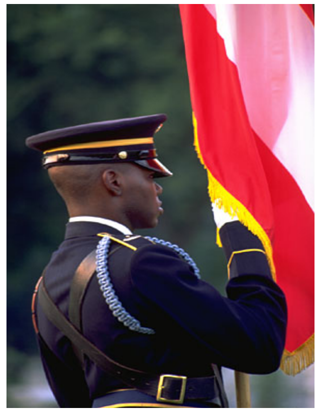
PERFORMANCE AND ACCOUNTABILITY REPORT

Fiscal Year 2004

DECA AT A GLANCE

Established	1991
Headquarters	1300 E Street Ft. Lee, VA 23801 www.commissaries.com www.deca.mil (for authorized parties)
FY 2004 General Operating Costs	$1.123 billion
FY 2004 Sales from Commissary Products	$5.2 billion
Total Employees	Approximately 18,000
Total Full-Time Equivalents (FTE)	Approximately 15,400
Regional Offices	3 (East, West and Europe)
Commissaries	273
Authorized Patrons	Approximately 11.6 million



MISSION

"Deliver the Premier Qualify of Life Benefit to the Armed Services Community to enhance recruiting, retention, and readiness by *Efficiently and Effectively* providing exceptional savings, excellent products and superior services, every time, every place!"

VALUES

DeCA's shared values are Leadership – Integrity – Flexibility – Enjoyment ("LIFE")

Leadership: We expect passion, courage and excellence!

Integrity: We demand honesty, professionalism and trustworthiness!

Flexibility: We cultivate innovation, empowerment and competence!

Enjoyment: We foster teamwork, recognition and opportunity!

VISION

DeCA's vision will focus on people – customers, workforce and partners – all working together to create "Raving Fans."

"LIFE and Raving Fans" – Together, these ideals are the impulses that will propel DeCA to achieve its goals

GOALS

Customers…Premier Quality of Life Benefit

Workforce…Employer of Choice

Partners…Best Business Models and Practices

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<u>FOREWARD</u>

The Defense Commissary Agency (DeCA), as part of the Department of Defense (DoD), is required to prepare annual financial statements. These financial statements must be prepared in accordance with Office of Management (OMB) directives, which implement the *Chief Financial Officers Act of 1990* (CFO Act). The DoD uses the information in DeCA's annual financial statements to prepare the DoD annual financial statements.

To enhance the presentation of performance, management, and financial information, OMB requires DoD and other agencies to incorporate their annual financial statements into a Performance and Accountability Report (PAR). Although DeCA is not required to prepare a separate PAR, we have prepared this document (using the same statutory guidance framework) to demonstrate accountability. This PAR provides summary performance information rather than the comprehensive presentation included in the DoD PAR.

PART I

MANAGEMENT'S DISCUSSION AND ANALYSIS

CEO's MESSAGE

I am pleased to present the annual report of the Defense Commissary Agency's (DeCA) financial and programmatic results for fiscal year 2004. DeCA is committed to operating the commissary system in an efficient manner; thereby, providing significant savings to its patrons. During this past year, we embarked on reengineering and restructuring our organization to become more responsive to customer and store-level needs. The new corporate structure postures us to better focus on store needs, become more efficient and effective, and reduce corporate costs.

On April 4, 2004, a provisional realignment of our business areas and offices was established as our first step in implementing our corporate reengineering initiative. The realignment ensures the maximum numbers of employees are in direct-service positions in order to improve commissary store support and productivity, while enhancing efficiency above the store-level. Organization processes were realigned to enhance all functions and processes needed to support commissaries on a day-to-day basis and improve functional oversight and policy. The new organizational structure is built around the agency's key processes. DeCA will cascade the reengineering effort down to regional and store-level with a completion date in fiscal year 2007.

The above-store level reengineering focus identifies a single process owner for each of the following *mission critical* processes – performance and policy, sales, systems engineering, planning, program management, and health, safety and security. A new corporate-level position of Chief Operating Officer will oversee the agency's processes that focus directly on store-level operations and requirements.

Another new corporate-level position established is the agency's Chief Support Officer (CSO). The CSO will have command and control over a multitude of critical *mission support* processes to include human resources, contracting, finance, accounting, budgeting, information technology, corporate communications, and equal employment opportunity.

DeCA's fiscal year 2004 performance data indicates positive progress in meeting the established performance plan. Through metrics, we directly link resource requirements to desired outcomes supporting the President's Management Agenda and the Department of Defense Balanced Scorecard. Using a business-based approach, we have increased sales while raising customer satisfaction to an all-time high.

We are pleased that for the 3rd year in a row, independent auditors have given our financial statements an unqualified opinion. However, the report by the independent auditors on DeCA's internal controls over financial reporting identified areas of nonconformance related to accounting for Property, Plant, and Equipment and controls associated with our financial systems. Except for these nonconformance's, I certify that DeCA's management control systems, taken as a whole, provide reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA) are achieved. In addition, we have evaluated our financial management systems, as required by the Federal Financial Management Improvement Act of 1996 (FFMIA). We found that our systems fall short of the integrated systems requirements. In addition, transactions at the detail level are not compliant with the US Standard General Ledger. The Department of Defense (DoD) is actively working on improving the system-wide architecture for DoD entities by fiscal year 2007 that meets the requirements of FMFIA and FFMIA.

As we face the challenges of the present and the future – base closure and realignment, changing marketplace, organizational realignment, and executive branch initiatives, including implementation of the National Security Personnel System – I am confident and optimistic of our capability to deliver the premier quality-of-life benefit to the Armed Services community. DeCA's support to our uniformed personnel and their families provides both an economic advantage and a 'taste of home' to Service members deployed around the world. I am confident that these contributions will continue.

Patrick B. Nixon
Chief Executive Officer

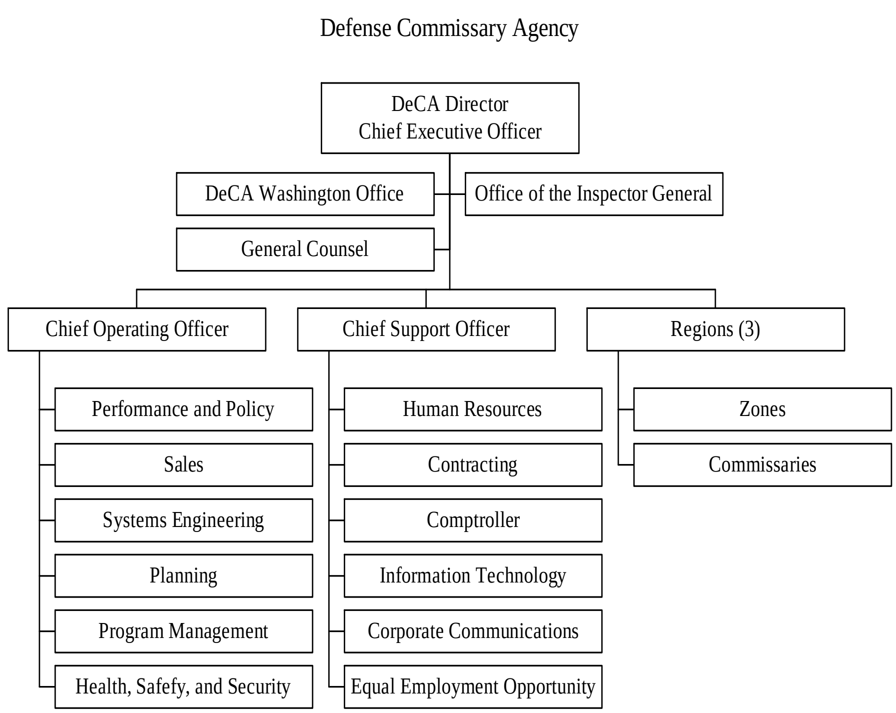
OVERVIEW OF DeCA

ORGANIZATION:

The Defense Commissary Agency (DeCA) is a component of the Department of Defense (DoD) reporting to the Under Secretary of Defense for Personnel and Readiness. In 1989, the House Armed Services Committee appointed the Jones Commission to analyze the commissary systems (i.e., grocery stores or supermarkets) operated by the four military services. To provide better service for military patrons at a lower cost, the Commission recommended consolidation of the four separate commissary systems. On October 1, 1991, DeCA was established.

DeCA is headquartered at Fort Lee, Virginia. It operates 273 commissaries worldwide. Three region headquarters provide localized management and support. Two regions manage stores in the continental United States and the Pacific, and one manages Europe. Field Operating Activities perform services for the regions and their commissaries, including centralized purchasing of national brand sales items.

DeCA implemented the first phase of a major reengineering effort on April 4, 2004. The Headquarters and Field Operating Activities were realigned in order improve store level support and productivity while enhancing above store efficiency. Processes were separated into Operations and Support. Operations has direct responsibility for all functions and processes needed to take care of the stores on a day to day basis. Support has direct responsibility for functional oversight and policy.



During fiscal year 2004, DeCA's operations included commissaries with annual sales of $5.2 billion and more than 18,000 employees. DeCA operates its commissaries around the world to support the military services. Patrons include approximately 11.6 million active duty military, reservists, retirees, and family members. Congress authorizes DoD to operate its commissaries as a significant non-pay benefit to supplement military income as an integral part of the overall military pay and benefit. DeCA sells its groceries and household supplies to the military community at its cost to include a 1 percent allowance for losses on most grocery items. Patrons also pay a five percent surcharge which funds construction programs and our stores' information management equipment. By selling goods at cost or near cost, DeCA provides the lowest overall prices and the maximum savings benefit.

SOURCES OF FUNDS:

Within DeCA's working capital fund (WCF) there are two activity groups - Commissary Resale Stocks and Commissary Operations. DoD defines these two activity groups as business areas for fund control purposes. Commissary Resale Stocks finance the purchase of grocery, meat and produce items for resale to authorized patrons. The primary revenue source for this activity group is the sale of inventory to commissary patrons. Sales from grocery products during FY 2004 were approximately $5.2 billion.

Commissary Operations finance the operating costs of resale stores, agency and region headquarters, field operating activities, and support services. The primary revenue source for this activity group is a direct appropriation to the Defense WCF, which in turn transfers the funds to the DeCA WCF. DeCA received approximately $1.1 billion in appropriation transfers during FY 2004. Commissary Operations also receives limited additional revenues from manufacturers' coupon redemption fees, handling fees for tobacco products, and reimbursements for other support.

DeCA's Surcharge Collections Trust Fund is funded, for the most part, by a five percent surcharge applied to each customer sale. This fund, established by law, primarily finances DeCA's store-level information systems equipment and maintenance, and construction programs.

PERFORMANCE GOALS SUMMARY

CORPORATE OBJECTIVES:

DeCA's *Corporate Strategic Plan* is the basis for DeCA's goals, objectives, and strategies and is summarized in the following table. DeCA's most recent performance plan for FY 2004 – 2009 provides a road map to further improve and enhance the commissary benefit. Each objective was designed to enhance DeCA's concept of operations, while keeping service to the customer at the forefront. The commissary benefit clearly improves military quality of life, and has a positive impact on the recruitment, retention, and readiness of today's military. DeCA remains focused on its customers and will provide them greater conveniences and a better shopping experience, while continuing efforts to increase the number of authorized patrons currently using the benefit.

Goal	*Objective*	*Strategy*
People First	Improve quality of life for DeCA employees and provide improved customer service for DeCA's customers and partners.	Beginning in FY 2004, implement programs that support DeCA's employees, customers, and partners, and by FY 2008, ensure initiatives are fully functioning agency wide.
Sustain Customer Savings	Continue to sustain savings to our customers of 30% over the commercial grocery and super center competition through FY 2009, while expanding customer traffic and increasing sales.	Savings are being tracked using a comprehensive database of actual prices of items sold and scanned by DeCA and competitive grocery and super center chains using standard industry procedures. A market basket sampling approach is used to compare non-scannable or non-comparable items like produce and meat.
Reduce Unit Costs	By the end of FY 2004, reduce agency operating unit costs by up to 1% from an FY 2002 baseline without inflation, while meeting or exceeding output, customer service and quality standards.	DeCA is constantly identifying and analyzing fundamental changes in the way DeCA is structured and conducts business in order to improve efficiency and further reduce costs while sustaining customer service and satisfaction metrics. DeCA is currently implementing a major reengineering initiative that began on April 4, 2004 to improve commissary store support and productivity, while enhancing above store efficiency.
Improve Technology	Deliver fully integrated capital investment programs that result in operational efficiencies, contribute to improved sales and savings, and exceed the expectations of our customers, workforce and partners.	Beginning in FY 2004, implement leading edge technologies that integrate business processes, enhance agency performance and promote interoperability throughout the military resale system. By the end of FY 2007, DeCA will migrate essential business legacy systems to interface with a common data repository.
Improve the Infrastructure	Deliver fully integrated facilities programs that result in operational efficiencies, contribute to improved sales and savings, and exceed the expectations of our customers, workforce and partners. Provide resale facilities that are conveniently located, properly sized, configured and maintained.	We will maintain a pace of construction, maintenance and repair to eliminate the construction backlog by the end of FY 2009. As we do this, we will ensure each store is properly sized to best serve its market area, and continue to "right-size" the total number of commissaries. This includes building stores in new locations where we should be serving the military, and closing stores where they are not needed. By the end of FY 2005, we will complete the deployment of a décor upgrade package to increase the appeal of commissaries to our patrons.

