

Independent Auditors' Report



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

December 12, 2017

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

SUBJECT: Transmittal of the Disclaimer of Opinion on the Defense Logistics Agency General
Fund Financial Statements and Related Footnotes for FY 2017
(Project No. D2016-D000FE-0208.000, Report No. DODIG-2018-051)

We contracted with the independent public accounting firm of Ernst & Young to audit the Defense Logistics Agency (DLA) FY 2017 General Fund Financial Statements and related footnotes as of September 30, 2017, and for the year then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. The contract required Ernst & Young to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008. Ernst & Young's Independent Auditor's Reports are attached.

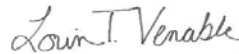
Ernst & Young's audit resulted in a disclaimer of opinion. Ernst & Young could not obtain sufficient, competent evidential matter to support the reported amount within the DLA financial statements. As a result, Ernst & Young could not conclude whether the financial statements and related footnotes were fairly presented in accordance with accounting principles generally accepted in the United States of America. Accordingly, Ernst & Young did not express an opinion on the DLA FY 2017 General Fund Financial Statements and related footnotes.

Ernst & Young's separate report on "Internal Control over Financial Reporting" discusses six material weaknesses related to DLA's internal controls over financial reporting. Ernst & Young's report also includes a significant deficiency related to financial reporting. Ernst & Young's additional report on "Compliance and Other Matters Based on an Audit of the Financial Statements Performed" discusses four instances of noncompliance with applicable laws and regulations.

In relation to the contract, we reviewed Ernst & Young's report and related documentation and discussed the audit results with Ernst & Young representatives. Our review, as differentiated from an audit conducted in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the DLA's FY 2017 General Fund Financial Statements and related footnotes, conclusions about the effectiveness of internal control, conclusions on whether the DLA's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the DLA complied with laws and regulations.

Ernst & Young is responsible for the attached reports, dated December 12, 2017, and the conclusions expressed in these reports. However, our review disclosed no instances in which Ernst & Young did not comply, in all material respects, with GAGAS.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945.



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

Attachments:
As stated



Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors

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

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the General Fund of the Defense Logistics Agency (“DLA”), which comprise of the balance sheet as of September 30, 2017, and the related statements of net costs, changes in net position, and statement of budgetary resources for the year ended September 30, 2017, and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

The Department of Defense, including DLA, continues to have unresolved accounting issues and material weaknesses in internal controls that cause DLA to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on DLA’s financial statements as a whole for the year ended September 30, 2017.

Disclaimer of Opinion

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



Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Financial Information and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise DLA's basic financial statements. The Other Financial Information, as identified on DLA's Agency Financial Report Table of Contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Other Financial Information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in an engagement to perform an audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Other Financial Information.

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



Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated December 12, 2017 on our consideration of DLA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering DLA's internal control over financial reporting and compliance.

Ernst + Young LLP

December 12, 2017



Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (“OMB”) Bullet No. 17-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the General Fund of the Defense Logistics Agency (DLA), which comprise the balance sheet as of September 30, 2017, and the related statement of net cost, changes in net position, and statement of budgetary resources for the fiscal year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 12, 2017. The report states that because of matters described in the Basis for Disclaimer Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on the financial statements as of and for the fiscal year ended September 30, 2017 and the related notes to the financial statements.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered DLA's internal control over financial reporting (“internal control”) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of DLA's internal control. Accordingly, we do not express an opinion on the effectiveness of DLA's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 17-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (“FMFIA”), such as those controls relevant to ensuring efficient operations.

A *deficiency in internal control* over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. GAAP such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more



than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. As described below we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

Material weaknesses

During our audit, we noted the following matters involving internal control over financial reporting and its operation that we consider to be material weaknesses as defined above.

- I. Property, Plant, and Equipment (PP&E) – PP&E includes internal use software and construction-in-progress. We found that DLA has not completed an analysis of existence and completeness of PP&E records for which they are the FRO, had not completed their process to value PP&E beginning balances, and have weaknesses in the processes of maintaining and reconciling PP&E records. The combination of these findings led us to conclude that there is a material weakness related to PP&E. The matters identified related to PP&E are further described in Appendix A.
- II. Fund Balance with Treasury (FBwT) – DLA is unable to reconcile the FBwT ending balances from general ledger directly to the U.S. Treasury. DLA, in conjunction with DFAS, has implemented the Cash Management Reconciliation (CMR) and Defense Reconciliation Reporting Tool (DRRT) processes as mechanisms to reconcile DLA's general ledger to Treasury. However, these tools have known control deficiencies and reconciling issues within the process. In addition, DLA does not have sufficient policies, procedures or controls in place for the end-to-end FBwT process. These deficiencies supported a conclusion of a material weakness in FBwT. The matters noted are further described in Appendix A.
- III. Accounts Payable (AP) - AP falls within the scope of DLAs procure to pay process. We found that DLA was unable to adequately support the accounts payable and related budgetary beginning balances, had issues recording transactions in the proper period, and lacked overall policies, procedures, and internal controls in the procure to pay process. This combination of deficiencies is considered to be a material weakness. The matters identified related to AP are further described in Appendix A.



