closure activities to a different degree than anticipated when calculating the estimates. DLA TF EL can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

The calculation of DLA TF EL relies on site/asset inventories. An asset inventory obtained from DLA Strategic Materials provides the basis for asset-related EL estimates. The EL for these line items are estimated annually to account for changes to inventories.

The DLA TF utilizes a formalized Site ID process to identify, track, and evaluate environmental events where the potential for an out-year EL exists but the EL is not probable and measurable. These environmental events will be re-evaluated in the following fiscal year to determine if any changes have taken place and sufficient information/data is available to create an estimate of future costs that would be included in the DLA TF EL balance.

Unrecognized Costs: The DLA TF systematically recognizes asset-related EL over the useful life of PP&E

assets in accordance with DoD FMR Volume 4, Chapter 13 - *Environmental and Disposal Liabilities*, Paragraph 130203 (April 2018). The total recognized Environmental Closure Requirements liability EL is stated above in the footnote and the associated unrecognized Closure EL is $36 thousand. DLA TF has no reportable Asset-related EL for Asbestos or GE. Asset-related EL are amortized based on the useful life of the assets as defined in DoD FMR Volume 4, Chapter 24 – *Real Property*, Paragraph 240206.B, Table 24-1: DoD Useful Lives for Depreciable Real Property Assets (October 2019).

(Refer to Note 1.C., *Departures from U.S. GAAP,* related to Environmental and Disposal Liabilities and Commitments and Contingencies; Note 5, *Liabilities not Covered by Budgetary Resources;* and Note 9, *Commitments and Contingencies*.)

Note 8: Other Liabilities (Unaudited)

Other Liabilities as of September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

FY 2021	Current	Noncurrent	Total
Other than Intragovernmental Other Liabilities			
Accrued Funded Payroll and Benefits	$ 262	$ -	$ 262
Total Other than Intragovernmental Other Liabilities	**$ 262**	**$ -**	**$ 262**

FY 2020	Current	Noncurrent	Total
Other than Intragovernmental Other Liabilities			
Accrued Funded Payroll and Benefits	$ 299	$ -	$ 299
Total Other than Intragovernmental Other Liabilities	**$ 299**	**$ -**	**$ 299**

Accrued Funded Payroll and Benefits (Other than Intragovernmental) include salaries, wages, and other compensation earned by employees but not yet disbursed.

DLA Flu Program – Ahead of the Curve for 2021

Army Sgt. Martin Manalo prepares to administer a flu shot at the chapel annex Jan. 15, 2021, on Caserma Ederle. The Defense Logistics Agency Troop Support Medical supply chain ensures warfighters like this have the vaccines available to administer on members, dependents and retirees on time each flu season. Photo By: Army

Note 9: Commitments and Contingencies (Unaudited)

Accrued and reasonably possible environmental and legal contingent liabilities as of September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

FY 2021						
		Accrued Liabilities	Estimated Range of Loss			
			Lower End		Upper End	
Environmental Contingencies						
Probable	$	9,800	$	-	$	-
Reasonably Possible			$	-	$	-
Legal Contingencies						
Probable	$	-	$	-	$	-
Reasonably Possible			$	-	$	-

FY 2020						
		Accrued Liabilities	Estimated Range of Loss			
			Lower End		Upper End	
Environmental Contingencies						
Probable	$	11,115	$	-	$	-
Reasonably Possible			$	-	$	-
Legal Contingencies						
Probable	$	-	$	-	$	-
Reasonably Possible			$	-	$	300

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

Legal Contingencies: The DLA TF was a party in various administrative proceedings and legal actions related to claims for environmental damages, equal opportunity matters, and contractual bid protests as of September 30, 2020. DLA's Automated Workflow and Reporting System (AWARS) is used by the Office of General Counsel to report the outcomes and possible liability amounts of open cases.

Cases for which legal counsel determines an adverse outcome is reasonably possible and the possible financial outflow is measurable, are not recorded, but disclosed as reasonably possible for financial reporting purposes.

DLA has zero matters that are identified as a probable, reasonably possible, or remote liability as of September 30, 2021.

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

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Environmental and Disposal Liabilities and Commitments and Contingencies; Note 5, *Liabilities Not Covered by Budgetary Resources*; and Note 7, *Environmental and Disposal Liabilities*.)