FISCAL YEAR 2004 PERFORMANCE GOALS AND RESULTS:

DeCA has developed a strong business case for all decisions, using metrics to accurately measure performance against our Performance Plan. We are one of only six defense agencies that have received an unqualified opinion or "clean audit" of our financial statements from a public accounting firm. Information systems are now better matched to commercial standards, and we are working towards parity when measured against our industry's standards.

In doing all of the above, we have linked together Planning, Programming, Budgeting and Execution (PPBE), to demonstrate our commitment to both performance improvement and cost per unit of output reductions. The Agency's strategic plan and corporate objectives provide the road map to ensure the continuation of the commissary benefit. Below are some of the key goals and measures that drive agency performance.

PERFORMANCE-AT-A-GLANCE:

Performance Measure	FY 2004 Goal	FY 2004 Actual	FY 2003 Actual
Customer Savings	30%	32.1%	32.1%
Commissary Customer Service Survey (CCSS)	4.42	4.47	4.42
American Customer Satisfaction Index (ACSI)	75	TBD Feb 05	76
Unit Costs	0.2214	0.2146	0.2172
Facility Condition Index (FCI)	77.1	TBD Feb 05	74.5

CONTROLS AND STATEMENT OF FINANCIAL ASSURANCE

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE:

At the present time, DeCA is reviewing many of the financial processes it performs for the purpose of eliminating, improving or automating manual processes and eliminating redundancies. DeCA's automation goal is to use current technology in eliminating redundant data input of financial transactions, and to reduce or consolidate financial business systems.

STATEMENT OF FINANCIAL ASSURANCE:

DeCA's system of internal accounting and administrative control, in effect during the fiscal year ended September 30, 2004, has been evaluated in accordance with the guidance provided by: The Office of Management and Budget Circular A-123 (Revised); *Management Accountability and Control*, dated June 21, 1995 as implemented by DoD Directive 5010.38; *Management Control Program*, dated August 26, 1996; and DoD Instruction 5010.40, *Management Control Program Procedures*, dated August 28, 1996.

The objectives of the system of internal accounting and administrative control of DeCA are to provide reasonable assurance that: 1) obligations and costs are in compliance with applicable laws; 2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and 3) that revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial and statistical reports, and to maintain accountability over the assets.

The results of the evaluation indicate that the system of internal accounting and administrative control of DeCA in effect during the fiscal year ended September 30, 2004, taken as a whole, comply with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved.

Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles in the U.S., and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

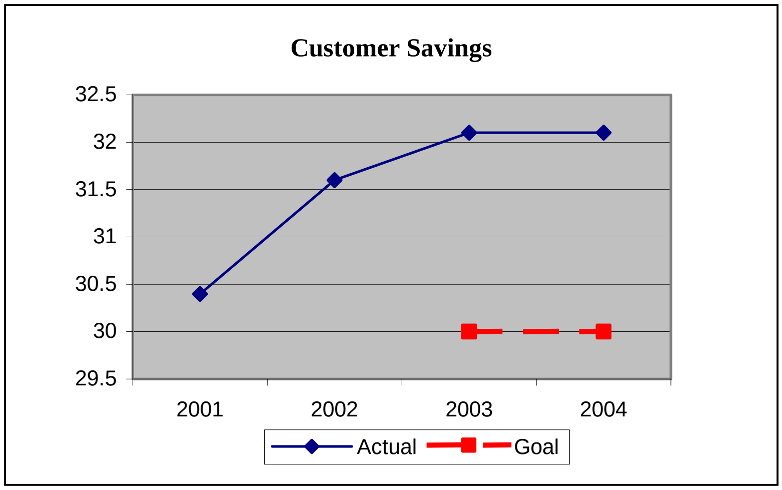
PART II

PERFORMANCE SECTION

PERFORMANCE ANALYSIS

DeCA has achieved or exceeded all of its performance goals for FY 2004. The following charts and discussions illustrate how well our achievements compare to our targets. The charts also depict our performance for the last four years, if data is available. DeCA did not establish some targets until FY 2002 or 2003. One indicator was not tracked until FY 2002 and a goal was not established until FY 2004.

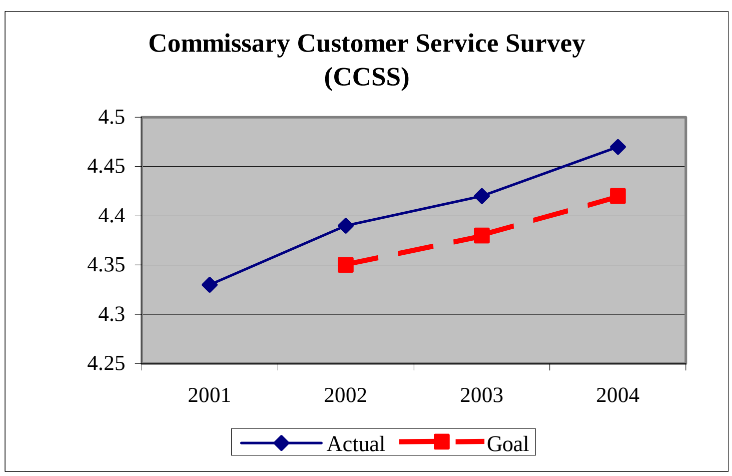
Customer Savings:



Background: The patron savings are calculated using a comprehensive database of actual prices for Universal Product Coded (UPC) items from commercial grocery stores and commissaries to perform the analysis for locations within the 48 contiguous states (over 30,000 items are compiled). All major supermarket chains (e.g., Kroger Co., Winn Dixie, Giant Foods, HEB, etc.) as well as supercenters are included in the comparison. Because the database contains only items with a UPC, prices for fresh meat and produce are obtained by physical audit at randomly selected commissaries and nearby commercial grocery stores. This methodology was validated by the Air Force Audit Agency.

Results: DeCA's FY 2004 customer savings of 32.1 percent continues to exceed the goal of 30 percent. The dollar value of the 2.1 percent added savings to our customers is $158 million.

Commissary Customer Service Survey (CCSS):



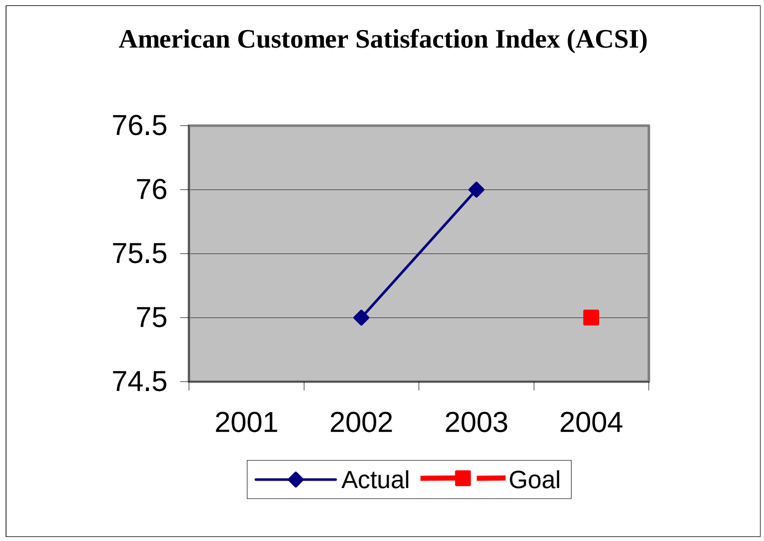
Background: Customer satisfaction is evaluated by surveys based on statistically sound sampling techniques. In the past, the CCSS was conducted twice a year (spring and fall) but this year it was conducted only once to allow more time to complete the data collection and analysis. Surveys will now be conducted in September each year with reportable results in December.

Also, DeCA incorporated recommendations of the Government Accountability Office (GAO) audit in modifying the method of weighting the surveys. All scores are now weighted to account for differences in commissary size.

Results: The FY 2004 score (from February 2004 results for survey conducted in September 2003) of 4.47 exceeded the FY 2004 goal of 4.42 and is projected to improve.

American Customer Satisfaction Index (ACSI):

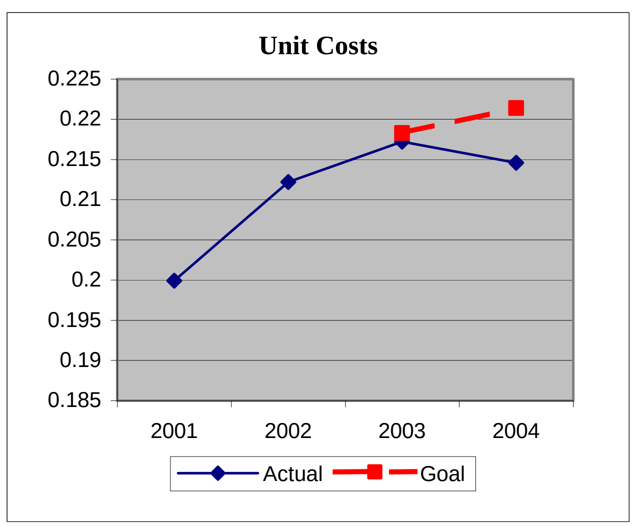
Background: The ACSI is produced annually through a partnership of the University of Michigan Business School, the American Society for Quality, and the international consulting firm, Claes Fornell International Group. The ACSI is a uniform, independent measure that is general enough to be comparable across sectors, industries, and organizations of the U.S. economy. The ACSI is measured as a multivariable set of equations and utilizes cause and effect relationships to explain customer loyalty and ties that loyalty to customer satisfaction.



Results: The FY 2004 goal is 75. In the February 2004 report, DeCA received a score of 76 for FY 2003. This score was above the grocery industry average of 74 and exceeded the score of 75, which DeCA received in FY 2002. The FY 2004 results of the ACSI will not be available until February 2005.

Unit Costs:

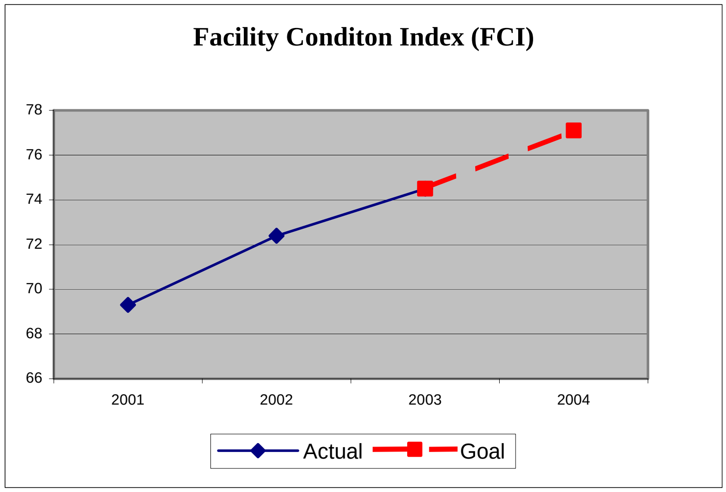
Background: Unit cost is the total of commissary operations funding divided by the total sales revenue. The FY 2004 performance plan set the unit cost metric at $0.2198, based on operating costs of $1,121 million and sales of $5,101 million. OSD Program Budget Decision (PBD) 426, December 2003, revised the FY 2004 commissary operating costs to $1,130 million. Therefore, the resulting unit cost goal was revised to $0.2214.



Results: The unit cost for FY 2004 is $0.2146, which is 3.1 percent under the revised goal of $0.2214 for FY 2004.

Facility Condition Index (FCI):

Background: The FCI is a numerical expression of the physical state of a commissary store. The FCI is a weighted measure of a commissary's condition, refrigeration system, and energy usage and efficiency. The FCI reflects the overall condition of commissary plant and facilities. The goal for FY 2004 is 77.1. The FCI is used as a leading indicator in assessing the effectiveness of the investment of surcharge funding in the physical facilities program.



Results: FY 2003 FCI results were reported in February 2004, with a score of 74.5, which matched the FY 2003 goal. The FY 2004 results of the FCI will not be available until February 2005.

