Audit Report

INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND REGULATIONS FOR THE FY 1997 FINANCIAL STATEMENTS OF THE DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Report Number 98-148 June 5, 1998

Office of the Inspector General
Department of Defense

Additional Information and Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932 or visit the Inspector General, DoD, Home Page at: WWW.DODIG.OSD.MIL.

Suggestions for Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8908 (DSN 664-8908) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
FFMIA	Federal Financial Management Improvement Act
IG	Inspector General
OMB	Office of Management and Budget
USGSGL	U.S. Government Standard General Ledger
WCF	Working Capital Fund

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

June 5, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and Regulations for the FY 1997 Financial Statements of the Defense Logistics Agency Working Capital Fund (Report No. 98-148)

We are providing this final report for information and use. Because this report contains no recommendations, written comments are not required, and none were received. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. The Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," requires the Inspector General, DoD, to render an opinion on financial statements such as those of the Defense Logistics Agency, and to report on the adequacy of internal controls and compliance with laws and regulations.

On February 27, 1998, we issued a disclaimer of opinion on the FYs 1997 and 1996 Financial Statements of the Defense Logistics Agency Working Capital Fund. We identified internal control weaknesses and instances of noncompliance with laws and regulations that merit management's attention. Part I includes separate sections on internal controls and compliance with laws and regulations. Part II provides relevant appendixes for management's use. Appendix C includes the FY 1997 Financial Statements of the Defense Logistics Agency Working Capital Fund and our disclaimer of opinion.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. James L. Kornides, Audit Program Director, at (614) 751-1400, extension 11, e-mail jkornides@DODIG.OSD.MIL, or Mr. Timothy F. Soltis, Audit Project Manager, at (614) 751-1400, extension 13, e-mail tsoltis@DODIG.OSD.MIL. If management requests, we will provide a formal briefing on the audit results. See Appendix F for the report distribution. A list of audit team members is inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-148 **June 5, 1998**
(Project No. 8FJ-2002.03)

Internal Controls and Compliance With Laws and Regulations for the FY 1997 Financial Statements of the Defense Logistics Agency Working Capital Fund

Executive Summary

Introduction. This audit was performed as part of our effort to meet the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," as amended by Public Law 103-356, the "Federal Financial Management Act of 1994." The legislation requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements. The Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service are responsible for establishing and maintaining adequate internal controls and for complying with laws and regulations that govern DLA financial accounting and reporting. Our responsibility is to render an opinion on the financial statements based on our work, and to determine whether internal controls were adequate and whether management complied with applicable laws and regulations.

Before FY 1991, the DoD operated a significant number of commercial and industrial facilities under a revolving fund concept. In FY 1991, the revolving funds were consolidated to form the Defense Business Operations Fund. The Inspector General, DoD, was responsible for auditing and rendering an opinion on the Defense Business Operations Fund Consolidated Financial Statements. In December 1996, the Under Secretary of Defense (Comptroller) began a process that restructured the Defense Business Operations Fund into eight separate working capital funds. The DLA Working Capital Fund was created when the Defense Business Operations Fund was restructured.

Audit Objectives. The overall objective of our audit was to determine whether the FY 1997 Financial Statements of the DLA Working Capital Fund were presented fairly and in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as modified by Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. We also assessed internal controls and compliance with laws and regulations.

Disclaimer of Opinion. We were unable to render an opinion on the FYs 1997 and 1996 Financial Statements of the DLA Working Capital Fund because we did not perform sufficient work and because our limited work disclosed additional scope limitations. We did not receive a complete set of financial statements in sufficient time to completely perform our audit; therefore, we could not consider that information in attempting to render an opinion. We also had difficulty in gaining access to financial data in the DLA automated systems (See Appendix A). Additionally, because of

significant deficiencies in the accounting systems and internal controls, we were unable to verify the $9.8 billion inventory balance on the FY 1997 financial statements.

We also did not review the FY 1996 comparative data presented on the FY 1997 Financial Statements of the DLA Working Capital Fund. We did not render an opinion on the FY 1996 Financial Statements of the DLA Defense Business Operations Fund because they were not presented as separate statements in FY 1996; instead, they were consolidated with other Defense Business Operations Fund activities.

Our audit work indicated that accounting systems were not in compliance with accounting standards. We also identified significant deficiencies in internal controls over inventory valuation and presentation; inventory record accuracy; inventory adjustments; Fund Balance With Treasury; and Property, Plant, and Equipment.

Internal Controls. Internal controls were not adequate to ensure the accurate reporting of inventory accounts on the financial statements. As a result, the inventory reported on the FY 1997 Financial Statements of the DLA Working Capital Fund, which totaled $9.8 billion, was not properly valued, described, and disclosed.

We followed up on previously identified internal control deficiencies in Fund Balance With Treasury and Property, Plant, and Equipment. These deficiencies had been identified in prior reports issued by the Inspector General, DoD. Part I.A. is our report on internal controls.

Compliance With Laws and Regulations. Part I.B. is our report on compliance with laws and regulations. Because of our limited scope, we could not determine the range and magnitude of noncompliance with laws and regulations that may have affected the reliability of the FY 1997 Financial Statements of the DLA Working Capital Fund. However, we identified instances of noncompliance with:

- DoD 7000.14-R, the "DoD Financial Management Regulation," for accounting systems;
- Statement of Federal Financial Accounting Standards No. 3 for inventory valuation and classification; and
- Military Standard Requisitioning and Issue Procedures for materiel returns.

Table of Contents

Part I - Audit Results

Audit Background

Introduction. This audit was performed as part of our effort to meet the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. The legislation requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements.

Accounting Functions and Responsibilities. The Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service (DFAS) are responsible for establishing and maintaining adequate internal controls and for complying with laws and regulations that govern DLA financial accounting and reporting. Our responsibility is to render an opinion on the financial statements based on our work, and to determine whether internal controls were adequate and whether management complied with applicable laws and regulations.

Accounting Principles. The DLA Working Capital Fund (WCF) Consolidated Financial Statements for FYs 1997 and 1996 were to be prepared in accordance with the Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as amended by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. Footnote 1 of the DLA WCF Financial Statements discusses the significant accounting policies used to prepare the financial statements.

Disclaimer of Opinion. We were unable to render an opinion on the FYs 1997 and 1996 Financial Statements of the DLA WCF because we did not perform sufficient work and because our limited work disclosed additional scope limitations. We did not receive a complete set of financial statements in sufficient time to completely perform out audit; therefore, we could not consider that information in attempting to render an opinion. We also had difficulty in gaining access to financial data in the DLA automated systems (See Appendix A). Because of significant deficiencies in the accounting systems and internal controls, we were unable to verify the $9.8 billion inventory balance on the FY 1997 financial statements.

We also did not review the FY 1996 comparative data presented on the FY 1997 Financial Statements of the DLA WCF. We did not render an opinion on the FY 1996 Financial Statements of the DLA Defense Business Operations Fund (DBOF) because they were not presented as separate statements in FY 1996; instead, they were consolidated with other DBOF activities.

Our audit work indicated that accounting systems were not in compliance with accounting standards. We also identified material deficiencies in internal controls over inventory valuation and presentation; inventory record accuracy; inventory adjustments; Fund Balance With Treasury; and Property, Plant, and Equipment. Our disclaimer of opinion report was included in the financial statements transmitted by the Under Secretary of Defense (Comptroller) to OMB. Appendix C includes the financial statements and auditor opinion.

Defense Business Operations Fund. Before FY 1991, DoD operated a number of commercial and industrial facilities under a revolving fund concept. In FY 1991, the revolving funds were consolidated to form the DBOF. The primary goals of the DBOF were to consolidate similar functions and reduce costs through better business practices. DBOF was also intended to promote total cost visibility, full cost recovery, and better budget estimates. The Inspector General (IG), DoD, was responsible for auditing and rendering an opinion on the DBOF Consolidated Financial Statements.

During FY 1997, the Under Secretary of Defense (Comptroller) restructured the DBOF into eight WCFs. Separate WCFs were created for the Army, the Navy, and the Air Force. A single, Defense-wide WCF was also created for the Defense agencies. The Under Secretary of Defense (Comptroller) then restructured the Defense-wide WCF into five funds, including a separate WCF for DLA. The Military Departments and Defense agencies manage the functional and financial aspects of their funds.

A WCF is a revolving fund that operates as an accounting entity. Within each WCF, business areas or activity groups, such as Supply Management, are financed through customer reimbursement. The assets of each business area are capitalized under the WCF, and most income results from collections from customers.

Defense Logistics Agency Working Capital Fund. The DLA WCF finances six business areas* that provide logistics support to DoD and other authorized customers. The FY 1997 Consolidated Financial Statements of the DLA WCF reported assets of $12 billion, liabilities of $2 billion, and revenues of $12.9 billion. Inventory was the largest asset account on the financial statements. DLA reported $9.8 billion as Inventory, Net, which accounted for 82 percent of the Total Entity Assets reported on the FY 1997 Consolidated Statement of Financial Position of the DLA WCF.

Audit Objectives

The overall objective of our audit was to determine whether the FY 1997 Financial Statements of the DLA WCF were presented fairly and in accordance with OMB Bulletin No. 94-01, "Form and Content of Agency

*The six DLA business areas are: Supply Management, Distribution Depots, Reutilization and Marketing, Industrial Plant Equipment, Information Services, and the Defense Automated Printing Service.

Financial Statements," November 16, 1993, as amended by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. We also assessed internal controls and compliance with laws and regulations.

Part I. A. - Review of Internal Controls

Introduction

Audit Responsibilities. Our audit objective was to determine whether controls over transactions supporting the accounts in the FY 1997 DLA WCF financial statements were adequate to ensure that the accounts were free of material error. In planning and performing our audit of the DLA WCF accounts for the year ended September 30, 1997, we evaluated the internal controls in order to:

- determine the auditing procedures necessary to render an opinion on the financial statements, and
- determine whether internal controls had been established.

That determination included obtaining an understanding of the internal control policies and procedures, as well as assessing the level of control risk relevant to significant accounting cycles and account balances.

Management Responsibilities. DLA and DFAS management were responsible for establishing and maintaining internal controls over the DLA WCF. Internal controls should provide management with reasonable but not absolute assurance that:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, and misappropriation;
- transactions that could have a direct and material effect on the consolidating statements, including those related to obligations and costs, are executed in compliance with laws and regulations directly related to the statements, and with any laws and regulations that OMB, DLA management, and the IG, DoD, have identified as being significant and for which compliance can be objectively measured and evaluated.

Internal Control Elements. The three elements of internal controls are the control environment, accounting and related systems, and control procedures. The control environment is the collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific policies and procedures. Such factors include management's philosophy and operating style, the entity's organizational structure, and personnel policies and practices. The control environment reflects the overall attitude, awareness, and actions of management concerning the importance of controls and the emphasis placed on them by the entity. Accounting and related systems are the methods and records established to identify, assemble, analyze, classify, record, and report on the entity's transactions and maintain accountability for the related assets and liabilities. Control procedures are the policies and procedures, in addition to the control environment and accounting and related systems, that management has established to provide reasonable assurance that specific objectives will be achieved.

Reportable Conditions

Our audit of the FY 1997 Financial Statements of the DLA WCF disclosed reportable conditions as defined by Government auditing standards and DoD Directive 5010.38, "Management Control Program," August 26, 1996.

Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and to ensure the preparation of reliable and accurate financial information for use in managing and evaluating operational performance. A material weakness is a reportable condition in which the design or operation of internal controls does not reduce to a relatively low level the risk that errors or irregularities could occur.

Our consideration of internal controls would not necessarily disclose all reportable conditions, and would not necessarily disclose all reportable conditions that are considered to be material weaknesses.

Inventory Controls. Internal controls were not adequate to ensure the accurate reporting of inventory accounts on the FY 1997 Financial Statements of the DLA WCF. As a result, $9.8 billion of inventory was not properly valued, classified, described, and disclosed. Our audit work and management disclosures identified the following internal control deficiencies with inventory valuation and presentation, accuracy of inventory records, and inventory adjustments.

Inventory Valuation and Presentation. Inventory accounts were overstated, and related expense accounts were understated. Most problems with inventory valuation occurred because of noncompliance with specific regulations (see Part I.B.) Also, DLA internal controls were not adequate to ensure that subsistence and fuel inventories were properly valued, described, and disclosed in the financial statements. Specifically:

- The Financial Inventory Accounting report, which supported the reported fuel inventory balance, contained negative quantities and dollar amounts. We could not assess the impact of the negative quantities and dollar amounts on the financial statements because the Defense Energy Support Center was not able to provide detailed records to support the reported balance.

- Inactive stock was not properly classified and disclosed on the financial statements. Specifically, $3.1 billion of stocks retained for economic and contingency reasons, and

$1.8 billion of stocks retained for potential reutilization, were improperly reported as Inventory Held for Sale instead of Excess, Obsolete, and Unserviceable Inventory.

- The $385 million of subsistence stock (inventory managed by the Defense Supply Center Philadelphia) also did not reflect the uncertainty of future sales. During the last several years, DLA has implemented commercial practices, such as the expanded use of direct vendor deliveries and prime contractors, to provide more efficient customer support. The expanded use of commercial supply sources reduced demands for subsistence items (most of which have limited shelf lives) stored in DoD-owned warehouses. DLA did not expect to sell many of the subsistence items that were in inventory during FY 1997, but the financial statements did not reduce the value of the inventory to reflect its uncertain future sales.

Inventory Record Accuracy. The DLA sampling plans, used to measure inventory record accuracy at the DLA distribution depots, did not meet the requirements of the "Chief Financial Officers Act of 1990," and the results of physical inventories taken during the year could not be used for that purpose. In addition, inventory in-transit accounts were not reconciled to subsidiary records.

Sampling Plans. Maintaining accurate inventory records and effectively measuring the accuracy of records has been a continuing problem. During FY 1997, DLA used 3 different sampling plans to measure inventory accuracy at its 21 distribution depots because only 7 of the 21 depots had fully converted from Military Department legacy systems to the Distribution Standard System. (After the remaining depots install the Distribution Standard System, DLA plans to implement a single sampling plan.) The other depots that conducted statistical sampling used a sampling plan designed for Air Force or Navy legacy systems. The results of the inventories taken during FY 1997 showed accuracy rates ranging from 74 to 97 percent. However, those results could not be used to determine the overall accuracy of the inventory reported on the DLA WCF financial statements because:

- All three sampling plans were designed to measure record accuracy for logistics purposes. The methods used to select items for physical counts did not allow for projections of error rates based on quantity and condition, which are needed to evaluate the accuracy of inventory records for financial statement purposes.