Note 10: Undelivered Orders (Unaudited)

Undelivered Orders (UDOs) for the years ended September 30, 2021 and 2020, respectively, consist of the following (dollars in thousands):

	FY 2021	FY 2020
Intragovernmental Undelivered Orders		
Unpaid	$ 19,945	$ 13,718
Total Intragovernmental Undelivered Orders	**19,945**	**13,718**
Other than Intragovernmental Undelivered Orders		
Unpaid	8,497	23,467
Paid	915	-
Total Other than Intragovernmental Undelivered Orders	**9,412**	**23,467**
Total Undelivered Orders	**$ 29,357**	**$ 37,185**

UDOs represent the amount of goods and/or services ordered to perform DLA TF's mission objectives that have not been received. Unpaid UDOs represent obligations for goods and services that have not been received or paid. Whereas, paid UDOs represent obligations for goods and services that have been paid for in advance of receipt. For the years ended September 30, 2021 and 2020, respectively, DLA TF does not have intragovernmental paid UDO balances.

Due to system limitations, DLA TF is unable to determine the Intragovernmental and Other than Intragovernmental allocation of unpaid UDOs. DLA TF estimates the allocation of Intragovernmental and Other than Intragovernmental unpaid UDOs based on funded liabilities, and excluding payroll and employee benefit liabilities.

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

Corps Combat

Marines disembark from an amphibious combat vehicle during a training exercise at Marine Corps Air Ground Combat Center Twentynine Palms, Calif., April 7, 2021. Photo By: Marine Corps Cpl. Jamin M. Powell

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

Reconciliation of Net Cost to Net Outlays for the years ended September 30, 2021 and 2020, consist of the following (dollars in thousands):

FY 2021	Intragovernmental	Other than Intragovernmental	Total
NET COST	**$ 14,075**	**$ (123,764)**	**$ (109,689)**
Components of Net Cost That are Not Part of Net Outlays			
General Property Plant and Equipment Depreciation	-	(222)	(222)
Cost of Goods Sold	-	(72,156)	(72,156)
Net Gains/(Losses)	-	85	85
Net Gains/(Losses) Related to Inventory Valuation Adjustment	-	135,224	135,224
Increase/(Decrease) in Assets:			
Accounts Receivable, Net	-	(34)	(34)
Advances and Prepayments	-	(240)	(240)
(Increase)/Decrease in Liabilities:			
Accounts Payable	743	3,288	4,031
Environmental and Disposal Liabilities	-	1,315	1,315
Federal Employee Benefits Payable	-	618	618
Advances from Others and Deferred Revenue	-	2,795	2,795
Other Liabilities	89	37	126
Other Financing Sources:			
Imputed Financing	(488)	-	(488)
Total Components of Net Cost That are Not Part of Net Outlays	**344**	**70,710**	**71,054**
Components of Net Outlays That are Not Part of Net Cost			
Acquisition of Inventory	-	5,732	5,732
Total Components of Net Outlays That are Not Part of Net Cost	**-**	**5,732**	**5,732**
NET OUTLAYS	**$ 14,419**	**$ (47,322)**	**(32,903)**
Outlays, Net, Statement of Budgetary Resources			**(32,903)**
Reconciling Difference			**$ -**

FY 2020	Intragovernmental	Other than Intragovernmental	Total
NET COST	**$ 11,958**	**$ 27,190**	**$ 39,148**
Components of Net Cost That are Not Part of Net Outlays			
General Property Plant and Equipment Depreciation	-	(223)	(223)
Cost of Goods Sold	-	(41,222)	(41,222)
Net Gains/(Losses)	-	2,485	2,485
Net Gains/(Losses) Related to Inventory Valuation Adjustment	-	-	-
Increase/(Decrease) in Assets:			
Accounts Receivable, Net	-	12	12
Advances and Prepayments	-	1,155	1,155
(Increase)/Decrease in Liabilities:			
Accounts Payable	6	2,022	2,028
Environmental and Disposal Liabilities	-	6,440	6,440
Federal Employee Benefits Payable	-	110	110
Advances from Others and Deferred Revenue	-	(2,795)	(2,795)
Other Liabilities	(6)	(49)	(55)
Other Financing Sources:			
Imputed Financing	(495)	-	(495)
Total Components of Net Cost That are Not Part of Net Outlays	**(495)**	**(32,065)**	**(32,560)**
Components of Net Outlays That are Not Part of Net Cost			
Acquisition of Inventory	-	-	-
Total Components of Net Outlays That are Not Part of Net Cost	**-**	**-**	**-**
NET OUTLAYS	**$ 11,463**	**$ (4,875)**	**6,588**
Outlays, Net, Statement of Budgetary Resources			**6,588**
Reconciling Difference			**$ -**