ACCOMPLISHMENTS

Since FY 2001, DeCA has implemented several initiatives that support the President's Management Agenda (PMA) and have resulted in improved levels of service to our customers, reduction in the taxpayer dollars needed to operate the commissary system, and more effective use of our resources.

Through implementation of cultural, managerial, and organizational changes, the number of budgeted civilian full-time equivalents (FTE) was decreased by almost 10 percent, from 17,117 in FY 2000 to 15,464 by the end of FY 2004.

DeCA received an unqualified opinion our FY 2001 balance sheet. DeCA's financial statements received unqualified audit opinions for FY 2002, FY 2003 and FY 2004.

Since FY 2001, DeCA has improved its workforce diversity by increased representation in the following groups:

- African Americans 148
- Hispanics 78
- Asians 355

For career progression, primary concentration is placed on increasing representation at the General Schedule (GS) 12 through 15 senior grade levels. Throughout these grade levels, African Americans have the greatest increase at 23. Hispanics increased by 4. Asians increased by 10. In FY 2002, DeCA hired a female into the SES ranks. Since FY 2001, DeCA has hired 67 students with disabilities under the Workforce Recruitment Program and increased its overall number of employees with disabilities by 10.

DeCA has significantly improved its information assurance posture. In 2001, one of DeCA's mission essential information technology systems, Point of Sale (POS), had an Interim Authority to Operate. In 2004, DeCA is 100 percent DoD Information Technology Security Certification and Accreditation Process (DITSCAP) compliant on all mission essential systems, platforms and networks. A secure environment ensures that data is kept safe during transmission and that customer's personal data is not compromised.

DeCA uses Electronic Data Interchange (EDI) for ordering, receiving, and pricing. In 2001, all information was transmitted through a modem line. Since then, File Transfer Protocol has been added for DeCA's industry partners and EDI Internet has been added as an alternative data access method. The current environment has resulted in equal and accurate data exchange with our trading partners, who supply commissary patrons with products valued at over $5 billion annually**.**

Using a combination of OMB Circular A-76 initiatives and alternative competition sourcing mechanisms, DeCA has completed competitions on 3,572 FTEs (637 FTEs as A-76 Commercial Activities studies and 2,935 FTEs as alternative mechanisms to A-76). DeCA's cost savings are $6.7 million for 754 civilian FTE reductions achieved through A-76 and Commercial Activities from FY 2001 through FY 2004.

DeCA recently completed its first semi-annual performance report to OSD Program Analysis and Evaluation (PA&E) on year-to-date progress toward meeting FY 2004 goals. DeCA met or exceeded the performance measure targets for Total Agency Resources, customer savings, customer satisfaction, and FCI. The DeCA Director and senior DeCA managers review specific programs and processes, with associated measures, during the weekly corporate staff reviews and in Resource Management Council meetings to make timely and informed decisions. The FY 2005 President's Budget accurately reflects the full cost of achieving these performance goals that are linked to the Agency's strategic goals, objectives, and performance measures.

NEAR AND LONG-TERM PLANS

DeCA conducted an agency-level corporate reengineering review resulting in a provisional realignment of business areas and staff offices at the headquarters and field operating activities. The provisional realignment was implemented in April 2004. The review optimized the organization above and at store level. The realignment ensures the largest numbers of employees possible are in service positions in order to improve commissary store support and productivity, while enhancing above store efficiency. Organization processes were realigned to enhance all functions and processes needed to support commissaries on a day-to-day basis and improve functional oversight and policy. The skills and leadership abilities of senior personnel were analyzed and reassignments were effected to maximize the current corporate force structure. This effort further enhanced DeCA's succession planning efforts by updating our inventory of highly skilled and leadership focused candidates in the Agency's Corporate Development Program. DeCA will cascade the reengineering effort down to regional and store level with a completion date of FY 2007.

Through continued implementation of the PMA initiatives, DeCA's performance against strategic goals and objectives indicates positive progress in meeting our deliverables. DeCA is delivering its commitment to military quality of life while operating in the most cost efficient and effective manner utilizing best business practices.

PART III

FINANCIAL SECTION

COMPTROLLER'S MESSAGE

This fiscal year (FY) we continued to make improvements in financial reporting areas and accountability. We established an Integrated Process Team to analyze and establish procedures for recording and reporting our general Property, Plant, and Equipment. In addition, we conducted a full 21-day 'Mock Year-end' cycle at the end of third quarter FY 2004 to ensure we can meet the tight timelines required by DoD for FY 2004 year-end. All our partners - OSD, DFAS, DoD IG and our independent audit firm - were fully engaged in this critical effort.

DeCA will address the FY 2004 Plant, Property, and Equipment Reportable condition by: enhancing policies and procedures (September 2005); conducting further research of inventory items/capital assets and making corrections (September 2005); and providing enhanced inventory training of personnel (September 2005).

Information Technology (IT) systems, policies and procedures will also be improved by September 2005 to mitigate the FY 2004 Reportable condition associated with IT. Continuing efforts will be made to ensure full remedial actions are in place by September 2007.

Our monthly audit committee meeting with representatives from DeCA, DoD IG, OSD, DFAS, and participation from our independent audit firm has been invaluable in identifying areas for improvement and resolving potential and real issues. Our milestones for achieving reporting requirements by predetermined dates assured that all financial reports and taskings were completed on time. Close interaction with our accounting support office at DFAS-Columbus, and our region liaison offices ensured timely and accurate financial data was provided to all parties. The assistance provided throughout the year by our audit firm has maintained our position of being one of six agencies within the entire DoD to achieve an unqualified opinion on its annual financial statements.

Since FY 1992, DeCA has carried a negative balance of available, unobligated budgetary resources. This situation occurred because more obligations than cash were transferred to liquidate liabilities when DeCA was established in FY 1992. When DeCA was realigned to its own Defense Working Capital Fund (DWCF) sub-account in FY 1999, $318 million in unliquidated obligations were transferred to DeCA's WCF but only $149 million in funding was provided. In December 2002, DoD Program Budget Decision - 419R directed the Under Secretary of Defense, Comptroller to study the problem and come up with a solution to eliminate the negative balance. On January 22, 2004, the Office of the Secretary of Defense, Comptroller approved the transfer of nonexpenditure cash from the Services and DWCF in the amount of $163.1 million. The result of this transfer will eliminate more than a decade old systemic problem and correct a negative unexpended appropriation reflected on DeCA's financial statements.

Due to the recent hurricane activity, we expect some product loss in the affected commissaries, primarily because of loss of refrigeration and leaking roofs. There will also be costs associated with repairing the damage to the commissaries themselves. We do not have an accurate assessment of the damages at this point.

DeCA continues to provide maximum value and savings to Service members and their families thanks to our sound financial management, our commitment to continuous improvement in business practices and, most importantly, the extraordinary talent and commitment of our staff. We look forward to achieving many more milestones in the years ahead.

Jimaye H. Sones
Comptroller

FINANCIAL STATEMENT SUMMARY

DeCA's financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of Title 31, U.S.C. 35125 (b). These statements have been prepared from DeCA's books and records in accordance with the formats prescribed by the Office of Management and Budget. These statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. As such, some liabilities cannot be liquidated without legislation that provides resources to do so.

DeCA's Consolidated Balance Sheets, Statements of Net Cost, Changes in Net Position, Financing, and Combined Statements of Budgetary Resources are presented in a two-year comparative format, as required by OMB Bulletin Number 01-09, *Form and Content of Agency Financial Statements*, dated September 25, 2001. The following section provides a brief description of (a) the nature of each required financial statement and its relevance to DeCA, (b) significant fluctuations from FY 2003 to FY 2004, and (c) certain significant balances, where necessary, to help clarify their link to DeCA's operations.

When the Office of the Secretary of Defense (OSD) established DeCA as a separate working capital fund in FY 1999, unliquidated obligations were transferred without adequate budgetary resources to liquidate the obligations.

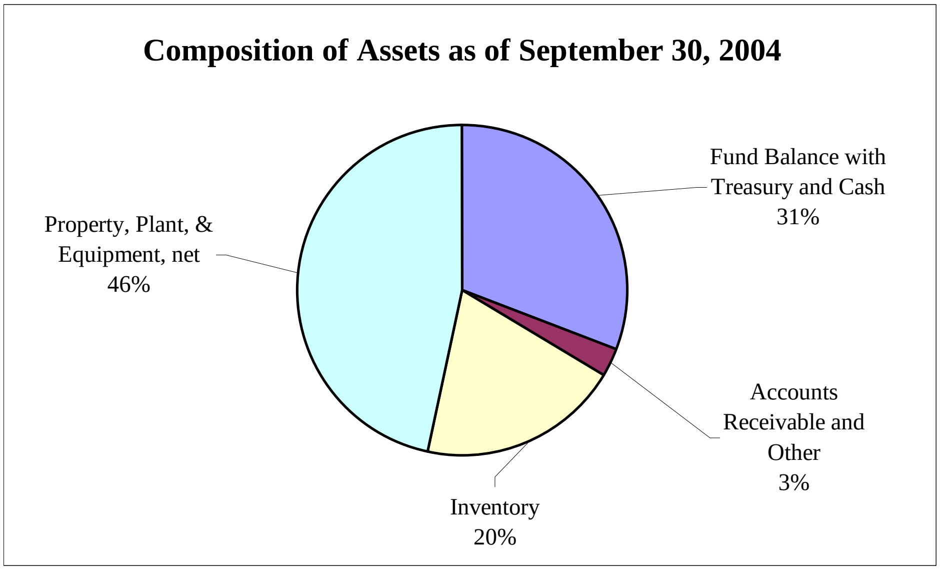
In February 2004, DeCA received a $163.1 million cash transfer from the Services and Defense agencies' working capital fund accounts. This primarily liquidated the remaining negative balance that originated when DoD transferred to DeCA more obligations than cash upon the establishment of the DeCA Working Capital Fund in October 1998 (see Note 8). To eliminate the negative unobligated balance, DeCA plans to implement cost savings initiatives through process reengineering and through closure of the Roosevelt Roads commissary. DeCA will also maintain costs at or below the FY 2005 budget. DeCA is on track to eliminate the negative unobligated balance by September 30, 2005.

Balance Sheet:

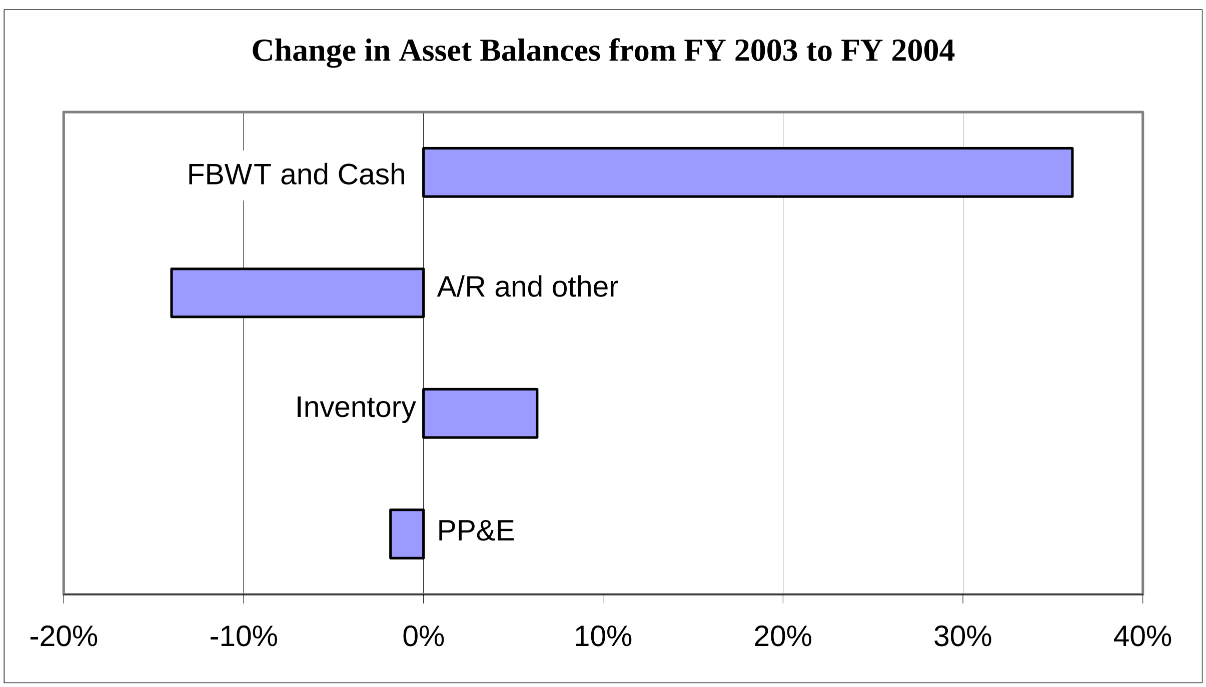
The Balance Sheet presents the value of assets available for use by DeCA against the amounts owed (liabilities) and amounts that comprise the difference (net position).