- Four depots, which stored about 7 percent of DLA-managed items during FY 1997, were not included in any sampling plan. Two depots were former Marine depots at Barstow, California, and Albany, Georgia, which were not able to perform statistical sampling. The distribution depot at

Letterkenny, Pennsylvania, was not included in a sampling plan because it is scheduled for closure. The distribution depot at Columbus, Ohio, was not included in a sampling plan because the depot was working to improve significant problems with the accuracy of locations and quantities recorded. Those problems were identified in IG, DoD, Report No. 97-102, "Inventory Accuracy at the Defense Depot, Columbus, Ohio," February 28, 1997.

Inventory In-transit Accounts. General ledger accounts for Inventory In-transit were not reconciled to subsidiary records. The subsidiary records were not updated for certain transactions, such as "issues for relocation" and "receipts for other than procurement - relocation." Also, the accuracy of the subsidiary reports had not been verified since FY 1993. These problems have been reported as material weaknesses in the DFAS Columbus Center's annual statements of assurance since FY 1994, and are not expected to be corrected before September 30, 1999.

Inventory Adjustments. Large numbers of adjustments were made to the inventory records.

- The year-end trial balance showed that inventory adjustments totaling $1.08 billion were made to reconcile the distribution depots' accountable records with the inventory control points' financial records. The trial balance also showed other large inventory adjustments for items such as inventory gains, inventory losses, incoming shipment gains, and incoming shipment losses.

- Approximately 25 percent of the Military Department field organizations' returns of DLA-managed materiel received by the distribution depots during FY 1997 were not authorized by DLA inventory control points to be returned. The distribution depots accepted the unauthorized returns and processed the materiel into the supply system for future issue.

- DFAS also made unsupported adjustments to reconcile the automated fuel records with the trial balance. After matching the Fuels Inventory Report to the trial balance, journal vouchers were created to reconcile the two amounts.

Followup on Prior Audits

During the audit, we followed up on previously reported problems in the Fund Balance With Treasury and Property, Plant, and Equipment accounts. Our review showed that the internal control deficiencies had not been corrected.

Fund Balance With the Treasury. In IG, DoD, Report No. 94-159, "Fund Balance With the Treasury Accounts on the FY 1993 Financial Statements of the DLA Business Areas of the Defense Business Operations Fund," June 30, 1994, we reported that the collection and disbursement data compiled by DFAS lacked audit trails and proper matching procedures. The data also were not reconciled to the DLA accounting records.

Our followup work showed that DFAS still could not provide an adequate audit trail showing the organizations that processed collections and disbursements. Also, the collection and disbursement amounts reported to the Department of the Treasury differed from the trial balances that DFAS used to prepare the financial statements, and DFAS could not explain the differences. These unreconciled differences were reported in Accounts Receivable and Accounts Payable, making those accounts unauditable.

Property, Plant, and Equipment Accounts. The IG, DoD, has issued three audit reports on the Property, Plant, and Equipment account of the DLA WCF. They are:

- IG, DoD, Report No. 94-149, "Property, Plant, and Equipment Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 1993," June 28, 1994.
- IG, DoD, Report No. 97-148, "Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting," May 29, 1997.
- IG, DoD, Report No. 98-060, "Joint Logistics Systems Center Reporting of Systems Development Costs," February 3, 1998.

All three reports showed that the reported balance of DLA Property, Plant, and Equipment was materially misstated.

At the end of FY 1997, DLA had not fully made the transition to the Defense Property Accountability System. Also, in the footnotes to the financial statements, DLA disclosed that no documentation existed to support the recorded acquisition costs of some property.

Part I. B. - Review of Compliance With Laws and Regulations

Introduction

We audited selected financial data in the FY 1997 Financial Statements of the DLA WCF for material instances of noncompliance with laws and regulations. Such tests are required by the "Chief Financial Officers Act of 1990," as amended by the "Federal Financial Management Act of 1994."

The Deputy Under Secretary of Defense (Comptroller); the Director, DLA; and the Director, DFAS, are responsible for ensuring compliance with laws and regulations applicable to the DLA WCF. As part of obtaining reasonable assurance on whether the financial statements were free of material misstatements, we tested compliance with the laws and regulations listed in Appendix E.

Reportable Conditions

Material instances of noncompliance with laws and regulations are failures to follow laws or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures is either material to the financial statements, or that the sensitivity of the matter would cause others to perceive it as significant.

Title 31 U.S.C. 3512, "Federal Financial Management Improvement Act of 1996." On September 9, 1997, OMB issued a memorandum, "Implementation Guidance for the Federal Financial Management Improvement Act (FFMIA) of 1996." The FFMIA requires Federal agencies to implement and maintain financial management systems that comply substantially with Federal requirements for financial management systems, applicable Federal accounting standards, and the U.S. Government Standard General Ledger (USGSGL) at the transaction level. The FFMIA also requires that we report on agency compliance with Federal requirements and accounting standards and the USGSGL. These requirements are well-established in the following Federal policy documents.

- OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, establishes Government policy for developing, evaluating, and reporting on financial management systems. It requires financial management systems to provide complete, reliable, consistent, timely, and useful financial management information. To achieve this goal, DoD and other Federal agencies must establish and maintain a single, integrated financial management system using the USGSGL.

- OMB Circular No. A-134, "Financial Accounting Principles and Standards," May 20, 1993, establishes policies and procedures for approving and publishing financial accounting principles and standards. It also establishes the policies that Executive branch agencies and OMB are to follow in seeking and providing interpretations and other advice related to the standards.

- The Joint Financial Management Improvement Program is a cooperative undertaking of the OMB, the Department of the Treasury, and the Office of Personnel Management, working with each other and with operating agencies to improve financial management practices throughout the Government. The Joint Financial Management Improvement Program has published a series of "Federal Financial Management System Requirements."

- The "Core Financial System Requirements," September 1995, which are part of the Joint Financial Management Improvement Program "Federal Financial Management System Requirements," establish standard requirements for the foundation modules of an agency's integrated financial management system. These requirements state that a financial management system must support the partnership between program and financial managers and assure the integrity of information for decisionmaking and measuring performance.

As part of our audit to obtain reasonable assurance about whether the FY 1997 Financial Statements of the DLA WCF were free of material misstatement, we tested compliance with certain provisions of laws and regulations when noncompliance could have a direct and material effect on the determination of amounts in the financial statements. We also tested compliance with certain other laws and regulations specified in OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, as modified by OMB Bulletin No. 98-04, "Addendum to OMB Bulletin No. 93-06," January 16, 1998. In planning and performing our tests of compliance, we considered the implementation guidance issued by OMB on September 9, 1997, relating to the FFMIA.

For FY 1997, the financial management systems that support the DLA WCF Financial Statements were not in substantial compliance with the requirements of the FFMIA. DoD financial management systems comprise multiple finance, accounting, and feeder systems that are the responsibility of DFAS, the Military Departments, and the Defense agencies. DoD financial management systems were unable to produce auditable and timely financial statements for FY 1997 primarily because the accounting and related systems were not designed for financial reporting. As a result, the financial condition of DoD and its operating results for FY 1997 were not verifiable, and DoD had no assurance that it was properly managing its resources.

Defense Logistics Agency Compliance With Laws and Regulations. We identified instances of noncompliance with laws and regulations in the DLA WCF. We did not perform all tests necessary to determine whether the DLA WCF fully complied with all applicable laws and regulations. Therefore, we could not determine the range and magnitude of noncompliance with laws and regulations that may affect the reliability of the DLA WCF financial statements.

Compliance With Laws. Financial management systems did not comply with Federal requirements, Federal accounting standards, and the USGSGL at the transaction level, as required by the FFMIA and OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, as modified by OMB Bulletin No. 98-04, "Addendum to OMB Bulletin No. 93-06," January 16, 1998.

Weaknesses in DoD accounting systems have been reported since DBOF was established. Data from the deficient systems were used to prepare the FY 1997 Financial Statements of the DLA WCF. DFAS and DLA acknowledged that the primary accounting and financial systems used to report information for the financial statements were not in compliance with accounting requirements.

The DFAS Columbus Center's Defense Accounting System Project Office is responsible for managing the migratory systems at DFAS Columbus Center as they relate to the DFAS Accounting Systems Strategic Plan for DLA accounting systems. The duties of the Defense Accounting System Project Office include deployment of selected migratory systems and approving system change requests for the legacy systems.

During FY 1997, a study was conducted to identify a migratory system strategy to replace existing financial systems for the DLA WCF. Until the migratory strategy is established and accounting systems are selected, the time frames and costs of installing compliant accounting systems and producing auditable financial statements will remain unknown.

Compliance With Regulations. We identified instances of noncompliance with regulations for accounting systems, inventory valuation, and materiel returns.

Accounting Systems. DLA and DFAS reported in their FY 1997 annual statements of assurance that the Standard Automated Material Management System, the Defense Integrated Subsistence Management System, and the Defense Fuel Automated Management System did not comply with the accounting requirements in DoD 7000.14-R, the "DoD Financial Management Regulation." The systems also did not comply with OMB Circular No. A-127.

Inventory Valuation. DLA did not properly value or present inactive stock in the financial statements. DLA followed DoD accounting policy and valued its $3.1 billion of stocks retained for economic and contingency reasons at their latest acquisition value. However, the DoD policy was not consistent with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," October 27, 1993, and did not ensure that the value of retention stocks reported on the financial statements reflected their uncertain future utility. As a result, the $9.8 billion reported on the financial statements as Inventory, Net, was overstated by as much as $3 billion, and related inventory expense accounts were understated by the same amount. In addition, DLA did not establish allowance accounts to recognize the holding gains and losses associated with periodic inventory valuation.

Materiel Returns. We also identified a lack of compliance with DoD 4000.25-1-M, "Military Standard Requisitioning and Issue Procedures," May 1987, regarding materiel returns. The Manual requires field organizations to obtain authorization before returning materiel that is managed by the DLA inventory control points to the distribution depots.

Part II - Additional Information

Appendix A. Audit Process

Scope

Statements Reviewed. The scope of our audit was limited. We examined the Statement of Financial Position, with primary emphasis on the inventory accounts because they represented 82 percent of Total Entity Assets. Except for some aspects of inventory-related expenses and distribution depot revenues, we did not examine the Statement of Operations and Changes in Net Position or the Statement of Cash Flows. We reviewed management disclosures made in the financial statements and annual statements of assurance, evaluated DLA financial systems for compliance with Federal accounting requirements, performed tests of internal controls over the inventory accounts, and followed up on prior audit reports on DBOF.

Scope Limitations. Our audit objectives were to perform tests of internal controls over the inventory accounts of the DLA WCF and to follow up on previously reported internal control weaknesses in the Fund Balance With Treasury and Property, Plant, and Equipment accounts. Scope limitations prevented us from achieving these objectives. Because we did not receive the final version (version 3) of the financial statements in a timely manner, we could not consider that information in our review of internal controls. Consequently, we were not able to adequately accomplish the audit.

We had difficulty in gaining access to financial data in the DLA automated systems. Specifically, we did not receive the data we requested; we experienced major delays in obtaining the data; or we were required to substantially modify our audit methodology because of untimely or unavailable data. Most of the financial-related data and internal controls that support the financial statements reside in DLA automated systems. It was difficult or impossible for us to analyze data, evaluate management assertions, or test specific control procedures without computer assistance from the DLA Systems Design Center or the DLA Operations Research and Resource Analysis Office. Both offices operate on a fee-for-service basis and would not assist us in our audit without appropriate funding.

On March 2, 1998, we issued a memorandum to the Under Secretary of Defense (Aquisition and Technology) and the Under Secretary of Defense (Comptroller) describing the difficulties we encountered during the audit in gaining access to DLA personnel and records. In response to our memorandum, the Deputy Director, DLA, issued a policy to DLA Executive Management Team Commanders, Primary Level Field Activities on April 3, 1998 requiring all audit requests for access and information be handled expeditiously.

The fact that we did not receive the financial statements and other information from DLA in a timely manner contributed to our disclaimer of opinion on the FY 1997 DLA WCF Financial Statements.

Accounting Principles. Accounting principles and standards for the Federal Government are under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to three officials for approval. Those three officials are the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. The Director, OMB, and the Comptroller General issue standards agreed on by the three officials. To date, seven accounting standards and two accounting concepts have been published in final form. Accounting Standard No. 8 has been approved by the Federal Accounting Standards Advisory Board, but has not yet been issued. In addition, the Federal Accounting Standards Advisory Board issued an exposure draft, "Amendments to Accounting for Property, Plant, and Equipment," February 13, 1998, proposing amendments to Standards No. 6 and No. 8. These standards and concepts constitute generally accepted accounting principles for the Federal Government. OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01, incorporates these standards and concepts and should be used by Federal agencies to prepare their financial statements. The table below lists the "Statements of Federal Financial Accounting Standards and Concepts."

Statements of Federal Financial Accounting Standards and Concepts

Accounting Standards and Concepts	Title	Status	Fiscal Year Effective
Standard No. 1	Accounting for Selected Assets and Liabilities, March 30, 1993	Final	1994
Standard No. 2	Accounting for Direct Loans and Loan Guarantees, August 23, 1993	Final	1994
Standard No. 3	Accounting for Inventory and Related Property, October 27, 1993	Final	1994
Standard No. 4	Managerial Cost Accounting Concepts and Standards for the Federal Government, July 31, 1995	Final	1998
Standard No. 5	Accounting for Liabilities of the Federal Government, December 20, 1995	Final	1997
Standard No. 6	Accounting for Property, Plant, and Equipment, November 30, 1995	Final*	1998
Standard No. 7	Accounting for Revenue and Other Financing Sources, May 10, 1996	Final	1998
Standard No. 8	Supplementary Stewardship Reporting, June 11, 1996	Approved*	
Concept No. 1	Objectives of Federal Financial Reporting, September 2, 1993	Final	
Concept No. 2	Entity and Display, June 6, 1995	Final	

* FASAB issued an exposure draft, "Amendments to Accounting for Property, Plant, and Equipment," on February 13, 1998. The exposure draft contains proposed amendments to Standards No. 6 and No. 8.

Through FY 1997, agencies were required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 94-01, as amended by OMB Bulletin No. 97-01. The FY 1997 hierarchy includes standards agreed to and published by the Director, OMB; the Secretary of the Treasury; and the Comptroller

General of the United States. It also includes the requirements for the form and content of financial statements outlined in OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01; accounting standards contained in agency accounting policy; and accounting principles published by other authoritative sources.