- IV. Financial Reporting – DLA’s financial statement preparation process lacks sufficient, appropriate reviews to identify inaccurate balances on the face of the financial statements as well as completeness and accuracy of disclosures. We considered these deficiencies to be a material weakness. The matters noted are further described in Appendix A.
- V. Oversight and Monitoring - DLA does not have an effective OMB Circular A-123 program, which impacted DLA’s ability to appropriately identify and address significant risks for all key business processes. DLA has not implemented appropriate internal controls, including the documentation of policies and procedures that describe DLA’s environment related to end-to-end business processes, roles and responsibilities, monitoring of service providers, related parties, systems, risks and controls. DLA’s lack of documented controls prevent the consistent execution and proper review of data/reports used in the execution of key controls, as well as appropriate evidence of management review controls. We consider these overall weaknesses in the internal control structure to be a material weakness. The matters noted are further described in Appendix A.
- VI. Information systems – Our assessment of DLA’s IT controls and the computing environment identified deficiencies which collectively constitute a material weakness in the design and operation of information systems controls over financial data. We reviewed each finding individually as well as in aggregate. Based on our review, we have identified four areas of deficiency which, when aggregated, result in a material weakness. The deficiencies relate to the following four areas:
- Access controls / user access
 - Configuration management / change controls
 - Segregation of duties controls
 - Security management / governance over implementation of security controls

Refer to Appendix A for additional detail in these four areas.

Significant deficiencies

During our audit, we also noted the following matters involving internal control over financial reporting and its operation that we consider to be a significant deficiency, as defined above.

- I. Environmental liabilities is comprised of clean-up costs associated with the restoration of sites on real property that DLA manages. The lack of formal policies, procedures and supporting documentation does not allow for DLA to substantiate the completeness and valuation of its EL. The matters identified related to EL are further described in Appendix B.



DLA's Response to Findings

DLA's response to the findings identified in our engagement, as described above, are included in its letter dated December 12, 2017, which has been included at the end of this report. DLA's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Ernst + Young LLP

December 12, 2017



Appendix A – Material Weaknesses

Property, Plant and Equipment

Property, Plant, and equipment (PP&E), is comprised of internal use software and construction-in-progress (CIP). In this, the initial financial statement audit of DLA, we found that DLA was not able to adequately support the existence, completion or valuation of its PP&E.

DLA lacks policies, procedures and controls to verify the existence and completeness of internal use software (IUS) due to:

- DLA does not have documented policies and procedures in place to perform an inventory of IUS assets on a consistent basis. Unlike performing an inventory of physical assets, the existence of IUS is validated by verifying that the software functionalities and/or objects are still in use. DLA policy requires that the inventory is performed on 10% of the population each month. However, DLA does not comply with the policy on a consistent basis.
- DLA has not designed adequate internal controls to identify when assets are completed and should be placed in service. DLA policy states that IUS assets are recorded as in-service PP&E upon the completion of the asset. However, DLA does not have a process in place to ensure that completed assets are placed in service in the correct period.

DLA lacks policies and procedures to review the construction-in-progress (CIP) balance due to:

- Policies and procedures are not in place to ensure that the information reported directly by the construction agent and used for financial reporting is reviewed by DLA. There were a significant number of inactive projects that were reported by the construction agent resulting in misstatements in the financial statements (totaling approximately \$465 million). DLA sub-allots funds to construction agents, such as the U.S. Army Corps of Engineers and the Naval Facilities Engineering Command (NAVFAC), for construction projections which DLA is authorized to perform. The funds are tracked separately by each construction agent and reported to the Defense Finance and Accounting Services (DFAS) directly by each construction agent. These amounts are then reported in DLA's financial statements.

DLA is unable to provide supporting documentation to substantiate construction-in-progress (CIP), including beginning balances.

- Supporting documentation is not available or insufficient to substantiate approximately \$384 million of the CIP assets.



DLA was unable to substantiate the values assigned to IUS assets are in accordance with FASAB SFFAS 10, *Accounting for Internal Use Software*.

- Supporting documentation was not available to substantiate whether the values recorded were in accordance with SFFAS 10 for approximately \$100 million of the IUS beginning balance.
- DLA was unable to substantiate the in-service date of the IUS assets, which is the basis for the asset amortization. The documentation, such as the evidence demonstrating that the asset was tested and accepted, is not retained or available.
- DLA inappropriately recorded approximately \$46 million of IUS assets that DLA does not own in the balance sheet.

DLA has not appropriately designed controls to adequately detect material misstatements in the financial statements.

- DLA has not designed and implemented sufficiently precise management review controls, including outlining the specific procedure required to evidence that the controls were performed. DLA's control activities include a significant number of management review controls. Management review controls are normally designed to detect and correct errors, whereby the reviewer determines whether information is complete and accurate, accounting is appropriate, and potential errors or misstatements. The internal control activities over PP&E are not sufficiently designed to prevent or detect material misstatements in the financial statements.

DLA lacks policies and procedures to identify and assess lease arrangements and to properly account for lease obligations and disclose lease commitments, in accordance with FASAB SFFAS 5, *Accounting for Liabilities of the Government; Capital Leases*, and SFFAS 6, *Accounting for Property, Plant, and Equipment*.

- DLA has not completed procedures to identify all of its leasing arrangements, including assessing whether the leasing arrangements should be accounted for as a capital or operating lease.
- The financial statements do not include disclosures for its policy to account for lease arrangements; any operating lease commitments; and future minimum payments due.

