May 2011

UNITED STATES DEPARTMENT OF DEFENSE

Financial Improvement and Audit Readiness (FIAR) Plan Status Report

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER) / CFO

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Message from the Under Secretary of Defense (Comptroller)

Financial statement audit readiness has been a goal at the Department of Defense (DoD) for many years. Given DoD's size and complexity, however, it has been difficult to achieve.

In the National Defense Authorization Act for Fiscal Year 2010, Congress established a deadline for the Department to achieve audit readiness by the end of Fiscal Year 2017, and financial managers across the Department are striving to comply. The Financial Improvement and Audit Readiness (FIAR) Plan is an important part of this DoD-wide effort. Its initial focus is on the financial information that is actually used for decision making. This FIAR Plan Status Report provides the latest information on our progress.

As this report states, the DoD Components have achieved audit readiness of several key elements of the Statement of Budgetary Resources, as well as significant amounts of our mission critical assets. This progress, as well as the ongoing audit of the U.S. Marine Corps Statement of Budgetary Resources, is strong evidence that we are moving toward audit readiness and the goal established by the Congress.

As we move ahead, it is important for the American public to understand that – although the Department does not yet meet commercial audit standards – their tax dollars are being managed responsibly. The DoD financial management workforce is well trained to ensure compliance with financial laws, regulations, and processes. Thousands of auditors are also at work, ensuring that our programs and payments comply fully with financial management requirements.

Our recent progress and accomplishments, combined with strong support from the Department's senior leaders and continued focus by our financial management workforce, gives me confidence that we are making significant progress toward our goal of financial auditability by September 30, 2017.

Robert F. Hale

Robert F. Hale
Under Secretary of Defense (Comptroller)/
Chief Financial Officer

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Preparation of this study/report cost the Department of Defense a total of approximately $257,752 in Fiscal Year 2011.

Executive Summary

The Financial Improvement and Audit Readiness (FIAR) Plan Status Report ("Report") was prepared in accordance with Section 1003 of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2010. The Report also serves as the Department's annual Financial Management Improvement Plan, required by Section 1008(a) of the NDAA for FY 2002, to address the issues preventing the reliability of Department of Defense (DoD) financial statements.

This Report is organized differently from previous Reports. Those Reports were organized by FIAR Strategy waves (explained in Appendix 1), and within each wave section, the DoD Components' plans and status were presented. To better present each Component's overall FIAR plans, status, and progress, this Report is organized by Component. Since the Department's ability to achieve auditable financial statements depends on the progress of each Component, the presentation in this Report provides a clearer view of each Component's progress toward achieving audit readiness by September 30, 2017. Accordingly, there are separate sections for each Military Department and the other Defense organizations.

ACHIEVING AUDIT READINESS BY SEPTEMBER 30, 2017

In recent testimony before congressional committees, the Secretary of Defense, Robert Gates; Deputy Secretary of Defense/Chief Management Officer (CMO), William Lynn; and Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD(C)), Robert Hale stated their commitment to achieve audit readiness by September 30, 2017, as required by the FY 2010 NDAA. Since passage of the Chief Financial Officers Act of 1990, the Department has expressed many times to the Congress its intentions to achieve auditable financial statements. However, the Department's commitment today is supported by significant changes that enable it to meet this commitment. The changes include:

Visible Leadership and Department-wide Audit Readiness Goal. Auditability by 2017 is a Secretary of Defense designated priority and Strategic Management Goal.

Accountability and Incentives. Overall accountability rests with the Deputy Secretary of Defense/CMO, while day-to-day responsibility has been placed on senior executives, both financial and functional, across the Department who are being held accountable for meeting audit readiness milestones and outcomes through organizational and individual performance plans and evaluations.

Broader Functional Community Support and Participation. A streamlined approach with well defined short-term and long-term milestones focusing first on information most often used to manage the Department (Budgetary and Mission Critical Asset information) has better engaged the functional community.

Senior Leadership Oversight and Involvement. Progress is reported and monitored by a formal and regularly scheduled FIAR governance process that involves the Deputy Secretary of Defense/CMO, USD(C), DoD Deputy CMO, Military Department CMOs and Financial Management/Comptrollers, and senior leaders from the functional communities.

Integrated Audit Ready Systems Environment Work. The modernization of the Department's business and financial systems through the deployment of ERP systems utilizing process reengineering and business best practices is concurrently taking place and has been integrated into the Components' financial improvement plans.

Resources to Accomplish FIAR Goals and Objectives. Resources of approximately $300 million are being applied annually on DoD Component FIAR activity (excludes ERP resources).

In addition to these important changes, the Department's mandated, standard FIAR Strategy and Methodology (explained in Appendix 2) remain a consistent foundation for achieving the goal of audit readiness. The FIAR Strategy and Methodology employed by the DoD Components ensure FIAR activities are consistently and effectively executed, while providing the capability needed by the Department to monitor and report progress.

INITIAL STREAMLINED FIAR PRIORITIES

A key change enabling the Department to commit to audit readiness by September 30, 2017, was establishing two initial priorities that focus FIAR activities first on information most often used to manage the Department, one of which also results in an auditable Statement of Budgetary Resources (SBR). The initial FIAR priorities are:

- Budgetary information, and
- Mission Critical Asset information.

The initial priorities resulted in a streamlined approach that required the DoD Components to expeditiously adjust their financial improvement plans (FIPs) and to develop well defined short-term and long-term milestones to improve processes, controls, and systems. The Components' FIPs now have been adjusted, work redirected as needed, and significant progress is being made. The adjusted plans and accomplishments are summarized in Section I and more fully described and presented in their individual sections of this Report.

A significant benefit of the initial streamlined FIAR priorities is more extensive participation of the non-financial communities, because they see the benefits to their operations and to the warfighter. This too enables the Department to commit to audit readiness by the statutory deadline.

SUBSEQUENT FIAR PRIORITIES

After establishing the initial FIAR priorities, the USD(C) began searching for a cost-effective approach to achieve auditability of the DoD Balance Sheet, while mindful of the limited utility of Balance Sheet information for DoD decision makers and the significant and costly challenges that had to be overcome. Mr. Hale expressed these challenges in testimony before congressional committees and in meetings with members of the Congress. Responding to the challenges in the FY 2011 NDAA, the Congress required the USD(C) to:

- Examine the costs and benefits of alternative approaches to the valuation of Balance Sheet assets,
- Select a valuation approach that is consistent with principles of sound financial management and the conservation of taxpayer resources, and
- Prepare a business case supporting the selected approach.

As required by the NDAA, the Department examined the costs and benefits of various valuation alternatives, selected an approach for pertinent Balance Sheet assets, and prepared a business case to support the selected alternatives. The resulting Business Case is provided in Appendix 3 of this Report.

Also as required by the NDAA, the USD(C) consulted with other Federal officials, such as the Controller of the Office of Management and Budget, Comptroller General of the United States, and senior members of the Government Accountability Office. In each instance, the discussions were positive and supported the Department's valuation approach and results of the Business Case.

Business Case Interviews

An important element of the Business Case involved interviews with numerous decision makers at various levels throughout the Department. The purpose of the interviews was to determine if historical acquisition cost information recorded in DoD accounting systems and reported on the Balance Sheet was used for purposes other than financial reporting. The interviews also were used to identify the cost information used when making decisions such as acquisition, replacement, maintenance, life-cycle, upgrade, and disposal.

The interviews concluded that cost information of many types (e.g., plant replacement value, lifecycle costs, parametric cost estimates) from many different sources (e.g., commercial cost indices, weapons system manufacturers) is routinely used throughout the

Department, but audited Balance Sheet cost information recorded in DoD accounting systems is of low value for:

- Real Property,
- Inventory,
- Operating Materials and Supplies (OM&S), and
- General Equipment.

The interviews also concluded that auditable acquisition costs of military equipment assets is of very low value to DoD decision makers.

Business Case Impact on Audit Readiness

Based on the Business Case, the Department concluded that the cost to achieve auditable Balance Sheet asset values is prohibitively expensive until the initial FIAR priorities are achieved and the DoD Components' ERPs have been deployed and are capturing transaction-level cost information. In addition, the Department concluded that the cost to achieve auditable values of legacy assets also is prohibitively expensive since the use of such information was of limited value to DoD decision makers.

To implement these conclusions, the Department established *subsequent* FIAR priorities, as follows:

1. For Real Property, Inventory, OM&S, and General Equipment a two-phased approach will be used:
    - *Before completion of the initial FIAR priorities and deployment of the ERPs*, the Department will report on the Balance Sheet the recorded costs of legacy assets and new acquisitions recorded in systems of record or accounting systems and indicate in the notes to the Balance Sheet that such amounts are not auditable.
    - *After completion of the initial FIAR priorities and the deployment of the ERPs*, the Department will report on the Balance Sheet:
        – The cost of legacy assets and indicate that such amounts have not been audited, and
        – The cost of new acquisitions and indicate that such amounts have been audited.
2. For Military Equipment, the Department and Office of Management and Budget will ask the Federal Accounting Standards Advisory Board to change the Federal accounting standards as follows:
    - Permit the expensing of military equipment acquisition costs, and
    - Require the reporting of military equipment quantities as Required Supplementary Information in DoD financial statements.