Assets – As of the September 30, 2004, DeCA's assets were $1,774 million. The assets of DeCA are the resources available to pay liabilities or satisfy future service needs.

DeCA's major categories of assets, as a percentage of total assets, are as follows:



The following chart presents the percentage change in major asset balances from September 30, 2003 to September 30, 2004. A discussion of significant fluctuations follows.



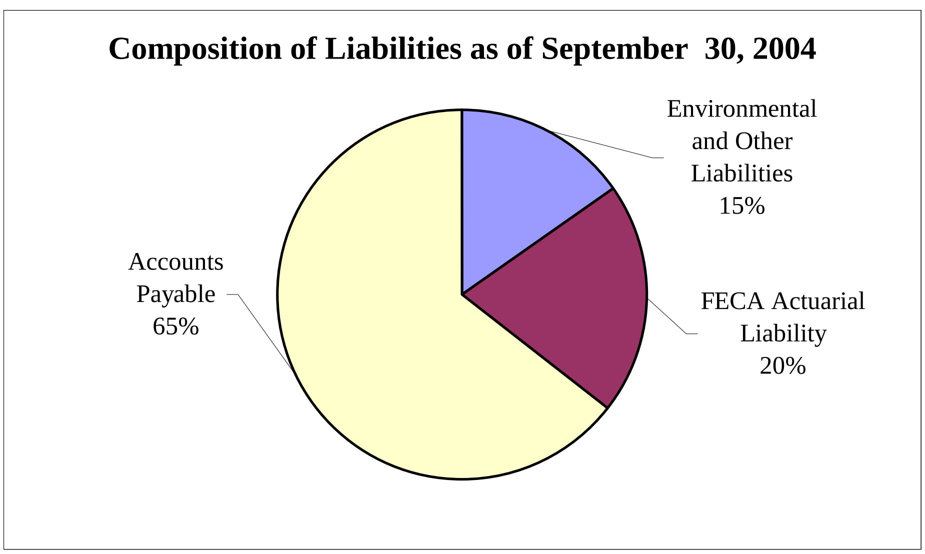
Fund balance with Treasury (FBWT) and Cash is primarily funding available through U.S. Department of the Treasury accounts from which DeCA is authorized to make expenditures to pay liabilities. It also includes monies available at commissaries, or those deposits that have not yet been deposited to the U.S. Department of the Treasury. As of September 30, 2004, DeCA has an overall $546.7 million, or 31% of total assets, in its fund balance with Treasury and cash. This is an increase of $145 million or 36% over the prior year balance. This increase is primarily due to the transfer or $163 million from the DoD Services to correct a shortfall of funding dating back to FY 1999 as discussed in notes 2 and 8 to the financial statements.

Accounts Receivable and Other primarily represents amounts due from governmental and public customers of DeCA. Accounts receivable and other decreased by approximately $8 million, or 14%. This decrease was primarily caused by the increased use of credit cards for Federal customers, and a reduction in receivables.

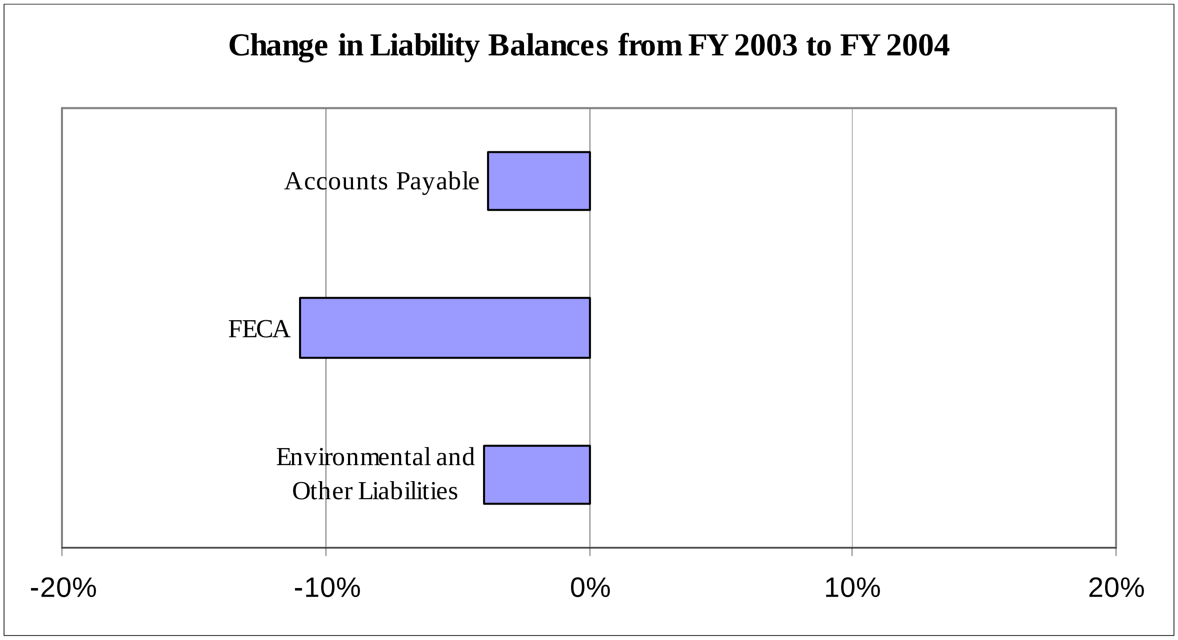
Inventory represents 20% of DeCA's current year assets, and comprises grocery products held for resale to DeCA patrons at DeCA facilities. Inventory increased by $21 million, or 6%, over prior year. This increase resulted from a combination of increased inventory on hand to support increased sales, and an increase in the prices of inventory products.

General Property, Plant and Equipment, net (PP&E) represents 46% of DeCA's current assets, and primarily comprises capitalized real and personal property held to fulfill DeCA's mission of selling groceries to its patrons. PP&E decreased by $15 million, or approximately 2%, from FY 2003. This decrease is primarily due to adjustments related to the retirement of equipment.

Liabilities - On September 30, 2004, DeCA reported liabilities of $859 million. Liabilities are probable and measurable future outflows of resources arising from past transactions or events. The chart below depicts DeCA's major categories of liabilities as a percentage of total liabilities.



The following chart presents the percentage change in major liability balances from September 30, 2003 to September 30, 2004. A discussion of significant fluctuations follows.



Accounts Payable consists of DeCA's current liability for goods and services delivered or received, but not yet paid, prior to year-end. DeCA's accounts payable decreased by $22 million, or approximately 4 percent, due to DeCA's aggressive liquidation of accounts payable transactions in FY 2004.

Federal Employees Compensation Act (FECA) Actuarial Liability comprises 20% of DeCA's current year liabilities, and consists of DeCA's expected liability for death, disability, and medical costs for approved workers compensation cases, plus a component for incurred but not reported claims. The Department of Labor (DoL) calculates the liability for the DoD, and DoD attributes a proportionate amount to DeCA based upon actual workers' compensation payments to DeCA employees over the preceding four years. The actuarial liability decreased by $21 million in FY 2004, or approximately 11 percent; because of the decreased amount allocated to DeCA by the DoD.

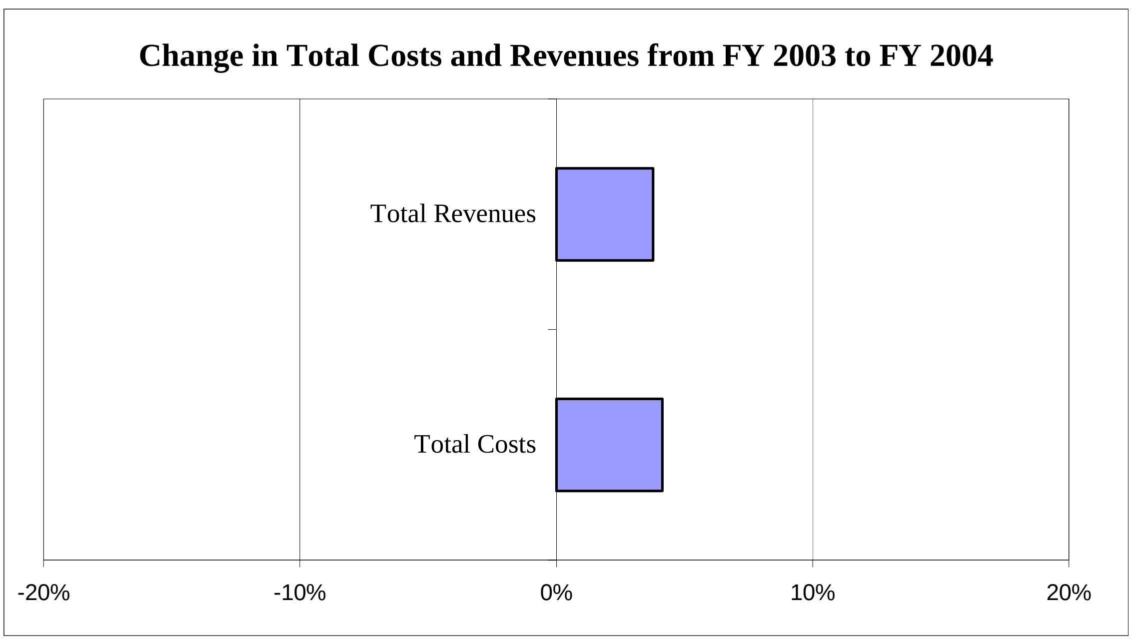
Environmental and Other Liabilities are potential costs to clean up items such as asbestos, lead paint and other hazardous materials from our commissaries. It also includes liabilities for accrued payroll and benefits, accrued unfunded leave, and foreign national separation pay. A decrease of $5.5 million, or 4 percent, from FY 2003 is primarily due to a change in the method for determining the rate used to estimate the environmental liabilities.

Statement of Net Cost:

The Statement of Net Cost presents the annual cost of operating DeCA programs. The gross costs for DeCA less the earned revenue from grocery sales and other revenue sources are used to derive DeCA's net cost of operations. DeCA's gross costs are primarily accounted for in the three major activity groups of DeCA:

- *Surcharge Collections Trust Fund* includes the costs to construct and remodel commissary facilities.
- *Commissary Operations* includes the associated payroll and operational costs necessary to operate the commissary system; and
- *Commissary Resale Stocks* includes the costs to purchase grocery inventory for resale.

The following chart presents the percentage change in total costs and total revenues from September 30, 2003 to September 30, 2004. A discussion of significant fluctuations follows.



During FY 2004 total revenues and costs remained relatively unchanged from prior year. There was a minor increase in sales with the public of approximately $200 million, with a corresponding increase in total costs of the same amount. Also, a more precise method was put in place for tracking trading partners at a transactions level. As a result, there was an increase in governmental costs and a corresponding decrease in public costs.

Statement of Changes in Net Position:

The Statement of Changes in Net Position represents those accounting transactions that caused the net position of the balance sheet to change from the beginning to the end of the reporting period. Various financing sources increase net position, including appropriations transfers and imputed financing from costs absorbed by others. DeCA's net cost of operations serves to reduce net position.

DeCA's net position increased by $191 million, from $724 million in FY 2003 to $915 million in FY 2004, or a 26 percent increase. The change in net position can be primarily attributed to the $163 million transferred to DeCA from other Defense agencies to correct a long-standing negative balance in our unexpended appropriations. In addition, during FY 2004, DeCA began recognizing non-exchange revenue in the amount of $21.2 million for free labor received from the country of Japan.

Statement of Budgetary Resources:

This statement provides information on the budgetary resources available to DeCA for fiscal year 2003 and 2004, and the status of those budgetary resources at year-end. The outlays reported on this statement reflect the actual cash disbursed for the year by Treasury for DeCA's obligations. The budgetary resources increased by $389 million, or 6 percent from FY 2003 to FY 2004, which is mainly attributed to the $163 million transfer from other Defense agencies.

Statement of Financing:

This statement reconciles the resources available to DeCA to finance operations, and the net cost of operating the commissary system. *Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided* includes the change in undelivered orders and unfilled customer orders. *Resources that finance the acquisition of assets* are additions and reductions to capital and other asset balances during the fiscal year. *Components requiring or generating resources in future periods* disclose the net increase in liabilities that are not covered by current budgetary resources.

LIMITATIONS OF THE FINANCIAL STATEMENTS

DeCA prepared its financial statements to report its financial position and results of operations, pursuant to the requirements established by the DoD to comply with the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994.*

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

These statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. The U. S. Congress cannot liquidate liabilities not covered by budgetary resources without the enactment of an appropriation, and the Federal Government, other than for contracts, can abrogate payment of all liabilities.