Recommendations

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



- Update the IUS process memos and standard operating procedures to adequately describe the policies and procedures in place to inventory IUS assets.
- Design and implement policies and procedures that require for adequate documentation to be maintained that evidence how DLA verifies the asset is still in use and that the listing of the IUS assets is complete.
- Design and implement policies and procedures that ensures the IUS assets are recorded in the appropriate period. This includes reviewing a complete and accurate list of all projects that have successfully completed end user testing and verifying that the projects have been recorded in EBS as active IUS assets.
- In the short-term, DLA should design and implement a review control that allows DS project management personnel to review the amounts reported by the constructions agents in sufficient time for DLA to adjust the amounts reported in their financial statements based on this review.
- In the long-term, DLA should pursue a solution where CIP transactions can be recorded in EBS when they occur.
- Obtain and maintain all supporting documentation (invoices, contracts, project management reports) related to the CIP Projects from NAVFAC, USACE, and other construction agents to substantiate the balances recorded for those projects.
- Retain all documentation related to CIP Projects in a central repository and organize them for the purposes of determining project status and supporting the value of the projects.
- Design a process where CIP transactions can be recorded in EBS when they occur.
- Design and implement policies and procedures that allow DLA Installation Management Project Management personnel to review, at least quarterly, the status of projects recorded as CIP, invoices, project management reports, and contracts to ensure that all documentation agrees with activity related to the CIP project.
- Design and implement policies and procedures to perform a reconciliation for the construction-in-progress U.S. Standard General Ledger (USSGL) accounts and agree the amounts recorded in EBS to the invoices, project status reports, and other documentation to substantiate the balances as of the financial statement date.
- Design and implement policies and procedures to perform a reconciliation for the USSGL accounts related to providing sub-allotments to its construction agents. This should include the MILCON Program Form (DoD Form 1390) for the Fiscal Year, the NDAA budget execution, and the receipt of allocated funds from OSD based on the NDAA request.
- Adopt a policy to prospectively capitalize IUS assets, as described in *Statement of Federal Financial Accounting Standards 50: Establishing Opening Balances for General Property, Plant, and Equipment (SFFAS 50)*. SFFAS 50 permits the exclusion of IUS and IUS under development from the opening balance as of the opening balance date.
- Design and implement policies and procedures to ensure that DLA maintains sufficient supporting documentation to demonstrate that its IUS expenditures are appropriately capitalized, in accordance with SFFAS 10.



- EY recommends that DLA undertake the following corrective actions for the conditions noted:
 - Adjust their PPE balance to remove the asset owned by other agencies.
 - Design and implement policies and procedures for the monitoring of completion of IUS assets that DLA is developing for other agencies.
- Design and implement policies and procedures to ensure that the performance of review controls are adequately documented and supported by evidential matter.
- Develop a central repository to retain evidence of control performance and management review.
- Design and implement policies and procedures that include variance thresholds to ensure that the review of significant financial data is precise.
- Design and implement policies and procedures that detail the related documentation and evidential matter to be inspected as part of the review.
- Complete analysis of their leases to determine if DLA has entered into any leasing arrangements that should be accounted for and reported as a capital lease.
- Design and implement policies and procedures to identify and account for leasing arrangements including whether the leases should be accounted for and reported as capital or operating leases, in accordance with SFFAS 6.20.
- Develop policies and procedures to review all leasing arrangements to gather the information necessary to prepare and include the required disclosures for capital and operating leases in the financial statements, in accordance with OMB A-136 II.4.9.18.



Fund Balance with Treasury

Fund Balance with Treasury represents the aggregate amount of funds in DLA's account with Treasury. Through our audit procedures, we identified deficiencies related to DLA's processes of recording and reconciling transactions involving Fund Balance with Treasury.

DLA is unable to reconcile FBwT from general ledger directly to the U.S. Treasury:

- DLA, in conjunction with DFAS, has implemented the Cash Management Reconciliation (CMR) and Defense Reconciliation Reporting Tool (DRRT) processes as mechanisms to attempt to tie EBS to the Treasury. However, the CMR and DRRT processes are not sufficient to produce a complete and accurate reconciliation of DLA's general ledger to U.S. Treasury. There are known differences between CMR and Treasury. In addition, there are known control deficiencies in the DRRT process.

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

- DLA has not finalized a FBwT process narrative or systems flow to document the flow of data through DLA and DFAS systems from the initiation of a transaction to reporting in the financial statements, the key stakeholders within the process, or the flow of data between stakeholders. Additionally, DLA has not identified risks and controls for the end-to-end FBwT process.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Work with DFAS to obtain a Service Organization Controls Report for the CMR performed by the Defense Finance Accounting Service in order to obtain assurance on whether the CMR process is complete and accurate.
- Work with DFAS to obtain a Service Organization Controls Report for the Department 97 Report Reconciliation Tool (DRRT) process performed by the Defense Finance Accounting Service -Columbus in order to determine whether the controls in place are operating effectively.
- Work with DFAS to establish a process, including a key control, for DLA to monitor the status of significantly aged unreconciled transactions in both the CMR and DRRT processes on a frequent basis.
- Work with DFAS to create an updated policy and procedure for the DRRT process that addresses issues of maintaining sufficient evidential matter to support ongoing remediation efforts on undistributed transactions.



- Develop policies and procedures to establish DLA's involvement in monitoring undistributed funds and assisting DFAS with the research and the clearing process.
- Continue Finalize a Standard Operating Procedure or Process Cycle Narrative that documents the end-to-end process for FBwT, including the initiation, recording, processing and reporting of FBwT transactions
- Finalize a Standard Operating Procedure or Process Cycle Narrative that documents the policies and procedures that the Defense Logistics Agency has in place to monitor the CMR and DDRT produced by the Defense Finance and Accounting Services. The Standard Operating Procedure or Process Cycle Narrative should include all key controls, process owners, data interfaces and Federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used for the FBWT process.
- Designate a DLA point of contact responsible for overseeing the FBwT process, understanding the complex process flow as well as key risk points as well as communication with DFAS.