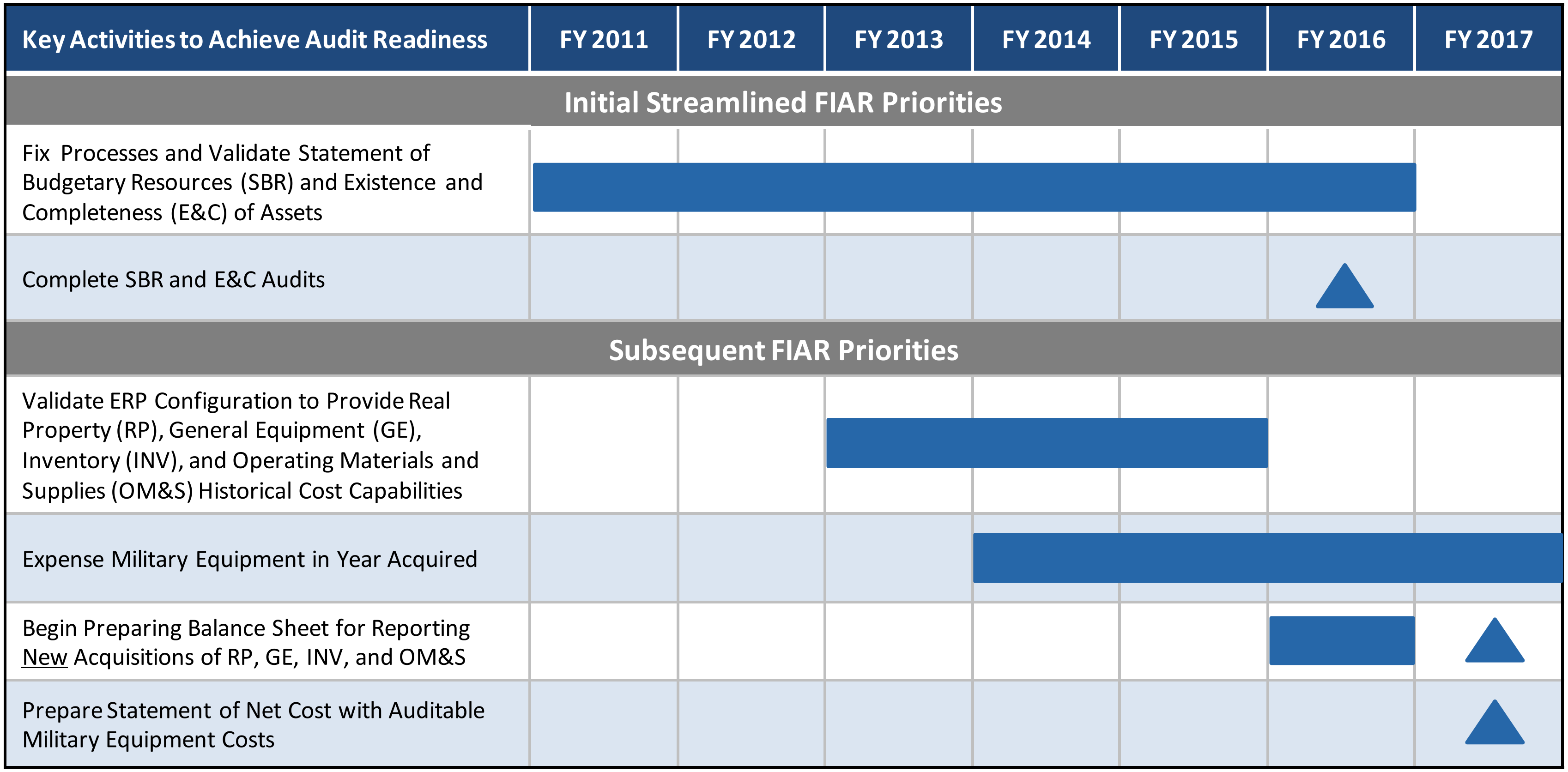
Figure 1 summarizes the above and the results of the asset valuation decisions made by the Department and supported by the Business Case.

Figure 1. Summary Results of Business Case for Valuing Assets

Asset Type	Legacy Asset Costs	New Asset Costs
Real Property, General Equipment, Inventory, and Operating Materials and Supplies	Report on the Balance Sheet as recorded and do not audit.	Report on the Balance Sheet and audit after the initial FIAR priorities are complete.
Military Equipment	Expense acquisition costs.	Expense acquisition costs.

Figure 2 provides the timeline for accomplishing the initial and subsequent FIAR priorities. It is through the combination and successful completion of the initial and subsequent FIAR priorities that the Department will meet its commitment to audit readiness by 2017. This phased plan will meet the needs of the Public and Congress in a cost effective manner.

Figure 2. Timeline to Audit Ready Financial Statements in FY 2017



PROGRESS TO DATE

Audit Opinions

The Department has made measured progress in improving financial information, achieving full auditability, and sustaining those improvements, as demonstrated by the financial statement audit opinions identified in Figure 3.

The organizations with unqualified audit opinions received $96 billion in budgetary resources in FY 2010, which is more than the budgetary resources under audit in 13 of the 24 individual Chief Financial Officers (CFO) Act Federal agencies.

Figure 3. Financial Statement Audit Opinions

FY 2010 Unqualified Audit Opinions
U.S. Army Corps of Engineers - Civil Works
Defense Contract Audit Agency
Defense Commissary Agency
Defense Finance and Accounting Service
Office of the Inspector General
Military Retirement Fund

U.S. Marine Corps

Demonstrating the Department's commitment to achieve audit readiness is the significant progress made by the U.S. Marine Corps (USMC) in improving budgetary and other financial information used by decision makers and in obtaining acquisition, logistics, and other business community support for achieving auditable financial statements. Because of the Service-wide participation in improving business and financial processes and internal controls, the USMC began the process of auditing its FY 2010 Statement of Budgetary Resources (SBR). This is a significant accomplishment, since the USMC is the first Military Service expected to have one of its financial statements successfully audited.

The FY 2010 audit of the USMC SBR concluded with a disclaimer of opinion due to the complexities of the USMC operating and systems environment. Audit efforts concentrated primarily on validating beginning balance obligations across key budgetary general ledger accounts and information technology testing across three major systems. The lessons learned and subsequent process enhancements demonstrate a continued and unwavering commitment to financial improvement and accountability.

Since the USMC made progress toward correcting the deficiencies from the FY 2010 SBR audit, the decision was made to proceed with a FY 2011 SBR audit, which began in January 2011. The USMC remains focused and resolute in its pursuit of an unqualified financial statement audit opinion and embraces its role as a catalyst in promoting audit readiness and sustainment across the DoD.

Audit Readiness Assertions

Progress continues to be made in accomplishing the priorities of Budgetary and Mission Critical Asset information, as demonstrated by the audit readiness assertions since the November 2010 Report. They include the following:

- Army asserted in Quarter 2 of FY 2011 existence and completeness audit readiness for 8 types of Military Equipment.
- Army asserted in Quarter 2 of FY 2011 existence and completeness audit readiness for fire and rescue General Equipment.
- Air Force asserted in Quarter 1 of FY 2011 existence and completeness audit readiness for Military Equipment.
- Air Force asserted in Quarter 1 of FY 2011 audit readiness of the Fund Balance with Treasury (FBWT) reconciliation process.

Figure 4 identifies all of the audit readiness assertions that have been accomplished by the DoD Components. They include assertions for all financial statements, the SBR, portions (assessable units) of the SBR, and assessable units of mission critical assets for existence and completeness.

Figure 4. FIAR Priority Audit Readiness Assertions

DoD Component	Audit Readiness Assertions	Assertion Date	Status
All Financial Statements			
DISA – WCF	All Financial Statements	Q3 FY 2010	Under Audit
Statement of Budgetary Resources (SBR) Audit			
U.S. Marine Corps	SBR	Q4 FY 2008	Under Audit
Army	Appropriations Received	Q4 FY 2010	Under Independent Public Accountant Examination
Navy	Appropriations Received	Q2 FY 2009	Under Independent Public Accountant Examination
Navy	Civilian Pay	Q3 FY 2010	Additional Corrective Actions Needed
Navy	Transportation of People	Q4 FY 2010	Additional Corrective Actions Needed
Air Force	Appropriations Received	Q4 FY 2010	Under Independent Public Accountant Examination
Air Force	FBWT Reconciliation	Q1 FY 2011	Under Independent Public Accountant Examination
Air Force	Rescissions	Q4 FY 2010	Under Independent Public Accountant Examination
Air Force	Non-expenditure Transfers	Q4 FY 2010	Under Independent Public Accountant Examination
Defense Logistics Agency	Appropriations Received	Q4 FY 2010	Additional Corrective Actions Needed
Mission Critical Asset Existence and Completeness Audit			
Army	Military Equipment – 8 Asset Types	Q2 FY 2011	OUSD(C) Validation Underway
Army	General Equipment – Fire & Rescue	Q2 FY 2011	OUSD(C) Validation Underway
Navy	Military Equipment	Q4 FY 2010	OUSD(C) Validation Underway
Navy	OM&S - Ordnance	Q4 FY 2010	Additional Corrective Actions Needed
Air Force	Military Equipment	Q1 FY 2011	Additional Corrective Actions Needed

AUDIT READINESS TARGET DATES FOR KEY ELEMENTS OF THE INITIAL FIAR PRIORITIES

To meet the DoD commitment to audit readiness in 2017, the Department is intensely focusing on the key elements of the initial FIAR priorities (i.e., Budgetary and Mission Critical Asset information) that must be completed incrementally over the next six years. Progress is closely monitored by the USD(C), Deputy CFO, Deputy CMO, and other senior leaders in the OUSD(Acquisition, Technology and Logistics) and the FIAR governance process. The FIAR governance process is described in Appendix 4.

Closely monitoring progress ensures issues or impediments that arise, that impede progress, are resolved as expeditiously as possible. For example, when the Components encountered delays in service provider support during the transfer of enterprise systems from the Business Transformation Agency to the Defense Logistics Agency (DLA), the issue was discussed at a FIAR Committee meeting and brought to the attention of the DLA.

The key elements that are being monitored for the SBR are:

- Fund Balance with Treasury
- Civilian Pay
- Military Pay
- Contracts
- Reimbursables
- Military Standard Requisitioning and Issuing Procedures (MILSTRIP)
- Financial Reporting
- Full SBR.

The key elements that are being monitored for mission critical assets are:

- Military Equipment
- Real Property
- Operating Materials and Supplies
- Inventory
- General Equipment.

The target dates (fiscal years) for accomplishing the initial FIAR priorities are provided in Figures 5 and 6. These figures show when the Army, Navy, Air Force, and DLA will complete validation of the key elements of the SBR and mission critical asset existence and completeness. Highlights of what is shown in the figures follow:

- The Army will achieve audit readiness of its General Fund SBR and mission critical assets in FY 2015.
- The Navy will assert audit readiness of its General Fund SBR in FY 2013 and its mission critical assets will be audit ready in FY 2015.
- The Air Force General Fund SBR will be audit ready in FY 2017, as well as its mission critical assets.
- The DLA SBR will be audit ready in FY 2017 and its mission critical assets will be audit ready in FY 2015.