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DEFENSE COMMISSARY AGENCY
CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30
(in thousands)

	2004	2003
Assets		
Intragovernmental:		
Fund balance with Treasury (Note 2)	$ 450,368	$ 280,475
Accounts receivable and other	252	6,565
Total intragovernmental assets	450,620	287,040
Cash	96,318	121,273
Accounts receivable and other	51,387	53,483
Inventory	349,794	328,965
General property, plant, and equipment, net (Note 3)	825,787	841,136
Total assets	$ 1,773,906	$ 1,631,897
Liabilities (Note 4)		
Intragovernmental:		
Accounts payable	$ 150,753	$ 147,905
Other liabilities	39,976	39,981
Total intragovernmental liabilities	190,729	187,886
Accounts payable	401,990	426,738
Federal Employees Compensation Act actuarial liability	174,076	195,440
Environmental liabilities	9,015	13,435
Other liabilities	82,834	83,909
Total liabilities	858,644	907,408
Commitment and contingencies (Note 9)		
Net position (Note 5)		
Unexpended appropriations	17,816	(135,706)
Cumulative results of operations	897,446	860,195
Total net position	915,262	724,489
Total liabilities and net position	$ 1,773,906	$ 1,631,897

The accompanying notes are an integral part of the financial statements.

DEFENSE COMMISSARY AGENCY
CONSOLIDATED STATEMENTS OF NET COST
FOR THE YEARS ENDED SEPTEMBER 30
(in thousands)

	2004	2003
Program costs		
With the public	$ 5,874,637	$ 5,906,920
Intragovernmental (Note 6)	787,470	490,260
Total	6,662,107	6,397,180
Earned revenue		
From the public	(5,521,946)	(5,315,746)
Intragovernmental	(3,932)	(8,887)
Total	(5,525,878)	(5,324,633)
Net cost of operations	$ 1,136,229	$ 1,072,547

The accompanying notes are an integral part of the financial statements.

DEFENSE COMMISSARY AGENCY
CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION
FOR THE YEARS ENDED SEPTEMBER 30
(in thousands)

	2004		2003	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning balances	$ 860,195	$ (135,706)	$ 841,100	$ (30,155)
Budgetary financing sources				
Appropriation transfer	-	1,089,482	-	959,395
Non-exchange revenue	21,190	-	-	-
Appropriations transfers used	1,098,834	(1,098,834)	1,064,785	(1,064,785)
Transfers in (Note 8)	163,100	-	-	-
Equity transfer (Note 8)	(163,100)	163,100	-	-
Other	16,582	-	(1,758)	(161)
Other financing sources				
Imputed financing (Note 7)	36,648	-	33,302	-
Other	226	(226)	(4,687)	-
Total financing sources	1,173,480	153,522	1,091,642	(105,551)
Net cost of operations	1,136,229	-	1,072,547	-
Ending balances	$ 897,446	$ 17,816	$ 860,195	$ (135,706)

The accompanying notes are an integral part of the financial statements.

DEFENSE COMMISSARY AGENCY
COMBINED STATEMENTS OF BUDGETARY RESOURCES
FOR THE YEARS ENDED SEPTEMBER 30
(in thousands)

	2004	2003
Budgetary resources (Note 8)		
Budget authority	$ 1,098,948	$ 967,075
Unobligated balance brought forward	(193,586)	(93,296)
Net transfers and adjustments	163,173	-
Spending authority from offsetting collections	5,530,387	5,335,843
Recoveries of prior year obligations	21,353	22,829
Permanently not available	(10,167)	(10,930)
Total budgetary resources	$ 6,610,108	$ 6,221,521
Status of budgetary resources		
Obligations incurred		
Direct	$ 1,106,751	$ 1,075,085
Reimbursable	5,530,454	5,340,022
Total obligations incurred	6,637,205	6,415,107
Unobligated balance	(27,097)	(193,586)
Total status of budgetary resources	$ 6,610,108	$ 6,221,521
Relationship of obligations to outlays		
Obligated balance, net - beginning of period	$ 746,426	$ 717,331
Total obligations incurred	6,637,205	6,415,107
Less: spending authority from offsetting collections and recoveries of prior year obligations	(5,551,740)	(5,358,672)
Obligated balance, net - end of period	(749,542)	(746,426)
Total outlays	$ 1,082,349	$ 1,027,340
Outlays		
Disbursements	$ 6,639,668	$ 6,359,818
Collections	(5,557,319)	(5,332,478)
Total outlays	$ 1,082,349	$ 1,027,340

The accompanying notes are an integral part of the financial statements.

DEFENSE COMMISSARY AGENCY
CONSOLIDATED STATEMENTS OF FINANCING
FOR THE YEARS ENDED SEPTEMBER 30
(in thousands)

	2004	2003
Resources used to finance activities		
Budgetary resources obligated:		
Obligations incurred	$ 6,637,205	$ 6,415,107
Less: Spending authority from offsetting collections and recoveries	(5,551,740)	(5,358,672)
Obligations, net of offsetting collections and recoveries	1,085,465	1,056,435
Other resources:		
Imputed financing from costs absorbed by others (Note 7)	36,648	33,302
Other	-	(4,687)
Net other resources used to finance activities	36,648	28,615
Total resources used to finance activities	1,122,113	1,085,050
Resources used to finance the net costs of operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:		
Undelivered orders	3,483	(37,751)
Unfilled customer orders	(91)	(35)
Resources that fund expenses recognized in prior periods	(25,881)	(3,897)
Resources that finance the acquisition of assets	(5,009,336)	(4,794,372)
Total resources used to finance items not part of the net cost of operations	(5,031,825)	(4,836,055)
Total resources used to finance the net cost of operations	(3,909,712)	(3,751,005)
Components of the net cost of operations that will not require or generate resources in the current period		
Components requiring or generating resources in future periods -		
Increase in exchange revenue receivable from the public and other	6,510	9,367
Components not requiring or generating resources in future periods:		
Cost of goods sold	4,904,126	4,720,016
Depreciation and amortization	116,313	92,748
Revaluation of assets/liabilities	(2,458)	1,609
Non-exchange revenue and other	21,450	(188)
Total components of net cost of operations that will not require or generate resources in the current period	5,045,941	4,823,552
Net cost of operations	$ 1,136,229	$ 1,072,547

The accompanying notes are an integral part of the financial statements.

DEFENSE COMMISSARY AGENCY
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Reporting Entity

The Defense Commissary Agency (DeCA) provides grocery, meat, and produce items to members of the U. S. Armed Forces, their dependents, retirees, and other authorized patrons, including other governmental entities. DeCA is a Department of Defense (DoD) agency under the control of the Under Secretary of Defense for Personnel and Readiness. DeCA was created in 1991 after the House Armed Services Committee-appointed Jones Commission recommended that a single agency be responsible for operating the military commissary system to increase effectiveness and at a lower cost.

DeCA, with its headquarters located at Fort Lee near Petersburg, Virginia, has three regional offices located at Kaiserslautern, Germany; Virginia Beach, Virginia; and Sacramento, California. DeCA operations are financed primarily by a working capital fund (WCF) and surcharge collections.

DeCA's WCF is considered part of the DoD's WCF, which includes the financial activity for the Defense Finance and Accounting Service (DFAS), the Defense Logistics Agency, the Defense Information Systems Agency, and the Defense Security Service. Within DeCA's WCF, there are two activity groups, Commissary Resale Stocks and Commissary Operations. DoD defines these two activity groups as business areas for fund control purposes. Commissary Resale Stocks finances the purchase of grocery, meat and produce items for resale to authorized patrons. The primary revenue source for this activity group is the sale of inventory to commissary patrons. Commissary Operations finance the operating costs of resale stores, agency and region headquarters, field operating activities, and support services. The primary revenue source for this activity group is a direct appropriation to the Defense WCF, which in turn transfers the funds to the DeCA WCF. Commissary Operations also receives additional revenues from manufacturers' coupon redemption fees, handling fees for tobacco products, and reimbursements for other support. DeCA receives an annual operating budget from DoD that establishes limitations for annual cost authority and annual capital expenditures for the two business areas.

DeCA's Surcharge Collections Trust Fund is funded primarily by a five percent surcharge applied to each sale. This fund, established by law, primarily finances DeCA's store-level information management equipment and support, and construction programs. The use of budgetary resources associated with the Surcharge Collections Trust Fund is limited by public law.

The Commissary Resale Stocks activity group of the DeCA WCF and the Surcharge Collections Trust Fund have authority to invoke contract authority when obligations exceed earnings.

DeCA also receives minor amounts of military construction and procurement appropriated funds.

B. Basis of Presentation and Accounting

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position, status and availability of budgetary resources, and the reconciliation between proprietary and budgetary accounts of DeCA. The Chief Financial Officers (CFO) Act of 1990, expanded by the Government Reform Act (GMRA) of 1994, requires DoD to prepare financial statements. DoD, in turn, requires DeCA to prepare audited financial statements. The financial statements have been prepared from the books and records of DeCA in accordance with accounting principles generally accepted in the United States of America and DoD accounting policies, which are summarized in this note. These financial statements, with the exception of the Statement of Budgetary Resources, are, therefore different from the financial management reports prepared by DeCA that are used to monitor and control DeCA's use of budgetary resources pursuant to Office of Management and Budget (OMB) directives.

All dollar amounts are in thousands.

C. Fund Balance with Treasury

Fund balance with Treasury (FBWT) is the aggregate amount of funds in DeCA's accounts with the U.S. Department of Treasury (Treasury). FBWT primarily represents appropriated, revolving, and trust funds that are available to pay current liabilities and finance authorized purchases.

Note 2 provides specific, detailed information concerning FBWT.

D. Cash

Cash primarily consists of receipts from sales occurring during the last several days of the fiscal year that have been deposited into financial institutions, but are not yet credited to DeCA's FBWT.

E. Accounts Receivable

Accounts receivable consists of amounts owed to DeCA by other Federal agencies and the public. Federal accounts receivable arise generally from the provision of goods and services to other federal agencies. No allowance for doubtful accounts is determined for Federal accounts receivable.

Receivables from the public generally arise from the sale of grocery, meat, and produce items to authorized patrons. An allowance for doubtful accounts is established for reporting purposes based on past experience in the collection of accounts receivable and analysis of outstanding balances using the percentage of receivables. The allowance for loss on receivables account is adjusted accordingly at the time of collection or write-off during the fiscal year. Non-Federal accounts receivable are reported net of the allowance.

F. Inventory

Inventory consisting primarily of grocery, meat, and produce items held for resale is stated at approximate cost as required by Statement of Federal Financial Accounting Standards (SFFAS) Number 3, *Accounting for Inventory & Related Property*.

G. General Property, Plant and Equipment

General property, plant and equipment (PP&E) consists of building, structures, and facilities (BSF), software, equipment, and construction-in-progress. PP&E is stated at acquisition cost, less accumulated depreciation. DoD establishes capitalization and depreciation policies for PP&E.

BSF is included in PP&E under DoD's "Preponderance of Use" policy. This policy recognizes that the DoD agencies that gain the most benefit by virtue of space usage should record the asset as general PP&E.

PP&E acquisitions are capitalized if the acquisition cost is $100,000 or more, and has a useful life of two or more years.

Depreciation is recognized on all PP&E, except construction-in-progress, on the straight-line basis over the estimated useful life of the asset. The useful lives are generally 40 years for buildings, structures, and facilities, and 5 years for software and equipment.

Note 3 provides specific, detailed information concerning General Property, Plant, and Equipment.

H. Other Liabilities

Other liabilities consist of payments DeCA owes to the Department of Labor (DOL) for workers' compensation paid under the Federal Employees Compensation Act (FECA), accrued payroll and benefits (including employer contributions and payroll taxes), foreign national separation pay, and accrued leave.

Workers' Compensation. FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. DOL is responsible for administering the program and making payments for claims from eligible individuals. Subsequently, DOL bills Federal agencies for those claims from the individuals associated with the respective agency. The actuarially determined liability related to workers' compensation is described below.

Accrued Payroll and Benefits. Accrued payroll and benefits includes the portion of employee compensation earned, but not paid, at the end of the fiscal year along with DeCA's share of associated taxes, benefits, and retirement plan contributions.

Foreign National Separation Pay. DeCA operates in numerous foreign countries. These countries establish tariff agreements that outline certain employment terms and conditions related to its citizens. Under these tariff agreements, citizens for certain countries are entitled to special pay in the event their employment is terminated.

Accrued Leave. Federal employees' annual leave is accrued as it is earned. The accrual is reduced annually for actual leave taken and increased for leave earned. Each year, the accrued annual leave balance is also adjusted to reflect the latest pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. DeCA employees can earn compensatory leave in lieu of overtime pay.

