DEFENSE COMMISSARY AGENCY

PERFORMANCE AND ACCOUNTABILITY REPORT

Fiscal Year 2007

DECA-AT-A-GLANCE

Established	1991
Headquarters	1300 E Street Fort Lee, VA 23801 www.commissaries.com www.deca.mil (for authorized parties)
FY 2007 Operations Costs	$1.2 billion
FY 2007 Sales	$5.5 billion
Total Employees	Approximately 17,500
Regional Offices	3 (East, West, and Europe)
Commissaries	260
Customers	Approximately 11.8 million

DeCA MISSION• • •

Deliver a Premier Commissary Benefit to the Armed Services Community that:

- Encourages an exciting shopping experience;
- Satisfies customer demand for quality grocery and household products; and
- Delivers exceptional savings while
  - Enhancing quality of life;
  - Fostering recruitment, retention and readiness; and
  - Supporting war fighters' peace of mind, knowing their families have secure and affordable access to American products.

DeCA VALUES• • •

Leadership – **I**ntegrity – **F**lexibility – **E**njoyment

"LIFE": These four words comprise the acronym "LIFE" and are the corporate values DeCA wants employees to represent as the agency moves forward. The values are the engine behind a new vision that highlights DeCA's commitment to the people who deliver and receive the commissary benefit.

Leadership: We expect passion, courage, and excellence!

Integrity: We demand honesty, professionalism, and trustworthiness!

Flexibility: We cultivate innovation, empowerment, and competence!

Enjoyment: We foster teamwork, recognition, and opportunity!

DeCA VISION• • •

Patrons, Workforce and Stakeholders working together to create "RAVING FANS!"

DeCA's VISION will focus on people – all working together to create "Raving Fans."

DeCA GOALS• • •

Customers: Preserve and Deliver a Premier Quality of Life Benefit

Workforce: Transform the Workforce to become more agile, knowledgeable, and motivated to provide exceptional customer service

Partners: Maintain and communicate the relevance of the commissary benefit through constant innovation and by strengthening our internal governance

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FOREWARD

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

To enhance the presentation of performance, management, and financial information, OMB requires DoD and other agencies to incorporate their annual financial statements into a Performance and Accountability Report (PAR). Although DeCA is not required to prepare a separate PAR, we have prepared this document which is closely aligned to the statutory guidance framework to demonstrate accountability.

DIRECTOR'S MESSAGE

The Performance and Accountability Report for fiscal year 2007 once again reflects the Defense Commissary Agency's (DeCA) commitment to maintaining accurate financial reports and overall fiscal responsibility. Accountability is entrenched throughout the organization, not just financially, but operationally as well. This past year, our corporate governance actions resulted in record sales, a hallmark "Store of the Future" opening, increased patron satisfaction, deployment of a state-of-the-art point of sale system as well as successful initiatives such as Workforce of the Future, Virtual Commissary, Outreach Program, Scholarships for Military Children Program, and a sixth "clean" unqualified audit opinion.

As we begin our 16th year of delivering the premier quality-of-life benefit to our country's most deserving customers and their families around the world, we continue to re-evaluate our metrics to better use and prioritize resources, increase support to our stores, and achieve desired outcomes in support of the President's Management Agenda and the Defense Department's Balanced Scorecard. We continue to be a leader in the Department of Defense (DoD) for implementing the requirements of the Office of Management and Budget Circular A-123, *Management's Responsibility for Internal Control*, Appendix A. Results have shown that our overall internal controls are strong. In fact, we received the highest score in DoD for our fiscal year 2006 statement of annual assurance. Through our internal control program, fiscal responsibility permeates throughout the Agency from cashier to store director to senior management.

Performance data indicates more progress in meeting our established goals and targets. Sales increased for the fifth fiscal year in a row, increasing $123 million (2.3 percent) over fiscal year 2006, despite the closure of additional commissaries and a continually changing environment of troop movements and family relocations. Patron satisfaction surveys revealed a 7.6 percent increase in customer satisfaction over fiscal year 2006 survey results. DeCA achieved such sales success and all-time high customer satisfaction by seeking a best business model approach to delivering the benefit. For example, we tested and deployed a best business model using industry practices and small business capabilities to produce commissary fresh fruits and vegetables. By directly outsourcing produce, DeCA eliminated middleman costs, gained oversight over purchasing and distribution, increased buying power through centralized procurement, and became better positioned to take advantage of promotional pricing. The results are impressive, with double-digit percentage increases in patron savings and tonnage sold, and wide reports of increased customer satisfaction. Ordering lead time with the simplified, web-based system has been cut in half. Produce delivery time and frequency has improved, with an accompanying increase in quality including better opportunities to obtain "first pick" of available produce. Sales in other departments have also grown measurably; patrons shop more frequently for produce and are buying other items at the same time. Our new produce acquisition has been a resounding success for the patron, DeCA and DoD.

One of the biggest accomplishments in fiscal year 2007 was in April when we opened our "Store of the Future" in San Diego, CA. Whether for pantry-loading or grab-and-go, our patrons enjoy a variety of shopping experiences in this ultra-modern commissary.

Patrons are the focus of all our initiatives leveraging technology, technology, human resources, operations or marketing. Our state-of-the-art point-of-sale system, Commissary Advanced Resale Transaction System (CARTS), was designed to improve customer service and business functionality to keep pace with commercial industry through self-checkouts, electronic benefit transfers, check truncation, and check imaging. Installation and implementation began in October 2006 and we are on track to deploy the system at all of our stores by May 2008. Our Warehouse Management System, which manages the receiving, storing, and shipping functions of our central distribution centers was, deployed in Germany during February and March of 2007.

The Workforce of the Future is one of many programs we began implementing in fiscal year 2006 to better support the needs of our customers. It was designed to provide a more productive, flexible store-level labor force better able to respond to customer needs on the commissary sales floor and checkout lanes. The critical strategic elements associated with this initiative are: a simplified organizational structure, which should streamline the workforce and produce desired savings; training for employees and managers on how to accomplish every task in the store; and new multi-skilled position descriptions creating store associates and general managers. Through fiscal year 2007, 52 stores now have this new type of workforce in place.

Virtual Commissary is an internet based shopping alternative designed to provide the commissary benefit to military families around the world – wherever they serve, even when they are separated from traditional brick and mortar commissaries. So far, results are impressive with 96,000 unique visits or "hits" since the concept debuted in October 2005. Those numbers are remarkable considering the test items consisted of only seven gift baskets. Functionality of the service will improve with Phase II, which will feature a significant increase in the items offered to our patrons. It is scheduled for testing in the beginning of fiscal year 2008.

Other initiatives that are serving our customers well are Outreach Programs to the military community such as the DeCA Dietician. In FY 2007, DeCA hired a registered dietician to help promote health and wellness in our stores. We also formed a partnership with DoD, establishing a nutrition committee promoting DeCA as the department's nutritional leader. Commissary Awareness Month, another Outreach Program aimed at military members and their families, promotes the benefits and everyday savings they can realize by shopping regularly at their commissary. Initiatives such as these are helping us create an unequaled shopping experience for our patrons – and we will continue this emphasis in the future.

Commissaries are an integral part of military life, helping to create a sense of community at military installations worldwide. As an example, in fiscal year 2007, the Scholarships for the Military Children Program in DeCA commissaries awarded about $4.7 million to nearly 3,000 well-deserving recipients. Additionally, in fiscal year 2007, 27% of DeCA's workforce consisted of military spouses, while 11% were dependents. These factors support DeCA's commitment to meeting the expectations of our military patrons.

Finally, we are pleased and proud that for the sixth year in a row, independent auditors have given our financial statements an unqualified “clean” audit opinion. This certifies that DeCA’s management control systems, except for the nonconformance controls associated with our financial systems and reported by the independent auditors, taken as a whole, provide reasonable assurance that the objectives of the Federal Managers’ Financial Integrity Act of 1982 are achieved. We have also evaluated our financial management systems as required by the Federal Financial Management Improvement Act of 1996. As we acknowledged in previous audits, along with most DoD agencies, our systems are not compliant with the U.S. Standard General Ledger. To meet this requirement, DoD, with participation by DeCA and other entities, is working to improve a system-wide architecture that will meet the requirements of both acts.

As we face present and future challenges – base realignment and closure, marketplace changes, organizational realignment, and political initiatives – I remain confident in DeCA’s commitment to enhancing our business processes to meet those challenges. We will remain the premier quality-of-life benefit to the men and women of the Armed Services community – relevant, responsive and recognized – a global mission serving a global force. I reiterate my pledge that DeCA will deliver both a critical economic advantage and a “taste of home” to our nation’s Service members deployed around the world. Truly, their commissary is here to serve their needs.

Patrick B. Nixon
Director

PART I

MANAGEMENT'S DISCUSSION AND ANALYSIS

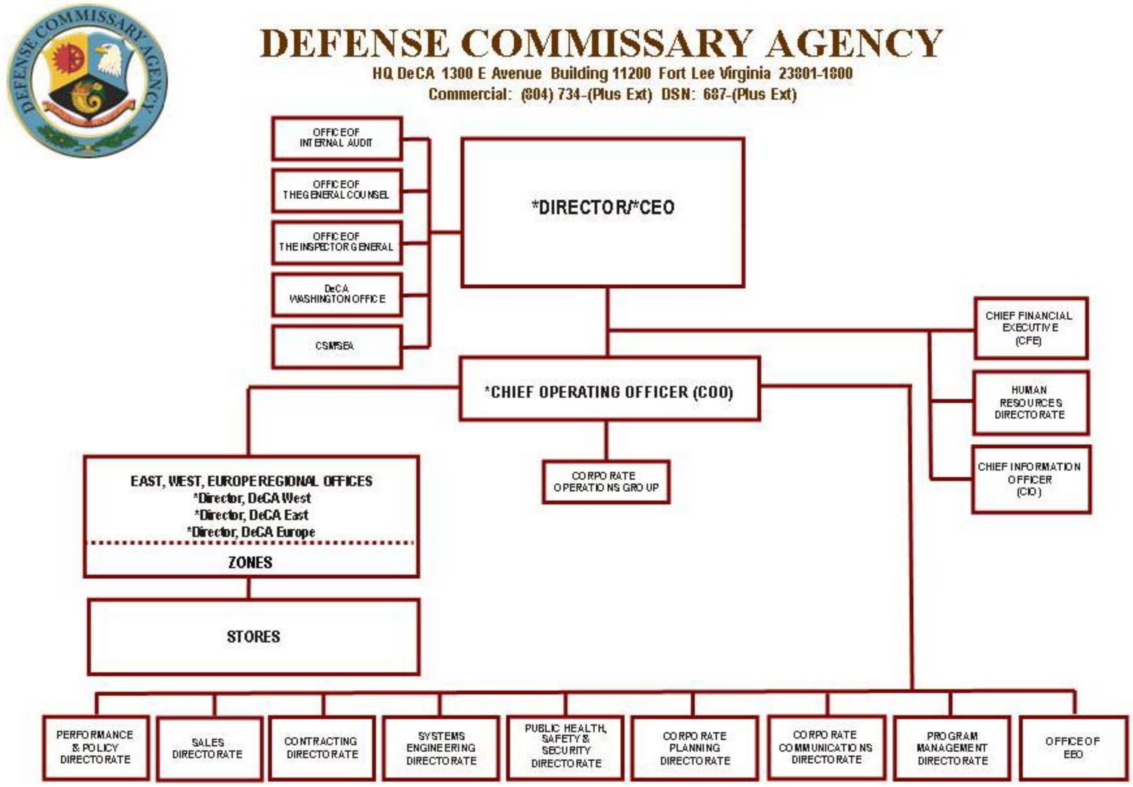
OVERVIEW OF DeCA

ORGANIZATION AND MISSION:

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

DeCA is headquartered at Fort Lee, Virginia and operates a worldwide system of 260 commissaries. Three regional offices provide day-to-day management and support, which are located in Fort Lee, Virginia; Sacramento, California; and Kapaun Air Station, Germany. Our commissaries sell food and related household items to active, reserve, and guard members of the Uniformed Services, retirees of these services, authorized family members, and other authorized patrons. Field Operating Activities (FOA) perform services for the regional offices and their commissaries, including centralized purchasing of national brand items and centralized financial management.

DeCA continues its restructuring of above store-level operations to more sharply focus agency resources on supporting store operations. During FY 2006, in consonance with Base Realignment and Closure (BRAC) decisions, DeCA moved to a more centralized support structure. Various support functions, previously located at the East and West Regional Offices, were centralized at DeCA-HQ to ensure consistency and standardization of processes and outputs. A review of our overseas support activities was initiated with the intent to reorganize due to future base restructuring and to continue centralization of resources to DeCA HQ. The restructuring will begin implementation in FY 2008 in consonance with the Integrated Global Presence Basing Strategy. The current organizational structure of DeCA is shown in the chart on the following page.



* Indicates SES position

As of September 2007

DeCA's process improvement program is ongoing through the use of Lean Six Sigma to improve performance and resource efficiencies. DeCA has recruited its second wave of black belts and has instituted the concept of the embedded black belt. This concept allows black belts who have worked with Lean Six Sigma to return to various functional areas thereby bringing the tools of process improvement into the daily operations. Process improvement efforts have been undertaken in areas such as contract requirements, equipment inventories, and security and background clearance activities. The use of process improvements tools is critical as we continue to centralize processes that were previously performed throughout DeCA with diverse methodologies.

