Defense Logistics Agency

Fiscal Year 2006

Annual Financial Report

Working Capital Fund
and
General Fund

(Unaudited)

Defense Logistics Agency

Working Capital Fund and General Fund

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Message from the Director

October 2006

In fulfilling its support to the warfighter this past year, the Defense Logistics Agency (DLA) workforce provided approximately $35 billion worth of logistics support to include more than $30 billion worth of food, clothing, fuel, spare parts and medicine to all of America's Armed Forces in all types of environments. It did so around the clock and at scores of locations around the world. As DLA celebrates its 45th anniversary, we can proudly reflect on the year's many successes as demonstrated by: our improved support to the warfighter; the improved performance and accountability of our distribution depots, transformation and corporate climate; reductions in customer rate; and the continued roll out of our business system modernization. These successes are directly attributable to the hard work and dedication of our world class professionals – the 22,000 men and women who operate in a continuously fluid global logistics environment. This dedication to excellence culminates in our annual employee recognition awards. It is apparent that our best asset is our people; and DLA's outstanding workforce serves as a role model of exemplary performance for which all of us can be proud.

While DLA continues to excel as the Department's Logistics Combat Support Agency, the readers should note that a significant portion of DLA's financial data is derived from antiquated legacy processes, systems and sources that cannot yet be audited. We are continuing to execute a focused, coordinated, and deliberate process to improve the accuracy, completeness and reliability of the financial data that will be presented in future financial reports. By executing this approach, we expect DLA's balance sheet will pass an audit by 2010.

As I begin my first year as the Director of DLA, I want to emphasize that we will always focus on delivering a Department of Defense enterprise logistics solution while obtaining the best value for the people, the warfighters, that we support. I am confident that by embracing the business relationship opportunities in this environment, we will continue to adapt and transform in a manner that allows us to work smarter and faster as we strive to deliver goods, materiel and services to the warfighter worldwide on time...every time.

R. T. Dail

ROBERT T. DAIL
Lieutenant General, USA
Director

DEFENSE LOGISTICS AGENCY

Consolidated Management's Discussion & Analysis

DESCRIPTION OF THE DEFENSE LOGISTICS AGENCY

The Defense Logistics Agency (DLA) is the logistics combat support agency of the Department of Defense (DoD) and receives its oversight and staff direction from the Deputy Under Secretary of Defense for Logistics and Materiel Readiness. Our primary mission is to provide best value logistics solutions to meet the needs of America's Armed Forces around-the-clock and around-the-world in times of peace, national emergency, and war. Execution of the United States national defense strategy depends on DLA logistics support to feed, clothe, fuel, medicate and treat, and sustain our troops and many of our nation's allies. We support DoD objectives and missions with involvement in the full range of military operations -- from participation with multi-national forces engaged in large-scale combat operations, peacekeeping efforts, emergency support, and humanitarian assistance to the global war on terrorism.

DLA manages more than 5.2 million items and disseminates logistics cataloging information for most items managed by DLA that support the DoD, other Federal Agencies, and U.S. international partners. Among the materiel we manage are fuel and repair parts for weapon systems as well as food, clothing, and medical supplies needed to deploy and sustain U.S. Forces. We receive, issue, and distribute these items through a network of supply depots and commercial supplier relationships; and through our reutilization and marketing services, we manage DoD programs to reutilize, transfer, donate, or sell surplus and excess materiel and dispose of hazardous materiel. We also administer the DoD document automation and production services.

Our missions have evolved and grown over the past four decades to an extent that if our forces fight with it, wear it, eat it, or burn it as fuel, we probably buy it; warehouse and distribute it; or arrange for its reuse, sale, or disposal after the owner no longer needs it.

Our Vision:

Today and Tomorrow, Best Value Integrated Supply Chain Solutions…
Meeting the Needs of the Warfighter and Their Supporters.
Right Item, Right Service, Right Place, Right Price, Right Time. . .Every Time.

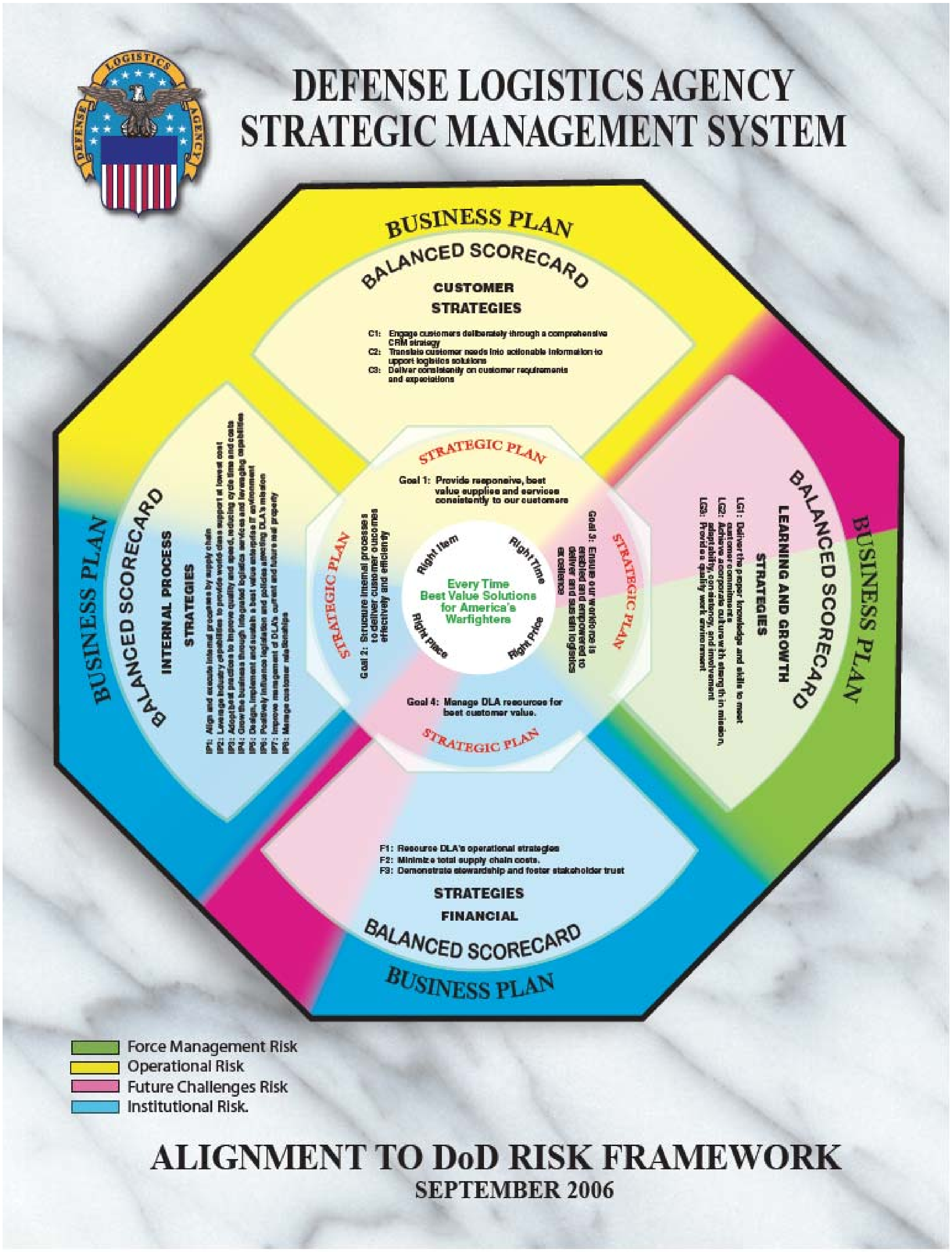
Agency Strategic Goals and Strategies

We are innovating - with improved supply chain operations - DoD logistics processes that significantly contribute to the advances made in the technological sophistication, speed, and mobility of our Armed Forces. We are adept at adapting to changing global logistics requirements to meet the needs of projected deployments in response to crises around-the-world -- often in remote locations with primitive, if any, roads, airfields, and seaports.

To remain adept to change, while formulating and executing strategy that produces outcomes supporting joint capabilities, DLA uses a four tier planning process. The top tier, long-term strategic plan is formulated by DLA senior leaders, who consider customer segments under varying scenarios and develop strategies to build core competencies to meet customer needs. The DLA Enterprise Balanced Scorecard (BSC) - our performance plan - is the second tier with an emphasis on identifying the strategies necessary to transform the Agency in the mid-term. The Enterprise Business Plan (EBP) is the third tier. It identifies the investments and actions necessary to execute our strategies and realize our objectives and the benefits of specific actions in the near-term. The fourth tier is performance measurement, analysis, and reporting. This level includes review and analysis of the Agency's performance against the Strategic Plan, BSC, and EBP. Furthermore, as the Agency transforms from a legacy system, Standard Automated Materiel Management System (SAMMS) to Business Systems Modernization (BSM), we are measuring enterprise performance at various levels to include supply chain, customer, and weapon system.

Our Strategic Management System maps and tracks transformation strategies. These strategies and objectives in the DLA Strategic Plan and Balanced Scorecard are focused on our customer transformational needs and are aligned with the DoD Risk Framework/Scorecard. The color-coded alignment wheel, provided below, and an alignment matrix communicate - throughout the Defense community - how DLA's strategies and objectives are cross-mapped to the relevant DoD Scorecard elements.

At the heart of the alignment graphic is the DLA vision. Concentric layers - moving from inside to the outer ring of the graphic - pictorially represent our Strategic Management System (comprised of the Strategic Plan, Balanced Scorecard, and Business Plan) and demonstrate DLA's support in each of the corresponding DoD scorecard quadrants. The color coded portions align to the DoD Scorecard where green = Force Management Risk, yellow = Operational Risk, rose = Future Challenges Risk, and blue = Institutional Risk. As a DoD logistics provider, DLA closely aligns with the Institutional Risk quadrant, the object of which is to improve DoD processes and efficiencies. In addition, there is an excellent alignment between DLA's Customer Quadrant to the DoD's Operational Risk Quadrant, which defines force readiness objectives. For example, DLA's Customer Relationship Management initiatives are placing teams into theaters during contingencies and forging service-level agreements with mutually collaborated service requirements and measures of performance. Lastly, both our initiatives to perform skills gap assessments of our workforce and the design and implementation of modern information technology systems will lead to meeting Future Challenges Risk Quadrant objectives.


DEFENSE LOGISTICS AGENCY
STRATEGIC MANAGEMENT SYSTEM
BUSINESS PLAN
BALANCED SCORECARD
CUSTOMER
STRATEGIES
C1: Engage customers deliberately through a comprehensive CRM strategy
C2: Translate customer needs into actionable information to upport logistics solutions
C3: Deliver consistently on customer requirements and expectations
STRATEGIC PLAN
Goal 1: Provide responsive, best value supplies and services consistently to our customers
Goal 2: Structure internal processes to deliver customer outcomes effectively and efficiently
Goal 3: Ensure our workforce is enabled and empowered to deliver and sustain logistics excellence
Goal 4: Manage DLA resources for best customer value.
Right Item
Right Time
Right Place
Right Price
Every Time
Best Value Solutions
for America's
Warfighters
INTERNAL PROCESS
STRATEGIES
LEARNING AND GROWTH
STRATEGIES
F1: Resource DLA's operational strategies
F2: Minimize total supply chain costs.
F3: Demonstrate stewardship and foster stakeholder trust
STRATEGIES
FINANCIAL
Force Management Risk
Operational Risk
Future Challenges Risk
Institutional Risk.
ALIGNMENT TO DoD RISK FRAMEWORK
SEPTEMBER 2006

Our Strategic Plan identifies DLA's four strategic goals:

Strategic Goals
• Provide responsive, integrated, best-value supplies and services consistently to our customers. • Develop, institute, and consistently enhance the internal processes required to deliver value-added logistics solutions to the warfighter. • Ensure our workforce is diverse, enabled, and empowered to deliver and sustain logistics excellence. • Manage DLA resources for best customer value.

We will achieve these strategic goals through a series of integrated enterprise-wide strategies.

Goal 1. Provide responsive, integrated, best-value supplies and services consistently to our customers.

Strategy 1.1. Engage existing and potential customers deliberately by executing a comprehensive Customer Relationship Management strategy.

Strategy 1.2. Translate customer needs into actionable information to support the development of logistics solutions that maximize readiness and combat power.

Strategy 1.3. Deliver consistently on customer requirements and expectations.

Goal 2. Develop, institute, and consistently enhance the internal processes required to deliver value-added logistics solutions to the warfighter.

Strategy 2.1. Align and execute internal processes by supply chain to provide value-added logistics to the warfighter.

Strategy 2.2. Leverage industry capabilities to provide world class support to the warfighter at the lowest possible cost.

Strategy 2.3. Adopt, institutionalize, and continuously improve best business practices to improve quality and speed and to reduce cycle time and costs.

Strategy 2.4. Grow the business by providing/integrating logistics services and leveraging DLA capabilities to meet warfighter requirements.

Strategy 2.5. Design, implement, and sustain a best value enterprise IT environment.

Strategy 2.6. Positively influence legislation, policy, regulations, and directives affecting DLA's logistics mission.

Strategy 2.7. Improve management of DLA's current and future real property.

Strategy 2.8. Manage customer relationships.

Goal 3. Ensure our workforce is diverse, enabled, and empowered to deliver and sustain logistics excellence.

Strategy 3.1. Deliver the proper knowledge and skills to meet DLA's commitments to our customers.

Strategy 3.2. Achieve a corporate culture that has strength in mission, adaptability, consistency, and involvement.

Strategy 3.3. Provide a quality work environment.

Goal 4. Manage DLA resources for best customer value.

Strategy 4.1. Resource DLA's operational strategies.

Strategy 4.2. Minimize total supply chain costs.

Strategy 4.3 Demonstrate stewardship and foster stakeholder trust.

In fiscal year (FY) 2006 DLA published its Transformation Roadmap to communicate to its customers, stakeholders, and employees the portfolio of thirteen plans and programs underway to execute DLA's role in the DoD overarching transformation strategy. DLA's transformation strategy is designed to deliver dramatically improved warfighter support at reduced cost through business process re-engineering, workforce development, technology modernization, and organizational change. The transformation effort envisions the future DLA as:

- customer-focused with world-class Military Service and warfighter partnering; and
- a significant contributor to military readiness as the supply chain integrator for subsistence, medical, clothing and textiles, construction/barrier materiel, and fuel.

Each of DLA's 13 transformational programs leverages the capabilities of the others to synergistically deliver projected outcomes. Consequently, completion of all the programs is necessary for full realization of the agency's transformation. The program descriptions follow:

Customer Relationship Management (CRM) – The deployment of a portfolio of Military Service and Combatant Commander engagement capabilities designed to more accurately predict future military requirements, define mutually agreed upon levels of support for those requirements, and monitor the level of actual performance achieved. CRM is the combination of skilled DLA employees, advanced customer interaction processes and technology that refines – from the warrior's view point – the right item, right place, right time.

Supplier Relationship Management (SRM) – The management, synchronization, and integration of the supply chains to effectively and efficiently meet the Military Services' materiel requirements. While CRM will provide the highly refined definition of future requirements, SRM will orchestrate America's industrial base to ensure those requirements are fully met at the least possible cost.

Business Systems Modernization (BSM) – The re-engineering of DLA's internal materiel management processes to best business practices by replacing decades-old software with commercial-off-the-shelf solutions. BSM is the engine or heart of the transformation. It delivers an integrated set of software applications running on a single hardware platform that all of the agency's transformational initiatives will leverage as they are developed and deployed. The tangible benefits BSM brings to the warfighter include: improved materiel availability, reduced customer wait time, reduced cost, and improved data integrity.

Business Systems Modernization Energy (BSM-E) – An information management system that supports DLA's current and expanding mission with timely and accurate information for decision-making in planning and executing energy management. Similar to BSM, it uses commercial off-the-shelf (COTS) software to perform its mission and will be incorporated into the overall BSM architecture after development. BSM-E supports the business functions of acquisition and contract management, supply management, facilities management, financial management, and decision support for all offices.

Distribution Planning and Management System (DPMS) – Computer software that improves the coordination, visibility, and positioning of supplies and equipment. The result is better management of product movement from vendors to DLA customers and from DLA distribution centers to DLA customers. DPMS will provide DLA with the means to continuously collect and access real-time information on the location, movement and status of equipment and supplies. Access to this information will facilitate the seamless flow of materiel from the point of origin to the point of consumption.

Integrated Data Environment (IDE) – The use of commercial-off-the-shelf software to deliver data brokering services that improve the interoperability and visibility of DLA data and information. These services support DLA and DoD transformation efforts using net-centric enterprise service principles. The IDE objectives are to make data and information visible, interoperable, and accessible for authorized users (via machine-to-machine interfaces) from a single entry point; and to improve data quality through the coordinated application of business rules and standards. The principal benefit of the IDE will be the reduction in the number of system-to-system data interfaces and the operational cost associated with these interfaces. Following the successful deployment of IDE Phase I (the Asset Visibility application) in January 2006, IDE Phase II (supporting all DLA transformation programs) began expanding the data sharing services to the Military Services and other Defense Agencies. Also during Phase II the IDE infrastructure will be enhanced to accommodate additional interfaces to supply and transportation source systems.

Retail Integration – DLA's program to extend consumable item supply chain responsibility beyond the wholesale level to the point of consumption. Through efforts such as the National Inventory

Management Strategy (NIMS), Air Force Inventory Efficiency (AFIE), and the Base Realignment and Closure (BRAC) supply, storage and distribution concepts, the agency is contributing to improved life-cycle materiel management for DoD. DLA continues its transformation from a manager of supplies to a manager of complete supply chains. Instead of concentrating on the traditional wholesale segment, DLA will provide supply management from the factory to the point of hand-off to the ultimate customer. The results will be lower overall DoD inventory and inventory management costs, improved demand visibility, and a reduction in the Military Services' investments without reducing support.

DLA Global Stock Positioning Strategy – A portfolio of capabilities to ensure the right inventory is at the right locations at the right time for the least cost. The underlying goal is to achieve an efficient system structure that is responsive to the customer and maintains warfighter readiness. Stock positioning policies balance the tradeoffs between customer responsiveness, aggregate stocking, and distribution and transportation costs.

DoD Executive Agent (EA) – The focal point for providing continuous, sustainable and global end-to-end supply chain support, as required by end users. The Director of DLA was designated by the Deputy Secretary of Defense as the DoD EA for Subsistence, Bulk Petroleum, Construction and Barrier Materials, and Medical Materiel. DoD EA designation for Clothing and Textiles is expected during the first quarter FY 2007. The DoD EA ensures effective end-to-end supply chain support by developing coordinated processes and support plans with all elements of the supply chain to enable the transition from peacetime to wartime and/or contingency or emergency operations.

Product Data Management Initiative – DLA's strategy for transforming the agency's technical and quality business process and associated capabilities. The technical and quality business process is one of the five core business processes comprising DLA's overall BSM strategy and is focused on identifying the "Right Item" to ensure customers get the correct part for their specific requirements in a timely, cost effective, and reliable manner.

Workforce Transformation – A portfolio of strategic initiatives for addressing critical human resource issues facing the agency. The initiatives are designed to make DLA a more customer-focused and a world-class employer of choice. This initiative is important to ensure the DLA workforce is enabled and empowered to deliver logistics excellence. The comprehensive array of initiatives, generated by the human resource strategies, benefits the entire DLA workforce and ensures that the mission and functions of DLA are accomplished.

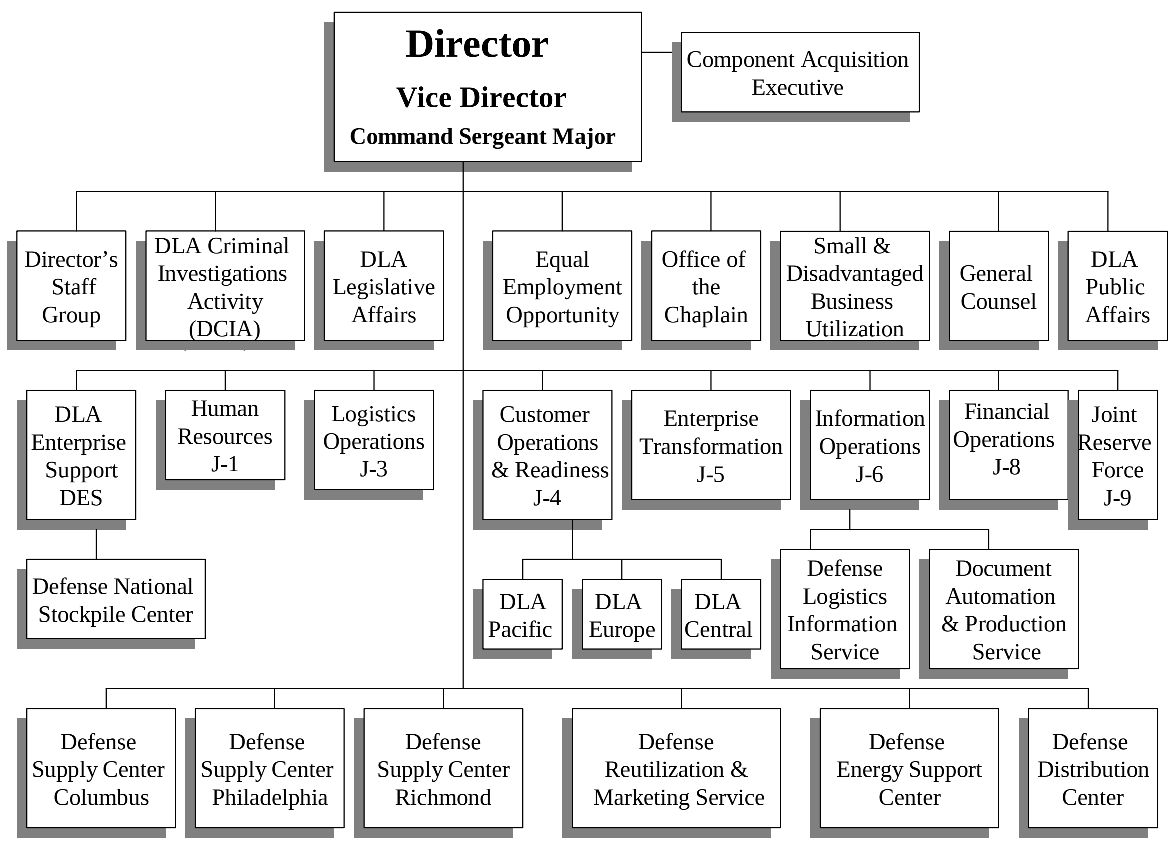
Reutilization Modernization Program (RMP) – DLA's strategy to replace the current Defense Reutilization and Marketing Service (DRMS) information technology (IT) systems with a solution based on best business practices and COTS software products. RMP will integrate IT for DRMS into the overall IT solution set for DLA. RMP will leverage efforts already completed and underway within the agency - such as other transformation initiatives (BSM, CRM, etc.) - to incorporate DRMS information needs into the DLA end-state architecture.

Base Realignment and Closure (BRAC) 2005 – A set of infrastructure decisions designed to eliminate unnecessary infrastructure – and its related cost. Consequently, the money saved can be diverted to DoD's war-fighting efforts. The four DLA targeted focus areas are: the reconfiguration of supply, storage, and distribution facilities and assets; the privatization of management responsibilities for tires, compressed gas cylinders, packaged petroleum and lubricants; the procurement of DoD depot level repairables and transfer of Military Service managed consumable items to DLA; and the attainment of efficiencies through further discretionary consolidation and relocation of other DLA functions.

ORGANIZATION

DLA maintains a global presence and accomplishes its mission with approximately 21,200 civilian personnel, 500 active duty personnel, and 750 reserve personnel. Despite our significant mission expansion over the last 40 years, our workforce is now at the smallest level since 1963. Agency leaders are committed to the continuous assessment and transformation of our organizational culture, size, structure, and alignment through enterprise integration and partnering with the private sector. These efforts will enable us to implement an enterprise business model and develop, deploy, and execute an improved set of corporate business processes and strategies. By organizing as a single, integrated business enterprise, we will be in position to focus more efficiently and effectively on supporting the DoD's supply chain, enhancing the Armed Forces' readiness, and providing for the warfighter during contingency operations. We are proactive in our approach to serving those who depend on us for their mission needs; and we constantly meet face-to-face with our customers to determine their requirements and how we can best fulfill them.

Our organizational structure is depicted below:



DLA's core functions are directed or supported by:

- Human Resources (J-1) provides a full range of civilian human resources services for the DLA civilian and military workforce. J-1 conducts these services from its customer support offices located in Columbus, OH, and New Cumberland, PA; a centralized military personnel support organization located at HQ DLA in Fort Belvoir, VA; and the DLA Training Center, which provides training support to its workforce - located in Columbus, OH.

- Logistics Operations (J-3) is responsible for the end-to-end supply chain management of DLA's eight supply chains, providing logistics and acquisition policy, guidance and oversight, and monitoring supply chain performance. J-3 is the principal strategic, operational and tactical planner for DLA business operations, championing best business practices, business systems modernization, and value-added logistics solutions for the warfighter. J-3 oversees the daily operation of the DLA Logistics Field Activities.

- Customer Operations and Readiness (J-4) leads DLA's transformation efforts in customer relations management by serving as the DLA enterprise customer advocate. J-4 enables customer readiness and sustainment by obtaining insight into the warfighter's requirements and expectations through proactive engagement and support; solving the Military Services' and Joint Commanders' complex logistics integration, visibility, and readiness challenges; and expanding joint planning and DLA tactics, techniques, and procedures for contingencies by establishing mid and long-term customer strategies.

- Strategic Planning and Enterprise Transformation (J-5) is DLA's Strategy Management Office, responsible for agency strategic planning and overall management of enterprise transformation programs. Additionally, J-5 manages and directs the BRAC 2005 implementation. The Director, J-5 communicates and executes the DLA Director's vision and senior leaderships' strategies and objectives for attainment of that vision through the DLA Strategic Plan, the Balanced Scorecard, and the DLA Business Plan while aligning with the DoD Risk Scorecard and the President's Management Agenda. Further, J-5 ensures horizontal integration and execution of strategy by sponsoring cross-functional processes and collaboration forums for enterprise decision-making. J-5 develops implementation plans, policy and guidance for DLA's BRAC implementation and is the DLA staff liaison for operational issues with the office of the Secretary of Defense, the Military Services, and internal DLA activities.

- Information Operations (J-6) is DLA's knowledge broker, and is responsible for providing comprehensive, best practice technological support to the DoD/DLA logistics community resulting in the highest quality of information systems, efficient and economical computing, data management, electronic commerce, and telecommunication services. The Director, J-6, is responsible for the development and compliance of information technology (IT) policy; the development of IT plans and strategies; and the establishment of IT standards, processes, and measurements. The Director, J-6, also serves as the Agency's Chief Information Officer. Information Operations includes oversight of two field activities: the Defense Logistics Information Service and the Document Automation and Production Service.

- Financial Operations (J-8) is the Agency's Chief Financial Officer and - as the financial management process owner - is the single spokesperson on financial management matters with external organizations. J-8 is responsible for designing, implementing, and executing standard financial processes across the Agency, while determining financial services' resource requirements and performance targets and establishing financial core competency requirements.

- Joint Reserve Force (JRF) (J-9) supports DLA with trained, ready, and available reservists, of all reserve components, for contingency operations, peacetime contributory support, wartime surge support, and planning support. Further, J-9 advises the Director, DLA, on the planning and application of JRF support in accordance with DoD and Military Service readiness and activation policies.

- DLA Enterprise Support (DES) oversees common corporate/enterprise mission support across all of DLA such as environment, safety, and occupational health; installation management; morale, welfare, and recreation; public safety; DLA Europe and DLA Pacific support; and the administration of the Defense National Stockpile Center. DES also provides operational support to Headquarters, DLA Activity Group missions.

The Defense-wide Working Capital Fund (DWCF) is the primary source of funds for DLA operations. During FY 2006, DLA executed a total budget program of more than $34.8 billion. The four DLA activity groups funded by the DWCF - and included in these statements - are supply management, distribution, reutilization and marketing, and document automation and production. Each year, DLA either obtains or returns funds to the DWCF and other DoD appropriations.

The following activity groups are financed by customer orders and direct appropriations through the DWCF:

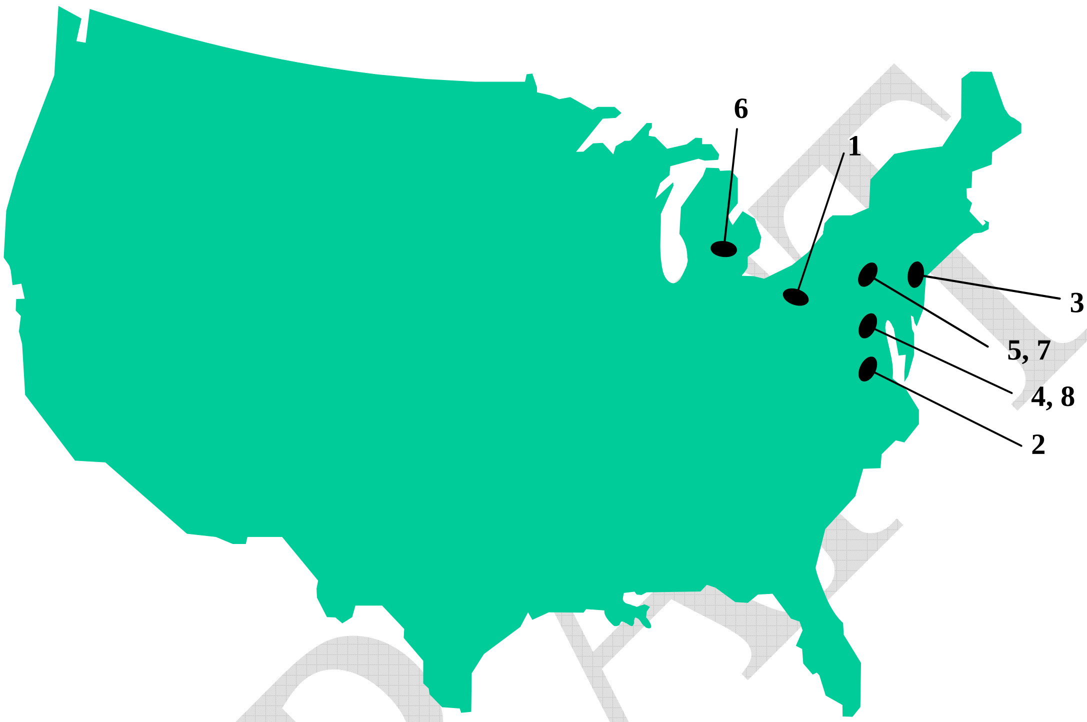
Supply Management: The Supply Management activity group provides customer support through its management of logistics processes. This includes centralized management of logistics catalog information, energy, repair parts, operating supply items, food, pharmaceuticals, medical and surgical supplies, construction materiel and equipment, and clothing and textiles. Supply Management operates through three supply centers located in Columbus, OH; Richmond, VA; and Philadelphia, PA; and the Defense Energy Support Center located at Fort Belvoir, VA. The Supply Management activity group is the largest of our business areas. It makes up about 96% of the assets, 87% of the liabilities, and 93% of revenue and costs on the financial statements.

Distribution: The Distribution activity group provides a single, unified materiel distribution system for DoD. In addition to its primary mission of receiving, storing, and issuing materiel worldwide, distribution depots perform other functions that include - but are not limited to - providing refrigerated storage, cylinder refurbishment, tent repair, medical unit assemblies, kitting, and set assembly or disassembly. The Distribution activity group is under the control of the Defense Distribution Center in New Cumberland, PA, and includes 26 subordinate distribution centers located throughout the United States, Europe, and the Pacific region.

Reutilization and Marketing: The Reutilization and Marketing activity group supports and coordinates the disposal of excess and surplus property within DoD. Property not reutilized within DoD is available for transfer to other Federal agencies or for donation to authorized non-profit organizations, state governments, and local governments. Property not reused, transferred, or donated is either sold to the public on a competitive basis or disposed of in an environmentally safe manner. A critical part of the Reutilization and Marketing mission is to arrange for the worldwide disposal of hazardous waste in compliance with law and regulation. The activity group accomplishes its mission from a Headquarters in Battle Creek, MI, and 85 Defense Reutilization and Marketing Offices located on military installations around the world.

Document Automation & Production: The Document Automation & Production Service (DAPS) activity group provides printing, duplicating and document automation services within DoD. This mission encompasses the full range of automated services to include: document workflow conversion, electronic storage and output, and distribution of hard copy and digital information. DAPS' focus is on enabling customers to transition from hardcopy to digital/electronic-based document management. DAPS manages its worldwide mission through its headquarters in Mechanicsburg, PA, and a network of 194 production facilities.

DEFENSE LOGISTICS AGENCY ACTIVITY GROUP PRINCIPAL LOCATIONS



1. Defense Supply Center Columbus (DSCC)
2. Defense Supply Center Richmond (DSCR)
3. Defense Supply Center Philadelphia (DSCP)
4. Defense Energy Support Center (DESC)
5. Defense Distribution Center (DDC)
6. Defense Reutilization and Marketing Service (DRMS)
7. Document Automation & Production Service (DAPS)
8. Defense Logistic Agency Headquarters (DLA HQ)

DLA also received about $725 million in General Funds direct appropriations, which accounted for approximately 2% of DLA's total budget program for FY 2006. These appropriations included: Operation and Maintenance (O&M), Research, Development, Test and Evaluation (RDT&E), Military Construction (MILCON), Procurement, Family Housing Construction, Family Housing O&M and Family Housing Improvement Fund.