Scope of Review. The major reason we were unable to render an opinion on the financial statements was that a decision to audit the newly created DLA WCF was not made until August 1997. It was not feasible for us to plan and perform a complete financial statement audit, as defined by Government auditing standards, in the time available. Therefore, we limited the scope of our audit of the FY 1997 Financial Statements of the DLA WCF to:

- reviewing management disclosures made in the financial statements and annual statements of assurance,
- evaluating DLA financial systems for compliance with Federal accounting requirements,
- performing tests of internal controls over the inventory accounts, and
- following up on prior audit reports on DBOF.

Our work in FY 1996 was on the former DBOF Consolidated Financial Statements and was not focused on the DLA activities in DBOF. During the audit, we identified additional scope limitations that prevented us from achieving our objectives.

We reviewed internal controls related to the matters discussed in this report. We identified weaknesses in internal controls over accounting systems; inventory; Fund Balance With Treasury; Property, Plant, and Equipment; and materiel returns. Our consideration of the internal controls would not necessarily disclose all reportable conditions, and would not necessarily disclose all reportable conditions that are also considered material weaknesses.

Compliance with laws and regulations is the responsibility of DLA management. We identified instances of noncompliance with laws and regulations that materially affected the DLA WCF financial statements.

Methodology

Auditing Standards. We conducted this financial-related audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD, and OMB Bulletin No. 93-06, as modified by OMB Bulletin No. 98-04. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatements. We also relied on our professional judgment in assessing the materiality of matters affecting the fair presentation of the financial statements, related internal controls, and compliance with laws and regulations.

Computer-Processed Data. We did not rely on computer-processed data in performing our assessment of internal controls and compliance with laws and regulations.

Audit Period. The audit was conducted from October 1997 through February 1998.

Representation Letters. On March 20, 1998, we received a legal representation letter from DLA, and on March 25, 1998, we received a management representation letter from DLA. Appendix D includes both letters.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available on request.

Appendix B. Prior Audit Reports

The following audit reports identified internal control deficiencies in selected DLA accounts.

IG, DoD, Report No. 98-072, "Defense Business Operations Fund Inventory Record Accuracy," February 12, 1998. The overall objective of this audit was to determine whether inventory amounts on the FY 1996 DBOF Consolidated Financial Statements were presented fairly. The scope of the audit was limited because DoD had not developed and executed a DBOF-wide sample. The limited audit work indicated that DBOF inventory records were not accurate. We recommended that the Director, DLA, correct the automated location reconciliation program to provide periodic reconciliation of the DLA inventory control points' inventory records with the records maintained by depots and other storage sites. We also recommended that the Deputy Under Secretary of Defense (Logistics), in coordination with the Under Secretary of Defense (Comptroller), establish the framework for the annual statistical samples of wholesale and retail inventory records, assign an official to oversee the development of the samples, and direct the Military Departments and DLA to perform the samples. The Deputy Under Secretary of Defense (Logistics) agreed to take actions which satisfy the intent of the recommendation. The Director, DLA, identified actions taken to correct and implement the automated location reconciliation program and to implement a program for researching and evaluating discrepancies identified during the reconciliation.

IG, DoD, Report No. 98-060, "Joint Logistics System Center Reporting of Systems Development Costs," February 3, 1998. This report stated that the Joint Logistics Systems Center did not transfer about $173 million of systems development costs, incurred through the end of FY 1996, to the supply management area of the DLA WCF. This caused the Property, Plant, and Equipment account to be understated by $173 million. The report recommended that the Under Secretary of Defense (Comptroller) provide guidance to the Joint Logistics Systems Center on how to equitably transfer the systems development costs to the appropriate DoD WCF organizations. Management agreed and initiated action to develop policy that will equitably allocate the systems development costs.

IG, DoD, Report No. 98-019, "Inventory Record Accuracy and Management Controls at the Defense Logistics Agency Distribution Depots," November 10, 1997. The objective of this report was to evaluate inventory record accuracy and management controls at the DLA distribution depots. We also evaluated the segments of the DLA management control program that affect the accuracy of inventory records. The report concluded that inventory record accuracy and management controls at the DLA distribution depots were not adequate. The sampling plan did not assess the accuracy of dollar values, as required by the "Chief Financial Officers Act of 1990." Also, controls were not in place to ensure that all scheduled inventories were completed, that data transferred from legacy systems to the Distribution Standard System were accurate, and that standard operating procedures were established for the distribution depots.

Additionally, the Deputy Under Secretary of Defense (Logistics) did not establish a standard against which the DLA could measure inventory record accuracy; we recommended that the Deputy Under Secretary establish such a standard. We also recommended that the Director, DLA, establish a tracking mechanism to ensure that all inventories are conducted, ensure the accuracy of data transferred to the Distribution Standard System, and implement standard operating procedures at all depots. The Deputy Under Secrerary concurred with the recommendations. The Deputy Director, DLA, concurred with the recommendation to establish a tracking process to improve inventory management and ensure inventory accuracy.

IG, DoD, Report No. 97-178, "Internal Controls and Compliance With Laws and Regulations for the Defense Business Operations Fund Consolidated Financial Statements for FY 1996," June 26, 1997. The objective of this audit was to determine whether internal controls were adequate to ensure that the FY 1996 DBOF Consolidated Financial Statements were free of material error and to assess compliance with laws and regulations that materially affected the financial statements. The report stated that sound internal controls had not been established. Material weaknesses included inadequate accounting systems and a lack of policy and procedures. Noncompliance with laws and regulations continued to affect the reliability of the DBOF financial statements. Noncompliance with DoD 7000.14-R was identified in areas such as Property, Plant, and Equipment; accounts payable; depreciation; and revenue recognition. No recommendations were made in the report because the issues had been identified previously.

IG, DoD, Report No. 97-159, "Inventory Accuracy at the Defense Depot, Susquehanna, Pennsylvania," June 12, 1997. The report stated that the custodial records of the Defense Depot, Susquehanna, Pennsylvania, did not show correct inventory balances for 1,969 consumable items for which management responsibility had been transferred from the Navy to the DLA under the Consumable Item Transfer Program. Consequently, the DLA financial statements were misstated by $16 million. The Defense Depot also retained $1 million in obsolete inventory and did not assign storage locations to materiel located in a warehouse it shared with the Naval Inventory Control Point, Mechanicsburg, Pennsylvania. The report recommended that DLA identify and dispose of obsolete items, perform a wall-to-wall inventory of items stored in the warehouse that DLA shared with the Naval Inventory Control Point, and assign storage locations to the materiel stored there. DLA agreed with the recommendations.

IG, DoD, Report No. 97-148, "Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting," May 29, 1997. The report concluded that DLA had made progress toward correcting problems identified in prior audit reports. The efforts resulted in a $1.3 billion increase in the Property, Plant, and Equipment reported in the FY 1995 financial records. However, three DLA organizations, including 50 separate activities and locations, did not identify and report at least $422.3 million of capital assets. The report recommended that DLA identify all Property, Plant, and Equipment used in its operations and report these assets in its financial statements. In addition, the report recommended that DLA establish procedures to ensure that all assets are entered into the Defense Property and Accountability System. DLA generally agreed to implement the recommendations.

Property and Accountability System. DLA generally agreed to implement the recommendations.

IG, DoD, Report No. 97-102, "Inventory Accuracy at the Defense Depot, Columbus, Ohio," February 28, 1997. This report was part of the overall audit of the accuracy of inventory accounts on the FY 1996 DBOF financial statements. This report addressed the accuracy of inventory records at the Defense Depot, Columbus, Ohio. The Defense Depot, Columbus, Ohio, did not include 696,380 chemical suits in its inventory records, and incorrectly reported the quantities and values of six types of chemical suits. As a result, the inventory records at the Defense Depot, Columbus, Ohio, were misstated, which materially distorted the accuracy of the total inventory reported. We recommended that the Commander, Defense Depot, Columbus, Ohio, revise inventory procedures to include the following:

- researching the causes of discrepancies;
- marking storage locations with permanent identification numbers; and
- validating the identification numbers against the storage locations listed in inventory records.

DLA concurred with the recommendations.

Appendix C. Financial Statements and Auditor Opinion

This appendix (a total of 53 pages) consists of the FY 1997 Financial Statements of the Defense Logistics Agency Working Capital Fund and the auditor opinion.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

CONSOLIDATED OVERVIEW

Overview

DEFENSE LOGISTICS AGENCY
DEFENSE WORKING CAPITAL FUND
FY 97 OVERVIEW

Introduction

The Defense Working Capital Fund (DWCF) combined existing business-like operations into a single revolving fund. The DWCF operates under the concept that the costs of providing/receiving a product and/or service should be visible to both the customer and provider. The DWCF provides a management structure that allows more DoD components the ability to provide and receive the best support at the lowest cost. A major feature of this structure is charging customers the total cost of providing a product and/or service. Reimbursements from the customers provide the working capital for the fund.

In FY 97, the Defense Logistics Agency (DLA) had five active activity groups funded through the DWCF and two inactive activity groups, as follows:

Active	
Supply Management Activity Group	97X4930.5C
Distribution Depots Activity Group	7X4930.5B
Reutilization and Marketing Service Activity Group	97X4930.5N
Information Services Activity Group	97X4930.5F50
Automated Printing Service Activity Group	97X4930.5G
Inactive	
Industrial Plant Equipment	97X4930.5M
Clothing Factory	97X4930.5Q

Supply Management Activity Group

The primary mission of the Supply Management Activity Group (Supply) is customer support through management of logistics processes, which includes:

- Inventory management for both peacetime and combat support;
- Transportation management (shared with the Distribution Depots Activity Group) for quick response in both normal and emergency situations;
- Technical management, which guarantees product quality and proper pricing of materiel; and
- Procurement management, which ensures that DoD gets the best value in procuring supplies with taxpayer dollars.

Supply manages approximately 4.0 million items used by the Military Services. Supply received 20 million requisitions in FY 97 and had sales amounting to $11.4 billion. Supply operates through five Defense Supply Centers and supporting activities with approximately 10,000 employees at the end of FY 97. The DLA supply centers procure the supplies in sufficient quantities to meet the Services' projected needs. The Columbus, Richmond and Industrial centers procure hardware items, including electronic components, industrial equipment, weapons support items, and construction materiel. The Fuels Supply Center purchases bulk petroleum and natural gas. The Personnel Support Center buys troop support materiel, i.e., subsistence stocks, medical supplies, clothing and textiles. The supplies are stored and distributed either through a complex of depots (Distribution Depots Activity Group) or shipped directly from vendors to customers.

Distribution Depots Activity Group

The primary mission of the Distribution Depots Activity Group (Distribution) is the distribution and storage of wholesale and retail materiel in support of customers worldwide. Distribution is responsible for receipt, storage, issue, packing, preservation and transportation arrangements for all items placed under its accountability by DLA and Military Service Inventory Control Points (ICPs). Currently this includes 6 million line items, 27 million annual transactions and nearly 32 million square feet of occupied storage space managed through the Defense Distribution Center and its 24 subordinate distribution depots positioned in the Continental United States and Europe.

These depots store a wide range of DoD commodities and end items for the support of the Military Services and authorized civil agency requisitioners. In addition to handling general supplies, individual depots specialize in unusual or difficult-to-handle items within DoD. These specializations include storage and transportation of DoD's packaged hazardous and flammable materials, performance of deployable medical hospital assembly operations and the wholesale distribution of semi-perishable food items.

Reutilization and Marketing Service Activity Group

The primary mission of the Defense Reutilization and Marketing Service (DRMS) Activity Group is the reuse of excess and surplus property within the government and other authorized agencies and the disposal of remaining property and hazardous waste items through sales and contractual vehicles. Items not reutilized within DoD are screened for possible transfer to other Federal agencies or for donation to local governments. Surplus property not reutilized is then offered for sale to the public on a competitive basis. Overall command and control of this program is accomplished by DRMS, which consists of a headquarters organization in Battle Creek, Michigan, and two operations offices, East and West. The mission of this organization is accomplished by individual Defense Reutilization and Marketing Offices (DRMOs) located on military installations throughout the world. DRMOs receive, classify, segregate, demilitarize, account for and report excess materiel for screening, lotting, merchandising, and sales. Excess items received by the DRMOs and meeting military service criteria are automatically referred to

DoD item managers through front-end screening notices. Inventory managers with requirements submit automated requisitions using standard requisition and issues procedures.

The disposition of hazardous property is accomplished according to its classification as hazardous waste or materiel in accordance with various stringent Federal, state and local laws. In this capacity, DRMS handles the majority of DoD property governed by the Resource Conservation Recovery Act (RCRA) of 1976, as amended. Generally all hazardous waste is directly disposed of through contracts funded by the military services. However, hazardous materiel has reutilization value and goes through the same general procedures as all other DoD property, with the distinction that it receives much closer scrutiny before it is offered for sale to the public.

The economic recovery of precious metals from excess and surplus metal-bearing materiel is also performed by DRMS. The recovered precious metal is used for authorized internal purposes or as Government Furnished Material (GFM). The costs to recover this materiel are passed on to the users.

Information Services Activity Group

The Information Services Activity Group was revised to include a DLA element at the beginning of FY 1996. On October 1, 1995, DLA began operation of its Information Services Activity Group with a single Central Design Activity (CDA), the DLA System Design Center (DSDC). The Activity Group combines DSDC and the Defense Automatic Addressing System Center (DAASC) with over 1,100 employees and an operating budget of $129.0 million.

The DLA Systems Design Center (DSDC) serves as a primary provider of integrated information management support, delivering responsive and innovative solutions to meet the DLA and DoD customers' needs. DSDC is the DLA Central Design Activity (CDA) operating within the Information Services Activity Group of the Defense Working Capital Fund. DSDC headquarters are in Columbus, Ohio, with nine other geographically dispersed satellite sites. These sites, which include Ogden, Utah and Battle Creek, Michigan, among others, allow for co-location with some of our major customers. DSDC currently has three major program areas. They are:

- Software development and maintenance
- Technology and infrastructure support to DLA
- The Defense Automatic Addressing System Center and Laboratory Operations (DAASC).

Software development and maintenance represents the primary mission of DSDC. This includes the design and development of new applications in direct support of DLA's mission and the maintenance of existing production legacy and migration Automated Information Systems (AIS).