2007 HIGHLIGHTS:

During FY 2007, DeCA's operations included commissaries with annual sales of $5.5 billion and 17,500 employees. DeCA operates its commissaries around the world to support the military services. Patrons include approximately 11.8 million active duty military, reservists, retirees, family members, and authorized civilians working overseas. Congress authorizes DoD to operate its commissaries as a significant non-pay benefit to supplement military income as an integral part of the overall military pay and benefit package. DeCA sells its groceries and household supplies to the military community at its approximate cost. Patrons also pay a five percent surcharge which funds construction programs and our stores' equipment, including information management systems. By selling goods at cost, DeCA provides the lowest overall prices and the maximum savings benefit to our customers.

DeCA closed four Outside the Continental United States (OCONUS) commissaries in 2007 - Bad Nauheim, Giessen, Babenhousen, and McCully Barracks, Germany as well as the Lakenheath Central Distribution Center in England.

The Defense Commissary Agency is strengthening its foundation of budget and performance integration by rebuilding the process for validating and testing internal controls for financial management from the ground up, involving all areas and activities of the commissary system. As a result, DeCA has established itself as a leader in the DoD's compliance with OMB Circular No. A-123, *Management's Responsibility for Internal Controls*. Upon a joint recommendation of the Chief Financial Officers Council and the President's Council on Integrity and Efficiency to strengthen Circular No. A-123, OMB revised the circular in 2004 to incorporate requirements consistent with the Sarbanes-Oxley Act of 2002, P.L. 107-204 (SOX) into federal financial management. The changes were effective beginning with FY 2006 and were set forth in Circular No. A-123, Appendix A. The requirements included in Appendix A strengthened the process for conducting and documenting management's assessment of internal control over financial reporting and provided a separate statement of assurance on the effectiveness of these controls.

DeCA received the highest score in DoD on its annual Statement of Assurance for FY 2006. The Agency scored 3.2 points out of a possible 3.4 points. The Chief Operating Officer, Mr. Richard Page, accepted the award for the Agency's performance from the Deputy Secretary of Defense, Gordon England, on August 3, 2007. The benefits to the Agency for embracing this new methodology go beyond awards and recognition. This program has resulted in cost avoidance and improved compliance with internal controls and business processes. In addition, functional leaders from facilities, sales, and property accountability have become valued stakeholders in the financial reporting process of the Agency.

DeCA submitted its Spring 2007 update to the Program Assessment and Rating Tool (PART) for 2006 in connection with the OMB 2007 PART cycle. The PART is OMB's tool to create and track performance and efficiency outcomes, assess competing funding demands among agencies, and set funding priorities. DeCA's submission consisted of the President's FY 2008-2013 budget figures, the FY 2006 actual performance measures, and the FY 2007 Improvement Plan.

SOURCES OF FUNDS:

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

Commissary Operations finances the operating costs of commissaries, agency and region headquarters, and FOAs. The primary revenue source for this activity group is a direct appropriation to the Defense WCF, which in turn transfers the funds to the DeCA WCF. DeCA received approximately $1.2 billion in appropriation transfers during FY 2007. Commissary Operations also received limited additional revenues from manufacturers' coupon redemption fees, handling fees for tobacco products, and reimbursements for other support.

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

PERFORMANCE GOALS SUMMARY

CORPORATE OBJECTIVES:

DeCA's *Corporate Strategic Plan* sets forth the Agency's values, vision, goals, objectives and strategies to ensure achievement of the entrusted mission. During FY 2007, the strategic plan was revised to reflect changes in our strategies and actions; to better lead us into the future. DeCA's goals and strategies are as follows:

GOAL 1

Preserve and deliver a premier quality-of-life benefit.

The commissary benefit continues to be rated as one of the *most valued benefits* by our military personnel who consider the commissary a much-prized part of their community. As the grocery leader for the military, we believe it is our job to ensure military families get the best grocery deal for their hard-earned dollars along with a satisfying shopping experience. Our goal is to continue to meet or exceed our patrons' expectations while controlling costs.

STRATEGIES

- **Increase the opportunity for authorized patrons to utilize their commissary benefit.**
- **Customize the benefit to better serve our patrons.**
- **Explore joint ventures and other cooperative efforts to generate efficiencies in the military resale system.**
- **Continue to optimize store and support operations by implementing process improvements and technological advances.**
- **Optimize use of surcharge construction dollars.**

GOAL 2

Transform the workforce to become more agile, knowledgeable and motivated to provide exceptional customer service.

By empowering our people and providing them multi-faceted training and experiences that enhance their skills, they will improve service to our valued patrons. The DeCA workforce is known for its deep commitment to our patrons and the commissary benefit. In turn, DeCA is committed to providing every employee a workplace where they are respected and valued. We are building an environment to support and create a workforce to accomplish our mission more effectively.

STRATEGIES

- **Implement a productive, flexible workforce at store level that better serves the needs of our stakeholders and is viable in a competitive sourcing environment.**
- **Ensure a fair and equitable work environment that shows we value our employees.**
- **Plan, guide, and support a cultural transformation of the agency that results in more effective support to our stores.**

GOAL 3

Maintain and communicate the relevance of the commissary benefit through constant innovation and by strengthening our internal governance.

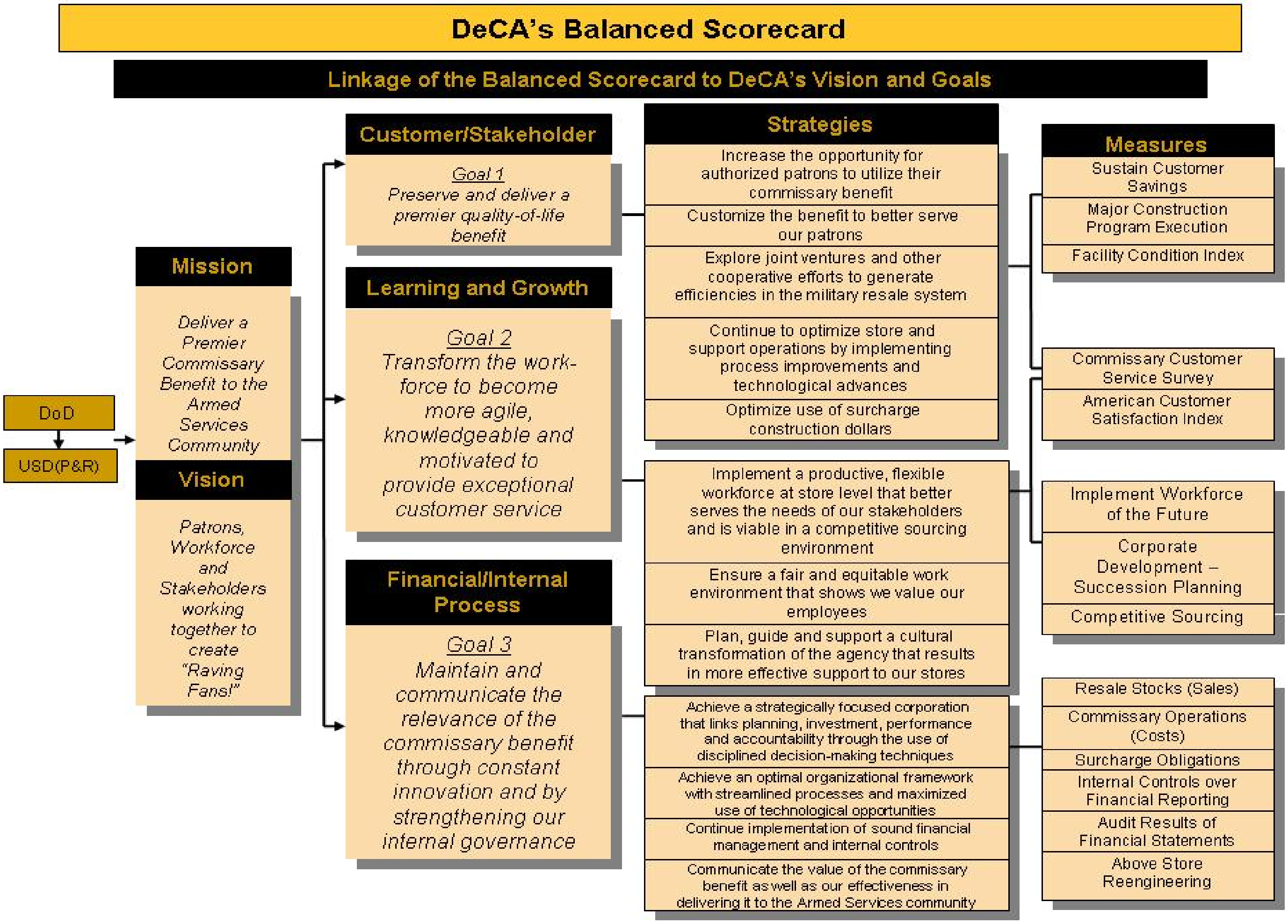
DeCA is committed to working with its stakeholders — the Department of Defense (DoD), the military services, patrons, and the workforce, as well as, manufacturers, distributors, brokers, and exchange partners — to identify and implement business process improvements for more efficient and effective operations, while improving customer service. We will manage the business while being good stewards of the military's premier quality-of-life benefit.

STRATEGIES

- **Achieve a strategically focused corporation that links planning, investment, performance and accountability through the use of disciplined decision-making techniques.**
- **Achieve an optimal organizational framework with streamlined processes and maximized use of technological opportunities.**
- **Continue implementation of sound financial management and internal controls.**
- **Communicate the value of the commissary benefit as well as our effectiveness in delivering it to the Armed Services community.**

FISCAL YEAR 2007 PERFORMANCE GOALS AND RESULTS:

The Defense Commissary Agency implemented the Balanced Scorecard (BSC) at the end of FY 2006. The BSC maps DeCA's performance measures and corporate strategies using the Norton and Kaplan risk management framework, which complements the DoD risk management framework in the DoD BSC. The DeCA continues to refine and strengthen these performance metrics to establish linkage between resource requirements and outputs. This effort provides meaningful information for program evaluation and decision making processes. In addition, it articulates the expectations for DeCA's performance during FY 2007 – 2013 in investing in technologies, programs, and product support necessary to provide the commissary benefit to military personnel and their families. The BSC does not alter the basic mission, operations, authority, or reporting channels for the agency, but complements best business strategies to increase business productivity and customer satisfaction by operating effectively and efficiently. BSC maps to our corporate strategies as shown by the following chart.



We use Planning, Programming, Budgeting and Execution (PPBE) to demonstrate our commitment to both performance improvement and cost reduction. DeCA's strategic plan, corporate objectives, and strategies continue to provide an improved road map to further transform and enhance the commissary benefit with a more balanced approach towards achieving our goals and objectives. We have refined our goals and objectives and continually revisit our strategies to better serve our customers, integrate our business processes, and enhance corporate performance. One key performance goal is to achieve an unqualified audit opinion each year from an independent audit firm. As DeCA began the FY 2007 program, we were one of only six of the DoD's subordinate financial statement reporting entities that received an unqualified audit opinion of our respective FY 2006 financial statements. We received our sixth unqualified audit opinion on our FY 2007 statements.

PERFORMANCE-AT-A-GLANCE

Performance Measure	*FY 2005 Actual*	*FY 2006 Actual*	*FY 2007 Estimate*	*FY 2007 Actual*
Customer Savings	32.0%	32.0%	30.0%	Not available until FY08
Commissary Customer Service Survey (CCSS)	4.55	4.61	4.55	4.61
American Customer Satisfaction Index (ACSI)	77.00	77.00	Meet or Exceed Industry	Not available until 2/08
Facility Condition Index (FCI)	75.00	74.40	76.00	74.93

FINANCIAL STATEMENT SUMMARY

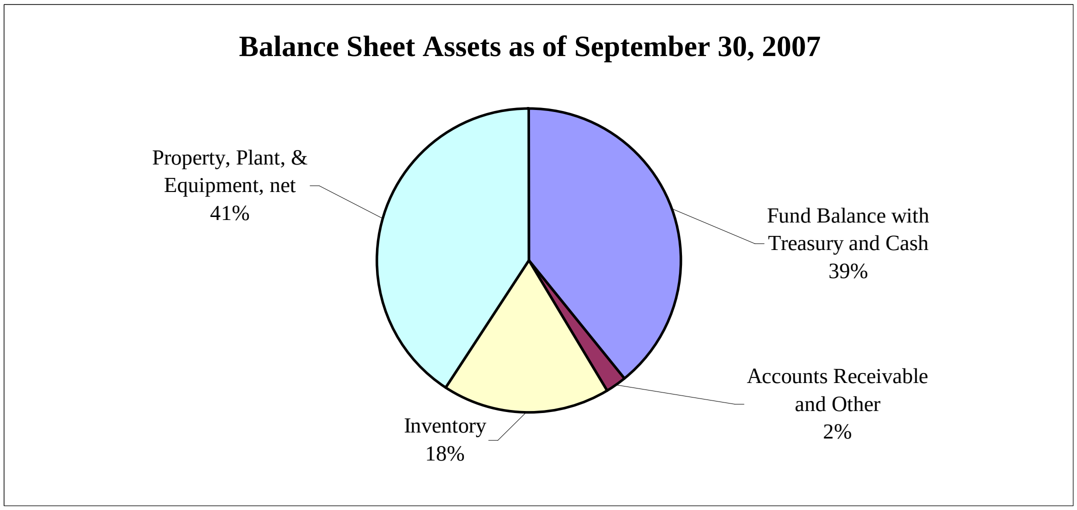
DeCA's financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of Title 31, U.S.C. 35125 (b). These statements have been prepared from DeCA's books and records in accordance with the formats prescribed by the OMB.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

DeCA's Consolidated Balance Sheets, Statements of Net Cost, Changes in Net Position, and Combined Statements of Budgetary Resources are presented in a two-year comparative format, as required by OMB Circular No. A-136, *Financial Reporting Requirements*, revised in June 2007. The Statement of Financing is no longer a required principal statement; however, the information is now disclosed in Note 10, Reconciliation of Net Cost of Operations to Budget. The following section provides a brief description of (a) the nature of each required financial statement and its relevance to DeCA, (b) significant fluctuations from FY 2007 to FY 2006, and (c) certain significant balances that help clarify their link to DeCA's operations.