Figure 5. Audit Readiness Validation Completion Target Dates for Key Elements of the Statement of Budgetary Resources

SBR Element	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Fund Balance with Treasury			Navy, DLA		Army	Air Force	
Civilian Pay		Navy			Army	Air Force	DLA
Military Pay			Navy		Army		Air Force
Contracts		Navy			Army	Air Force	DLA
Reimbursables		Navy			Army	Air Force	DLA
MILSTRIP		Navy					
Financial Reporting			Navy		Army	Air Force	DLA
Full SBR			Navy		Army		Air Force, DLA

Legend: Army Navy Air Force DLA

Figure 6. Audit Readiness Validation Completion Target Dates for Key Elements of Mission Critical Asset Existence and Completeness

Balance Sheet	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Military Equipment	Air Force			Navy	Army		
Real Property			Army, Air Force	Navy, DLA			
Operating Materials and Supplies					Army, Navy		Air Force
Inventory				Navy	Army, DLA	Air Force	
General Equipment				DLA	Army, Navy		Air Force

Legend: Army Navy Air Force DLA

AUDIT READINESS INTERIM TERM GOALS FOR INITIAL FIAR PRIORITIES

When the initial FIAR priorities to improve Budgetary and Mission Critical Asset information were established, the USD(C) required the DoD Components to identify interim term goals for achieving the priorities. Interim term goals are defined as goals to be achieved by the end of FY 2012. Figures 7 and 8 provide the DoD Component interim term goals.

The interim term goals are essential to ensuring incremental progress is made by the Components. They also provide visibility of current and near term FIAR activity for DoD senior leadership to include the Deputy Secretary of Defense/CMO and the CMOs of the Military Departments. At an April 2011 meeting chaired by the Deputy Secretary of Defense/CMO, the Military Department CMOs committed to achieving the interim term goals identified in Figures 7 and 8.

There are many interim term goals, but the most significant include:

- Army, Navy, and Air Force will begin an independent public accountant (IPA) examination of Appropriations Received in Quarter 3 of FY 2011.
- Army will begin an IPA examination of General Fund Enterprise Business System (GFEBS) Wave 1 Sites SBR in Quarter 3 of FY 2011.
- Navy and Air Force will begin an IPA examination of most of their military equipment assets in Quarter 3 and Quarter 4 of FY 2011, respectively.
- During the remaining quarters of FY 2011, Navy will assist the USMC to achieve an opinion on its FY 2011 SBR.
- Air Force will begin an IPA examination of Fund Balance with Treasury reconciliation in Quarter 4 of FY 2011.
- Army will fully deploy GFEBS in Quarter 2 of FY 2012.
- Navy will begin an IPA examination of one Major Defense Acquisition Program in Quarter 1 of FY 2012.
- Air Force will assert SBR audit readiness of Defense Enterprise Accounting and Management System (DEAMS) at Scott Air Force Base in Quarter 4 of FY 2012.

The above goals, to include the associated FIAR strategy and challenges, are described in each of the Components' sections within this Report.

Figure 7. FY 2011 Audit Readiness Interim Term Goals for Initial FIAR Priorities

Audit Readiness Goals	FY 2011	
	Quarter 3	Quarter 4
Begin IPA Examination of Appropriations Received		
Begin IPA Examination of Army Wave 1 GFEBS Sites SBR		
Begin IPA Examination of Military Equipment Existence and Completion		
Achieve an Audit Opinion on USMC FY 2011 SBR		
Begin IPA Examination of Fund Balance with Treasury Reconciliation		

Legend: Army Navy Air Force

Figure 8. FY 2012 Audit Readiness Interim Term Goals for Initial FIAR Priorities

Audit Readiness Goals	FY 2012			
	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Begin IPA Examination of SBR Audit Readiness of One Major Defense Acquisition Program				
Fully Deploy GFEBS				
Begin IPA Examination of Contracts, Military Standard Requisitioning and Issue (MILSTRIP), and Reimbursable Orders SBR Units				
• Begin IPA Examination of Army Wave 2 GFEBS Sites SBR • Assert Existence and Completeness Audit Readiness of Operating Materials and Supplies Quick Wins				
• Begin IPA Examination of FBWT Reconciliation • Assert SBR Audit Readiness of One Entity Using Navy ERP				
• Assert SBR Audit Readiness of Scott AFB Entity Using DEAMS • Assert SBR Audit Readiness of One Major Defense Acquisition Program				

Legend: Army Navy Air Force

I. Achieving Audit Readiness

This section of the Report describes the Department's commitment and strategy for improving the accuracy, reliability, and timeliness of financial information for decision making and for achieving fully auditable financial statements. It also responds to requirements in the FY 2011 National Defense Authorization Act (NDAA) to:

- Evaluate alternatives for valuing mission critical assets reported on the Balance Sheet and to perform a business case to support the alternatives selected by the Department, and
- Evaluate and establish incentives for achieving audit readiness.

In addition, this section provides:

- Audit readiness wave and Enterprise Resource Planning (ERP) system milestones,
- Interim term goals for achieving the initial FIAR priorities,
- Resources committed to achieving auditability, and
- Recent FIAR activity that supports audit readiness.

ACHIEVING AUDIT READINESS BY SEPT 30, 2017

In recent testimony before congressional committees, the Secretary of Defense, Robert Gates; Deputy Secretary of Defense/Chief Management Officer (CMO), William Lynn; and Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD(C)), Robert Hale stated their commitment to achieve audit readiness by September 30, 2017, as required by the Congress. Undoubtedly, since the CFO Act of 1990, the Department has expressed many times to the Congress its intentions to achieve auditable financial statements. However, the Department's commitment today is supported by significant changes that contribute to its ability to achieve audit readiness by 2017. The changes include:

Visible Leadership and Department-wide Audit Readiness Goal. Auditability by 2017 is a Secretary of Defense designated priority and Strategic Management Goal.

Accountability and Incentives. Overall accountability rests with the Deputy Secretary of Defense/CMO, while day-to-day responsibility has been placed on senior executives, both financial and functional, across the Department who are being held accountable for meeting audit readiness milestones and outcomes through organizational and individual performance plans and evaluations.

Broader Functional Community Support and Participation. A streamlined approach with well defined short-term and long-term milestones focusing first on information most often used to manage the Department (Budgetary and Mission Critical Asset information) has better engaged the functional community.

Senior Leadership Oversight and Involvement. Progress is reported and monitored by a formal and regularly scheduled FIAR governance process that involves the Deputy Secretary of Defense/CMO, USD(C), DoD Deputy CMO, Military Department CMOs and Financial Management/Comptrollers, and senior leaders from the functional communities.

Integrated Audit Ready Systems Environment Work. The modernization of the Department's business and financial systems through the deployment of ERP systems utilizing process reengineering and business best practices is concurrently taking place and has been integrated into the Components' financial improvement plans.

Resources to Accomplish FIAR Goals and Objectives. Resources of approximately $300 million are being applied annually on DoD Component FIAR activity (excludes ERP resources).

In addition to the above empowering significant changes, the Department continues to mandate the use of an effective FIAR Strategy and Methodology. The FIAR Strategy is briefly described below. Also, the results of a business case analysis, discussed in a following subsection, will have a significant impact in resolving one the Department's most challenging impediments (i.e., asset valuation) to producing auditable financial statements.

FIAR Strategy

The FIAR Strategy (Figure I-1) focuses financial improvement work into five well-defined and distinct waves of activity that incrementally lead to audit readiness, while prioritizing and improving first the information most often used by DoD management. The strategy is consistent with, and focuses improvement work on, the objectives and priorities established by the USD(C) in August 2009.

Figure I-1. FIAR Strategy

The FIAR Strategy also draws from the strengths of several alternative approaches and groups individual end-to-end processes into one or multiple waves. Corrective actions are prioritized within each wave by end-to-end processes including corresponding line-items reported on other financial statements, as well as by dependencies on service providers and systems modernization.

The Components are ensuring appropriate controls are in place and operating effectively for relevant financial reporting processes prior to asserting each wave as complete (e.g., controls over the presentation and disclosure for the Statement of Budgetary Resources must be asserted ready at the end of Wave 2).

The FAIR Strategy Waves 1 through 3 are consistent with the initial FIAR priorities. They represent significant levels of effort and accomplishment and are being worked concurrently, as shown in Figure I-1.

- Wave 1 – Appropriations Received Audit
- Wave 2 – Statement of Budgetary Resources (SBR) Audit
- Wave 3 – Mission Critical Asset Existence and Completeness Audit

Wave 4 and Wave 5 represent work to achieve the subsequent FIAR priorities and full audit readiness.

- Wave 4 – Full Financial Statement Audit, Except for Legacy Assets (New Asset Valuation)
- Wave 5 – Full Financial Statement Audit

Sections II – V of this Report provide the DoD Component plans and progress to achieve the objectives of the FIAR Strategy. Additional information on the FIAR Waves and Strategy is contained in Appendix 1 and Appendix 2, respectively.

INITIAL FIAR PRIORITIES

The primary objective of the initial FIAR priorities is to focus financial improvement work on the processes, controls, and systems supporting information that is most often used to manage the Department, while continuing financial improvement to achieve unqualified audit opinions on DoD financial statements. To achieve that objective, the USD(C) assigned a high priority to:

- Budgetary information, and
- Mission Critical Asset information.

Budgetary Information

The first initial FIAR priority focuses improvement work on processes, controls, and systems that report budgetary information. By focusing improvement activities on budgetary information and ensuring it is timely, reliably, and accurately produced, the Department will accomplish the objective to improve information most often used by management and also meet the goal of obtaining auditable financial statements starting with the SBR.

The benefits of focusing improvement efforts on budgetary information and the SBR include:

- Improving the visibility of budgetary transactions resulting in more effective use of resources,
- Providing for operational efficiencies through more readily available and accurate cost and financial information,
- Improving fiscal stewardship (ensures that funds appropriated, expended, and recorded are reported accurately, reliably, and timely),
- Improving budget processes and controls (reduces Antideficiency Act violations), and
- Linking fund execution to the President's Budget (provides more consistency with the financial environment).