Accounts Payable

Accounts Payable (AP) falls within the scope of DLAs procure to pay process. Through our audit procedures, we identified deficiencies in DLA processes for recognizing and supporting accounts payable and the related budgetary balances, recording transactions in the proper period and documenting policies, procedures and controls in a sufficient manner.

DLA is unable to substantiate Accounts Payable and Undelivered Orders due to:

- Supporting documentation was not provided to substantiate the samples tested from the following accounts:
 - Accounts Payable
 - Negative Payables
 - Undelivered Orders, Unpaid
 - Upward Adjustments
- Goods and/or services received as of year-end were not recorded as an expense/asset and not applied to the Undelivered Order balance.
- Upward/Downward adjustment related to the prior year were recorded in FY 2017.

DLA does not have policies and procedures in place to manage stale payables/obligations

- A timely review and monitoring is not performed for the following account balances:
 - Negative Payables – There is a significant number of aged transactions that may no longer be valid.
 - Undelivered Orders (UDO), Unpaid – Approximately \$90 million in UDOs that had no activity (payables, expenses, outlays) for at least two years.

DLA does not adhere to the Treasury Financial Manual USSGL Posting Logic due to the following:

- A general ledger account is inappropriately being used to track accounts payable activity. DLA uses Negative Payables to track outstanding goods receipt and to prevent inventory from showing as available for distribution when the items are not physically available. The related posting logic is not recording assets or expenses at the appropriate point in time. In addition, an Undelivered Order, Paid is recorded for these transactions, but they the proprietary entry for the payment made in advance is not recorded.



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

- Transactions were not recorded at the detailed transaction level. DLA recorded transactions at a summary level for certain budgetary and proprietary accounts. As a result, each EBS summary level record contains multiple individual transactions.
 - Transactions are posted in detail to the Fund Balance with Treasury (FBwT) account (general ledger account 1010), but summarized when posting to the other proprietary and budgetary accounts. A reconciliation is not performed to ensure that all detailed transactions posted to the FBwT agree to the summarized postings to the corresponding budgetary general ledger accounts.
 - Additionally, budgetary accounts (obligations, expenses, payables) are not tied to the FBwT transactions and are posted in summary within the general ledger.

DLA does not have controls that are operating effectively in the accounts payable process due to the following:

- Controls for the proper approval of invoice; receiving reports; and purpose, time and amount for the following accounts were not operating effectively: Account Payable, Negative Payables, and Expense accounts.
- Control for the government purchase card expenditure approval due to the following was not operating effectively. The Approving/Billing Official (A/BO) has the ability to approve the monthly statement in US Bank Access Online and certify that statement for payment without any secondary review. When the government purchase card holder (GPCH) is not available to reconcile purchase card transactions to the statement, the A/BO has the authority to perform the reconciliation and prepare the form 1901 (Request for Purchase). Also, the A/BO can approve the GPC monthly bill in U.S. Bank Online for payment.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Evaluate current policies and procedures against practices in the field to identify the root cause(s) of conditions. Identify key gaps and inconsistencies in current procedures versus field implementation.
- Based on the evaluation, perform updates to identified policies, procedures, desk guides, and/or accounting manuals to completely and accurately reflect current key procure to pay processes as well as provide clarification/updates to areas where differences between policy and implementation are noted.



- Consider providing trainings and implementation guidance on any current and/or new/updated procedures where issues were noted to ensure consistent application of procedures including:
 - Ensure procure to pay process owners' document detailed explanation (i.e. cause, impact) for discrepancies or missing documentation.
 - Ensure documentation standards are clear including supporting documentation that is complete, accurate, and prepared timely.
 - Ensure process owners understand key supporting documentation.
- Consider increasing communication between DLA HQ and process owners to ensure sufficient, complete documentation is provided as part of documentation requests.
- After processes have been evaluated and procedures have been updated, as needed, implement and/or strengthen review procedures to ensure transactions are recorded accurately, timely and process owners can obtain and provide supporting documentation for the transactions.
- EY recommends that DLA write off residual accounts payable for paid and completed transactions. EY recommends that DLA removes activity from the general ledger detail that were completed in prior years. DLA should monitor the UDO balances and identify stale UDOs for deobligation. DLA should examine their account balances on the balance sheet and statement of budgetary resources to determine the magnitude of aged balances by account.
- Perform an analysis of transactions posted at or near year-end to determine the overall significance of the issue across all general ledger accounts. Based on this analysis, perform corrective action on incorrect transactions, as necessary.
- Implement and/or enhance DLA's year-end process, including key controls, for monitoring potential business events that will need to be entered into the general ledger prior to year-end close.
- Update policies and procedures to document year-end processes for identifying, monitoring and recording transactions prior to financial statement close.
- EY recommends that DLA discontinue the use of the negative payable account. In addition, DLA should develop, test, and implement a process to ensure that all transactions related to proper recording and reporting for expenses and inventory items are in compliance with the TFM USSGL postings at the transaction level. This would include developing an entity wide standard process and procedure of identifying the financial events that requires the recognition of an account payable based on standard accounting guidance (Ex. Treasury FMS USSGL guidance - Recognition of a Liability). EY further recommends, that once the new procedures are in place, stakeholders are educated on the new process. EY further recommends that any process, procedure, or policy documentation for accounts payable be updated to reflect the use of the asset or expense accounts instead of the negative payable accounts.
- EY recommends that DLA implement and maintain financial management systems that comply substantially with Federal financial management systems requirements and the



United States Government Standard General Ledger at the transaction level. DLA should establish a process that reconciles the transaction level detail to the summarized postings in each account.