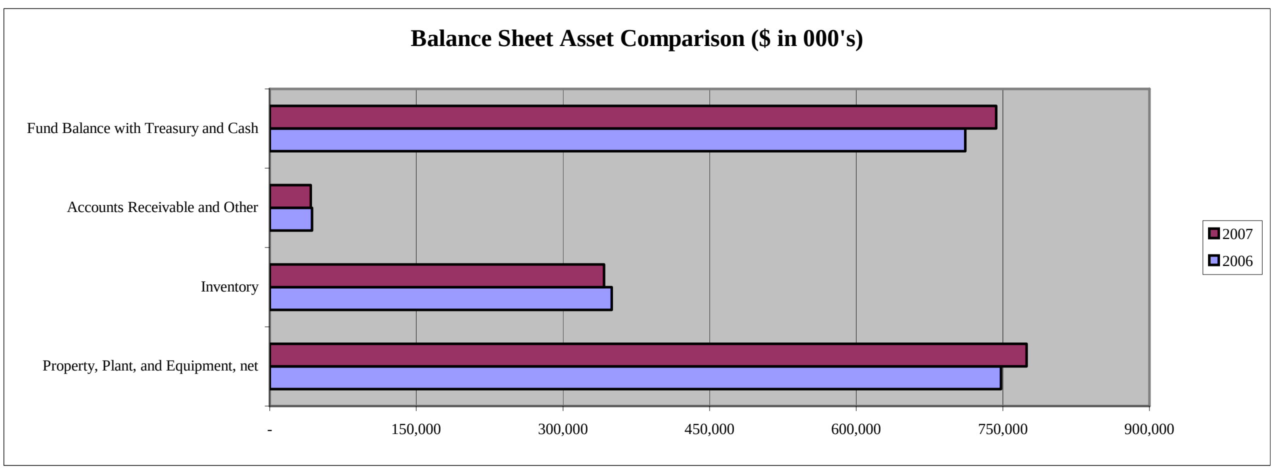
BALANCE SHEET:

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

Assets – As of the September 30, 2007, DeCA's assets were $1.9 billion. The assets of DeCA are the resources available to pay liabilities or satisfy future service needs. DeCA's major categories of assets, as a percentage of total assets, are as follows:



The following chart presents comparative data of major asset balances as of September 30, 2007 and September 30, 2006. A discussion of significant fluctuations follows.



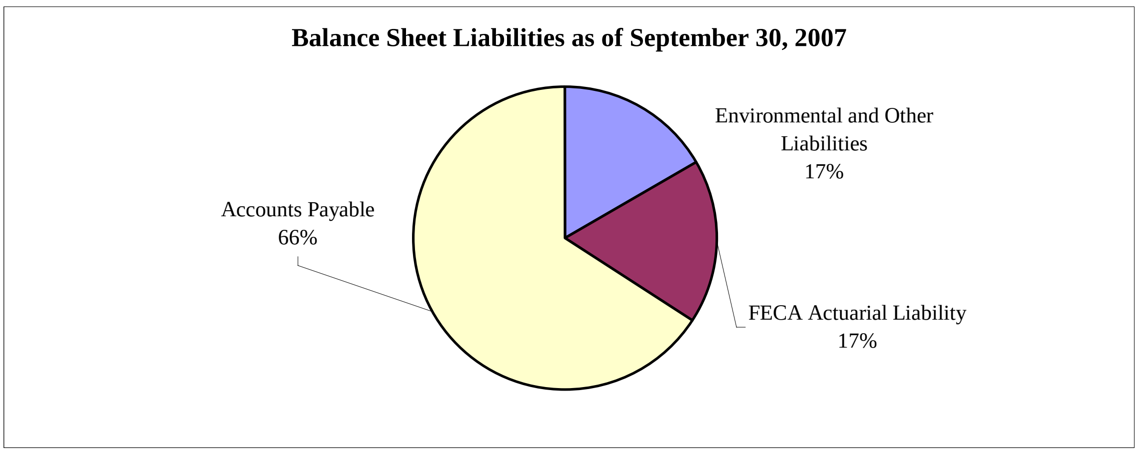
Fund balance with Treasury (FBWT) and Cash is primarily funding available through U.S. Department of the Treasury accounts from which DeCA is authorized to make expenditures to pay liabilities. It also includes monies available at commissaries or those deposits that have not yet been deposited to the U.S. Department of the Treasury. As of September 30, 2007, DeCA has an overall $743.2 million or 39 percent of its assets in FBWT and cash. This is an increase of $32 million, or 4 percent. Increases were due to increased sales and surcharge collections.

Accounts Receivable and Other represents 2 percent of DeCA's current year assets and primarily represents amounts due from DeCA customers. Accounts receivable and other decreased by approximately $1.3 million, or 3 percent. This decrease was primarily caused by the implementation of the Returned Check Management program and overall higher collections.

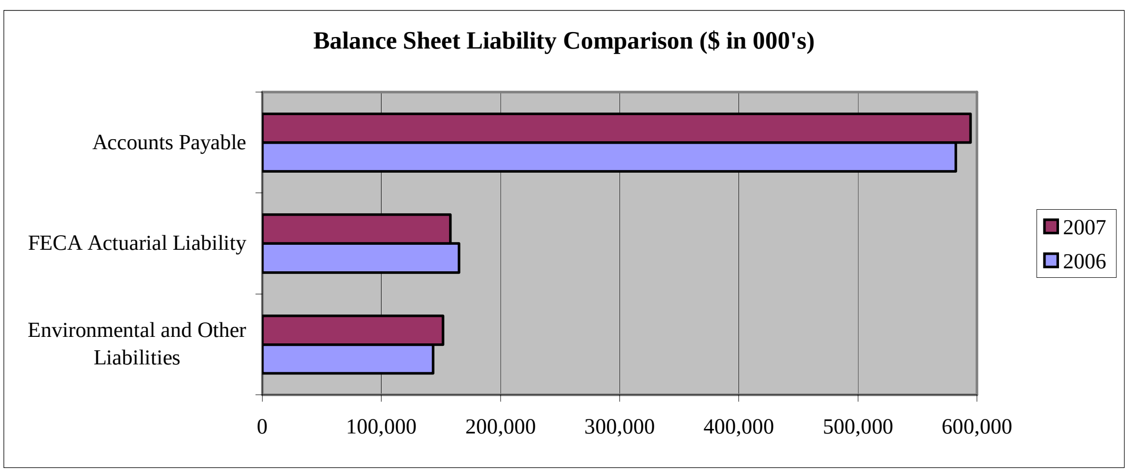
Inventory represents 18 percent of DeCA's current year assets and comprises grocery products held for resale to DeCA patrons at DeCA facilities. Inventory decreased by $8 million, or 2 percent. The decrease was due to a worldwide case lot sale in September.

General Property, Plant and Equipment (PP&E), net represents 41 percent of DeCA's current year assets, and is primarily comprised of capitalized real and personal property held to fulfill DeCA's mission of selling groceries to its patrons. PP&E increased by $26 million, or 4 percent. The majority of the real property increases were due to the implementation and testing of the Commissary Advanced Resale Transaction System (CARTS).

Liabilities – On September 30, 2007, DeCA reported liabilities of $904 million. Liabilities are probable and measurable future outflows of resources arising from past transactions or events. The following chart depicts DeCA's major categories of liabilities as a percentage of total liabilities.



The following chart presents comparative data of major liability balances as of September 30, 2007 and September 30, 2006. A discussion of significant fluctuations follows.



Accounts Payable comprises 66 percent of DeCA's current year liabilities, and consists of DeCA's liability for goods and services delivered or received, but not yet paid, prior to year-end. DeCA's accounts payable increased by $12 million, or 2 percent. The increase was due to higher purchases of inventory as a result of increased sales and the purchase of software and equipment in the 4th quarter for the deployment of CARTS.

Federal Employees Compensation Act (FECA) Actuarial Liability comprises 17 percent of DeCA's current year liabilities and consists of DeCA's expected liability for death, disability, and medical costs for approved workers compensation cases as well as a component for incurred, but not reported claims. The Department of Labor (DOL) calculates the liability for the DoD. Then DoD allocates a proportionate amount to DeCA based upon actual workers' compensation payments to DeCA employees over the preceding four years. The actuarial liability decreased by $7 million, or 4 percent because of the decreased amount allocated to DeCA by the DoD.

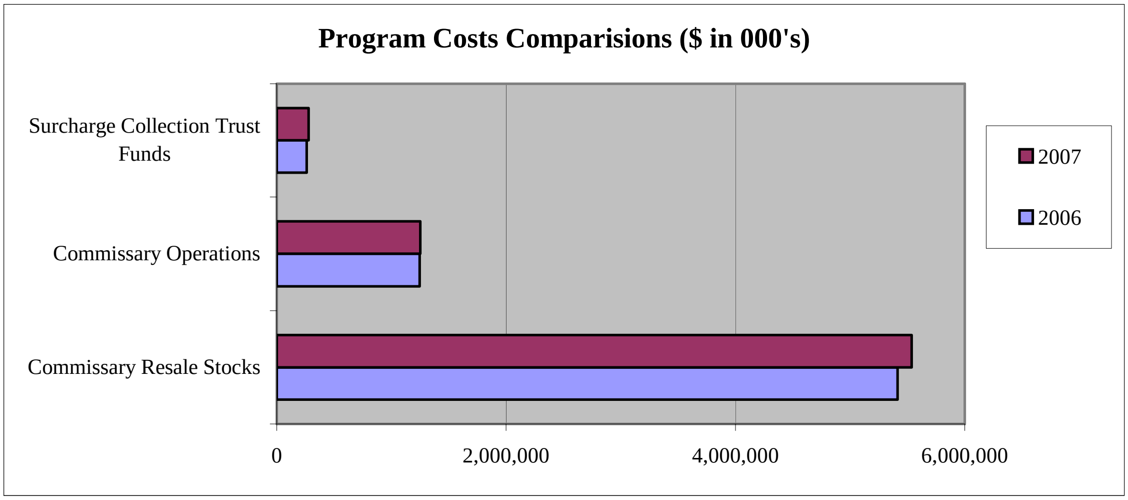
Environmental and Other Liabilities are potential costs to clean up items such as asbestos, lead paint and other hazardous materials from our commissaries. It also includes liabilities for accrued payroll and benefits, accrued unfunded leave, and foreign national separation pay. These liabilities increased $8 million, or 6 percent primarily due to increases in environmental cost factors and increases in payroll during FY 2007.

STATEMENT OF NET COST:

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

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

The chart on the following page compares the gross costs between FY 2007 and FY 2006 in the three major DeCA activity groups.



STATEMENT OF CHANGES IN NET POSITION:

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

DeCA's net position increased by $35 million, or 4 percent. The change in net position resulted from a $20 million increase in the cumulative results of operations and a $15 million increase in FY 2007 unexpended appropriations.

STATEMENT OF BUDGETARY RESOURCES:

This statement provides information on the budgetary resources available to DeCA for fiscal year 2007 and 2006 and the status of those budgetary resources at year-end. The outlays reported on this statement reflect the actual cash disbursed for the year by Treasury for DeCA's obligations. The budgetary resources increased by $180 million, or 3 percent. This increase is primarily attributed to increases in contract authority, appropriation transfers, and unobligated balances brought forward from FY 2006 due to delayed construction programs.

CONTROLS AND STATEMENT OF FINANCIAL ASSURANCE

DeCA accepts the responsibility of reporting performance and financial data accurately and reliably with the same vigor as we accept and conduct business and manage commissary operations. All performance data for this report is gathered and reported through a system of rigorous controls and quality checks. Representatives from each directorate or process gather year-end performance data from their respective program and project officers. The process owners and/or directors for each area or office review and validate the data. Accountants and analysts in the Office of the Chief Financial Executive also review this data before it is archived with all pertinent source information. In addition, DeCA uses various management information systems regularly to track and report on performance and financial data. FY 2007 marked the fourth year that DeCA produced financial reports within accelerated timeframes.

OMB CIRCULAR NO. A-123, MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTORLS, APPENDIX A:

OMB Circular No. A-123, Appendix A, has been fully implemented throughout DeCA. Fifteen processes were considered material to DeCA's financial statements. For those processes, 473 key controls were identified and tested. Eighty-eight percent of these controls were found to be operating effectively with zero exceptions; five percent were operating effectively with limited exceptions; and seven percent of the controls needed a corrective action plan to bring it to the required level of effectiveness. None of the ineffective controls were considered by management to be material weaknesses. The testing and monitoring of these key controls provided an extraordinary opportunity to increase the efficiency and effectiveness of those controls, which ensure timely, useful, and reliable financial information for the Agency

During 2007, deliverables to include Phase I, Process Narratives and Flow Charts and Phase II, Risk Analysis, were forwarded to the Financial Improvement and Audit Readiness Directorate, Office of the Under Secretary of Defense (Comptroller) within the required timeline. Phase III, Identify Internal Controls and Test Methods, was submitted six weeks ahead of schedule. Phase IV, Test Plans, was submitted on April 30, 2007. Phase V, Control Analysis was completed June 26, 2007. All the tests results contained in the Control Analysis were incorporated into the Annual Statement of Assurance for FY 2007.