Mission Critical Asset Information

The second initial FIAR priority focuses improvement work on information essential to effectively manage the Department's mission critical assets. For purposes of this priority, mission critical assets include:

- Military Equipment (e.g., ships, aircraft, combat vehicles)
- Real Property (e.g., land, buildings, structures)
- Inventory (e.g., rations, supplies, spare parts, fuel)
- Operating Materials and Supplies (e.g., munitions)
- General Equipment (e.g., training equipment, special tooling and test equipment, shipyard cranes, and fire and rescue equipment)

Some of the same information needed to manage the Department's mission critical assets is also needed for financial statement audits. Such information includes:

- Unique Identifiers (e.g., item unique identification [IUID] number, Real Property Unique Identification [RPUID] number, aircraft tail number, ship number)
- Location (e.g., military installation/base)
- Condition (e.g., operational status/in-service)
- Accountable Organization (e.g., 374th Tactical Airlift Wing)
- Accountable Individual (e.g., SSGT John Smith)

This information, and other management and financial information, is recorded in the Department's property and logistics systems. Ensuring that important management information regarding mission critical assets is accurately recorded in the Component's property and logistics systems is the objective of this priority.

The benefits of focusing improvement efforts on mission critical asset information include:

- Assists the Department in achieving its long-standing goal of total asset visibility;
- More reliable and accurate logistics supply chain and inventory systems;
- Improved ability to timely acquire, maintain, and retire assets;
- More effective utilization of assets;
- Better control over assets preventing their misuse, theft, or loss; and
- Reduction of unnecessary reordering.

SUBSEQUENT FIAR PRIORITIES

After establishing the initial FIAR priorities, the USD(C) began searching for a cost effective approach to achieve auditability of the DoD Balance Sheet, while mindful of the limited utility of Balance Sheet information and the significant and costly challenges that had to be overcome. The USD(C) expressed these challenges in testimony before congressional committees and in meetings with members of the Congress. Responding to the challenges in the FY 2011 NDAA, the Congress required the USD(C) to:

- Examine the costs and benefits of alternative approaches to the valuation of Balance Sheet assets,
- Select an approach to such valuation that is consistent with principles of sound financial management and the conservation of taxpayer resources, and
- Prepare a business case supporting the selected approach.

As required by the NDAA, the Department examined the costs and benefits of various valuation alternatives, selected an approach for pertinent Balance Sheet assets, and prepared a business case to support the selected alternatives. The Business Case is provided in Appendix 3 of this Report.

Business Case Interviews

An important element of the Business Case was interviews conducted with numerous decision makers at various levels throughout the Department. The purpose of the interviews was to determine if historical acquisition cost information recorded in DoD accounting systems and reported on the Balance Sheet was used for purposes other than financial reporting. The interviews also were used to identify the cost information used when making decisions such as acquisition, replacement, maintenance, life-cycle, upgrade, and disposal.

The interviews concluded that cost information of many types (e.g., Plant Replacement Value, lifecycle costs, parametric cost estimates) from many different sources (e.g., commercial cost indices, weapons system manufacturers) is routinely used throughout the Department, but audited Balance Sheet cost information recorded in DoD accounting systems is of limited value for:

- Real Property,
- Inventory,
- Operating Materials and Supplies (OM&S), and
- General Equipment.

The interviews also concluded that auditable acquisition costs of military equipment assets is of low value to DoD decision makers.

Business Case Impact on Audit Readiness

Based on the Business Case, the Department concluded that the cost to achieve auditable Balance Sheet asset values was prohibitively expensive until the initial FIAR priorities are achieved and the DoD Components' ERP systems have been deployed and operating effectively (i.e., capturing transaction-level cost information). In addition, the Department concluded that the cost to achieve auditable values of legacy assets also was prohibitively expensive since the use of such information was of low value to DoD decision makers.

To implement these conclusions, the Department has established *subsequent* FIAR priorities, as follows:

1. <u>For Real Property, Inventory, OM&S, and General Equipment</u> a two phased approach will be used:
   - *Before completion of the initial FIAR priorities and deployment of the ERPs*, report on the Balance Sheet the recorded costs of legacy assets and new acquisitions recorded in systems of record or accounting systems and indicate in the notes to the Balance Sheet that such amounts are not auditable.
   - *After completion of the Initial FIAR Priorities and the deployment of the ERPs*, the Department will report on the Balance Sheet:

– The cost of legacy assets and indicate that such amounts have not been audited, and

– The cost of new acquisitions and indicate that such amounts have been audited.

2. For Military Equipment, the Department and Office of Management and Budget will request the Federal Accounting Standards Advisory Board change the Federal accounting standards to:

- Permit the expensing of military equipment acquisition costs, and
- Require the reporting of military equipment quantities as Required Supplementary Information in DoD financial statements.

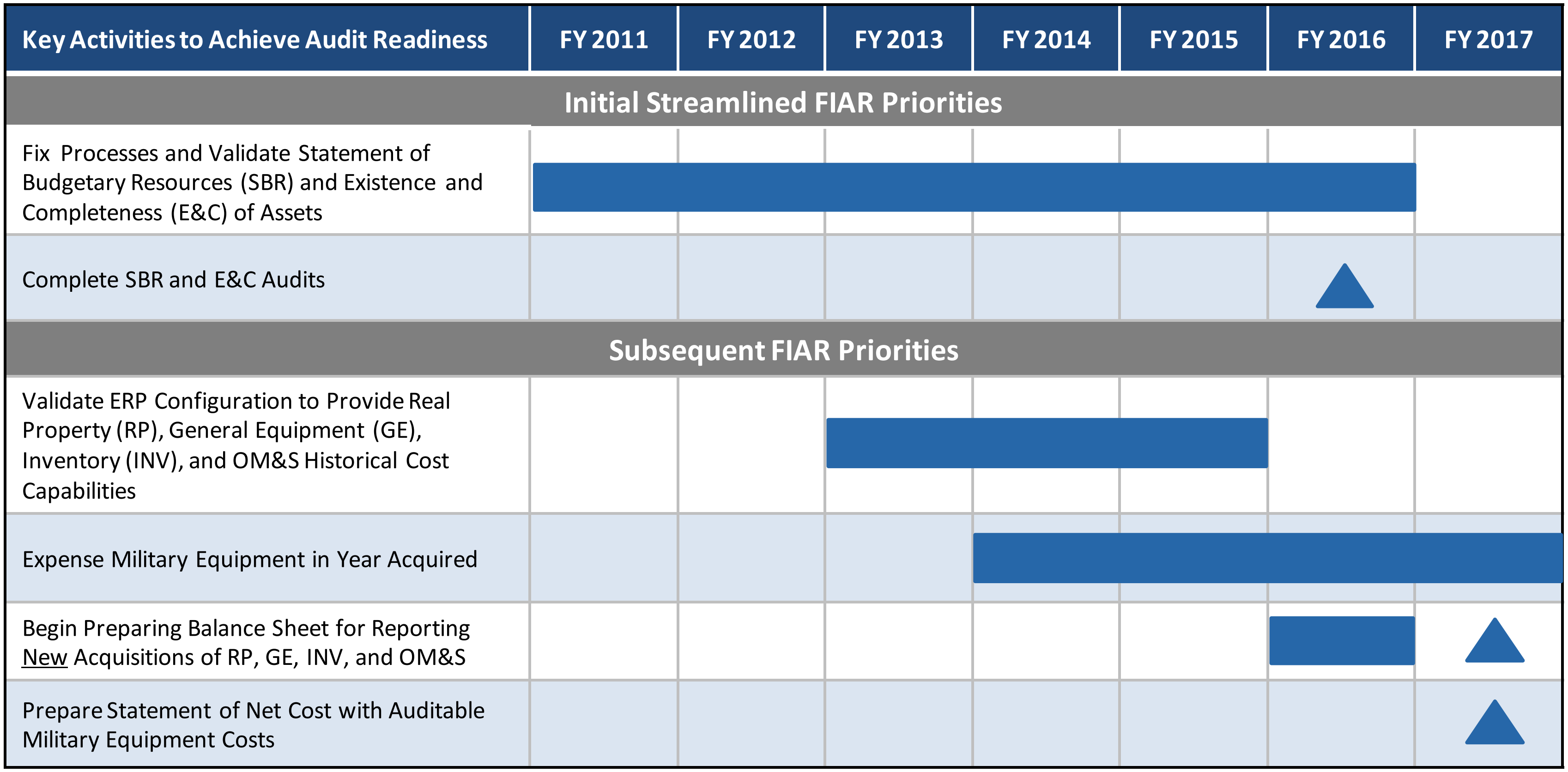
Figure I-2 summarizes the above and the results of the asset valuation decisions made by the Department and supported by the Business Case.

Figure I-2. Summary Results of Business Case for Valuing Assets

Asset Type	Legacy Asset Costs	New Asset Costs
Real Property, General Equipment, Inventory, and Operating Materials and Supplies	Report on the Balance Sheet as recorded and do not audit.	Report on the Balance Sheet and audit after the initial priorities are compete.
Military Equipment	Expense acquisition costs.	Expense acquisition costs.

Figure I-3 provides the timeline for accomplishing the initial and subsequent FIAR priorities. It is through the combination and successful completion of the initial and subsequent FIAR priorities that the Department will meet its commitment to audit readiness by 2017. This phased plan will meet the needs of the Public and Congress in a cost effective manner.

Figure I-3. Timeline to Audit Ready Financial Statements in FY 2017



AUDIT READINESS PLANS

To achieve the FIAR priorities, the DoD Components plan and execute audit readiness work utilizing standard Financial Improvement Plans (FIPs). The milestones that are presented in Figures I-4 and I-5 were obtained from the Components' FIPs. A brief explanation of each figure follows.

Figure I-4. DoD Audit Readiness Wave and ERP Milestones. This figure provides Appropriations Received Audit (Wave 1), SBR Audit (Wave 2), and Existence and Completeness of Mission Critical Assets Audit (Wave 3) milestones for achieving the initial FIAR priorities to improve Budgetary and Mission Critical Asset information by Component through FY 2017.