Note 4 provides specific, detailed information about Other Liabilities.

I. Actuarial Liability

In addition to the liabilities discussed above, DeCA records an actuarial liability for its remaining workers' compensation benefits. This liability, which is developed by DOL and provided to DoD after the end of each fiscal year, includes the expected future costs associated with death, disability, medical, and miscellaneous items for approved compensation cases. DOL determines the liability using a method that employs historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. The assumed interest rate for 10-year U.S. Treasury notes and bonds are 4.88 and 4.35 percent at September 30, 2004 and September 20, 2003, respectively. DoD uses a three-year moving average to distribute the actuarial liability to the various DoD agencies based on actual costs incurred by the respective DoD components.

J. Imputed Financing and Costs

DeCA recognizes imputed financing and costs related to Federal retirement plans, health benefits and life insurance, and the use of DoD fixed assets.

Retirement Plans. There are two primary retirement systems for Federal employees. Employees hired before January 1, 1984, may participate in the Civil Service Retirement System (CSRS). On January 1, 1984, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security.

Employees hired before January 1, 1984, elected to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to which DeCA automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. For most employees hired since December 31, 1983, DeCA also contributes the employer's matching share for Social Security.

DeCA does not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management (OPM) and FERS. DeCA recognizes imputed financing source and program expense for the difference between its contributions to Federal employee pension and other retirement benefits and the estimated actuarial costs as computed by the OPM.

Health Benefits and Life Insurance. The majority of DeCA employees are authorized to participate in the Federal Employees' Health Benefit (FEHB) program and the Federal Employees Group Life Insurance (FEGLI) program, which are administered by OPM. DeCA recognizes an imputed financing source and a program expense for these benefits.

Use of DoD Fixed Assets. DeCA receives use of some buildings without being the preponderant user, as described in Note 1.G. Therefore, certain buildings, and the related depreciation expense, are not recognized. Instead, DeCA recognizes an imputed financing source and a program expense for the rent-free building benefit.

K. Environmental Liabilities

DeCA's environmental liabilities reflect the potential liability associated with the clean-up and removal of environmentally hazardous materials, primarily asbestos, lead-based paint, polychlorinated biphenyls, and soil/water contamination, in DeCA's facilities. DeCA estimates its environmental liability based on the number of facilities constructed before 1988 that have not been remediated. The portion of the liability associated with those facilities with planned renovation projects during the next year are reported as current liabilities. The estimate is periodically adjusted upon completion of scheduled renovation projects. Actual costs may differ from the estimate due to possible changes resulting from inflation, deflation, technology, and/or applicable laws and regulations.

L. Net Position

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

Unexpended appropriations represent the amount of unobligated and unexpended budget authority. Unexpended appropriations are reduced for appropriations used and adjusted for other changes in budgetary resources, such as transfers and rescissions.

Cumulative results of operations represent the excess of revenues over expenses and transfers to the U.S. Treasury in the WCF since inception.

Note 5 provides specific, detailed information on Net Position.

M. Non-Exchange Revenue

Beginning in FY 2004, DeCA recognizes non-exchange revenue for the labor received at no cost for local nationals working in the country of Japan in the amount of $21.2 million. The Government of Japan pays the salary for local national employees up to a specified annual ceiling amount. Payroll over this ceiling is charged to the U.S. Government.

N. Use of Estimates

DeCA has made certain estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent liabilities, and the reporting of revenue and expenses in the financial statements. Actual results could differ from these estimates.

O. Reclassifications

Certain FY 2004 balances have been reclassified, retitled, or combined with other financial statement line items for consistency with current year presentation.

NOTE 2 - FUND BALANCE WITH TREASURY

FWBT consists of three types of funds – appropriated funds, revolving, and trust funds. Revolving funds involve DeCA's WCF, and trust funds involve the Surcharge Collections. Appropriated funds include military construction and procurement funds.

The following table shows the balance for each type of fund as of September 30, 2004 and 2003:

Fund balances:	**2004**	**2003**
Appropriated funds	$ 193,962	$ 62,133
Revolving funds	78,443	42,084
Trust funds	177,963	176,258
Total	$ 450,368	$ 280,475

The following table shows the status of the fund balances as of September 30, 2004 and 2003:

Status of fund balances:	**Appropriated**	**Revolving**	**Trust**	**Total**
Unobligated balance available	$ (27,140)	$ -	$ -	$ (27,140)
Unobligated balance unavailable	43	-	-	43
Obligated balance not yet disbursed, net of contract authority	221,059	78,443	177,963	477,465
Total as of September 30, 2004	$ 193,962	$ 78,443	$ 177,963	$ 450,368

Status of fund balances:	**Appropriated**	**Revolving**	**Trust**	**Total**
Unobligated balance available	$ (193,586)	$ -	$ -	$ (193,586)
Obligated balance not yet disbursed, net of contract authority	255,719	42,084	176,258	474,061
Total as of September 30, 2003	$ 62,133	$ 42,084	$ 176,258	$ 280,475

The unobligated available fund balance as of September 30, 2004 and 2003 is negative because obligations exceed budget authority. Effective October 1, 1998, the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) established new Treasury codes, referred to as subheads, for the two activity groups within DeCA's WCF. In conjunction with the establishment of the new Treasury codes, the OUSD(C) directed a transfer of net obligations, which were originally obligated under the old Treasury codes, to the Commissary Operations and Commissary Stock Resale activity groups. However, the OUSD(C) did not direct a transfer of the corresponding budget authority. In FY 2004 and as discussed in Note 8, the negative unobligated balance decreased because DeCA received a cash transfer from the Army, Navy, Air Force, and Defense-wide WCF accounts to DeCA's WCF account in the amount of $163.1 million. DeCA is working to correct the remaining negative balance by the end of FY 2005.

NOTE 3 - GENERAL PROPERTY, PLANT, AND EQUIPMENT

General property, plant, and equipment (PP&E) at September 30, 2004 and 2003 is summarized as follows:

PP&E category		Acquisition Value		Accumulated Depreciation		Net
Buildings, structures, and facilities	$	1,777,774	$	(1,090,844)	$	686,930
Software		9,422		(4,540)		4,882
Equipment and other assets		177,914		(112,363)		65,551
Construction-in-progress		68,424		-		68,424
Total as of September 30, 2004	$	2,033,534	$	(1,207,747)	$	825,787

PP&E category		Acquisition Value		Accumulated Depreciation		Net
Buildings, structures, and facilities	$	1,726,575	$	(1,036,301)	$	690,274
Software		8,513		(3,402)		5,111
Equipment and other assets		176,099		(93,650)		82,449
Construction-in-progress		63,302		-		63,302
Total as of September 30, 2003	$	1,974,489	$	(1,133,353)	$	841,136

NOTE 4 - LIABILITIES

The following table summarizes total liabilities covered and not covered by budgetary resources as of September 30, 2004 and 2003:

Intragovernmental:	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Accounts payable	$ 150,753	$ -	$ 150,753
Other liabilities	2,385	37,591	39,976
Subtotal	153,138	37,591	190,729
With the public:			
Accounts payable	401,990	-	401,990
Federal Employees Compensation Act actuarial liability	-	174,076	174,076
Environmental liability	-	9,015	9,015
Other liabilities	33,018	49,816	82,834
Subtotal	435,008	232,907	667,915
Total as of September 30, 2004	$ 588,146	$ 270,498	$ 858,644

Intragovernmental:	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Accounts payable	$ 147,905	$ -	$ 147,905
Other liabilities	2,356	37,625	39,981
Subtotal	150,261	37,625	187,886
With the public:			
Accounts payable	426,738	-	426,738
Federal Employees Compensation Act actuarial liability	-	195,440	195,440
Environmental liability	-	13,435	13,435
Other liabilities	37,439	46,470	83,909
Subtotal	464,177	255,345	719,522
Total as of September 30, 2003	$ 614,438	$ 292,970	$ 907,408

Other liabilities consist primarily of workers' compensation, accrued payroll and benefits, accrued unfunded annual and other leave, and foreign national separation pay. The following table summarizes other liabilities current and non-current as of September 30, 2004 and 2003.

Other liabilities	Current Liabilities	Non-Current Liabilities	Total
Intragovernment:			
Workers compensation	$ 16,696	$ 20,832	$ 37,528
Employer contributions and payroll taxes payroll	2,385	-	2,385
Other	63	-	63
Subtotal	19,144	20,832	39,976
With the public:			
Accrued funded payroll and benefits	38,572	-	38,572
Foreign national separation pay	11,669	-	11,669
Accrued unfunded annual leave	38,147	-	38,147
Liability for deposit funds	(5,554)	-	(5,554)
Subtotal	82,834	-	82,834
Total as of September 30, 2004	$ 101,978	$ 20,832	$ 122,810

Other liabilities	Current Liabilities	Non-Current Liabilities	Total
Intragovernment:			
Workers compensation	$ 16,329	$ 21,296	$ 37,625
Employer contributions and payroll taxes payroll	2,356	-	2,356
Subtotal	18,685	21,296	39,981
With the public:			
Accrued funded payroll and benefits	37,439	-	37,439
Foreign national separation pay	9,681	-	9,681
Accrued unfunded annual leave	36,789	-	36,789
Subtotal	83,909	-	83,909
Total as of September 30, 2003	$ 102,594	$ 21,296	$ 123,890

NOTE 5 - NET POSITION

The following table summarizes the net position by fund type as of September 30, 2004 and 2003:

Net position:	General Fund	Working Capital Fund	Total
Unexpended appropriations	$ 345	$ 17,471	$ 17,816
Cumulative results of operations	950,018	(52,572)	897,446
Total as of September 30, 2004	$ 950,363	$ (35,101)	$ 915,262

Net position:	General Fund	Working Capital Fund	Total
Unexpended appropriations	$ 617	$ (136,323)	$ (135,706)
Cumulative results of operations	954,777	(94,582)	860,195
Total as of September 30, 2003	$ 955,394	$ (230,905)	$ 724,489

NOTE 6 – INTRAGOVERNMENTAL COST

The Consolidated Statements of Net Cost reflects intragovernmental cost of $787,470 and $490,260 in fiscal years 2004 and 2003, respectively, which represents the purchase of grocery, meat, and produce items from other Federal entities.

NOTE 7 – IMPUTED FINANCING

The imputed financing and cost for employee benefits for FY 2004 and 2003 is summarized below:

Benefit category	2004	2003
CSRS/FERS	$ 11,141	$ 11,730
FEHB	24,208	21,485
FEGLI	90	87
Use of DoD assets	1,209	-
Total	$ 36,648	$ 33,302

Beginning in FY 2004, DeCA receives use of six buildings without being the preponderant user. The estimated rent-free value of two of the buildings was $1.2 million in fiscal year 2004. Per OUSD(C) guidance, the estimated rent-free value of the remaining four buildings was not calculated in FY 2004, and is not believed to be significant.

NOTE 8 - STATEMENTS OF CHANGES IN NET POSITION AND BUDGETARY RESOURCES

The Statement of Budgetary Resources is a combined statement and, as such, intra-entity transactions have not been eliminated. The combined Statement of Budgetary Resources has been prepared to coincide with the amounts shown in the President's Budget (Budget of the United States of America). However, the President's Budget is prepared from the Standard Form (SF) 133, Report on Budget Execution. Due to timing and the need for accelerated reporting at fiscal year end, the SF 133 is prepared using estimates, while the Statement of Budgetary Resources has been adjusted for actual results. As such, the FY 2004 Statement of Budgetary Resources may differ from the amounts in the President's Budget by the differences between estimates used for the SF 133 and the actual results reported in the Statement of Budgetary Resources.

The amounts reported in the FY 2003 Statement of Budgetary Resources are in agreement with the amounts reported for the DeCA Working Capital Fund of the President's Budget. The FY 2004 amounts will be available in the President's Budget during FY 2005. Both documents can be located at the OMB website (http://www.whitehouse.gov/omb).

As discussed in Note 2, DeCA has reported various amounts of negative unobligated balances at each fiscal year end through September 30, 2004. During fiscal year 2004, OUSD(C) transferred $163,100 from the Army, Navy, Air Force, and Defense-wide WCF accounts to DeCA's WCF account. In accordance with U.S. Standard General Ledger (USSGL) requirements, the transfer was initially recorded as an addition to cumulative results of operations. As the purpose of the transfer was to increase DeCA's overall budgetary resources and correct the negative unobligated balance situation, DeCA management recorded an equity transfer to reclassify the transfer from cumulative results of operations to unexpended appropriations.