Technology and infrastructure support and the DAASC constitute the remaining 30 percent or $38.1 million of total annual revenue. Infrastructure is the term used to describe the technology environment under the direct control of DLA. This environment consists of the facilities, computing platforms, hardware systems, software systems, network configurations, shared services, data architectures, repositories and information technology processes required to support the DLA mission. DSDC provides technology support in areas such as operating system installation and support, capacity planning and management, Electronic Commerce/ Electronic Data Interchange (EC/EDI), telecommunications support such as local area network (LAN) design and support, and the Defense Message System (DMS).

The DAASC, which was capitalized during FY94, is now a part of DSDC and serves as an essential utility, which provides two critical types of services to users. These are core supply and logistical transaction addressing and routing services and custom user-oriented management information services. The DAASC primary location is in Dayton, Ohio, with a satellite in Tracy, California. DoD users with a logistics or supply requirement process a transaction through their unique supply system which, in turn, transmits the requirement to the DAASC for editing, addressing and routing to the correct source of supply. DAASC operates 24 hours a day, 365 days a year processing an average of 4.5 million transactions daily. In addition, DAASC provides support to the Foreign Military Sales (FMS) Program with annual revenues of approximately $1.0 million.

DSDC services are utilized by a wide variety of DLA and DoD customers. Our products and services benefit the DLA supply centers by providing the means by which requisitions are processed and item buys are recommended. The distribution depots process line items shipped and receipts processed using systems DSDC developed. The Defense Contract Management Command (DCMC) uses our systems to process contractual documents worth billions of dollars. In the end, the war fighter benefits because his logistical needs are met, due in large part to the systems developed and maintained by DSDC.

Automated Printing Services Activity Group

The Automated Printing Service Activity Group's primary mission is printing, duplicating, and document automation for the Department of Defense (DoD). In FY 97, the Deputy Secretary of Defense changed the name of "Defense Printing Service" to "Defense Automated Printing Service" (DAPS). This change reflects the DAPS role in the DoD transition from hardcopy to electronic-based document management. DAPS has direct responsibility for the DoD automated printing program encompassing electronic conversion, retrieval, output, and distribution of digital and hard copy information. DAPS provides quality products and services that are competitively priced and delivered on time to their customers. DAPS is one of the first government organizations to conduct intra-government business using Visa's International Merchant Purchase Authorization Card (IMPAC). The use of the IMPAC card has resulted in significant cost savings, reduction in time required to process transactions, and in addition, it is "user friendly."

DAPS is comprised of a Corporate Support Team located at Fort Belvoir, Virginia, 78 major field locations and 163 smaller document automation facilities. Approximately 1,900 civilian personnel support the DAPS mission.

Industrial Plant Equipment

The Industrial Plant Equipment (IPE) Activity Group's primary function was dedicated to meeting the worldwide needs of the Department of Defense metal working machinery maintenance and the repair of current in-use Industrial Plant Equipment. IPE also supported the Military Services in times of National Emergency. The Defense Industrial Reserve Act (50 U.S.C. 451 et seq.) required IPE to provide for an industrial reserve of machine tools. Since FY 87, amendments to this Act have required the Services to pay for the repair, overhead and storage of Industrial Plant Equipment. The Services made economic decisions to engage IPE to perform reimbursable repair, rebuild or refabrication of equipment or procure new items. Eventually DLA downsized the industrial reserve to a demand based reparable inventory.

In January 1992, DLA consolidated the Defense Industrial Plant Equipment Center (DIPEC) with the Defense Supply Center Richmond (DSCR). DSCR manages the maintenance facility located in Mechanicsburg, Pennsylvania. In March 1992, the Office of Secretary of Defense (Production & Logistics) assigned single DoD Consolidated Materiel Management of FSG 34 reparable equipment to DLA. During FY 93, the New Procurement mission of the Industrial Plant Equipment Activity Group was transferred to the DLA Supply Management Activity Group and the Reparable Inventory storage function moved to the DLA Distribution Depots Activity Group. During FY 97, the depot maintenance mission of the IPE Activity Group was transferred to the Supply Management Activity Group.

The Reparable Inventory is demand based and retained for reutilization as an economic alternative to procurement of new equipment. The inventory is reported as Principal Inventory (Federal Supply Class 34) in the Supply System Inventory Report (SSIR) provided to the Office of Secretary of Defense (Production & Logistics). DSCR operates a system for the identification of metalworking machinery and performs associated federal cataloging tasks. DSCR also publishes handbooks and provides technical data in support of FSG 34 reparable machine acquisition, storage, maintenance and movement.

Financial activity associated with contracts let before IPE's consolidation into Supply Management is expected to continue for the 5M appropriation for several years, at the conclusion of which all residual financial balances will be closed.

Clothing Factory

Through FY 94, DLA had a sixth business area, the Clothing Factory (97X4930.5Q). Effective September 30, 1994, the Clothing factory was closed under the Defense Base

Realignment and Closure Act (BRAC). At that date, all of its operations were discontinued, except for the Flag and Embroidery function which was transferred to Clothing & Textiles (C&T), located at the DPSC, Philadelphia, PA. All residual financial balances were closed during FY 97.

Strategic Operating Initiatives and Program Performance Measures

DLA continues its focus to operate in a manner similar to commercial firms in the marketplace, with an emphasis on increased customer satisfaction. DLA emphasizes quality improvement, commercial business practices and modern technologies to reduce the cost to the customer while maintaining the maximum level of readiness support for the Services.

In January 1994, DLA was selected as the initial DoD pilot project under the Government Performance and Results Act of 1993 (GPRA). Although DLA completed its requirements under this project, it continues to establish an annual performance plan including operating initiatives designed to focus on specific objectives presented in the DoD Logistics Strategic Plan and the DLA Corporate Plan.

The program performance measures for each of the activity groups are included in the respective area's overview section. The operating initiatives are presented under four broad strategic goals. The following are the DLA strategic goals and representative activity groups initiatives.

1) Put Cutomers First

Supply

Stock Availability – Stock Availability measurement applies to NonFuel (excluding subsistence) and is the percentage of demands processed by the supply system without interruption. While it is a measure of timeliness, quantity, and customer satisfaction, DLA NonFuel (excluding subsistence) is funded to reach a targeted Supply Availability goal of 85%.

War Reserve Availability – Although the Fuel commodity availability always has been 100% in peacetime, its true purpose is to have enough fuel available in each Commander in Chief's (CINC) area of responsibility to prevent War Reserves levels from being penetrated. The performance for this goal is determined by the number of fuel types (in each CINC's area of responsibility where there is enough fuel on hand to meet his War Reserve requirement) to the total number of fuel types managed in all CINCs' area. This is referred to as the War Reserve Availability measure.

Distribution Depots

Customer Satisfaction Index – The success of Distribution in meeting its mission is measured primarily through the satisfaction of its customers. In October 1994, DLA Corporate Administration, at the direction of DLA Materiel Management (MM), conducted a survey of 30,000 customers, asking each their opinions on DLA MM products and services. The goal was to determine customer satisfaction with DLA in three areas: quality, responsiveness, and price. Results from this survey serve as a baseline for customer satisfaction measurement and reporting. DLA MM conducts a survey of a random sample of customers annually, comparing the results with the baseline survey. The customer satisfaction index which is the primary program performance measure for this initiative is based on survey data and measures the percentage of customers who are satisfied with DLA services/products.

Reutilization and Marketing Service

Reutilization/Transfer/Donation Enhancements – DRMS continued to excel in its first mission of reutilizing, transferring and donating (R/T/D) property to authorized customers. In FY 97, DRMS reutilized, transferred or donated $3.9 billion based on transfer value. This represented 18 percent of generations against our GPRA goal of 17.5 percent. At a fully burdened cost of $72 million, DRMS provided $3.9 billion in cost avoidance to DoD, Federal and State customers at a cost of $0.018 on the dollar of acquisition value. DRMS achieved this performance through improved automation, aggressive customer promotion through conferences and publications, and commodity analysis to target property to R/T/D customer needs. DRMS maintains a toll free customer service phone line to address questions or concerns participants may have pertaining to the R/T/D program.

Information Services

Ontime Deliverables – The success of Information Services in meeting its mission is measured primarily through the satisfaction of its customers. Ontime Deliverables is one program performance measure that exists to measure the current developmental status of project completion, and it compares the estimated project completion date to the current status (or the actual completion date) for deliverables. The delta provides information as to whether the development is within the stated tolerance of the estimate (either ahead of, exactly on, or behind schedule).

Automated Printing Service

Customer Satisfaction Index – A survey was administered to 412 customers randomly selected from a population of 2,533. To ensure that the survey results accurately reflected our customers' opinions, DAPS customers were divided into groups based on the branch of DoD Service, the DAPS geographic area, the length of time the customer had interacted with DAPS, and the volume of business revenue provided by the customer.

2) Improve the Process of Delivering Logistics Support

Supply

Total Asset Visibility – This initiative has been divided into a number of sub-Initiatives for both Supply and Distribution. One Supply initiative is In-Storage Visibility of Retail Assets. Progress on this initiative is tracked based on a number of factors and is discussed below:

In-Storage Visibility of Retail Assets promotes the visibility of retail assets available for use in filling backorders and offsetting new procurement. This initiative has reached an Initial Operation Capability (IOC) phase with selected Navy, Army, Air Force and Marine activities. As of the end of FY 97, approximately $59 million worth of retail asset redistributions from IOC sites have been accomplished at the direction of DLA Inventory Control Points (ICPs) to fill backorders and offset new procurements.

Distribution Depots

Mail-like Matter Movement (M3) – This is an initiative under the Express Delivery Reinvention Lab, a partnership with the U.S. Air Force, TRANSCOM, and Federal Express. M3 of classified materiel allows secret and confidential cargo to move quickly, securely and cheaply via express transportation within the Continental United States (CONUS).

Reutilization and Marketing Services

WorldWideWeb (WWW) – A Hammer Award was presented to a team of DRMS employees for the Information Superhighway Initiative. The award recognized process changes made possible because of the team's development of the DRMS WWW site. It allows anyone with a graphical interface to the Internet to search by noun, Federal Supply Class (FSC), national stock number (NSN) and geographic location. The DRMS WWW site was widely used, with over 3.5 million Web pages viewed. DRMS implemented a number of enhancements to the WWW site in FY 97. These included:

- Redesign of the Web site to establish a common "look and feel" to enable users to utilize DRMS processes more easily.

- Import of the Fed Log (FLIS) CDs to the Oracle database, allowing FLIS data to be linked to online property searches.
- Establishment of links from search output to available photographs of property.
- Posting of hazardous waste procurement solicitations.

Automated Printing Services

DAPS is dedicated to the transition from paper to electronic-based document management, and is an integral part of the DoD plan to evolve into the age of electronic documentation. DAPS is leading the effort to substantially reduce paper-based bulk printing and warehousing. This will be accomplished by converting paper documents to digital form, and providing the infrastructure for quick, economical, and secure digital distribution and output at the point of need.

3) Empower Employees

All Activity Groups

Employee empowerment initiatives continued to receive the full support of DLA. These initiatives include Affirmative Action Recognition, Employee Recognition, Equal Employment Opportunity Coverage, Professional Development and Teaming. As further illustration of the agency's commitment to this vital area, DLA established a separate office dedicated to employee development. Our efforts to develop the logistics workforce into a multiskilled and highly flexible resource are imperative with the downsizing efforts being undertaken throughout the DoD.

4) Increase readiness at reduced cost

Supply

Shift to Commercial Practices (SCP) – SCP includes Prime Vendor Contracts, Quick Response Contracts, Corporate Contracts, Customer Value Contracts, and all other long-term contracts. The SCP objective is to minimize operating and inventory investment costs using DLA leverage, and improve responsiveness to customers. A multi-faceted approach for achieving these objectives uses strategies such as direct vendor delivery, prime vendor, long-term/multi-year contracting, just-in-time delivery, and electronic commerce/electronic data interchange (EC/EDI). These contracts yield better quality, lower prices, shorter lead times and a reduced vendor base. Progress on this initiative is tracked based on a number of factors, two of which are discussed below:

- *Shift to Commercial Practices (SCP) as a Percent of Dollars Obligated* – SCP as a percent of dollars obligated grew to 78% (including DFSC), 61% (excluding DFSC) for year end FY97, up 72% (including DFSC) from 58% (excluding DFSC) at year end FY96.
- *EC/EDI Utilization as a Percent of Contracting Actions* – EC/EDI utilization measures the efficiency gained through the use of EC/EDI technology. The goal is to reach 85% utilization by 1998. EC/EDI utilization as a percent of contract actions for FY97 was 76%, up from 70% in FY96, and 67% in FY95.

Distribution Depots

Inventory Accuracy – DLA's policy states that accurate inventory records form the cornerstone of effective inventory control. One of our primary objectives is to maintain on-hand balance integrity. In order to attain current and future goals, the distribution depots will be required to conduct wall-to-wall inventories at selected depots and/or within isolated work centers. These inventories will be designed to increase the accuracy of inventory records, formalize and implement cycle count procedures to identify and correct processes, and implement quality control techniques to ensure that distribution balance-affecting processes are performed correctly.

Reutilization and Marketing Service

Activity Based Costing – DRMS partnered with KPMG Peat Marwick LLP to implement Activity Based Costing (ABC) to better measure the true cost of its processes. The DRMS ABC application assigns labor and non-labor costs to activities based on the level of effort spent on each activity. Activity costs are then directed to processes (reutilization, transfer, donation, sales, etc.). Finally, the process costs are directed to Federal Supply Class (FSC), giving DRMS visibility of the cost of disposing of individual commodities by the type of disposal method used (i.e., the cost to reutilize a vehicle, the cost to sell an engine, etc.). The ABC data will be used to identify areas for cost reduction, to support cost recovery billings to the Military Services and in making privatization decisions.

Financial Management and the Chief Financial Officers Act of 1990

In 1990, Congress passed the Chief Financial Officers Act (the Act) which mandated the preparation of financial statements in accordance with Generally Accepted Accounting Principles. The Act, along with the creation of the Defense Working Capital Fund (DWCF), formerly known as the Defense Business Operations Fund (DBOF), represented a fundamental shift in traditional fund management (i.e., obligations and outlays) to a more commercial, business-oriented approach.