The DLA O&M appropriation, $353.6 million, funded two distinct groups: Other Logistics Services (OLS) and Other Logistics Programs (OLP). The OLS group included approximately 30 programs and incurred $271.3 million in costs associated with the DLA logistics mission, such as: Price Comparability, Warstoppers, Hard Copy Map Function, Unemployment, Morale Welfare & Recreation, and Disaster Relief Blankets. In addition, OLS included programs added by either the Department of Defense or Congress, such as Logistics Transformation. The OLP group consisted of approximately nine program offices for which DLA either provided administrative support or had program oversight, such as the Defense Property Accountability System and the Continuity of Operations Program.

The DLA RDT&E appropriation, $226.2 million, primarily supported two types of efforts: Advanced Technology Development (Logistics Research and Development Technology Demonstration and Defense Microelectronics Equipment) and Operational System Development (Industrial Preparedness/Manufactured Technology and Logistics Support Activities).

The DLA MILCON appropriation, $137.5 million, funded major construction projects to replace, renovate or build new facilities. The Army Corps of Engineers and Naval Facilities Engineering Command are the primary design and construction agents for this program.

The DLA Procurement appropriation, $8.2 million, funded the purchase of mission essential equipment, including automated data processing, telecommunications equipment, microelectronics equipment and passenger carrying motor vehicles.

The DLA Family Housing O&M appropriation, $1.2 million, supported an inventory of 201 units located at the Defense Supply Center, Richmond, Virginia (31), the Distribution Depot Susquehanna, Pennsylvania (140), and the Distribution Depot San Joaquin, California (30). DLA's Family Housing program consisted of routine operation requirements including management and utility costs, carpet and linoleum replacement, painting, and replacement of appliances. Periodically, there are requests for Family Housing Construction funding for large-scale renovations and unit replacements.

DLA also manages the National Defense Stockpile Transaction Fund, a separate revolving fund that strives to provide the safe, secure and environmentally sound stewardship for strategic and critical materiel in the United States National Defense Stockpile. The Transaction Fund and related financial events are not accounted for in these financial statements, but are embedded in the Department of Defense Agency-wide financial statements.

FINANCIAL CONDITION

The financial statements have been prepared to report the financial position and results of operations for the Department, pursuant to the requirements of the Title 31, United States Code, Section 3515(b).

While the statements have been prepared from the books and records of the entity 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.

To the extent possible, the financial statements have been prepared in accordance with federal accounting standards. At times, the Department is unable to implement all elements of the standards due to financial management systems limitations. The Department continues to implement system improvements to address these limitations. There are other instances when the Department's application of the accounting standards is different from the auditor's application of the standards. In those situations, the DoD has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent. The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

The Defense Working Capital Fund (DWCF) is a revolving fund that fosters a demand-driven cost-based relationship between customers (primarily the military operating forces) and suppliers (the DoD's business-driven support organizations). In this capacity, the operations of a DWCF activity are financed with the funded orders placed by its customers and satisfied by that activity. The expected outcome of this relationship is the effective and efficient delivery of goods and services. Since the financial structure of the DLA DWCF allows for the identification of the cost to produce goods and services and subsequently set prices, the customer can use both pricing and delivery information in its decision-making process. This visibility also enables DLA managers to use performance measures to ensure that the activities operate consistent with budget execution targets, address program requirements, and foster productivity improvements.

The DLA DWCF finished FY 2006 with total assets valued at approximately $21.5 billion and liabilities of $3.8 billion from the Consolidated Balance Sheet and a net operating gain of slightly less than $600 million on program costs of approximately $35.2 billion and revenues of approximately $35.8 billion from the Consolidated Statement of Net Cost.

The General Funds are appropriated by Congress which also grants authority to the Office of the Secretary of Defense (OSD) and its components to obligate funds and pay for goods and services from their annual budgets. After funds are appropriated, apportioned by OMB, and allotted by OSD, the funds may be used to acquire goods and services. The DLA General Funds are comprised of Operation and Maintenance (O&M); Research, Development, Test and Evaluation (RDT&E); Military Construction (MILCON); Procurement; Family Housing Construction; Family Housing O&M; and Family Housing Improvement Fund. Both detail and summary level financial reports are available to provide the information necessary to make suitable management decisions pertaining to the allocation and use of General Funds.

The DLA General Funds finished FY 2006 with total assets valued at approximately $1.2 billion and liabilities of $278 million from the Consolidated Balance Sheet.

SYSTEMS, CONTROLS, and AUDITABILITY

The Defense Logistics Agency (DLA) senior management evaluated the system of internal accounting and administrative controls in effect during the fiscal year and as of the reporting period of July 1, 2005 through June 30, 2006. This evaluation was done in accordance with guidance provided by OMB Circular A-123, "Management's Responsibility for Internal Control," dated August 5, 2005, as implemented by DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," dated January 4, 2006, and DoD Memorandum, "Fiscal Year 2006 Guidance for the Preparation of the Statement of Assurance," dated November 8, 2005. The OMB guidelines were issued in conjunction with the Comptroller General of the United States, as required by the "Federal Managers' Financial Integrity Act of 1982." Included was an evaluation of whether the system of internal accounting and administrative controls for DLA complies with standards prescribed by the Comptroller General.

There are three objectives of DLA's system of internal accounting and administrative controls. The first is to provide reasonable assurance that obligations and costs comply with applicable laws. The second is to provide reasonable assurance that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation. Finally, the third is to provide reasonable assurance that revenue 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 assets.

The results indicate that the DLA system of internal accounting and administrative controls, in effect during the FY 2006, taken as a whole, complies with the requirement to provide reasonable assurance that the objectives mentioned above were achieved.

Systems

For most of its history, DLA performed its complex, worldwide logistics mission with strong command and control lines along multiple business segments and programs. Over time, this led to "stovepipe" organizations that developed their own automated management (legacy) information systems and accounting processes.

While these business practices worked well to serve the customer, they also produced a fragmented and very complex set of accounting processes and financial systems. Often these business practices applied accounting methods and systems differently to account for essentially the same types of transactions. As part of our logistics transformation initiatives, we will dramatically improve the accuracy, timeliness, and relevance of the financial management data maintained in our logistics systems.

The Defense Finance and Accounting Service (DFAS) prepared the FY 2006 DLA financial statements from available automated finance, accounting, and feeder systems (such as acquisition, logistics, and personnel systems) and manual processes. Since most of these automated systems were designed decades before the current Federal accounting standards were developed, it is difficult to collect the data needed to prepare financial statements that comply with Federal standards. Additionally, there is often insufficient documentation available to show how financial transactions are processed through those systems. These factors make it impractical to audit the financial statements and for DLA to demonstrate a high level of internal control and compliance with pertinent financial laws and regulations. Lastly, some data comes from DFAS systems that are not linked with DLA systems and cannot easily pass data among other DFAS systems.

DLA has a multitude of short and long-term efforts designed to fully assess its financial operations and to develop integrated systems and processes that are compliant with Federal system and accounting requirements. Two of our major strategies include:

- An upgrade of the DLA logistics management systems (supply/non-energy) through the Business Systems Modernization (BSM) initiative. BSM is designed to improve business practices and replace aging legacy logistics systems with commercial-off-the-shelf (COTS) enterprise resource planning software that is compliant with Federal Financial Management Improvement Act (FFMIA) of 1996 requirements. BSM is expected to reduce costs, eliminate systemic deficiencies, and provide the necessary audit trails to demonstrate financial stewardship and pass the scrutiny of financial audits. The initial release Concept Demonstration began processing customer orders on August 1, 2002, using the BSM tools and reengineered processes for about 170,000 selected items. Functionality, users, and a small number of items were systematically and incrementally converted to the Concept Demonstration enabling it to validate system functionality prior to deploying BSM across DLA. DLA executed this incremental approach:

    - Release 1.1, Battle Dress Uniforms, became operational in November 2003;
    - Release 1.2 implemented BSM interface with DLA's procurement legacy systems in May 2004;
    - Release 2.0 retrofit to Concept Demonstration occurred on 31 July 2004;
    - Followed by Releases 2.1.1 (December 2004), 2.1.2 (March 2005), and Release 2.1.3 (July 2005); and
    - Release 2.2 (January 2006) completed the BSM Approved Blueprint and provided the functionality required to run the business.

  By the end of September 2006, BSM supported approximately 3.7 million items and 6,800 users. Release 2.2.1 in October 2006 will add the functionality needed to support the Joint Medical Community. When fully implemented in December 2006, BSM will support approximately 5.2 million items and 7,000 users.

- The fuel legacy system is also being upgraded to a COTS package, the Fuel Automated System (FAS). FAS is an automated information system designed to support the Defense Energy Support Center (DESC) and the Military Services in performing their respective responsibilities in fuels supply chain management. FAS provides for point of sale data collection, inventory control, financial management, accounting, procurement, and facilities management. An independent verification and validation contractor concurred with the DESC executive management assertion that FAS is compliant with FFMIA requirements. In December 2003, DLA was directed to converge FAS with BSM. The Energy Convergence Program, when implemented, will fully assess all of DESC's financial operations, and will develop integrated systems and processes that comply with Federal system and accounting requirements. The newly designated BSM Energy system is expected to achieve full operational capability by 2007.

Management Controls

The Managers' Internal Control (MIC) Program is fully developed at DLA, and the Headquarters (HQ DLA) Business Offices and Field Activities (FA) have continued to make progress in the expanded reporting of weaknesses and controls. DLA continuously reviews current processes and procedures to ensure existing internal controls are in place, working as intended, or are being enhanced. Each directorate, field activity, and major office has a MIC Program Monitor assigned to oversee the program. These monitors are responsible for ensuring that their respective organizations follow the prescribed requirements and regulations, as set forth in OMB, DoD, and DLA guidelines; provide assistance regarding the performance of objective assessments; and report weaknesses and concerns arising from those assessments.

DLA MIC Program Monitors annually review risk areas to determine what should be assessed for the coming fiscal year. The objectives are developed and included in the MIC Program for each HQ DLA Directorate and FA; and all assessments are reviewed and approved by senior management and the MIC Program Team, at both the FA and the HQ DLA levels.

MIC Program performance standards are part of DLA's supervisory/managerial performance plans and include MIC Program responsibilities. As part of the DLA Internal Support Review program, updated status reports on MIC program weaknesses and concerns are addressed on a quarterly basis to the DLA senior leadership.

The DLA Senior Assessment Team (SAT) oversees the OMB Circular A-123, Appendix A requirements for the Agency. Appendix A requires - at a minimum – that DLA reports on the effectiveness of the key business process internal controls that significantly affect its financial reporting. DoD determined that limiting assessments to key focus areas, which are material to DoD's financial statements, would be the most economical approach and result in significant improvements for its reporting entities. Accordingly, under the leadership and direction of the SAT and the MIC Program Team, DLA Focus Area Leads are responsible for assessing the effectiveness of internal controls over financial reporting and preparing annual statements of assurance that follow strict rules established by DoD. If material weaknesses are discovered, Focus Area Leads are responsible for developing and executing Corrective Action Plans to resolve them. As such, Corrective Action Plans document and fix material weaknesses in internal controls over financial reporting. Progress in executing Corrective Action Plans are reported to the SAT, DoD, and the DLA Corporate Board through Balanced Scorecard Metrics at least quarterly. In addition, Corrective Action Plans are reported to the DoD Financial Improvement and Audit Readiness (FIAR) Directorate, through its web-based FIAR tool.

Progress within the DLA Financial Operations (J-8) included the vertical organizational participation in identifying and resolving internal control deficiencies; refinements of relevant DLA One Book chapters/procedures; further refinements to agreements with customers and providers; and continued recognition of current process improvements to ensure existing internal controls remain in place or are enhanced. J-8 reviewed current business practices, assessed management controls, conducted biweekly audit updates, and performed risk analysis as part of its evaluation.

Auditability Initiatives

DoD Financial Improvement Initiative (FII). In support of the strategic goal to demonstrate readiness for financial statement audit, DLA continues to execute a comprehensive – yet fluid, end-to-end approach to achieve auditability. DLA will adhere to the five phase process contained in the DoD Comptroller's Financial Improvement Initiative (FII) Business Rules that culminates with the conduct of a financial statement audit. The five phases include: 1) Discovery and Correction, 2) Validation, 3) Assertion, 4) Assessment, and 5) Audit. DLA is responsible for phases 1 through 3, while the DoD Inspector General is responsible for overseeing and conducting the remaining two phases. DLA's progress is monitored by the DoD Comptroller Financial Improvement and Audit Readiness (FIAR) Directorate.

DLA Financial Transformation Plan. The *Financial Transformation Plan* compliments the DoD Comptroller's Financial Improvement Initiative (FII) Business Rules and documents the strategies to achieve both auditability (the mid-term goal) and improve financial stewardship (the long-term goal). As such, it communicates these strategies throughout DLA and to our external stakeholders. A major element to the plan's execution is the use of an Independent Public Accountant (IPA) firm to conduct Discovery (focused assessments using audit-like procedures) on the areas that have not yet undergone a review and/or audit. During FY 2006, DLA engaged the services of an additional commercial firm that will assist with implementation of corrective action and process documentation required by both the FII Business Rules and the revised OMB Circular A-123. The added benefit of this financial transformation effort will be the credibility that is earned by passing the scrutiny of a financial statement audit. The plan will be continually updated/revised as progress is made toward these goals or as circumstances warrant.

Progressing Toward Auditability

Under the leadership and direction of the DLA Audit Committee, the Auditability Working Group (AWG) and its subordinate Issue Resolution Teams (IRTs) are responsible for creating and implementing strategies that both resolve reported audit findings and document the approaches to maintain and sustain auditability. These organizations are comprised of senior managers and personnel representing both DLA and Defense Finance and Accounting Service (DFAS). Each IRT is led by a member of the DLA Process Owner's (Flag Officer/SES level) staff and is responsible for developing and executing the Plans of Action and Milestones (POAMs) to resolve audit impediments. As such, POAMs document DLA's approach to fix audit impediments; contain the actions required to document the business processes and related internal controls; and identify the steps required to validate the outcome of the corrective actions and prepare the requisite management assertions. Progress in executing the POAMs and related corrective action key milestones are reported monthly to the AWG, bi-monthly to the Audit Committee, and quarterly to the DLA Corporate Board through Balanced Scorecard metrics. POAM key milestones are also reported to the DoD FIAR Directorate through its web-based FIAR tool and included in the DoD FIAR Plan – the Department's comprehensive approach to achieve DoD-wide auditability.

Starting in FY 2006, DLA updates – on a monthly basis - its key milestones reported in the FIAR tool. Due to the number of newly discovered audit impediments and the scarcity of available funding, the IRT leads recently revised and extended their key milestones and assertion target dates. Consequently, the majority of these dates now extend to the end of FY 2009.

As of the 3rd Quarter, FY 2006, IRT leads reported on 17 POAMs and 348 critical actions items through Balanced Scorecard metrics. IRT leads had completed 126 of these items; however, the remaining actions are subject to change due to new discovery and new policy requirements, such as those levied by OMB Circular A-123, Appendix A.

OTHER ACCOMPANYING INFORMATION

Executive Agent (EA): An Executive Agent is defined as "*The Head of a DoD Component to whom the Secretary of Defense or the Deputy Secretary of Defense has assigned specific responsibilities, functions, and authorities to provide defined levels of support for operational missions, or administrative or other designated activities that involve two or more of the DoD Components.*" The Deputy Secretary of Defense has designated the Director of the Defense Logistics Agency as the Executive Agent for Subsistence (Class I), Bulk Petroleum (Class III), Construction and Barrier Materiel (Class IV) and Medical Materiel (Class VIII). Accomplishments by DLA as the Executive Agent are as follows:

- For Class I (Subsistence): 1) established the Joint Subsistence Policy Board with representation from the Military Services to coordinate the development of plans and policies and an Executive Agent Project Office to guide and manage EA initiatives for Class I; 2) developed a 21-Day Menu and Go to War Catalog; and 3) completed the initial Critical Design Review for the Common Food Management System.

- For Class III (Bulk Petroleum): 1) established the Core Steering Group and DESC Executive Agent Project Office to guide and manage EA initiatives for Class III; 2) procured receipt meters for tactical locations in the Central Command Area of Responsibility (CENTCOM AOR) to enhance accountability; 3) initiated studies to optimize petroleum quality information management systems and petroleum laboratory utilization; 4) developed joint specifications for tactical fuel bladders supporting centralized procurement and standardized fuel filter requirements that reduced the number of National Stock Numbers from 30 to 6; and 5) stood-up a computer based Joint Petroleum Training Module and instructor lead Joint Fuels Laboratory Course.

- For Class IV (Construction/Barrier Materiel): 1) established the Joint Class IV Council to coordinate and resolve construction/barrier materiel related matters and an Executive Agent Project Office to guide and manage EA initiatives for Class IV; and 2) developed Plans of Action and Milestones for identified gaps and seams in the end-to-end supply chain.

- For Class VIII (Medical Materiel): 1) developed consolidated program FY 2008-2013 Program Budget Review guidance for medical materiel; 2) the Chairman of the Joint Chiefs of Staff approved DLA recommendations for Theater Lead Agents for Medical Materiel (TLAMM) in the Pacific Command (USPACOM), European Command (USEUCOM) and Central Command (USCENTCOM); 3) initiated the process designating TLAMMs for the Northern Command (USNORTHCOM) and Southern Command (USSOUTHCOM); 4) signed a Performance-Based Agreement between the Army Surgeon General, the Army G4, and the Director of the Defense Logistics Agency that synchronizes support for 21 medical power projection platforms and theater distribution centers; and 5) supported the development of future (2015) joint medical logistics and infrastructure support capabilities through the Joint Forces Command (USJFCOM) led Joint Force Health Protection transformation initiative.

Reservists: Among the manpower available to DLA were 754 reservists, - authorized and funded by the Military Services. The reservists are utilized by DLA in a variety of capacities in support of peacetime operations, contingencies, and wartime surges. Since September 11, 2001, the wartime surges have been supported with the mobilization of 383 reservists during Operations ENDURING FREEDOM and IRAQI FREEDOM. During FY 2006, 67 reservists mobilized and provided support to DLA's three Contingency Support Teams (DCSTs) in Kuwait, Iraq and Afghanistan, while six reservists staffed the Sustainment Division of the U.S. Central Command's Deployment and Distribution Operations Center. Collectively, activated reservists logged more than 20,800 man-days of support to DCSTs, field activities, and headquarters missions. Reservists provided 8,540 man-days of operational support to the various stateside DLA activities during their statutory annual training. To further enhance support to DLA's worldwide missions, the Marine Corps authorized 15 reservists beginning October 1, 2006.

Defense Logistics Agency
Working Capital Fund

Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2006 and 2005

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Balance Sheets
As of September 30, 2006 and 2005
(In Thousands)

	2006 Consolidated	2005 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Accounts Receivable (Note 4)	$ 857,284	$ 995,583
Other Assets (Note 5)	124,925	124,925
Total Intragovernmental Assets	$ 982,209	$ 1,120,508
Cash and Other Monetary Assets (Note 6)	$ 12,100	$ 19,463
Accounts Receivable, Net (Note 4)	570,080	571,419
Inventory and Related Property, Net (Note 7)	17,913,093	15,989,708
General Property, Plant, and Equipment, Net (Note 8)	1,920,819	1,896,019
Other Assets (Note 5)	60,341	196,768
TOTAL ASSETS	$ 21,458,642	$ 19,793,885
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	$ 93,288	$ 136,891
Other Liabilities (Notes 12 & 13)	86,885	69,310
Total Intragovernmental Liabilities	$ 180,173	$ 206,201
Accounts Payable (Note 10)	$ 3,032,382	$ 2,664,567
Military Retirement and Other Federal Employment Benefits (Note 14)	253,172	273,303
Environmental and Disposable Liabilities (Note 11)	104,136	40,412
Other Liabilities (Notes 12 & 13)	246,998	300,192
TOTAL LIABILITIES	$ 3,816,861	$ 3,484,675
NET POSITION		
Cumulative Results of Operations – Other Funds	$ 17,641,781	$ 16,309,210
TOTAL NET POSITION	$ 17,641,781	$ 16,309,210
TOTAL LIABILITIES AND NET POSITION	$ 21,458,642	$ 19,793,885

The accompanying notes are an integral part of these statements.

Unaudited

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Statements of Net Cost
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 15)

	2006 Consolidated	2005 Consolidated
Program Costs		
Gross Costs	$ 35,161,318	$ 33,095,523
(Less: Earned Revenue)	(35,759,143)	(32,391,104)
Net Program Costs	$ (597,825)	$ 704,419
Net Cost of Operations	$ (597,825)	$ 704,419

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 16,184,285	$ 15,087,150
Prior Period Adjustments:		
Corrections of Errors (+ /-)	124,925	124,925
Beginning Balances, as adjusted	16,309,210	15,212,075
Budgetary Financing Sources:		
Appropriations used	681,678	1,096,298
Transfers-in/out without reimbursement (+ /-)	16,165	180,118
Other Financing Sources:		
Transfers-in/out without reimbursement (+ /-)	(109,083)	381,175
Imputed financing from costs absorbed by others	145,986	143,963
Total Financing Sources	734,746	1,801,554
Net Cost of Operations (+ /-)	(597,825)	704,419
Net Change	1,332,571	1,097,135
Ending Balances	$ 17,641,781	$ 16,309,210

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006 Consolidated	2005 Consolidated
UNEXPENDED APPROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	$ 2,147,051	$ 1,246,300
Appropriations transferred-in/out (+/-)	(1,465,200)	(150,000)
Other adjustments (rescissions, etc.) (+/-)	(173)	-
Appropriations used	(681,678)	(1,096,300)
Ending Balances	$ -	$ -

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ (35,476)	$ (78,215)
Recoveries of prior year unpaid obligations	446,035	-
Budget authority:		
Appropriation	2,147,051	1,246,300
Contract authority	33,797,628	34,320,606
Spending authority from offsetting collections:		
Earned		
Collected	34,627,477	31,679,283
Change in receivables from Federal sources	11,761	(164,389)
Change in unfilled customer orders		
Advance received	(11,219)	18,169
Without advance from Federal sources	685,356	185,749
Subtotal	71,258,054	67,285,718
Nonexpenditure transfers, net, anticipated and actual	(1,449,329)	30,119
Permanently not available	(36,099,085)	(32,585,827)
Total Budgetary Resources	$ 34,120,199	$ 34,651,795

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006 Combined	2005 Combined
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 34,151,019	$ 34,687,273
Subtotal	34,151,019	34,687,273
Unobligated balance:		
Apportioned	(30,820)	(35,476)
Subtotal	(30,820)	(35,476)
Unobligated balance not available	-	(2)
Total Status of Budgetary Resources	$ 34,120,199	$ 34,651,795
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 15,342,337	$ 13,959,214
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(4,596,998)	(4,575,637)
Total unpaid obligated balance	10,745,339	9,383,577
Obligations incurred net (+ /-)	34,151,019	34,687,273
Less: Gross outlays	(35,206,622)	(33,304,149)
Less: Recoveries of prior year unpaid obligations, actual	(446,035)	-
Change in uncollected customer payments from Federal sources (+ /-)	(697,116)	(21,360)
Obligated balance, net – end of period		
Unpaid obligations	13,840,700	15,342,337
Less: Uncollected customer payments from Federal sources (+ /-)	(5,294,115)	(4,596,998)
Total unpaid obligated balance, net, end of period	8,546,585	10,745,339
Net Outlays		
Net Outlays:		
Gross outlays	35,206,622	33,304,149
Less: Offsetting collections	(34,616,258)	(31,697,452)
Net Outlays	$ 590,364	$ 1,606,697

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 34,151,019	$ 34,687,272
Less: Spending authority from offsetting collections and recoveries	(35,759,409)	(31,718,812)
Obligations net of offsetting collections and recoveries	(1,608,390)	2,968,460
Net obligations	(1,608,390)	2,968,460
Other Resources		
Transfers-in/out without reimbursement (+/-)	(109,083)	381,174
Imputed financing from costs absorbed by others	145,986	143,962
Net other resources used to finance activities	36,903	525,136
Total resources used to finance activities	$ (1,571,487)	$ 3,493,596
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	2,105,935	(1,495,537)
Unfilled Customer Orders	674,136	203,918
Resources that fund expenses recognized in prior periods	(160,202)	(88,686)
Resources that finance the acquisition of assets	(29,148,247)	(26,137,064)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Other (+/-)	109,083	(381,175)
Total resources used to finance items not part of the net cost of operations	(26,419,295)	(27,898,544)
Total resources used to finance the net cost of operations	$ (27,990,782)	$ (24,404,948)

The accompanying notes are an integral part of these statements.

Unaudited

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006 Consolidated	2005 Consolidated
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 annual leave liability	$ 6,949	$ -
Increase in environmental and disposal liability	63,724	40,412
Other (+/-)	128,085	2,183
Total components of Net Cost of Operations that will require or generate resources in future periods	198,758	42,595
Components Not Requiring or Generating Resources		
Depreciation and amortization	188,874	145,277
Revaluation of assets or liabilities (+/-)	(309,084)	(407,243)
Other (+/-)		
Cost of Goods Sold	27,315,970	25,294,908
Other	(1,561)	33,830
Total components of Net Cost of Operations that will not require or generate resources	27,194,199	25,066,772
Total components of net cost of operations that will not require or generate resources in the current period	27,392,957	25,109,367
Net Cost of Operations	$ (597,825)	$ 704,419

The accompanying notes are an integral part of these statements.

Defense Logistics Agency
Working Capital Fund

Notes to the
Consolidated and Combined Financial Statements
For the Years Ended September 30, 2006 and 2005

Note 1. Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position, net costs, and changes in net position of the Defense Logistics Agency (DLA) Working Capital Fund (WCF), as required by the "Chief Financial Officers Act of 1990", expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The accompanying financial statements have been prepared from the books and records of DLA in accordance with the "Department of Defense (DoD) Financial Management Regulation" (FMR), the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible, generally accepted accounting principles (GAAP). The accompanying financial statements account for all DLA WCF resources for which DLA is responsible. Information relative to classified assets, programs, and operations is aggregated and reported in such that is not discernable.

The DLA is unable to fully implement all elements of GAAP and OMB Circular A-136 due to limitations of its financial management processes and systems and nonfinancial systems and processes that feed into the financial statements. The DLA derives its reported values and information for major asset and liability categories largely from nonfinancial feeder systems, such as acquisition, property, and logistic systems. Most of these systems were designed to support reporting requirements that focused on management concerns, such as asset accountability and funds control, rather than preparing financial statements in accordance with GAAP. The DLA continues to implement process and system improvements to address the limitations of its financial and nonfinancial feeder systems. The DLA currently has six identified financial statement material weaknesses: Intragovernmental Eliminations, system sustainability related to audit data extraction, supporting documentations for accounts payables, system account balances change request, inventory valuations and unsupported and supported undistributed disbursements.

B. Mission of the Reporting Entity

The DLA's primary mission is to provide best value logistics solutions to meet the needs of America's Armed Forces around the clock and around the world in times of peace, national emergency, and war. Support begins with joint planning for parts used in new weapons systems, extends through production and contract support, distribution and warehousing, and concludes with the disposal of materiel that is obsolete, worn out, or no longer needed.

The DLA provides supply support, technical/logistics services and quality support to all branches of the Military and other nonDoD customers. The services provided fall into the following activity groups: Supply Management; Defense Distribution Command (DDC); Defense Reutilization and Marketing Service (DRMS); and the Document Automation and Production Service (DAPS).

C. Appropriations and Funds

The DLA receives its appropriations and funds as general or working capital (revolving) funds. The DLA uses these appropriations and funds to execute its mission.

These appropriations and funds are apportioned to DLA. An apportionment is a plan, approved by Office of Management and Budget (OMB), to spend resources provided by law. OMB usually uses one of three categories to distribute these budgetary resources. Category A apportionments distribute budgetary resources by fiscal quarters. Category B apportionments typically distribute budgetary resources by activities, projects, objects or a combination of these categories. Category C apportionments may be used in multi year and no year Treasury Appropriation Fund Symbol (TAFS) to apportion funds into future fiscal years. Certain TAFS are exempt from apportionment and from using program reporting categories (See OMB Circular A-11, Preparation, Submission, and Execution of the Budget).

The Defense Working Capital Fund (DWCF) primarily provides goods and services on a reimbursable basis. The DWCF received its initial funding through an appropriation or a transfer of resources from existing appropriations or funds and receives supplemental appropriations as needed to sustain the DWCF operations. As part of DWCF, DLA is provided two forms of budgetary authority: contract authority and anticipated reimbursement authority. The DLA's Supply Management, DDC, and DRMS field activities are provided contract authority for both operations and capital programs. The DAPS is provided anticipated reimbursement authority for its operations and contract authority for its capital programs. Contract authority allows for the incurring of obligations prior to receipt of customer orders. In contrast, anticipated reimbursement authority requires the receipt of customer orders prior to incurring obligations. Contract authority must subsequently be liquidated through the receipt of customer orders, appropriations and transfers.

D. Basis of Accounting

For Fiscal Year 2006, the DLA financial management systems are unable to meet all of the requirements for full accrual accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Since many DLA financial and nonfinancial feeder systems and processes were implemented prior to the issuance of GAAP, these systems were not designed to collect and record financial information on an accrual basis. Most of the DLA's legacy systems were designed to record information on a budgetary basis.

The DLA is currently revising its legacy accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until such time as DLA financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DLA will continue to face obstacles as a result of its systems limitations. Efforts are underway to bring DLA systems and processes into compliance with GAAP. In the meantime, some financial data is based on budgetary transactions (obligations, disbursements, and collections), data calls, accruals, and transactions from nonfinancial feeder systems.

The preparation of financial statements requires management to make certain estimates and assumptions that affect the reported amount of assets and liabilities, at the date of the financial statements, and the amount of revenues and costs reported during the period. Actual results could differ from the adjusted amounts. Also, due to legacy system limitations and to comply with certain DoD accounting policy directives, DLA financial statements contain numerous adjustments to amounts reported in the Trial Balances. The Defense Finance and Accounting Service (DFAS), the accounting service provider making most of the accounting adjustments, has been unable to demonstrate that the adjustments are supported by suitable transaction detail or well controlled business processes.

In addition, DLA is mandated by Government and Performance and Results Act (GPRA) and cost accounting requirements in the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government" to perform cost accounting. The DLA legacy systems do not have the capability to fully comply with these requirements.

E. Revenues and Other Financing Sources

Revenue is recognized on an accrual basis, which is at the point when services are performed or a product is sold. The DLA DWCF performs services on behalf of DoD for other federal agencies and the public at full cost in accordance with OMB Circular A-25 "User Charges". The DDC recognizes revenue in accordance with the percentage of completion method. The Supply Management activities recognize revenue from the sale of inventory. DRMS activities recognize revenue from Service Level Billing, reimbursement of hazardous waste disposal or other services. By law, DRMS cannot recoup costs from transfer and donation customers, but is mandated to include these costs in their overhead.

The US has agreements with foreign countries that include either direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where US troops are stationed, and where the US fleet is in a port. The DLA does not include nonmonetary support provided by US allies for common defense and mutual security in its list of other financing sources that appear in the Statement of Financing and Statement of Net Cost.

F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because DLA's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expense, accounts payable, environmental liabilities, and unbilled revenue. The DLA's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Net increases or decreases in unexpended appropriations are recognized as a change in the net position.

Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made. Operating expenses are adjusted as a result of the elimination of balances between DoD Components

G. Accounting for Intragovernmental Activities

Preparation of consolidated financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, DLA is unable to accurately identify most of its intragovernmental transactions by customer because the current legacy systems throughout the DoD do not track buyer and seller data needed to match these related transactions. Seller entities within DoD provide summary seller side balances for revenue, accounts receivable, and unearned revenue to the buyer side internal DoD accounting offices. In most cases, the buyer side records are adjusted to agree with DoD seller side balances often forcing DLA to make unsupported adjustments. The DoD intragovernmental balances are then eliminated. The DoD is developing long-term system improvements that will include sufficient up front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service is responsible for eliminating transactions between DoD and other federal agencies. Both the Treasury Financial Manual, Part 2 – Chapter 4700, “Agency Reporting Requirements for the Financial Report of the United States Government” and the Treasury’s “Federal Intragovernmental Transactions Accounting Policy Guide” provide guidance for reporting and reconciling intragovernmental balances. Although DLA is unable to fully reconcile intragovernmental transactions with all federal partners, a process has been created that reconciles balances pertaining to borrowings from the US Treasury and the Federal Financing Bank, Federal Employees’ Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD’s proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The DoD’s financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

The DoD interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements either do not reflect, or were adjusted to reflect, the results of the following events:

Civilian/Military Retirement Systems

The DLA’s civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) while the Military Retirement System (MRS) covers military personnel. Additionally, personnel covered by FERS and MRS also have varying coverage under Social Security. The DLA finances only a portion of the civilian pensions. While reporting and funding civilian pensions under CSRS and FERS is the responsibility of OPM, DLA recognizes an imputed expense for the portion of civilian employee pension's benefit on the Statement of Net Cost. The DLA also recognizes corresponding imputed revenue from the civilian employee pension's benefit on the Statement of Changes in Net Position.

Actuarial Liability

The DLA DWCF reports the unfunded actuarial liability for civilian personnel in its financial statements. The liability is recorded each year based on estimates provided by the DOL.

H. Transactions with Foreign Governments and International Organizations

The DLA Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976". Under the provisions of this Act, DLA has authority to sell defense articles and services to certain foreign countries and international organizations generally at no profit or loss to the US Government. These external customers may be required to make payments in advance of receiving the goods or services.