Total budgetary resources in FY 2004 and FY 2003 consist primarily of spending authority from offsetting collections in the amount of $5,530,387 and $5,335,843, respectively, and an appropriation transfer from the Defense WCF in the amount of $1,089,482 and $959,395, respectively. The appropriation transfer is available indefinitely. Spending authority from offsetting collections results primarily from the sale of grocery, meat, and produce items.

Total budget authority in fiscal years 2004 and 2003 includes $9,466 and $7,680, respectively, of contract authority.

The obligated balance, net - end of period is comprised of the following components as of September 30, 2004 and 2003:

Obligated balance, net - end of period	**2004**	**2003**
Accounts receivable and cash	$ (144,813)	$ (171,655)
Unfilled customer order from Federal sources	(2,179)	(2,269)
Undelivered orders	304,355	307,704
Accounts payable and other liabilities	592,179	612,646
Total obligated balance, net - end of period	$ 749,542	$ 746,426

NOTE 9 - CONTINGENCIES

DeCA is a party in various administrative proceedings, legal actions and tort claims which may ultimately result in settlements or decisions adverse to the Federal government. DeCA has not accrued any amounts for contingent liabilities as the potential losses have not been determined to be probable and/or the amounts cannot be estimated. The amounts claimed related to the significant actions total approximately $27.0 million to $46.0 million as of September 30, 2004. As of September 30, 2003, the amounts claimed related to the significant actions totaled $44.6 million to $64.1 million.

During the end of FY 2004 DeCA commissaries experienced product loss and structural damage as a result of hurricane activity. The amount of product loss and structural damage is unknown and is not believed to be significant as of September 30, 2004.

DEFENSE COMMMISARY AGENCY
REQUIRED SUPPLEMENTARY INFORMATION
INTRAGOVERNMENTAL BALANCES
AS OF SEPTEMBER 30

	Fund Balance with Treasury		Accounts Receivable	
Agency	**2004**	**2003**	**2004**	**2003**
Department of Treasury	$ 450,368	$ 280,475	$ -	$ -
Department of State	-	-	103	3,522
Department of Homeland Security	-	-	-	1,853
Department of Defense	-	-	149	1,190
Total	$ 450,368	$ 280,475	$ 252	$ 6,565

	Accounts Payable		Other Liabilities	
Agency	**2004**	**2003**	**2004**	**2003**
Department of Treasury	$ 1,487	$ -	$ 63	$ -
Department of Labor	-	-	37,528	37,625
General services Administration	5,099	3,839	-	-
Department of Defense	143,114	143,722	-	-
Office of Personnel Management	593	-	2,385	2,356
Other	460	344	-	-
Total	$ 150,753	$ 147,905	$ 39,976	$ 39,981

	Expenses		Revenue	
Agency	**2004**	**2003**	**2004**	**2003**
Department of Treasury	$ 1,774	$ -	$ -	$ -
Department of State	-	16	1,195	217
Department of Labor	16,232	16,618	-	-
Department of Homeland Security	86	-	1,608	1,463
General Services Administration	21,529	2,299	-	-
Department of Defense	639,961	371,656	1,129	7,207
NASA	1,400	-	-	-
Office of Personnel Management	104,770	99,480	-	-
Other	1,718	191	-	-
Total as of September 30, 2004	$ 787,470	$ 490,260	$ 3,932	$ 8,887

	Transfers-In	
Agency	**2004**	**2003**
Air Force Working Capital Fund	$ 10,900	$ -
Army Working Capital Fund	41,600	-
Navy Working Capital Fund	42,800	-
Other Defense Working Capital Fund	67,800	-
Total as of September 30, 2003	$ 163,100	$ -

DEFENSE COMMMISARY AGENCY
REQUIRED SUPPLEMENTARY INFORMATION
COMBINING STATEMENT OF BUDGETARY RESOURCES
FOR THE YEAR ENDED SEPTEMBER 30, 2004

	Defense Working Capital Funds			General Funds			
	Operations	Resale	Other	Surcharge	Military Construction	Procurement	Combined
Budgetary resources							
Budget authority	$ 1,097,046	$ 1,666	$ -	$ -	$ 236	$ -	$ 1,098,948
Unobligated balance brought forward	(193,702)	-	-	-	88	28	(193,586)
Net transfers	163,100	-	-	-	73	-	163,173
Spending authority from offsetting collections	26,006	5,234,837	-	269,544	-	-	5,530,387
Recoveries of prior year obligations	12,774	8,476	-	103	-	-	21,353
Permanently not available	-	-	-	(10,167)	-	-	(10,167)
Total budgetary resources	$ 1,105,224	$ 5,244,979	$ -	$ 259,480	$ 397	$ 28	$ 6,610,108
Status of budgetary resources							
Obligations incurred:							
Direct	$ 1,106,508	$ -	$ -	$ -	$ 243	$ -	$ 1,106,751
Reimbursable	25,995	5,244,979	-	259,480	-	-	5,530,454
Total obligations incurred	1,132,503	5,244,979	-	259,480	243	-	6,637,205
Unobligated balances	(27,279)	-	-	-	154	28	(27,097)
Total status of budgetary resources	$ 1,105,224	$ 5,244,979	$ -	$ 259,480	$ 397	$ 28	$ 6,610,108
Relationship of obligations to outlays							
Obligated balance, net - beginning of period	$ 271,465	$ 196,841	$ 8,033	$ 270,573	$ (486)	$ -	$ 746,426
Total obligations incurred	1,132,503	5,244,979	-	259,480	243	-	6,637,205
Less: spending authority from offsetting collections and recoveries of prior year obligations	(38,780)	(5,243,313)	-	(269,647)	-	-	(5,551,740)
Obligated balance, net - end of period:	(244,250)	(233,520)	(9,378)	(262,112)	(282)	-	(749,542)
Total outlays	$ 1,120,938	$ (35,013)	$ (1,345)	$ (1,706)	$ (525)	$ -	$ 1,082,349
Outlays							
Disbursements	$ 1,149,187	$ 5,224,743	$ (132)	$ 266,395	$ (525)	$ -	$ 6,639,668
Collections	(28,249)	(5,259,756)	(1,213)	(268,101)	-	-	(5,557,319)
Total outlays	$ 1,120,938	$ (35,013)	$ (1,345)	$ (1,706)	$ (525)	$ -	$ 1,082,349

DEFENSE COMMMISARY AGENCY
REQUIRED SUPPLEMENTARY INFORMATION
COMBINING STATEMENT OF BUDGETARY RESOURCES
FOR THE YEAR ENDED SEPTEMBER 30, 2003

	Defense Working Capital Funds			General Funds			
	Operations	Resale	Other	Surcharge	Military Construction	Procurement	Combined
Budgetary resources							
Budget authority	$ 963,673	$ 3,120	$ -	$ -	$ 282	$ -	$ 967,075
Unobligated balance brought forward	(93,339)	-	-	-	15	28	(93,296)
Spending authority from offsetting collections	33,371	5,040,624	-	261,848	-	-	5,335,843
Recoveries of prior year obligations	10,839	10,914	-	1,076	-	-	22,829
Permanently not available	-	-	-	(10,930)	-	-	(10,930)
Total budgetary resources	$ 914,544	$ 5,054,658	$ -	$ 251,994	$ 297	$ 28	$ 6,221,521
Status of budgetary resources							
Obligations incurred:							
Direct	$ 1,074,876	$ -	$ -	$ -	$ 209	$ -	$ 1,075,085
Reimbursable	33,370	5,054,658	-	251,994		-	5,340,022
Total obligations incurred	1,108,246	5,054,658	-	251,994	209	-	6,415,107
Unobligated balances	(193,702)	-	-	-	88	28	(193,586)
Total status of budgetary resources	$ 914,544	$ 5,054,658	$ -	$ 251,994	$ 297	$ 28	$ 6,221,521
Relationship of obligations to outlays							
Obligated balance, net - beginning of period	$ 286,893	$ 197,183	$ (2,305)	$ 235,453	$ 107	$ -	$ 717,331
Total obligations incurred	1,108,247	5,054,658	-	251,993	209	-	6,415,107
Less: spending authority from offsetting collections and recoveries of prior year obligations	(44,210)	(5,051,538)	-	(262,924)	-	-	(5,358,672)
Obligated balance, net - end of period:	(271,465)	(196,841)	(8,033)	(270,573)	486	-	(746,426)
Total outlays	$ 1,079,465	$ 3,462	$ (10,338)	$ (46,051)	$ 802	$ -	$ 1,027,340
Outlays							
Disbursements	$ 1,109,911	$ 5,043,227	$ (8,538)	$ 214,416	$ 802	$ -	$ 6,359,818
Collections	(30,446)	(5,039,765)	(1,800)	(260,467)	-	-	(5,332,478)
Total outlays	$ 1,079,465	$ 3,462	$ (10,338)	$ (46,051)	$ 802	$ -	$ 1,027,340

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2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Audit Committee
Defense Commissary Agency:

We have audited the accompanying consolidated balance sheets of the Defense Commissary Agency (DeCA) as of September 30, 2004 and 2003, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statement of budgetary resources for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered DeCA's internal control over financial reporting and tested DeCA's compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on its financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that DeCA's financial statements as of and for the years ended September 30, 2004 and 2003, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

- ***Property, Plant, and Equipment.*** DeCA's controls over the accountability and record-keeping of its capitalized and non-capitalized equipment.

- ***Information Technology.*** The general and application controls associated with DeCA's financial and financial-related systems continue to need improvement.

However, these reportable conditions are not believed to be material weaknesses.

The results of our tests of compliance with certain provisions of laws, regulations, and contracts, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards,* issued by the Comptroller General of the United States, or Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

The results of our tests of FFMIA disclosed instances where DeCA's financial management systems did not substantially comply with Federal financial management system requirements, and were not compliant with the U.S. Standard General Ledger at the transaction level.

The following sections discuss our opinion on DeCA's financial statements, our consideration of DeCA's internal control over financial reporting, our tests of DeCA's compliance with certain provisions of applicable laws, regulations, and contracts, and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of DeCA as of September 30, 2004 and 2003, and the related statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of DeCA as of September 30, 2004 and 2003, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the management overview and required supplementary information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America, or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The management overview section, other accompanying information on pages 1 to 24, and other accompanying information included on pages 44 to 46 are an integral part of DeCA's *Fiscal Year 2004 Annual Financial Report*. However, this information is not a required part of the financial statements and is presented for purposes of additional analysis. The supplementary information and other accompanying information on pages 44 to 46 have been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole. The information in the management overview section and other accompanying information on pages 1 to 24 have not been subjected to the same auditing procedures and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect DeCA’s ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

In our fiscal year 2004 audit, we noted certain matters, described in Exhibit 1, involving internal control over financial reporting and its operation that we consider to be reportable conditions. However, none of the reportable conditions are believed to be material weaknesses.

A summary of the status of prior year reportable conditions is included as Exhibit 2.

We also noted other matters involving internal control over financial reporting and its operation that we will report to the management of DeCA in a separate letter.

COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, and contracts, as described in the “Responsibilities” section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed instances in which DeCA’s financial systems did not substantially comply with Federal system requirements, and were not compliant with the United States Standard General Ledger at the transaction level.

Details of this compliance issue are included in Exhibit 3.

RESPONSIBILITIES

Management's Responsibilities. The *Government Management Reform Act of 1994* (GMRA) requires each Chief Financial Officer (CFO) Act agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To assist the Department of Defense in meeting the GMRA reporting requirements, DeCA prepares annual financial statements.

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparing the management overview (including the performance measures), and Required Supplementary Information; and
- Complying with laws, regulations, and contracts, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2004 and 2003 financial statements of DeCA based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2004 audit, we considered DeCA's internal controls over financial reporting by obtaining an understanding of DeCA's internal controls, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02 with respect to internal controls related to performance measures determined by management to be key and reported in the management overview, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether DeCA's fiscal year 2004 financial statements are free of material misstatement, we performed tests of DeCA's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to DeCA. Providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No 01-02 and FFMIA, we are required to report whether DeCA's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

This report is intended for the information and use of DeCA's management, the Department of Defense, OMB, the Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 29, 2004

Reportable Conditions

Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect DeCA's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

We consider the following to be reportable conditions.

Property, Plant, and Equipment

Condition

DeCA does not have adequate policies and procedures in place to ensure the proper accountability and record-keeping of its capitalized and non-capitalized equipment.

Discussion

Significant deficiencies exist in the management analysis and oversight functions performed by DeCA's Property Record Management Office (PRMO), region, and commissary personnel. Specifically, DeCA does not:

- Have standard operating procedures in place to require specific periodic reviews of DeCA's property database, the Defense Property Accountability System (DPAS).

- Perform high-level reviews and comparisons of property records between DeCA locations.

- Query the property database to identify and correct erroneous data (e.g., property assigned to closed commissaries).