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

More specifically, for FY 2021, the key reconciling differences between the net cost and net outlays for DLA TF include: (1) the cost of goods sold, which related to stockpile material transactions, representing the sales activity for Other than

Intragovernmental customers; (2) Increases in Net Gains Related to Inventory Valuation Adjustment which were due to the stockpile materials value adjustments; and (3) the acquisition of Inventory.

For FY 2020, the key reconciling differences between the net cost and net outlays for DLA TF include: (1) the cost of goods sold, which related to stockpile material transactions, representing the sales activity for Other than Intragovernmental customers; (2) the net gains, which was primarily due to inventory movements related to the acquisition and upgrade/recondition of stockpile materials; and (3) the decrease in Environmental and Disposal Liabilities, which was primarily attributed to the decline in the Non-BRAC Environmental corrective actions.

The DLA TF does not have an established policy to identify and reconcile net cost to net outlays and/or identify components of net cost or net outlays that have not been properly accounted for. For FY 2020, acquisition of inventory balances should be but are not included in the Components of Net Outlays That are Not a Part of Net Cost. However, DLA TF will continue to investigate and resolve the causes of the items not included in the reconciliation and any reconciling differences.

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

(Refer to Note 1.C., *Departures from U.S. GAAP*, related to Accounts Receivable, Revenue, and Gains, Inventory and Related Property, Net, and Accounts Payable, and Undelivered Orders, Reconciliation of Net Cost to Net Outlays.)

Mountain Flight

Navy Petty Officers 2nd Class Aaron White and Richard Derrick participate in a mountain flying training event in Fallon, Nev., April 9, 2021. Photo By: Navy Chief Petty Officer Shannon Renfroe

Note 12: Restatements of the FY 2020 Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position (Unaudited)

In FY 2021, DLA TF restated its FY 2020 financial statements in response to errors in the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position. The impact of these errors resulted in DLA TF's net position reported on the financial statements being overstated by $5.8 million. DLA TF made adjustments to its recognition of: (1) inventory and related gains and losses; (2) advances and prepayments and accounts payable and the related gross cost; (3) accounts payable and the related gross cost. DLA TF recorded the restatement adjustments in three categories:

Physical Inventory Quantity Adjustments: The DLA TF performs weight re-verifications on certain stockpile materials to verify inventory quantities are accurate. The inventory and related gain and loss balances were adjusted to reflect the results of the weight re-verification performed during FY 2020 and not recorded as of September 30, 2020. The correction impacted the FY 2020 Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position by decreasing Inventory and Related Property by $6.0 million, increasing gross cost and earned revenue by $9.3 million and $3.3 million, respectively, resulting in an overall increase in Net Cost and decrease in Net Position of $6.0 million. The adjustments were applied entirely to FY 2020, without performing an analysis to determine what was attributable to FY 2019 and prior years.

Recycling and Reuse Program: As part of the Strategic Material Recycling and Reuse Program (SMRRP), the government provides excess-to-need or end-of-life aerospace turbine engine parts to a Contractor for sorting, demilitarizing, removing any precious-metal containing coatings, and sending the inventory item back to DLA SM. During FY 2020, DLA TF improperly recognized expenses upon being invoiced by the contractor. DLA TF should have recorded advances and prepayments for the amounts paid prior to receiving inventory and then capitalized the incurred costs upon receipt. No liability should have been recorded for amounts invoiced by the contractor for undelivered inventory. The adjustment recorded by DLA TF impacted the FY 2020 Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position by increasing advances and prepayments by $1.2 million, decreasing accounts payable by $89.0 thousand, and reducing gross cost by a net amount of $1.2 million, resulting in an overall decrease in Net Cost and increase Net Position of $1.2 million.

Liability for Return of Material: The FY 2020 gross cost and related accounts payable balances were corrected to reflect materials owed back to a contractor after having received a refund for the material that did not conform to the specified requirements. The correction impacted the FY 2020 Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position by increasing accounts payable and the related gross cost by $1.1 million, resulting in an overall increase in Net Cost and a decrease in Net Position of $1.1 million.