I. Funds with the U.S. Treasury

The DWCF are established under the authority of Title 10, United States Code (U.S.C.), Section 2208. The TAFS for the DWCF is 97X4930.005 and the DLA's financial resources are maintained in this US Treasury account.

The DLA maintains a financial record of its fund balance with treasury (FBWT) for each of its activities. The US Treasury reports FBWT at the Treasury appropriation symbol level; however, Columbus Cash Accountability System provides the detail at the subhead/limit level. The DLA is one of several Defense Agencies that are part of the same DWCF appropriation, with the funding for each business area controlled at the limit level, which is one level below the appropriation level. Treasury is not able to identify FBWT separately for DLA.

The DFAS, Military Services, US Army Corps of Engineers (USACE), and State Department's disbursing stations process all of DLA's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares daily and monthly reports that provide information to the Department of the Treasury on check issues, electronic fund transfers, interagency transfers, and deposits. To determine DLA's FBWT, DFAS utilizes a Cash Management Report to process and monitor current year cash transactions, transfers and apportionments at the limit level.

Differences between DLA's recorded FBWT and Treasury fund balance are reconciled to the extent possible by DFAS. These differences, called undistributed disbursements and collections, are generally caused by intransit and unmatched disbursements as described in section 1.Y.

J. Foreign Currency

Cash is the total of cash resources under the control of DoD, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total US dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts. The majority of cash and all foreign currency is classified as nonentity and, therefore, is restricted. Amounts reported consist primarily of cash and foreign currency held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

Furthermore, DLA conducts a portion of its operations overseas. The gains and losses on purchases made overseas are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of the fiscal year. Foreign currency fluctuations require adjustments to the original obligation amount at the time a payment is disbursed. The US Congress has established a special account to report gains and losses that occur from foreign currency transactions. As a result, DLA does not separately identify currency fluctuations in its financial statements.

K. Accounts Receivable

As presented on the balance sheet, accounts receivable include accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. In accordance with current DoD policy, DLA does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are resolved between the agencies (per the Code of Federal Regulations 4 CFR 101). The DLA bases the estimate of uncollectible accounts receivable from the public on percentage method.

The DLA accounts receivable balances also include balances associated with fuel exchange agreements (FEAs). These FEAs, also known as replacement-in-kind agreements, are international acquisition and cross servicing agreements established between DLA Defense Energy Support Center (DESC) and the Military Departments of other nations. The DLA utilizes FEAs to reimburse fuel provided by Foreign Militaries to the US Military. Settlement can be made either in fuel or cash. For cash settlements, the agreements typically call for reciprocal pricing (i.e. prices cannot be more than the participants charge their own Military). The DESC charges DoD standard prices to foreign militaries. According to current DoD policy, exchange transactions such as FEAs must be settled through the issuance or receipt of replacement supplies or services within 12 months of the original transaction. If the exchange transactions are not settled within this period, they are converted to reimbursable transactions and the resulting accounts receivable or accounts payable is liquidated within 30 days.

The DESC accounts for fuel provided under FEAs as a nonfederal accounts receivable. As the settlement of the exchange transactions is authorized to take up to 12 months, the analysis of the nonfederal accounts payable balances greater than 180 days old could be distorted. To assist in the analysis, Note 4 Accounts Receivable separates FEA transaction balances from the remainder of the nonfederal accounts payable.

L. Direct Loans and Loan Guarantees

The DLA WCF does not have loans receivable.

M. Inventories and Related Property

The SFFAS No. 3 distinguishes between inventory held for sale; inventory held in reserve for future sale; and excess, obsolete, and unserviceable inventory. Because operational cycles are irregular and the military risks associated with stock out positions have no commercial parallel, DoD policy does not recognize either a management or a valuation difference between inventory held for current sale and inventory held in reserve for future sales. The DLA holds materiel based on military need and support for contingencies. The DLA does not separately account for inventory held for current or future sale.

Inventory Composition: The DLA inventory composition is comprised of Energy and Nonenergy. The Nonenergy inventory is further broken down into supply chains that are grouped as either Troop Support or Hardware. These supply chains represent the transformation from the old legacy environment of commodity based inventory. The Nonenergy inventory is reported in both the legacy systems and in BSM.

Energy consists of jet fuels, aviation gasoline, automotive gasoline, heating oils, power generation, naval propulsion fuels, lubricants, and missile propellants. Currently the inventory for Energy is stored at more than 700 Defense Fuel Supply Points (DFSP) world wide.

Nonenergy consists of: Hardware and Troop Support supply chains. Hardware includes the commodity based inventories of Industrial (lathes, planers, welders, presses); Construction and Equipment (cranes, wallboards, fencing, circuit breakers); and General (rope, tubing, lamps). Troops Support includes the commodity based inventories of Subsistence (food service, produce and rations); Clothing and Textiles (tents, flags, shoes, battle dress uniforms); and Medical (x-ray machine, hospital beds, drugs, surgical instruments).

Information Related to Inventory, Net

Inventory Composition Classification: Inventory is tangible personal property that is:

1. Held for sale;
2. In the process of production for sale; or
3. To be consumed in the production of goods for sale or in the provision of services for a fee.

Inventory available and purchased for resale includes consumable spare and repair parts owned and managed by DLA. It also includes materiel held in reserve for future sale due to a managerial determination that it should be retained to support military or national contingencies.

Condition Codes A through H and S are utilized to reflect materiel condition prior to turn in to the Defense Reutilization and Marketing Service (DRMS).

Inventory held for repair is damaged inventory that requires repair to make it suitable for sale. Many of the inventory items are more economical to repair than to procure. In addition, because DoD often relies on weapon systems and machinery no longer in production, DoD supports a process for the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready and mobile military force. These condition codes include the following; condition code E Unserviceable (LIMITED RESTORATION) is materiel which involves only limited expense or effort to restore to serviceable condition and which is accomplished in the storage activity where the stock is located. Condition code F Unserviceable (REPARABLE) is economically reparable materiel which requires repair, overhaul, or reconditioning. Condition code G Unserviceable (INCOMPLETE) is materiel requiring additional parts or components to complete the end item prior to issue.

Excess, obsolete, and unserviceable (EOU) inventory consists of excess inventory, scrap materiel and items that cannot be economically repaired and are awaiting disposal. These condition codes include the following: condition code H Unserviceable for materiel that has been determined to be unserviceable and that does not meet repair criteria. Condition code P Unserviceable (RECLAMATION) is materiel determined to be unserviceable, uneconomically reparable as a result of physical inspection, tear down or engineering decision. Condition Code S Unserviceable (SCRAP) is materiel that has no value except for its basic materiel content. No stock will be recorded as on hand in Condition Code S. This code is used only on transactions for shipments to DRMS. All of the inventory held by DRMS is considered EOU, and therefore valued at zero using a revaluation allowance to reduce the gross value.

Inventory Valuation: The OUSD(C) prescribed moving average cost (MAC) as the inventory valuation method to be used within the Department in a July 6, 2001 memo. However, it also noted that the DoD component legacy inventory systems were designed for materiel management rather than for financial accounting purposes. Although legacy systems provide visibility and accountability for inventory items, they do not maintain the historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these legacy systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (Public Law 104-208). Therefore, until the legacy systems are replaced, an alternative valuation methodology (model) was mandated. The alternative valuation method attempts to convert latest acquisition cost (LAC) and standard price to Adjusted LAC by adjusting for holding gains and losses.

Through the implementation of the Business System Modernization (BSM), DLA has transitioned 95% of its nonenergy inventory to the MAC valuation method. The DLA's energy supply chain has 100% of its inventory being accounted for in BSM Energy (BSM-E) using an OUSD(C) approved transactional first-in first-out (FIFO) accounting method. DLA has 3% of its total inventories in legacy systems that are reported at Adjusted LAC.

The net value of condemned materiel held at DLA storage activities and all excess materiel held by DRMS is zero. It is DoD policy that the cost of disposal of this materiel is considered to be greater than the potential scrap value that might be realized from the sale of this materiel. Related property consists of Operating Materials and Supply (OM&S). The OM&S are valued using the MAC method. The DLA uses the consumption method of accounting for OM&S, expensing material when it is issued to the end user.

N. Investments in U.S. Treasury Securities

The DLA WCF does not have investments in US Treasury Securities.

O. General Property, Plant and Equipment

The Department is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property Plant and Equipment (PP&E) to one that is specific for each individual category.

Beginning in the 3rd Quarter of FY 2006, the capitalization threshold was revised from $100,000 to $20,000 for real property (land, buildings, structures, facilities, and construction-in-progress or (CIP)). The current $100,000 capitalization threshold remains unchanged for the remaining General PP&E categories.

Prior to the 3rd Quarter, FY 2006, General PP&E assets were capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD capitalization threshold of $100,000. In addition, DoD requires capitalization of General PP&E improvement costs over DoD capitalization threshold of $100,000. All General PP&E, other than land and CIP, is depreciated using the straight line method over the estimated useful life of the asset.

Prior to FY 1996, DoD capitalized General PP&E with an acquisition cost of $15,000, $25,000 or $50,000 and an estimated useful life of two or more years for fiscal years 1993, 1994, and 1995 respectively. These assets remain capitalized and reported on WCF financial statements.

For DLA WCF activities, all PP&E used in the performance of the DWCF mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E categories. The heritage assets and stewardship land owned or maintained at DLA WCF installations and other material disclosures are provided in Note 8 – General PP&E, Net.

The DLA PP&E in the possession of contractors is included in the values reported in Note 8 for the major asset classes of land and buildings, structures, and facilities. Further, the DLA general PP&E personal property (major asset classes of software and equipment) does not include all of the assets above the DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total general PP&E net book value. The DoD is developing new policies and a contractor reporting process to capture general PP&E information for future reporting purposes to comply with GAAP.

P. Advances and Prepayments

The DLA records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. The DLA recognizes advances and prepayments as expenses when it receives the related goods and services.

Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. It is DoD policy to recognize the applicable asset or liability when a capital lease is equivalent to an installment purchase of property and the value equals or exceeds the current DoD capitalization threshold. The policy also requires recording the lesser of the present value of the rental and other lease payments during the lease term excluding portions representing executory costs paid to the lessor or the asset's fair value. The DoD deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest is applied to reduce the net minimum lease payments to present value and is calculated at the incremental borrowing rate from the inception of the lease. In addition, DLA classifies leases that do not transfer substantially all of the benefits or risks of ownership as operating leases and records payment expenses over the lease term.

R. Other Assets

Other assets includes those assets, such as military and civil service employee pay advances, travel advances, and contract financing payments, that are not reported elsewhere on the Department's Balance Sheet.

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost reimbursement contracts. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction in Progress in Note 8, General PP&E.

The DLA conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. The DLA provides financing payments when necessary to alleviate the potential financial burden on the contractor caused by long-term contracts.

The FAR allows DLA to make financing payments for fixed price contracts. The DLA reports these financing payments as "other assets" because DLA does not become liable until after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, DLA is not obligated to reimburse the contractor for its costs and the contractor is liable to repay DLA for the full amount of the prepayment or advance.

Beginning in 4th Quarter, FY 2006, the Department of Defense (DoD) implemented a change in the financial reporting practices for progress payments based on cost, a type of contract financing payment that is authorized in contracts that include the FAR contract clause 52.232-16, "Progress Payments." Specifically, when the contract authorizes progress payments based on cost, the Department will calculate and report a contingent liability, with a corresponding increase in Other Assets, for estimated contractor incurred costs in excess of progress payments. By reporting a contingent liability, the Department recognizes the potential outflow of future resources that is conditional upon the contractor's delivery and Government acceptance of the product/service.

S. <u>Contingencies and Other Liabilities</u>

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DLA recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting disclosure is limited when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The DLA's loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as vehicle accidents, property damages or damages related to the environment, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the DLA assets. This type of liability has two components: environmental and nonenvironmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the DoD's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of Federal Government."

The DLA is a party in various administrative proceedings, legal actions, and claims brought against the agency. In the opinion of DLA management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of DLA.

T. Accrued Leave

Military and civilian leave is accrued as earned. The accrued amounts are reduced for actual leave taken and increased for leave earned. Military accrued leave balances are reported on the respective Military Department financial statements. The balances for civilian accrued leave are adjusted quarterly to reflect changes. The balances for military and civilian leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of non vested leave are expensed as taken. As a DWCF, DLA is required by the DoD FMR to fund civilian accrued leave earned but not taken.

U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations: The DLA unexpended WCF appropriations represent amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Result of Operations: This represents the excess of revenues over expenses less refunds to customers and returns to the US Treasury since fund inception.

Beginning with FY 1998, the cumulative results of operations also include transfer in and out assets without reimbursement.

V. Treaties for Use of Foreign Bases

The DLA has the use of land, buildings, and other facilities, which are located overseas and were obtained through various international treaties and agreements negotiated by the Department of State. The DLA purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow DLA components continued use of these properties until the treaty expires. The DLA's fixed assets decrease when a treaty is not renewed or if an agreement cannot be reached. Therefore, when treaties or other agreements are terminated, and use of a foreign base is prohibited, losses are recorded for the value of any nonretrievable capital assets. The value recorded is net of the amount negotiated between the US and the host country that is paid to the US for such capital assets.

W. Comparative Data

Fluctuations between FY 2005 and FY 2006 are explained in the Notes to the Financial Statements for the Balance Sheet, the Statement of Changes in Net Position, and the Statement of Net Costs. An explanation is provided when a comparative period variance is either greater than 10% or the variance exceeds 2% of total assets.

X. Unexpended Obligations

The DLA obligates funds to provide goods and services for outstanding orders not yet delivered. The Statement of Changes in Net Position does not reflect a liability for payment of goods and services not yet delivered. This information is available on the Statement of Budgetary Resources.

Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the US Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. Intransit payments are those payments that have been made to other agencies or entities that have not been recorded in the accounting records. These payments are applied to the entities' outstanding accounts payable balance. Intransit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

As the specific nature (federal/nonfederal) of the undistributed transactions is not known, DLA follows DoD policy, as stated in DoD FMR Volume 6B, Chapter 4, to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed disbursements are recorded in other liabilities. Actions are on going in conjunction with DFAS to improve the reconciliation process to support these adjustments.

Note 2. Nonentity Assets

As of September 30	2006	2005
(Amounts in thousands)		
Nonfederal Assets		
Cash and Other Monetary Assets	$ 7,970	$ 18,952
Accounts Receivable	2,481	2,910
Total Nonfederal Assets	$ 10,451	$ 21,862
Total Nonentity Assets	$ 10,451	$ 21,862
Total Entity Assets	$ 21,448,191	$ 19,772,023
Total Assets	$ 21,458,642	$ 19,793,885

Fluctuations and Abnormalities

The total nonentity assets decreased by $11.4 million or 52% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

Nonfederal cash and other monetary assets decreased by $11.0 million. The collections held for others decreased $8.6 million due to a process change in the 3rd Quarter, FY 2006. Previously, sales proceeds collected by Defense Reutilization and Marketing Service (DRMS) that include amounts owed to another agency or transferable to another account were held in suspense until all transfers were completed, and then the remaining sales proceeds were transferred to the DRMS Working Capital Fund account. In the current process, proceeds are collected into the DRMS Working Capital Fund account, and only the amount required to be returned is transferred to the suspense account and then forwarded on to the appropriate account or activity.

A decrease of $2.4 million in bid deposits is attributable to the reduction of National term sale contracts in the 3rd and 4th Quarter, FY 2006. This occurred as a result of the issuance of the Scrap Venture partnership contract in the 4th Quarter, FY 2005. The contract replaced hundreds of term scrap contracts that are now being closed out with the remaining bid deposits returned to the contractor.

Information Related to Nonentity Assets

Asset accounts are categorized as either entity or nonentity. Entity accounts consist of resources that the agency has the authority to use or that management is legally obligated to use to meet entity obligations. Nonentity accounts are assets that are held by an entity, but are not available for use in the operations of the entity.

Cash and other monetary assets: Cash consists of cash resources under the control of the Defense Logistics Agency.

Restriction on cash: The $8.0 million in cash primarily represent bid deposits or prepayments received by DRMS still remaining in suspense accounts as of September 30, 2006. In accordance with Department of Defense Financial Management Regulation Volume 11A, Chapter 5, bid deposits, otherwise known as prepayments are recorded in suspense account X6501. At the time the successful bid selection is made, these funds are collected from the successful bidder(s) and held until the end of the contract to cover any unpaid bills. After contract closeout, any remaining prepayment is refunded to the sales contractor. The DRMS is also required, by regulation, to return a portion of sales proceeds for certain types of property to other accounts. Proceeds due to other activities or funds are held temporarily in the same account as the prepayments. For financial statement presentation these collections are shown as nonentity assets.

Nonfederal accounts receivable: The $2.5 million consists of interest and penalties that are related to the nonfederal accounts receivable that have been referred to Defense Finance and Accounting Service Debt Management for collection. This amount is nonentity because upon collection, the amount will be transferred to Treasury. An offsetting liability has been recorded to account for this action.

Note 3. Fund Balance with Treasury

Information Related to Fund Balance with Treasury

The fund balance with treasury (FBWT) is an asset account that reflects the available budget spending authority. This represents the total of all unobligated and obligated, but not yet disbursed, account balances. It also includes collections with the Department of the Treasury (Treasury) as reflected on the financial records of Defense Logistics Agency (DLA).

Fund Balances with Treasury (FBWT) versus Agency-Fund Balance with Treasury

The Department of Defense (DoD) maintains the Defense Working Capital Fund (DWCF) FBWT at the Treasury appropriation symbol level. All Defense Agencies that are part of the DWCF transfer the FBWT recorded in the financial records to the DoD Other Defense Organization (ODO) level. Thus DLA WCF entities do not report FBWT on the financial statements.

Status of Fund Balance with Treasury

As of September 30	2006		2005	
(Amounts in thousands)				
Unobligated Balance				
Available	$	(30,820)	$	(35,476)
Obligated Balance not yet Disbursed	$	13,840,699	$	15,342,337
NonFBWT Budgetary Accounts	$	(12,906,483)	$	(14,510,651)
Total	$	903,396	$	796,210

Fluctuations and Abnormalities

The total status of FBWT increased by $107.2 million or 13% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006. The increase is mainly attributed to higher contract authority received for increased program requirements for higher fuel prices and higher product quantities and prices for FY 2006. Most of these requirements are related to Global War on Terrorism and other war related efforts.

Unobligated balance available increased by $4.7 million or 13%. The increase is primarily due to an adjustment in Document Automation and Production Service to adjust the balance of Contract Authority. An analysis of the unobligated balance since inception, found Contract Authority to be understated.

Obligated balance not yet disbursed decreased by $1.5 billion or 10%. The Distribution Depot Center's balance decreased $248.7 million or 34% due to Over Ocean Transportation undelivered orders that were drawn down and closed in 1st Quarter, FY 2006. Nonenergy supply's undelivered orders decreased by $748.0 million primarily in response to reductions in customer demand during FY 2006. The Defense Energy Supply Center's (DESC) balance had an overall decrease of $198.0 million due to a decrease in orders related to minimum price guarantee contracts. For 4th quarter, FY 2006 the overall reduction in the quantity for these contracts was at a higher rate than the offsetting increases in the price resulting in an overall reduction in the orders.

NonFBWT budgetary accounts balance increased by $1.6 billion or 11%. The increase is primarily due to contract authority liquidated, which is equal to the amount of funds collected, received from appropriations, and cash transfers. The net increase in nonFBWT accounts is mainly attributed to higher sales price per barrel of fuel, which resulted in a higher contract authority liquidated in FY 2006 versus FY 2005.

Other Information Related to Fund Balance with Treasury

The status of FBWT consists of unobligated balances and obligated balances not yet disbursed. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the status includes various accounts that affect either budgetary reporting or FBWT, but not both.

Unobligated balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated balance is classified as available or unavailable.

Obligated balance not yet disbursed represents budgetary authority that has been obligated for goods or services that have not yet been paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which do not have budgetary authority, such as clearing accounts.

NonFBWT budgetary accounts represents budgetary account balances that do not have FBWT, such as contract authority. This category reduces the status of FBWT.

The DLA does not have unobligated balances for restricted future use and are not apportioned for current use.

Disclosures Related to Suspense/Budget Clearing Accounts

Not applicable for DLA Working Capital Fund.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
(Amounts in thousands)				
Total Problem Disbursements, Absolute Value				
Unmatched Disbursements (UMDs)	$ 36,615	$ 70,884	$ 66,862	$ (4,022)
Negative Unliquidated Obligations (NULO)	1,453	564	1,603	1,039
Total In-transit Disbursements, Net	$ (7,739)	$ (776)	$ 83,599	$ 84,375

Fluctuations and Abnormalities

The negative unliquidated obligation (NULOs) increased by $1.0 million, or 184% from 4th Quarter, FY 2005 compared to 4th Quarter, 2006. Of this variance, $220.0 thousand has been coordinated with DLA's Field Support Offices and is awaiting obligation and receipt documentation. Discrepancies between billings and disbursements account for $170.0 thousand. There were $303.0 thousand in payments to an incorrect line of accounting after a Schedule of Withdrawal and Credits Voucher (SF1081) cut off deadline. Due to this missed cut off, a manual posting to the accounting records resulted in the NULO. Due to a reconciliation of Powertrack transactions, there remains an amount of $68.0 thousand that is a NULO. The remainder of the variance is attributable to backlogs made up of numerous small dollar transactions.

The intransits increased by $84.4 million or 100% for 4th Quarter, FY 2006 compared to 4th Quarter, FY 2005. Of this increase, $38.4 million are net disbursements caused by transactions that post to the default account due to the submission of erroneous reporting data elements into the Headquarters Accounting and Reporting System. These transactions are systemically corrected through the interfund clearance reporting process. These transactions are posted to Treasury and are included as intransit amounts for DLA, however, these amounts are not posted to any trial balance until they are researched by DFAS and posted to the proper appropriation. In September 2005, the transactions in the default account were not inclusively reported to DLA WCF. As of 1st Quarter, FY 2006, these transactions were, and continue to be included in DLA intransit numbers.

In the fuels business entity, $5.8 million of interfund transactions are uncleared due to Bunkers Open Market processing. These transactions originate from mobile disbursing stations on ships and require extensive review due to insufficient information.

Due to improved and refined processes regarding the classification and reporting of intransit and unmatched disbursement amounts, differences exist in comparison of prior year and current year amounts and are explained according to Columbus Cash Accountability System (CCAS) Tier classifications.

Tier 3 represents differences between what has been posted by DFAS Accounting Operations Division to Defense Disbursing Analysis Reporting System (DDARS). This Tier is the responsibility of Accounting Operations staff to resolve outstanding transactions and includes transactions classified as an Intransit, Received Awaiting Processing (RAP). In CCAS, historically, classification of intransits or UMDs was dependent upon whether there is an interface from the source of the transaction or DDARS into the respective accounting system. For those in which an interface exists, the UMD classification was given. For those in which the interface does not exit, the intransit, RAP classification was given.

A process change occurred in FY 2006 where Intransit (RAP) transactions that were partially processed are now presented as UMDs. The affect of this accounting change includes where previously the net dollar value of an intransits is now presented as an absolute dollar value of an UMD. The net dollar value of this impact on reclassifications to intransits in September 2006 when compared to September 2005 data is $22.8 million. The business area and corresponding amounts affected by this process change are as follows: BSM - $10.2 million, fuels – $(1.1) million and Stockfund - $13.6 million.

In addition, due to the close out of the legacy Defense Integrated Subsistence Management System and associated transfer of data to Business Systems Modernization (BSM), $6.1 million remains as intransit data.

Other Information Related to Problem Disbursements

Problem Disbursements (PD) are reported as an absolute value amount. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus). Below is a description of each type of PD:

- A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

- A NULO occurs when a payment is made against a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

- The Intransits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity that have not been posted to the accounting system.

Note 4. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
Intragovernmental Receivables	$ 857,284	N/A	$ 857,284	$ 995,583
Nonfederal Receivables (From the Public)	$ 603,512	$ (33,432)	$ 570,080	$ 571,419
Total Accounts Receivable	$ 1,460,796	$ (33,432)	$ 1,427,364	$ 1,567,002

Fluctuations and/or Abnormalities

Total accounts receivable decreased by $139.7 million or 9% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

Intragovernmental receivables decreased by $138.3 million or 14%. The decrease resulted from reductions in the construction and equipment supply chain of $33.8 million and the subsistence supply chain of $27.7 million from reduced demand from the Services and foreign military sales. These sales reductions relate to combat uniforms, extreme cold weather clothing systems, footwear, modular sleep systems, communications hardware, bastions and fencing, facilities maintenance, lumber, industrial plant equipment (boring mills, pipe benders, diesel engines and dehumidifiers) throughout FY 2006. Additionally, the prime vendor programs (Maintenance, Repair and Operations, Dive and Fire programs) also decreased during FY 2006.

In addition, Business System Modernization (BSM) receivables decreased by $38.0 million from delayed billings in 4th Quarter, FY 2006. BSM energy decreased by $9.9 million from a combination of reduced sales and increased collections during FY 2006.

Nonfederal receivables decreased by $1.3 million or 0.2%.

Information Related to Accounts Receivable

Allowance for Estimated Uncollectibles: The primary method the Defense Logistics Agency (DLA) uses for calculating the allowance for estimated uncollectible amounts is the percentage method. The Defense Energy Support Center (DESC) uses the historical average method. The Defense Logistics Information Service and DESC Missile Fuels use the direct write-off methodology because of the limited amount of write-offs done by these activities.

Aged Accounts Receivable

As of September 30	2006		2005	
	Intra-governmental	Nonfederal	Intra-governmental	Nonfederal
(Amounts in thousands)				
CATEGORY				
Nondelinquent				
Current	$ 738,330	$ 185,897	$ 627,097	$ 285,263
Noncurrent	189,408	111,447	217,968	84,145
Delinquent				
1 to 30 days	$ 34,135	$ 93,064	$ 70,572	$ 65,626
31 to 60 days	21,348	23,998	2,942	40,675
61 to 90 days	1,541	52,032	21,827	11,678
91 to 180 days	17,800	42,525	42,440	67,867
181 days to 1 year	23,570	50,526	48,467	43,040
Greater than 1 year and less than or equal to 2 years	19,560	35,725	43,050	24,814
Greater than 2 years and lessthan or equal to 6 years	10,023	13,480	6,611	1,313
Greater than 6 years and lessthan or equal to 10 years	(12)	1,245	(53)	(25)
Greater than 10 years	0	1,443	0	0
Subtotal	$ 1,055,703	$ 611,382	$ 1,080,921	$ 624,396
Less Supported Undistributed Collections	(56,447)	(7,871)	(53,592)	(18,381)
Less Eliminations	(141,973)	0	(31,748)	0
Total	$ 857,283	$ 603,511	$ 995,581	$ 606,015

Aged Accounts Receivable

Delinquent intragovernmental accounts receivables over 30 days is $93.8 million. This amount includes $29.6 million outside DoD.

For the receivables within DoD, $59.0 million is related to military service customers requisitioning supply items from DLA outside the interfund system. These bills are reviewed to determine whether they should have been billed through the interfund system or the Intragovernmental Payment and Collection (IPAC) system. In cases where the billing is through the IPAC system, customers may reject bills until they validate and reconcile the amount. Of the remaining balance, $36.9 million, relates to problems in matching detail billings to various

Military Interdepartmental Purchase Requests; and $3.9 million is related to billing and classification errors.

For the accounts receivable outside DoD, $11.7 million is related to delinquent receivables due from the Department of Education in Puerto Rico. The DLA has been working with the account manager on open bills and determined that $7.3 million was collected in September but posted to a suspense account. The remaining balance is still being pursued. Of the remaining balance, $5.5 million is currently being reconciled with General Services Administration and National Aeronautical and Space Administration on the detail backup, and $5.0 million relates to refunds due from the Internal Revenue Service for federal excise taxes on fuels.

Delinquent nonfederal accounts receivable over 30 days is $221.0 million. Of this amount, DLA and Defense Finance and Accounting Service (DFAS) are actively pursuing $203.0 million. The remaining balance of $18.0 million is in the following debt categories: In litigation, $8.2 million; in bankruptcy, $6.2 million; in dispute with Deferment/Contract Appeals Board, $2.9 million; and at Department of Treasury for cross-servicing or offsets, $0.7 million.

The DLA was only recently able to produce dunning letters from the BSM system. The first letters were produced at the end of May, 2006 and sent to customers in early June, 2006. With the BSM dunning process now in place, further reductions in delinquent accounts receivable balances will occur as customers make payments or as DLA refers the delinquent debt to the DFAS Debt Management Office.

Note 5. Other Assets

As of September 30	2006	2005
(Amounts in thousands)		
Intragovernmental Other Assets		
Other Assets	$ 124,925	$ 124,925
Total Intragovernmental Other Assets	$ 124,925	$ 124,925
Nonfederal Other Assets		
Outstanding Contract Financing Payments	$ 59,591	$ 195,680
Other Assets (With the Public)	750	1,088
Total Nonfederal Other Assets	$ 60,341	$ 196,768
Total Other Assets	$ 185,266	$ 321,693

Fluctuations and Abnormalities

Total other assets decreased by $136.4 million or 42% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

The total nonfederal other asset decreased by $136.4 million, or 69%. The outstanding contract financing payments decreased by $136.1 million or 70% for 4th Quarter, FY 2006. The decrease is a result of Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service (DFAS) comprehensive validation of all progress payments open in the accounting system to the payment records. This validation began in 2nd Quarter, FY 2005, and is expected to be completed in 1st Quarter, FY 2007. The largest decrease in FY 2006, $128.8 million, occurred in Clothing & Textile (C&T) supply chain. Of the $128.8 million, 70% was due to the close-out of progress payments for contractors who had filed for bankruptcy or are out-of-business and 30% was due to the lack of sufficient supporting documentation to substantiate the account balance. The remainder of the decrease in outstanding contract financing payments is due to routine C&T contractor performance and delivery.

<u>Information Related to Other Assets</u>

Other assets are those not reported in a separate category on the balance sheet. They include other intragovernmental advances and prepayments to other federal entities. Advances are cash outlays made by a federal entity to other federal entities as advance payments for the costs of goods and services the entity receives. Prepayments are payments made by a federal entity to cover certain periodic expenses before those expenses are incurred.

Nonfederal other assets consist primarily of contract financing payments to vendors for materiel purchases. The DLA accounts for contract financing payments (progress payments) per guidance from the Department of Defense Financial Management Regulation for fixed price contracts performed by Defense contractors. These financing payments are generally for long lead-time items and the majority of DLA payments are in the C&T supply chain. There are two types of financing payments: one is based on percentage-of-completion and the other based on costs. The DLA, in conjunction with DFAS, is conducting a validation of outstanding contract financing payments.

Contract terms and conditions for certain types of contract financing payments convey certain rights to the DLA that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the government. The government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and DLA is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

Beginning in 4th Quarter, FY 2006, Department of Defense implemented a change in the financial reporting practices for progress payments based on cost, a type of contract financing payment that is authorized in contracts that include the Federal Acquisition Regulations contract clause 52.232-16, “Progress Payments.” Specifically, when the contract authorizes progress payments based on cost, DLA will calculate and report a contingent liability, with a corresponding increase in other assets, for estimated contractor incurred costs in excess of the progress payments made. By reporting a contingent liability, DLA recognizes the potential outflow of future resources that is conditional upon the contractor’s delivery and government acceptance of the product/service.

The outstanding contract financing payment balance of $59.6 million is comprised of $50.0 million in contract financing payments and an additional $9.6 million in estimated future funded payments that will be paid to the contractor upon future delivery and government acceptance of a satisfactory product.

Other assets with the public includes amounts for travel advances made to military and civilian employees, and civilian employee salary advances.

Disclosure Related to Intragovernmental Other Asset

The DLA reported a prior period adjustment of $124.9 million in 4th Quarter, FY 2006 to recognize as an other asset the right to approximately 6.4 million barrels of crude oil held by the Department of Energy (DoE) on behalf of the Department of Defense (DoD). Legislation enacted in November 1992 Public Law 102-396, Sec. 9149 provided appropriations and established the requirement for DoE to acquire and maintain a strategic petroleum reserve for national defense purposes. Section 9149 provided $125.6 million to DoD, to be transferred to DoE for the acquisition, storage and drawdown of such reserve. Proceeds of any sales of this reserve will be deposited to the accounts of, and remain available to DoD until expended. The funds were provided to DoE in FY 1993 to acquire the reserve, however due to an accounting error, the full balance of the transaction with DoE was expensed in DoD Agency-wide Statement of Net Cost in FY 1993 and no asset was established. This prior period adjustment establishes the original appropriation amount of $125.6 million, less $0.7 million that the law allowed DoE to use to offset certain costs as an other asset in DLA’s Balance Sheet (refer to disclosures in Notes 5 and 16), with an adjustment to DLA Beginning Net Position for FY 2006 and FY 2005. The difference between the amount appropriated and the balance recognized as other assets represents the reimbursement of costs to DoE of acquiring and storing the inventory. The DoE reports this crude oil in inventory in their financial statements, with an offsetting custodial liability to DoD. To date none of the reserve has been drawn upon, thus the full inventory remains on hand with DoE. By law, the reserve cannot be drawn down or released to DoD without the President (with the advice of the Secretary of Defense) making findings under Section 161(d) of the Energy Policy and Conservation Act (42 USC 6241(d)).

Note 6. Cash and Other Monetary Assets

As of September 30	2006	2005
(Amounts in thousands)		
Cash	$ 12,100	$ 19,463
Total Cash, Foreign Currency, & Other Monetary Assets	$ 12,100	$ 19,463

<u>Fluctuations and Abnormalities</u>

The cash decreased by $7.4 million or 38% between 4th Quarter, FY 2005 to 4th Quarter, FY 2006. The main drivers were decreases of $11.0 million in collections held for others and bid deposits held by Defense Reutilization and Marketing Service (DRMS).