- Analyze the property database to ensure register components, which are DeCA's most significant class of capital assets, are properly recorded among DeCA locations.

- Review the property database to assist stores in resolving items that have likely been transferred between locations.

As a result of our audit tests of the 273 commissaries, we found:

- 98 commissaries had different numbers of register components recorded as capital equipment, which did not agree to the number of register systems on hand at the commissary. Based on research performed by DeCA during the last week of fiscal year 2004, DeCA was able to reduce this number of commissaries with incomplete register components to 69 locations.

- 1 closed commissary had capital and non-capital equipment items recorded on its property records.

- 2 commissaries had no register system components recorded in capital equipment.

Criteria

Department of Defense Financial Management Regulation, volume 4, chapter 1, *Financial Control of Assets*, states that assets shall be under continuous accounting control from acquisition to disposition. Such control helps ensure proper and authorized use as well as adequate care and preservation, since no asset can be acquired, put into use, transferred, written down, or disposed of, without proper authorization necessary to document and record the transaction.

Recommendation

We recommend that DeCA:

1. Develop policies and procedures to conduct periodic reviews and reconciliations of the personal property records. These reviews may consist of reviewing property records for capital equipment recorded as non-capital equipment, reviewing store property records for unequal register system components, reviewing property listing for closed stores that have property on record, and any additional reviews that may detect other abnormalities in the property listing.

2. Perform an immediate and complete review of register system components reported as capital equipment. Determine the cause for unequal components and train employees appropriately in order to avoid differences from occurring in the future.

3. Develop written procedures and guidance for the conduct of accountable inventories by store and region personnel.

Management Response

DeCA concurs that additional processes, policies, and training changes are needed to improve equipment accountability throughout DeCA. Necessary actions will be completed by December 2005.

Information Technology

Condition

The general and application controls associated with DeCA's financial systems continue to need improvement. Due to the sensitive nature of the issues identified, we will provide DeCA officials with a separate, restricted distribution report, which contains the detailed results of our review, along with specific recommendations.

Discussion

As part of our fiscal year 2004 audit of DeCA's financial statements, we performed a follow-up to our review of information technology general and application controls over the following key DeCA applications that support financial transactions and reporting:

- DeCA Interactive Business System (DIBS);

- Electronic Data Interchange (EDI);
- Standard Automated Voucher Examination System (SAVES);
- Accounting and Inventory Management System (AIMS);
- Point of Sale – Modernization (POS-M); and
- PkMS Warehouse Management System.

We also performed a follow-up to our prior year limited general and applications controls review over those applications owned and operated by other DoD components that support DeCA financial transactions and reporting. These applications included:

- Defense Business Management System (DBMS);
- Standard Financial System (STANFINS);
- Columbus Cash Accountability System (CCAS).
- Defense Property Accountability System (DPAS); and
- Defense Civilian Payroll System (DCPS).

Our separate report will identify internal control weaknesses for the financial systems that require management attention. We will also provide management with an evaluation of the current status of previously identified information technology vulnerabilities.

Criteria

We performed our review in compliance with guidance established in the Government Accountability Office *Financial Audit Manual* and *Federal Information System Controls Audit Manual*. We also used the following Federal and DoD security guidelines as criteria for determining whether controls were in place and operating as intended:

- OMB Circular Number A-130, Management of Federal Information Resources,
- OMB Circular Number A-127, Financial Management Systems,
- OMB Circular Number A-123, Management Accountability and Control,
- Public Law 100-235, The Computer Security Act of 1987,
- National Institute of Standards and Technologies (NIST) publications,
- DoD Directive 5200.28, Security Requirements for Automated Information Systems, and
- DoD Instruction 5200.4, DoD Information Technology Security Certification and Accreditation Process (DITSCAP).

Recommendation

Due to the sensitive nature of these findings, our separate report will recommend that DeCA management implement certain procedures to address the general and application controls vulnerabilities of its financial systems.

Management Response

Management's response will be included in the separate report.

Exhibit 2

Status of Prior Year Reportable Conditions

Area	Status as of September 30, 2003	Status as of September 30, 2004
Property, Plant, and Equipment	**Reportable Condition:** DeCA does not have adequate policies and procedures in place to ensure the proper accountability and record-keeping of its capitalized and non-capitalized equipment.	**Continue as a reportable condition:** Improvements have been made to resolve some weaknesses noted in the prior year. However, significant effort must be made to improve accountability and record-keeping of equipment.
Information Technology	**Reportable Condition:** The general and application controls associated with DeCA's financial and financial-related systems continue to need improvement.	**Continue as a reportable condition:** Improvements have been made to resolve some weaknesses noted in the prior year. However, significant effort must be made to resolve security and access control weaknesses over key systems.

Compliance with Laws and Regulations

This section discusses issues related to noncompliance with laws and regulations that could have a material impact on DeCA's financial statements.

Federal Financial Management Improvement Act of 1996 (FFMIA)

Condition

As noted in prior reports, DeCA was not in substantial compliance with FFMIA.

Discussion

Defense Finance and Accounting Services (DFAS) uses two separate accounting systems to process DeCA transactions. DBMS accounts for transactions associated with the appropriated funds and surcharge collections. STANFINS accounts for all resale inventory transactions and all transactions for the European Region. As a result, there are two STANFINS databases – one for resale transactions, and one for all transactions for the European Region. These two databases do not interface. In addition, STANFINS does not interface with DBMS. Thus, there are three core accounting systems that DFAS uses to account for DeCA transactions. Since these systems do not interface, DeCA is not in compliance with Federal financial management system requirements, which call for a single, integrated financial system.

In addition, both STANFINS and DBMS are not compliant with the U.S. Standard General Ledger. Neither system is able to process transactions in accordance with the U.S. Standard General Ledger at the detail level, and extensive manual processes are required to adjust STANFINS and DBMS balances to allow for compilation of DeCA's financial statements. For example, DBMS does not contain a general ledger account to record unexpended appropriation transfers. DFAS-CO and DeCA personnel must use a combination of information inside and outside of DBMS to calculate unexpended appropriation transfers at the end of each reporting period.

Criteria

FFMIA requires that an agency's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level.

Recommendation

As noted in prior reports, we again recommend that DeCA continue to work with DFAS to implement actions to comply with the requirements of FFMIA.

Management Response

DeCA will work with DFAS to implement changes in policies, procedures, and systems in order to satisfy the requirements of FFMIA by FY 2007.

DEFENSE COMMISSARY AGENCY
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REPLY TO
ATTENTION OF

IG

September 16, 2004

MEMORANDUM FOR DIRECTOR, DEFENSE COMMISSARY AGENCY/
CHIEF EXECUTIVE OFFICER

SUBJECT: Summary of Serious Management and Performance Challenges

OMB Memorandum dated October 18, 2002, and OMB Memorandum M-03-13 dated May 21, 2003, requires this office provide you with our perspective on the most serious management and performance challenges facing DeCA for inclusion in the Agency's annual *Performance and Accountability Report.*

The OIG considers the issues herewith to be of significant importance, that if not successfully addressed, may impede DeCA's efforts to promote economy, efficiency, and effectiveness in its management and operations because they are vital to the Agency's mission. This office believes that by judiciously and expeditiously addressing these issues DeCA can enhance program efficiency and effectiveness; avoid potential operational and security problems; decrease fraud, waste, abuse and mismanagement; and achieve cost savings and/or realize substantial cost avoidance.

Information Technology Security Must Remain a Priority

DeCA's Information Systems Management and Control is critical to benefit delivery. Our **FY 2004 Federal Information Security Management Act (FISMA)**[1] review found that DeCA has made significant progress and should receive very good to excellent information assurance grades on certification and accreditation, security configuration, and incident detection/reporting from the Department. However, we found that some IT security issues remain and need to be resolved. If they are not, I believe the Agency may be vulnerable in the areas of computer network defense (to include incident and emergency response), COOP, adequacy of platform security and other security controls (mandated testing, compliance audits, IA program awareness, etc.). This vulnerability may adversely affect the purchase and life cycle management of critical systems to include DeCA's signature program CARTS. The DoDIG Audit on Federal IT Security Training and the ongoing DISA audit on DeCA's PKI & PKE infrastructure may identify additional improvement opportunities. DeCA's external auditor (KPMG) stated in its 2003 Independent Auditors' Report that financial related security access controls, although not believed to be a material weakness, are a reportable condition and need improvement. The OIG believes this area is a serious management challenge.

[1] FISMA provides a comprehensive framework for ensuring that information resources supporting Federal operations and assets employ effective security controls. FISMA requires agencies to conduct annual information security program reviews and Offices of the Inspector General to perform independent evaluations of those programs.

Financial and Resource Management Impact Issues

DeCA received a reasonable assurance statement from its external auditor for FY 2003 that it's financial and performance reporting was reliable with no material weaknesses found. In order to help ensure the Agency sustains this opinion I believe challenges in the following areas must be addressed:

Plant, Property, Equipment and Environmental Program Management

Plant, property and equipment management were of special interest to the OIG, DCIS, and KPMG in FY 03 and FY 04. The Operations and Comptroller community assiduously worked to improve Agency performance with respect to the Plant Property Accountability System in FY 04 by performing a 100 percent inventory of equipment, making necessary accounting adjustments, and issuing a PAT report[2] with process recommendations and milestones for achieving them. However, management reported that some PAT recommendations remain to be resolved. In FY 04 DeCA recognized that considerable gain can be realized by developing a more responsible solid waste (cardboard and plastic) management program. I was advised that DeCA's re-engineering efforts in these areas should improve performance. The challenge will be in guiding the business transformation efforts to ensure broad based cooperation, ownership, and accountability for more positive results.

Management and Internal Controls

At the benefit delivery level the OIG tested 13 percent of all commissaries in FY 04 and found there continued to be regulatory compliance improvement. FY 04 unannounced inspections scores were 2 percent better than FY 03 and 5 percent better than FY 02 with an average compliance rating of approximately 80 percent. As of August 23, 2004, management reported that 94 percent of IG findings had been corrected. Released OIG audit reports of the Direct Store Delivery (DSD) process at two commissaries and one on the Planning Process for DeCA Surcharge Construction Projects revealed no significant problems and that reliable management and internal controls existed. Notwithstanding these improvements, the OIG conducted special reviews[3] of tobacco consignment, use of government funds in a program office, and meat/produce inventory internal controls. An OIG investigation[3] substantiated allegations of Government Purchase Card misuse at a DeCA activity. These reviews and investigation revealed several thousands of dollars were mismanaged, unaccounted for, or wasted because management and internal controls were weak, ignored, not enforced/or not fully enforced. The OIG Review Reports and investigative summary were forwarded to the responsible authorities for corrective action. DeCA's challenge in FY 2005 will be to (1) strengthen controls in these areas; (2) prevent internal control lapses from occurring in other critical process and

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[2] DeCA Property Accountability Improvement and Corrective Action Process Action Team 12/08/03 - 02/14/04 recommended process and staffing changes.

[3] AFFES/Fort Sill Commissary Tobacco Account Inventory Difference Reconciliation Effort; Proper Controls over Government Funds - Center for Learning; Management Control Review - Excessive Meat & Produce Inventory to Sales Ratios; Wright Patterson GPC Split Purchase Abuses.

program areas; and, (3) ensure the Agency complies with the control requirements of the **Federal Managers' Financial Integrity Act (FMIA) and OMB Circular No. A-123**.

John T. Maffei
Acting Inspector General

Glossary of Acronyms

ACSI – American Customer Satisfaction Index

CCSS – Commissary Customer Service Survey

COB – Commissary Operating Board

COOP – Contingency Operations Plan

DeCA – Defense Commissary Agency

DITSCAP – DoD Information Technology Security Certification and Accreditation Process

DoD – Department of Defense

DoL – Department of Labor

DPAS – Defense Property Accounting System

DWCF – Defense Working Capital Fund

EDI – Electronic Data Interchange

FBWT – Fund Balance With Treasury

FCI – Facility Condition Index

FECA – Federal Employees Compensation Act

FFMIA – Federal Financial Management Improvement Act of 1996

FMFIA – Federal Managers' Financial Integrity Act

FTE – Full Time Equivalent

GAO – Government Accountability Office

IPT - Integrated Process Team

LIFE - Leadership – Integrity – Flexibility – Enjoyment

OMB – Office of Management and Budget

OSD (P&R) - Office of Secretary of Defense (Personnel & Readiness)

PA&E – Program Analysis and Evaluation

PBD – Program Budget Decision

PMA – President Management Agenda

POS – Point of Sale

PPBE – Planning, Programming, Budgeting and Execution

SES – Senior Executive Service

UPC – Universal Product Code

USD(C) – Under Secretary of Defense (Comptroller)

WCF – Working Capital Fund