(Refer to Note 1.C., Departures from U.S. GAAP, related to Advances and Prepayments; Accounts Payable, Expenses, and Undelivered Orders; and Inventory and Related Property, Net).

Ramstein Support

Air Force Capt. Ranon Barber stacks dinner meals at Ramstein Air Base, Germany, Aug. 26, 2021. Barber supported Operation Allies Refuge through building pods, replacing old cots with new ones and stocking meals for evacuees from Afghanistan. Photo By: Air Force Airman Jared Lovett

Balance Sheet (dollars in thousands) As of September 30, 2020	Unaudited FY 2020 As Previously Reported[12]	Unaudited FY 2020 Adjustments	Unaudited FY 2020 As Restated
ASSETS			
Intragovernmental			
Fund Balance with Treasury (Note 2)	$ 280,730	$ -	$ 280,730
Total Intragovernmental	**280,730**	**-**	**280,730**
Other than Intragovernmental			
Accounts Receivable	38	-	38
Inventory and Related Property, Net (Note 3)	746,382	(5,955)	740,427
General Property Plant and Equipment, Net (Note 4)	1,019	-	1,019
Advances and Prepayments	-	1,155	1,155
Total Other than Intragovernmental Assets	**747,439**	**(4,800)**	**742,639**
TOTAL ASSETS	**$ 1,028,169**	**$ (4,800)**	**$ 1,023,369**
LIABILITIES (Note 5)			
Intragovernmental			
Accounts Payable	$ 1,505	$ -	$ 1,505
Other Liabilities (Note 6)	371	-	371
Total Intragovernmental Liabilities	**1,876**	**-**	**1,876**
Other than Intragovernmental			
Accounts Payable	2,574	1,035	3,609
Environmental and Disposal Liabilities (Note 7)	11,115	-	11,115
Federal Employee Benefits Payable (Note 6)	2,790	-	2,790
Advances from Others and Deferred Revenue	2,795	-	2,795
Other Liabilities (Note 8)	299	-	299
Total Other than Intragovernmental	**19,573**	**1,035**	**20,608**
TOTAL LIABILITIES	**21,449**	**1,035**	**22,484**
Commitments and Contingencies (Note 9)			
NET POSITION			
Cumulative Results of Operations-Funds from Other than Dedicated Collections	1,006,720	(5,835)	1,000,885
TOTAL NET POSITION	**1,006,720**	**(5,835)**	**1,000,885**
TOTAL LIABILITIES AND NET POSITION	**$ 1,028,169**	**$ (4,800)**	**$ 1,023,369**

[12] Certain balances were reclassified on the FY 2020 Balance Sheet to conform to the FY 2021 financial statement presentation requirements in accordance with OMB Circular A-136, as amended.

Statement of Net Cost For the Year Ended September 30, 2020 (dollars in thousands)	Unaudited FY 2020 As Previously Reported	Unaudited FY 2020 Adjustments	Unaudited FY 2020 As Restated
Operations, Readiness & Support			
Gross Cost	$ 95,815	$ 9,157	$ 104,972
Less: Earned Revenue	(62,502)	(3,322)	(65,824)
Net Cost	**33,313**	**5,835**	**39,148**
NET COST OF OPERATIONS	**$ 33,313**	**$ 5,835**	**$ 39,148**

Statement of Changes in Net Position For the Year Ended September 30, 2020 (dollars in thousands)	Unaudited FY 2020 As Previously Reported	Unaudited FY 2020 Adjustments	Unaudited FY 2020 As Restated
Cumulative Results of Operations			
Beginning Balances	$ 1,039,538	$ -	$ 1,039,538
Imputed Financing	495	-	495
Net Cost of Operations	**33,313**	**5,835**	**39,148**
Net Change in Cumulative Results of Operations	**(32,818)**	**5,835**	**(26,983)**
Cumulative Results of Operations: Ending Balance	**1,006,720**	**(5,835)**	**1,000,885**
TOTAL NET POSITION	**$ 1,006,720**	**$ (5,835)**	**$ 1,000,885**

Aid for Haiti

Navy Petty Officer 2nd Class Michael Kane unloads boxes of food in Saint-Louis-du-Sud, Haiti, Aug. 28, 2021, to support humanitarian assistance and disaster relief efforts following a 7.2 magnitude earthquake.