DLA began preparing financial statements in accordance with the Act in 1992 and believes the information reported continues to improve. Nevertheless, several challenges remain and are discussed in the following paragraphs. During FY 94, DLA established short and long-term goals for creating a comprehensive financial management system, and undertook a number of initiatives to identify and assess the financial statement impact of current accounting practices. These goals and initiatives enabled DLA to establish milestones to improve financial data accuracy and reliability. DLA has worked diligently to reach these milestones during FY 95, FY 96 and FY 97, with significant progress achieved in the areas of accounts payable and receivable, property, plant and equipment and financial analysis. This process continues in FY 98.

The Federal accounting community continues to establish "Generally Accepted Accounting Principles" for federal agencies, with additional guidance issued to reporting units by their respective Comptroller divisions. The continuing development of "Generally Accepted Accounting Principles" will greatly enhance the accuracy and usefulness of reported financial information. However, reported financial information may be inconsistent in the short-term.

Supply is currently unable to comply with certain requirements under Federal Accounting Standards Advisory Board (FASAB) Statement Number 3 regarding the recognition of unrealized holding gains and losses upon the sale of inventory. Supply records these gains and losses when there is a change in the carrying cost. In FY 98, DLA-HQ and DFAS plan to work together to achieve a reliable and accurate solution to recognize these gains and losses at the proper time.

"DoD Guidance on Form and Content of Financial Statements for FY 97 Financial Activity" requires that intrafund transactions be identified and eliminated. Currently, the Office of the Secretary of Defense (OSD) has not issued detailed accounting guidance regarding this reporting requirement and current accounting systems used to record the financial information have not been designed to identify and retain this information. Therefore, in order to comply with this requirement, estimated calculations are provided.

Traditional fund management, prior to DWCF, did not require the calculation of depreciation on property, plant and equipment (PP&E). As a result, PP&E was not always accurately reflected in the accounting records, and through FY 94 DLA had not properly accounted for all the PP&E for which it was responsible. Significant progress has been made toward correcting this situation. In conjunction with the implementation of the Defense Property Accounting System (DPAS), all DLA field activities undertook the review and revision of their property records. Additionally, DLA began validating the records of sites with significant balances and/or discrepancies. DPAS implementation was substantially completed through the end FY 97.

Accounts Receivable and Accounts Payable include "undistributed" amounts which represent the differences between collections and disbursements on the general ledger and those which have been reported through the finance network/ACRS cash report. The Department has recognized the "undistributed" problem and is currently pursuing corrective actions. The Defense Finance and Accounting Service (DFAS) site in Columbus, OH, which supports DLA, has also recognized this problem and has assigned accounting personnel for each DLA activity group the responsibility of reconciling the finance network and ACRS cash figures.

Overview

Accounts Receivable and Accounts Payable include overaged and negative amounts that are currently under investigation for system and processing deficiencies. Significant progress has been made in resolving some of the overaged amounts within Accounts Receivable and Accounts Payable as a result of continuing emphasis on Unmatched Disbursements and Negative Unliquidated Obligations.

Financial Performance Measures

The financial performance measures for each of the activity groups are included in the respective area overview sections.

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

CONSOLIDATED PRINCIPAL STATEMENTS

Principal Statements

Department of Defense
Defense Logistics Agency - Working Capital Fund - Consolidated Statements
Statement of Financial Position
As of September 30, 1997
(Thousands)

ASSETS	1997	1996
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	($414,163)	$424,157
(2) Investments, Net (Note 4)	0	0
(3) Accounts Receivable, Net (Note 5)	639,674	769,606
(4) Interest Receivable	0	0
(5) Advances and Prepayments	22	119
(6) Other Federal (Intragovernmental) (Note 6)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	0	0
(2) Accounts Receivable, Net (Note 5)	177,701	205,665
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	0
(4) Interest Receivable, Net	0	0
(5) Advances and Prepayments	178,244	199,752
(6) Other Non-Federal (Governmental) (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	9,824,808	9.542,887
e. Work in Process (Note 9)	0	0
f. Operating Materials/Supplies, Net (Note 10)	18,850	1,653
g. Stockpile Materials, Net (Note 11)	0	0
h. Seized Property (Note 12)	0	0
i. Forfeited Property, Net (Note 13)	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	0
k. Property, Plant and Equipment, Net (Note 15)	1,272,251	808,548
l. War Reserves	0	0
m. Other Entity Assets	237,353	246,773
n. Total Entity Assets	$11,934,740	$12,199,160
2. Non-Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	$23,762	$21,937
(2) Accounts Receivable, Net (Note 5)	0	0
(3) Interest Receivable, Net	0	0
(4) Other (Note 6)	0	0

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency - Working Capital Fund - Consolidated Statements
Statement of Financial Position
As of September 30, 1997
(Thousands)

ASSETS, Continued	1997	1996
2. Non-Entity Assets:		
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Receivable, Net (Note 5)	$0	$0
(2) Interest Receivable, Net	0	0
(3) Other (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Other Non-Entity Assets	65,966	38,362
e. Total Non-Entity Assets	$89,728	$60,299
3. Total Assets	$12,024,468	$12,259,459
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$677,526	$826,069
(2) Interest Payable	0	0
(3) Debt (Note 16)	0	0
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	87,544	183,069
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	811,824	931,484
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	16,235	5,272
(b) Annual Accrued Leave	102,190	96,496
(c) Severance Pay and Separation Allowance	0	0
(3) Interest Payable	0	0
(4) Liabilities for Loan Guarantees (Note 7)	0	0
(5) Lease Liabilities (Note 18)	0	0
(6) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	67,519	65,324
c. Total Liabilities Covered by Budgetary Resources:	$1,762,838	$2,107,714

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency - Working Capital Fund - Consolidated Statements
Statement of Financial Position
As of September 30, 1997
(Thousands)

LIABILITIES, Continued	**1997**	**1996**
5. Liabilities Not Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$0	$0
(2) Debt (Note 16)	0	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	0	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	191,226	0
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	0	0
c. Total Liabilities Not Covered by Budgetary Resources	$191.226	$0
6. Total Liabilities	$1.954.064	$2.107.714
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$0	$0
b. Invested Capital	20.020.765	24,768,356
c. Cumulative Results of Operations	(9,759,135)	(8,630,905)
d. Other	0	(5,985,706)
e. Future Funding Requirements	(191.226)	0
f. Total Net Position	$10.070.404	$10.151,745
8. Total Liabilities and Net Position	$12.024.468	$12,259.459

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency - Working Capital Fund - Consolidated Statements
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used	$0	$0
2. Revenues from Sales of Goods and Services		
a. To the Public	364,690	392,855
b. Intragovernmental	12,263,255	12,733,177
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	244,897	101,321
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	0	0
8. Total Revenues and Financing Sources	$12,872,842	$13,227,353
EXPENSES		
9. Program or Operating Expenses (Note 23)	$2,535,115	$4,497,343
10. Cost of Goods Sold (Note 24)		
a. To the Public	397,498	156,912
b. Intragovernmental	10,064,031	8,554,585
11. Depreciation and Amortization	92,624	76,510
12. Bad Debts and Writeoffs	132	19
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	143	224
14. Other Expenses (Note 25)	993,642	820,516
15. Total Expenses	$14,083,185	$14,106,109
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	($1,210,343)	($878,756)
17. Plus (Minus) Extraordinary Items (Note 26)	(825)	(2,500)
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($1,211,168)	($881,256)

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency - Working Capital Fund - Consolidated Statements
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
EXPENSES, Continued		
19. Net Position, Beginning Balance, as Previously Stated	$10,151,745	$10,876,495
20. Adjustments (Note 27)	78,391	(375,389)
21. Net Position, Beginning Balance, as Restated	$10,230,136	$10,501,106
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(1,211,168)	(881,256)
23. Plus (Minus) Non Operating Changes (Note 28)	1,051,436	531,895
24. Net Position, Ending Balance	$10,070,404	$10,151,745

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency - Working Capital Fund - Consolidated Statements
Statement of Cash Flows
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($1.211.168)	($881.256)
Adjustments Affecting Cash Flow:		
2. Appropriated Capital Used	0	0
3. Decrease (Increase) in Accounts Receivable	(96,385)	701,043
4. Decrease (Increase) in Other Assets	1,471,392	928,056
5. Increase (Decrease) in Accounts Payable	(14,061)	(44.301)
6. Increase (Decrease) in Other Liabilities	(78,209)	30,416
7. Depreciation and Amortization	92,620	76,510
8. Other Unfunded Expenses	0	(97,819)
9. Other Adjustments	(238.324)	(112,478)
10. Total Adjustments	$1,137,033	$1.481.427
11. Net Cash Provided (Used) by Operating Activities	($74.135)	$600,171
CASH FLOWS FROM INVESTING ACTIVITIES		
12. Sale of Property, Plant and Equipment	$0	$0
13. Purchase of Property, Plant and Equipment	(227,729)	(131,414)
14. Sale of Securities	0	0
15. Purchase of Securities	0	0
16. Collection of Loans Receivable	0	0
17. Creation of Loans Receivable	0	0
18. Other Investing Cash Provided (Used)	0	0
19. Net Cash Provided (Used) by Investing Activities	($227.729)	($131.414)
CASH FLOWS FROM FINANCING ACTIVITIES		
20. Appropriations (Current Warrants)	$0	$0
21. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	7,445	330,824
22. Deduct:		
a. Withdrawals	0	0
b. Transfers of Cash to Others	543,901	1.182.252
23. Net Appropriations	($536,456)	($851.428)

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Logistics Agency - Working Capital Fund - Consolidated Statements
Statement of Cash Flows
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
CASH FLOWS FROM FINANCING ACTIVITIES, Continued		
24. Borrowing from the Public	$0	$0
25. Repayments on Loans to the Public	0	0
26. Borrowing from the Treasury and the Federal Financing Bank	0	0
27. Repayments on Loans from the Treasury and the Federal Financing Bank	0	0
28. Other Borrowings and Repayments	0	0
29. Net Cash Provided (Used) by Financing Activities	($536,456)	($851,428)
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	($838,320)	($382,671)
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	$424,157	$806,828
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	($414,163)	$424,157

Supplemental Disclosure of Cash Flow Information:	1997	1996
33. Total Interest Paid	$1,671	$679

Supplemental Schedule of Financing and Investing Activity:	1997	1996
34. Property and Equipment Acquired Under Capital Lease Obligations	$0	$0
35. Property Acquired Under Long-Term Financing Arrangements	$0	$0
36. Other Exchanges of Non-cash Assets or Liabilities	$1,640,769	$1,417,377

The accompanying notes are an integral part of these statements.

Principal Statements

DEFENSE LOGISTICS AGENCY

WORKING CAPITAL FUND

FOOTNOTES TO THE CONSOLIDATED PRINCIPAL STATEMENTS

DEFENSE WORKING CAPITAL FUND
CONSOLIDATED
NOTES TO THE PRINCIPAL STATEMENTS
AS OF SEPTEMBER 30, 1997

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation:

These financial statements have been prepared to report the financial position and results of operations of the Defense Logistics Agency (DLA), as required by the Chief Financial Officers (CFO) Act of 1990. They have been prepared from the accounting records of DLA in accordance with the hierarchy of accounting standards as prescribed by the Federal Accounting Standards Advisory Board (FASAB), OMB Bulletin 94-01 and supplemental DoD guidance. The accounting standards prescribed by the FASAB, in the DoD Accounting Manual (DoD 7220.9-M) and in the Financial Management Regulation (DoD 7000.14-R) were followed, as appropriate. To the extent that guidance is not provided by one of these standards, DLA accounts for transactions in accordance with guidance promulgated by the GAO, OMB, Department of Treasury, and commercial Generally Accepted Accounting Principles. These statements differ from the DLA financial reports prepared to monitor and control the use of budgetary resources. Amounts presented in the financial statements and footnotes are rounded to the nearest thousand dollars unless otherwise indicated.

B. Reporting Entity:

The Defense Logistics Agency (DLA) is a combat support agency responsible for worldwide logistics support throughout the Department of Defense (DoD). The primary focus of DLA is to provide logistics support to the warfighter. In addition, DLA provides support to relief efforts during times of national emergency.

DLA Supply Management Activity Group (Supply) helps carry out this mission by procuring, managing and supplying over three billion consumable items to Military Departments, other DoD components, Federal agencies and selected foreign governments. Supply is funded through the Defense Working Capital Fund (DWCF). The appropriation symbol is 97X4930.5C.

The Distribution Depot Activity Group (Distribution) receives, stores and distributes commodities, principal end items, and depot level reparables for the Military Departments and other DoD components, Federal agencies, and selective foreign governments. The current depot structure encompasses 24 depots and 5 storage locations. All depot sites report directly to the Defense Distribution Center (DDC) located at New Cumberland, Pennsylvania. Distribution's mission is funded through the Defense Working Capital Fund (DWCF). The appropriation symbol is 97X4930.5B.

The overall mission of the Defense Reutilization and Marketing Service Activity Group (DRMS) is to provide reutilization services to DoD. DRMS accomplishes its mission through the individual Defense Reutilization and Marketing Offices (DRMOs) located on military installations throughout the world. DRMOs receive, classify, segregate, demilitarize, account for and report excess materiel for screening, lotting, merchandising, and sale. They also have the mission of hazardous property disposal and the economic recovery of precious metals from excess and surplus precious metal-bearing materiel. The appropriation symbol is 97X4930.5N.

The Information Services Activity Group was revised to include a Defense Logistics Agency (DLA) element at the beginning of FY 96. On October 1, 1995, DLA began operation of its Information Services Activity Group with a single Central Design Activity (CDA), the DLA System Design Center (DSDC). The Activity Group combines DSDC and the Defense Automatic Addressing System Center (DAASC) with over 1,100 employees and an operating budget of $129 million.

The DLA Systems Design Center (DSDC) serves as a primary provider of integrated information management support, delivering responsive and innovative solutions to meet DLA and DoD customers' needs. DSDC is the DLA CDA operating within the Information Services Activity Group of the Defense Working Capital Fund. DSDC headquarters are in Columbus, Ohio, with nine other geographically dispersed satellite sites. These sites, which include Ogden, Utah and Battle Creek, Michigan, among others, allow for co-location with some of our major customers. The appropriation symbol is 97X4930.5F50.

Defense Automated Printing Service Activity Group (DAPS) has direct responsibility for the DoD printing program and document automation, encompassing value-added conversion, electronic storage and output, and the distribution of hard copy and digital information. DAPS manages a worldwide printing, duplicating, document automation, production, and procurement network.