The collections held for others decreased $8.6 million due to a process change in the 3rd Quarter, FY 2006. Previously, sales proceeds collected by DRMS that include amounts owed to another agency or transferable to another account were held in suspense until all transfers were completed, and then the remaining sales proceeds were transferred to the DRMS Working Capital Fund account. In the current process, proceeds are collected into the DRMS Working Capital Fund account, and only the amount required to be returned is transferred to the suspense account and then forwarded on to the appropriate account or activity.

A decrease of $2.4 million in bid deposits is attributable to the reduction of national term sale contracts in the 3rd and 4th Quarter, FY 2006. This occurred as a result of the issuance of the Scrap Venture partnership contract in the 4th Quarter, FY 2005. The contract replaced hundreds of term scrap contracts that are now being closed out with the remaining bid deposits returned to the contractor.

This decrease was offset by a $3.6 million increase in cash at Document Automation and Production Service. Beginning the with 1st Quarter, FY 2006, Defense Finance and Accounting Service changed the process of accounting for checks received from customers for services or refunds. Customer checks are deposited to Treasury accounts and until they have cleared the customer's bank account, they are classified as undeposited collections, other monetary assets. When customer checks have cleared they are recorded as cash collections in fund balance with Treasury.

<u>Information Related to Cash and Other Monetary Assets</u>

Cash consists of cash resources under the control of the Defense Logistics Agency. When DRMS enters into a long-term contract with a buyer purchasing excess/surplus government property or scrap, DRMS requires a prepayment. These prepayments are classified as restricted cash and held until the close of the contract to cover any unpaid bills. Of the $12.1 million in cash, $8.0 million is classified as restricted cash.

Note 7. Inventory and Related Property

As of September 30	2006	2005
(Amounts in thousands)		
Inventory, Net	$ 17,904,388	$ 15,980,584
Operating Materials & Supplies, Net	8,705	9,124
Total	$ 17,913,093	$ 15,989,708

Inventory, Net increased by $1.9 billion or 12% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006. The major portion of the inventory variance is explained in the following section.

Inventory, Net

As of September 30	2006			2005	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
(Amounts in thousands)					
Inventory Categories					
Available and Purchased for Resale	$ 17,945,875	$ (55,072)	17,890,803	$ 15,974,935	LAC,MAC
Held for Repair	20,255	(6,670)	13,585	5,649	LAC,MAC
Excess, Obsolete, and Unserviceable	7,239,828	(7,239,828)	0	0	NRV
Total	$ 25,205,958	$ (7,301,570)	17,904,388	$ 15,980,584	

Legend for Valuation Methods:	
Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses	NRV = Net Realizable Value
SP = Standard Price	O = Other
AC = Actual Cost	MAC = Moving Average Cost

Fluctuations and Abnormalities

Inventory available and purchased for resale, net increased by $1.9 billion or 12% between 4th Quarter, FY 2005 to 4th Quarter, FY 2006. Beginning in 4th Quarter, FY 2000, Defense Logistics Agency (DLA) began the transition from the legacy supply systems to the Business Systems Modernization (BSM) and 4th Quarter, FY 2005 for BSM Energy (BSM-E). The BSM initiative is a movement to an integrated system managed by supply chain and projected to be completed 1st Quarter, FY 2007. With the migration into BSM and BSM-E from the legacy systems, the changes in net inventory value are shown in Table 1.

Table 1 (Trial Balance data)

Dollars in millions	Legacy	BSM/BSM-E	Net Change
Energy	$0.00	$792.9	$792.9 Million
NonEnergy	($7,031.3)	$7,973.3	$942.3 Million

The Energy inventory increase of $792.9 million resulted from an increase in cost/barrel of $14.98/barrel, from $68.48/barrel in FY 2005 to $83.46/barrel in FY 2006. In addition, inventory quantity decreased by approximately 0.4 million barrels mbbls, from 59.3 mbbls in FY 2005 to 58.9 mbbls in FY 2006. This increase was offset by a reduction in the inventory accrual due to reporting monthly accruals starting in 3rd Quarter, FY 2006, where previously accruals were posted at yearend based upon Stock Points physical inventory counts.

The DLA increased its Nonenergy inventory levels by $1.1 billion during FY 2006 to ensure optimum customer support, to meet congressionally mandated objectives and in anticipation of future demand. An increase of $561.8 million in inventory levels is attributed to the long lead time associated with the inventory pipeline and to a decrease in demand by the services for such items as: army combat uniforms, extreme cold weather clothing systems, footwear, and modular sleep systems, bastions, fencing sandbags, space heaters, tent heaters, construction equipment, and pallets. Aviation hardware increased by $120.0 million primarily due to an increase in customer returns from the services. In addition, DLA experienced a $201.0 million increase in Subsistence driven by increases in Meals Ready to Eat (MRE), due to purchases (3.18 million cases) to reach the increased congressionally mandated objective of 5.0 million cases and the 0.25 million case disaster reserve for use by the Federal Emergency Management Agency (FEMA), and a $4.62 increase in the cost per MRE case. The change in valuation as inventory moved from the Standard Automated Materiel Management System (Adjusted LAC basis) to BSM (Moving Average Cost (MAC) basis) resulted in an increase of $39.0 million.

<u>Other Information Related to Inventory, Net</u>

The total gross value of available and purchased for resale amount is composed of materiel in BSM, BSM-E and legacy systems in Table 2 (in millions):

Table 2

System	Inventory Gross Value	Valuation Method
BSM	$ 12,348.4	MAC
BSM-E	$ 5,012.2	Transactional FIFO
Legacy	$ 585.3	Adjusted LAC
Total	$ 17,945.9	

Restrictions of Inventory Use, Sale, or Disposition: Inventory in litigation (condition code L) is materiel held pending litigation or negotiation with contractors or common carriers, and remains in condition code L until the litigation is negotiated or settled. The balance as of September 30, 2006 was $89.9 million.

Decision Criteria for Identifying the Category to which Inventory is assigned:
In order to standardize reporting of the categories serviceable, unserviceable and excess, obsolete and unserviceable, DLA implemented the Under Secretary of Defense (Comptroller) (USD(C)) condition code crosswalk as defined in the memorandum, "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies."

Inventory Category	Condition Code
Serviceable	A, B, C, D
Unserviceable	E, F, G, H, J, K, L, M, N, R
Excess, Obsolete, Unserviceable	H, P, S

<u>Minimum Inventory Levels</u>

The DLA has congressionally mandated minimum levels of specific inventory items. These items are not necessarily restricted on use, rather these are mandated minimum levels for DLA, which drive fluctuations in the DLA inventory levels. The MRE have a congressionally mandated level of 5.0 million cases. In addition, MRE have a disaster reserve level of 250,000 cases for use by the FEMA, Department of Homeland Security.

Petroleum inventories are comprised mostly of military specification products and are stocked primarily to meet wartime operation plans and ensure that DLA has sufficient stocks in place to minimize any risk to the war fighter. Wartime petroleum requirements are calculated by military services and vetted through Combatant Commanders; DESC then works with the Combatant Commanders to position those stocks where space permits and within the funded volumes. The current wartime stockage objective is 33.4 mbbls. Peacetime bulk petroleum inventory requirements are calculated by DESC in accordance with guidelines provided by USD(C) and are positioned by DESC prior to placing war reserve inventories. The peacetime objective is 26.8 mbbls. These inventories are not physically segregated in tankage, meaning that wartime (appropriated funded) stocks can be used to meet peacetime (working capital funded) requirement.

Operating Materials and Supplies, Net

As of September 30	2006			2005	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
OM&S Categories					
Held for Use	$ 8,705	$ 0	$ 0	$ 9,124	SP, MAC
Total	$ 8,705	$ 0	$ 8,705	$ 9,124	

Legend for Valuation Methods:

MAC = Moving Average Cost
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
O = Other

<u>Information Related to OM&S</u>

The DLA Operating Materials and Supplies (OM&S) are classified as "held for use" and are held by the Document Automation and Production Service (DAPS).

The OM&S are composed primarily of paper and toner, as well as CD-ROM disks. The DAPS uses an assorted variety of paper, in size, color, and texture/weight. These materials and supplies are consumed in the production of end products for DAPS customers. The use of CD-ROM disks is increasing due to technological improvements to the automated production of electronic documents. The OM&S are accounted for using the consumption method.

The DLA has no restrictions on the use of OM&S.

Note 8. General PP&E, Net

As of September 30	2006					2005
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
Major Asset Classes						
Buildings, Structures, and Facilities	S/L	20 Or 40	$ 1,829,395	$ (1,147,474)	$ 681,921	$ 742,786
Software	S/L	2-5 Or 10	1,112,485	(405,284)	707,201	762,938
General Equipment	S/L	5 Or 10	621,120	(382,734)	238,386	228,906
Construction-in-Progress	N/A	N/A	293,300	N/A	293,300	161,389
Other			32	(21)	11	0
Total General PP&E			$ 3,856,332	$ (1,935,513)	$ 1,920,819	$ 1,896.019

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable

<u>Other Information Related to General PP&E, Net</u>

Other represents a net asset total related to a problem in BSM regarding Multi-Use Heritage Assets. The Asset Class that the DSCC O Club (previously considered a multi-use heritage asset) was assigned to was built incorrectly in BSM. No change was done this quarter to this record while DLA was attempting to make an asset class determination. DLA has concluded that DSCC O Club did not meet the requirements of a Multi-Use Heritage Asset. This problem should be corrected in future financial statements.

There are no known restrictions on the use or convertibility of general PP&E.

<u>Other Disclosures Related to General PP&E</u>

Stewardship Land and Heritage Assets

Stewardship land and heritage assets are resources that protect, restore, enhance, modernize, preserve and sustain mission capabilities within the DLA through effective planning and management of natural and cultural resources to guarantee access to all such assets in its possession. While DLA has no stewardship assets, its heritage assets are resources that are managed to provide multiple use activities for the public benefit to include compliance with required federal laws, executive orders, DoD policies, final governing standards and other binding agreements.

The DLA mission is to provide best value logistics support to America's Armed Forces, in peace and war around the clock, around the world. The DLA has heritage assets that are resources that we protect and preserve as part of the DLA mission and for public benefit. Part of the DLA mission is stewardship responsibility in maintaining national treasures of historical significance. The DLA heritage assets consist of one monument and two cemeteries which have cultural value and two buildings which have historical value. The DLA is committed to maintain these resources to ensure the historical integrity for years to come.

<u>Monuments & Memorials</u>: The DLA Defense Supply Center – Richmond (DSCR) has one monument, the Native American Monument, established to honor the Native American culture.

<u>Cemeteries</u>: The DSCR has established two cemeteries: One contains African American remains unearthed during the construction of a child development center, and the other is for the Gregory family. The Gregory was one of the families that had owned the property prior to its acquisition by the US Government.

<u>Buildings & Structures</u>: Executive Order 11593 regarding the protection and enhancement of the cultural environment established Bellwood, Chesterfield County, Virginia in the National Register. Operated by the DSCR, the Bellwood Home is an early 19th Century plantation house.

Building 280, Marine Barracks, Pearl Harbor, Hawaii is a World War II wooden barracks identified as a historic asset. This building is partially occupied by personnel from the Defense Supply Center Philadelphia – Pacific as a tenant with the financial responsibility for sustainment. The DLA occupied portion of the building has been renovated and is in good repair.

Other Disclosures Related to General PP&E for Heritage Assets

The DLA reports insignificant restrictions on the use or convertibility of general PP&E for heritage assets associated with the Department of Historical Preservation under the state and other minor restrictions as such by the installation host(s) where DLA is a tenant activity through real-estate agreements and Interdepartmental Service Support Agreements.

Other Information Related to Assets Under Capital Lease

The DLA has contracted with a third party to review DLA's leases to determine which are capital or operating leases. This contract commenced 4th Quarter, FY 2006 and will be completed 2nd Quarter, FY 2007. The DLA is developing guidance which will be issued in a subsequent period to appropriately record this asset in the financial statements.

As of the 4th Quarter, FY 2006, DLA currently has at least one capital lease. The Defense Supply Center Columbus has an ambulance under lease which was entered into October 2000 for a period of seven years at a monthly rental of $2.3 thousand. Part of the monthly rental payment is $270 for maintenance, because DLA does not have the inherent capability to properly maintain the ambulance. Due to current system limitations, DLA is unable to properly report this asset on the financial statements. Currently, the lease liability is recorded as a part of accounts payable and the asset is not recognized as part of PP&E. Had DLA been able to capture this data properly in the accounting system, the acquisition cost of the asset would be recorded as $137.0 thousand with accumulated depreciation of $117.4 thousand, for a net book value of $19.6 thousand.

Note 9. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
Intragovernmental Liabilities		
Other	$ 34,968	$ 60,208
Total Intragovernmental Liabilities	$ 34,968	$ 60,208
Nonfederal Liabilities		
Military Retirement and Other Federal Employment Benefits	$ 253,171	$ 273,302
Environmental Liabilities	87,152	38,358
Other Liabilities	17,752	51
Total Nonfederal Liabilities	$ 358,075	$ 311,711
Total Liabilities Not Covered by Budgetary Resources	$ 393,043	$ 371,919
Total Liabilities Covered by Budgetary Resources	$ 3,423,818	$ 3,112,756
Total Liabilities	$ 3,816,861	$ 3,484,675

Information Related to Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources: Those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date.

Other Disclosures:

The intragovernmental liabilities, other consists of amounts accrued for Federal Employees' Compensation Act and amounts due representing interest receivable on overdue public accounts receivable that must be remitted to the Department of the Treasury upon receipt.

The nonfederal liabilities, other consists of contingent legal liabilities deemed probable. Starting 3rd Quarter, FY 2006, in accordance with Department of Defense guidance, this category also includes an accrual for civilian employee compensatory time and credit hours earned but not used.

Note 10. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
Intragovernmental Payables	$ 93,288	$ N/A	$ 93,288	$ 136,891
Nonfederal Payables (to the Public)	3,030,456	1,926	3,032,382	2,664,567
Total	$ 3,123,744	$ 1,926	$ 3,125,670	$ 2,801,458

Fluctuations and Abnormalities

Total payables increased by $324.2 million or 12% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

Intragovernmental payables decreased by $43.6 million or 32%. This is driven primarily by a decrease of $41.4 million due to aggressive efforts during FY 2006 by the Defense Logistics Agency (DLA) to reduce overaged accounts payables.

Nonfederal payables increased by $367.8 million or 14%. This is driven by an increase of $348.0 million in fuel costs, $68.48/barrel in FY 2005 and $83.46/barrel in FY 2006 an increase of $14.98/barrel or 22%. Nonenergy supply increased by $391.4 million primarily due to delayed vendor invoicing and payment due to the migration into Business System Modernization. These increases were offset by a number of decreases. There was a $233.4 million decrease in Over Ocean Transportation (OOT) payables, primarily due to a reduction of expected OOT payable accruals that the United States Transportation Command did not bill at the expected level. In addition there was a $92.8 million decrease due to aggressive efforts during FY 2006 by the Defense Logistics Agency (DLA) to reduce overaged accounts payables, and for an increase in processing disbursements. Beginning in 4th Quarter, FY 2006, there was a change in the way Federal Employees Compensation Act liabilities were recognized, resulting in a $19.5 million reduction in nonfederal accounts payable. The other major reduction was $17.5 million related to a 1st quarter FY 2006 change in reporting probable contingencies for Distribution as another liability instead of as a payable.

Information Related to Accounts Payable

Intragovernmental accounts payable consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Nonfederal payables include amounts owed to nonfederal government entities.

Note 11. Environmental Liabilities and Disposal Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Environmental Liabilities-- Nonfederal				
Accrued Environmental Restoration Liabilities				
Environmental Corrective Action	$ 27,148	$ 76,988	$ 104,136	$ 40,412
Total Environmental Liabilities	$ 27,148	$ 76,988	$ 104,136	$ 40,412

Fluctuations and Abnormalities

Total environmental liabilities increased by $63.7 million or 158% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

An increase in Defense Energy Support Center (DESC) of $48.8 million is a result of changes in the Remedial Action Cost Engineering Requirements (RACER) estimate. This increase was primarily the result of additional sites where a leak or spill from a fuel tank had occurred and estimated clean up liability had been identified. The most significant of the above increases, identified in 1st Quarter, FY 2006, was a $17.7 million increase due to a leak from a fuel tank at the Defense Fuel Supply Point at Point Loma, California. The remaining $14.9 million increase, of the $63.7 million total increase, resulted from DESC not including in the FY 2005 statements the prior year carryover of undelivered orders from environmental clean up contracts as part of the estimated liability.

General Disclosures (WCF)

Environmental disclosures are not applicable to the Defense Logistics Agency (DLA) Working Capital Fund. Disclosure of amounts related to the unrecognized portion of the estimated total cleanup cost associated with general property, plant, and equipment (PP&E) and the estimated cleanup costs associated with PP&E placed into service during each fiscal year will be disclosed in future periods once DLA has implemented the process to record this data. DLA has no changes in environmental liabilities (EL) related to changes in total cleanup costs due to changes in laws, regulations, and/or technology. DLA has no changes in EL related to the portion of changes in estimated costs due to changes in laws and technology that is related to prior periods.

The majority of DLA's EL are from out-year RACER estimates for 176 sites. Although DLA has instituted extensive internal controls to ensure that these estimates are accurate and reproducible, they are generally considered accurate at +/- 30-50%. The stated noncurrent liability is an estimate of future liabilities, as the majority of DLA sites will require cleanup for up to 30 years. Estimates for work that are more than 1-2 years in the future may be subject to significant change.

The DLA is currently developing a plan for collecting and reporting environmental liabilities (EL) for NonDefense Environmental Restoration Program (NonDERP) contamination at DLA managed installations including government owned contractor operated fuel points, and for Service owned and operated fuel terminals where DLA stores fuel. The DLA is developing an environmental template that will be used to capture the EL for the Service-owned fuel terminals, to include legacy wastes.

The NonDERP estimated total cleanup cost for current liabilities is based on current cleanup work to be performed in the current year and the unliquidated obligations from prior years. The noncurrent liability is the portion of the cleanup cost estimated by the RACER model for future years.

Types of Environmental Liabilities and Disposal Liabilities Identified

The DLA has cleanup requirements for NonDERP in accordance with the Comprehensive Environmental Response, Compensation Liability Act (CERCLA), Resource Conservation and Recovery Act, and the Superfund Amendment and Reauthorization Act (SARA), as well as Other Environmental contamination on installations managed by DLA in accordance with Resource Conservation and Recovery Act (RCRA).

Applicable Laws and Regulations for Cleanup Requirements

The DLA is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other past activity, which may have created a public health or environmental risk. The DLA is required to follow CERCLA, RCRA, and the SARA to clean up contamination on installations managed by DLA in coordination with regulatory agencies. This cleanup may at times extend beyond installation boundaries onto privately owned property and to sites where DLA is named as a potentially responsible party by a regulatory agency.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating Periods

The DLA uses RACER, an independently validated model, to estimate environmental liabilities. The DLA validates the model in accordance with DoD Instruction 5000.61 and primarily uses the model to estimate the liabilities based on data received for each cleanup site during an annual interview with Installation Program Managers. Data gathered about the cleanup sites from these interviews is entered into the RACER model. Estimates from that process make up the cost to complete for each cleanup site.

In compliance with accounting standards, DLA is developing a process to capture and expense the costs for cleanup associated with general property, plant and equipment (PP&E). Data on the

EL cost linked to PP&E was gathered during FY 2006 and will be the basis for the development and implementation of this process.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to inflation, deflation, technology, or applicable laws and regulations

The DLA had changes in estimates resulting from better site characterization and improved analysis by program managers. Environmental liabilities are expected to fluctuate due to changes in agreements with regulatory agencies.

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

The environmental liabilities for DLA are based on accounting estimates and assumptions that are believed to be reasonable based upon information available at the time of the RACER calculation. The actual results may materially vary from the accounting estimates if agreements with the regulatory agencies require different remediation than anticipated at the time of the calculation. The liabilities can be further impacted if further investigation of the environmental sites discloses contamination different than known at the time of the estimate.

Note 12. Other Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Intragovernmental				
Advances from Others	$ 18,489	$ 0	$ 18,489	$ 0
FECA Reimbursement to the Department of Labor	24,369	32,675	57,044	57,298
Other Liabilities	11,352	0	11,352	12,012
Total Intragovernmental Other Liabilities	$ 54,210	$ 32,675	$ 86,885	$ 69,310
Nonfederal				
Accrued Funded Payroll and Benefits	$ 154,476	$ 0	$ 154,476	$ 155,332
Advances from Others	116,804	0	116,804	146,690
Deposit Funds and Suspense Accounts	(54,630)	0	(54,630)	(4,160)
Accrued Unfunded Annual Leave	6,950	1	6,951	0
Other Liabilities	13,628	9,769	23,397	2,331
Total Nonfederal Other Liabilities	$ 237,228	$ 9,770	$ 246,998	$ 300,193
Total Other Liabilities	$ 291,438	$ 42,445	$ 333,883	$ 369,503

Fluctuations and Abnormalities

Total other liabilities decreased by $35.6 million, or 10% between 4th Quarter, FY 2005 to 4th Quarter, FY 2006.

The main driver of the increase in intragovernmental other liabilities was an increase in the intragovernmetal advances from others of $18.5 million. Starting in the 2nd Quarter, FY 2006, the Defense Logistics Agency (DLA) now has the ability to identify trading partners on prepayments for Defense Reutilization and Marketing Service (DRMS) billings to the Military Services for hazardous waste disposal. The Military Services pay when the delivery order is issued, rather than when the services are performed. DRMS now accounts for this unearned revenue as advances.

Nonfederal total other liabilities decreased by $53.2 million or 18%.

The nonfederal advances from others decreased by $29.9 million or 20%. The majority is from the process improvement that corrected reporting of prepayments by the Military Services to DRMS of $17.5 million starting in the 2nd Quarter, FY 2006 referred to in the above paragraph. The remainder of the variance was caused by a $6.6 million decrease at Defense Supply Center Columbus from cancellation of the payroll pilot program in 2nd Quarter, FY 2006. In 3rd Qtr, FY 2006, there was a reduction of approximately $4 million in advance payments to Defense Energy Support Center by the Coalition Provisional Authority in direct support of the Iraqi Humanitarian assistance mission.

Nonfederal deposit funds and suspense accounts decreased by $50.5 million or over 100% because of reductions in unsupported undistributed collections reclassified to US Standard General Ledger (USSGL) 2400. The amount reported as unsupported undistributed collections by Supply Management decreased by $12.8 million because the National Security Agency (NSA) stockfund was moved out of DLA. Because the details of NSA transactions had not been available to DLA, all of these undistributed collections were considered unsupported. In addition, the Document Automation and Production Service (DAPS) unsupported undistributed collections decreased by $29.4 million because of the introduction of a new cash reporting system that contains more accurate data. The DAPS has a large, abnormal amount of unsupported undistributed collections in large part because $45.0 million of cash was not transferred from the Navy when DAPS operations was transferred from the Navy to DLA. This results in the collections reported by DAPS being significantly higher than the collections reported by Department of Treasury, which creates an abnormal unsupported undistributed collection amount. This issue is still pending a decision by the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)).

The accrued unfunded annual leave increased by $7.0 million or 100%. Starting in 3rd Quarter, FY 2006, OUSD(C) directed that this line also include civilian employee compensatory time and credit hours earned but not used. This change accounts for the entire increase.

Nonfederal other liabilities increased by $21.1 million or 904%. This is attributable to a $10.8 million increase in probable contingent legal liabilities and a $9.6 million increase for estimated contractor incurred costs in excess of progress payments. The DLA established a process during 1st Quarter, FY 2006 to record probable liabilities. The main drivers are $8.5 million in contract appeals and $2.2 million in court cases. In the 4th Quarter, FY 2006, OUSD(C) directed the recognition of contingent liabilities for contracts with progress payments based on cost.

Information Related to Other Liabilities

Intragovernmental other liabilities represent liabilities of civilian employees' health benefits, life insurance, retirement benefits, voluntary separation incentive payments and amounts due representing interest receivable on overdue public accounts receivable that must be remitted to Department of Treasury upon receipt.

Nonfederal deposit funds and suspense accounts liabilities consists of amounts for unsupported undistributed collections.

Nonfederal other liabilities include employer contributions and payroll taxes payable, contingent liabilities and future contract financing payments.

The major breakout on nonfederal other liabilities are as follows:

A. Accrued funded payroll and benefits for $154.5 million;
B. Advances from others for $116.8 million;
D. Deposit funds and suspense accounts for ($54.6 million); and
E. Accrued unfunded annual leave for $6.9 million.

<u>Other Disclosures Related to Other Liabilities</u>

The nonfederal other liabilities balance includes $9.6 million in estimated future contract financing payments that will be paid to the contractor upon delivery and government acceptance of a satisfactory product. In accordance with contract terms, specific rights to the contractor's work vests with the government when a specific type of contract financing payments is made, thereby protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The DLA is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and government acceptance of a satisfactory product. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to DLA and the amount of potential future payments are estimable; DLA has recognized a contingent liability for estimated future payments, which are conditional pending delivery and government acceptance of a satisfactory product.

The Federal Employees Compensation Act liability of $0.25 due to Department of Labor is delinquent as of September 30, 2006. The DLA reviewed supporting documentation and established that the bill was under allocated. This will be paid during the next billing cycle.

Note 13. Commitments and Contingencies

Information Related to Commitments and Contingencies

The Defense Logistics Agency (DLA) is a party in various administrative and judicial forums, involving issues such as contracts, environmental matters and equal opportunity. The DLA has accrued contingent liabilities for legal actions, which are in a forum and where DLA Office of the General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The DLA records Judgment Fund liabilities in Note 12, "Other Liabilities" and Note 10 "Accounts Payable."

Amounts disclosed for litigations claims, and assessments are fully supportable, and agree with the management summary schedule.

The DLA is involved in suits before the United States Court of Federal Claims regarding the use of economic price adjustment clauses in fuels contracts awarded from 1982 through 1999. The DLA continues to believe that the use of those clauses was proper and in accordance with law, making the claims and suits unjustified.

In previous financial statements, DLA had reported that there were 27 cases pertaining to challenges to the economic price adjustment clauses. The value of those cases was approximately $3.0 billion and reported in the footnotes to the financial statements. The DLA did not recognize this amount as a contingent legal liability in the financial statements because DLA determined an outflow of cash was remote.

The Court of Appeals ruled in April 2005 in the Tesoro Hawaii and Hermes cases that Defense Energy Support Center's economic price adjustment clauses are authorized by the Federal Acquisition Regulation. The court's decision is precedent and applies to the remaining 25 cases pending in the Court of Federal Claims. Plaintiffs in many of these cases are pursuing alternative theories, meaning that the cases are not yet finished. In the current round of the litigation, three of four Court of Federal Claims judges have issued decisions in August-September 2006, dismissing cases in their entirety. The decisions are not precedent for other cases, and plaintiffs can appeal the decisions to the Court of Appeals. We are waiting on a decision from one other judge.

<u>Other Information Related to Commitments and Contingencies</u>

The reasonably possible loss contingencies involve the following types of cases: ASBCA (Armed Services Board of Contract Appeals – Department of Defense's (DoD) administrative board which decides contract disputes between DoD parties and contractor courts); United States Federal Court cases (United States District Courts, Court of Federal Claims, Courts of Appeal, Bankruptcy Courts, Supreme Court) involving disputes between the United States and private parties; and Equal Employment Opportunity Commission (EEOC) which contains discrimination complaints filed by employees.

The DLA has reasonable possible loss contingencies of $27.0 thousand. This is comprised of one Court case of $15.0 thousand and several small EEOC cases totaling $12.0 thousand.

The DLA has no obligations related to cancelled appropriations for which the DLA has a contractual commitment for payment, and $10.5 billion for contractual arrangements which may require future financial obligations (e.g., undelivered orders).

Note 14. Military Retirement and Other Federal Employment Benefits

As of September 30	2006				2005
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
(Amounts in thousands)					
Other Actuarial Benefits					
FECA	$ 253,172	0	$ 0	$ 253,172	$ 273,302
Total Other Actuarial Benefits	$ 253,172	0	$ 0	$ 253,172	$ 273,302
Other Federal Employment Benefits	$ 0	0	$ 0	$ 0	$ 0
Total Military Retirement and Other Federal Employment Benefits:	$ 253,172	0	$ 0	$ 253,172	$ 273,302

Actuarial Cost Method Used:
Assumptions:
Market Value of Investments in Market-based and Marketable Securities:

Other Information Related to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

Federal Employees Compensation Act (FECA): The Defense Logistics Agency's (DLA) actuarial liability for workers' compensation benefits is developed by the Department of Labor's (DOL) Employment Standards Administration (ESA) and provided to DLA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's (OMB) economic assumptions for 10-year US Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also applied to the calculation of projected future benefits.

The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using OMB's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting are as follows:

2006

5.170% in Year 1

5.313% in Year 2

and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors Cost Of Living Adjustments (COLAs) and medical inflation factors Consumer Price Index Medical (CPIMs) were applied to the calculation of projected future benefits. These factors were also used to adjust the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPIM
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection.

Changes in Calculation of Actuarial Liability: There was a change in the allocation of the overall DLA FECA liability to the Working Capital Fund beginning in the 4th Quarter, FY 2006. This change was the result of a process improvement. The previous allocation method was based on gross compensation at each of the DLA activities. Now, on a quarterly basis, the accrued FECA liability is allocated based on the amount charged in the current FECA billing to each of the DLA activities.

Note 15. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue		
As of September 30	2006	2005
(Amounts in thousands)		
Intragovernmental Costs	$ 2,427,583	$ 2,529,561
Public Costs	32,733,735	30,565,962
Total Costs	$ 35,161,318	$ 33,095,523
Intragovernmental Earned Revenue	$ (31,276,914)	$ (28,926,941)
Public Earned Revenue	(4,482,229)	(3,464,163)
Total Earned Revenue	$ (35,759,143)	$ (32,391,104)
Net Cost of Operations	$ (597,825)	$ 704,419

<u>Fluctuations and Abnormalities</u>

Net cost of operations decreased by $1.3 billion or 185% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

The total costs increased $2.1 billion, or 6%.

Public costs increased by $2.2 billion, a 7% increase. The primary driver was an increase of $2.8 billion in Energy due to an $14.98/barrel increase in product cost from $68.48/barrel in FY 2005 to $83.46/barrel in FY 2006 and an increase in quantity purchased of 3.4 million barrels from 130.8 in FY 2005 to 134.2 in FY06. This was off set by a decrease of $391.6 million for a reduction in over ocean transportation surcharge and the reduction of accruals that United States Transportation Command did not bill.

Total Revenue increased $3.4 billion, or 10%.

Intragovernmental earned revenue increased by $2.3 billion, an 8% increase, primarily due to the higher sale price per barrel of fuel. During FY 2005, the Defense Energy Supply Center charged a sale price of $61.65/barrel. In FY 2006, the sale price rose to $94.33/barrel. The increased revenue from intragovernmental fuel sales accounted for $3.7 billion of the increase. This increase was offset by an overall decrease in supply revenue of $1.2 billion from reduced demand by the Services and foreign military sales. These reductions were for combat uniforms, extreme cold weather clothing systems, footwear, and modular sleep systems, communication hardware, bastions and fencing, facilities maintenance, lumber, industrial plant equipment (boring mills, pipe benders, diesel engines, and dehumidifiers), and a decrease in the prime vendor programs (Maintenance, Repair and Operations; Dive; and Fire programs). Additionally, Distribution decreased $152.1 million primarily due to a reduction in Over Ocean

Transportation, primarily attributed to the Army, and a decrease in revenue associated with the storage of materiel for Navy, Air Force and Defense Logistics Agency (DLA) inventory control points.

Public earned revenue increased by $1.0 billion, a 29% increase. The primary driver was the $32.68/barrel increase in sale price per barrel of fuel, $61.65/barrel in FY 2005 to $94.33/barrel in FY 2006. The increased revenue from fuel sales to the public (foreign governments and commercial Department of Defense (DoD) contractors) accounted for $753.9 million of the increase.

Information Related to the Statement of Net Cost

The consolidated statement of net cost (SoNC) in the federal government is unique because its focus is on providing an understanding of the net cost of programs and/or organizations that the federal government supports through specific or general appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

Intragovernmental costs and revenue are related to transactions made between two reporting entities within the federal government, while public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The amounts presented in SoNC are based on funding, obligation, accrual and disbursing transactions. The DLA systems do not always record the transactions on an accrual basis as required by generally accepted accounting principles. The information presented also includes data from nonfinancial feeder systems to capture all cost such as payroll expenses, accounts payable, and environmental liabilities.

The majority of accounting systems currently supporting DLA do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations for all trading partners. Current DoD policy directs that the expenses and accounts payable of intragovernmental trading partners be adjusted to agree with the revenue and accounts receivable of the “selling” partner. Therefore, intragovernmental costs are adjusted based upon amounts reported, and gross costs with public represents actual costs with the public and any intragovernmental costs that were not reported by the “selling” partner.

Other Disclosures

The DLA recognized $1.6 thousand in costs for acquiring, constructing, improving, reconstructing, or renovating heritage assets in FY 2006.