FEDERAL MANAGERS FINANCIAL INTEGRITY ACT (FMFIA) STATEMENT OF ASSURANCE:

In FY 2007, DeCA reported an unqualified assurance statement. In determining the type of assurance, the director considered information from various sources, which included management reviews, Inspector General and Government Accountability Office reports, audits of financial statements, reviews of financial and computer systems, and other information provided by committees of jurisdiction. Internal control reports and assessments discussed those issues considered to be material at the agency level. However, they were just one piece of DeCA's multi-faceted reporting strategy. Other elements of the strategy included (1) our internal performance and results report, which presented annual measurements of DeCA's performance indicators; and (2) our annual financial statement and audit report, which presented findings from an independent audit firm. DeCA received the highest score in DoD on the Annual Statement of Assurance for FY 2006.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA) STATEMENT OF ASSURANCE:

During FY 2007, we noted that our systems are not compliant with the U.S. Standard General Ledger. DeCA, jointly with DoD, is actively working on improving the system-wide architecture in order to be fully compliant with FFMIA.

LIMITATIONS OF THE FINANCIAL STATEMENTS

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

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

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

PART II

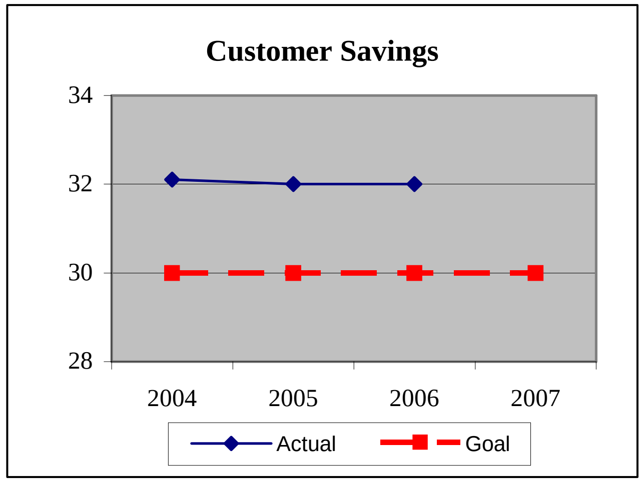
PERFORMANCE SECTION

PERFORMANCE ANALYSIS

DeCA exceeded its performance goals for FY 2007, except for the Facility Condition Index (FCI). The following charts and discussions illustrate how our achievements compare to our targets for the last four years. The Customer Savings score for FY 2007 and the American Customer Satisfaction Index (ACSI) score for FY 2007 will not be available until FY 2008.

Customer Savings:

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

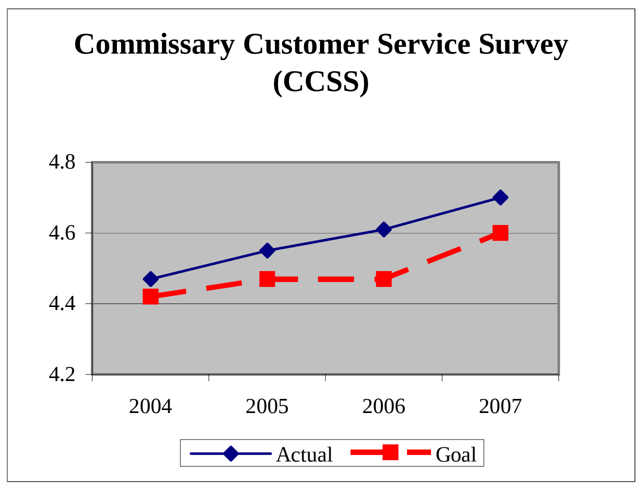


Results: The results for FY 2007 will not be available until after the publication of our PAR. The FY 2007 goal is to sustain customer savings of at least 30 percent.

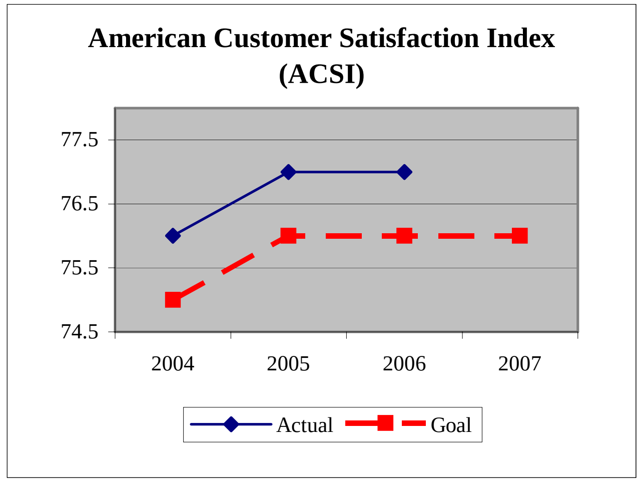
Commissary Customer Service Survey (CCSS):

Background: Customer satisfaction is evaluated by surveys based on statistically sound sampling techniques and all scores are weighted to account for differences in commissary size.

Results: The Defense Commissary Agency exceeded the FY 2007 CCSS goal of 4.55 by scoring 4.60. The survey was administered to almost 22,000 commissary patrons in CONUS and OCONUS.



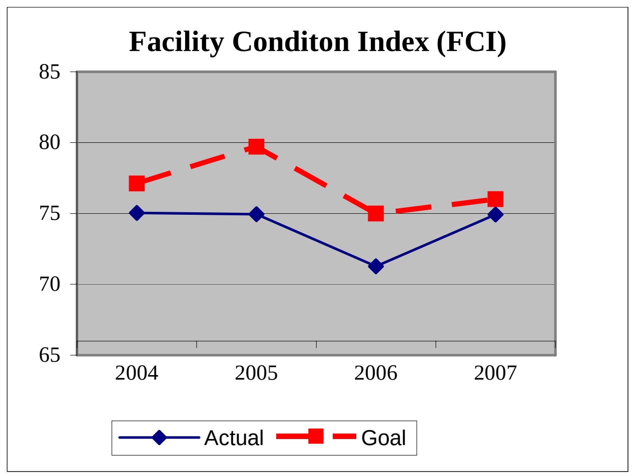
American Customer Satisfaction Index (ACSI):



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

Results: The FY 2006 goal was a score of 76. In the report released in February 2007, DeCA received a score of 77 for FY 2006. This score was above the grocery industry average of 74. In addition, DeCA's strong customer satisfaction led to a below-average complaint rate. The FY 2007 goal is to meet or exceed the industry average. Results of the ACSI for FY 2007 will not be available until February 2008.

Facility Condition Index (FCI):



Background: The FCI is a numerical expression of the physical state of a commissary store. The FCI is a weighted measure of a commissary's condition, refrigeration system, and energy usage and efficiency. The FCI reflects the overall condition of commissary plants and facilities and is used as a leading indicator in assessing the effectiveness of surcharge-funded building investments. The FCI goals were reevaluated and realigned in FY 2006 due to changes in technology, decreased budgets, and reduced buying power. In addition, previous Base Realignment and Closures (BRAC) have resulted in the closure of several commissaries and BRAC 2005 and Global Basing will close approximately 30 more. Many of the targeted facilities are modern stores with high FCI scores, which will further reduce our overall score.

Results: The revised goal for FY 2007 is a score of 76. The actual FY 2007 FCI score is 74.93, which is 98.59 percent of the Balance Score Card goal.

ACCOMPLISHMENTS

DeCA continues to implement initiatives that support the President's Management Agenda (PMA) and that honor its commitment to prudent stewardship of taxpayer funds. These actions have resulted in improved levels of service to our customers, corporate succession planning, reduction in skill gaps, and more effective use of our resources.

STRATEGIC MANAGEMENT OF HUMAN CAPITAL:

The Office of Personnel Management (OPM) mandated that the Federal Government meet aggressive hiring timeline goals. DoD established a benchmark for tracking progress in achieving this goal and has developed specific performance measures on the total number of days for hiring decisions to be made. There is a 30-day model for the Senior Executive Service (SES) positions and there is a 45-day model for non-SES positions. The Agency is committed to meeting the OPM standards for hiring and has also established internal strategies to further reduce hiring time. The Agency tracks the time it takes to fill positions using the event coding in the Defense Civilian Personnel Data System. Separate standards have been established for an internal commissary store fill rate, an external commissary store fill rate, and a region and headquarters fill rate. We had one SES position to fill in FY 2007, which was filled well within the guidelines during 4th quarter. The fill rate for non-SES positions has been well below the DoD mandate of 45 days for each quarter in FY 2007.

COMPETITIVE SOURCING:

DeCA was on track to meet our goal to review 50 percent of the Federal Activities Inventory Reform Act (FAIR) inventory by the end of FY 2008. However, the National Defense Authorization Act of FY 2006 waived DeCA from having to conduct any cost comparison studies of commissary store functions until December 31, 2008.

DeCA publicly announced the competition of DeCA's Resale Accounting functions, containing 141 positions, on June 13, 2006. DeCA engaged an independent contractor to develop the resale accounting performance work statement (PWS). Pre-solicitation was placed in FedBizOopps on July 25, 2007 and preparation to issue a solicitation is proceeding. This study will result in the re-engineering and consolidation of various functions and services, which will allow for staffing reductions and projected savings over the next 5 years.

IMPROVED FINANCIAL PERFORMANCE:

The Agency's financial performance continues to improve. Once again we received an unqualified audit opinion on our consolidated financial statements in FY 2007 - our sixth in a row. DeCA's FY 2007 travel card delinquency rate was 0.55 percent, which was well within the DoD mandate of less than 2 percent. DeCA's Government Purchase Card rate as of September 20, 2007 was 0 percent; the allowable amount by DoD.

EXPANDED ELECTRONIC GOVERNMENT:

DoD mandates that all major information technology (IT) investments have an acceptable business case, which includes security, measures of success linked to the modernization blueprint, program management, risk management as well as cost, schedule, and performance goals. DeCA's new point-of-sale system replacement, Commissary Advanced Resale Transaction System (CARTS), is an Acquisition Category 1AC system with the Assistant Secretary Defense (Networks and Information Integration) (ASD(NII)) as the Milestone Decision Authority. This authority was in turn delegated to DeCA. Also, all services/agencies must submit an Exhibit 300 to OMB for all major IT investments and receive a score of four or higher from OMB. The FY 2006 CARTS OMB Exhibit 300 received a score of five. The Project Management Office (PMO) is tracking cost, schedule, and performance for CARTS in compliance with DoD's Earned Value Management policy. The DoD Acquisition Decision Memorandum, dated February 8, 2007, granted Milestone C approval and entry into the Production and Deployment Phase for the CARTS Program. The PMO is monitoring program execution and submits Acquisition Program Baseline (APB) status through the quarterly Defense Acquisition Executive Summary report.

All mission essential IT systems are properly secured (certified, accredited, or otherwise authorized). System information for Mission Essential and Mission Support systems is recorded in the DoD Information Technology Portfolio Repository (DITPR). To date, DeCA's portfolio contains 24 systems and 1 network enclave. DeCA's IT certification and accreditation is broken down as follows: 19 systems and the network enclave have Authority to Operate (ATO) Certification and Accreditation (C&A), 2 systems have Initial Authority to Operate (IATO) C&A, 2 systems are in pre-deployment stage (C&A not yet required), and 1 legacy system is scheduled to be decommissioned.

As required by DoD, agencies/services must contribute to and participate in E-Gov initiatives, rather than creating redundant or agency unique IT projects. DeCA supports the E-Gov initiatives and has no redundant IT initiatives or Lines of Business (LoB). DeCA has implemented processes supporting: (1) government-to-business transactions (via Electronic Commerce/Electronic Data Interchange) and (2) government-to-citizen transactions (Virtual Commissary and other services available through www.commissaries.com that increase the commissary benefit). Additionally, DeCA has realized internal efficiencies and effectiveness by using DoD systems applicable to the Agency such as Defense Travel System (DTS), Defense Property Accountability System (DPAS), Defense Civilian Personnel Data System (DCPDS), and Defense Civilian Pay System (DCPS).

A Memorandum of Understanding and Memorandum of Agreement have been signed by both DeCA and the Air Force Education and Training Command (ATEC) to provide DeCA an automated learning management system. The Meridian Learning Management System (MLMS) used by ATEC grants DeCA the ability to track and manage E-Learning courses and mandatory training. The Agency is currently updating 65 "Grocery Skills" courses for migration to MLMS.

The Information Assurance Workforce Improvement Program (IA-WIP) was initiated in December 2005 with a 4 year timeline to have 100 percent of the information assurance workforce certified. This program ensures a professional, highly capable information assurance workforce. DeCA has exceeded the DoD certification goal for FY 2007, with 14 percent of our workforce certified.

DeCA implemented a Privacy Impact Assessment (PIA) process on December 1, 2006 to ensure compliance with OMB and DoD guidance. CARTS and DeCA's Web based Virtual Commissary are the only two systems identified that require a PIA. The PIA's have been posted to DeCA's public Web site and forwarded to OMB and DoD as required.

PERFORMANCE IMPROVEMENT:

DeCA established a Corporate Governance Board (CGB) during FY 2006. Meetings are held every two to three weeks and address: (1) proposed concepts and initiatives to include approval, program assistance, and resourcing; (2) quarterly program reviews related to cost, schedule, and performance; (3) process owner support issues and major initiatives; (4) significant policy changes or external mandate activities; and (5) financial and planning guidance to managers. DeCA senior managers regularly utilize financial and performance measures during these quarterly performance reviews to allocate resources, make management decisions, and improve performance and efficiency.