- Update existing internal control documentation to accurately describe the process and identify key internal controls over financial reporting.
- Monitor, review, and validate whether controls are operating effectively on an on-going basis.
- Update existing internal control activities to produce evidence that the control occurred (e.g. signature) after the control is executed.
- DLA should implement limiting the A/BO to one key role to either approving GPC purchases on DLA form 1901 or approving payments of the GPC monthly bill in U.S. Bank Online. If DLA is unable to properly segregate the duties, DLA should require a secondary reviewer as a mitigating factor to approve the monthly bill or approving the form 1901.



Financial Reporting

Financial Reporting encompasses all aspects of operations affecting DLA's ability to produce reliable financial statements and disclosures. This process starts with establishing an effective governance structure to identify and assess risk and continues with developing a control environment that is effective and efficient to manage identified risks. Through our audit procedures, we identified a number of deficiencies in DLA processes related to the accumulation and presentation of their financial position and results of operations.

DLA does not have sufficient policies and procedures in place around the implementation and monitoring of EBS:

- DLA is unable to adequately demonstrate that business events are linked to the correct posting logic.
 - In DLA's posting logic reference book, which was manually generated, there are multiple scenarios associated with same transaction description and SAP T-Code (i.e. EBS doc type).
 - In DLA's posting logic reference book, there is no attribute or data field to indicate the type of transaction posting in the Enterprise Business System (EBS). Therefore, DLA is unable to crosswalk the reference book to the EBS.
 - DLA is unable to produce a posting logic directly from EBS
- DLA does not have any monitoring or review control in place to ensure that EBS posting logic is configured in accordance with the USSGL and that transactions are posting accordingly.

DLA does not have sufficient controls in place to validate that EBS proprietary general ledger accounts agree to budgetary accounts:

- DLA has known reconciliation issues between budgetary and proprietary tie points. Based on walkthrough procedures performed, EY noted that the DFAS posts an unsupported quarterly JVs in Defense Departmental Reporting System (DDRS) to ensure DLA's budgetary accounts reconcile to the proprietary accounts.

DLA does not have sufficient controls in place around the quarterly reconciliation of EBS to the financial statements:

- DLA does not perform a sufficient Unadjusted Trial Balance (UTB) to Adjusted Trial Balance (ATB) reconciliation.
 - DLA uses data pulled out of DDRS as a starting point for the crosswalk instead using data directly pulled from EBS.



- DLA lacks controls to validate the completeness and accuracy of the data and reports used to create the reconciliation.
 - Lack of master listing of files used and the purpose of each file within the reconciliation.
 - Lack of a review to ensure that feeder files and adjustments are valid and agree to supporting documentation.
- DLA does not perform the quarterly UTB to ATB reconciliation in a timely manner.
 - DLA does not perform the reconciliation until after the quarter-end as well as fiscal year-end has been closed.
 - Per SOP, DFAS should provide DLA with the data files needed for the reconciliation 5 days after quarter/year-end close. However, the reconciliation is completed approximately two months subsequent to quarter-close.

DLA does not perform a sufficient review of quarterly adjustments and JVs made by a DFAS:

- DLA does not have a comprehensive listing of adjustments that occur in DDRS including:
 - The source of each file and parameters to generate the files
 - The required files or reports needed from DFAS to support each adjustment as well as the parameters of each file or report
 - The rationale or business purpose for each adjustment and the evidential matter to support the amounts
- DLA does not review each type of adjustment and feeder files to determine completeness, accuracy, validity and impact of information posted to DLA's financial statements.
 - In several cases, prior year adjustments were used in the reconciliation of the DDRS-B unadjusted trial balance (UTB) to the DDRS-B adjusted trial balance (ATB) that did not have evidence of review by DLA.
 - Trial balance input adjustments occurred during the interface of DDRS-B to DDRS-AFS that were not reviewed by DLA.
- DLA relies on DFAS to make various adjustments that are maintained within DDRS-B versus making the corrective updates within EBS.
 - Within the quarterly reviews, prior year adjustments were used as offsetting entries to current year adjustments.
- DLA does not perform a reconciliation in a timely manner to allow for adjustments to be reviewed prior to the generation of the financial statements.
- DLA is currently remediating the trading partner elimination process to be completed in FY 2018. EY noted the following during FY 2017:
 - Supporting documentation to reconcile the variances between DLA and trading partners is not obtained timely.
 - DLA relies on contractor maintained software tools to determine the balances for trading partners. There is no evidence that DLA assesses the completeness or accuracy of data input or output from this tool.



- Adjustments made to Accounts Receivable, Accounts Payable, Revenue, Expenses and undisbursed funds are not appropriately supported.
- DFAS performs quarterly elimination adjustments to DLA financial statements for both waived and non-waived entities
 - EY noted that there is not a complete reconciliation at the agreement level to the trading partner adjustments that are being made. Trading partner adjustments are recorded in DDRS-AFS as “top-side” adjustments and are identified as “unsupported” by DFAS.