Photo By: Navy Petty Officer 2nd Class John Bellino

SECTION 3

Other Information (Unaudited)

Fast Rope ▶

Marines fast-rope during training aboard the USS Makin Island in the Pacific Ocean, Oct. 16, 2020.

Photo Credit: Navy Petty Officer 3rd Class Ethan Morrow

SECTION 3

In this section

Double Pump Deployment
Sailors aboard the aircraft carrier Dwight D. Eisenhower prepare for a replenishment-at-sea on Feb. 4 in the Atlantic Ocean. It’s been a long year for everyone, but doubly so for the men and women of the aircraft carrier Dwight D. Eisenhower, who are days away from commencing their second deployment in the past 12 months.

Photo Credit: Mass Communication Specialist Seaman Apprentice Mo Bourdi/Navy

Management Challenges

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

July 27, 2021

MEMORANDUM FOR VICE ADMIRAL MICHELLE C. SKUBIC, DIRECTOR, DLA

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

Although significant progress has been made in the management of DLA and the reduction of risks facing the organization, especially due to the actions of the Enterprise Risk Management Office, the Office of the Inspector General (OIG) sees 15 areas where major challenges remain. The 15 challenge areas are:

a. Sales of DoD Property. Insufficient policy and oversight of DLA sales of property requires action to establish clear policy guidelines and oversight authority. This concern was formally recognized in a finding in FY18 during an Agency Management Review and has not been corrected to date. Multiple components of DLA are involved in sales of DoD property. DLA Headquarters has limited expertise within the staff. Sales procedures and process are impacted by law and rules from several governmental agencies. An unclear policy proponent and corresponding lack of oversight of execution within DLA is an area of risk that requires mitigation and remediation.

b. Contracting Officers Representatives. Although this area was identified last year, this challenge remains on the list because of the significant concerns about the quality of Contracting Officers Representatives work. Contracting Officers Representative files almost always contained inadequate evidence supporting monitoring of contractors. These results are important to DLA because the preponderance of our supplies and services are acquired through contract. Given the significant number of DLA contracts, to improve audit readiness, it is essential to improve Contracting Officer Representative performance and quality of work.

c. Financial Liability Investigations. Based on numerous OIG investigations, financial liability investigation of property losses were inadequate and failed to hold responsible officials accountable for failure to maintain accountability of property under their control. The OIG audit division has begun research on this topic and anticipates issuing an audit report in FY 2022.

d. Critical Warfighter Items and Whole of Government. Despite the pandemic and the shortage of supplies, DLA has maintained outstanding support to the Warfighters. However, as continuing emphasis is placed on the Whole of Government effort, DLA must remain vigilant that the Whole of Government effort doesn't overshadow

Warfighter support since both efforts will be competing for many of the same product lines – e.g., pharmaceuticals, clothing and textiles, food and water, and fuel.

e. Supply Chain Security and Risk Management. DLA needs to continually evaluate our supply chains for single-point failures to prevent disruptions to DLA's Warfighter and Whole of Government customers. The supply risk management process is critical to identify risks to our supply chains while developing mitigation strategies, to reduce the risk to acceptable levels when feasible or develop mitigating strategies when mitigation isn't feasible. This challenge highlights the lack of domestically based integrated supply chains, just-in-time inventory management, as well as other risks in DLA's reliance on the Defense industrial base – that individually and collectively increase risk to the process.

f. Nonconforming Inventory. The induction of repair parts from commercial suppliers must be continuously monitored and reviewed to prevent nonconforming and counterfeit parts from entering the DLA supply chains and causing major risks to our Warfighters and Whole of Government customers.

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

h. DLA Cybersecurity and Resiliency. Cybersecurity is an inherent risk and the most persistent threat to DLA operations. The resiliency of DLA to identify and counter cyber intrusions is paramount to DLA success. With the majority of the DLA workforce now teleworking via potentially less secure home networks, DLA's cybersecurity risk profile is increased. DLA must continually stress that employees have a personal responsibility for network security. While the DLA J6 achieved impressive sustainment of DLA networks during the pandemic, it is imperative that continued and innovative resources be employed to retain this resiliency. These efforts are essential to ensure that employees remain as productive as possible and that new software, as well as major updates, are conducted in as seamless a manner as possible with minimal disruption.