Figure I-4 also contains key milestones for the Components' deployment of their ERP systems. An ERP is an automated system using commercial off-the-shelf software consisting of multiple, integrated functional modules that perform a variety of business related tasks such as general ledger accounting, payroll, and supply chain management.

The ERP milestones are included in Figure I-4 because they are changing business and financial operations by eliminating over 500 legacy systems that cost hundreds of millions of dollars annually to operate. In addition, the ERPs are significantly changing the Component and Defense Agency service provider business and financial processes and controls and directly affect their FIPs. Furthermore, the Department's goals to improve financial information and to sustain audit readiness are dependent in part on the successful deployment of the ERPs.

Figure I-5. Interim Term Goals for Initial FIAR Priorities. This figure provides interim term goals and milestones for the initial FIAR priorities by DoD Component, which are defined as goals and milestones that will be achieved by the end of FY 2012. The November 2011 Report will include interim term goals and milestones through FY 2013.

The majority of the milestone completion dates in both figures have not changed from those presented in the November 2010 Report. Where the milestones have changed, they are shown symbolically in the figures and explained in the accompanying narrative, as well as in the Component sections of this Report.

AUDIT READINESS WAVE AND ERP MILESTONES

Figure I-4 provides the DoD Components' milestones by audit readiness wave. The audit readiness waves are explained in Appendix 1.

Figure I-4 identifies symbolically the audit readiness validation completion and ERP milestones that have changed since the milestones were first reported in either the May 2010 or November 2010 FIAR Reports. The purpose of symbolically identifying these milestones is to provide a historical "baseline" for changed milestones. Five audit readiness validation milestones and nine ERP milestones have changed, as described below.

Information pertaining these milestones and each Component's strategy, plans, and progress is provided in their respective sections of this Report.

Accomplishments

The following milestones were completed since the November 2010 report.

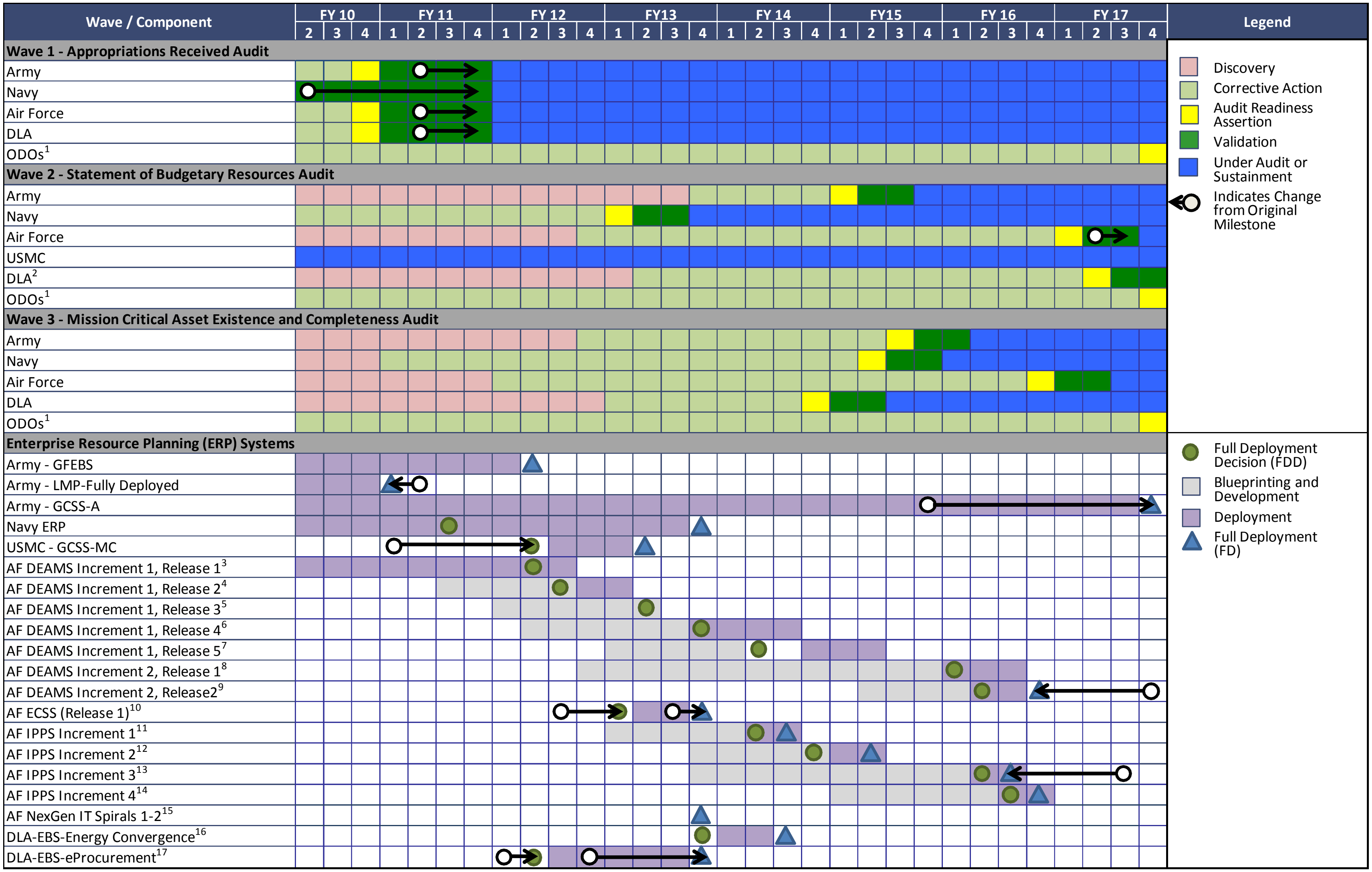
- Army reported Full Deployment of the Logistics Modernization Program (ERP) system in Quarter 1 of FY 2011.

Changes to Milestones

- Army Appropriations Received (Wave 1) audit readiness validation was to be completed in Quarter 2 of FY 2011, but will now be completed in Quarter 4 of FY 2011.
- Army completed the Full Deployment milestone for the Logistics Modernization Program (ERP) system in Quarter 1 of FY 2011, which is a quarter earlier than planned.
- Army adjusted the Full Deployment milestone for the Global Combat Support System-Army (ERP) system from Quarter 4 of FY 2015 to Quarter 4 of FY 2017.
- Navy Appropriations Received (Wave 1) audit readiness validation was to be completed in Quarter 2 of FY 2010, but will now be completed in Quarter 4 of FY 2011.
- USMC moved its ERP, Global Combat Support System-Marine Corps (GCSS-MC), Full Deployment Decision milestone from Quarter 1 of FY 2011 to Quarter 2 of FY 2012.
- Air Force Appropriations Received (Wave 1) audit readiness validation was to be completed in Quarter 2 of FY 2011, but will now be completed in Quarter 4 of FY 2011.

- Air Force moved the milestone for completing the SBR audit readiness validation from Quarter 2 of FY 2017 to Quarter 3 of FY 2017.
- Air Force moved the milestone for Full Deployment of the Defense Enterprise Accounting and Management (DEAMS) ERP from Quarter 4 of FY 2017 to Quarter 4 of FY 2016.
- Air Force moved two milestones (Full Deployment Decision and Full Deployment) for the Expeditionary Combat Support System (ERP) that were planned for Quarter 3 of FY 2012 and Quarter 3 of FY 2013 to Quarter 1 of FY 2013 and Quarter 4 of FY 2013, respectively.
- Air Force moved the Full Deployment milestone for the Integrated Personnel Pay System (IPPS) ERP Increment 3 from Quarter 3 of FY 2017 to Quarter 3 of FY 2016.
- DLA Appropriations Received (Wave 1) audit readiness validation was to be completed in Quarter 2 of FY 2011, but will now be completed in Quarter 4 of FY 2011.
- DLA moved two milestones (Full Deployment Decision and Full Deployment) for the Enterprise Business System eProcurement ERP that were planned for Quarter 1 of FY 2012 and Quarter 4 of FY 2012 to Quarter 2 of FY 2012 and Quarter 4 of FY 2013, respectively.

Figure I-4. DoD Audit Readiness Wave and ERP Milestones



INTERIM TERM GOALS FOR INITIAL FIAR PRIORITIES

Figure I-5 provides the DoD Component interim term goals and milestones (defined as milestones to be completed by the end of FY 2012). Figure I-5 identifies symbolically the audit readiness validation completion and ERP milestones that have changed since the May 2010 and November 2010 Reports. The purpose of symbolically identifying these milestones is to provide a historical "baseline" for changed milestones. Nine audit readiness validation milestones have changed, as described below.

Information pertaining the milestones and each Component's strategy, plans, and progress to achieve the initial FIAR priorities is provided in their respective sections of this Report.

Accomplishments

The following milestones were completed since the November 2010 report.

- Army asserted existence and completeness audit readiness for eight types of Military Equipment in Quarter 2 of FY 2011.
- Army asserted existence and completeness audit readiness for General Equipment fire and rescue assets in Quarter 2 of FY 2011.
- Air Force asserted the capability to reconcile Fund Balance with Treasury (FBWT) in Quarter 1 of FY 2011.
- Air Force asserted in Quarter 1 of FY 2011 complete audit readiness of Military Equipment by asserting Existence, Completeness, Valuation, Rights, and Disclosure.