During EY’s review of the Q3 and Q4 FY17 financial statements and footnote disclosure, we determined that level of review performed was insufficient to detect and correct misstatements in the financials and related disclosures:

- Inaccurate balances reported in the financial statements and notes
 - DLA prepared the year-end AFR package and excluded the funds executed by the United States Army Corps of Engineers, which is material to the General Fund financial statements.
 - Supporting documentation did not adequately support the balances recorded in the Notes.
- Lack of complete and accurate disclosures
 - Note 1 Significant Accounting Policies (SAP) did not completely and accurately summarize the accounting principles and methods of applying those principles.
 - Note 1 SAP did not appropriately disclose management’s judgements relevant to valuation, recognition, and allocation of assets, liabilities, expenses and revenues.
 - Note 1 SAP did not sufficiently describe changes or non-compliance in GAAP reporting.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Evaluate EBS posting logic and evidential matter to ensure system posting logic is configured in compliance with USSGL and DOD SFIS.
- Evaluate EBS system capabilities and provide a system-generated mapping report which ties EBS configured posting logic to EBS transaction codes and movement types and USSGL/DOD transaction numbers
- Document clear descriptions of business events and varying circumstances that impact or change the posting logic
- Document transaction description based on the EBS doc type to identify the type of transactions within EBS universe of transactions.



- Implement monitoring or review control to ensure EBS transactions are being posted as intended.
- Analyze and investigate the known budgetary to proprietary tie point variances at a business process level to determine the root cause.
- Assess their current policies and procedures around the budgetary to proprietary reconciliations including the design of key controls in the process. DLA should design a control that focuses on addressing the root cause of the variances in order to resolve current underlying issues as well as prevent future variances from occurring.
- Evaluate the current process for creating UTB to ATB:
 - Identify areas to create efficiencies through automating the process.
 - Consider other reconciliation options to design a reconciliation that is performed in conjunction with the production of the DDRS-AFS trial balance and not subsequent to the production.
 - Consider the design of the reconciliation and ensure data is being pulled from the proper sources to ensure completeness and accuracy of data interfaces.
 - Consider documenting the list of reports generated by DFAS and the specific parameters used to generate the reports
- As a part of the Managers Internal Control Program (MICP), assess the risks associated with the process to generate the financial statements including the complexity, extent of manual processes, decentralization and reliance on third party data. Based on the assessed risks, determine if sufficient policies, procedures and controls are in place to address risks related to the compilation of the financial statements.
- Evaluate the current support agreement with DFAS to determine if agreement sufficiently documents roles, responsibilities, communications and timelines needed to support DLA's reconciliation requirements.
- Evaluate the policies and procedures in place over the financial reporting process including the specific roles of DLA and DFAS:
 - Document the list of reports generated by DFAS and the specific parameters used to generate the reports
 - Include a control(s) for reviewing all the files that are used to adjust the ending balances within EBS in the creation of the adjusted trial balances.
 - Document the business need for adjustments and the appropriate evidential matter required to support adjustments
- Evaluate current quarterly adjustments and prior year adjustments to determine which of those recorded in DDRS-B could be eliminated by making the adjustment within EBS.
- Evaluate trading partner adjustments, prioritize based on dollar value and risk and begin a reconciliation process at the agreement level.
- Implement additional controls for agreement level reconciliations with DLA trading partners and develop a process for resolving differences at the agreement level in a timely manner.



- Evaluate system capabilities to include recording and monitoring transactions at the trading partner and agreement level
- Finalize updated policies and procedures for identifying, researching and reconciling variances between DLA general ledger data and trading partners. Include considerations for:
 - Review of appropriate classification between federal and non-federal
 - Review impact on both proprietary and budgetary general ledger accounts
- Work with DFAS and OSD as necessary to continue to resolve issues with trading partners at the Department level.
- Evaluate all components of OMB-136 and determine if disclosures are complete, accurate and compliant. Incorporate updates to footnotes as necessary.
- Re-assess review controls associated with the financial statement review process and consider including:
 - A review of revised OMB-136 requirements to ensure updated guidance is evaluated and incorporated in a timely manner.
 - Other reviews by business process areas to ensure disclosures are complete, accurate and compliant. These reviews should ensure that footnote disclosure are consistent with business activity occurring throughout the year.
 - An assessment of current checklists used in the financial reporting process to determine if checklists need to include enhanced review procedures.



Oversight and Monitoring

Oversight and monitoring relates to DLA's lack of establishment and implementation of a sufficient control environment, enterprise-wide.

DLA lacks a sufficient control environment related to Internal Controls over Financial Reporting including a sufficient A-123 program:

- A sufficient risk assessment, performed at the appropriated level, related to reporting such as documenting the complexity of programs, accounting estimates, related party transactions, and extent of manual processes.
- An evaluation of fraud risks and the approach to implement financial and administrative control activities to mitigate identified material fraud risks.
- A finalized policy or procedure to develop and implement ERM and internal control, including anti-deficiency act reporting, that includes the appropriate documentation requirements that are necessary as a part of an effective internal control system.

DLA lacks sufficient policies and procedures around financial reporting including:

- Sufficient written policies and procedures do not exist related to Management Review Controls for the Financial Reporting Process. The identified management review controls do not accurately describe the procedures performed to detect or correct an error.
- Policies or procedures are not in place to verify the accuracy and completeness of system generated reports used in the execution of controls.