DeCA's Program Assessment Rating Tool (PART) performance measures were documented in the President's FY 2008-2013 Budget. DeCA's PART was included in the budget submission when it went before Congress and was signed on February 6, 2007. The Agency had 12 performance measures documented in the 2006 PART, with one base lined at FY 2000, six base lined at FY 2001, and two base lined at FY 2002. These nine baselines were revalidated and were found to be reliable and sound. The three new performance measures added in FY 2006, Major Construction Project Execution, Internal Controls over Financial Reporting, and Audited Results of Financial Statements all met or exceeded the FY 2006 goals thereby establishing auditable and valid results and the establishment of solid baselines for future trends analysis. The Integrated Program Budget Review was completed on August 31, 2007 and serves as the baseline for the FY 2009 President's Budget due in February 2008.

NEAR AND LONG-TERM PLANS

DeCA ENTERPRISE BUSINESS SYSTEM (DEBS):

DEBS is a new IT system in development that will retire multiple legacy systems that currently support the cataloging, ordering, receiving, inventory accountability, and promotions business processes. The legacy systems include the DeCA Interactive Business System, Automated Vendor Credit Memorandum, Computer Assisted Ordering, Sales Order System, Commissary Online Product Pricing System, Web Pricing, Warehouse Management System, Central Meat Processing Plant, Store Ordered/Vendor Shipped, and Meat/Produce.

The current business process is managed by this large and diverse group of information systems, which require manual support of complex interfaces, do not meet current DoD security standards, and are becoming increasingly expensive to maintain. DeCA has identified the redundancies and inefficiencies and streamlined the current business processes for the Requirement Management Plan. DeCA completed the Concept Refinement Phase for DEBS, which defined the Initial Concept, and developed the technology and strategy for the system. The plan is to achieve high system availability with low maintenance costs, improve business functionality and management reporting, enhance data security, and improve its flexible, open systems architecture. Utilizing leading edge supply chain management capability, DEBS will allow DeCA to keep pace with the commercial grocery industry. The program received Milestone A approval in 4th quarter FY 2007 as well as the approval to obligate funds. Milestone B approval is expected in August 2008.

ORGANIZATION AND PROCESS REENGINEERING:

DeCA completed the consolidation of many corporate and store support functions such as procurement, comptroller, operations, and human resources at DeCA-Headquarters (HQ) and the field operating agencies (FOAs). The “above-store” level reengineering process eliminated layering and realigned the “above-store” operations of two region components, DeCA-East Virginia Beach and San Antonio. As a result of the DeCA reengineering process, a Business Case for Continuity of Operations (COOP) relocation has been prepared and briefed to the agency Corporate Governance Board (CGB) and implementation will begin in FY 2008.

WORKFORCE OF THE FUTURE:

The Workforce of the Future (WOF) concept will enable DeCA to implement a more productive, flexible store level workforce that better serves the needs of our stakeholders and is more viable in a competitive sourcing environment. The WOF was implemented at 52 commissaries as of September 30, 2007 with the goal to reach all CONUS commissaries by the end of FY 2008.

SUMMARY

In summary, DeCA’s past performance and FY 2007 performance indicates positive progress. DeCA’s investment in human capital, technologies, programs, and product support are necessary to achieve and provide the commissary benefit to the Total Force personnel and their families.

PART III

FINANCIAL SECTION

CHIEF FINANCIAL EXECUTIVE'S MESSAGE

Fiscal Year (FY) 2007 saw the Defense Commissary Agency (DeCA) excel once again in every aspect of financial management and performance measurement as we showed continued progress in meeting established goals and targets. Sales and customer service are at an all time high while operating costs, in constant dollars, continued to drop in FY 2007. Our corporate governance efforts have scrutinized the use and prioritization of our resources continuing to make us "good stewards" of our dollars.

In FY 2006, DeCA transitioned to a Balanced Scorecard process, which incorporates and compliments the President's Management Agenda. I am pleased to report that DeCA scored green on the FY 2007 metrics for all perspectives - financial, customer, internal business/processes as well as the learning and growth perspective. The commissary benefit remains the premier quality of life benefit for service members as we continue to increase the value of the benefit without increasing costs.

As reported last year, DeCA has been a strong advocate of the Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control,* Appendix A requirements. Led by our Senior Assessment Team, and building on the successes of our accounting team and audit committee, the results of our efforts are significant. We have become the Department of Defense (DoD) poster child for the sound stewardship of taxpayer dollars and in all areas of financial management.

The Defense Commissary Agency achieved the top ranking score in DoD for its FY 2006 Annual Statement of Assurance. The Agency's score increased 14 percent over FY 2005, from 2.8 to 3.2. This achievement culminated in DeCA being presented a "Check It Award of Excellence" by Mr. Gordon England, Deputy Secretary of Defense in August 2007.

We were also recognized for our unique idea promoting DoD's "Check It Campaign". Because DeCA employees' commitment and dedication to our unique mission directly touches the lives of our patrons, we developed the slogan, "They're doing their BEST for us, are we doing our BEST for them?" We hope this campaign will serve as a daily reminder that an effective internal control environment is one in which we constantly strive to do the job the right way, every day.

The Agency was one of only six DoD entities who earned an unqualified, "clean" audit opinion from an independent audit firm at the end of FY 2006. We have continued this streak by obtaining our sixth "clean" audit opinion for FY 2007. This is a significant accomplishment by DeCA in light of our reliance upon legacy systems, which have resulted in our only significant deficiency for FY 2007. Although these legacy systems do not comply with the U.S. Standard General Ledger, DeCA continues to meet Federal system requirements and Federal Accounting Standards. This is contributable to the Agency's stringent reviews of internal controls, continued compliance with Federal and DoD guidelines as well as meticulous reviews and reconciliations conducted during the financial statement reporting process.

In the FY 2006 Performance and Accountability Report (PAR), I reported that our resource management processes and structure underwent substantial changes as our budget, manpower, accounting, and payroll liaison functions, previously performed at the Continental U.S. (CONUS) Regions, were realigned to the DeCA-HQ and Field Operating Activities (FOA) at Fort Lee. Further, these functions were consolidated into two directorates - the Budget and Manpower Directorate and the Accounting Directorate. During FY 2007, through our improvement of internal controls and review of internal functions and processes, we have witnessed more efficient and effective daily transaction processing and financial reporting. We reviewed our resource management structure in Europe and the Far East and have made proposals that will culminate in the consolidation of additional workload to DeCA-HQ. Also, in FY 2007, a commercial activities (A-76) study of our Resale Accounting Division continued with the development of the Performance Work Statement (PWS) and the formulation of the government's in-house Most Efficient Organization (MEO) team.

In FY 2007, the DeCA audit committee, with members from the Office of the Under Secretary of Defense-Comptroller Office, DoD Office of the Inspector General, Defense Finance and Accounting Service-Columbus (DFAS-CO), and representation from multiple DeCA offices, continued to meet regularly with our independent audit firm, KPMG, to discuss issues, develop policies, and implement procedures to enhance accountability and financial management. These efforts, combined with additional internal control reviews, continue to improve our financial processes and support the maintenance of a "clean" (unqualified) audit opinion.

In summary, FY 2007 yielded great results for the Agency, both financially and operationally. Our continued success in meeting the challenges in FY 2008 and beyond will be traced to our corporate approach to governance and teamwork between functional areas. Our internal control processes will continue to be refined, each time delving deeper into our processes, to bring significant improvements for our patrons and other stakeholders.

Pamela F. Conklin
Chief Financial Executive

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

	2007	2006
Assets		
Intragovernmental:		
Fund balance with Treasury (Note 2)	$ 618,158	$ 617,791
Accounts receivable and other	242	179
Total intragovernmental assets	618,400	617,970
Cash	125,048	93,755
Accounts receivable and other, net	41,664	43,001
Inventory	341,905	349,937
General property, plant, and equipment, net (Note 3)	774,342	748,033
Total assets	$ 1,901,359	$ 1,852,696
Liabilities (Note 4)		
Intragovernmental:		
Accounts payable	$ 128,426	$ 120,267
Other liabilities	40,195	40,532
Total intragovernmental liabilities	168,621	160,799
Accounts payable	466,135	461,930
Federal Employees Compensation Act actuarial liability	157,870	165,173
Environmental liabilities	32,315	29,040
Other liabilities	79,163	73,885
Total liabilities	904,104	890,827
Net position (Note 5)		
Unexpended appropriations	41,645	26,346
Cumulative results of operations - earmarked fund (Note 9)	1,000,569	990,807
Cumulative results of operations - other funds	(44,959)	(55,284)
Total cumulative results of operations	955,610	935,523
Total net position	997,255	961,869
Total liabilities and net position	$ 1,901,359	$ 1,852,696

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

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

Program costs:	**2007**	**2006**
Gross costs	$ 7,069,610	$ 6,923,518
Less: earned revenue	(5,858,349)	(5,718,836)
Net cost of operations (Note 6)	$ 1,211,261	$ 1,204,682

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

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

	2007			2006		
	Earmarked Fund	**All Other Funds**	**Consolidated Total**	**Earmarked Fund**	**All Other Funds**	**Consolidated Total**
Cumulative results of operations:						
Beginning balance	$ 990,807	$ (55,284)	$ 935,523	$ 949,289	$ (65,204)	$ 884,085
Budgetary financing sources						
Non-exchange revenue	-	19,583	19,583	-	19,840	19,840
Appropriations transfers used	-	1,175,098	1,175,098	-	1,208,974	1,208,974
Transfers in (out)	4,159	(4,159)	-	4,431	7,569	12,000
Other financing sources (uses)						
Imputed financing (Note 7)	-	36,034	36,034	-	35,816	35,816
Transfers in (out)	11,373	-	11,373	-	-	-
Other - gain (losses) in capital assets	(10,407)	(333)	(10,740)	(20,062)	(448)	(20,510)
Total financing sources (uses)	5,125	1,226,223	1,231,348	(15,631)	1,271,751	1,256,120
Net (cost) income from operations	4,637	(1,215,898)	(1,211,261)	57,149	(1,261,831)	(1,204,682)
Net change	9,762	10,325	20,087	41,518	9,920	51,438
Cumulative results of operations	$ 1,000,569	$ (44,959)	$ 955,610	$ 990,807	$ (55,284)	$ 935,523

Continued on the following page.

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

	2007			2006		
	Earmarked Fund	**All Other Funds**	**Consolidated Total**	**Earmarked Fund**	**All Other Funds**	**Consolidated Total**
Unexpended appropriations:						
Beginning balance	$ -	$ 26,346	$ 26,346	$ -	$ 50,384	$ 50,384
Budgetary financing sources						
Appropriation transfer	-	1,184,449	1,184,449	-	1,197,021	1,197,021
Appropriations transfers used	-	(1,175,098)	(1,175,098)	-	(1,208,974)	(1,208,974)
Transfers in (out)	-	10,564	10,564	-	-	-
Other financing sources (uses)						
Other adjustments (recissions)	-	(4,616)	(4,616)	-	(12,085)	(12,085)
Total financing sources	-	15,299	15,299	-	(24,038)	(24,038)
Unexpended appropriations	$ -	$ 41,645	$ 41,645	$ -	$ 26,346	$ 26,346

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

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

	2007	2006
Budgetary resources (Note 8)		
Unobligated balance brought forward	$ 19,516	$ 11,472
Recoveries of prior year unpaid obligations	523	11,926
Budget authority	6,772,267	6,632,957
Spending authority from offsetting collections	5,853,272	5,772,118
Net transfers and adjustments	10,564	12,000
Permanently not available	(5,557,142)	(5,522,344)
Total budgetary resources	$ 7,099,000	$ 6,918,129
Status of budgetary resources		
Obligations incurred:		
Direct	$ 1,177,134	$ 1,189,969
Reimbursable	5,908,954	5,708,644
Total obligations incurred	7,086,088	6,898,613
Unobligated balance - apportioned	12,897	6,417
Unobligated balance - not available	15	13,099
Total status of budgetary resources	$ 7,099,000	$ 6,918,129
Change in obligated balance		
Obligated balance, net - beginning of year (Note 8)	$ 803,984	$ 774,090
Total obligations incurred	7,086,088	6,898,613
Less: gross outlays	(7,015,350)	(6,870,722)
Less: recoveries of prior year unpaid obligations	(523)	(11,926)
Change in uncollected customer payments from Federal sources	(27,952)	13,929
Obligated balance, net - end of year (Note 8)	$ 846,247	$ 803,984
Net outlays		
Gross outlays	$ 7,015,350	$ 6,870,722
Offsetting collections	(5,825,320)	(5,786,047)
Net outlays	$ 1,190,030	$ 1,084,675

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

DEFENSE COMMISSARY AGENCY
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Reporting Entity

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

DeCA, with its headquarters located at Fort Lee near Petersburg, Virginia, has three regional offices located at Kaiserslautern, Germany; Fort Lee, Virginia; and Sacramento, California. DeCA operations are financed primarily by a working capital fund (WCF) and surcharge collections. Additionally, in FY 2006, the Office of Management and Budget (OMB) established a new fund to be used in support of Hurricane Katrina relief efforts. DeCA also receives minor amounts of military construction appropriated funds.

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

DeCA's Surcharge Collections Trust Fund is funded primarily by a five percent surcharge applied to each sale. This fund, established by law, primarily finances DeCA's store-level information management equipment and support, and construction programs. The use of budgetary resources associated with the Surcharge Collections Trust Fund is limited by public law. The Surcharge Collections Trust Fund has been identified as an earmarked fund and the required related information is disclosed in Note 9.

The Surcharge Collections Trust Fund was established as the repository for the surcharge collected on the cost of commissary goods paid for by authorized patrons. The monies collected are used to finance certain operating expenses and capital purchases of DeCA, which are precluded by law from being paid with appropriated funds.