Changes to Milestones

- Army Appropriations Received (Wave 1) audit readiness validation was planned to be completed in Quarter 2 of FY 2011, but now will be completed in Quarter 4 of FY 2011.
- Army adjusted the audit readiness validation completion milestone for General Funds Enterprise Business System (ERP) Wave 1 entities from Quarter 3 of FY 2011 to Quarter 4 of FY 2011.
- Navy Appropriations Received (Wave 1) audit readiness validation was to be completed in Quarter 2 of FY 2010 and now will be completed in Quarter 4 of FY 2011.
- Navy moved the completion of the audit readiness validation milestone for Civilian Pay from Quarter 4 of FY 2010 to Quarter 4 of FY 2012.
- Air Force Appropriations Received (Wave 1) audit readiness validation was planned to be completed in Quarter 2 of FY 2011, but now will be completed in Quarter 4 of FY 2011.
- Air Force adjusted the completion of the audit readiness validation milestones for Rescissions and Non-expenditure Transfers from Quarter 2 of FY 2011 to Quarter 4 of FY 2011.
- Air Force adjusted the completion of the audit readiness validation milestone for Operating Materials and Supplies (OM&S) – Missile Motors from Quarter 3 of FY 2011 to Quarter 1 of FY 2012.
- Air Force adjusted the completion of the audit readiness validation milestone for OM&S – Spare Engines from Quarter 4 of FY 2011 to Quarter 1 of FY 2012.
- DLA Appropriations Received (Wave 1) audit readiness validation was planned to be completed in Quarter 2 of FY 2011, but now will be completed in Quarter 4 of FY 2011.

Figure I-5. Interim Term Goals for Initial FIAR Priorities (Wave 1, Wave 2, and Wave 3)

Component	Goals	FY 10			FY 11				FY 12			
		2	3	4	1	2	3	4	1	2	3	4
Financial Statement Audits	**Achieve and Sustain Audit Opinions**											
USACE, DCAA, DFAS, DeCA, MERHCF, MRF, TRICARE-CRM, OIG	Sustain Audit Opinions											
USMC	Achieve and Sustain SBR Audit Opinion											
DISA-WCF	Achieve and Sustain Audit Opinion											
Wave 1 - Appropriations Received Audit	**Achieve, Validate and Sustain Audit Readiness**											
Army	Achieve, Validate and Sustain Audit Readiness											
Navy	Validate and Sustain Audit Readiness											
Air Force	Achieve, Validate and Sustain Audit Readiness											
DLA	Achieve, Validate and Sustain Audit Readiness											
Wave 2 - Statement of Budgetary Resources Audit	**Achieve, Validate and Sustain Incremental Audit Readiness**											
Army	Examination of GFEBS Wave 1 Sites											
	Examination of GFEBS Waves 1 & 2 Sites											
Navy	Military Pay											
	Civilian Pay											
	MILSTRIP Orders											
	Reimbursable Authority											
	Reimbursable Work Orders - Grantor											
	Contracts											
	Net Outlays (Includes FBWT)											
	Financial Statement Compilation and Reporting											
	Examination of One Acquisition Program											
	Examination of One Navy ERP Entity											
Air Force	Rescissions											
	Non-expenditure Transfers											
	Funds Distribution to Base											
	FBWT Reconciliation											
	Examination of One Acquisition Program											
	Examination of DEAMS at TRANSCOM/Scott AFB											
DLA	FBWT											
Wave 3 - Mission Critical Asset Existence and Completeness Audit	**Achieve, Validate and Sustain Incremental Audit Readiness**											
Army	Military Equipment (8 Asset Types)											
	General Equipment - Fire and Rescue											
Navy	Military Equipment (4 Asset Types)											
	OM&S - Ordnance											
Air Force	Military Equipment											
	OM&S - Missile Motors											
	OM&S - Spare Engines											
	OM&S - Cruise Missiles & Drones											

Legend

- FIP Development Underway
- Discovery
- Corrective Action
- Audit Readiness Assertion
- Validation
- Under Audit or Sustainment
- Capability to Reconcile FBWT
- Indicates Change from Original Milestone

INCENTIVES FOR ACHIEVING AUDIT READINESS

The Department's financial management improvement priorities, which have been incorporated in the FIAR Plan and Components' Financial Improvement Plans, focus improvement work on information that is most often used by decision makers – budgetary information and information on mission critical assets. These priorities are critical to achieving auditable financial statements and support financial improvement efforts with a clear and valuable purpose that impacts the Department's ability to effectively support the warfighter.

Improving budgetary and mission critical asset information allows commanders and other leaders to better meet mission needs with their available resources. The Department believes that the alignment of operational and financial objectives is the most effective incentive to improve financial management. Regardless of this alignment and because the DoD is committed to achieving audit readiness by September 30, 2017, the Department has implemented other effective incentives (Incentives 1, 3, and 4 in Figure I-6) and will be seeking congressional approval of another incentive (Incentive 2 in Figure I-6).

Figure I-6. Incentives for Achieving Audit Readiness

Incentives	Incentive Description	Implementation Status / Plans
1. FIAR goals in Senior Executive Service (SES) Performance Plans.	Performance Plans of appropriate SES members, both in the Financial and Functional Communities, include FIAR goals (e.g., timely achievement of FIAR milestones).	• FY 2011 SES Performance Plans in various Offices of the Secretary of Defense and the DoD Components include FIAR goals. • Secretary of the Army directed FIAR goals be included in SES Performance Plans in FY 2012. • DoD will continue to require FIAR goals in appropriate SES Performance Plans in FY 2012 and beyond.
2. Increases in thresholds for reprogramming of funds.	Increased reprogramming thresholds will be granted to DoD Components that receive a positive audit opinion on their Statement of Budgetary Resources.	• DoD will propose changes to reprogramming thresholds when auditability is achieved.

Incentives	Incentive Description	Implementation Status / Plans
3. Component audit costs funded by the Office of the Secretary of Defense after a successful audit.	The cost of auditing incremental improvements to achieving auditability and of complete financial statement audits is significant and impacts the availability of Component funds for other purposes. To offset this funding requirement, the Office of the Secretary of Defense will fund subsequent year audit costs after the first successful audit.	• Implementation is planned once an audit is successful.
4. Highlight successes as they occur.	The DoD Components are very competitive, and this incentive will publicize and reward successful audits by using various methods that foster more competition. Options for highlighting and recognizing success include: achievement or other types of awards presented by the Secretary or Deputy Secretary of Defense or other senior leaders to the Components, commands, organizations, or individuals; announcements at various DoD conferences; articles in various DoD publications, financial management professional journals, and trade magazines; and public new releases.	• Successful audits (e.g., Army Corps of Engineers) are presently highlighted in the semiannual FIAR Plan Status Report and other reports, presentations, and briefings. • Recognition of achieving audit readiness is presently ongoing for the U.S. Marine Corps SBR audit. • Other recognition in the form of awards will be assessed on a case by case basis.

As required by Section 881(d) of the FY 2011 NDAA, the Department considered the following incentive options suggested by the Congress, but determined that they were not useful or needed, and therefore, they are not being implemented.

- Consistent with the need to fund urgent warfighter requirements and operational needs, priority in the release of appropriated funds.
- Relief from the frequency of financial reporting in cases in which such reporting is not required by law.
- Relief from Department obligation and expenditure thresholds to the extent that such thresholds establish requirements more restrictive than those required by law.

FIAR RESOURCES

Applying the right level of resources to achieving the FIAR goals and priorities in a time of significant budget constraints is challenging, but it has the attention of the Department's senior leaders, who are balancing competing funding requirements and applying an appropriate level of resources to FIAR efforts.

The FIAR activities funded by the amounts in Figure I-7 include conducting audit readiness activities, hiring independent public accounting (IPA) firms to conduct validations and audits, and resolving financial system issues (i.e., achieving an audit ready systems environment). Each of these activities is described below.

Audit Readiness includes the resources for evaluation, discovery, and corrective actions of the Components and their service providers (e.g. Defense Finance and Accounting Service) to include documenting and/or modifying processes and controls, identifying internal control deficiencies through testing and remediation of deficiencies, and evaluating transaction-level evidential matter and ensuring that it is readily available. Also included are the resources for activities to test or verify audit readiness after completing corrective actions and preparation of management assertion packages

Audit/Validation includes the resources for validations, examinations, and financial statement audits conducted by IPAs.

Financial Systems includes the resources for designing and achieving an audit ready systems environment. This includes ERP deployment costs. It also includes the resources to make needed and cost effective changes to legacy systems that will be part of the audit ready systems environment. Financial System resources include: design, development, deployment, interfaces, data conversion and cleansing, independent verification and validation and testing, implementation of controls and control testing, and system and process documentation.

The Army, Navy, Air Force, and Defense Logistics Agency sections of this Report provide the amount of FIAR resources budgeted by Component.

Figure I-7. DoD FIAR Resources ($ in Millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Audit Readiness	$ 98	$ 170	$ 189	$ 185	$ 181	$ 164	$ 163
Audit/Validation	$ -	$ 21	$ 23	$ 38	$ 42	$ 42	$ 42
Audit Readiness and Audit Subtotal	98	191	212	223	223	206	205
Financial Systems							
Non-Enterprise Resource Planning Systems (ERPs)	118	122	113	108	87	77	65
ERPs	1,354	1,552	1,478	1,285	1,238	1,323	1,086
Financial Systems Subtotal	1,472	1,674	1,591	1,393	1,325	1,400	1,151
Total Resources	$ 1,570	$ 1,865	$ 1,803	$ 1,616	$ 1,548	$ 1,606	$ 1,356

ACTIVITIES SINCE THE NOVEMBER 2010 REPORT

The following describes significant FIAR related activities within the Department since the November 2010 Report that impact achieving audit readiness and support the Department's commitment to achieving it in 2017.

FIAR Communications

Communicating the FIAR goals and objectives across the Department, and not just to the financial community, is critical to achieving improved financial information and audit readiness. Recognizing this need, the Department established a communication plan and is implementing it. The following identifies the most significant recent communication activities and actions.

FIAR Conference. A conference was conducted on March 23 and 24, 2011, to advocate support of the Department's commitment for achieving auditable financial statements by 2017. The conference was attended by 320 leaders and staff from most of the DoD Components. Participating in the conference were senior leaders from the Congress, Office of Management and Budget, Government Accountability Office, and industry. The conference will be an annual event.

FIAR Blog. The OUSD(C) established a blog and has been regularly posting articles to it. Many of the articles were written by the Deputy Chief Financial Officer (CFO).

FIAR Seminar. The Department is partnering with the CFO Academy to develop and regularly conduct seminars for academy instructors and students that explain the Department's FIAR goals and objectives, FIAR Strategy, and FIAR Methodology.

FIAR Articles for Various Publications. The Department has written and published articles for Financial Management Online (FM Online), a Web-based communication resource, and the Army Sustainment magazine. Other articles will be written for various DoD and DoD-related associations (e.g., Association of Military Comptrollers) and industry trade journals.