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

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

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

l. Special Emphasis Programs. DLA has at least three special emphasis programs – PTAP (Procurement Technical Assistance Program), NWRM (Nuclear Weapons Related Material), and Strategic Materials – that, while currently in good shape, requires continual management emphasis. While the PTAP program may transition to DoD, we will continue to include it on this list until the transition is complete.

m. Trade Security Controls. DoD delegates Export Control requirements for Trade Security Controls (TSC) policy, controls, and enforcement for the DoD to DLA. The required functions include policy, issuance of End Use Certificates (EUC) to qualified entities, and enforcement through Post Sales Investigations. As noted in paragraph a. above, DLA has inadequate sales oversight structure and execution policy. This shortfall in guidance results in conflict between TSC and sales contracts at Disposition Services that requires both policy and contracting changes to realign. Disposition Services implemented a new business model that sells export-controlled DoD personal property to the contractor. The contractor becomes the first non-DoD owner and is issued a single EUC that is renewed on a periodic basis. This permits the contractor to sell controlled property to anyone, nullifying the EUC process for export-controlled DoD personal property. DLA must resolve the guidance and execution for export controls.

n. Post-Pandemic Reduction of Telework. DLA executed a superlative pivot to full time telework by the eligible office workforce while maintaining operational readiness and providing a safe secure workplace for employees in industrial operations. The reduction of telework and return to onsite offices represents a significant challenge. Numerous studies and reports indicate a fundamental change in attitudes by the workforce across the nation. Employees are seeking greater control over schedules, flexibility, and how work is conducted. Other structural supports such as childcare, school schedules and methods, and availability of public transport affect the willingness and mobility of the workforce. Balancing telework and return to centralized offices could present a significant challenge through employee turnover leading to a loss of knowledge and experience in critical skill areas, while extenuating the efforts to acculturate new employees. DLA is addressing this challenge in the strategic plan and by encouraging senior leaders to be as flexible as possible. Although this challenge is being addressed through the Future of Work Line of Effort it nonetheless presents a situation that requires much thought, understanding, flexibility, and adaptability to retain the well-qualified and resilient workforce DLA requires.

o. Climate Change Management. DLA J3 has begun addressing this topic. However, because it is a reasonably new topic, additional senior leader focus is required as the expectation is that DLA will be required to assist DoD by leading the way in procuring carbon-pollution free electricity, developing alternative fuel costing policy, and incorporating the social cost of greenhouse gases into product costs. DLA must have a deliberate plan in place before the requirements outpaces the current capability of both DLA Energy and the DLA Environmental Office.

It is important that DLA leadership recognize these challenges facing the organization for DLA to provide the best value to the taxpayer and the best support to the warfighter. Addressing each of these challenges will improve the internal control structure of DLA and thereby help the organization in achieving an unmodified financial statement opinion.

WILLIAM A. RIGBY
Inspector General

Summary of Financial Statement Audit and Management Assurances

The audit reports on the FY 2021 and FY 2020 DLA TF financial statements identified six material weaknesses for DLA TF. Table 1 below provides a summary of the financial statement audit results for FY 2021 and FY 2020, as restated.

Although the material weaknesses overall are not resolved, DLA is continuing to develop CAPs to resolve specific findings associated with the material weaknesses.

Table 1: FY 2021 Summary of the Financial Statement Audit

Audit Opinion	Disclaimer				
Restatement	Yes				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Inventory	1	-	-	-	1
Fund Balance with Treasury	1	-	-	-	1
Accounts Payable and Expenses	1	-	-	-	1
Financial Reporting	1	-	-	-	1
Oversight and Monitoring	1	-	-	-	1
Information Systems	1	-	-	-	1
Total Material Weaknesses	**6**	**-**	**-**	**-**	**6**

The DLA SOA package only includes self- identified material weaknesses and significant deficiencies for internal DoD reporting; however, DLA continues to monitor the financial statement audit material weakness areas separately. DLA's FY 2021 Material Weaknesses and Significant Deficiencies template included a total of three self-identified material weaknesses in the area of ICOR-O, summarized in the table below. In FY 2021, the five ICOR material weaknesses and four ICOFS non-conformances were based on financial statement audit NFRs across all funds. However, DLA has determined these audit identified ICOR material weaknesses and ICOFS non-conformances are still present and have not been remediated in FY 2021. The DLA Audit Task Force continues to separately track financial statement audit findings and CAPs related to the ICOR material weaknesses and ICOFS non-conformances and report these to the ODCFO.