On 1 October 1996, Defense Printing Service (DPS) was renamed Defense Automated Printing Service (DAPS) as it converted from the Navy Defense Business Operations Funds to the DLA Defense Working Capital Fund. Also in May 1997, Defense Finance and Accounting Service (DFAS) began the implementation of the Defense Working Accounting System (DWAS). DWAS is the first Commercial Off The Shelf DoD migratory accounting system.

The CFO Act requires DAPS, as a business entity under DWCF, to provide audited financial statements. Due to the difficulties DFAS encountered while implementing the new system, accounting reports were not available to DAPS at the end of the fiscal year, thus an audit to confirm the validity of the data reported could not be prepared. The appropriation symbol is 97X4930.5G.

The overall mission of the Industrial Plant Equipment Activity Group (IPE) is to repair, overhaul, rebuild, and modify industrial plant equipment for the Military Services. This Activity Group also supplies depot maintenance support to the DLA National General Reserves of IPE and provides on site repair services at DoD industrial activities. This mission is funded through the Defense Working Capital Fund (DWCF). The appropriation symbol is 97X4930.5M. Effective FY 97, this Activity Group was merged with the Supply Management Activity Group.

The Clothing Factory (Clothing) manufactured clothing and textile items for all DoD components. Effective September 30, 1994, the Clothing factory was closed under the Defense Base Realignment and Closure Act (BRAC). At that date, all of its operations were discontinued, except for the Flag and Embroidery function which was transferred to Clothing & Textiles. DoD policy for the Personal Property Utilization and Disposal Program requires all installations cited for closure to cooperate with the community in identifying related property that may be available for civilian use. All residual balances have been researched and closed. Clothing's mission was funded through the Defense Business Operations Fund (DBOF) now known as the Defense Working Capital Fund (DWCF). The appropriation symbol is 97X4930.5Q.

C. Budgets and Budgetary Accounting:

Each Activity Group receives an annual operating budget (AOB) in unit cost terms. Unit Cost Resourcing provides the operating expense authority/cost authority for such items as salaries, nonlabor expenses, and materiel within each activity. Cost authority or the amount "earned" depends on the actual work load times the unit cost goals. Each Activity Group can also receive reimbursable authority for outputs/goods and services that are not contained in the unit cost goals. Host support for a tenant is an example.

Activity Groups may also receive a capital budget that provides the obligation authority for the purchase of equipment, minor construction, ADP and telecommunications, and software development.

D. Basis of Accounting:

Transactions are recorded on an accrual basis and on a budgetary basis. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

"DoD Guidance on Form and Content of Financial Statements for FY 97 Financial Activity" requires that intrafund transactions be identified and eliminated. However, the Office of the Secretary of Defense (OSD) has not issued official accounting guidance regarding this reporting requirement and current accounting systems used to record earnings, expenses, collections and disbursements have not been designed to identify and retain this information at the appropriate detail level. Therefore, in order to comply with this requirement, estimated calculations are provided. Note 29 identifies the eliminations in general terms; however, due to our inability to capture the necessary financial data, certain schedules are completed in full while others are incomplete.

E. Revenues and Other Financing Sources:

Revenues and financing sources for Supply consist of reimbursements from customers for sales of inventory and services.

Revenues and financing sources for Distribution consist of reimbursements from Supply Management for receipt and issue of materiel and reimbursable funding provided by local activities for non-mission work. Revenues are recognized when earned based on actual workload for the period. Revenue may be billed up to two months after work is performed. These financial statements include an adjustment to accrue for these billings.

Revenues and financing sources for DRMS consist of proceeds from the sale of property to the public along with reimbursements from the hazardous disposal and precious metals recovery programs. Revenue is not earned for the reutilization, transfer, and donation programs.

Revenues and financing sources for Information Services, DAPS and IPE consist of reimbursements from customers for services provided. Revenues are recognized when the service has been performed.

Revenues and financing sources for Clothing consist of reimbursements from customers (primarily Supply Management and the Base Realignment and Closure (BRAC) account) for work performed and services rendered. Revenues are recognized on a percentage of physical completion basis.

F. Accounting for Intragovernmental Activities:

DLA, as an agency of the Federal government, interacts with, and is dependent upon, other financial activities of the government as a whole. As a result, these financial statements do not reflect the results of all financial decisions applicable to DLA as though the agency were a stand-alone entity.

DLA's proportionate share of the public debt and related expenses of the Federal Government are not included in these financial statements because debt and related interest costs are not apportioned to Federal agencies.

Also, financing for the construction of DoD facilities is obtained through appropriations from Congress. To the extent that this financing may have been ultimately obtained through the issuance of public debt, interest costs have not been capitalized because the Treasury Department does not allocate interest costs to the benefiting agencies.

G. Funds with the U.S. Treasury and Cash:

Generally, Fund Balances with Treasury represent the aggregate amount of an entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. DWCF Activity Groups account for cash collections and disbursements. Beginning balances are not allocated to the Activity Groups. As a result, only cash collections, disbursements, and transfers are presented on the statements of financial position.

In accordance with guidance issued by OSD, DLA obtains cash receipt and disbursement information from the finance network/ACRS cash report. This report is not reconciled to the Statements of Transactions on a timely basis and contains differences from amounts recorded on the general ledger. Differences between the finance network/ACRS cash report and general ledger balances are recorded as "undistributed" amounts in Accounts Receivable and Accounts Payable.

H. Foreign Currency:

Gains and losses from foreign currency transactions are not recognized in the statement of operations. They are absorbed by budgetary transactions in which obligations are increased or decreased to reflect foreign currency fluctuations. There are no foreign currency translation adjustments.

I. Accounts Receivable:

Accounts receivable are reflected from Federal and non-federal sources. An allowance for uncollectible accounts has not been established as DLA has generally not experienced significant uncollectible amounts.

Accounts receivable include amounts which represent the differences between collections on the general ledger and those which have been reported through the finance network/ACRS cash report. As a result of the transfer of accounting and management responsibilities, DLA has had limited capability to reconcile these differences.

Accounts receivable also include numerous over-aged and negative transactions. See Note 31 for detail on the amounts of these transactions at year-end.

J. Loans Receivable:

DLA Activity Groups do not lend money.

K. **Inventories:**

SUPPLY

Inventories are valued at Latest Acquisition Cost (LAC). The latest acquisition cost method provides that the last representative invoice price shall be applied to all like units held, including units acquired through donation, non-monetary exchange, and return from end use or reutilization. The difference between contract cost (historical cost) and the inventory valued at LAC is reported as a component of cost of goods sold in the Statement of Operations. Official accounting guidance requires that this amount be recognized upon the sale or disposal of materiel, rather than as the price variance occurs. Currently, DLA Supply Management's accounting systems are unable to comply with this accounting guidance and the holding gains and losses are recognized when the price change occurs.

DISTRIBUTION

Distribution performs the warehousing function for the DoD; however, it owns no materiel inventory. Inventory stored in the depots is owned and managed by other Activity Groups (primarily DLA and the Services' Supply Management) and by entities outside the DWCF.

DRMS

DRMS does not have inventory. Disposal property is classified and reported as "Other Entity Assets" in accordance with DoD reporting guidance. This property is not "primarily" held for sale, and therefore does not meet the definition of inventory for classification purposes.

INFORMATION SERVICES

No inventories are maintained.

DAPS

Inventories include operating supplies and non-consumable items. Direct material inventory is valued at the weighted average method.

IPE

IPE repairs, overhauls, rebuilds and modifies industrial plant equipment; however, IPE owns no materiel inventory.

CLOTHING

No inventories remain.

L. **Investments in U.S. Government Securities:**

DLA Activity Groups do not invest in U.S. Government securities.

M. Property, Plant and Equipment:

Equipment is capitalized according to DWCF policy, when the following criteria are met:

- Acquisition cost, book value, or when applicable, an estimated fair market value is greater than or equal to $15,000 for FY 93, greater than or equal to $25,000 for FY 94, greater than or equal to $50,000 for FY 95, greater than or equal to $100,000 for FY96 and FY97.

- Estimated useful life is two years or more.

Capital assets in DLA, with the exception of DAPS, are input at the detail level into the Defense Property Accountability System (DPAS). DPAS transmits summarized information to the Defense Business Management System (DBMS) for financial reporting purposes. Capital assets are reported at their acquisition cost less any accumulated depreciation. The acquisition cost includes all the costs necessary to put the asset in place and into the form in which it will be used. The capital assets for DLA include such items as ADP equipment, materiel handling equipment, and software.

The General Accounting Office (GAO) has determined that real property used by any DWCF activity, but under the jurisdiction of the Military Departments, represents an asset of the DWCF activity and such property should be reported on the financial statements as an Entity asset to show the full costs of all resources and assets used in operations. These amounts should be recorded at acquisition cost, or if unavailable, at fair market value. Documentation to support the recorded acquisition cost of many older properties is unavailable, and DoD believes it is not cost effective to obtain fair market value appraisals for many of these properties. These older properties would in all likelihood be fully depreciated, resulting in no impact to these financial statements.

Routine maintenance and repair costs are expensed when incurred. Depreciation for property and equipment is recorded on a straight-line basis.

N. Prepaid and Deferred Charges:

Payments before the receipt of goods and services are recorded as advances at the time of prepayment. Expenses are recognized when the related goods and services are received.

O. Leases:

DLA is committed to operating leases and rental agreements. Generally, these leases and agreements are for the rental of equipment, space and operating facilities. Payments under these operating leases are expensed as incurred.

Additionally, Supply Management may act as host to tenant activities on certain installations. These amounts are billed under Interagency Service Agreements and generally have only included the fees for services provided. Revenue is recognized when the amounts are received from the tenant activity.

DLA may also be party (as lessee) to a limited number of leases that meet the criteria of capital leases. However, DLA's accounting systems do not allow for the identification of these arrangements as capital leases. Therefore, payments under these arrangements are not capitalized, but expensed as incurred.

P. Contingencies:

DLA may be party to various legal and administrative claims and actions. In management's opinion, the resolution of these actions will not materially affect DLA operations or financial position. Therefore, no contingent liabilities have been recognized in the Statement of Financial Position.

Q. Accrued Leave:

Civilian annual leave is accrued as earned, and accrued hours are reduced as leave is taken. Unused annual leave is reported as a funded expense and the liability is reduced as leave is taken. The balance for accrued leave reflects current pay rates, and each year, the balance in the accrued annual leave account is adjusted to reflect changes to those rates. Sick leave and other types of nonvested leave are expensed as taken.

R. Equity:

Equity consists of invested capital, capitalization of assets, cumulative results of operations, future funding requirements, and other equity balances.

S. Aircraft/Ship Crashes:

This does not apply to DLA Activity Groups.

T. Treaties for Use of Foreign Bases:

DLA has not entered into treaties for the use of foreign bases.

Footnotes

U. Comparative Data:

The financial statements present FY 96 and FY 97, with the exception of DAPS, which is new in FY 97. This comparative data is presented to provide an understanding of changes in the financial position and operations of the DLA Activity Groups.

Note 2. Fund Balances with Treasury

A. Business Operations Fund (USD(C)) and All Other Funds and Accounts:

Not applicable.

B. Business Operations Fund Activities Below USD(C) Level:

Entity Assets:

	1997	1996
Beginning Balance	424,157	806,828
Transfers of Cash to Others	(629,884)	(1,182,252)
Transfers of Cash from Others	93,428	330,824
Funds Collected	13,540,831	13,580,977
Funds Disbursed	(13,842,695)	(13,112,220)
Ending Balance	(414,163)	424,157

C. Business Operations Fund Activities and All Other Funds and Accounts:

Non-Entity Assets:	Funds Collected	Funds Disbursed
Beginning Balance	174,898	152,961
Funds Collected	51,414	0
Funds Disbursed	0	49,589
Ending Balance	226,312	202,550

D. Other Information:

Cash collections and disbursements data for the financial statements is obtained from the Military Services' Listing and ACRS cash report. These reports are then reconciled to the general ledger and all differences are recorded as undistributed amounts in accounts receivable and accounts payable.

Non-entity assets represent amounts included in temporary suspense which are forwarded to non-DWCF recipients. That balance is stated in Note 2C.

Note 3. Cash, Foreign Currency and Other Monetary Assets

Not applicable.

Note 4. Investments

Not applicable.

Note 5. Accounts Receivable, Net

	(1) Gross Amount Due	(2) Allowance For Estimated Uncollectible	(3) Allowance Method Used	(4) Net Amount Due
A. Entity Receivables:				
Intragovernmental	639,674	0	N/A	639,674
Governmental	177,792	(91)	Actual	177,701
B. Non-Entity Receivables:				
Intragovernmental	0	0	N/A	0
Governmental	0	0	N/A	0
Total	817,466	(91)	N/A	817,375

C. Other Information:

The difference between cash collections in the ACRS cash report and the general ledger is undistributed. This amount is recorded as an adjustment to accounts receivable.

Note 6. Other Assets

Not applicable.

Note 7. Loans and Loan Guarantees, Non-Federal Borrowers

Not applicable.

Footnotes

Note 8. Inventory, Net

A. Inventory Categories:

		Inventory Amount	Allowance for Losses	Inventory Net	Valuation Method
(1)	Held for Current Sale	9,939,942	0	9,939,942	LAC
(2)	Held in Reserve for Future Sale/War Reserve Materiel	1,588,372	0	1,588,372	LAC
(3)	Excess,Obsolete,&Unserviceable	(1,811,944)	0	(1,811,944)	% of LAC
(4)	Held for Repair	108,438	0	108,438	LAC
	Total	9,824,808	0	$9,824,808	

B. Restrictions on Inventory Use, Sale, or Disposition:

"Held in Reserve for Future Sale" is inventory being held for research or reclassification. This inventory is held until final disposition and is not available for immediate sale. War Reserve Materiel are considered restricted, also. These materiel are used in the event of a war or national emergency.

C. Other Information:

1. Inventory Held for Sale - This category of inventory includes most supply system materiel that is in an issuable condition.

2. Excess, Obsolete and Unserviceable - This category consists of items that are determined to be beyond economic and contingency retention stock levels, and as a result, arereported as potential reutilization/disposal materiel. This category also includes inventory that is no longer needed due to changes in technology, laws, customs or operations. Unserviceable items includes items not expected to survive repair after a technical evaluation at a maintenance activity is performed, and also includes damaged inventory that is not economical to repair.

3. Inventory Held For Repair - These are inventory items that are not in an issuable condition (but are not beyond economical repair) and are awaiting repair before they are eligible for sale.

Note 9. Work in Process

Not applicable.