FIAR Professional Development

As reported in the November 2010 FIAR Plan Status Report, the Department developed professional development curriculum in support of the FIAR goals to achieve and sustain both audit readiness and unqualified assurance on the effectiveness of internal controls. The curriculum was designed to enhance Department-wide knowledge and understanding of the FIAR goals and priorities, introduce the FIAR Guidance and its step-by-step instructions to become audit ready, and reinforce the Department's Internal Control over Financial Reporting requirements. The curriculum was approved for Continuing Professional Education credits in accordance with the standards established by the National Association of State Boards of Accountancy.

The FIAR professional development curriculum includes four courses designed to address lessons learned from the Department's audit readiness efforts to date, feedback from successful and unsuccessful financial statement audits, and feedback from individual Components and service providers. The Department is planning to incorporate the curriculum in the Military Departments' professional development schools and institutions, as well as the Service Academies and Naval Post Graduate School.

The Department also is developing three additional courses for achieving audit readiness including a course on evidential matter (supporting documentation) required by financial statement auditors. These courses are scheduled to be completed and available later this year.

By the end of July 2011, approximately 650 participants will have completed one or more classroom training courses. However, the Department has many thousands of dispersed people that should have this training; therefore, the Department will be developing Internet-based training that is planned to be available in FY 2012.

To help increase the outreach even further, the Department is partnering with the CFO Academy to develop an Accounting Certification to help cultivate individuals with expanded accounting skills that understand the DoD process for achieving audit readiness.

II. Army Audit Readiness Plans

In previous versions of this Report, the Department of the Army ("Army") audit readiness plans were presented in separate sections by Wave. In this Report, all of the Army plans to achieve audit readiness are presented and described in this section. A complete summary of the Army audit readiness and Enterprise Resource Planning (ERP) system deployment milestones is presented in Figure II-1. The changes to milestones identified in this figure are explained in subsequent subsections.

The Army's senior leaders are actively engaged in financial improvement efforts and are working to ensure the Office of the Assistant Secretary of the Army (Financial Management and Comptroller) (OASA(FM&C)) receives sufficient support across the Army. Specifically, the Secretary of the Army directed all senior Army leaders to:

- Support the OASA(FM&C)'s audit readiness activities,
- Identify a single point of contact responsible for coordinating audit readiness activities within their organization, and
- Include audit readiness goals in annual Performance Plans for all relevant members of the Senior Executive Service.

To facilitate communication about the Army's audit readiness efforts, the OASA(FM&C) is utilizing numerous forums to increase awareness and support across the Army. These forums include monthly FIAR Committee meetings, quarterly Financial Improvement Plan (FIP) In-process Reviews, quarterly Audit Committee meetings, quarterly Senior Leader Steering Group meetings, and the annual Army FIP Conference. These forums communicate the status of Army audit readiness to key business process owners ensuring they understand their role in the Army's approach to achieve audit readiness and to provide progress reports.

Along with these important meetings, the Army is communicating its audit readiness strategy to a broader audience with several Web-based and printed documents. Issued in 2010, the Army Audit Readiness Strategy document serves as a high-level overview of the overarching audit readiness framework, priorities and a timeline for completion. Complementing the Audit Readiness Strategy is the Army Business Rules document, which details roles, responsibilities and processes for the Army FIP, Internal Controls over Financial Reporting (ICOFR), and audit requirements. The Audit Readiness Strategy and Business Rules will be updated as needed and published annually.

In addition, the Army is providing regular updates to business process owners across the Army through a quarterly newsletter, *The FIP Report*. It provides updates on audit readiness activities, information on upcoming training, and other current financial management topics. The first newsletter was published in February 2011.

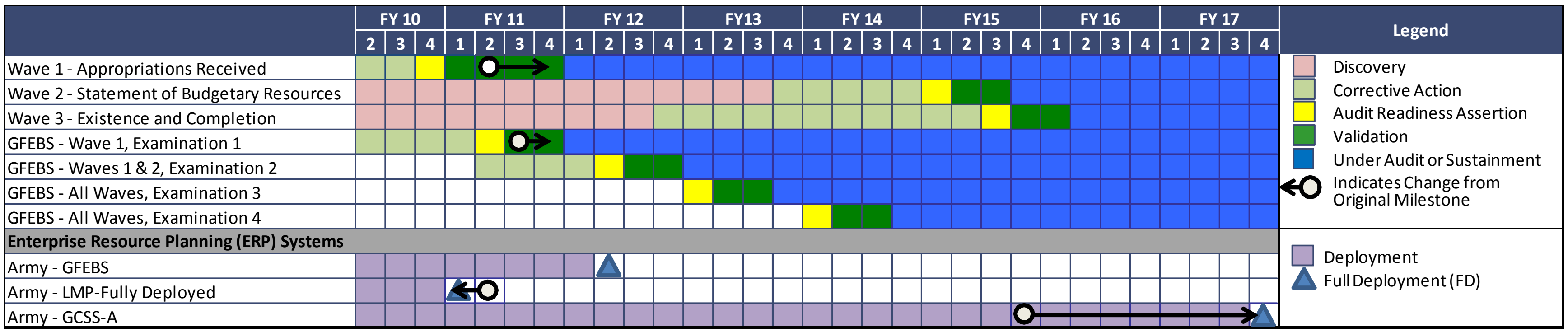
The Army is using instructor led, and in the future, Web-based training modules to train business process owners and service providers. The OASA(FM&C) has created several training modules, including Army FIP 101, Audit Readiness 101, and Internal Controls 101, that will be delivered to Command headquarters, including DFAS, during regularly scheduled quarterly visits and at installations on an as-needed or as-requested basis.

The Army has fully resourced and is executing a comprehensive audit readiness plan built to allow the Army to achieve the Department's and Congressionally-mandated audit readiness requirements and, more importantly, sustain these improvements. The Army's approach is synchronized with the deployment of modern financial systems and focuses heavily on training and developing Army personnel across all business processes to support and sustain audit readiness.

Included in the following subsections are:

- Army FIAR Resources,
- Status and Plans for the Statement of Budgetary Resources (Wave 1 and Wave 2),
- Status and Plans for Existence and Completeness of Mission Critical Assets (Wave 3), and
- Audit Readiness Environment Assessments.

Figure II-1. Army Audit Readiness and ERP Plans



Army FIAR Resources

The Army continues to demonstrate its commitment to financial improvement and audit readiness by allocating the financial resources necessary to achieve unqualified audit opinions. The Army's FIAR funding is categorized by the following areas: Audit Readiness, Audit/ Validation, and Financial Systems. Each of these areas is explained below, and the amounts applied to each are presented in Figure II-2.

Audit Readiness includes the resources for discovery, evaluation, control testing, and corrective actions related to Army and service provider (e.g., Defense Finance and Accounting Service) business processes. These actions include documenting end-to-end business processes, identifying controls supporting business processes, testing controls to ensure effectiveness, and implementing corrective actions where a controls are ineffective. Audit readiness actions also include evaluation of transaction-level evidential matter and supporting documentation to ensure it is readily available and properly supports the financial transactions. These actions aid the Army in executing business transformation and achieving auditability, developing financial improvement plans and corrective actions, monitoring completion of corrective actions, performing evaluation/discovery activities at various installations for both the SBR and the existence and completeness of mission critical assets, and facilitating the development of financial management human capital.

Audit/Validation includes the resources for validations, examinations, and financial statement audits conducted by independent public accounting (IPA) firms.

The Army will engage an IPA to perform examinations of the SBR over a four year period between FY 2011 and FY 2014. The IPA examinations will identify further corrective actions required for audit readiness. Additionally, the Army will engage its network of Internal Review and Audit Compliance activities and the Army Audit Agency to sustain audit readiness by conducting follow-up reviews and audits employing audit like procedures.

Financial Systems includes the resources for designing and achieving an audit ready systems environment. This includes Enterprise Resource Planning (ERP) system deployment costs. It also includes the resources to make needed and cost effective changes to legacy systems that will be part of the audit ready systems environment. The ERP systems are critical to the Army's audit readiness efforts as they will replace existing systems and business practices that are not auditable. Financial system resources include design, development, deployment, interfaces, data conversion and cleansing, independent verification and validation, testing, implementation of controls and control testing, and system and process documentation.

The Army continues to transform its financial management systems environment through the ongoing implementation of modern financial systems. Significant resources have been allocated to the implementation of ERP systems, including the General Fund Enterprise Business System (GFEBS), the Logistics Modernization Program (LMP), Global Combat Support System – Army (GCSS-A) and Integrated Personnel and Pay System – Army (IPPS-A). Funding for these systems is provided in Figure II-2.

Figure II-2. Army FIAR Resources ($ in Millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Audit Readiness	$ 9	$ 41	$ 43	$ 44	$ 41	$ 24	$ 24
Audit/Validation	-	5	5	20	25	25	25
Audit Readiness and Audit Subtotal	9	46	48	64	66	49	49
Financial Systems							
Non-Enterprise Resource Planning Systems (ERPs)	-	-	-	-	-	-	-
General Funds Enterprise Business System	135	186	85	61	66	57	69
Logistics Modernization Program	238	204	156	128	120	118	115
Global Combat Support Systems - Army	115	124	218	257	269	265	140
Integrated Personnel and Pay System - Army	49	108	69	54	65	67	89
Financial Systems Subtotal	537	622	528	500	520	507	413
Total Resources	$ 546	$ 668	$ 576	$ 564	$ 586	$ 556	$ 462

Audit Ready Statement of Budgetary Resources (Wave 1 & Wave 2)

In accordance with DoD FIAR goals and objectives, the National Defense Authorization Act (NDAA) for FY 2010, and Under Secretary of the Army direction, the Army initiated a General Fund Statement of Budgetary Resources (SBR) discovery and evaluation effort in March 2010.

Appropriations Received (Wave 1)

The Army asserted its General Fund SBR Appropriations Received as audit ready on September 28, 2010, and is currently implementing several corrective actions identified during the assertion process. The IPA examination of General Fund Appropriations Received began in April 2011. This examination covers the Army General Fund appropriations that exceeded $225 billion in FY 2011.