Note 16. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(Amounts in thousands)				
Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
Errors and Omissions in Prior Year Accounting Reports	$ 124,925	$ 0	$ 124,925	$ 0
Total Prior Period Adjustments	$ 124,925	$ 0	$ 124,925	$ 0
Imputed Financing				
Civilian CSRS/FERS Retirement	$ 58,260	$ 0	$ 60,051	$ 0
Civilian Health	87,175	0	82,395	0
Civilian Life Insurance	237	0	231	0
Judgment Fund	314	0	1,286	0
Total Imputed Financing	$ 145,986	$ 0	$ 143,963	$ 0

Other Information Related to Statement of Changes in Net Position

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System, Federal Employees Retirement System, Federal Employee Health Benefits and Federal Employee Group Life Insurance, do not fully cover the US Government's cost to provide these benefits. The financial statements include an imputed cost made to recognize the difference between the government's and Defense Logistics Agency's (DLA) costs of providing these benefits to the employees and contributions made by and for them. The OPM provides the cost factors to Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) OUSD (P&R) and DLA for validation. After validation, OUSD (P&R) provides the imputed costs to the reporting components for inclusion in their financial statements.

The Judgment Fund imputed financing recognizes DLA's expense when unfavorable litigation outcomes occur and settlement payments have been made on DLA's behalf by the US Treasury's Judgment Fund. These imputed payments are nonreimbursable to the Judgment Fund.

Other Disclosures Related to the Statement of Changes in Net Position

The errors and omissions in prior year accounting reports and total prior period adjustments. The DLA reported a prior period adjustment of $124.9 million in 4th Quarter, FY 2006 to recognize as an other asset the right to approximately 6.4 million barrels of crude oil held by the Department of Energy (DoE) on behalf of the Department of Defense (DoD). Legislation enacted in November 1992 Public Law 102-396, Sec. 9149 provided appropriations and established the requirement for DoE to acquire and maintain a strategic petroleum reserve for national defense purposes. Section 9149 provided $125.6 million to DoD, to be transferred to DoE for the acquisition, storage and drawdown of such reserve. Proceeds of any sales of this reserve will be deposited to the accounts of, and remain available to the DoD until expended. The funds were provided to DoE in FY 1993 to acquire the reserve, however due to an accounting error, the full balance of the transaction with DoE was expensed in the DoD Agency-wide Statement of Net Cost in FY 1993 and no asset was established. This prior period adjustment establishes the original appropriation amount of $125.6 million, less $.7 million that the law allowed DoE to use to offset certain costs as an other asset in DLA's Balance Sheet (refer to disclosures in Notes 5 and 16), with an adjustment to the DLA Beginning Net Position for FY 2006 and FY 2005. The difference between the amount appropriated and the balance recognized as other assets represents the reimbursement of costs to DoE of acquiring and storing the inventory. The DoE reports this crude oil in inventory in their financial statements, with an offsetting custodial liability to DoD. To date none of the reserve has been drawn upon, thus the full inventory remains on hand with DoE. By law, the reserve cannot be drawn down or released to DoD without the President (with the advice of the Secretary of Defense) making findings under Section 161(d) of the Energy Policy and Conservation Act (42 USC 6241(d)).

Note 17. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 10,511,696	$ 12,617,632
Available Borrowing and Contract Authority at the End of the Period	7,612,368	9,913,653

Information Related to the Statement of Budgetary Resources

Intraentity Transactions

The statement of budgetary resources (SBR) does not eliminate intraentity transactions because the statements are presented as combined and combining.

Apportionment Categories

Office of Management and Budget Circular A-136, specifically requires disclosures of the amount of direct and reimbursable obligations incurred against amounts apportioned under category A direct obligations, category B reimbursable obligations, and exempt from apportionment. This disclosure should agree with the aggregate of the related information as included in each reporting entity's Standard Form 133, Report on Budget Execution and Budgetary Resources, and the SBR. The Defense Logistics Agency (DLA) has no category A direct or reimbursable obligations, no category B direct obligations, or any exempt obligations. Category B reimbursable obligations total $34.2 billion.

Undelivered Orders

Undelivered orders presented in the SBR consist of undelivered orders unpaid for reimbursable obligations.

Spending Authority from Offsetting Collections

Adjustments in funds that are temporarily not available pursuant to the Public Law, and those that are permanently not available (included in the "Adjustments" line on the SBR), are not included in the "Spending Authority from Offsetting Collections and Adjustments" line on the Statement of Financing.

Appropriations Received

The DLA has received a total of $2.2 billion in appropriations as of 4th Quarter, FY 2006. These appropriations liquidate realized contract authority and do not provide new budgetary obligation authority. The DLA received $19.7 million in prior year transfer due to the Hurricane Katrina Relief Effort, reprogramming action FY06-01 IR, Public Law 109-62. An additional $2.0 billion was received from the Department of Defense Emergency Supplemental Appropriation Act, Public Law 109-148 and $132.8 million from Public Law 109-234. These appropriations addressed hurricanes in the Gulf of the Mexico, pandemic influenza, and the Global War on Terrorism. Of the appropriations received, $1.5 billion was subsequently transferred to other Defense Components pursuant to DoD reprogramming action FY 06-05 PA in accordance with the provisions of Public Law 109-148 and 109-163.

Note 18. Disclosures Related to the Statement of Financing

Information Related to the Statement of Financing

The Statement of Financing (SOF) provides information on the total resources used by the agency - both those received through the budget and those received by other means. It reconciles the status of budgetary resources to the net cost of operations for a given reporting period. It articulates and details the relationship between net obligations from budgetary accounting and net cost of operation from proprietary accounting.

Due to the Department of Defense (DoD) financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data are a previously identified deficiency for both Defense Logistics Agency (DLA) and DoD.

The SOF is presented as combined or combining statements rather than consolidated statements due to the intragovernmental transactions not being eliminated. The following lines on the SOF are presented as combined:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Adjustments in funds that are temporarily not available pursuant to public law, and those that are permanently not available (included in the adjustments line on the Statement of Budgetary Resources (SBR)), are not included in spending authority from offsetting collections and the adjustments line on either the SBR or the SOF.

Liabilities not covered by budgetary resources consist of offsets to nonentity assets (interest, penalties, fines and administrative fees), environmental liabilities, probable contingent legal liabilities and military retirement benefits and other employment actuarial liabilities for DLA Working Capital Fund (WCF). There are no amounts in the current year for resources in future periods for DLA Working Capital Fund, as revenues are generated to cover liabilities during current years. Therefore, amounts reported as requiring resources in future periods do not have a relationship to liabilities not covered by budgetary resources.

Other Material Changes

The SOF requires that adjustments be processed because of imbalances between the budgetary and proprietary amounts recorded in DLA's legacy accounting systems. The balancing entries for DLA include \$102.3 million in adjustments to resources that finance the acquisition of assets. In addition, adjustments for \$0.5 million were processed to components not requiring or generating resources other line. These adjustments were required in order to bring SOF into agreement with the Statement of Net Cost.

Explanation of Other Lines

Other Resources Used to Finance Activities: Other. This line consists of gains and losses accumulated from various transactions, which have no budgetary impact.

Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations: Other This amount mainly consists of end-of-quarter fund balance with treasury (FBWT) that is transferred to Defense Working Capital Fund (DWCF) level. This transfer is done because FBWT is managed at the DWCF level.

Components Requiring or Generating Resources in Future Period: Other. This amount consists of contingent legal liabilities that are considered probable.

Components Not Requiring or Generating Resources: Other This amount is comprised of changes in the allowance for bad debt and miscellaneous expenses that did not require budgetary resources.

Defense Logistics Agency
Working Capital Fund

Required Supplementary Information for the
Years Ended September 30, 2006 and 2005

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

HERITAGE ASSETS
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	Measurement Quantity	As of 9/30/05	Additions	Deletions	As of 9/30/06
Museums	Each	–	–	–	–
Monuments/Memorials	Each	1	–	–	1
Cemeteries	Sites	2	–	–	2
Archeological Sites	Sites	–	–	–	–
Building and Structures	Each	2	–	–	2
Major Collections	–	–	–	–	–

Stewardship Land and Heritage Assets

Heritage assets and stewardship land are categories of PP&E that are not reported on the balance sheet, with one exception. As required by SFFAS Number 16, *Amendments to Accounting for Property, Plant, and Equipment*, the cost of acquiring, improving, and reconstructing all multi-use heritage assets, those heritage assets used predominately in General government operations, shall be capitalized as General PP&E and depreciated. Prior to FY 2006, this information was reported in Required Supplemental Stewardship Information (RSSI).

The DLA has no stewardship land.

Heritage assets are items with historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics that are expected to be preserved.

Monuments & Memorials: The Defense Supply Center – Richmond (DSCR) has jointly established with the local Native American organization a Native American Monument honoring the Native American culture.

Cemeteries: The DSCR has established a cemetery for African American remains unearthed during the construction of a child development center. The DSCR also has established a cemetery for the Gregory Family. They were one of the families that had owned the property prior to its acquisition by the Government.

Buildings & Structures: Executive Order 11593 regarding the protection and enhancement of the cultural environment established Bellwood, Chesterfield County, Virginia in the National Register. Operated by the DSCR, the Bellwood home is an early 19th Century plantation house highlighted by slender columns extending up two stories. It also serves as DSCR Officers' Club.

Building 280, Marine Barracks, Pearl Harbor, Hawaii is a World War II wooden barracks identified as a historic asset. This building is occupied by personnel from the Defense Supply Center Philadelphia – Pacific as a tenant with the financial responsibility for sustainment. The occupied portion of the building has been renovated and is in good repair. This building was previously removed due to reclassification; however, it has been added to the record based on clarification of the reporting requirement.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Real Property Deferred Maintenance
As of September 30, 2006
(In Thousands)

Annual Sustainment FY 2006

Property Type	Restoration Prior	1. Required	2. Actual	3. Difference	Restoration Restoration Ending
Buildings, Structures, and Utilities	$219,430				

FY 2006 sustainment requirements for DLA are from version 7.0 of the DoD Facilities Sustainment Model (FSM). The annual sustainment requirement for FY 2006 has been deflated from FSM 7.0 data for FY 07 for DLA. The requirements and funding represent facilities funded from Operations & Maintenance (O&M), Defense Wide Family Housing appropriations, and the Defense Wide Working Capital Fund (WCF), and from Non-Appropriated Funds (NAF). DLA sustainment data includes facilities that are multi-use heritage assets.

Annual Deferred Sustainment Trend

Property Type	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Buildings, Structures, and Utilities	$218,424	$293,443	$239,953	$219,430	$219,430

Comprehensive real property condition information is unavailable as the majority of the facilities for which the Agency is responsible for sustainment or restoration and modernization since they are not under DLA's operational control, e.g., fuel storage and handling facilities. Condition assessments from the Military Services on these facilities have not been made available to DLA. DoD Management Initiative Decision 909 has tasked DLA with providing a comprehensive facility condition assessment of the DoD fuels infrastructure at Military Service managed installations. However, the actual survey results will not be complete before the end of FY 06. Insufficient human and financial resources are available to annually assess all Agency facilities and manage the resulting data. As a result, accurate restoration and modernization requirements are not available for all DLA sites. The estimates listed above are for DLA permitted sites. The facilities at these locations are predominantly C-1.

Defense Logistics Agency
Working Capital Fund

Supply Management Activity Group Overview

Supply Management Activity Group

The Supply Management Activity Group consists of three supply centers, one support center, two service centers, and a variety of support organizations. The supply centers are located at the Defense Supply Center Columbus (DSCC) in Columbus, Ohio; the Defense Supply Center Richmond (DSCR) in Richmond, Virginia; and the Defense Supply Center Philadelphia (DSCP) in Philadelphia, Pennsylvania. DLA supports its Military Service customers by managing supply chain business processes that ensure worldwide logistics support is provided at the right time, to the right place, and consistently at the best value in peacetime, emergency, and wartime scenarios. Each supply center acts as a supply chain lead for one or more commodity groups. Each commodity group contains common suppliers, similar items, and to some extent, similar customers. They are formed to improve alignment with industry and customers. The seven supply chains at these three centers include: land, air, and maritime (associated with weapon system spare parts and related consumable materiel), construction and equipment, food, clothing and textiles, and medical. The Defense Energy Support Center (DESC), which is located at Fort Belvoir, VA, purchases, manages, positions, and sells fuel to the Military Services and provides centralized energy supply chain support to meet the energy needs of the military installations. The service centers are the Defense Logistics Information Service, which is responsible for providing cataloging capability; and the Defense Automatic Addressing Service Center, which is responsible for maintaining addresses of customers and suppliers.

Mission

The Supply Management Activity Group's mission is to provide materiel and logistics services that support peacetime and combat operations, combat preparedness, emergency support, and humanitarian aid. These services include the integrated materiel management of more than 5.2 million national stock numbered items support the eight separate supply chains. The support requirements are dynamic, and DLA continues to shift its approach in response to evolving changes in national priorities, requirements of the Military Services, technology, and the commercial marketplace. The primary logistics functions include:

- Supply-chain integration and inventory management;
- Transportation management (shared with the Distribution Activity Group);
- Technical management, which guarantees product quality and proper pricing of materiel;
- Procurement management, ensuring DoD gets the best value;
- Logistics data and information collection, management, and distribution and providing for the integration and availability of this information; and
- Logistics management process and processing of logistics and standard Military Logistics Systems transactions

During FY 2006, DLA supported 1,411 different weapon systems; managed fuel that generated net sales of 133.9 million barrels; and received a daily average of 54,000 requisitions that led to a daily average of 8,200 contracts awarded. There are more than 9,450 civilian, 325 active duty military, and 380 military reserve personnel that support this business area. The Supply Management Activity Group generated revenue which totaled about $33.3 billion during FY 2006. This is an increase of almost $3.7 billion from the previous year.

Strategic Goals

The long-term goals of the Supply Management Activity Group are consistent with the goals contained in the DLA Strategic Plan. These goals will be achieved through a series of supporting strategies and executed by the supply centers.

Two primary performance indicators were tracked during FY 2006: Materiel Availability (MA) by Supply Chain and Business Systems Modernization (BSM) Logistics Response Time (LRT).

- **Materiel Availability (MA) by Supply Chain**: MA by supply chain measures the percent of orders received that are immediately filled either from DLA inventory or that of our contractors through pre-existing contracts. The availability calculation compares backorders established to orders received for a specific period of time. MA is a comprehensive measure of materiel support to our customers since it includes both stocked and non-stocked materiel, whereas our previous performance measure, supply availability, only considered stocked materiel. The following table displays each Non-Energy supply chain MA.

Materiel Availability (MA)	FY 2005 Actual	FY 2006 Goal	FY 2006 Actual
Clothing & Textiles (C&T)	93.4%	92.0%	92.4%
Medical	88.1%	88.0%	95.2%
Subsistence	100.0%	100.0%	100.0%
Construction & Equipment (C&E)	87.3%	88.0%	85.9%
Aviation	87.3%	87.8%	87.4%
Land	85.2%	86.0%	87.5%
Maritime	88.9%	88.0%	89.5%

DLA maintained or improved MA from FY 2005 levels for each Non-Energy Supply Chain during FY 2006 except for Clothing and Textiles (C&T) and Construction and Equipment (C&E). In FY 2005, C&T's MA was high due to an inventory investment that preceded an expected short-term increase in demand; and the FY 2006 MA trended downward as planned. Prior to FY 2006, C&E employees had little experience using the BSM system, and issues relating to converting specific C&E long-term contract clauses to BSM extended the learning curve associated with implementing the new system and adversely impacted the C&E MA.

The large improvement in Medical MA reflects a correction to the calculation to include part numbered items in addition to items with National Stock Numbers that comprise the Medical supply chain.

In order to better support the Warfighter, inventory was purchased in advance of requirements expected for Land supply chain materiel. Performance exceeded expectations due to this increased on-hand inventory and lower demand.

- **Business Systems Modernization (BSM) Logistics Response Time (LRT):** BSM LRT is the amount of time lapse between the receipt and the filling of a requisition. Items supported by BSM had an average LRT of 11.4 days, which is an improvement of 3.3 days – or 22.4% – over the FY 2005 experience.

Future Business Systems Modernization (BSM) Metrics

In January 2005 DLA began to transition data from the existing legacy system (Standard Automated Materiel Management System - SAMMS) to BSM. This transition necessitated an integrated approach to measuring enterprise performance that is not dependent on the system under which items are being managed. As a result, the twelve transition metrics defined below represent DLA's future key performance indicators (KPIs) and supporting metrics.

- **Stock Availability (STA)** is the percent of customer orders shipped in time to meet the required delivery date. STA is a customer focused metric that provides customer visibility on DLA performance - getting materiel into the transportation pipeline in a timely manner.

- **Materiel Availability (MA)** measures the percent of orders for which DLA has materiel available on the first pass of the order. For DLA direct support items (where DLA maintains materiel at a depot to support the customer), MA is very close to the traditional measure of supply availability.

- **Sales Orders** are the number of customer orders (requisitions) received.

- **Backorders** measure the number of and dollar value of customer orders unfilled, on hand, and aged greater than 180 days.

- **Purchase Requisitions (PRs)** are the number on hand.

- **PRs exceeding Administrative Lead Time** are the number of PRs that have not been awarded within the expected administrative lead time.

- **Administrative Lead Time (for government processing) and Production Lead Time (for contractor processing)** are segmented measures of time to obtain materiel by contract.

- **Attainment to Plan (ATP)** identifies the percentage of PRs and Stock Transport Orders (redistribution orders) generated through the supply planning process which fail or meet three criteria: quantity, quality, and time. An increase in ATP demonstrates that supply plans are more reliable and lower safety stock levels (smaller inventory investments) are necessary.

- **Net Operating Result** compares business results to the business plan for revenues, expenses and gains or losses.

- **Gross Sales at Standard Price** is the revenue generated by the sale of materiel.

- **Obligations and Cash Performance** measure funds execution and cash position relative to the budgets and plans.

These metrics will provide a disciplined process to continually track the performance of items that are transitioned to BSM; and measure DLA performance at an enterprise level. All metrics are tracked at supply chain, customer, and weapon system levels and include order fulfillment, technical/quality, procurement, and financial performance metrics. KPIs and supporting metrics are tracked, as their BSM metrics reports stabilize. DLA will complete its transition to the BSM KPIs in FY 2007.

FY 2006 Accomplishments

Supplier Relationship Management (SRM): SRM is a major transformation effort which encompasses all of the Agency's supplier facing initiatives. The focus of SRM is to transition from managing supplies to managing suppliers as a means to better serve the warfighter. When established, these enhanced relationships between DLA and its suppliers will allow the Agency to achieve the underlying goal of having "the right part, at the right time, at the right price." Consequently, SRM will affirm DLA as an integral partner in the end-to-end supply chain that links our suppliers to our customers. Detailed below are some of the key initiatives within SRM including Strategic Materiel Sourcing (SMS), Strategic Supplier Alliances (SSAs), Supply Chain Alliances (SCAs), and Performance-Based Logistics (PBL):

- **Strategic Materiel Sourcing (SMS):** SMS focuses on stratifying and satisfying customer driven high demand and readiness hardware items - 390,000 items of the 3.6 million hardware items managed by DLA - through long-term agreements. While the 390,000 targeted SMS items account for only 11% of the DLA managed hardware items, they account for 88% of its hardware procurement actions and 87% of its hardware sales. The primary performance measurement of the SMS program is inventory savings. Since the inception of this program, DLA has realized over $247 million in one-time inventory savings including $57 million in savings during the first three quarters of FY 2006. DLA currently has a total of 154,000 items under long-term agreements. These agreements include Prime Vendor Agreements, Corporate Contracts, and standard Long-Term Contracts (LTCs).

- **Strategic Supplier Alliances (SSAs):** SSAs are long-term partnerships - formed with DLA's key suppliers - that allow the Agency and the supplier to work together by sharing information and jointly working problem areas. The result is added value for both parties and improved support to the warfighters. Each one of the 28 SSAs is assigned to a Supplier Relationship Manager, whose primary responsibility is the maintenance and success of the partnership. Significant savings in reduced lead-times and prices have been realized. For example, in one partnership, Administrative Lead Time (ALT) was reduced, on average, by 43.9% with on time delivery of about 96%; while another ALT was reduced, on average, by 31.0% with on time delivery of 93.5%. Similar results occurred with the other SSAs.

- **Supply Chain Alliances (SCAs):** SCAs are alliances with the next tier of key suppliers who provide items with lower customer demand and readiness impact. Generally, these alliances do not require the high level of interaction and management attention that is received on an SSA. Additionally, SCAs can be formed with competitive suppliers, something not possible with SSAs. However, while SCAs require less involved relationships, they still further the goals of the SRM initiative and add value to both DLA and the supplier. Because SCAs have been very recently developed, there is no definitive performance data to report; however, it is anticipated that - as they mature - SCAs will produce similar lead time and price reductions results as those generated by SSAs. DLA has formed SCAs with 13 suppliers, satisfying the goal of having 12 in place by FY 2007.

- **Performance-Based Logistics (PBL):** PBLs are: 1) the preferred contract method to support weapon systems; 2) mandatory for all new major systems and for fielded Acquisition Category (ACAT) I and II systems; and 3) expected to increase support to warfighters through increased materiel availability, improved reliability, and enhanced obsolescence management. During FY 2006, DLA participated in six new agreements in support of PBLs. These agreements support the Air Force's KC-135 and B-1; and the Navy's F/A 18-FIRST, H-46, and the Naval Nuclear Reactor Program. In addition, these agreements captured sales of $141.1 million through the 3rd Quarter, FY 2006 and enabled DLA to meet its goal of implementing five to fifteen PBL/Performance Based Agreements (PBAs) five years earlier than its target date of FY 2011.

Retail Integration: Retail integration is a transformational program to extend DLA's consumable item supply chain management beyond the wholesale level, providing products and services all the way to the point of consumption. DLA will manage and may also own inventory currently owned by its customers. Using initiatives such as the National Inventory Management Strategy (NIMS) and the Base Realignment and Closure supply, storage and distribution concepts, DLA will replace distinct wholesale and retail inventories with a national inventory that can be managed in a more integrated manner. The Naval Station Ingleside, Texas pilot project - implemented in July 2003- provided better demand visibility; and DLA was able to increase supply availability by nearly 20% without an increase to inventory. The most recent NIMS site was implemented in August 2005 at Naval Air Station Whidbey Island, Washington. As the strategy becomes more fully integrated into our business systems, benefits will include: reduced wait times, higher levels of supply readiness, tailored logistics support solutions, better inventory visibility, optimized supply chain, and better resource use.

Customer Relationship Management: DLA is implementing a Customer Relationship Management (CRM) program to more deliberately understand customer needs and meet customer expectations. The automated system portion of the program has created greater efficiencies and effectiveness in executing that program. In March 2006, CRM Release 1.0 was implemented and it included the Sales and Marketing modules; and in April 2006, the Analytics and Service modules were implemented. Currently there are over 1,300 CRM system users.

- **Client Level Survey:** DLA recently completed a client-level survey to supplement its traditional yearly customer satisfaction survey. While the customer satisfaction survey sought input from a cross-section of DLA's customer base, the client-level survey focused on the opinion of the upper echelon clients – those with the officer rank of O-6 and above. And whereas the annual satisfaction survey concentrated on satisfaction and transactional information, the client-level survey is focused on evaluating our partnerships and reputation, with an eye toward identifying areas for improvement. The client-level survey yielded insights to both successes and opportunities for improvement. The overall client-level satisfaction was reported at 67%, which is consistent with results for similar respondents in the previous larger overall customer satisfaction survey. Additionally, 86% indicated they would recommend DLA to another unit or colleague, which suggests strong performance. Specific successes mentioned by the customers were that we deliver well, that DLA has a relatively good reputation, and that they value our support. At the same time, they told us we could be more proactive in partnering with them; better understand their mission and readiness needs; and better promote DLA's capabilities and the value that DLA brings to the war fighter. As a consequence, we are developing an overall action plan to address areas for improvement.

Financial Performance Measures

DLA establishes its prices predicated on three primary factors: 1) its current financial position, as determined by the Accumulated Operating Result (AOR); 2) its projected cash position relative to the stated objective; and 3) the estimated expenses that will be incurred to generate the estimated revenue. It is Agency policy to set prices that achieve an AOR of zero over the long-term and maintain cash balances that preclude an Anti-Deficiency Act violation. In addition, not all costs attributed to the business are recovered by the business - imputed costs, depreciation expenses applied to investments funded from General Fund accounts, and the recording of revenue that is for non-expense items (peacetime inventory augmentation, mobilization inventories, and adjustments to the cash position). The Results section below more fully describes DLA achievement during FY 2006.

DLA measures the effectiveness of program budgeting and execution with unit cost performance measures. The following table depicts the Supply Management unit cost results for the fuel commodity:

Unit Cost Results	**FY 06 Goal**	**FY 06 Actual**
Product Cost per Barrel of Fuel	$77.30	$80.37
Non-Product Cost per Barrel of Fuel	$8.17	$8.59
Total Cost per Barrel of Fuel	$85.47	$88.96

The total cost per barrel of fuel is comprised of the composite product cost (the acquisition cost of a barrel of petroleum product sold) and the non-product cost (operations costs for fuel services, transportation, storage, and overhead). This unit cost ended the year over plan by $3.49 (a 4.1% increase) due to sales that were 4.3 million barrels higher than the planned sales of 129.6 million barrels and a composite refined product cost of $80.37 ($3.07 per barrel higher than the planned cost). The non-product cost increase was due primarily to higher terminal operations and pipeline fee increases; while market conditions led to higher fuel product costs.

The following table depicts the Supply Management unit cost result for the non-energy commodities:

Unit Cost Results	**FY 06 Goal**	**FY 06 Actual**
Non-Energy	$.94	$.95

The Non-Energy unit cost was $.95, which exceeded the plan by $.01. The actual unit cost was higher than the plan primarily due to support of OEF/OIF demands (23% of the total FY 2006 sales) with enhanced inventory levels (an investment of $320 million) and procurement of materiel in anticipation of sales that did not materialize (due to reduced funding from the Military Services).

The DLA also measured and monitored financial performance of its Non-Energy business segment by comparing the Cost Recovery Rate (CRR) approved in the budget to that which was executed. The CRR is a composite rate that is calculated by dividing its related operating costs by the cost of goods sold; and is used as an aggregate measurement of the costs that DLA incurred to generate a level of sales. The long-term financial goal is to achieve a break-even budget-related accumulated operating result. DLA's composite FY 2006 CRR goal was 14.4%. The actual CRR was 14.6%, which was 0.2% higher than the FY 2006 President's Budget and is attributed to decreased sales that finished 6% below the plan. This sales decrease was directly related to financial constraints within the DoD.

Results

The Supply Management Net Cost of Operations, which includes costs (military construction depreciation, imputed expenses, and accounting adjustments) not recovered by the Defense-wide Working Capital Fund, reflects a gain of approximately $590 million. The increase is primarily attributable to the Energy business segment where we sold 4.3 million more barrels than planned, 129.6 million, and at a higher composite price relative to the actual market costs; however, this was somewhat offset by an overall decrease in the Non-energy business segment supply due to decreased demand by the Military Services.

Defense Logistics Agency
Working Capital Fund

Supply Management

Comparative Financial Statements
As of and for the Years Ended September 30, 2006 and 2005

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Comparative Balance Sheets
As of September 30, 2006 and 2005
(In Thousands)

		2006		2005
ASSETS (Note 2)				
Intragovernmental:				
Accounts Receivable (Note 4)	$	697,942	$	908,193
Other Assets (Note 5)		124,925		-
Total Intragovernmental Assets		822,867		908,193
Accounts Receivable (Note 4)		567,335		560,359
Inventory and Related Property (Note 7)		17,904,388		15,980,585
General Property, Plant and Equipment (Note 8)		1,262,816		1,187,772
Other Assets (Note 5)		60,049		196,356
TOTAL ASSETS	$	20,617,455	$	18,833,265
LIABILITIES (Note 9)				
Intragovernmental:				
Accounts Payable (Note 10)	$	42,167	$	106,885
Other Liabilities (Note 12 and Note 13)		16,799		42,774
Total Intragovernmental Liabilities		58,966		149,659
Accounts Payable (Note 10)		2,832,801		2,083,428
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 14)		37,380		167,038
Environmental Liabilities (Note 11)		104,135		40,412
Other Liabilities (Note 12 and Note 13)		234,993		243,534
TOTAL LIABILITIES		3,268,275		2,684,071
NET POSITION				
Cumulative Results of Operations		17,349,180		16,149,194
TOTAL NET POSITION		17,349,180		16,149,194
TOTAL LIABILITIES AND NET POSITION	$	20,617,455	$	18,833,265

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Comparative Statements of Net Cost
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 15)

	2006	2005
Program Costs		
Gross Costs	$ 31,945,957	$ 30,242,822
(Less: Earned Revenue)	(32,536,251)	(29,644,860)
Net Program Costs	(590,294)	597,962
Net Cost of Operations	$ (590,294)	$ 597,962

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

SUPPLY MANAGEMENT

Comparative Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006	2005
Beginning Balances	$ 16,274,118	$ 14,838,824
Budgetary Financing Sources:		
Appropriations used	654,901	1,096,099
Transfers-in/out without reimbursement	15,246	180,119
Other Financing Sources:		
Transfers-in/out without reimbursement	(270,383)	548,348
Imputed Financing Sources	85,004	83,766
Total Financing Sources	484,768	1,908,332
Net Cost of Operations	(590,294)	597,962
Net Change	1,075,062	1,310,370
Ending Balances	$ 17,349,180	$ 16,149,194

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Comparative Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006	2005
UNEXPENDED APROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	$ 2,120,101	$ 1,246,100
Appropriations transferred-in/out (+/-)	(1,465,200)	(150,000)
Appropriations used	(654,901)	(1,096,100)
Ending Balances	$ -	$ -

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006	2005
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Recoveries of prior year unpaid obligations	$ 446,034	$ -
Budget Authority:		
Appropriations received	2,120,101	1,246,100
Contract Authority	31,051,479	31,223,095
Spending authority from offsetting collections:		
Earned		
Collected	31,471,504	27,983,463
Change in receivables from Federal sources	(52,541)	43,180
Change in unfilled customer orders		
Advance received	(13,757)	30,273
Without advance from Federal sources	742,063	115,057
Subtotal	65,318,849	60,641,168
Nonexpenditure transfer, net, anticipated and actual	(1,450,247)	24,193
Permanently not available	(33,263,156)	(29,442,560)
Total Budgetary Resources	$ 31,051,480	$ 31,222,801
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 31,051,480	$ 31,222,801
Total Status of Budgetary Resources	$ 31,051,480	$ 31,222,801
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 14,384,387	$ 12,981,885
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(4,255,413)	(4,097,176)
Total unpaid obligated balance	10,128,974	8,884,709
Obligations incurred net (+ /-)	31,051,480	3,122,800
Less: Gross outlays	(31,862,528)	(29,820,298)
Less: Recoveries of prior year unpaid obligations, actual	(446,034)	-
Change in uncollected customer payments from Federal sources (+ /-)	689,521	158,237
Obligated balance, net – end of period		
Unpaid obligations	13,127,304	14,384,387
Less: Uncollected customer payments (+ /-) from Federal sources (+ /-)	(4,944,935)	(4,255,413)
Total unpaid obligated balance, net, end of period	8,182,369	10,128,974
Net Outlays		
Net Outlays:		
Gross outlays	31,862,528	29,820,299
Less: Offsetting collections	(31,457,747)	(28,013,736)
Net Outlays	$ 404,781	$ 1,806,563

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
SUPPLY MANAGEMENT

Comparative Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006	2005
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 31,051,480	$ 31,222,801
Less: Spending authority from offsetting collections and recoveries	(32,593,304)	(28,171,973)
Obligations net of offsetting collections and recoveries	(1,541,824)	3,050,828
Net obligations	(1,541,824)	3,050,828
Other Resources		
Transfers-in/out without reimbursement (+/-)	(270,383)	548,348
Imputed Financing Sources	85,004	83,766
Net other resources used to finance activities	(185,379)	632,114
Total resources used to finance activities	(1,727,203)	3,682,942
Resources Used to Finance Items Not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	2,229,440	(1,551,217)
Unfilled Customer Orders	728,306	145,330
Resources that fund expenses recognized in prior periods	(157,692)	(86,986)
Resources that finance the acquisition of assets	(29,102,474)	(26,083,704)
Other	270,383	(548,348)
Total resources used to finance items not part of the net cost of operations	(26,032,037)	(28,124,925)
Total resources used to finance the net cost of operations	(27,759,240)	(24,441,983)
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 annual leave liability	5,036	-
Increase in environmental and disposal liability	63,723	40,412
Other	2,520	51
Total components of Net Cost of Operations that will require or generate resources in future periods	71,279	40,463
Components not Requiring or Generating Resources		
Depreciation and amortization	114,682	67,775
Revaluation of assets or liabilities (+/-)	(330,808)	(395,749)
Cost of Goods Sold	27,315,970	25,294,908
Other	(2,177)	32,548
Total components of Net Cost of Operations that will not require or generate resources	27,097,667	24,999,482
Total components of net cost of operations that will not require or generate resources in the current period	27,168,946	25,039,945
Net Cost of Operations	$ (590,294)	$ 597,962

The accompanying notes are an integral part of these statements.

Defense Logistics Agency
Working Capital Fund

Distribution Overview

DISTRIBUTION ACTIVITY GROUP

The Distribution Activity Group operates through the Defense Distribution Center (DDC) in New Cumberland, PA, and 26 subordinate distribution centers located throughout the United States, Europe, Pacific and Southwest Asia region. The group's mission is to manage the receipt, storage, and issuance of DoD materiel. It may deliver that materiel to customers collocated on a base or to far-off ships, posts, and repair facilities. The activity group uses contracts with commercial sources to transport items from DLA-owned warehouses directly to customers worldwide. Some distribution centers are highly automated facilities that were specifically designed to provide global support for general commodities; while others fill customer requirements on a regional basis or may provide global support for materiel that requires special equipment, facilities, or training. For example, one distribution center - with nine subordinate satellite operations - provides global support for all map distribution requirements. The distribution centers maintain the accountable inventory records and are responsible for preserving about $94 billion (at selling price) in DoD materiel, representing over 3.8 million items. In addition, they processed 23 million receipt and issue transactions during FY 2006 and their business services generated more than $2.5 billion in revenue. This activity group employs approximately 8,100 civilian, 115 active duty, and 180 reserve military personnel.