Note 10. Operating Materials and Supplies (OM&S), Net

A. OM&S Categories:	(1) OM&S Amount	(2) Allowance for Losses	(3) OM&S, Net	(4) Valuation Method
(1) Held for Use	18,850	0	18,850	LAC
(2) Held in Reserve for Future Sale	0	0	0	
(3) Excess, Obsolete, & Unserviceable	0	0	0	
(4) Held for Repair	0	0	0	LAC
Total	18.850	0	18,850	

Note 11. Stockpile Materiel

Not applicable.

Note 12. Seized Property

Not applicable.

Note 13. Forfeited Property, Net

Not applicable.

Note 14. Goods Held Under Price Support and Stabilization Programs, Net

Not applicable.

Note 15. Property, Plant and Equipment, Net

Classes of Fixed Assets	(1) Depreciation Method*	(2) Service Life*	(3) Acquisition Value	(4) Accumulated Depreciation	(5) Net Book Value
A. Land:	-	-	0	0	0
B. Structures, Facilities, Leasehold Improvements:	SL	20	1,743,308	1,023,821	719,487
C. Military Equipment:	-	-	68,144	44,687	23,457
D. ADP:	SL	5	12,422	11,575	847
E. Equipment:	SL	10	751,897	302,256	449,641
F. Assets under Capital Lease:	-	-	0	0	0
G. Other:	-	-	495	0	495
H. Natural Resources:	-	-	0	0	0
I. Construction in Progress:	-	-	78,324	0	78,324
Total:			2,654,590	1,382,339	1,272,251

* Key:

Depreciation Methods	Range of Service Life
SL - Straight Line	1-5 - 1 to 5 Years
DD - Double-Declining Balance	6-10 - 6 to 10 Years
SY - Sum of the Years' Digits	11-20 - 11 to 20 Years
IN - Interest (sinking fund)	>20 - Over 20 Years
PR - Production (activity or use method)	
OT - Other (describe)	

J. Other Information:

Capital assets in DLA, with the exception of DAPS, are input at the detail level into the Defense Property Accountability System (DPAS). DPAS transmits summarized information to the Defense Business Management System (DBMS) for financial reporting purposes.

Distribution is in the process of implementing the Distribution Standard System (DSS) throughout all of its depots. Through 9/30/97, the total cost of this system is in excess of $80 million. Distribution is in the process of determining how to implement the guidance contained in the DoD Financial Management Regulation, establishing the appropriate time DSS was placed in service and therefore begins depreciating. However, for the FY 97 financial statements, this amount has not been capitalized.

Documentation to support the recorded acquisition cost of many older properties is unavailable. Additionally, DoD believes it is not cost effective in many cases to obtain fair market value appraisals for many of these properties. These older properties would in all likelihood be fully depreciated, resulting in no impact to these financial statements.

Note 16. Debt

Not applicable.

Note 17. Other Liabilities

A. Other Liabilities Covered by Budgetary Resources:

	Non-Current Liabilities	Current Liabilities	Total
1. Intragovernmental			
(a) Reserve for equity for others	0	135,833	135,833
(b) Undistributed Cash Disbursements	0	(72,051)	(72,051)
(c) Suspense Account	0	23,762	23,762
Total	0	87,544	87,544
2. Governmental			
(a) Other	0	10,945	10,945
(b) Deferred Revenue	56,574	0	56,574
Total	56,574	10,945	67,519

B. Other Information:

"Reserve for equity for others" includes the amounts of cash transferred to Supply by participating civilian agencies or Military Services.

"Suspense Account" represents amounts included in temporary suspense which are forwarded to non-DWCF recipients.

Governmental "Other" represents a general ledger amount to temporarily classify liabilities until specific account distribution or liquidation is determined.

C. Other Liabilities Not Covered by Budgetary Resources:

Not applicable.

D. Other Information:

Not applicable.

Footnotes

Note 18. Leases:

A. Entity as Lessee:

DLA is committed to operating leases and rental agreements. Generally, these leases and agreements are for the rental of equipment, space and operating facilities. DLA generally leases facilities and equipment from year to year under Interservice Support Agreements. Although these agreements may extend for longer than one year, the majority can be renegotiated, and thus are not considered noncancelable. Rental expense associated with these agreements is expensed when paid.

B. Entity as Lessor:

DLA may act as host to tenant activities on certain installations. Amounts are billed under Interservice Support Agreements and generally have included only the fees for services provided.

C. Other Information:

Not applicable.

Note 19. Pensions and Other Actuarial Liabilities

Major Program Activities	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate	Assets Available to Pay Benefits	Unfunded Actuarial Liability
A. Pension and Health Plans	0	0	0	0
B. Insurance/Annuity Programs	0	0	0	0
C. Other	0	0	0	191,226
D. **Total**	0	0	0	191,226

E. Other Information:

Future workers' compensation figures are provided by the Department of Labor. The liability for future workers' compensation (FWC) benefits 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 related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's, June 10, 1997, economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

1997	
Year 1	6.24%
Year 2	5.82%
Year 3	5.60%
Year 4	5.45%
Year 5 & thereafter	5.40%

Note 20. Net Position

	Revolving Funds	Trust Funds	Appropriated Funds	Total
A. Unexpended Appropriations:				
(1) Unobligated,	0	0	0	0
(2) Undelivered Orders	0	0	0	0
B. Invested Capital:	20,020,765	0	0	20,020,765
C. Cumulative Results of Operations:	(9,759,135)	0	0	(9,759,135)
D. Other:	0	0	0	0
E. Future Funding Requirements:	(191,226)	0	0	(191.226)
F. Total:	10,070,404	0	0	10.070.404

G. Other Information:

See individual Activity Group footnotes for Other Information concerning Net Position.

Note 21. Taxes

Not applicable.

Note 22. Other Revenue and Financing Sources

A. Other Revenues and Financing Sources:	1997	1996
(1) GLAC 480-Otl:er	69,528	101,321
(2) GLAC 560-Other	2,782	0
(3) Imputed Pension & Other Reitrement Benefits (ORB):		
(a) CSRS/FERS Retirement	121,289	0
(b) FEHB	51,144	0
(c) FGLI	154	0
Total	244,897	101,321

B. Other Information:

Items (1) and (2): Other revenue and financing sources include cash collections which do not relate to the primary mission of the DLA Activity Groups.

Item (3): Represents the imputed financing for pensions and other retirement benefits. The Office of Personnel Management (OPM) is the administrative entity for pensions and other retirement benefits (ORB). OPM accounts for and reports the pension liability in the financial statements while the employer discloses the imputed financing. OPM actuaries provide the normal cost rates which are used to calculate the imputed financing.

Note 23. Program or Operating Expenses

	1997	1996
A. Operating Expenses by Object Classification:		
(1) Personal Services and Benefits	638,449	1,475,156
(2) Travel and Transportation	96,236	546,152
(3) Rental, Communication and Utilities	39,731	68,997
(4) Printing and Reproduction	12,690	14,972
(5) Contractual Services	936,743	1,395,629
(6) Supplies and Materials	33,066	85,653
(7) Equipment not Capitalized	92,361	100,883
(8) Grants, Subsidies and Contributions	203	207
(9) Insurance Claims and Indemnities	0	0
(10) Others (describe):		
(a) Interest	1,671	679
(b) Transportation - Materiel	292,052	375,529
(c) Repair Expense - Materiel	12,934	17,781
(d) Other Expenses	378,979	415,705
(11) Total Expenses by Object Class	2,535,115	4,497,343

B. Operating Expenses by Program:

Not applicable.

C. Other Information:

As directed by DFAS Headquarters, operating expenses for FY 97 have been considered on Line A.2 of Cost of Goods and Services Sold of Note 24, rather than as Operating Expenses, as declared in FY 96. The above Operating Expenses for FY97 include only the Supply Management Activity Group. FY96 Expenses include all Activity Groups, therefore, the data is not comparable for the two fiscal years.

Note 24. Cost of Goods and Services Sold

A. Cost of Services Sold:

(1) Beginning Work-in-Process	0
(2) Plus: Operating Expenses	1,455,227
(3) Minus: Ending Work-in-Process	0
(4) Minus: Completed Work for Activity Retention	(5,194)
Cost of Services Sold	1,450,033

B. Cost of Materiel Sold from Inventory:

(1) Beginning Inventory - L.A.C	9,540,719
(2) Minus: Beginning Allowance for Unrealized Holding Gains (Losses)	0
(3) Plus: Purchases at Cost	8,728,499
(4) Plus: Customer Returns-Credit Given	0
(5) Plus: DLR Exchange Credits	0
(6) Minus: Inventory Losses Realized	(820,996)
(7) Minus: Ending Inventory - L.A.C.	(9,824,808)
(8) Plus: Ending Allowance for Unrealized Holding Gains (Losses)	0
(9) Minus: Equity Transfers of Inventory to Others	(25,995)
(10) Plus: Equity Transfers of Inventory from Others	1,414,077
(11) Equals: Cost of Goods Sold from Inventory	9,011,496

C. Other Information:

The costs of inventory sold are not specifically identified to the buyer (Government or Public). However, sales are identified to the buyer, therefore a sales allocation percentage is applied to the total cost of goods sold to report the costs as Intragovernmental or to the Public. The sales allocation percentage for the Public sales was approximately 2%.

Footnotes

Note 25. Other Expenses

A. Other Expenses:

	1997	1996
(1) Potential Reutilization	98,538	(251,883)
(2) Property Disposal	711,385	1,074,512
(3) Loss Due to Shrinkage, Theft	11,072	0
(4) Real Property Maintenance	60	0
(5) Prior Year Expense Adjustment	0	(2,113)
(6) Imputed Pension & Other Reitrement Benefits (ORB):		
(a) CSRS/FERS Retirement	121,289	0
(b) FEHB	51,144	0
(c) FGLI	154	0
Total	993,642	820,516

B. Other Information:

Potential Reutilization Inventory (previously called potential excess inventory) are inventory items in excess of approved force acquisition objectives and approved force retention stock objectives. These assets are written down in accordance with current DoD accounting guidance to a percentage of LAC. The percentage that is applied to these assets depends upon whether the item is serviceable or unserviceable.

Item (6), above, represents the imputed expense for pensions and other retirement benefits. The Office of Personnel Management (OPM) is the administrative entity responsible for pensions and other retirement benefits (ORB). OPM accounts for and reports the pension liability in their financial statements while the employer discloses the imputed expenses. OPM actuaries provide the normal cost rates which are used to calculate the imputed expenses.

Note 26. Extraordinary Items

In FY96, DRMS recorded an expense of $2,500,000 (in whole dollars) to settle litigation over a prior year sale of ships. This expense is unusual in nature and not expected to recur.

In FY97, DRMS recorded an expense of $825,000 (in whole dollars) to settle litigation over a claim regarding the misrepresentation of weight and metallurigical content of 535 M551 AR/AAV tanks located at Anniston Army Depot. This expense is unusual in nature and not expected to recur.

Note 27. Prior Period Adjustments

	1997	1996
A. Prior Period Adjustments:		
(1) Understatement of expenses in FY95 (5B)	0	(4,877)
(2) Overstatement of revenues in FY94 (5B)	0	(30,141)
(3) Subsistence Transportation (5C)	0	(19,511)
(4) Fuels-Congressional Mandated Refund (5C)	0	(137,600)
(5) JLSC Transfer (5C)	0	(46,720)
(6) Prior Period Unfunded (5C)	0	(66,811)
(7) Adjustment to Capitalized Assets (5C)	0	(82,339)
(8) Prior Period Expense Adjustment (5M)	7	(93)
(9) De-Obligation of expenses from FY92 through FY95	0	12,705
(10) Overstatement of expenses in FY96 (5B)	1,511	0
(11) Unfunded Annual Leave (5C)	(48,265)	0
(12) DLA PAC (5C)	5,924	0
(13) Other (5C)	73,882	0
(14) Adjustment to Capitalized Assets (5N)	22,896	0
(15) Prior Period Expense Adjustment (5N)	(4,117)	0
(16) Prior Period Expense Adjustment (5N)	(446)	0
(17) Prior Period Expense Adjustment (5N)	(6,033)	0
(18) DLA PAC Transfer Adjustment (5N)	(12)	0
(19) Overstatement of expenses in FY96 (5B)	33,044	0
Total	78,391	(375,389)

Note 28. Non-Operating Changes (Transfers and Donations)

	1997	1996
A. Increases:		
(1) Transfers-In:		
(a) Cash	1,428,653	1,818,862
(b) Equipment	126,232	79,010
(c) Disposal Property	40,256	0
(2) Donations Received	263,988	35,136
(3) Other Increases - cash and consumable item transfers	1,432,806	1,285,766
(4) **Total Increases**	3,291,935	3,218,774
B. Decreases:		
(1) Transfers-Out:		
(a) Cash	1,908,909	2,660,450
(b) Equipment	115,222	10,593
(c) Disposal Property	2,267	3,574
(2) Donations	0	0
(3) Other Decreases	214,101	12,262
(4) **Total Decreases**	2,240,499	2,686,879
C. Net Non-Operating Changes (Transfers):	1,051,436	531,895

D. Other Information

Not applicable.

Note 29. Intrafund Eliminations

Schedule A: Not applicable.