DLA does not perform sufficient oversight and monitoring of service organization control reports:

- DLA has not associated each relevant Complementary User Entity Controls (CUECs) to specific DLA controls.
- DLA has not identified specific DLA compensating controls for DFAS controls deemed ineffective in the DFAS SOC 1 report.
- DLA has unresolved control gaps relate both to addressing control issues identified in the DFAS SOC report as well as with DLA's CUECs
- DLA's evaluation was not performed by the subject matter experts in a timely manner. As of May 21, 2017, the SMEs had not reviewed the evaluation and the controls identified were identified as possible mitigating controls.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Continue to design and implement DLA SOA policy at all levels throughout the organization and emphasize the importance of the Manager's Internal Control Program



- (MICP) from DLA leadership. This will help bring visibility, education and support to the program from across the organization.
- Ensure DLA SOA policy includes proper detail and guidance for conducting the risk assessment process, including:
 - all aspects of the risk management process are reviewed at least once a year;
 - risks themselves are subjected to review with appropriate frequency; and
 - provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed
 - Identify, document and communicate MICP roles and responsibilities. Ensure proper groups and personnel are involved at the appropriate levels to produce the most results based, cost effective control environment.
 - Develop, document and maintain supporting documentation as a part of the MICP and for the Statement of Assurance as evidence that DLA developed management control plans, performed risk assessments, performed ongoing monitoring, developed corrective action plans and tracked progress towards remediation for each separate fund
 - Provide formal training and guidance, on an annual basis, to those involved in the MICP to ensure roles, responsibilities and objectives are properly understood, carried out in a timely manner, and executed consistently across the organization.
 - Increase the resources dedicated to the A-123 program, as needed, to completely execute all aspects of the program requirements on an on-going basis.
 - Utilizing the updated risk assessment, DLA should design and implement a control testing strategy appropriate to address the risks.
 - DLA should evaluate the current review controls identified to operate over an entire process:
 - Evaluate single controls to determine if multiple controls actually exist in the process
 - Assess control descriptions to ensure they are documented completely including how the control is applied, who is responsible, how frequently it is performed, and how the control is evidenced.
 - Evaluate the current policies and procedures for evaluating information produced by the entity.
 - Foot system generated financial reports
 - Perform a tie-out of system generated reports to the trial balance
 - Verify that the parameters used to generate the reports or data are appropriate
 - Judgmentally select a sample of transactions or balances in the report and validate that the transactions are accurate.
 - Implement a process to identify, monitor and maintain related parties and material related party transactions. Additionally, management should perform a review of these sales transactions on a regular basis and disclose any material related party transactions in the notes to their financial statements.



- DLA should develop and maintain internal control documentation relating to the identification of related parties and related party transactions.
- DLA should analyze if current policies and procedures are sufficient for the process and update if necessary.
 - Ensure that appropriate personnel are involved in the process
 - Evaluate that proper roles and responsibilities are identified and communicated
 - Ensure timelines are defined
- DLA should determine if controls need to be established for the SOC 1 review process and ensure controls are properly identified, designed and operating effectively
- DLA should associate specific DLA controls to CUECs as well as DFAS controls determined to be ineffective



Financial Information Systems

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

Our assessment of the Information Technology ("IT") controls and the computing environment identified deficiencies in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate.

The deficiencies relate to the following areas:

- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Security management / governance over implementation of security controls

(a) Access controls / user access

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

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

- Access was not restricted to authorized users and was not assigned in accordance with the principle of least privilege.
- Lack of monitoring and auditing security violations and sensitive user activities, including activities of privileged users logs were not documented, not being performed, or not configured appropriately within systems.



- Lack of enforcement and documentation of session inactivity parameters.
- Lack of enforcement for procedures related to establishing new users, monitoring unused IDs, locked IDs, terminated users, or access re-certifications.
- Lack of policies and procedures for account authorization, provisioning, and termination.

(b) Configuration management / change controls

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

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

- Inability to identify all application changes made to production during the audit period.
- Lack of monitoring and recording of changes made to applications by DLA management.
- Users have access privileges enabling them to bypass the configuration management process and make changes directly to production.
- Testing of new changes does not include documentation of review and approval per DLA policies.

(c) Segregation of duties ("SoD") controls

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

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

- DLA management did not identify segregation of duties conflicts that consider both IT and business process roles and activities across DLA-owned applications.
- Segregation of Duties review within the user provisioning process is not performed consistently across all applications.



- Administrator and super user privileges are not restricted through user groups and permissions. In some cases, users can create and assign roles to themselves roles including DISA administrators.
- Business end users have access to roles intended for IT privileged users.

(d) Security Management / governance over implementation of security controls

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures and controls implement the entity-wide policy. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

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

- Service Organization Control (SOC) reports are not reviewed, specifically, to assess Complementary User Entity Controls (CUECs). In addition, SLAs with DISA are not reviewed and updated in a timely manner.
- Lack of application specific access control policies/procedures to consider unique business rules/processes, roles and responsibilities, and technologies.
- System Security Plan (SSP) does not reflect the existing IT controls environment or include all requirements of DoDI 8510.01.
- DLA does not perform complete risk assessments on an annual basis to facilitate identification of new threats and vulnerabilities.

Recommendations

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

Access controls / user access / segregation of duties

- Restrict access to authorized users in accordance with least privilege principles.
- Document and follow procedures related to user account management and segregation of duties.
- Implement stronger security controls and restricting user access to programs and data to



the minimum level required by the user's responsibilities, to include encrypting sensitive data.