Mission

The mission of the Distribution Activity Group is to provide the full range of distribution services and information enabling a seamless, tailored worldwide DoD distribution network that delivers effective, efficient and innovative support to the Combatant Commands, the Military Services and other Agencies during peace and war. The distribution network ensures that America's Warfighters receive competitively priced and best value distribution services by providing "around the clock - around the world," world-class service. The Distribution Activity Group is also responsible for the DLA transportation management functions which supports all shipments, both first and second destination.

Strategic Goals

The strategic goals established by the Distribution Activity Group are consistent with those contained in the DLA Strategic Plan. These goals are achieved through a series of supporting strategies that will:

- Increase our reliability and value coupled with a faster response time to our customers by continuously improving and reengineering business practices;

- Provide best-value solutions to our customers by continuously evaluating our activities and implementing changes, as necessary, to ensure efficient and effective distribution operations; and

- Reduce under-utilized infrastructure by eliminating unnecessary storage capacity.

FY 2006 Accomplishments

Infrastructure Cost Reduction through A-76 Cost Comparisons. In FY 1998, we began the process of competing our depots with private industry. The goal of these competitions is to reduce operating costs either by reengineering existing depot business processes or by inserting the market forces of competition into the distribution functions. As of the end of FY 2006, 13 sites have been competed, with the government retaining depot operations at six sites, while the other seven were contracted with private industry. The estimated long-term (FY 1998 - FY 2013) net savings from these thirteen competitions is in excess of $560 million.

Domestic Disaster Support: As part of the DLA Domestic Disaster plan to support the Federal Emergency Management Agency (FEMA) the DDC developed distribution initiatives to maintain 100% In-Transit Visibility of DLA shipped supplies using satellite tracking capability. DDC established a Defense Transportation Tracking System account to track DDC booked DLA shipments from the commercial vendor and/or distribution center to the FEMA drop-off destination. The DDC also established a Deployable Distribution Center, with positions battle-rostered and available to respond to domestic disaster situations in CONUS. This response will be in concert with the coordinated requirements and capabilities of both FEMA and the U.S. Northern Command (USNORTHCOM).

Theater Consolidation and Shipping Point – Kuwait: In FY 2006, DLA accepted the transfer of the Army Theater Distribution Center (TDC) in Kuwait at Camp Arifjan and established the Theater Consolidation and Shipping Point (TCSP). The TCSP is the primary conduit for sustaining theater operations by rapidly consolidating or segregating shipments from multiple sources and then preparing and forwarding those shipments directly to the customer. Key features of the TCSP include the capability to maintain visibility of the transportation control numbers; and asset control. Collectively, these features will allow for the movement of palletized materiel directly from the receiving dock to the shipping dock. The ability to “cross-dock” eliminates the need for any storage or staging and facilitates an efficient transition from inbound to outbound operations.

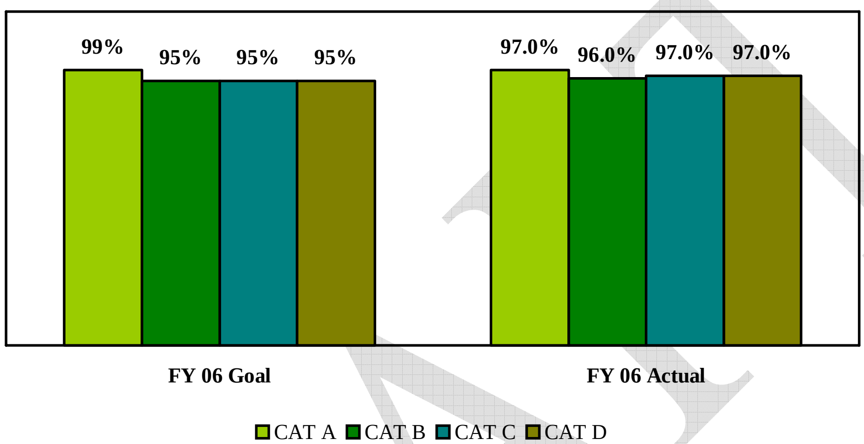
Program Performance Measures

Inventory Record Accuracy: This performance metric measures the accuracy of inventory records using statistical sampling techniques, which are performed semi-annually. Starting in FY 1999, DLA incorporated established DoD stratification and tolerance levels into the inventory sampling methodology. The DoD plan takes into consideration item characteristics such as dollar value and provides a means to focus resources commensurate with the significance of the errors found.

The FY 2006 goals for inventory accuracy were: 99% for items in the high dollar strata (Category A) and 95% for the remaining three strata. Our record accuracy for the high dollar Category (A) was 99%; Category (B) was 96%; Category (C) was 97%; and Category (D) was 97%.

Category A: Unit Price > $1,000
Category B: Unit of Issue Not Equal to Each **OR** On-Hand Balance > 50 **AND** Extended Dollar Value < $50,000 **OR** Activity > 50 per year
Category C: On-Hand Balance < 50 **AND** Date of Last Inventory > 24 Months
Category D: All Others

Inventory Accuracy
% Accuracy of Inventory Records



The FY 2006 year-end performance sample inventory shows improved performance in three of the four categories. Overall, nine depots have met the goal in all four categories with the remaining sites showing marked improvement. DDC achieved its accuracy goals by correcting its accountable balance records and providing training in distribution processes.

Maintaining Process Performance: The actual FY 2006 workload of 23 million lines was 10% less than projected. All performance metrics were within the DLA goals. Continued operational streamlining and reengineering of the workplaces has had a positive impact on performance:

	FY 06 Goal	FY 06 Actual
High Priority Requisitions (Shipped in)	1 Day	0.7 Day
Routine Requisitions (Shipped in)	1 Day	0.8 Day
New Procurement Receipts (Stored in)	1 Day	0.8 Day
Customer Returns (Stored in)	3 Days	2.0 Days
Denial Rate (Ordered Materiel Unavailable)	0.5%	0.40%
Location Accuracy (Materiel locations verified)	99.0%	99.6%

Program Initiatives

The following initiatives led to greater operational efficiencies and effectiveness of the Distribution Activity Group during FY 2006:

- **Deployment Distribution Operations Center Pilot Project:** DLA partnered with the United States Transportation Command, the Joint Munitions Command, and the United States Central Command to establish the Deployment Distribution Operations Center (DDOC) pilot project. The DDOC is a cross-command, cross-Service team that focuses on integrating movement of DLA and Military Service sustainment cargo, deploying forces and equipment, and managing in-theater stocks. The goal is to optimize the use of personnel and equipment (aircraft, MHE, etc.) by improving asset visibility and sustaining pipeline velocity, using Department of Defense transportation assets.

- **Distribution Planning and Management System (DPMS):** DPMS is a DLA transformational initiative to improve the management of product movements from vendors and distribution centers to customers. When deployed it will result in better coordination, visibility, and precise stock positioning. The DPMS program reached full operational capability at the end of FY 2006.

- **Enterprise-wide Transportation System:** DLA will achieve economies and efficiencies by consolidating and centralizing the management and services for seven of its eight supply chains (Energy has transportation requirements unique to its supply chain). When completed near the end of FY 2007, this system will establish a single point of contact for vendors, supply chain representatives and eventually the carriers. It will improve the reliability and predictability of transportation delivery time and other services by standardizing business practices and driving down transportation lead time.

- **Customer Relationship Management (CRM):** CRM provides the processes and tools that will enable DLA to optimize value and exceed the expectations of both DLA and its customers. Standardized enterprise-wide processes for sales (Account and Opportunity Management), marketing, service management and analytics were developed and implemented. All CRM functional responsibilities in these processes reside in the DDC Customer Support (CS) organization. CS participates in all aspects of the CRM process transformation with 51 personnel assigned multiple CRM roles. While all personnel are assigned sales and service roles, 26 also hold marketing roles, while 5 hold analytics roles. In addition to this organic capability, CS has contractor support to fulfill its business process analyst (BPA) roles. The BPAs are actively engaged in developing systemic and process improvements as well as providing sustainment support for training and issue resolution for DDC end users.

- **Defense Transportation Coordination Initiative (DTCI):** DTCI is a Continental United States (CONUS) freight initiative that focuses on reducing cycle time and improving predictability through optimization and increased coordination. DTCI will provide DoD, DLA and the DDC with greater insight on shipment consolidation and transportation cost reduction opportunities throughout the DoD transportation enterprise. This initiative contributes to the DoD goal to integrate the Department's logistics to make it more responsive to warfighter readiness while achieving greater efficiency. DTCI contract award for selection of a nationwide transportation coordinator is expected in early FY 2007 and is anticipated to be rolled out to DDC Distribution Centers during FY 2008.

- **Augmentation of Passive Radio Frequency Identification (RFID) Portals:** The DDC installed passive radio frequency identification portals across its global logistics network. The current initiative to expand DDC's existing passive RFID infrastructure will bring DDC into compliance with the Department of Defense policy to make DOD distribution centers capable of receiving passive RFID tags as suppliers begin tagging their products in compliance with acquisition regulations. All 19 of DDC's distribution centers in the continental United States will be equipped with RFID portals by September of this year. Portal installation at DDC's seven overseas sites will be complete in FY 2007.

Financial Performance Measures

We measure the effectiveness of program budgeting and execution with unit cost performance measures. The following table depicts the distribution unit cost results for processing and storage cost rates.

Unit Cost Results	FY 06 Goal	FY 06 Actual
Unit Cost-Total Composite Processing Rate	$23.92	$23.95
Unit Cost-Covered Storage	$3.11	$3.40

The Unit Cost-Total Composite Processing Rate measures processing costs (direct, indirect, and applied overhead) relative to the number of line items (receipts and issues) processed.

The Unit Cost-Covered Storage measures the costs (direct, indirect, and applied overhead) to provide covered storage to the cubic footage used.

Actual processing unit cost was above goal by $.03. Actual processing workload was 22.6 million lines or 2.4 million lines more than our original FY 2006 estimate. Actual processing cost (without Second Destination Transportation) was $540 million, or $1.0 million above plan.

Actual covered storage unit cost was higher than the goal due to a reduced level of covered storage workload. Actual covered storage workload was 79 million cubic feet or 10 million cubic feet less than the 89 million cubic feet that was forecasted. Actual storage costs were $299 million or $14 million less than the $313 million budgeted due to decreased facility maintenance obligations and depreciation.

Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of expenses over revenue of approximately $14 million. This loss was primarily related to the processing business where workload declined significantly below forecasted levels. Because of the fixed and overhead components, the business area could not fully reduce costs enough to offset the decline in revenue caused by lower workload.

Defense Logistics Agency
Working Capital Fund

Distribution

Comparative Financial Statements
As of and for the Years Ended September 30, 2006 and 2005

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Comparative Balance Sheets
As of September 30, 2006 and 2005
(In Thousands)

	2006	2005
ASSETS (Note 2)		
Intragovernmental:		
Accounts Receivable (Note 4)	$ 156,040	$ 84,104
Total Intragovernmental Assets	$ 156,040	$ 84,104
Accounts Receivable, Net (Note 4)	$ 871	$ 2,407
General Property, Plant, and Equipment, Net (Note 8)	580,574	626,257
Other Assets (Note 5)	176	338
TOTAL ASSETS	$ 737,661	$ 713,106
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	$ 30,477	$ 33,529
Other Liabilities (Notes 12 & 13)	43,792	18,608
Total Intragovernmental Liabilities	$ 74,269	$ 52,137
Accounts Payable (Note 10)	$ 89,253	$ 461,714
Military Retirement and Other Federal Employment Benefits (Note 14)	186,714	77,315
Other Liabilities (Notes 12 & 13)	49,045	38,812
TOTAL LIABILITIES	$ 399,281	$ 629,978
NET POSITION		
Cumulative Results of Operations – Other Funds	$ 338,380	$ 83,128
TOTAL NET POSITION	$ 338,380	$ 83,128
TOTAL LIABILITIES AND NET POSITION	$ 737,661	$ 713,106

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Comparative Statements of Net Cost
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 15)

	2006	2005
Program Costs		
Gross Costs	$ 2,564,380	$ 2,904,590
(Less: Earned Revenue)	(2,550,372)	(2,767,143)
Net Program Costs	$ 14,008	$ 137,447
Net Cost of Operations	$ 14,008	$ 137,447

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Distribution

Comparative Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006	2005
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 83,128	$ 305,647
Budgetary Financing Sources:		
Appropriations used	25,000	200
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	196,871	(131,626)
Imputed financing from costs absorbed by others	47,389	46,354
Total Financing Sources	269,260	(85,072)
Net Cost of Operations (+/-)	14,008	137,447
Net Change	255,252	(222,519)
Ending Balances	$ 338,380	$ 83,128

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Comparative Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006	2005
UNEXPENDED APPROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	$ 25,000	$ 200
Appropriations used	(25,000)	(200)
Ending Balances	$ -	$ -

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006	2005
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Budget authority:		
Appropriation	$ 25,000	$ 200
Contract authority	2,452,624	2,788,702
Spending authority from offsetting collections:		
Earned		
Collected	2,482,910	2,960,640
Change in receivables from Federal sources	69,683	(199,932)
Change in unfilled customer orders		
Without advance from Federal sources	(53,160)	70,887
Subtotal	4,977,057	5,620,497
Permanently not available	(2,524,433)	(2,831,795)
Total Budgetary Resources	$ 2,452,624	$ 2,788,702

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006	2005
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 2,452,624	$ 2,788,702
Total Status of Budgetary Resources	$ 2,452,624	$ 2,788,702
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 721,862	$ 728,500
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(247,623)	(376,668)
Total unpaid obligated balance	474,239	351,832
Obligations incurred net (+/-)	2,452,624	2,788,702
Less: Gross outlays	(2,701,292)	(2,795,339)
Change in uncollected customer payments from Federal sources (+/-)	(16,523)	129,045
Obligated balance, net – end of period		
Unpaid obligations	473,195	721,863
Less: Uncollected customer payments from Federal sources (+/-)	(264,147)	(247,623)
Total unpaid obligated balance, net, end of period	209,048	474,240
Net Outlays		
Net Outlays:		
Gross outlays	2,701,292	2,795,339
Less: Offsetting collections	(2,482,910)	(2,960,640)
Net Outlays	$ 218,382	$ (165,301)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Comparative Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006	2005
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 2,452,624	$ 2,788,702
Less: Spending authority from offsetting collections and recoveries	(2,499,433)	(2,831,595)
Obligations net of offsetting collections and recoveries	(46,809)	(42,893)
Net obligations	(46,809)	(42,893)
Other Resources		
Transfers-in/out without reimbursement (+/-)	196,871	(131,626)
Imputed financing from costs absorbed by others	47,389	46,354
Net other resources used to finance activities	244,260	(85,272)
Total resources used to finance activities	$ 197,451	$ (128,165)
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	(108,334)	53,250
Unfilled Customer Orders	(53,160)	70,887
Resources that fund expenses recognized in prior periods	-	(109)
Resources that finance the acquisition of assets	(39,564)	(47,023)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Other (+/-)	(196,871)	131,626
Total resources used to finance items not part of the net cost of operations	(397,929)	208,631
Total resources used to finance the net cost of operations	$ (200,478)	$ 80,466

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Distribution

Comparative Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006	2005
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 annual leave liability	$ 1,055	$ -
Other (+/-)	124,961	1,479
Total components of Net Cost of Operations that will require or generate resources in future periods	126,016	1,479
Components Not Requiring or Generating Resources		
Depreciation and amortization	63,493	65,597
Revaluation of assets or liabilities (+/-)	25,244	(10,116)
Other (+/-)		
Other	(267)	21
Total components of Net Cost of Operations that will not require or generate resources	88,470	55,502
Total components of net cost of operations that will not require or generate resources in the current period	214,486	56,981
Net Cost of Operations	$ 14,008	$ 137,447

The accompanying notes are an integral part of these statements.

Defense Logistics Agency
Working Capital Fund

Reutilization and Marketing Overview

DEFENSE REUTILIZATION AND MARKETING ACTIVITY GROUP

The Defense Reutilization and Marketing Service (DRMS) coordinate the reuse of excess and surplus DoD property. The reutilization of excess materiel by DoD customers reduces the need to purchase new materiel. In FY 2006, materiel with an acquisition value of $24.7 billion was turned in to DRMS and $1.8 billion was reutilized within DoD. DRMS also oversees the demilitarization and disposal of the remaining property through transfers, donations, and sales, or its ultimate disposal as in the case with hazardous waste The DRMS headquarters is located in Battle Creek, MI, and its mission is accomplished through 85 Defense Reutilization and Marketing Offices (DRMOs) located on military installations throughout the world. DRMOs receive, classify, segregate, demilitarize, account for, and dispose of excess materiel in accordance with all applicable laws and regulations.

Mission

DRMS manages the reutilization, transfer, donation, and sale of military personal property as well as disposal of hazardous waste items no longer needed for national defense. The DRMS mission is to safeguard national security while maximizing the financial return on the initial equipment investment, conserve valuable natural resources, and protect the environment. The business services provided by this activity group generated revenues of more than $316 million in FY 2006 and employs approximately 1,380 civilian, 10 active duty, and 180 reserve military personnel.

Strategic Goals

The long-term goals of the Reutilization and Marketing activity group are consistent with the goals contained in the DLA Strategic Plan. These goals are achieved through a series of supporting objectives and initiatives designed to improve and reengineer business practices to ensure efficient, effective, and best-value operational support.

The DoD disposal business model calls for a balance between maximizing the use of property with an absolute requirement to prevent it from getting into the hands of the wrong people. DRMS is committed to eliminating the release of potentially harmful property to the public even if it results in reduced revenues and increased costs. It must continue to balance the maximum reutilization of property with controls over potential vulnerabilities and the costs and benefits of improvement.

DRMS' ultimate goals are to continue to provide quality support to the war fighter, mitigate risks to national security by strengthening the disposal process and inventory accountability, and ensure taxpayer dollars are spent appropriately.

In short, DRMS "PR0VES" it is the provider of choice for disposal solutions by:

Preventing unauthorized releases;
Reutilizing as much as possible, DRMS adds value to the American taxpayer. By ensuring
0 defects;
Verifying everything;
Executing its operations flawlessly, and
Selling only what should be sold, it protects National Security.

FY 2006 Accomplishments

Reduced Concurrent Procurement: Numerous actions were taken to reduce the frequency of organizations procuring the same items they are disposing as excess but still in serviceable condition. Specific actions included:

- Appointed DRMS personnel to work with the DLA Supply Centers to increase reutilization;
- Met with senior Military Service representatives to increase reutilization and determine how their existing systems can interface with DLA's systems;
- Increased use of existing DLA systems such as the Automated Asset Reutilization Program;
- Updated systems to allow DLA activities to automatically match DRMS excess property assets against DLA inventory retention levels;
- Expanded use of automated want lists; and
- Notified past customers of available property via email alerts and provided photographs of high dollar and/or unique good condition items on the DRMS website.

These actions resulted in annual increases of 8% in the number of line items and 20% in acquisition value of excess property reutilized/recouped by DLA Supply Centers as compared to FY 2005. Overall the reutilization rate for the best quality property increased from 18% in FY 2005 to 23% in FY 2006.

Enhanced Automated Asset Reutilization Program (AARP): AARP was integrated into Business Systems Modernization which became operational in January 2006. As a result, DLA is maximizing the utilization of its excess inventory assets and will reduce the need to procure items when quality assets are available. Since the beginning of January, DRMS filled almost 2,000 requisitions with an acquisition value of almost $1.5 million.

Established Controlled Property Centers (CPCs): CPCs receive, thoroughly review and research property with specified Local Stock Numbers and property consolidated into batchlots from designated feeder sites. After this process, the property goes through the appropriate disposition channel to mitigate the release of unauthorized property to the public. In August 2006, DRMS established the first CPC at Columbus, OH, which processed over 120 batchlots containing over 2,100 line items. Three additional CPCs will be established in CONUS early in FY 2007. Planning is underway to establish CPCs in the Europe and Asia Pacific areas.

Safeguarding Excess/Surplus Property: DRMS will spend $42 million from FY 2006 – 2011 on a priority basis to upgrade the physical security at DRMOs. Facility projects totaling $6.4 million were executed in FY 2006 based on the greatest need. Significant changes also were implemented to tighten the walk-in procedures for property removal. DRMS now ensures that authorization letters and potential screeners are independently verified before property is released. DRMS also instituted weekly site inspections of contractor facilities where security risks exist.

Most Efficient Organization (MEO): Transition to full MEO status for stock, store and issue functions in CONUS was completed with 100% inventory accuracy. The stand-up of the MEO has resulted in a reduced organizational and physical structure. The MEO operates 18 fully staffed DRMO warehousing operations compared to 68 prior to MEO implementation.

Disposal of Polychlorinated Biphenyls (PCBs): In May 2006, DRMS awarded a PCB disposal contract to a local Korean firm to obtain the international regulatory approvals to remove PCBs from Korea. Consequently, DRMS executed two shipments to Europe – effectively removing 377,000 pounds of PCBs from Korea. Final disposal of these PCBs will take place at an approved Treatment and Disposal Facility in France. DRMS also completed two commercial retrograde shipments of U.S.-made PCBs from Japan to the United States. As a result of these shipments, a total of 192,000 pounds of U.S.-made PCBs were disposed at an EPA-approved disposal facility in Kansas.

Fielding of Disposal Service Representatives (DSRs): DSRs are uniquely qualified to bring a vast array of knowledge, experience, and decision-making authority directly to the customer. Over 160 DSRs were permanently deployed to assist with issues such as pre-inspection of generator property, reutilization procurement, environmental support, and liaison with DRMS-contracted partners.

Forward Deployed Operations: In June 2006 DRMS opened a third DRMO, Camp Speicher, in Iraq; and a fourth DRMO, Camp Victory, is scheduled to open in October 2006. DRMS activities in Southwest Asia can now receive unserviceable personal property, as well as scrap and hazardous property. These forward locations are authorized to execute the full-range of operations to include: local disposal options, sales, demilitarization of military sensitive items, and the reutilization of in-theatre assets.

Environmental Management System (EMS): DRMS fully implemented its EMS by developing the DRMS EMS core instruction and site-specific supplements for the 101 designated facilities; and then training over 95 Environmental Management Representatives. This implementation was instrumental in the decision to honor the DLA Environmental Management System team with the Secretary of Defense Environmental Award in May 2006.

Scrap Venture (SV): In an effort to leverage the private sector's unique ability, DRMS partnered with a commercial firm to sell scrap throughout the continental United States, excluding the

Carolinas and Tennessee. In accordance with the agreement, DRMS received 80% of the proceeds derived from these sales. In FY 2006, the average price per pound of scrap sold under SV was $.16 compared to a pre-SV average of $.05.

Program Performance Measures

Reutilization/Transfer/Donation (R/T/D) rate: This indicator represents the aggregate number of line items of the property reutilized, transferred, and donated expressed as a percentage of the total line items disposed. The indicator applies to the available assets that are economically reused. It addresses disposal via reutilization by another defense customer, transfer to another Federal Agency, or donation to an eligible state or local government or to a non-profit organization. R/T/D dispositions, as a percentage of total dispositions, indicate compliance with Federal regulations that mandate reuse through these cost avoidance programs as the first priority of disposal. In FY 2006, DRMS successfully reutilized, transferred, or donated over 227,000 line items of excess property for an R/T/D rate of about 19.5%, which exceeded the goal of at least 17%.

- Operations Enduring Freedom and Iraqi Freedom Reutilization: Total reutilization supporting these two contingencies surpassed 31,000 line items with a value of $162 million. Examples of the types of items issued in support of these operations include vehicles, tanks, trucks, and body armor.

- Computers for Learning: DRMS is responsible for overseeing the transfer of computers to schools in support of the Department's Computers for Learning Program. In FY 2006, over 1,000 schools were approved to participate in the program, and computers worth over $79 million in acquisition value were transferred.

R/T/D will continue to increase as a percentage of total dispositions by:

- Marketing high dollar, good condition items through scrolling photos on the RTD website. This new advertising method became effective on March 29, 2006. In the first five months of operation, DRMS received almost 200 requisitions for property with an original acquisition value of $42 million.

- Pushing (to past customers) inventory alerts of the availability of same/similar items. This new initiative began on March 29, 2006. In the first five months of operation, DRMS received over 8,600 requisitions for property with an original acquisition value of $55 million.

- Implementing changes that will improve the information on available property. This includes providing more photos on the web and better written descriptions.

- Working closely with DLA and DoD supply centers to fill backorders and new purchase requests.

- Testing longer screening timeframes for higher quality property.

Financial Performance Measures

We measure the effectiveness of program budgeting and execution with unit cost performance measures. Cost is defined as obligations incurred in support of or attributed to the service performed. DRMS is measured on five unit cost goals; Receiving, Reutilization/Transfer/Donation (R/T/D), Useable Sales, Hazardous Waste Disposal, and Recycling/Disposal. The table below depicts the unit cost results for each category.

Financial Performance Measures	FY 06 Goal	FY 06 Actual
Cost incurred per line item of useable property received – Receiving	$27.372	$30.385
Cost incurred per line item – Reutilization/Transfer/Donation (R/T/D)	$277.063	$167.579
Cost incurred per line item – Useable Sales	$30.862	$28.173
Cost incurred per pound – Hazardous Waste Disposal	$0.175	$.264
Cost incurred per pound – Recycling/Disposal	$.040	$.037

The unit cost for Useable Property Received exceeded the plan by 11%. Costs were on plan, however, the number of line items received was 11% below plan (3.1 million line items actually received versus 3.5 million line items planned). This was primarily due to backlogs of property in CONUS during implementation of the Most Efficient Organization (MEO) where approximately 80% of the MEO workforce had no prior disposal experience. The MEO also had to reconstitute a government workforce at 10 DRMOs in the Northeastern U.S. which were converted from contractor performance. These factors resulted in decreased productivity during FY 2006. As employees receive training and gain experience, backlogs will decrease and are expected to be eliminated during the first quarter of FY 2007.

The unit cost for R/T/D was 40% lower than planned. Costs were below plan while workload was 25% above plan (227,000 line items disposed by R/T/D versus 181,500 line items planned). The additional workload was due primarily to hurricane-relief efforts and the initiatives designed to increase the reutilization of property to reduce concurrent procurement.

The unit cost for Useable Sales was 9% lower than planned. Costs were 25% below plan while workload was 18% below plan (533,700 line items sold versus 651,600 line items planned). The majority of useable property is sold through a Commercial Venture partnership. While fewer line items were sold than planned, revenue from the partnership met plan at $57 million.

The unit cost for Hazardous Waste (HW) Disposal was 51% above plan. This was due to less workload than planned (161.7 million pounds disposed versus 230.0 million pounds planned). The decreased workload was primarily in CONUS and due to the deployment of troops, particularly

National Guard and Reserve Units, to Southwest Asia. Some of the decrease can also be attributed to waste minimization efforts as generators implement new Environmental Management System (EMS) processes that reduce the procurement and production of hazardous substances.

The unit cost for Recycling/Disposal was 8% lower than planned. Costs were on plan while workload was 6% above plan (1,206 million pounds of scrap processed versus 1,142 million pounds planned). Much of this higher workload is attributed to disposal operations in Southwest Asia in support of Operation Enduring Freedom and Operation Iraqi Freedom (OEF/OIF).

Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of revenue over expenses of approximately $18 million. This gain reflects lower revenue (decreases in service level billings offset by increases in the scrap sales area), as well as overall decreases in expenses resulting from the cleanup of accounts payable records.

Defense Logistics Agency
Working Capital Fund

Reutilization and Marketing

Comparative Financial Statements
As of and for the Years Ended September 30, 2006 and 2005

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Comparative Balance Sheets
As of September 30, 2006 and 2005
(In Thousands)

	2006	2005
ASSETS (Note 2)		
Intragovernmental:		
Accounts Receivable (Note 4)	$ (33)	$ (101)
Total Intragovernmental Assets	$ (33)	$ (101)
Cash and Other Monetary Assets (Note 6)	$ 7,971	$ 18,952
Accounts Receivable, Net (Note 4)	1,641	6,827
General Property, Plant, and Equipment, Net (Note 8)	66,878	69,423
Other Assets (Note 5)	118	74
TOTAL ASSETS	$ 76,575	$ 95,175
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	$ 16,218	$ 16,065
Other Liabilities (Notes 12 & 13)	23,697	4,942
Total Intragovernmental Liabilities	$ 39,915	$ 21,007
Accounts Payable (Note 10)	$ 37,804	$ 48,371
Military Retirement and Other Federal Employment Benefits (Note 14)	18,799	18,203
Other Liabilities (Notes 12 & 13)	20,694	46,019
TOTAL LIABILITIES	$ 117,212	$ 133,600
NET POSITION		
Cumulative Results of Operations – Other Funds	$ (40,637)	$ (38,425)
TOTAL NET POSITION	$ (40,637)	$ (38,425)
TOTAL LIABILITIES AND NET POSITION	$ 76,575	$ 95,175

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Reutilization & Marketing

Comparative Statements of Net Cost
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 15)

		2006		2005
Program Costs				
Gross Costs	$	298,076	$	330,289
(Less: Earned Revenue)		(316,180)		(349,403)
Net Program Costs	$	(18,104)	$	(19,114)
Net Cost of Operations	$	(18,104)	$	(19,114)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Reutilization & Marketing

Comparative Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006	2005
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ (38,425)	$ (48,105)
Budgetary Financing Sources:		
Appropriations used	1,777	-
Transfers-in/out without reimbursement (+/-)	900	-
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(31,366)	(17,969)
Imputed financing from costs absorbed by others	8,373	8,535
Total Financing Sources	(20,316)	(9,434)
Net Cost of Operations (+/-)	(18,104)	(19,114)
Net Change	(2,212)	9,680
Ending Balances	$ (40,637)	$ (38,425)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Comparative Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006	2005
UNEXPENDED APPROPRIATIONS		
Budgetary Financing Sources:		
Appropriations received	$ 1,950	$ -
Other adjustments (rescissions, etc.) (+/-)	(173)	-
Appropriations used	(1,777)	-
Ending Balances	$ -	$ -

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006	2005
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ -	$ (36,104)
Budget authority:		
Appropriation	1,950	-
Contract authority	290,405	307,007
Spending authority from offsetting collections:		
Earned		
Collected	321,589	351,237
Change in receivables from Federal sources	(5,508)	(5,825)
Change in unfilled customer orders		
Advance received	2,341	(12,638)
Without advance from Federal sources	(3,663)	5,352
Subtotal	607,114	645,133
Nonexpenditure transfers, net, anticipated and actual	900	5,924
Permanently not available	(317,609)	(307,946)
Total Budgetary Resources	$ 290,405	$ 307,007

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006	2005
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 290,405	$ 307,007
Total Status of Budgetary Resources	$ 290,405	$ 307,007
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 128,319	$ 142,924
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(11,391)	(11,863)
Total unpaid obligated balance	116,928	131,061
Obligations incurred net (+/-)	290,405	307,007
Less: Gross outlays	(295,317)	(321,612)
Change in uncollected customer payments from Federal sources (+/-)	9,172	473
Obligated balance, net – end of period		
Unpaid obligations	123,408	128,319
Less: Uncollected customer payments from Federal sources (+/-)	(2,219)	(11,391)
Total unpaid obligated balance, net, end of period	121,189	116,928
Net Outlays		
Net Outlays:		
Gross outlays	295,316	321,612
Less: Offsetting collections	(323,930)	(338,599)
Net Outlays	$ (28,614)	$ (16,987)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Comparative Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

		2006		2005
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
Obligations incurred	$	290,405	$	307,007
Less: Spending authority from offsetting collections and recoveries		(314,759)		(338,126)
Obligations net of offsetting collections and recoveries		(24,354)		(31,119)
Net obligations		(24,354)		(31,119)
Other Resources				
Transfers-in/out without reimbursement (+/-)		(31,365)		(17,970)
Imputed financing from costs absorbed by others		8,373		8,535
Net other resources used to finance activities		(22,992)		(9,435)
Total resources used to finance activities	$	(47,346)	$	(40,554)
Resources Used to Finance Items Not Part of the Net Cost of Operations				
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:				
Undelivered Orders		(4,106)		8,855
Unfilled Customer Orders		(1,322)		(7,286)
Resources that fund expenses recognized in prior periods		(1,157)		-
Resources that finance the acquisition of assets		(5,226)		(6,276)
Other resources or adjustments to net obligated resources that do not affect net cost of operations				
Other (+/-)		31,366		17,969
Total resources used to finance items not part of the net cost of operations		19,555		13,262
Total resources used to finance the net cost of operations	$	(27,791)	$	(27,292)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Reutilization & Marketing

Comparative Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006	2005
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 annual leave liability	$ 828	$ -
Other (+/-)	596	653
Total components of Net Cost of Operations that will require or generate resources in future periods	1,424	653
Components Not Requiring or Generating Resources		
Depreciation and amortization	7,733	8,259
Revaluation of assets or liabilities (+/-)	(37)	13
Other (+/-)		
Other	567	(747)
Total components of Net Cost of Operations that will not require or generate resources	8,263	7,525
Total components of net cost of operations that will not require or generate resources in the current period	9,687	8,178
Net Cost of Operations	$ (18,104)	$ (19,114)

The accompanying notes are an integral part of these statements.