Schedule B:
Selling Activity:

	Column A	Column B	Column C	Column D
	Accounts *Receivable	Revenue	Unearned Revenue	*Collections
DLA, Distribution Depots	54,454	590,924	0	599,575
DLA, Supply Management,Materiel	42,730	33,032	0	32,476
DLA, Supply Management,Operations	127,639	236,996	0	165,843
DLA, Information Services	23,347	94,429	0	90,665
DLA, Industrial Plant & Equipment	(55)	(238)	0	(223)
DLA, Reutilization & Marketing	6,167	13,265	0	11,878
	254,282	968,408	0	900,214

Customer Activity:	Column A	Column B	Column C	Column D
	Accounts *Payable	Expenses	Advances	*Disbursements
Intra DLA Support	27,627	57,470	0	55,148
DLA Between DLA	84,399	277,374	0	234,786
DLA Precious Metals (DPDS)	1,765	6,204	0	7,249
Intra DLA (Stk Fnd or Indus Fnd)	140,490	627,360	0	603,031
TOTAL	254,281	968,408	0	900,214

Schedule C:

Selling Activity:	Column A	Column B	Column C	Column D
	Accounts *Receivable	Revenue	Unearned Revenue	*Collections
DLA, Distribution Depots	61,656	669,593	0	679,407
DLA, Supply Management,Materiel	370,123	10,668,302	0	10,686,117
DLA, Supply Management,Operations	134,249	266,569	0	220,942
DLA, Information Services	7,909	32,449	0	31,133
Defense Automated Printing Service	0	210,864	0	210,864
DLA, Industrial Plant & Equipment	1,281	5,434	0	5,088
DLA, Reutilization & Marketing	50,682	72,852	56,573	89,520
	625,900	11,926,063	56,573	11,923,071

Customer Activity:	Column A	Column B	Column C	Column D
	Accounts *Payable	Expenses	Advances	*Disbursements
Department of the Army	159,098	2,554,330	0	2,548,225
Department of the Navy	169,270	4,125,319	56,573	4,133,703
Department of the Air Force	150,909	4,494,052	0	4,476,204
Army WCF	0	474	0	474
Navy WCF	0	20,286	0	20,286
Air Force WCF	0	996	0	996
DFAS WCF	0	8,760	0	8,760
U.S. Army Corps of Engineers	4,716	8,980	0	6,836
Other Defense Organizations	141,907	712,866	0	727,587
TOTAL	625,900	11,926,063	56,573	11,923,071

Schedule D:

Selling Activity:	**Column A** Accounts *Receivable	**Column B** Revenue	**Column C** Unearned Revenue	**Column D** *Collections
DLA, Distribution Depots	201	15	0	627
DLA, Supply Management,Materiel	75,287	146,149	0	147,062
DLA, Supply Management,Operations	3,096	3,415	0	4,935
DLA, Information Services	(3,271)	5	0	(309)
Defense Automated Printing Service	0	13,700	0	13,700
DLA, Industrial Plant & Equipment	1,132	341	0	826
DLA, Reutilization & Marketing	1,302	648	0	1,577
	77,747	164,273	0	168,418

Customer Activity:	**Column A** Accounts *Payable	**Column B** Expenses	**Column C** Advances	**Column D** *Disbursements
General Services Administration	3,509	5,913	0	7,060
Agriculture	35,491	23,746	0	21,863
Interior	5,781	2,255	0	992
NASA	4,339	17,622	0	17,549
State	331	349	0	525
Transportation	2,380	10,034	0	9,996
Treasury	335	1,698	0	1,741
Veterans Afairs	2,835	4,112	0	4,265
All Other Government Agencies	22,746	98,544	0	104,427
TOTAL	77,747	164,273	0	168,418

Note 30. Contingencies

Not Applicable.

Note 31. Other Disclosures

UNMATCHED DISBURSEMENTS, NEGATIVE UNLIQUIDATED OBLIGATIONS, AND AGED IN-TRANSIT DISBURSEMENTS

Treasury Index 97 Appropriations	Sept 1996	Sept 1997	$ Change	% Change
Unmatched Disbursements	174,275	165,837	(8,438)	(5%)
Negative Unliquidated Obligations	7,748	21,654	13,906	179%
Aged In-Transit Disbursements	261,643	310,187	48,544	19%
Totals	443,666	497,678	54,012	12%

Footnotes

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

February 27, 1998

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

SUBJECT: Audit Opinion on the Defense Logistics Agency Working Capital Fund Financial Statements for FY 1997 (Project 8FI-2002)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements. The Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service (DFAS) are responsible for establishing and maintaining adequate internal controls and for complying with laws and regulations applicable to DLA financial accounting and reporting. Our responsibility is to render an opinion on the financial statements based on our work, and to determine whether internal controls were adequate and whether management complied with applicable laws and regulations.

Before FY 1991, the DoD operated a significant number of commercial and industrial facilities under a revolving fund concept. In FY 1991, the revolving funds were consolidated to form the Defense Business Operations Fund (DBOF). The Inspector General, DoD, was responsible for auditing and rendering an opinion on the DBOF consolidated financial statements. In December 1996, the Under Secretary of Defense (Comptroller) announced that the DBOF would be separated into working capital funds. At that time, no decision was made as to whether the Inspector General, DoD, would be required to render a separate audit opinion on the DLA Working Capital Fund.

Disclaimer of Opinion. We were unable to render an opinion on the FYs 1997 and 1996 DLA Working Capital Fund Financial Statements because we did not perform sufficient work, and our limited work disclosed additional scope limitations. DFAS was late in providing us with the final version (version 3) of the financial statements, and DLA was late in providing us with the management and legal representation letters and logistics data needed to support the reported inventory balances. Therefore, we could not consider that information in attempting to render an opinion. We also had difficulty in gaining access to financial data in the DLA automated systems. Because of significant deficiencies in the accounting systems and internal controls, we were unable to verify the inventory balances on the FY 1997 financial statements. For the following reasons, we could not verify the $9.8 billion inventory balance on the DLA financial statements.

o DLA sampling plans, which were used to measure inventory record accuracy at the DLA distribution depots, did not meet the requirements of the CFO Act, and the results of physical inventories taken during the year could not be used for that purpose.

o Large numbers of inventory adjustments were made when the accountable records of distribution depots were reconciled with the financial records of inventory control points.

o Inactive inventory was not properly classified, described, and disclosed in the financial statements.

o The Financial Inventory Accounting report, which supported the reported fuel inventory balance, contained negative inventory quantities and dollar amounts.

o DFAS made unsupported adjustments to reconcile the Financial Inventory Accounting report with the trial balance.

We also did not review the FY 1996 financial data presented on the DLA Working Capital Fund Financial Statements. The FY 1997 DLA Working Capital Fund Financial Statements presented data from the FY 1996 DBOF Consolidated Financial Statements for comparative purposes. The Inspector General, DoD, was unable to render an opinion on the FY 1996 DBOF Consolidated Financial Statements because of significant deficiencies in accounting systems and the lack of a sound internal control structure.

Accounting Principles. The DLA Working Capital Fund Consolidated Financial Statements for FYs 1997 and 1996 were prepared in accordance with the Office of Management and Budget (OMB) Bulletin 94-01, "Form and Content of Agency Financial Statements," November 1993, as supplemented by OMB Bulletin 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. These Bulletins incorporate the Statements of Federal Accounting Concepts and Standards recommended by the Federal Accounting Standards Advisory Board, which are approved by the Secretary of the Treasury; the Director, OMB; and the Comptroller General of the United States. Footnote 1 of the FY 1997 DLA Working Capital Fund Consolidated Financial Statements discusses the accounting policies that DLA followed in preparing the financial statements.

Internal Controls. We identified several major internal control weaknesses in the areas we reviewed. DFAS could not provide summary information to show the organizations that processed collections and disbursements, as reported in the Fund Balance With Treasury account. Additionally, the collection and disbursement amounts reported to the Department of the Treasury differed from amounts reported in the trial balances, and DFAS could not explain the differences. Unreconciled differences between Department of the Treasury balances and trial balances were reported in Accounts Receivable and Accounts Payable, making those accounts unauditable. Inventory accounts were overstated and related expense accounts were understated because inappropriate methods were used for inventory valuation. Additionally, DLA did not report all capital assets, lacked documentation to support the recorded acquisition costs of some property, and did not compute depreciation accurately.

Compliance With Laws and Regulations. We identified instances of noncompliance with laws and regulations in the DLA Working Capital Fund. DLA did not comply with Statement of Federal Financial Accounting Standards No. 3 for the identification and valuation of excess inventory. In addition, DLA did not adhere to the provisions of DoD 4000.25-1-M, "Military Standard Requisitioning and Issue Procedures," May 1987, for materiel returns.

Under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 93-06, Addendum 1, "Audit Requirements for Federal Financial Statements," January 16, 1998, our work disclosed that financial management systems did not comply with Federal financial management system requirements; applicable Federal accounting standards; and the United States Government Standard General Ledger at the transaction level.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Appendix D. Management and Legal Representation Letters

This appendix (a total of 5 pages) consists of the management and legal representation letters for the FY 1997 Financial Statements of the Defense Logistics Agency Working Capital Fund.

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

R TO FOX

MAR C 1 1998

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Management Representation Letter for the DLA Defense Working Capital Fund (DWCF) FY 1997 Financial Statements

For the purpose of expressing an opinion on whether the FY 1997 DLA DWCF financial statements are presented fairly and in accordance with generally accepted accounting principles and Office of Management and Budget (OMB) Bulletin 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, I confirm, to the best of my knowledge and belief, the following representations:

- I am responsible for the fair presentation of the DLA DWCF financial statements in accordance with generally accepted accounting principles and OMB Bulletin 94-01.

- I have made available to you all financial records and related data.

- I have no plans or intentions, other than any of those previously disclosed to you, that may materially affect the carrying value or classification of assets and liabilities.

- I have no knowledge of irregularities involving management or employees who have significant roles in the internal control structure that are not a matter of public record.

- I have no knowledge of other employees being involved in irregularities that could materially affect the financial statements that are not a matter of public record.

- I have not received communications from regulatory agencies or auditors concerning noncompliance with, or deficiencies in, financial reporting practices that could have a material effect on the financial statements that are not a matter of public record.

- Related third-party transactions and related amounts receivable or payable of interested participants, including assessments, loans, and guarantees, are not applicable.

- I have no knowledge of violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency that are not a matter of public record.

- o There are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Financial Accounting Standards Board Statement No. 5, "Accounting for Contingencies," March 1975.

- o There are no unasserted claims or assessments that our legal representatives have advised us are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board Statement No. 5.

- o I have no knowledge of material transactions that have not been properly recorded in the accounting records underlying the financial statements that are not a matter of public record.

- o Provisions, for material amounts, have been made to reduce excess or obsolete inventories to their estimated net realizable value.

- o To my knowledge, the Federal Government has satisfactory title to all reported assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.

- o Provision has been made for any material loss to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of normal requirements or at prices in excess of the prevailing market prices.

- o I have no knowledge of noncompliance with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

- o I have no knowledge of events that have occurred after the balance sheet date that would require adjustment to or disclosure in the financial statements that have not been previously identified on the statements.

Henry T. Glisson

HENRY T. GLISSON
Lieutenant General, USA
Director

Linda J. Furiga

LINDA J. FURIGA
Comptroller

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

I REPLY REFER TO GC

March 1, 1998

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

SUBJECT: Defense Logistics Agency Working Capital Fund for FY 1997

As General Counsel of the Defense Logistics Agency, I am responding to the annual requirement for a legal representation in connection with your examination of the Defense Logistics Agency Working Capital Fund (WCF) concerning matters that existed for FY 1997. The attached cases reported represent all pending or threatened litigation, claims, assessments, or probable claims of $100 million or more and could effect the WCF.

The General Counsel of the Defense Logistics Agency has general supervision of the Agency's legal affairs, including those involving the Working Capital Fund. In such capacity I have reviewed litigation and claims threatened or asserted involving the WCF.

Subject to the foregoing and to the last paragraph of this memorandum, I advise you that in FY 1997, neither I, nor any of my lawyers over whom I exercise general legal supervision, have given substantive attention to, or represented, the Working Capital Fund in connection with material loss contingencies coming within the scope of clause (a) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as indicated in the attachment to this memorandum.

The information set forth herein is as of the date of this memorandum and covers matters that existed in FY 1997 and to the date of this memorandum.

I confirm, that in the course of performing legal services for DLA, I have advised the Comptroller, DLA of all unasserted possible claims or assessments which, in my professional judgement, should be disclosed or considered for potential disclosure on our financial statements in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 5 "Accounting for Contingencies," December 1995.

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors Requests for Information (December 1975). Without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified, in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the American Bar Association Statement of

Policy, this will confirm as correct the Agency's understanding that whenever, in the course of performing legal services for the Agency with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, I have formed a professional conclusion that the Agency must disclose, or consider disclosure, concerning such possible claim or assessment, I, or one of the lawyers over whom I exercise general legal supervision, as a matter of professional responsibility to the Agency, will so advise the Agency and will consult with the Agency's managers concerning the question of such disclosure and the applicable requirement of Statement of Financial Accounting Standards No. 5.

BRUCE W. BAIRD
General Counsel

Attachments

cc: Comptroller, DLA

ATTACHMENT: CASE 1

The EROS appeals before the Armed Services Board of Contract Appeals, ASBCA Nos. 48355 and 48367 continue to represent a claim of approximately $263.9 million for a breach of contract. The current status of the case is summarized below:

a. This is a breach of contract and improper use of proprietary data claim based on a termination for the convenience of the Government of Contract SP4410-94-R-1001 in July 1994. The contract, awarded June 8, 1994, involved the scrapping and consignment resale of parts and metal from B-52 aircraft at the Davis-Monthan AFB, Tucson, AZ.

b. Discovery in this case is now active, as the closing date for discovery is May 1, 1998, with a hearing date of July 28-29, 1998. DRMS believes the chance for significant liability in this case is small. In addition, the Board found in its summary judgment decision that the amount guaranteed under the unique pricing formula of this contract was approximately $1.1 million (an amount with which Appellant disagrees).

c. Attorneys from DRMS-G, Battle Creek, MI are handling the litigation. No settlement of the matter is currently being pursued.

Appendix E. Laws and Regulations Reviewed

Public Law 104-208, "Federal Financial Management Improvement Act of 1996," October 1, 1996

Public Law 103-356, "Government Management Reform Act of 1994," October 13, 1994 (may be cited as the "Federal Financial Management Act of 1994")

Public Law 101-576, "Chief Financial Officers Act of 1990," November 15, 1990

Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982," September 8, 1982

OMB Bulletin No. 98-04, "Addendum to OMB Bulletin No. 93-06," January 16, 1998

OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996

OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993

OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993

OMB Circular No. A-127, "Financial Management Systems," as revised July 23, 1993

OMB Circular No. A-134, "Financial Accounting Principles and Standards," May 20, 1993

Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," October 27, 1993

Joint Financial Management Improvement Program "Core Financial System Requirements," September 1995 (part of the "Federal Financial Management System Requirements")

DoD 7000.14-R, "DoD Financial Management Regulation," volume 6, "Reporting Policy and Procedures," February 1996

DoD 7000.14-R, "DoD Financial Management Regulation," volume 11B, "Reimbursable Operations, Policy and Procedures - Defense Business Operations Fund," December 1994

DoD 7000.14-R, "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993

DoD Directive 5010.38, "Management Control Program," August 26, 1996

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Deputy Under Secretary of Defense (Acquisition Reform)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
Salvatore D. Guli
James L. Kornides
Tim F. Soltis
Kevin C. Currier
Barry N. Harle
Scott K. Miller
M. Terry Rohr
Brian L. Henry
Tony C. Hans
Karen M. Bennett
Susanne B. Allen