B. Basis of Presentation and Accounting

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

Effective FY 2007, the previously required Statement of Financing was removed as a basic financial statement. Federal agencies are now required to disclose the reconciliation of net cost of operations to budgetary accounts for the current and prior year in a note to the financial statements in accordance with OMB Circular No. A-136, *Financial Reporting Requirements*. See note 10 for specific disclosure related to DeCA's reconciliation of net cost of operations to budgetary accounts.

Transactions are recorded on both an accrual accounting basis and budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements on the use of Federal funds. All material intra-agency transactions and balances have been eliminated for presentation on a consolidated basis. However, the Statement of Budgetary Resources is presented on a combined basis in accordance with OMB Circular No. A-136, *Financial Reporting Requirements*.

Earmarked funds are financed by specifically identified revenues and other financing sources that are required by statue to be used for designated purposes and must be accounted for separately from the Federal government's general revenues.

All dollar amounts are in thousands.

C. Fund Balance with Treasury

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

Note 2 provides specific, detailed information concerning FBWT.

D. Cash

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

E. Accounts Receivable

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

Receivables from the public generally arise from manufacturer-related transactions, which are associated with the sale of grocery, meat, and produce items to authorized patrons. An allowance for doubtful accounts is established for reporting purposes based on past experience in the collection of accounts receivable and analysis of outstanding balances using the percentage of receivables. The allowance for loss on receivables account is adjusted accordingly at the time of collection or write-off during the fiscal year. Non-Federal accounts receivable are reported net of the allowance of $302 and $341 as of September 30, 2007 and September 30, 2006, respectively.

F. Inventory

Inventory consisting primarily of grocery, meat, and produce items held for resale is stated at approximate cost.

G. General Property, Plant, and Equipment

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

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

PP&E acquisitions are capitalized if they meet the capitalization threshold and have a useful life of two or more years.

In FY 2006, the capitalization threshold was revised from $100,000 to $20,000 for real property. The $100,000 capitalization threshold remains unchanged for the other PP&E categories.

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

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

H. Other Liabilities

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

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

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

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

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

Note 4 provides specific, detailed information about Other Liabilities.

I. Actuarial Liability

In addition to the liabilities discussed above, DeCA records an actuarial liability for its remaining workers' compensation benefits. This liability, which is developed by DOL and provided to DoD after the end of each fiscal year, includes the expected future costs associated with death, disability, medical, and miscellaneous items for approved compensation cases. DOL determines the liability using a method that employs historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. The assumed interest rate for 10-year U.S. Treasury notes and bonds is 5.078% and 5.170% at September 30, 2007 and 2006, respectively. DoD uses a three-year moving average to distribute the actuarial liability to the various DoD agencies based on actual costs incurred by the respective DoD components.

J. Imputed Financing and Costs

DeCA recognizes imputed financing and costs related to Federal retirement plans and health benefits and life insurance.

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

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

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

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

K. Environmental Liabilities

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

L. Net Position

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

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

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

Note 5 provides specific, detailed information on Net Position.

M. Non-Exchange Revenue

DeCA recognizes non-exchange revenue for the labor received at no cost for local nationals working in the country of Japan. The Government of Japan pays the salaries for local national employees up to a specified annual ceiling amount. Payroll over this ceiling is charged to DeCA.

N. Use of Estimates

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

O. Reclassifications

Certain FY 2006 balances have been reclassified, retitled, or combined with other financial statement line items for consistency with current year presentation.

NOTE 2 - FUND BALANCE WITH TREASURY

FBWT consists of three types of funds – appropriated, revolving, and trust. The revolving fund involves DeCA's Resale Fund, the trust fund involves the Surcharge Collections Trust Fund, and appropriated funds include commissary operations, military construction, procurement funds, and the Hurricane Katrina Fund.

The following table shows the balance for each type of fund as of September 30, 2007 and 2006:

Fund balances:	**2007**	**2006**
Appropriated funds	$ 257,974	$ 241,213
Revolving fund	42,838	69,765
Trust fund	317,346	306,813
Total	$ 618,158	$ 617,791

The following table shows the status of the fund balances as of September 30, 2007 and 2006:

Status of fund balances:	**Appropriated**	**Revolving**	**Trust**	**Total**
Unobligated balance available	$ 12,897	$ -	$ -	$ 12,897
Unobligated balance unavailable	15	-	-	15
Obligated balance not yet disbursed, net of contract authority	245,062	42,838	317,346	605,246
Total as of September 30, 2007	$ 257,974	$ 42,838	$ 317,346	$ 618,158

Status of fund balances:	**Appropriated**	**Revolving**	**Trust**	**Total**
Unobligated balance available	$ 6,417	$ -	$ -	$ 6,417
Unobligated balance unavailable	15	-	13,084	13,099
Obligated balance not yet disbursed, net of contract authority	234,781	69,765	293,729	598,275
Total as of September 30, 2006	$ 241,213	$ 69,765	$ 306,813	$ 617,791

NOTE 3 - GENERAL PROPERTY, PLANT, AND EQUIPMENT

General property, plant, and equipment (PP&E) at September 30, 2007 and 2006 is summarized as follows:

PP&E category		**Acquisition Value**		**Accumulated Depreciation**		**Net**
Buildings, structures, and facilities	$	1,924,266	$	(1,236,828)	$	687,438
Software		32,194		(9,252)		22,942
Equipment and other assets		176,046		(135,384)		40,662
Construction-in-progress		23,300		-		23,300
Total as of September 30, 2007	$	2,155,806	$	(1,381,464)	$	774,342

PP&E category		**Acquisition Value**		**Accumulated Depreciation**		**Net**
Buildings, structures, and facilities	$	1,833,065	$	(1,176,896)	$	656,169
Software		10,356		(6,223)		4,133
Equipment and other assets		168,228		(145,875)		22,353
Construction-in-progress		65,378		-		65,378
Total as of September 30, 2006	$	2,077,027	$	(1,328,994)	$	748,033

NOTE 4 - LIABILITIES

The following table summarizes total liabilities covered and not covered by budgetary resources as of September 30, 2007 and 2006:

Intragovernmental:	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Accounts payable	$ 128,426	$ -	$ 128,426
Other liabilities	2,768	37,427	40,195
Subtotal	131,194	37,427	168,621
With the public:			
Accounts payable	466,135	-	466,135
Federal Employees Compensation Act actuarial liability	-	157,870	157,870
Environmental liabilities	-	32,315	32,315
Other liabilities	20,215	58,948	79,163
Subtotal	486,350	249,133	735,483
Total as of September 30, 2007	$ 617,544	$ 286,560	$ 904,104

Intragovernmental:	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Accounts payable	$ 120,267	$ -	$ 120,267
Other liabilities	2,796	37,736	40,532
Subtotal	123,063	37,736	160,799
With the public:			
Accounts payable	461,930	-	461,930
Federal Employees Compensation Act actuarial liability	-	165,173	165,173
Environmental liabilities	-	29,040	29,040
Other liabilities	20,415	53,470	73,885
Subtotal	482,345	247,683	730,028
Total as of September 30, 2006	$ 605,408	$ 285,419	$ 890,827

Other liabilities consist primarily of workers' compensation, accrued payroll and benefits, accrued unfunded annual and other leave, and foreign national separation pay. The following table summarizes other liabilities current and non-current as of September 30, 2007 and 2006.

Other liabilities	**Current Liabilities**	**Non-Current Liabilities**	**Total**
Intragovernmental:			
Workers compensation	$ 16,444	$ 20,983	$ 37,427
Employer contributions and payroll taxes payroll	2,768	-	2,768
Subtotal	19,212	20,983	40,195
With the public:			
Accrued funded payroll and benefits	20,215	-	20,215
Foreign national separation pay	16,095	-	16,095
Accrued unfunded annual leave	40,283	-	40,283
Capital lease liability	2,570	-	2,570
Subtotal	79,163	-	79,163
Total as of September 30, 2007	$ 98,375	$ 20,983	$ 119,358

Other liabilities	**Current Liabilities**	**Non-Current Liabilities**	**Total**
Intragovernmental:			
Workers compensation	$ 16,336	$ 21,400	$ 37,736
Employer contributions and payroll taxes payroll	2,796	-	2,796
Subtotal	19,132	21,400	40,532
With the public:			
Accrued funded payroll and benefits	20,415	-	20,415
Foreign national separation pay	13,722	-	13,722
Accrued unfunded annual leave	39,748	-	39,748
Subtotal	73,885	-	73,885
Total as of September 30, 2006	$ 93,017	$ 21,400	$ 114,417

NOTE 5 - NET POSITION

The following table summarizes the net position by fund type as of September 30, 2007 and 2006:

Net position:	**General Fund**	**Working Capital Fund**	**Total**
Unexpended appropriations	$ 11,622	$ 30,023	$ 41,645
Cumulative results of operations - earmarked funds	1,000,569	-	1,000,569
Cumulative results of operations - other funds	-	(44,959)	(44,959)
Total cumulative results of operations	1,000,569	(44,959)	955,610
Total as of September 30, 2007	$ 1,012,191	$ (14,936)	$ 997,255

Net position:	**General Fund**	**Working Capital Fund**	**Total**
Unexpended appropriations	$ 934	$ 25,412	$ 26,346
Cumulative results of operations - earmarked funds	990,807	-	990,807
Cumulative results of operations - other funds	-	(55,284)	(55,284)
Total cumulative results of operations	990,807	(55,284)	935,523
Total as of September 30, 2006	$ 991,741	$ (29,872)	$ 961,869

NOTE 6 – INTRAGOVERNMENTAL COST

The Consolidated Statements of Net Cost reflects intragovernmental and public cost and exchange revenue as summarized in the following table for the years ended September 30, 2007 and 2006:

	2007	**2006**
Intragovernmental costs	$ 437,300	$ 467,690
Public costs	6,632,310	6,455,828
Intragovernmental earned revenue	(3,986)	(2,995)
Public earned revenue	(5,854,363)	(5,715,841)
Net cost of operations	$ 1,211,261	$ 1,204,682

Intragovernmental transactions and balances result from exchange transactions made between DeCA and another Federal entity, while those classified as "with the public" result from the exchange transactions between DeCA and non-Federal entities. However, when DeCA purchases goods from a federal entity, capitalizes them into inventory, and later sells to a non-federal entity, the revenue and related cost of goods sold is classified as "with the public." The purpose of this classification is to enable the Federal government to prepare consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

NOTE 7 – IMPUTED FINANCING

The imputed financing and cost for employee benefits for FY 2007 and 2006 is summarized below:

Benefit category	2007	2006
CSRS/FERS	$ 9,263	$ 9,838
FEHB	26,679	25,886
FEGLI	92	92
Total	$ 36,034	$ 35,816

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

The Statement of Budgetary Resources is a combined statement and, as such, intra-entity transactions have not been eliminated. The combined Statement of Budgetary Resources has been prepared to coincide with the amounts shown in the President's Budget (Budget of the United States of America). However, the President's Budget is prepared from the Standard Form (SF) 133, Report on Budget Execution. Due to timing and the need for accelerated reporting at fiscal year end, the SF 133 is prepared using estimates, while the Statement of Budgetary Resources has been adjusted for actual results. As such, the FY 2007 Statement of Budgetary Resources may differ from the amounts in the President's Budget by the differences between estimates used for the SF 133 and the actual results reported in the Statement of Budgetary Resources.

The amounts reported in the FY 2006 Statement of Budgetary Resources are in agreement with the amounts reported for the DeCA Working Capital Fund of the President's Budget. The FY 2007 amounts will be available in the President's Budget during FY 2008. Both documents can be located at the OMB website (http://www.whitehouse.gov/omb).

Total budget authority in FY 2007 and FY 2006 includes an appropriation transfer from the Defense WCF in the amount of $1,184,449 and $1,197,021, respectively and contract authority in the amount of $5,587,818 and $5,435,936, respectively. The appropriation transfer is available indefinitely. Contract authority primarily provides DeCA the ability to purchase grocery, meat, and produce items for resale to authorized commissary patrons. Spending authority from offsetting collections results primarily from the sale of grocery, meat, and produce items.

Undelivered orders as of September 30, 2007 and 2006 are $392,649 and $333,300, respectively.

The obligated balance, net - end of period is comprised of the following components for the year ended September 30, 2007 and 2006:

Obligated balance, net - beginning of period	**2007**	**2006**
Unpaid obligations - brought forward	$ 936,319	$ 920,354
Uncollected customer payments from Federal sources - brought forward	(132,335)	(146,264)
Total obligated balance, net - beginning of period	$ 803,984	$ 774,090
Obligated balance, net - end of period		
Unpaid obligations	$ 1,006,534	$ 936,319
Uncollected customer payments from Federal sources	(160,287)	(132,335)
Total obligated balance, net - end of period	$ 846,247	$ 803,984

NOTE 9 – EARMARKED FUND

The following table presents condensed data relating to DeCA's earmarked fund, the Surcharge Collections Trust Fund, as of and for the year ended September 30, 2007 and 2006:

Balance Sheet	**2007**	**2006**
Assets		
Fund balance with Treasury	$ 317,346	$ 306,813
Cash and accounts receivable	7,484	5,071
Property, plant, and equipment	752,262	729,155
Total assets	$ 1,077,092	$ 1,041,039
Liabilities		
Accounts payable	$ 44,208	$ 21,192
Environmental liabilities	32,315	29,040
Total liabilities	76,523	50,232
Cumulative results of operations	1,000,569	990,807
Total liabilities and net position	$ 1,077,092	$ 1,041,039
Statement of Net Cost		
Program costs	$ 279,983	$ 261,781
Less: earned revenue	(284,620)	(318,930)
Net income from operations	$ (4,637)	$ (57,149)

NOTE 10 – RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

The following table presents DeCA's reconciliation of net cost operations to budgetary accounts for the years ended September 30, 2007 and 2006.