Defense Logistics Agency
Working Capital Fund

Document Automation & Production Service
Overview

DOCUMENT AUTOMATION & PRODUCTION SERVICE

The Document Automation & Production Service (DAPS) is responsible for printing, duplicating, and document automation programs. This responsibility encompasses the full range of automated services to include: document workflow conversion, electronic storage and output, and distribution of hard copy and digital information. DAPS provides time sensitive, competitively priced, high quality products and services that are either produced in-house or procured through the Government Printing Office. DAPS manages its mission through a headquarters, located in Mechanicsburg, PA, and a worldwide network of 194 production facilities. During FY 2006, DAPS earned approximately $356 million in revenue and employed approximately 750 civilians at year-end. Major customers were: Air Force (23%), Navy (27%), Army (21%), Defense Agencies (23%), and non-DoD customers (6%).

Mission

The mission of DAPS is to provide best value document automation and management services in support of America's Armed Forces and Federal Agencies. DAPS' value to DoD is characterized by two elements. First, DAPS provides a full portfolio of best value document services ranging from traditional offset printing, through on-demand output, to online document services and workflow. Second, DAPS actively functions as a transformation agent moving DoD towards the use of online documents and services. These services include building libraries of digital documents to permit online access, providing multifunctional devices (that print from networks, copy, fax and scan) in customer workspaces, and converting paper documents to target digital formats.

Strategic Goals

DAPS is committed to the following goals:

- Serving as a major catalyst in transforming business by revolutionizing document automation services;
- Rapidly utilizing technology for agile and responsive internal business solutions;
- Aggressively pursuing partnerships with government, industry, and suppliers;
- Ensuring the DAPS workforce is enabled to deliver and sustain world-class performance;
- Striving to reduce costs, simplify organizational structure, eliminate unnecessary facilities, and ensure that equipment and personnel are commensurate with the workload; and
- Aligning our processes to focus on improving the quality of our products and services while meeting or exceeding our customers' delivery requirements.

Program Performance Measures

Conversion to Digital Format: This performance metric measures the number of pages that were converted to digital format during the year. Conversions are accomplished either in-house or by contract and include hardcopy to digital, system output to digital, and from one form of digital to another. Actual production of 62.0 million pages was 2% below the goal to convert 63.2 million pages. The primary reason for the below plan result was a decrease in the number of procurement solicitation pages processed through Procurement Gateway.

Product Rework: In-house rework percentage is used to measure the quality of delivered products. This performance metric is calculated by dividing revenue lost from orders not accepted by the total in-house production revenue. During FY 2006, DAPS achieved a rework percentage of 0.240 to better the goal of 0.304%.

Customer Satisfaction: This performance metric measures satisfied customers as the percentage of customers ranking DAPS performance as "satisfied" or "very satisfied." DAPS uses a survey professionally prepared and administered by an independent commercial entity to determine an overall customer satisfaction rating. DAPS achieved a customer satisfaction rating of 97% for FY 2006, exceeding its goal of 90%.

On-Time Delivery (In-house Production): This performance metric measures the timeliness of customer order completion. The performance metric is calculated by dividing the total number of orders filled on time by a DAPS owned and operated production facility (in-house) by the total number of orders filled by one of these facilities. DAPS achieved an on-time delivery rate of 99.27%, exceeding its goal of 98%.

Financial Performance Measures

In addition to program performance measures, DAPS measures the effectiveness of program budgeting and execution with a unit cost performance measure. It measures the total units produced relative to the total cost to produce those items.

Unit Cost Results	**FY 06 Goal**	**FY 06 Actual**
Unit Cost per In-House Production Unit	.0477	.0446

DAPS produced fewer - more than 5% fewer - in-house units than planned (2,841 million actual versus 3,003 million planned); and actual in-house costs were almost 12% lower than planned ($126.7 million actual versus $143.3 million planned). By incurring significantly less cost, while producing slightly fewer units DAPS was able to better its unit cost goal by more than 6%.

Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of revenue over expenses of more than $3.4 million.

Defense Logistics Agency
Working Capital Fund

Document Automation and Production Service

Comparative Financial Statements
As of and for the Years Ended September 30, 2006 and 2005

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Document Automation and Production Service

Comparative Balance Sheets
As of September 30, 2006 and 2005
(In Thousands)

	2006	2005
ASSETS (Note 2)		
Intragovernmental:		
Accounts Receivable (Note 4)	$ 3,334	$ 30,748
Total Intragovernmental Assets	$ 3,334	$ 30,748
Cash and Other Monetary Assets (Note 6)	$ 4,129	$ 511
Accounts Receivable, Net (Note 4)	233	1,827
Inventory and Related Property, Net (Note 7)	8,705	9,124
General Property, Plant, and Equipment, Net (Note 8)	10,551	12,567
Other Assets (Note 5)	(3)	-
TOTAL ASSETS	$ 26,949	$ 54,777
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	$ 4,428	$ 7,773
Other Liabilities (Notes 12 & 13)	2,596	2,986
Total Intragovernmental Liabilities	$ 7,024	$ 10,759
Accounts Payable (Note 10)	$ 72,524	$ 71,054
Military Retirement and Other Federal Employment Benefits (Note 14)	10,278	10,747
Other Liabilities (Notes 12 & 13)	(57,734)	(28,172)
TOTAL LIABILITIES	$ 32,092	$ 64,388
NET POSITION		
Cumulative Results of Operations – Other Funds	$ (5,143)	$ (9,611)
TOTAL NET POSITION	$ (5,143)	$ (9,611)
TOTAL LIABILITIES AND NET POSITION	$ 26,949	$ 54,777

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation and Production Service

Comparative Statements of Net Cost
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 15)

		2006		2005
Program Costs				
Gross Costs	$	352,905	$	384,122
(Less: Earned Revenue)		(356,338)		(395,998)
Net Program Costs	$	(3,433)	$	(11,876)
Net Cost of Operations	$	(3,433)	$	(11,876)

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Document Automation and Production Service

Comparative Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 16)

	2006	2005
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ (9,611)	$ (9,217)
Beginning Balances, as adjusted	(9,611)	(9,217)
Budgetary Financing Sources:		
Transfers-in/out without reimbursement (+/-)	19	-
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(4,204)	(17,578)
Imputed financing from costs absorbed by others	5,220	5,308
Total Financing Sources	1,035	(12,270)
Net Cost of Operations (+/-)	(3,433)	(11,876)
Net Change	4,468	(394)
Ending Balances	$ (5,143)	$ (9,611)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation and Production Service

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

		2006		2005
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources:				
Unobligated balance, brought forward, October 1	$	(35,476)	$	(42,111)
Budget authority:				
Contract authority		3,118		1,801
Spending authority from offsetting collections:				
Earned				
Collected		351,474		383,943
Change in receivables from Federal sources		129		(1,812)
Change in unfilled customer orders				
Advance received		197		534
Without advance from Federal sources		115		(5,547)
Subtotal		355,033		378,919
Nonexpenditure transfers, net, anticipated and actual		19		-
Permanently not available		6,114		(3,523)
Total Budgetary Resources	$	325,690	$	333,285

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation and Production Service

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 17)

	2006	2005
Status Of Budgetary Resources:		
Obligations incurred:		
Reimbursable	$ 356,510	$ 368,761
Subtotal	356,510	368,761
Unobligated balance:		
Apportioned	(30,820)	(35,476)
Subtotal	(30,820)	(35,476)
Total Status of Budgetary Resources	$ 325,690	$ 333,285
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 107,766	$ 105,904
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(82,570)	(89,928)
Total unpaid obligated balance	25,196	15,976
Obligations incurred net (+/-)	356,510	368,761
Less: Gross outlays	(347,485)	(366,898)
Change in uncollected customer payments from Federal sources (+/-)	(243)	7,358
Obligated balance, net – end of period		
Unpaid obligations	116,791	107,766
Less: Uncollected customer payments from Federal sources (+/-)	(82,813)	(82,569)
Total unpaid obligated balance, net, end of period	33,978	25,197
Net Outlays		
Net Outlays:		
Gross outlays	347,485	366,899
Less: Offsetting collections	(351,670)	(384,477)
Net Outlays	$ (4,185)	$ (17,578)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation and Production Service

Comparative Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006	2005
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 356,510	$ 368,761
Less: Spending authority from offsetting collections and recoveries	(351,914)	(377,118)
Obligations net of offsetting collections and recoveries	4,596	(8,357)
Net obligations	4,596	(8,357)
Other Resources		
Transfers-in/out without reimbursement (+/-)	(4,204)	(17,578)
Imputed financing from costs absorbed by others	5,220	5,308
Net other resources used to finance activities	1,016	(12,270)
Total resources used to finance activities	$ 5,612	$ (20,627)
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	(11,064)	(6,425)
Unfilled Customer Orders	311	(5,013)
Resources that fund expenses recognized in prior periods	(1,352)	(1,591)
Resources that finance the acquisition of assets	(983)	(61)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Other (+/-)	4,204	17,578
Total resources used to finance items not part of the net cost of operations	(8,884)	4,488
Total resources used to finance the net cost of operations	$ (3,272)	$ (16,139)

The accompanying notes are an integral part of these statements.

Unaudited

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND
Document Automation and Production Service

Comparative Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 18)

	2006	2005
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 annual leave liability	$ 31	$ -
Other (+/-)	8	-
Total components of Net Cost of Operations that will require or generate resources in future periods	39	-
Components Not Requiring or Generating Resources		
Depreciation and amortization	2,965	3,646
Revaluation of assets or liabilities (+/-)	(3,480)	(1,391)
Other (+/-)		
Other	315	2,008
Total components of Net Cost of Operations that will not require or generate resources	(200)	4,263
Total components of net cost of operations that will not require or generate resources in the current period	(161)	4,263
Net Cost of Operations	$ (3,433)	$ (11,876)

The accompanying notes are an integral part of these statements.

Defense Logistics Agency
General Fund

Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2006 and 2005

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Balance Sheets
As of September 30, 2006 and 2005
(In Thousands)

	2006 Consolidated	2005 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 783,763	$ 629,784
Accounts Receivable (Note 4)	7,945	1,224
Total Intragovernmental Assets	$ 791,708	$ 631,008
Accounts Receivable, Net (Note 4)	$ 365	$ (386)
General Property, Plant, and Equipment, Net (Note 6)	426,606	270,956
Other Assets (Note 5)	562	32
TOTAL ASSETS	$ 1,219,241	$ 901,610
LIABILITIES (Note 7)		
Intragovernmental:		
Accounts Payable (Note 8)	$ 3,781	$ 20,241
Other Liabilities (Note 10)	5,274	5,278
Total Intragovernmental Liabilities	$ 9,055	$ 25,519
Accounts Payable (Note 8)	$ 12,390	$ 10,051
Military Retirement and Other Federal Employment Benefits (Note 11)	6,787	5,402
Environmental and Disposable Liabilities (Note 9)	246,088	284,788
Other Liabilities (Note 10)	3,296	3,416
TOTAL LIABILITIES	$ 277,616	$ 329,176
NET POSITION		
Unexpended Appropriations – Other Funds	$ 780,802	$ 688,786
Cumulative Results of Operations – Other Funds	160,823	(116,352)
TOTAL NET POSITION	$ 941,625	$ 572,434
TOTAL LIABILITIES AND NET POSITION	$ 1,219,241	$ 901,610

The accompanying notes are an integral part of these statements.

Unaudited

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Statements of Net Cost
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 12)

	2006 Consolidated	2005 Consolidated
Program Costs		
Gross Costs	$ 377,073	$ 619,455
(Less: Earned Revenue)	(26,845)	(16,424)
Net Program Costs	$ 350,228	$ 603,031
Net Cost of Operations	$ 350,228	$ 603,031

The accompanying notes are an integral part of these statements.

Unaudited

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 13)

	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ (116,352)	$ (164,603)
Correction of Errors	-	(107,473)
Beginning Balances, as adjusted	$ (116,352)	$ (272,076)
Budgetary Financing Sources:		
Appropriations used	628,586	588,246
Other Financing Sources:		
Transfers-in/out without reimbursement (+ /-)	(71,901)	168,364
Imputed financing from costs absorbed by others	2,205	2,145
Other (+ /-)	68,513	-
Total Financing Sources	627,403	758,755
Net Cost of Operations (+ /-)	350,228	603,031
Net Change	277,175	155,724
Ending Balances	$ 160,823	$ (116,352)

The accompanying notes are an integral part of these statements.

Unaudited

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Statements of Changes in Net Position
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 13)

	2006 Consolidated	2005 Consolidated
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 688,786	$ 600,876
Budgetary Financing Sources:		
Appropriations received	$ 745,191	$ 655,926
Appropriations transferred-in/out (+ /-)	(8,266)	67,990
Other adjustments (rescissions, etc.) (+ /-)	(16,322)	(47,760)
Appropriations used	(628,587)	(588,246)
Total Financing Sources	92,016	87,910
Net Change	92,016	87,910
Ending Balances	$ 780,802	$ 688,786

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 14)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 160,922	$ 193,799
Recoveries of prior year unpaid obligations	48,770	10,428
Budget authority:		
Appropriation	745,191	655,926
Spending authority from offsetting collections:		
Earned		
Collected	20,470	19,290
Change in receivables from Federal sources	6,907	(2,765)
Subtotal	772,568	672,451
Nonexpenditure transfers, net, anticipated and actual	(8,266)	67,990
Permanently not available	(16,321)	(47,761)
Total Budgetary Resources	$ 957,673	$ 896,907

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 14)

	2006 Combined	2005 Combined
Status Of Budgetary Resources:		
Obligations incurred:		
Direct	$ 738,065	$ 718,076
Reimbursable	27,363	17,908
Subtotal	765,428	735,984
Unobligated balance:		
Apportioned	108,488	148,481
Subtotal	108,488	148,481
Unobligated balance not available	83,757	12,442
Total Status of Budgetary Resources	$ 957,673	$ 896,907
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 512,378	$ 505,722
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(1,389)	(4,153)
Total unpaid obligated balance	510,989	501,569
Obligations incurred net (+ /-)	765,428	735,985
Less: Gross outlays	(629,221)	(718,900)
Less: Recoveries of prior year unpaid obligations, actual	(48,770)	(10,428)
Change in uncollected customer payments from Federal sources (+ /-)	(6,907)	2,765
Obligated balance, net – end of period		
Unpaid obligations	599,813	512,378
Less: Uncollected customer payments from Federal sources (+ /-)	(8,296)	(1,389)
Total unpaid obligated balance, net, end of period	591,517	510,989
Net Outlays		
Net Outlays:		
Gross outlays	629,221	718,900
Less: Offsetting collections	(20,470)	(19,290)
Net Outlays	$ 608,751	$ 699,610

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 15)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 765,428	$ 735,984
Less: Spending authority from offsetting collections and recoveries	(76,147)	(26,953)
Obligations net of offsetting collections and recoveries	689,281	709,031
Net obligations	689,281	709,031
Other Resources		
Transfers-in/out without reimbursement (+/-)	(71,901)	168,365
Imputed financing from costs absorbed by others	2,205	2,145
Other (+/-)	68,512	-
Net other resources used to finance activities	(1,184)	170,510
Total resources used to finance activities	$ 688,097	$ 879,541
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	(104,434)	(55,636)
Resources that fund expenses recognized in prior periods	(41,951)	(413)
Resources that finance the acquisition of assets	-	(76,638)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Other (+/-)	3,389	(168,365)
Total resources used to finance items not part of the net cost of operations	(142,996)	(301,052)
Total resources used to finance the net cost of operations	$ 545,101	$ 578,489

The accompanying notes are an integral part of these statements.

Unaudited

DEPARTMENT OF DEFENSE
DEFENSE LOGISTICS AGENCY GENERAL FUND

Consolidated Statements of Financing
For the Years Ended September 30, 2006 and 2005
(In Thousands) (See Note 15)

	2006 Consolidated	2005 Consolidated
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 annual leave liability	$ 32	$ 305
Increase in environmental and disposal liability	-	497
Other (+/-)	3,060	424
Total components of Net Cost of Operations that will require or generate resources in future periods	3,092	1,226
Components Not Requiring or Generating Resources		
Revaluation of assets or liabilities (+/-)	29,587	23,316
Other (+/-)		
Other	(227,551)	-
Total components of Net Cost of Operations that will not require or generate resources	(197,964)	23,316
Total components of net cost of operations that will not require or generate resources in the current period	(194,872)	24,542
Net Cost of Operations	$ 350,229	$ 603,031

The accompanying notes are an integral part of these statements.

Defense Logistics Agency
General Fund

Notes to the
Consolidated and Combined Financial Statements
As of and for the Years Ended September 30, 2006 and 2005

Note 1. Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position, net costs, and changes in net position for the Defense Logistics Agency (DLA) General Fund (GF), as required by the "Chief Financial Officers Act of 1990," expanded by the "Government Management Reform Act of 1994," and other appropriate legislation. The accompanying financial statements have been prepared from the books and records of DLA in accordance with the "Department of Defense (DoD) Financial Management Regulation" (FMR); the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*; and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which DLA is responsible. Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernable.

The DLA is unable to fully implement all elements of GAAP and the OMB Circular A-136, due to limitations of its financial management processes and systems and nonfinancial systems and processes that feed into the financial statements. The DLA derives its reported values and information for major asset and liability categories largely from nonfinancial feeder systems, such as acquisition, property, and logistics systems. Most nonfinancial feeder systems were designed to support reporting requirements that focused on management concerns, such as asset accountability and funds control, rather than preparing financial statements in accordance with GAAP. The DLA currently has identified the Intergovernmental Eliminations entries as a financial statement material weakness.

The DLA continues to implement process and system improvements to address the limitations of its financial and nonfinancial feeder systems. During 2nd, 3rd, and 4th Quarters, FY 2006, GF compilation process improvements were implemented. The previous process was not auditable nor did it provide transparency required for meaningful presentation and analysis. With the revised compilation process, the data is tied to trial balance amounts (as adjusted), provides transparency, and will permit analysis in the future.

B. <u>Mission of the Reporting Entity</u>

The DLA's primary mission is to provide best value logistics solutions to meet the needs of America's Armed Forces around the clock and around the world in times of peace, national emergency, and war. Support begins with joint planning for parts used in new weapons systems; extends through production and contract support, distribution, and warehousing; and concludes with the disposal of materiel that is obsolete, worn out, or no longer needed.

C. Appropriations and Funds

The DLA GF receives the following appropriations: Military Construction (MILCON); Family Housing (FH); Procurement Defense-Wide (PDW); Operation & Maintenance (O&M); and Research, Development, Test, and Evaluation (RDT&E). The DLA GF uses these appropriations and funds to execute its mission.

These appropriations are apportioned to DLA. An apportionment is a plan, approved by OMB, to spend resources provided by law. OMB usually uses one of three categories to distribute these budgetary resources. Category A apportionments distribute budgetary resources by fiscal quarters. Category B apportionments typically distribute budgetary resources by activities, projects, objects, or a combination of these categories. Category C apportionments may be used in multi-year and no year Treasury Appropriation Fund Symbol (TAFS) to apportion funds into future fiscal years. Certain TAFS are exempt from apportionment and from using program reporting categories (See OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*).

Military Construction appropriation finances the construction of facilities to support DLA's logistic support mission to include DoD fuel infrastructure projects (strategic refueling mission, environmental concerns, and fuel operations). The normal useful life-cycle for this appropriation is ten years with five years for new obligations and five additional years to make obligation adjustments and disbursements.

Family Housing appropriation finances the routine O&M, and construction improvements of DLA's 201 housing units. Routine O&M includes management costs, utility costs, and cyclical maintenance such as painting and renovations. The normal useful life-cycle for this O&M appropriation is six years with one year for new obligations and five additional years to make obligation adjustments and disbursements. The normal useful life-cycle for the FH construction appropriation, which finances construction improvements, is ten years with five years for new obligations and five additional years to make obligation adjustments and disbursements.

Procurement Defense-Wide appropriation finances mission essential equipment, including automated data processing and telecommunications equipment and passenger carrying vehicles that afford a high degree of efficiency, effectiveness, and productivity in the accomplishment of the Agency's logistics mission. The normal useful life-cycle for PDW appropriation is eight years with three years for new obligations and five additional years to make obligation adjustments and disbursements.

Operation and Maintenance appropriation finances Other Logistics Services (OLS), Other Logistics Programs (OLP), and environmental programs. The OLS is comprised of programs and projects that are associated with DLA's primary mission. These programs and projects include price comparability, warstopper procurements, unemployment compensation, quality-of-life initiatives, and blankets for the homeless. The OLP is comprised of multiple program offices for which DLA is the executive agency or the budget administrator. The O&M finances OLP operating costs, such as contracts, supplies, equipment maintenance, communications, salaries, awards, personnel benefits, travel, per diem, and training. The normal useful life-cycle is six years with one year for new obligations and five additional years to make obligation adjustments and disbursements. Under environmental programs, DLA is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activities which have created a public health or environmental risk. The DLA has cleanup requirements for Defense Environmental Restoration Program (DERP) sites at active Base Realignment and Closure installations, as well as NonDERP contamination at active installations.

Research, Development, Test, and Evaluation (RDT&E) appropriation finances the development of major upgrades that increase the performance of existing systems, the purchase of test articles, and the developmental testing and/or initial operational test and evaluation prior to system acceptance. The RDT&E programs are Logistics R&D Technology Demonstration, Dual Use Application Programs, Electronic Commerce, Defense Technology Analysis, Industrial Preparedness/Manufacturing Technology, and Logistics Support Activities. The normal useful life-cycle is seven years with two years for new obligations and five additional years to make obligation adjustments and disbursements.

D. Basis of Accounting

For Fiscal Year 2006, the DLA financial management systems are unable to meet all of the requirements for full accrual accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Since many DLA financial and nonfinancial feeder systems and processes were implemented prior to the issuance of GAAP, these systems were not designed to collect and record financial information on an accrual basis. Most of the DLA's legacy systems were designed to record information on a budgetary basis.

The DLA is currently revising its legacy accounting systems to record transactions based on the US Standard General Ledger. Until such time as DLA's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DLA will continue to face obstacles as a result of its systems limitations. Efforts are underway to bring DLA's systems and processes into compliance with GAAP. In the meantime, some financial data is based on budgetary transactions (obligations, disbursements, and collections), data calls, and transactions from nonfinancial feeder systems.

The preparation of financial statements requires management to make certain estimates and assumptions that affect the reported amount of assets and liabilities, at the date of the financial statements, and the amount of revenues and costs reported during the period. Actual results could differ from the adjusted amounts. Also, due to legacy system limitations and to comply with certain DoD accounting policy directives, DLA financial statements contain numerous adjustments to amounts reported in the Trial Balances. The Defense and Accounting Service (DFAS), the accounting service provider making most of the accounting adjustments, has been unable to demonstrate that the adjustments are supported by suitable transaction detail or well controlled business processes.

In addition, DLA is mandated by Government Performance and Results Act and cost accounting requirements in the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial*

Cost Accounting Concepts and Standards for the Federal Government, to perform cost accounting. The DLA legacy systems do not have the capability to fully comply with this requirement.

E. Revenues and Other Financing Sources

Financing sources for DLA's GF are provided primarily through congressional appropriations that are received on either an annual or a multi-year basis. When authorized, these appropriations are supplemented by revenues generated by services through a reimbursable order process.

The US has agreements with foreign countries that include either direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where US troops are stationed, or where the US fleet is in a port. The DLA does not include nonmonetary support provided by US Allies for common defense and mutual security in its list of other financing sources that appear in the Statement of Financing and the Statement of Net Cost.

For intra-DoD transactions, the DLA reclassifies revenue between public and intragovernmental entities by adjusting the proprietary trial balance to agree with the sellers' records.

F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because DLA's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. Expenditures are recognized as expenses when depreciated in the case of property, plant, and equipment or consumed in the case of operating materials and supplies. Net increases or decreases in unexpended appropriations are recognized as a change in the net position.

Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made. Operating expenses were adjusted as a result of the elimination of balances between DoD components. Adjustment amounts and other related disclosures are disclosed in the applicable Notes.

G. Accounting for Intragovernmental Activities

Preparation of consolidated financial statements requires the elimination of transactions occurring among entities within the DoD or between two or more federal agencies. However, DLA is unable to accurately identify most of its intragovernmental transactions by customer because the current legacy systems throughout the DoD do not track buyer and seller data needed to match these related transactions. Seller entities within the DoD provide summary seller side balances for revenue, accounts receivable, and unearned revenue to the buyer side internal DoD accounting offices. In most cases, the buyer side records are adjusted to agree with DoD seller side balances, often forcing DLA to make unsupported adjustments. The DoD intragovernmental balances are then eliminated. The DoD is developing long-term system improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service is responsible for eliminating transactions between the DoD and other federal agencies. Both the Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. Although DLA is unable to fully reconcile intragovernmental transactions with all federal partners, a process has been created that reconciles balances pertaining to borrowings from the US Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

In addition, DoD interacts with, and is dependent upon, the financial activities of the federal government as a whole. Therefore, these financial statements either do not reflect, or were adjusted to reflect, the results of the following events:

<u>Civilian/Military Retirement Systems</u>
The DLA's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) while the Military Retirement System (MRS) covers military personnel. Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The DLA finances only a portion of the civilian pensions. While reporting and funding civilian pensions under CSRS and FERS is the responsibility of OPM, DLA recognizes an imputed expense for the portion of civilian employee pensions benefit in its Statement of Net Cost. The DLA also recognizes corresponding imputed revenue from the civilian employee pensions benefit in the Statement of Changes in Net Position.

<u>Actuarial Liability</u>
The DLA reports the unfunded actuarial liability for its civilian personnel retirement in its financial statements. The liability is recorded each year based on estimates provided by DOL.

H. Transactions with Foreign Governments and International Organizations

The DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the US Government. These external customers may be required to make payments in advance of receiving the goods or services.

I. Funds with the US Treasury

The DLA's financial resources are maintained in US Treasury accounts. The DFAS, Military Services, US Army Corps of Engineers (USACE), and State Department's disbursing stations process all of DLA's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares daily and monthly reports that provide information to the Department of the Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

The DLA maintains a record of its fund balance with treasury (FBWT) for each appropriation received. The US Treasury reports FBWT at the Treasury appropriation symbol level; however, the Columbus Cash Accountability System (CCAS) provides the detail at the subhead/limit level. The DLA GF is one of several Defense Agencies that receive appropriated funds, with the funding controlled at the basic symbol level. Treasury is not able to identify FBWT separately for DLA; however, CCAS identifies transactions at the subhead/limit level. To determine the individual Agency's FBWT, DFAS utilizes a Cash Management Report to process and monitor current year cash transactions, transfers, and apportionments at the limit level. Differences between the Agency's FBWT and the Treasury's fund balance are reconciled to the extent possible by DFAS. These differences, called undistributed disbursements and collections, are generally caused by intransit and unmatched disbursements as described in section 1.Y.

J. Foreign Currency

Cash is the total of cash resources under the control of DoD, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total US dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts. The majority of cash and all foreign currency is classified as nonentity and, therefore, is restricted. Amounts reported consist primarily of cash and foreign currency held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

Furthermore, DLA conducts a portion of its operations overseas. The gains and losses on purchases made overseas are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of the fiscal year. Foreign currency fluctuations require adjustments to the original obligation amount at the time a payment is disbursed. The US Congress has established a special account to report gains and losses that occur from foreign currency transactions. As a result, DLA does not separately identify currency fluctuations in its financial statements. The DLA appropriation most affected by these gains and losses is the MILCON appropriation.

K. Accounts Receivable

As presented on the balance sheet, accounts receivable include accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. In accordance with current DoD policy, DLA does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are resolved between the agencies (per the Code of Federal Regulations 4 CFR 101). DLA does not have an estimated method for uncollectible accounts receivable from the public based on full collection history.

The DLA General Fund accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Intragovernmental transactions are not fully reconciled. Therefore, DLA is unable to reconcile intragovernmental accounts receivable balances with its trading partners. The DoD, through the Business Transformation Agency, is developing long-term systems improvements that will capture the data necessary to perform reconciliations.

The DLA recovers the employee contribution amount of Federal Employees Health Benefits (FEHB) payments made on behalf of employees in leave without pay (LWOP) status. While in LWOP, FEHB payments continue to be made by the agency, to include the employee contribution made on the employee's behalf. When the employee comes back to work, they reimburse DLA. An exception to this recovery process is for FEHB payments made on behalf of employees called to active duty. In accordance with the DoD FMR, these payments are not recovered from the employees and are expensed. Effective with the 3rd Quarter, FY06, the amounts due for these employee FEHB payments are classified as accounts receivable.

L. Direct Loans and Loan Guarantees

The DLA GF does not have loans receivable.

M. Inventories and Related Property

The DLA GF does not have inventories and related property.

N. Investments in US Treasury Securities

The DLA GF does not have investments in US Treasury Securities.

O. General Property, Plant, and Equipment

The Department is moving away from a standard capitalization threshold for all categories (e.g., real property, military equipment, etc.) of General Property, Plant, and Equipment (PP&E) to one that is specific for each individual category.

Beginning in the 3rd Quarter, FY 2006, the capitalization threshold was revised from $100,000 to $20,000 for real property (land, buildings, structures, facilities, and construction-in-progress (CIP)). The current $100,000 capitalization threshold remains unchanged for the remaining General PP&E categories.

Prior to the 3rd Quarter, FY2006, General PP&E assets were capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the established DoD threshold of $100,000. Also, DoD requires capitalization of improvement costs over DoD capitalization threshold of $100,000 for General PP&E. All General PP&E, other than land and CIP, is depreciated using the straight-line method over the estimated useful life of the asset.

The GF General PP&E assets in these statements consist solely of CIP. Once the item is completed, it is transferred to the appropriate DLA DWCF activity.

P. Advances and Prepayments

The DLA records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the balance sheet. The DLA recognizes advances and prepayments as expenses when it receives the related goods and services.

Q. Leases

Generally, lease payments are for the rental of operating facilities and are classified as either capital or operating leases. A capital lease is recognized when a lease is essentially equivalent to an installment purchase of property and the value equals or exceeds the current DoD capitalization threshold. The amounts recorded is the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor), or the asset's fair value. The DLA deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest is applied to reduce the net minimum lease payments to its present value and is calculated at the incremental borrowing rate at the inception of the lease. In addition, the DLA classifies leases that do not transfer substantially all of the benefits or risks of ownership as operating leases and records payment expenses over the lease term.

R. Other Assets

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost reimbursement contracts. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property are reported as Construction in Progress in Note 6, General PP&E.

Other assets include travel advances and civilian employee salary advances. This category consists of Other Assets (with the public) where advances (travel and other advances) to civilian and military employees, advances to public contractors, and other assets are commonly reported.

S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DLA recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Other liabilities arise as a result of anticipated disposal costs for the DLA's assets. This type of liability has two components: environmental and nonenvironmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the DoD's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of Federal Government."

Financial statement reporting disclosure is limited to when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The DLA loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as vehicle accidents, property damages or damages related to the environment, and contract disputes.

The DLA is a party in various administrative proceedings, legal actions, and claims brought against the agency. In the opinion of DLA management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of DLA.

T. Accrued Leave

Military and civilian leave is accrued as earned and the accrued amounts are reduced for actual leave taken and increased for leave earned. Military accrued leave balances are reported on the respective Military Department financial statements. The balances for civilian accrued leave are adjusted quarterly to reflect changes. The balances for military and civilian leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of nonvested leave are expensed as taken. The DLA GF does not fund civilian annual leave earned but not taken, but records it as a future funded liability.

U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations: The DLA GF unexpended appropriations represent amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated in support of legal liabilities for payments that have not been made.

Cumulative Results of Operations: This represents the difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains).

V. Treaties for Use of Foreign Bases

The DLA components have the use of land, buildings, and other facilities, which are located overseas obtained through various international treaties and agreements negotiated by the Department of State. The DoD purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow DoD components continued use of these properties until the treaty expires. The DoD's fixed assets decrease by not renewing a treaty or not reaching agreements. Therefore, when treaties or other agreements are terminated, and use of a foreign base is prohibited, losses are recorded for the value of any nonretrievable capital assets. The value recorded is net of the amount negotiated between the US and the host country that is paid to the US for such capital assets.

W. Comparative Data

Fluctuations between FY 2005 and FY 2006 are explained in the Notes to the Financial Statements for the Balance Sheet, the Statement of Changes in Net Position, and the Statement of Net Costs. An explanation is provided when a comparative period variance is either greater than 10% or the variance exceeds 2% of total assets.

X. Unexpended Obligations

The DLA obligates funds to provide goods and services for outstanding orders not yet delivered. The Statement of Changes in Net Position does not reflect a liability for payment of goods and services not yet delivered. This information is available on the Statement of Budgetary Resources.

Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the US Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. Intransit payments are those payments that have been made to other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance. Intransit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

As the specific nature (federal/nonfederal) of the undistributed transactions is not known, DLA follows DoD policy, as stated in Department of Defense FMR, Volume 6B, Chapter 4, to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. Actions are ongoing in conjunction with DFAS to improve the reconciliation process to support these adjustments.