Table 2 summarizes DLA's FY2021 material weaknesses associated with DLA TF.

Table 2: Summary of Management Assurances						
Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Oversight and Monitoring	1	-	-	-	-	1
Financial Reporting	1	-	-	-	-	1
Fund Balance with Treasury	1	-	-	-	-	1
Plan-to-Stock: Inventory	1	-	-	-	-	1
Procure-to-Pay: Accounts Payable and Expenses	1	-	-	-	-	1
Total Material Weaknesses	**5**	**-**	**-**	**-**	**-**	**5**

Capsule Crew

Air Force pararescue jumpers and combat rescue officers practice retrieving astronauts from a SpaceX capsule mockup during the Rescue Force Qualification Course at Cape Canaveral Air Force Station, Florida, Feb. 23, 2021. Photo By: Air Force Staff Sgt. Christopher Muncy

Table 2: Summary of Management Assurances						
Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Supply Operations: Lack of policy and procedures in place over the manage-ment and oversite of First Article Test Exhibits	1	-	-	-	-	1
Contract Administra-tion: Nonverification of supplier invoices	1	-	-	-	-	1
Business Process Controls: Lack of procedures over the scrap management program	1	-	-	-	-	1
Total Material Weaknesses	3	-	-	-	-	3

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

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

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

Sea Ops

Military Sealift Command fleet replenishment oiler USNS Yukon conducts a consolidated cargo replenishment-at-sea with the MSC long-term chartered motor tanker ship Empire State off the coast of Southern California April 25-26, 2020. The CONSOL was part of MSC's COVID-19 precautions, with many of the supplies provided by the Defense Logistics Agency. Photo By: Sarah Burford, Military Sealift Command Pacific

Payment Integrity

The Payment Integrity Information Act of 2019 (PIIA) (Pub. L. 116-117), requires Agencies to review and assess all programs and activities they administer and identify those determined to be susceptible to significant improper payments (IPs), estimate the annual amount of IPs, and submit those estimates to Congress. In accordance with DoD 7000.14-R FMR, Volume 4, Chapter 14, Improper Payments, DoD components that entitle (i.e. process or compute) payments conduct risk assessments of their payment processes and random post- payment reviews to estimate IPs.

The OUSD(Comptroller) Accounting & Finance Policy Directorate (A&FP) compiles the Department-wide results annually as part of DoD's AFR. As DLA's Service Provider, DFAS entitles payments and provides the results of post-payment reviews to OUSD(Comptroller) A&FP on behalf of its customers. OMB Circular A-123, Appendix C defines an IP as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes duplicate payments, any payment made to an ineligible recipient, any payment for an ineligible good or service, any payment for a good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts.

In accordance with the PIIA, and Appendix B of the OMB Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements*, dated June 11, 2021, DoD reports payment integrity information (i.e., IPs) at the Agency-wide level in the consolidated DoD AFR. In addition, DoD provides data for display on https://paymentaccuracy.gov. For detailed reporting on DoD payment integrity, refer to the OI section of the consolidated DoD AFR at: https://comptroller.defense.gov/odcfo/afr2021.aspx.

Pentagon Sunrise

Officers salute an American flag unfurled over the side of the Pentagon at sunrise on the 20th anniversary of the 9-11 terrorist attacks at the Pentagon in Arlington, Virginia. Photo Credit: E.J. Hersom/DoD

APPENDIX

A / B / C

Island Wave ▶

Air Force Brig. Gen. Jeremy T. Sloane, center left, the 36th Wing commander, and loadmasters assigned to the 36th Airlift Squadron wave to the people of the Angaur, Palau, Dec. 7, 2020, during the second day of 2020 Operation Christmas Drop airdrops. The operation is the Defense Department's longest-running humanitarian operation, allowing the U.S. and its allies to deliver food, tools and clothing to people who live on remote southeastern Pacific islands.

Photo Credit: Air Force Staff Sgt. Gabrielle Spalding

Appendix A: Summary of FMFIA Definitions and Reporting

<table>
<tr><th>Category</th><th>Definition</th><th>Reporting</th></tr>
<tr><td>Control Deficiency</td><td>A. Exists when the design, implementation, or operation of a control does not allow management or personnel, in the normal course of performing their assigned functions, to achieve control objectives and address related risks.