Resources used to finance activities	**2007**	**2006**
Budgetary resources obligated:		
Obligations incurred	$ 7,086,088	$ 6,898,613
Less: spending authority from offsetting collections and recoveries	(5,853,795)	(5,784,044)
Obligations, net of offsetting collections and recoveries	1,232,293	1,114,569
Other resources:		
Imputed financing from costs absorbed by others (Note 7)	36,034	35,816
Transfers in (out)	11,373	-
Other - gain (losses) in capital assets	(10,740)	(20,510)
Net other resources used to finance activities	36,667	15,306
Total resources used to finance activities	1,268,960	1,129,875
Resources used to finance items not part of net costs of operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:		
Undelivered orders	(59,349)	(6,202)
Unfilled customer orders	(88)	532
Resources that fund expenses recognized in prior periods	(7,613)	(8,860)
Resources that finance the acquisition of assets	(5,625,356)	(5,461,000)
Other resources that do not affect net cost of operations	(633)	20,938
Total resources used to finance items not part of the net cost of operations	(5,693,039)	(5,454,592)
Total resources used to finance the net cost of operations	(4,424,079)	(4,324,717)
Components of the net cost of operations that will not require or generate resources in the current period		
Components requiring or generating resources in future periods -		
Increase in exchange revenue receivable from the public and other	111	(3,625)
Components not requiring or generating resources in future periods:		
Cost of goods sold	5,536,522	5,412,194
Depreciation and amortization	87,442	104,488
Revaluation of assets/liabilities	(8,476)	(6,368)
Non-exchange revenue and other	19,741	22,710
Total components of net cost of operations that will not require or generate resources in the current period	5,635,340	5,529,399
Net cost of operations	$ 1,211,261	$ 1,204,682

DEFENSE COMMMISARY AGENCY
REQUIRED SUPPLEMENTARY INFORMATION
COMBINING SCHEDULE OF BUDGETARY RESOURCES
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Defense Working Capital Funds			General Funds			
	Operations	Resale	Other	Surcharge	Military Construction	Katrina - Relief	Combined
Budgetary resources							
Unobligated balance brought forward	$ 6,401	$ -	$ -	$ 13,084	$ 31	$ -	$ 19,516
Recoveries of prior year obligations	-	523	-	-	-	-	523
Budget authority	1,190,038	5,538,294	-	43,525	410	-	6,772,267
Spending authority from offsetting collections	27,967	5,543,964	-	281,341	-	-	5,853,272
Net transfers and adjustments	-	-	-	-	34	10,530	10,564
Permanently not available	(10,625)	(5,544,487)	-	(2,030)	-	-	(5,557,142)
Total budgetary resources	$ 1,213,781	$ 5,538,294	$ -	$ 335,920	$ 475	$ 10,530	$ 7,099,000
Status of budgetary resources							
Obligations incurred:							
Direct	$ 1,176,734	$ -	$ -	$ -	$ 400	$ -	$ 1,177,134
Reimbursable	34,740	5,538,294	-	335,920	-	-	5,908,954
Total obligations incurred	1,211,474	5,538,294	-	335,920	400	-	7,086,088
Unobligated balances - appropriated	2,307	-	-	-	60	10,530	12,897
Unobligated balances - not available	-	-	-	-	15	-	15
Total status of budgetary resources	$ 1,213,781	$ 5,538,294	$ -	$ 335,920	$ 475	$ 10,530	$ 7,099,000
Change in obligated balance							
Obligated balance, net - beginning of period	$ 269,826	$ 230,264	$ 9,262	$ 293,729	$ 903	$ -	$ 803,984
Total obligations incurred	1,211,474	5,538,294	-	335,920	400	-	7,086,088
Less: gross outlays	(1,201,283)	(5,543,616)	-	(270,166)	(285)	-	(7,015,350)
Less: recoveries of prior year obligations	-	(523)	-	-	-	-	(523)
Change in uncollected customer payments from Federal sources	(35)	(27,274)	-	(643)	-	-	(27,952)
Obligated balance, net - end of period	$ 279,982	$ 197,145	$ 9,262	$ 358,840	$ 1,018	$ -	$ 846,247
Net Outlays							
Gross outlays	$ 1,201,283	$ 5,543,616	$ -	$ 270,166	$ 285	$ -	$ 7,015,350
Offsetting collections	(27,932)	(5,516,690)	-	(280,698)	-	-	(5,825,320)
Total net outlays	$ 1,173,351	$ 26,926	$ -	$ (10,532)	$ 285	$ -	$ 1,190,030

DEFENSE COMMMISARY AGENCY
REQUIRED SUPPLEMENTARY INFORMATION
COMBINING SCHEDULE OF BUDGETARY RESOURCES
FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Defense Working Capital Funds			General Funds			
	Operations	Resale	Other	Surcharge	Military Construction	Katrina - Relief	Combined
Budgetary resources							
Unobligated balance brought forward	$ 11,366	$ -	$ -	$ -	$ 106	$ -	$ 11,472
Recoveries of prior year obligations	-	11,909	-	17	-	-	11,926
Budget authority	1,161,224	5,433,650	-	-	397	37,686	6,632,957
Spending authority from offsetting collections	26,635	5,420,603	-	324,880	-	-	5,772,118
Net transfers and adjustments	12,000	-	-	-	-	-	12,000
Permanently not available	(11,647)	(5,435,858)	-	(74,832)	(7)	-	(5,522,344)
Total budgetary resources	$ 1,199,578	$ 5,430,304	$ -	$ 250,065	$ 496	$ 37,686	$ 6,918,129
Status of budgetary resources							
Obligations incurred:							
Direct	$ 1,148,910	$ 2,908	$ -	$ -	$ 465	$ 37,686	$ 1,189,969
Reimbursable	44,267	5,427,396	-	236,981	-		5,708,644
Total obligations incurred	1,193,177	5,430,304	-	236,981	465	37,686	6,898,613
Unobligated balances - apportioned	6,401	-	-	-	16	-	6,417
Unobligated balances - not available	-	-	-	13,084	15	-	13,099
Total status of budgetary resources	$ 1,199,578	$ 5,430,304	$ -	$ 250,065	$ 496	$ 37,686	$ 6,918,129
Change in obligated balance							
Obligated balance, net - beginning of period	$ 250,371	$ 224,769	$ 9,262	$ 289,189	$ 499	$ -	$ 774,090
Total obligations incurred	1,193,177	5,430,304	-	236,981	465	37,686	6,898,613
Less: gross outlays	(1,175,031)	(5,423,301)	-	(234,643)	(61)	(37,686)	(6,870,722)
Less: recoveries of prior year obligations	-	(11,909)	-	(17)	-	-	(11,926)
Change in uncollected customer payments from Federal sources	1,309	10,401	-	2,219	-	-	13,929
Obligated balance, net - end of period	$ 269,826	$ 230,264	$ 9,262	$ 293,729	$ 903	$ -	$ 803,984
Net outlays							
Gross outlays	$ 1,175,031	$ 5,423,301	$ -	$ 234,643	$ 61	$ 37,686	$ 6,870,722
Offsetting collections	(27,944)	(5,431,004)	-	(327,099)	-	-	(5,786,047)
Total net outlays	$ 1,147,087	$ (7,703)	$ -	$ (92,456)	$ 61	$ 37,686	$ 1,084,675

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Audit Committee
Defense Commissary Agency:

We have audited the accompanying consolidated balance sheets of the Defense Commissary Agency (DeCA) as of September 30, 2007 and 2006, and the related consolidated statements of net cost, changes in net position, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our fiscal year 2007 audit, we also considered DeCA's internal controls over financial reporting and performance measures and tested DeCA's compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on these consolidated financial statements.

SUMMARY

As stated in our opinion on the consolidated financial statements, we concluded that DeCA's consolidated financial statements as of and for the years ended September 30, 2007 and 2006, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1, B to the consolidated financial statements, DeCA changed its method of reporting the reconciliation of net cost to budget in fiscal year 2007.

Our consideration of internal control over financial reporting resulted in *Information Technology* being identified as a significant deficiency. Continued improvement is needed on the general and application controls associated with DeCA's financial and financial-related systems.

However, the significant deficiency is not believed to be a material weakness.

We noted no deficiencies involving the design of the internal control over the existence and completeness assertions related to key performance measures.

The results of our tests of compliance with certain provisions of laws, regulations, and contracts, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

The results of our tests of FFMIA disclosed instances where DeCA's financial management systems did not substantially comply with the United States Standard General Ledger at the transaction level.

The results of our tests of FFMIA disclosed no instances where DeCA's financial management systems did not substantially comply with Federal financial management system requirements and Federal accounting standards.

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

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the Defense Commissary Agency (DeCA) as of September 30, 2007 and 2006, and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources for the years then ended.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of DeCA as of September 30, 2007 and 2006, and its net costs, changes in net position, and budgetary resources for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1, B to the consolidated financial statements, DeCA changed its method of reporting the reconciliation of net cost to budget in fiscal year 2007.

The information in the Management Discussion and Analysis, Performance Section, and Required Supplementary Information sections is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency 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 DeCA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of DeCA's consolidated financial statements that is more than inconsequential will not be prevented or detected by DeCA's internal control over financial reporting. 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 by DeCA's internal control.

In our fiscal year 2007 audit, we considered the deficiency described in Exhibit 1 to be a significant deficiency in internal control over financial reporting. However, the significant deficiency is not believed to be a material weakness. Exhibit 2 presents the status of prior year reportable conditions.

INTERNAL CONTROL OVER PERFORMANCE MEASURES

Our tests of internal control over performance measures, as described in the Responsibilities section of this report, disclosed no deficiencies involving the design of the internal control over the existence and completeness assertions related to key performance measures.

COMPLIANCE AND OTHER MATTERS

The results of our tests of compliance described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed instances, described in Exhibit 3, where DeCA's financial management systems did not substantially comply with the United States Standard General Ledger at the transaction level.

The results of our tests of FFMIA disclosed no instances where DeCA's financial management systems did not substantially comply with Federal financial management system requirements and Federal accounting standards.

* * * * *

RESPONSIBILITIES

Management's Responsibilities. The United States Code Title 31 Section 3515 and 9106 require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, DeCA prepares and submits financial statements in accordance with OMB Circular No. A-136.

Management is responsible for the consolidated financial statements, including:

- Preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles;
- Preparing the Management Discussion and Analysis (including the performance measures) and Required Supplementary Information;
- Establishing and maintaining effective internal control; and
- Complying with laws, regulations, and contracts applicable to DeCA, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2007 and 2006 consolidated financial statements of DeCA based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of DeCA's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

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

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

In planning and performing our fiscal year 2007 audit, we considered DeCA's internal control over financial reporting by obtaining an understanding of DeCA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of DeCA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DeCA's internal control over financial reporting.

As required by OMB Bulletin No. 07-04, in our fiscal year 2007 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management Discussion and Analysis, and Performance sections, we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We limited our testing to those controls necessary to report deficiencies in the design of internal control over key performance measures in accordance with OMB Bulletin 07-04. However, our procedures were not designed to provide an opinion on internal control over reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether DeCA's fiscal year 2007 consolidated financial statements are free of material misstatement, we performed tests of DeCA's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to DeCA. However, providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 07-04 and FFMIA, we are required to report whether DeCA's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DeCA's response to the findings identified in our audit are presented in Exhibit 1 and 3. We did not audit DeCA's response and, accordingly, we express no opinion on it.

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

KPMG LLP

November 5, 2007

Significant Deficiencies

Under standards issued by the American Institute of Certified Public Accountants, a significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects DeCA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of DeCA's consolidated financial statements that is more than inconsequential will not be prevented or detected by DeCA's internal control over financial reporting.

We consider the following to be a significant deficiency.

Information Technology

Condition

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

Discussion

As part of our fiscal year 2007 audit of DeCA's financial statements, we tested the design and operating effectiveness of IT general and application controls over the following key DeCA applications that support financial transaction processing and reporting:

- DeCA Interactive Business System (DIBS);
- Standard Automated Voucher Examination System (SAVES);
- Accounting and Inventory Management System (AIMS);
- Commissary Advanced Resale Transaction System (CARTS);
- Point of Sale – Technical Refresh (POS-TR); and
- Warehouse Management System (WMS), formerly named Pick Ticket Warehouse Management System (PkMS).

We also performed a follow-up of Notifications of Finding and Recommendation (NFRs) issued as a result of our prior year IT general and application control testing over applications owned and operated by other DoD components that support DeCA financial transaction processing and reporting. These applications included:

- Defense Business Management System (DBMS);
- Standard Financial System (STANFINS);

We conducted test procedures during the period May 2007 to September 2007. Our separate report will identify internal control weaknesses for the financial systems that require management attention.

Cause

Our separate report will address the cause for each IT related finding.