Note 2. Nonentity Assets

As of September 30	2006	2005
(Amounts in thousands)		
Total Entity Assets	$ 1,219,241	$ 901,610
Total Assets	$ 1,219,241	$ 901,610

Information Related to Nonentity Assets

Asset accounts are categorized as either entity or nonentity. Entity accounts consist of resources that the agency has the authority to use or that management is legally obligated to use to meet entity obligations. Nonentity accounts are assets that are held by an entity, but are not available for use in the operations of the entity.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
Fund Balances		
Appropriated Funds	$ 783,763	$ 629,784
Total Fund Balances	$ 783,763	$ 629,784
Fund Balances Per Treasury Versus Agency		
Fund Balance per	783,763	629,784
Reconciling Amount	$ (783,763)	$ (629,784)

Fluctuations and Abnormalities

The fund balance with treasury (FBWT) increased $154.0 million, or 24% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006. The net increase in FBWT is primarily due to the receipt of additional appropriations and to the under execution of existing FY 2006 programs. The FY 2006 variance is comprised of increases in Operation and Maintenance (O&M), $95.1 million, Military Construction (MILCON), $25.9 million, Research, Development, Test and Evaluation (RDT&E), $33.4 million, and Procurement, $1.1 million. These increases were offset by decreases of $1.0 million in Family Housing (FH), and $0.7 million in Other. In FY 2006, O&M received $37.0 million in additional funds for fuel requirements. The MILCON received $32.0 million for ten new construction projects. The RDT&E received an additional $21.0 million.

Reconciling Amount

The Department of the Treasury reports fund balances to the Department of Defense (DoD). The reconciling amount of 784.0 million, stated in the chart above for Fund Balance with Treasury (FBWT), does not reconcile between the Department of Treasury and Defense Logistics Agency (DLA) because DLA is not identified as a separate disbursing entity within the Treasury.

The FY 2005 total fund balances $629.8 million does not agree with FY 2005 status of fund balance with treasury $671.9 million. This out of balance was caused by the compilation process that was being utilized in FY 2005. Starting with 3rd Quarter, FY 2006 a new General Fund compilation process was implemented, thus the corresponding FY 2006 amounts of $776.4 million are in agreement.

Information Related to Fund Balance with Treasury

The FBWT is an asset account that reflects the available budget spending authority. This represents the total of all unobligated and obligated, but not yet disbursed, account balances. It also includes disbursements and collections with the US Treasury as reflected in DLA's financial records.

Status of Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
Unobligated Balance		
Available	$ 108,487	$ 148,480
Unavailable	83,758	12,442
Obligated Balance not yet Disbursed	$ 599,814	$ 512,378
NonFBWT Budgetary Accounts	$ (8,296)	$ (1,389)
Total	$ 783,763	$ 671,911

Fluctuations and Abnormalities

The Status of FBWT increased by $111.9 million or 17% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006. This increase is primarily due to additional funding received by O&M and RDT&E in FY 2006.

The unobligated balance available decreased by $40.0 million or 27% in 4th Quarter, FY 2006. The decrease was primarily due to O&M receiving higher Title IX funding in 2005. Title IX received by O&M was funding in FY 2006 for DLA Warstoppers Medical requirements due to the Global War on Terrorism (GWOT) and Theater Consolidation Shipping Point, Kuwait.

The unobligated balance unavailable increased by $71.3 million or 573% in 4th Quarter, FY 2006. The majority of the increase occurred in O&M and MILCON. The O&M had approximately $44.7 million of beginning balance and undistributed fund adjustments. MILCON had $26.7 million of undistributed funds expired years adjustments. The expired funds were transferred from unobligated balance to unobligated balance unavailable. Prior to the adjustments these MILCON funds were treated as available, when they should have been treated as unavailable.

The obligated balance not yet disbursed increased by $87.4 million or 17% in 4th Quarter, FY 2006 due to late year end receipt and execution of supplemental funds related to GWOT by O&M and higher Defense Energy Support Center fuel and Base Realignment and Closure requirements.

The nonFBWT budgetary accounts balance decreased by $6.9 million or 497% due to Defense Micro Electronics Activity accepting additional National Aeronautical Space Administration orders in the 4th Quarter, FY 2006.

Other Information Related to Fund Balance with Treasury

The FBWT consists of unobligated and obligated balances not yet disbursed. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the status includes various accounts that affect either budgetary reporting or FBWT, but not both.

Unobligated balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated balance is classified as available or unavailable.

Obligated balance not yet disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which do not have budgetary authority, such as clearing accounts.

NonFBWT budgetary accounts include budgetary accounts that do not affect FBWT, such as contract authority, unfilled customer orders without advance and reimbursements and other income earned receivables. The budgetary authority has been provided to DLA or received from the customers; however, FBWT will not increase until the collection is made.

DLA does not have unobligated balances that are restricted future use and are not apportioned for current use.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
(Amounts in thousands)				
Total Problem Disbursements, Absolute Value				
Unmatched Disbursements (UMDs)	$ 0	$ 28	$ 163	$ 135
Negative Unliquidated Obligations (NULO)	4	6	50	44
Total In-transit Disbursements, Net	$ 2,954	$ 4,116	$ 4,178	$ 62

Fluctuations and Abnormalities

The unmatched disbursements increased by $135.0 thousand or 482% from 4th Quarter, FY 2005 to 4th Quarter, FY 2006. This is due entirely to improperly used change code functions in Defense Business Management System, and fund code changes on various documents that result in unmatched disbursements.

The negative unliquidated obligations increased by $44.0 thousand or 88% from 4th Quarter, FY 2005 to 4th Quarter, FY 2006. Of this amount, $40.7 thousand is attributed to recent transactions processed for RDT&E Appropriations and the Industrial Preparedness/Manufacturing Technology and Logistics RDT&E Technology Demonstration Programs and $8.9 thousand for O&M. These transactions are currently being researched by DFAS and DLA to determine the causative factors.

The intransits increased from 4th Quarter, FY 2005 to 4th Quarter, FY 2006, by $62.0 thousand or 2%. Due to improved and refined processes regarding the classification and reporting of intransit disbursement amounts, differences exist in comparison of prior year and current year amounts and are explained according to Columbus Cash Accountability System (CCAS) Tier classifications.

Tier 2 represents 1329 Military Service Listings to Defense Disbursing Analysis Reporting System (DDARS) differences, which are classified as Intransits, Transactions Not Received (TNR). The Transactions By Others Control area is responsible for resolution of these transactions. Within the overall TNR variance as a whole, the separation of the undistributed incoming Defense Cash Accountability System (DCAS) transactions that cite our fiscal station number is made versus all other transactions. The non undistributed DCAS source transactions are referred to as Statement of Transaction (SOT) variances. Both have been coded in CCAS as TNRs, but have different source files. In September 2005, only the undistributed DCAS transactions were reported due to large problems with cycle issues that was distorting the absolute values of the SOT variances. As of October 2005, all transactions in Tier 2 with the TNR classification are reported as Intransit amounts.

Other Information Related to Problem Disbursements

Problem disbursements are reported as an absolute value amount. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

A UMD occurs when a payment is not matched to a corresponding obligation in the accounting systems. This is often the result of timing issues. Payments by others can also create these issues when other agencies make disbursements on behalf of DLA. Often by the time the financial data on these transactions is received, it is difficult to match the payment to the original obligation because all the information in the line of accounting has been omitted.

A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving report for goods and services delivered under valid contracts.

The Intransit Disbursement represents the net value of disbursement and collections made by a Department of Defense disbursing activity on behalf of an accountable activity and that have not been posted to the accounting system.

Note 4. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
Intragovernmental Receivables	$ 7,945	N/A	$ 7,945	$ 1,224
Nonfederal Receivables (From the Public)	$ 365	$ 0	$ 365	$ (386)
Total Accounts Receivable	$ 8,310	$ 0	$ 8,310	$ 838

Fluctuations and Abnormalities

Total accounts receivable increased by $7.5 million or 892% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

Intragovernmental receivables increased by $6.7 million or 549% as a result of an increase in Defense Micro Electronics Activity's completed engineering work for National Aeronautics and Space Administration in compared to 4th Quarter, FY 2005.

Nonfederal receivables increased by $750 thousand or 194%. Foreign military sales increased by $87.4 thousand from prior year, public receivable increased by $259 thousand that is currently being research due to wrong line of accounting, and $13.5 thousand increase is related to an overpayment to a vendor. An additional $488 thousand increase is related to an abnormal balance in public accounts receivable due to a correction in FY 2005 to federal receivable to record canceled receivables which is the part of the CLRS process. These increases were offset by a $59 thousand receivable that transferred to federal due to documents that enable DFAS to identify DLA trading partners.

The DLA compilation process implemented changes during 2nd and 3rd Quarter, FY 2006 to achieve consistency and auditability. The previous process that provided the accounts receivable data was not auditable nor did it allow comparison with the current quarter. With the new process, the accounts receivable data is tied to trial balance amounts (as adjusted for eliminations) and will permit analysis in the future.

Information Related to Accounts Receivable

Allowance for Estimated Uncollectibles: Allowance for loss of public receivables has not been established based on full collection history.

Elimination Adjustments: Accounts receivable within Defense Logistics Agency (DLA) have been eliminated. Allocation of non Interfund, intragovernmental trading partner data is based on the percentage of funds recorded at the appropriation level for Interfund reimbursement transactions posted on DLA's general ledgers.

Aged Accounts Receivable

As of September 30	2006				2005			
	Intragovernmental		Nonfederal		Intragovernmental		Nonfederal	
(Amounts in thousands)								
CATEGORY								
Nondelinquent								
Current	$	10,754	$	365	$	1,017	$	(387)
Delinquent								
1 to 30 days	$	(2,810)	$	0	$	0	$	0
181 days to 1 year		0		0		0		1
Subtotal	$	7,944	$	365	$	1,017	$	(386)
Less Supported Undistributed Collections		0		0		309		0
Less Eliminations		0		0		(103)		0
Less Other		0		0		0		0
Total	$	7,944	$	365	$	1,223	$	(386)

Aged Accounts Receivable

Intragovernmental: Total intragovernmental accounts receivable of $7.9 million consists of the Operations and Maintenance Appropriation with $10.7 million of current debts and $(2.8) million in less than 31 days delinquent. The $(2.8) million was an over collection from NASA in 4th Quarter, FY 2006. This was an error in the amount recorded as collected and will be corrected in 1st Quarter, FY 2007. All open DLA accounts receivable for General Funds are nondelinquent.

Note 5. Other Assets

As of September 30	2006		2005	
(Amounts in thousands)				
Nonfederal Other Assets				
Outstanding Contract Financing Payments	$	550	$	0
Other Assets (With the Public)		12		32
Total Nonfederal Other Assets	$	562	$	32
Total Other Assets	$	562	$	32

Fluctuations and Abnormalities:

Total other assets increased $530.0 thousand or 1,656% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

This increase is primarily due to the recognition in 4th Quarter, FY 2006, of $440.0 thousand of progress payments in the Procurement Defense Wide appropriation. These payments had not previously been recognized as progress payments due to limitations in the legacy accounting system. In addition, the Office of the Under Secretary of Defense (Comptroller) mandated recognition of estimated potential outflow of assets. The Defense Logistics Agency (DLA) recorded $110.0 thousand as the amount of excess contractor costs over contract financing payments for specific contracts. The reported excess of contractor costs over contract financing payments is being calculated as the estimated payments to be made upon completion of the contract. The DLA recognized $110.0 thousand of other assets and a corresponding contingent liability in 4th Quarter, FY 2006.

<u>Information Related to Other Assets</u>

Other assets are those not reported in a separate category on the balance sheet. They include other intragovernmental advances and prepayments to other federal entities. Advances are cash outlays made by a federal entity to other federal entities as advance payments for the costs of goods and services the entity receives. Prepayments are payments made by a federal entity to cover certain periodic expenses before those expenses are incurred.

Nonfederal other assets consist primarily of contract financing payments to vendors for materiel purchases. The DLA accounts for contract financing payments (progress payments) per guidance from the Department of Defense Financial Management Regulation for fixed price contracts performed by Defense contractors. These financing payments are generally for long lead-time items.

Contract terms and conditions for certain types of contract financing payments convey certain rights to the DLA that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the government. The government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DLA is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

Beginning in 4th Quarter, FY 2006, DoD implemented a change in the financial reporting practices for progress payments based on cost, a type of contract financing payment that is authorized in contracts that include the Federal Acquisition Regulations contract clause 52.232-16, "Progress Payments." Specifically, when the contract authorizes progress payments based on cost, DLA will calculate and report a contingent liability, with a corresponding increase in other assets, for estimated contractor incurred costs in excess of the progress payments made. By reporting a contingent liability, DLA recognizes the potential outflow of future resources that is conditional upon the contractor's delivery and government acceptance of the product/service.

Other assets with the public include amounts for travel advances made to military and civilian employees, and civilian employee salary advances.

Note 6. General PP&E, Net

As of September 30	2006					2005
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
Major Asset Classes						
Land	N/A	N/A	$ 0	$ N/A	$ 0	$ 0
Buildings, Structures, and Facilities	S/L	20 Or 40	0	0	0	0
Leasehold Improvements	S/L	lease term	0	0	0	0
Software	S/L	2-5 Or 10	0	0	0	0
General Equipment	S/L	5 Or 10	0	0	0	0
Military Equipment	S/L	Various	0	0	0	0
Assets Under Capital Lease	S/L	lease term	0	0	0	0
Construction-in-Progress	N/A	N/A	426,606	N/A	426,606	270,956
Other			0	0	0	0
Total General PP&E			$ 426,606	$ 0	$ 426,606	$ 270,956

1 Note 15 for additional information on Capital Leases

Legend for Valuation Methods:
S/L = Straight Line   N/A = Not Applicable

Fluctuations and Abnormalities

For 4th Quarter, FY 2006, total general property, plant and equipment (PP&E) increased by $155.7 million or 57% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006. The majority of the increase is due to the recognition in FY 2006 of $163.6 million of Military Construction (MILCON) projects managed by Navy Facilities Engineering Command (NAVFAC). This increase was offset by a net decrease of $8.2 million in MILCON projects managed by the US Army Corps of Engineers (USACE) as they were completed and transferred out to Defense Logistics Agency (DLA) Working Capital Fund during FY 2006.

The construction-in-progress (CIP) reported during 4th Quarter, FY 2005 consisted only of projects managed by the USACE. During late 4th Quarter, FY 2005, DLA began working with the Defense Finance and Accounting Service, NAVFAC, and USACE to improve the CIP reporting process. NAVFAC projects were first reported as CIP in 1st Quarter, FY 2006.

Other Information Related to General PP&E, Net

The DLA general fund PP&E only has CIP. The CIP account is used to accumulate the costs of real property assets under construction until the construction is completed and the assets are available for use. The CIP is funded by the MILCON and Family Housing appropriations. These costs include direct labor, direct material, and overhead. Engineering and design costs are also captured in the CIP accounts. When construction is completed and the constructed asset is available for use, the asset is transferred from the CIP account to the appropriate property, plant, and equipment account. For major MILCON projects, DLA suballots construction funds to the USACE, the NAVFAC, and the Air Force. These agencies maintain CIP accounts for each construction project they are managing and are responsible for facilitating the transfer of associated costs to the applicable real property account.

Other Disclosures Related to General PP&E

PP&E Restrictions: As of 4th Quarter, FY 2006, there are no known use or convertibility restrictions on general PP&E.

Note 7. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
Intragovernmental Liabilities		
Other	5,132	5,134
Total Intragovernmental Liabilities	$ 5,132	$ 5,134
Nonfederal Liabilities		
Accounts Payable	$ 2,090	$ 3,663
Military Retirement and Other Federal Employment Benefits	6,787	5,402
Environmental Liabilities	204,824	257,863
Other Liabilities	2,413	2,381
Total Nonfederal Liabilities	$ 216,114	$ 269,309
Total Liabilities Not Covered by Budgetary Resources	$ 221,246	$ 274,443
Total Liabilities Covered by Budgetary Resources	$ 56,370	$ 54,733
Total Liabilities	$ 277,616	$ 329,176

Fluctuations and Abnormalities

Total liabilities not covered by budgetary resources decreased by $53.2 million or 19% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006. The main driver is a decrease in non funded environmental liabilities of $40.4 million in the accrued environmental restoration liabilities - active installations – installation restoration program and building demolition and debris removal. This decrease is due to the Defense Logistics Agency's (DLA) evaluation of clean-up activities and negotiations with regulators throughout FY 2006 on remedial actions necessary for site restorations, primarily at Defense Supply Center Richmond (DSCR) and Defense Distribution Depot San Joaquin (DDJC) – Sharpe.

Information Related to Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources: Those liabilities that are incurred by the reporting entity, which are not covered by realized budgetary resources as of the balance sheet. Budgetary resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year.

Other Disclosures:

The intragovernmental liabilities other is comprised of unemployment benefits for all Other Defense Organizations (ODO) due to system limitations that prohibit the Defense Logistics Agency (DLA) and the Department of Labor (DOL) from identifying balances due from various Defense organizations. As a result, a DoD policy was established to allocate appropriations to DLA to cover all billings for ODOs.

The nonfederal other liabilities are comprised of unfunded annual leave and compensatory time and credit hour leave earned but not used. Compensatory time and credit hour leave earned but not used are recorded as an unfunded liability as directed by the Office of the Under Secretary of Defense (Comptroller) starting in 3rd Quarter, FY 2006.

Note 8. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
Intragovernmental Payables	$ 3,781	$ N/A	$ 3,781	$ 20,241
Nonfederal Payables (to the Public)	12,390	0	12,390	10,051
Total	$ 16,171	$ 0	$ 16,171	$ 30,292

<u>Fluctuations and Abnormalities</u>

Total payables decreased $14.1 million or 47% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

Intragovernmental payables decreased by $16.5 million or 81%. This is primarily attributable to a $12.3 million decrease due to aggressive efforts during FY 2006 by the Defense Logistics Agency (DLA) to reduce overaged accounts payables.

Nonfederal payables increased by $2.4 million or 23%. This is attributable to a $2.4 million increase in Research Development Test Evaluation (RDT&E) for “Other Personal Services” due to an increase in programmatic funding in FY 2006 that resulted in more services being procured and invoiced at the end of the fiscal year for: DLA Logistics Research and Development Materiel Management Program, Manufacturing Technologies, and Casting Emission Reduction Program.

The DLA compilation process implemented changes during 2nd and 3rd Quarters, FY 2006 to achieve consistency and auditability. The previous process that provided the accounts payable data was not auditable nor did it allow comparison with the current quarter. With the new process, the accounts payable data is tied to trial balance amounts (as adjusted for eliminations) and will permit analysis in the future.

Information Related to Accounts Payable

Intragovernmental accounts payables are amounts owed to other federal agencies for goods or services ordered and received but not paid. Interest, penalties and administrative fees are not applicable to intragovernmental payables. Nonfederal accounts payable are amounts owed to the public or entities other than the federal government.

Note 9. Environmental Liabilities and Disposal Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Environmental Liabilities--Nonfederal				
Accrued Environmental Restoration Liabilities Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 29,888	$ 167,876	$ 197,764	$ 238,194
Other Accrued Environmental Liabilities—Active Installations Environmental Corrective Action	16	11,518	11,534	1,537
Base Realignment and Closure (BRAC) Installation Restoration Program	11,376	25,414	36,790	45,057
Environmental Disposal for Weapons Systems Programs				
Total Environmental Liabilities	$ 41,280	$ 204,808	$ 246,088	$ 284,788

<u>Fluctuation and Analysis:</u>

Total environmental liabilities decreased by $38.7 million or 14% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

Accrued environmental restoration liabilities – active installations – installation restoration program and building demolition and debris removal decreased by $40.4 million or 17%. This decrease is due to the Defense Logistics Agency's (DLA) evaluation of clean-up activities and negotiations with regulators throughout FY 2006 on remedial actions necessary for site restorations, primarily at Defense Supply Center Richmond (DSCR) and Defense Distribution Depot San Joaquin (DDJC) – Sharpe.

Other accrued environmental liabilities – active installations – environmental corrective action increased $9.9 million or 650% due to the identification during 4th Quarter, FY 2006, of 102 nondefense environmental restoration program (nonDERP) sites associated with plant property and equipment.

General Disclosures

Environmental disclosures will have data reported in future reporting periods once DLA has implemented the process to collect and report this data. DLA has no data to report for changes in total cleanup costs due to changes in laws, regulations, and/or technology. DLA has no data to report for the portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.

The majority of DLA's environmental liabilities (EL) are from out-year Remedial Action Cost Engineering & Requirements (RACER) estimates for 176 sites (173 active and 3 with no further action). Although DLA has instituted extensive internal controls to ensure that these estimates are accurate and reproducible, they are generally considered accurate at +/- 30-50%. The stated noncurrent liability is an estimate of future liabilities, as the majority of DLA sites will require cleanup for up to 30 years. Estimates for work that are more than 1-2 years in the future may be subject to significant change.

In August 2006 DLA executed the RACER model and it generated the FY 2007 Cost to Complete (CTC). The CTC estimate for the first year plus the unliquidated obligations as of yearend equals the current liability. All remaining CTC estimates are categorized as noncurrent liabilities.

The DLA has developed a template to capture future nonDERP EL at DLA managed installations and Military Service owned fuel terminals. The Military Service owned fuel terminals environmental liabilities will be reported at the end of Fiscal Year 2007.

Types of Environmental Liabilities and Disposal Liabilities Identified.

The DLA has cleanup requirements for Defense Environmental Restoration Program (DERP) sites at active and Base Realignment and Closures (BRAC) installations in accordance with Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and Superfund Amendment and Reauthorization Act (SARA), as well as other environmental contamination at active installations that is cleaned up in accordance with Resource Conversation and Recovery Act (RCRA).

Applicable Laws and Regulations for Cleanup Requirements.

The DLA is required to clean up contamination resulting from past waste disposal practices, and other activity that has created a public health or environmental risk. The DLA is required to follow CERCLA, RCRA, and SARA requirements to clean up contamination on installations managed by DLA in coordination with regulatory agencies. This cleanup may at times extend beyond installation boundaries into privately owned property and sites where the DLA is named as a potentially responsible party by a regulatory agency.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating Periods.

The DLA uses RACER, an independently validated model, to estimate environmental liabilities. The DLA validates the model in accordance with DoD Instruction 5000.61 and primarily uses the model to estimate the liabilities based on data received for each cleanup site during an annual interview with Installation Program Managers. Data gathered about the cleanup sites from these interviews is entered into the RACER model. Estimates from that process make up the cost to complete for each cleanup site.

In compliance with accounting standards, DLA is developing a process to capture and expense the costs for cleanup associated with general property, plant and equipment (PP&E). Data on the EL cost linked to PP&E was gathered during FY 2006 and will be the basis for the development and implementation of this process.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to inflation, deflation, technology, or applicable laws and regulations.

Currently, there are no changes due to inflation, deflation, technology, or applicable laws and regulations. However, ELs are expected to fluctuate due to changes in agreements with regulatory agencies.

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

ELs are accounting estimates based upon information available at the time of the calculation. These estimates may materially fluctuate from year to year based on agreements with regulatory agencies that may require a different cleanup approach than originally anticipated. The liabilities can be further impacted if investigation of the environmental site discloses contamination different than known at the time of the estimate.

Note 10. Other Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Intragovernmental				
FECA Reimbursement to the Department of Labor	$ 665	$ 223	$ 888	$ 1,132
Other Liabilities	4,386	0	4,386	4,146
Total Intragovernmental Other Liabilities	$ 5,051	$ 223	$ 5,274	$ 5,278
(Amounts in thousands)				
Nonfederal				
Accrued Funded Payroll and Benefits	0	0	0	623
Accrued Unfunded Annual Leave	2,413	0	2,413	2,381
Other Liabilities	773	110	883	412
Total Nonfederal Other Liabilities	$ 3,186	$ 110	$ 3,296	$ 3,416
Total Other Liabilities	$ 8,237	$ 333	$ 8,570	$ 8,694

Information Related to Other Liabilities

Intragovernmental other liabilities represent liabilities for civilian employees' health benefits, life insurance, unemployment benefits and retirement benefits.

The accrued unfunded annual leave consists of unfunded annual leave and compensatory time and credit hour leave earned but not used. Compensatory time and credit hour leave earned but not used are recorded as an unfunded liability as directed by the Office of the Under Secretary of Defense (Comptroller) starting in 3rd Quarter, FY 2006.

Nonfederal other liabilities consist of military construction and family housing project holdbacks and estimated future contract financing payments.

Other Disclosure Related to Other Liabilities

The nonfederal other liabilities balance includes $110.0 thousand in estimated future contract financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. In accordance with contract terms, specific rights to the contractor's work vests with the

Government when a specific type of contract financing payments is made, thereby protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Defense Logistics Agency (DLA) is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance of a satisfactory product. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to DLA and the amount of potential future payments are estimable; DLA has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance of a satisfactory product.

Note 11. Military Retirement and Other Federal Employment Benefits

As of September 30	2006			2005
	Present Value of Benefits	Assumed Interest Rate (%)	Unfunded Liability	Present Value of Benefits
(Amounts in thousands)				
Pension and Health Actuarial Benefits				
Other Actuarial Benefits				
FECA	$ 6,787		$ 6,787	$ 5,402
Total Other Actuarial Benefits	$ 6,787		$ 6,787	$ 5,402
Total Military Retirement and Other Federal Employment Benefits:	$ 6,787		$ 6,787	$ 5,402

Actuarial Cost Method Used:
Assumptions:
Market Value of Investments in Market-based and Marketable Securities:

<u>Fluctuations and Abnormalities</u>

Other Actuarial Benefits Federal Employees Compensation Act (FECA) increased by $1.4 million or 26% between 4th Quarter, Fiscal Year (FY) 2005 to 4th Quarter, FY 2006.

This increase is attributable to a change in the allocation of the overall Defense Logistics Agency (DLA) FECA liability to the General Fund (GF) beginning in the 4th Quarter, FY 2006. This change was the result of a process improvement. The previous allocation method was based on gross compensation at each of the DLA activities. The actuarial FECA liability is now allocated based on the amount charged in the current FECA billing to each of the DLA activities. The previous General Fund portion was 1.9% and is now 2.1%.

Other Information Related to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

Federal Employees Compensation Act (FECA): The DLA's actuarial liability for workers' compensation benefits is developed by the Department of Labor's (DOL) Employment Standards Administration (ESA) and provided to DLA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's (OMB) economic assumptions for 10-year US Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also applied to the calculation of projected future benefits.

The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using OMB's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting are as follows:

2006
5.170% in Year 1
5.313% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. These factors were also used to adjust the methodology's historical payments to current year constant dollars.

Note 12. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue		
As of September 30	2006	2005
(Amounts in thousands)		
Intragovernmental Costs	$ 239,667	$ 243,433
Public Costs	137,406	376,022
Total Costs	$ 377,073	$ 619,455
Intragovernmental Earned Revenue	$ (15,339)	$ (16,228)
Public Earned Revenue	(11,506)	(194)
Total Earned Revenue	$ (26,845)	$ (16,422)
Net Cost of Operations	$ 350,228	$ 603,033

Fluctuations and Abnormalities

A primary driver for all variances in costs and revenue are the changes in the General Fund (GF) compilation process implemented during 2nd and 3rd Quarters FY 2006. The previous process was not auditable nor did it allow comparison with the current quarter. With the new process, the data is tied to trial balance amounts (as adjusted) and will permit analysis in the future.

Net cost of operations decreased $252.8 million or 42%, from 4th Quarter, FY 2005 to 4th Quarter, FY 2006. The primary drivers of this decrease are described below:

Total costs decreased by $242.4 million or 39%. This decrease is primarily driven by the 1st Quarter, FY 2006, recording of $163.6 million construction in progress (CIP) reported by the Naval Facilities Engineering Command (NAVFAC) for approximately 170 construction projects. In prior reporting periods, the Defense Logistics Agency (DLA) had not been provided sufficient documentation by NAVFAC to record the CIP amounts, therefore no CIP was recorded. Beginning 1st Quarter, FY 2006, DLA and NAVFAC had been able to reasonably identify the CIP amount in Note 6 and reconcile to the reports provided by Defense Finance and Accounting Service Columbus on behalf of NAVFAC, resulting in a $163.6 million decrease to current year expenses being recorded. In addition there was a $47.9 million decrease in public costs due to delays in negotiations and execution of contractor awards for base realignment and closure requirements, mobilization warstoppers, and procurement technical assistance programs.

Total earned revenue increased by $10.4 million or 63%. This is due to increases in work performed by Other Logistics Programs, which are programs that DLA serves as either the executive agent or the budget administrator. Of these programs the Defense Microelectronics Activity, whose mission is to reverse-engineer microelectronic devices, had the largest increase.

Other Disclosures Related to the Statement of Net Cost

Intragovernmental costs and revenues are related to transactions made between two reporting entities within the Federal Government.

Public costs and revenue are exchange transaction made between the reporting entity and nonfederal entity

The Consolidated Statement of Net Cost in the federal government is unique because its focus is on providing an understanding of the net cost of programs and/or organizations that the federal government supports through specific or general appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

DLA is unable to compare its intragovernmental costs and revenue with the corresponding balances of its intragovernmental trading partners. The majority of accounting systems currently supporting DLA do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations for all trading partners. Current Department of Defense policy directs that the expenses and accounts payable of intra-governmental trading partners be adjusted to agree with the revenue and accounts receivable of the “selling” partner. Therefore, intragovernmental costs are adjusted based upon amounts reported, and gross costs with public represents actual costs with the public and any intragovernmental costs that were not reported by the “selling” partner.

The amounts presented in the consolidated statement of net cost are based on funding, obligation, accrual and disbursing transactions, which are not always recorded using accrual accounting. The DLA systems do not always record the transactions on an accrual basis as is required by the generally accepted accounting principles. The information presented also includes data from nonfinancial feeder systems to capture all cost such as payroll expenses, accounts payable, and environmental liabilities.

DLA has no costs associated with of the cost of acquiring, constructing, improving, reconstructing or renovating heritage assets.

Note 13. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2006	2005
	Cumulative Results of Operations	Cumulative Results of Operations
(Amounts in thousands)		
Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance		
Imputed Financing		
Civilian CSRS/FERS Retirement	$ 1,073	$ 1,103
Civilian Health	1,127	1,037
Civilian Life Insurance	5	5
Total Imputed Financing	$ 2,205	$ 2,145

Information Related to Statement of Changes in Net Position

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civilian Service Retirement System, Federal Employee Retirement System, Federal Employee Health Benefits and Federal Employee Group Life Insurance, do not fully cover the US Government's cost to provide these benefits. The financial statements include an imputed cost made to recognize the difference between the government's and Defense Logistics Agency's (DLA) costs of providing these benefits to the employees and contributions made by and for them. The OPM provides the cost factors to Defense Finance & Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) OUSD (P&R) and DLA for validation. After validation, OUSD (P&R) provides the imputed costs to the reporting components for inclusion in their financial statements.

Note 14. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 585,269	$ 480,836

Information Related to the Statement of Budgetary Resources

The Defense Logistics Agency (DLA) General Fund apportionment categories for obligations are category A direct and reimbursable obligations incurred and category B direct obligations incurred. There are no category B reimbursable or exempt obligations.

Direct Obligations Incurred – Apportionment Categories

Reporting Entity ($ millions)	Category A	Category B	Totals
DLA General Fund	$372.3	$365.8	$738.1

Reimbursable Obligations Incurred – Apportionment Categories

Reporting Entity ($ millions)	Category A	Category B	Totals
DLA General Fund	$27.4	$.00	$27.4

Apportionment Categories

The amount of direct obligations incurred and apportioned under category A is $372.3 million from Operation and Maintenance and category B is $365.8 million from all other appropriations. For reimbursable obligations incurred and apportioned, category A is $27.4 million.

Other Disclosures:

Intraentity transactions have not been eliminated because the statements are presented as combined.

There were no material adjustments to budgetary resources available at the beginning of the year.

DLA does not have any permanent indefinite appropriations.

There are no legal arrangements affecting the use of unobligated balances of budget authority.

DLA did not receive any capital infusions during the reporting period.

Note 15. Disclosures Related to the Statement of Financing

Information Related to the Statement of Financing

The Statement of Financing (SOF) provides information on the total resources used by the agency - both those received through the budget and those received by other means. It reconciles the status of budgetary resources to the net cost of operations for a given reporting period. It articulates and details the relationship between net obligations from budgetary accounting and net cost of operation from proprietary accounting.

Due to the Department of Defense (DoD) financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data are a previously identified deficiency for both the Defense Logistics Agency (DLA) and DoD.

The SOF is presented as combined or combining statements rather than consolidated statements due to the intra-governmental transactions not being eliminated. The following lines on the SOF are presented as combined:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Adjustments in funds that are temporarily not available pursuant to public law, and those that are permanently not available (included in the adjustments line on the Statement of Budgetary Resources (SBR)), are not included in spending authority from offsetting collections and the adjustments line on the SBR or on the SOF.

Liabilities not covered by budgetary resources consist of environmental liabilities, unemployment compensation, accounts payable from cancelled appropriations and military retirement benefits and other employment actuarial liabilities for DLA General Funds (GF). There are no amounts in the current year for resources in future periods for DLA GF, as appropriations are provided to cover liabilities during years currently budgeted. Therefore, amounts reported as requiring resources in future periods do not have a relationship to liabilities not covered by budgetary resources.

Explanation of Other Lines

Other Resources Used to Finance Activities: Other. This amount consists of gains and losses accumulated from various transactions, which have no budgetary impact.

Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations: Other. This line consists of gains and losses and transfers of construction in progress to other activities.

Components Requiring or Generating Resources in Future Period: Other. This amount consists of future funded expenses, including Federal Employee Compensation Act and unemployment expenses. This line also includes contingent legal liabilities that are considered probable. The DLA GF has no contingent legal liabilities.

Components Not Requiring or Generating Resources: Other. This line is mainly comprised of an offset for capitalized assets that were originally classified as operating expenses and miscellaneous expenses that did not require budgetary resources. It also includes changes in the allowance for bad debt and miscellaneous expenses that did not require budgetary resources.