- Identify sensitive business transactions in application business and privileged roles, segregate these roles and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.

Configuration management / change controls

- Identify and monitor applications changes made in the production environment.
- Segregate developers' access to the development and production environments,
- Review, approve, and monitor application changes completeness and accuracy, including emergency changes.

Security Management / governance over implementation of security controls

- Implement stronger security controls to improve the security documentation and testing of applications.
- Establish a process to evaluate and incorporate service providers' CUECs into security documentation and the current application control environment.



Appendix B - Significant Deficiency – Environmental Liabilities

Environmental Liabilities (EL) is comprised of clean-up costs associated with the restoration of sites that DLA manages. Through our audit procedures, we identified deficiencies in internal controls listed below, which, when aggregated, we consider to be a significant deficiency.

DLA is unable to substantiate the cost to complete estimates for environmental liabilities.

- Policies and procedures are not in place that adequately demonstrates the methodology used to derive the estimate was appropriate.
- The supporting documentation does not appropriately substantiate the estimate for the cost to complete the clean-up and restoration.

DLA is unable to substantiate the program management cost estimates for environmental liabilities.

- Policies and procedures not in place that adequately documents the methodology used to derive the estimate.
- The supporting documentation does not appropriately substantiate the estimate for the program management costs.

DLA has not appropriately designed controls to adequately detect material misstatements in EL.

- Controls are not designed to verify the completeness and accuracy of the system generated reports or data used in executing the control activity. DLA's EL control activities, including deriving the EL estimates, are dependent upon system-generated reports or data produced by information systems.

Recommendations

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

- Design and implement policies and procedures to ensure that process for preparing the cost to complete estimate is adequately documented and sufficiently describes the methodology used to derive the estimate.
- DLA should include procedures to verify that the supporting documentation used to derive the estimate properly reconciles to the cost to complete estimate.
- DLA should adequately document the qualifications of the specialist used in deriving the estimate to ensure and demonstrate that the specialists have the necessary competence, capabilities, and objectivity.



- Design and implement policies and procedures that adequately describe the process for preparing the estimate of the EL PM costs. The description should include sufficient detail for a reviewer to understand the process and evaluate whether the process used is reasonable and consistent with the policy.
- Implement policies and procedures to verify that the system generated reports or data used in the performance of the control is complete and accurate such as:
 - Foot system generated inventory reports;
 - Perform a tie-out of the system generated reports to the trial balance;
 - Verifying that the parameters used to generate the reports or data are appropriate
 - Judgmentally selecting a sample of transactions or balances in the report and validating that the transactions are accurate.



Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

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

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

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (“OMB”) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the General Fund of the Defense Logistics Agency (“DLA”), which comprise of the balance sheet as of September 30, 2017, and the related statement of net costs, changes in net position, and combined statement of budgetary resources for the year ended September 30, 2017, and the related notes to the financial statements and have issued our report thereon dated December 12, 2017. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2017 and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 17-03, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (“FFMIA”) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to DLA.

The results of our tests of compliance with laws and regulations described in the second paragraph of this report disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 17-03, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.



FFMIA

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

(a) Federal financial management system requirements

EY identified as part of the Financial Information Systems material weakness, contained in the *Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards* ("Report on Internal Control"), where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with user access, configuration management/change controls, segregation of duties and security management. These financial system deficiencies prevent DLA from being compliant with federal financial management system requirements and inhibit DLA's ability to prepare complete and accurate financial reporting.

(b) Noncompliance with applicable federal accounting standards

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

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

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

FMFIA

Federal Managers' Financial Integrity Act ("FMFIA") requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control.

The DLA was not able to provide evidence that they are in compliance with significant aspects of



Circular A-123, which implemented FMFIA. The DLA provided a FY 2017 Statement of Assurance, however there was not sufficient evidence that each process identified by DLA fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level. Based on the evidence received, EY notes that DLA has an A-123 testing strategy, however DLA is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

DLA's Response to Findings

Our Report on Internal Control dated December 12, 2017 includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance with FFMA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from DLA's management responsible for addressing the noncompliance are provided in their letter dated December 12, 2017. We did not audit management's comments and accordingly, we express no opinion on them.

Purpose of this Report

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

Ernst & Young LLP

December 12, 2017

Management's Response to Auditors' Report



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

DEC 12 2017

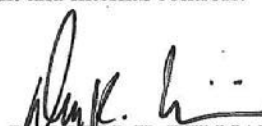
MEMORANDUM FOR DEPARTMENT OF DEFENSE OFFICE OF THE INSPECTOR
GENERAL

SUBJECT: Fiscal Year (FY) 2017 Financial Statement Audit – General Fund

Thank you for the opportunity to comment on the Independent Auditors' report on the audit of the Defense Logistics Agency's (DLA) FY 2017 financial statements. We agree with the Independent Public Accountant's (IPA) conclusions for the DLA inaugural Financial Statement Audit. This initial audit has provided us with a valuable independent view of our current financial operations. We concur with the reported findings as presented by the IPA.

For FY 2017, the engagement with the IPA was a positive partnership that facilitated an effective and efficient audit. The IPA's continual updates to our management team provided on-going insight during the audit. We are committed to resolving the material weaknesses and strengthening internal controls around DLA's operations.

I look forward to working collaboratively with the Office of the Inspector General and the IPA to strengthen DLA financial management and internal controls.


DARRELL K. WILLIAMS
Lieutenant General, USA
Director