Criteria

The *Federal Information Security Management Act* (FISMA), passed as part of the *Electronic Government Act of 2002*, mandates that Federal entities maintain IT security programs in accordance with OMB and National Institute of Standards and Technology (NIST) guidance. OMB Circular A-130, *Management of Federal Information Resources*, and various NIST guidelines describe specific essential criteria for maintaining effective general IT controls. In addition, OMB Circular A-127, *Financial Management Systems,* prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. Below are the OMB, NIST, DoD, and DeCA security guidelines that are referenced in detail in our separate IT report:

- OMB Circular Number A-130, *Management of Federal Information Resources*;
- OMB Circular Number A-127, *Financial Management Systems*;
- OMB Circular Number A-123, *Management's Responsibility for Internal Control;*
- Public Law 100-235, *The Computer Security Act of 1987*;
- NIST Special Publication 800-34, *Contingency Planning Guide for Information Technology System*;
- NIST Special Publication 800-53, *Recommended Security Controls for Federal Information Systems;*
- NIST Special Publication 800-12, *An Introduction to Computer Security;*
- NIST Special Publication 800-18, *Guide for Developing Security Plans for Information Technology Systems;*
- DoD Instruction 8500.2, *Information Assurance Implementation*;
- DoD Directive 5200.28, *Security Requirements for Automated Information Systems*;
- DoD 5200.28-STD, *Department of Defense Trusted Computer System Evaluation Criteria*;
- DoD Instruction 5200.4, *DoD Information Technology Security Certification and Accreditation Process (DITSCAP)*; and
- DeCA Directive 35-5, *Configuration management For Automated Information Systems.*

Recommendation

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

Management Response

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

Status of Prior Year Reportable Conditions

Area	Status as of September 30, 2006	Status as of September 30, 2007
Information Technology	**Reportable Condition:** The general and application controls associated with DeCA's financial and financial-related systems continue to need improvement.	**Continue as a Significant Deficiency:** Improvements have been made to resolve some weaknesses noted in the prior year. However, significant effort must be made to resolve security and access control weaknesses over key systems.

Compliance with Laws and Regulations

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

Federal Financial Management Improvement Act of 1996 (FFMIA)

Condition

We again noted that DeCA was not in substantial compliance with FFMIA.

Discussion

Defense Finance and Accounting Services (DFAS) uses two separate accounting systems to process DeCA transactions. DBMS accounts for transactions associated with the appropriated funds and surcharge collections and STANFINS accounts for all resale inventory transactions. STANFINS and DBMS are not compliant with the U.S. Standard General Ledger. Neither system is able to process transactions in accordance with the U.S. Standard General Ledger at the transaction level, and extensive manual processes are required to adjust STANFINS and DBMS balances to allow for compilation of DeCA's financial statements. For example, DBMS does not contain a general ledger account to record unexpended appropriation transfers. DFAS-CO and DeCA personnel must use a combination of information inside and outside of DBMS to calculate unexpended appropriation transfers at the end of each reporting period.

Criteria

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

Recommendation

We again recommend that DeCA continue to work with DFAS to implement actions to comply with the requirements of FFMIA.

Management Response

Throughout fiscal year 2007, DeCA, DFAS, and other Defense agencies have continued to work with the Business Transformation Agency (BTA) on the Defense Agencies Initiative (DAI) project. DAI is the Department of Defense's effort to streamline financial management capabilities, eliminate material weaknesses, and achieve financial statement auditability for all Defense agencies through the use of a single standardized system architecture. For DeCA, this single system solution will replace the current legacy systems, STANFINS and DBMS.

DeCA continues to be actively involved in providing agency requirements, describing current process flow of accounting and operational systems, participating in briefings and discussions, and providing other support as needed in relation to this project. Current milestones suggest that DAI will be deployed in waves. Wave One will include six Defense agencies and is scheduled to be completely deployed by the second quarter of fiscal year 2009. DeCA is not included in this first wave. Additional waves will then follow, with all Defense agencies scheduled for transition to DAI by fiscal year 2011.

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DEFENSE COMMISSARY AGENCY
HEADQUARTERS
1300 E AVENUE
FORT LEE, VIRGINIA 23801-1800

REPLY TO
ATTENTION OF
IG

October 11, 2007

MEMORANDUM FOR DIRECTOR, DEFENSE COMMISSARY AGENCY

SUBJECT: Summary of Serious Management and Performance Challenges

OMB Circular A-136 (Revised), "Financial Reporting Requirements," dated June 29, 2007, requires this office provide you with the Inspectors General perspective on the most serious management and performance challenges facing DeCA for inclusion in the Agency's annual *Performance and Accountability Report.*

The *Reports Consolidation Act of 2000 (Public Law 106-531)* left the determination and threshold of what constitutes a most serious management challenge to the discretion of the Inspectors General. Therefore, the following definition was applied in preparing this statement for Fiscal Year (FY) 2007:

Serious management challenges are mission critical areas or programs that have the potential for a perennial vulnerability that, without management's focused attention, could adversely impact Agency operations or strategic goals vital to the Agency's mission.

The DeCA Office of the Inspector General (OIG) contacted DeCA's Chief Internal Audit, read the Office of Internal Review (IR) audit reports and included, along with IG inspection and investigation data, audit information involving compliance, accountability, and delivery of services and benefits related to DeCA's mission and this perspective.

The DeCA-IG believes that by addressing program performance challenges and testing program control points DeCA can improve benefit delivery; avoid serious operational and financial problems; and decrease fraud, waste, abuse (FWA) and mismanagement.

Information Technology & Security Management

DeCA's Information Systems Program Management and Control continues to be critical to benefit delivery. DeCA relies strongly on electronic financial and operational reporting accuracy. Our FY 2007 Federal Information Security Management Act (FISMA)[1] review found that DeCA FISMA compliance improved over FY 2006 and the Agency's progress should once again cause it to receive good information assurance grades on certification, accreditation, and security configuration. DeCA is part of the Defense Information Technology Portfolio Registry (DITPR) and through its business process continually updates this registry. DeCA's score in 2007, as measured by the Joint Chief of Staff, increased from a C to a B. While results have

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

improved, the DeCA-OIG believes this area must be tested regularly through the use of internal management controls. The DeCA-OIG intends to conduct two quarterly reviews in FY 2008. Discussions with the DeCA-CIO and functional process owners have revealed they will take corrective action on IG findings identified and reported.

Also critical to DeCA's 2008 mission accomplishment is its ability to continue to successfully deploy, with OSD approval, the Commissary Advanced Resale Transaction System (CARTS) while mitigating supply chain, software, and training concerns. The Agency continued to assure CARTS complied with the DoD Business Management Modernization Program (BMMP) for discipline (cost, schedule, performance) and management of the CARTS purchase and interface with legacy system replacement and new requirement systems from the DoD and DeCA enterprise perspective. The challenge of finishing the legacy system migration to CARTS successfully on an acceptable schedule that realizes productivity gains while reducing significant legacy system maintenance costs remains.

Mandatory Information Assurance Awareness Training is required annually for all personnel that have access to the DeCA Network, Internet and E-Mail systems. The DeCA-OIG tested compliance with this requirement through a random sample of personnel at 41 stores (2 stores or 4.9 percent were non-compliant). A verification of training records of all users identified by DeCA-IT showed a confidence level of 95 percent (± five percent). The DeCA-OIG will continue to test compliance with this annual training requirement in FY 2008.

Financial & Resource Management

DeCA received an unqualified opinion statement from its external auditor for FY 2006 that its financial and performance reporting was reliable with no material weaknesses found. DeCA's Financial Management is considered a model in the DoD system.

DeCA-IR conducted audits at the Moody AFB, Langley AFB, Andrews AFB and Vandenberg AFB Commissaries during FY 2007 and published seven reports dealing with front-end operations. The audits found that while refund transactions, void previous transactions and cash cage safe procedures were properly performed, improvements were needed in following controls that were in place for change fund operations, sales store checker operations, manufacturer coupon handling, key controls, tender audit and suspended transactions. Six recommendations were offered to correct findings, which senior leadership agreed with and have taken corrective action on. The challenge is to reduce store checker operation issues as an increasing number of commissary Incident Reports detail cashier media handling problems (monetary shortages, coupon improprieties) and counterfeit money acceptance.

DeCA-IR issued a report on Accounts Payable/Unliquidated Obligations (AP/ULO) that found DeCA did not fully adhere to the DoD regulations to review all ULOs. IR recommended DeCA (1) review expense ULO categories that were 2 years or older in order to potentially de-obligate about $35.5 million of the $174 million in ULOs; (2) perform a one time ULO clean-up review with the functional process owners' help; (3) possibly de-obligate unsupported ULOs; and, (4) upon completion of the three aforementioned corrective actions, perform the required tri-annual reviews on remaining ULOs.

Plant, Property, Equipment Program Management

Plant, property and equipment management were of special interest to the DeCA Senior Assessment Team (SAT) and the DeCA-OIG in FY 2007. The DeCA-OIG tested the DeCA internal control procedures in the Defense Property Accountability System (DPAS) at commissaries during FY 2007 through its Inspection Compliance Program The system procedures, to include bar code scanning, are designed to reduce the time required to conduct the equipment inventory and reconcile differences between the book and physical inventory. A review was performed at 41 stores. Timely DPAS entry was not fully met at four stores for some equipment purchases/ receipts over $5,000.00. The challenge remains to ensure the DeCA standard is fully met for FY 2008. Doing so will help DeCA assure an external audit unqualified opinion statement for FY 2008.

Internal Controls

At the benefit delivery point the DeCA-OIG tested program regulatory compliance at 15.8 percent (41) of all (260) commissaries in FY 2007. The FY 2007 average unannounced inspection compliance score was 81.0 percent (the 2nd highest score in the past five years) versus 86.0 percent in FY 2006; 73.1 percent of stores tested were at or above the average. The DeCA-OIG tested regulatory compliance at 9 percent of the Agency's Central Distribution Centers (CDCs) and found an average compliance rating score of 73.5 percent on items tested. DeCA's challenge in FY 2008 will be to ensure the Agency successfully employs (1) the financial (and operational related) control requirements of OMB Circular No. A-123, Appendix A and it's related OSD guidance in mission critical and high risk areas, and, (2) DeCA SAT recommendations so that acceptable compliance ratings are attained.

The DeCA-OIG issued two evaluation reports involving the need to adhere to existing internal controls and institute new ones. The Guam Inventory-Taking Review (performed at the request of DeCA Region Senior Leadership) found many inventory taking controls and regulatory guidance were either ignored or not properly followed. The Dover AFB Commissary Vendor Credit Memo (VCM) Review (also performed at the request of DeCA Region Senior Leadership) identified over $100,000.00 in unauthorized and open VCMs that DeCA was subsequently able to recover from the vendor. Unauthorized VCMs occurred due to a breakdown in the internal control process. Corrective action was taken by management in these areas and internal controls were strengthened.

DeCA earned a Deputy Secretary of Defense "Check It Award of Excellence" for its Internal Management Control Awareness Program.

Human Capital Management & Future Workforce Configuration

On September 30, 2007, DeCA had approximately 17,466 employees worldwide. There were approximately 116 contractors at Headquarters DeCA. The primary Agency challenge in human capital for 2008 involves successful workforce of the future (WOF) rollout with associated savings designed to help reach program budget goals for the out years and plan development for the near term future retirement of key leadership personnel. DeCA must ensure its strategic vision for WOF and successor development is one better suited to function in an integrated, innovative and flexible business environment. DeCA finished the planned centralization of its functional processes and organizational structure in FY 2007 with concurrence from the DeCA Board of Directors (formerly known as the Commissary Operating Board COB).

The DeCA-IR issued two reports associated with human capital management (Recruitment Process Audit and Intermittent and Part-Time Employee Schedule Audit). On the Recruitment Process Audit IR found that DeCA had made great strides to reduce the time it took to process recruit actions (from 90 to 52 days). On the Intermittent and Part-Time Employee Schedule Audit, it was found that DeCA needed to improve scheduling of intermittent employees in order to better comply with Title 5 Code of Federal Regulation 340.403.

Personnel issues were the major FWA investigation and assistance items in FY 2007 and represented 19 percent of all issues/complaints/allegations received by the DeCA-OIG. There is a growing trend in the FWA area of complaints received about the abuse or potential abuse of TDY/PCS authorizations/vouchers. The DeCA-OIG congressional inquiry database revealed that 30 percent concerned commissary closures due to BRAC or the upgrade of commissaries needed where BRAC and service re-stationing actions indicated significant base population gains are imminent. Congressional inquiries decreased 22 percent in FY 2007. The total number of DeCA-OIG allegations, complaints, issues, contacts and referrals received in FY 2007 increased by 8 percent over FY 2006. The challenge remains to ensure that Agency personnel initiatives (WOF, alternative staffing, successor development, hiring and work assignment flexibilities, National Security Personnel System implementation, etc.) are designed to better allow DeCA to execute benefit delivery while helping to lower operating costs, are accomplished in a most ethical manner so that employee and stakeholder faith and trust, necessary to reach FYOP goals and ensure benefit survival, is unshaken.

John T. Maffei
Inspector General

Glossary of Acronyms

ACSI – American Customer Satisfaction Index

CARTS – Commissary Advanced Resale Transaction System

CCSS – Commissary Customer Service Survey

COB – Commissary Operating Board

COOP – Contingency Operations Plan

DeCA – Defense Commissary Agency

DITSCAP – DoD Information Technology Security Certification and Accreditation Process

DoD – Department of Defense

DOL – Department of Labor

DPAS – Defense Property Accounting System

DWCF – Defense Working Capital Fund

EDI – Electronic Data Interchange

FBWT – Fund Balance with Treasury

FCI – Facility Condition Index

FECA – Federal Employees Compensation Act

FFMIA – Federal Financial Management Improvement Act of 1996

FMFIA – Federal Managers' Financial Integrity Act

FTE – Full Time Equivalent

GAO – Government Accounting Office

LIFE - Leadership – Integrity – Flexibility – Enjoyment

MD&A – Management Discussion and Analysis

OMB – Office of Management and Budget

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

PA&E – Program Analysis and Evaluation

PBD – Program Budget Decision

PMA – President Management Agenda

PPBE – Planning, Programming, Budgeting and Execution

PP&E – Property, Plant and Equipment

SES – Senior Executive Service

UPC – Universal Product Code

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

WCF – Working Capital Fund