B. Deficiency in Design: A deficiency in design exists when:

(1) a control necessary to meet a control objective is missing

(2) an existing control is not properly designed so that even if the control operates as designed, the control objective would not be met.

C. Deficiency in Implementation: A deficiency in implementation exists when a properly designed control is not implemented correctly in the internal control system.

D. Deficiency in Operation: A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.</td><td>Internal to the organization and not reported externally. Progress against CAPs must be periodically assessed and reported to Agency management.</td></tr>
<tr><td>Significant Deficiency</td><td>A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet is important enough to merit attention by those charged with governance.</td><td>Self-identified significant deficiencies are reported to OUSD. Progress against CAPs must be periodically assessed and reported to Agency management.</td></tr>
</table>

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

Category	Definition	Reporting
Material Weakness	A. A material weakness is a significant deficiency that the Agency Head or Director determines to be significant enough to report outside of the Agency as a material weakness. In the context of the Green Book (https://www.gao.gov/greenbook), non-achievement of a relevant principle and related component results in a material weakness. B. **Internal Control Over Operations:** A material weakness in internal control over operations might include, but is not limited to conditions that: ● Impact the operating effectiveness of entry-level controls; ● Impair fulfillment of essential operations or missions; ● Deprive the public of needed services; or ● Significantly weaken established safeguards against fraud, waste, loss, unauthorized use, or misappropriation of funds, property, assets, or conflicts of interest. C. **Internal Control Over Reporting:** A material weakness in internal control over external financial reporting is a deficiency, or a combination of deficiencies, in internal control, in that there is a reasonable possibility a material misstatement of the entity's financial statements will not be prevented, or detected and corrected before issuance.	Material weaknesses and a summary of corrective actions must be reported to OMB and Congress through the AFR or other management reports. Self-identified material weaknesses are reported to OUSD. Progress against CAPs must be periodically assessed and reported to Agency management.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Appendix C: Abbreviations & Acronyms

A/BO	Approving/Billing Officials
A&FP	Accounting & Finance Policy Directorate
ADA	Anti-Deficiency Act
AFR	Agency Financial Report
AMP	Annual Materials Plan
A/OPC	Agency/Organization Program Coordinators
APR	Annual Performance Report
ASP	Annual Sales Plan
AWARS	Automated Workflow and Reporting System
BRAC	Base Realignment and Closure
CAC	Common Access Card
CAPs	Corrective Action Plans
CARS	Central Accounting and Reporting System
CCs	Critical Capabilities
CFO	Chief Financial Officers
Charge Card Act	Charge Card Abuse Prevention Act
CIO	Chief Information Officer
COLA	Cost of Living Adjustments
COTS	Commercial Off-The-Shelf
COVID-19	Coronavirus-19
CPM	Component Program Manager
CRO	Chief Risk Officer
CSRS	Civil Service Retirement System
CTC	Cost-to-Complete
DAI	Defense Agencies Initiative
DATA Act	Digital Accountability and Transparency Act
DCIA	Debt Collection Improvement Act
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DISA	Defense Information System Agency
DLA	Defense Logistics Agency
DoD	Department of Defense

DOL	Department of Labor
DSA	Defense Supply Agency
DCSA	Defense Contract Administration Services
DSS	Distribution Standard System
DQP	Data Quality Plan
EBS	Enterprise Business System
ECC	Resource Planning Central Component
EL	Environmental and Disposal Liabilities
ERM	Enterprise Risk Management
FASAB	Federal Accounting Standards Advisory Board
FBwT	Fund Balance with Treasury
FECA	Federal Employees' Compensation Act
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FFMSRs	Federal Financial Management System Requirements
FMFIA	Federal Managers' Financial Integrity Act
FMR	Financial Management Regulations
FPAs	Federal Program Agencies
FRDAA	Fraud Reduction and Data Analytics Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principle
GAO	Government Accountability Office
GF	General Fund
GMRA	Government Management Reform Act
GPC	Government Purchase Card
GPRA	Government Performance and Results Act
GSA	General Services Administration
HC	Historic Cost
ICOFS	Internal Controls over Financial Systems
ICOR-O	Internal Control over Operations
ICOR	Internal Control over Reporting
ID	Identification

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

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Defense Logistics Agency

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