Statement of Budgetary Resources (Wave 2)

The Army synchronized its SBR audit readiness site visit schedule directly with the General Fund Enterprise Business System (GFEBS) deployment plan because of the system's importance to Army audit readiness. By integrating the GFEBS deployment with SBR discovery and evaluation visits, the Army will validate its business processes and quickly discover system or process deficiencies in the GFEBS environment. Along with performing discovery and evaluation site visits at GFEBS locations, the Army, jointly with the Defense Finance and Accounting Service (DFAS), is conducting discovery, evaluation, and testing for Civilian Pay, Military Pay, Financial Reporting, and Fund Balance with Treasury business processes. Any needed process changes or control modifications identified through the course of these site visits will become tasks in the Army FIP and, upon full completion of these corrective actions, the Army will conduct follow-up testing to ensure the corrective actions were implemented effectively and the controls are operating as expected.

The Army is applying lessons learned from organizations that are preparing for, currently undergoing, or have successfully completed a financial statement audit, including the Navy, U.S. Marine Corps (USMC), and U.S. Army Corps of Engineers (USACE). The Army has made significant progress toward SBR auditability with the discovery effort to date because of these lessons learned, including the focus on document retention requirements, importance of systems controls, and personnel training and development to sustain audit readiness.

Since the start of the discovery and evaluation effort, the Army has conducted site visits at the GFEBS Wave 1 locations – Forts Stewart, Jackson, and Benning. The site visit teams have documented budget execution and monitoring processes for budgetary and reimbursable authority (including allotments and suballotments), obligations, and disbursements. The discovery and evaluation teams identified risks, ineffective controls, and other barriers to audit readiness. Senior level resource managers are aware of the deficiencies and corrective actions required to enable an audit ready environment. The Army is identifying and correcting past practices that impede successful audits to include training gaps that are being filled with additional training.

The Army's first attempt at testing manual process controls at the GFEBS wave 1 sites uncovered the need for significant training at the installation level. Because of the stove-piped nature of the legacy business environment, many individuals did not understand how their role fit within Army business processes. In addition, because of the drastic change from legacy systems to the modern ERP, many individuals had not been trained in the use of GFEBS in support of audit readiness testing or audit requests, which require different processes than legacy day-to-day business processes.

After performing phase 1 testing at the GFEBS Wave 1 locations in August 2010, the Army created a GFEBS SBR Audit Handbook. During testing, the Army found GFEBS users had difficulty retrieving supporting documentation and information from GFEBS for audit requests. The OASA(FM&C) created the SBR Audit Handbook to provide procedures for installation resource management to respond to audit testing requirements. The Army conducted its second phase of testing for budget execution processes at the GFEBS Wave 1 locations from January 30 to February 11, 2011. The Audit Handbook allows installation staffs to more effectively support the retesting in February 2011.

During the retesting effort in February 2011, the Army continued to identify additional training requirements, some failed process controls and potential system changes that need to occur within GFEBS. As the discovery, evaluation, and testing activities expand to GFEBS Wave 2 locations, which includes 17 additional installations, the Army will develop a clearer picture of the magnitude of manual process control failures. In addition, the GFEBS information technology general and application controls assessment work underway will identify automated system controls that exist or need to be designed to address manual control failures.

The Army plans to assert audit readiness for the entire SBR by FY 2015. To ensure the SBR is audit ready by FY 2015, the Army will undergo four examinations in FY 2011 through FY 2014, conducted by an IPA. During FY 2011, the IPA examination will focus on business activity transacted by GFEBS deployment Wave 1 locations for the following business processes:

- Funds Receipt, Distribution, and Monitoring,
- Contracts executed in the Standard Procurement System (SPS),
- Temporary Duty (TDY) travel executed in the Defense Travel System (DTS),
- Permanent Change of Station (PCS) travel, and
- Reimbursable Transactions (inbound and outbound).

The FY 2012 IPA examination will cover the same scope as the first examination, but will also include additional processes based on the work performed at GFEBS deployment Wave 2 locations. The FY 2013 and FY 2014 IPA examinations will cover all Army General Fund business activity at all GFEBS locations. This progressive approach of mapping end-to-end business processes, identifying and testing controls, and conducting a series of independent examinations will enable the Army to produce an audit ready SBR in FY 2015.

Missed Milestones and Remedial Actions

The following identifies and describes missed milestones and actions taken or planned to meet the revised milestone.

Missed Milestone: Appropriations Received Validation

Original Milestone Date: Quarter 2 of FY 2011

Reason Milestone Was Missed: Delay in awarding IPA contract to perform the validation.

Impact on Achieving Auditability in 2017: None

Revised Milestone: Quarter 4 of FY 2011

Actions to Ensure Milestone Will Be Met: The IPA contract has been awarded.

Missed Milestone: GFEBS Wave 1 Assertion

Original Milestone Date: Quarter 1 of FY 2011

Reason Milestone Was Missed: Although not identified as a change in Figure II-3, the assertion for GFEBS Wave 1 locations was postponed one quarter because GAO issued a stop work order while the Army SBR and existence and completeness contract was under protest from October 12 to December 3, 2010. This change also postpones the completion of the validation by one quarter, as shown in Figure II-3.

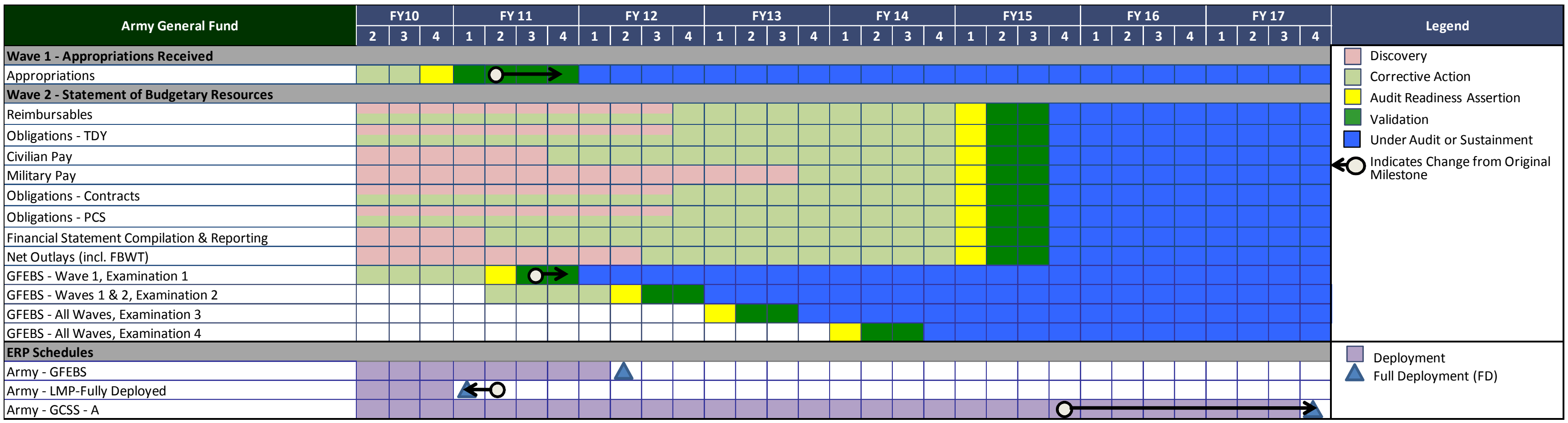
Impact on Achieving Auditability in FY 2017: None

Revised Milestone Date: Quarter 2 of FY 2011

Actions to Ensure Milestone Will Be Met: On January 3, 2011, the OASA(FM&C) held a kick-off meeting and quickly began site visits to the GFEBS Wave 1 sites – Forts Jackson, Stewart, and Benning – for controls retesting. After all GFEBS Wave 1 retesting is completed and the Army demonstrates that an effective control environment exists, the Army will hire an IPA to perform an examination of the Army Wave 1 sites.

Figure II-3 provides the Army's audit readiness milestones for the SBR and ERPs.

Figure II-3. Army SBR (Wave 1 and Wave 2) Audit Readiness and ERP Plans



Note to Figure II-3. Within Wave 2, for Reimbursables, Obligations – PCS, Obligations – TDY and Obligations – Contracts, the Army is conducting Discovery activity concurrently with Corrective actions.

Audit Ready Existence and Completeness of Assets (Wave 3)

The Army's status and plans for achieving the FIAR existence and completeness priority for Mission Critical Assets (i.e., Military Equipment, General Equipment, Real Property, Inventory, and Operating Materials and Supplies) is provided in this section. The OASA(FM&C) and Army G-4 prioritized the Army's initial existence and completeness efforts on Army installation general equipment and military equipment in coordination with OUSD(C) recommendations.

Military Equipment

The OASA(FM&C) and Army G-4 identified the military equipment assets for its initial existence and completeness efforts by first identifying primary sources of military equipment information, which include the following systems:

- Property Book Unit Supply Enhanced (PBUSE), the Army's accountable property system of record;
- Logistics Information Warehouse (LIW), which is the Army Chief Information Officer/G-6 designated authoritative repository for logistics information, and

- Capital Asset Management System – Military Equipment (CAMS-ME), previously used as a ME financial reporting system.

The specific military equipment assets identified for initial existence and completeness work are identified below. These initial assets were designated as “Quick Wins,” because they could be more quickly validated as audit ready.

- Apache AH-64A
- Apache Longbow AH-64D
- Aircraft Utility UC-35A
- CH-47F Improved Cargo Helicopter
- OH-58D Aerial Scout Helicopter
- Black Hawk Utility Helicopter UH-60L
- Black Hawk Utility Helicopter UH-60M
- UH-72A Light Utility Helicopter

The OASA(FM&C), Office of the Deputy Chief of Staff (DCS) of the Army, G-4 and DCS Army G-8 are coordinating to utilize the Army’s Equipment Readiness Codes (ERC) to identify the universe of Mission Critical Assets for the existence and completeness assertion by Quarter 1 of FY 2015. The Army will utilize current logistics and financial reporting systems to determine the universe of Mission Critical Assets. These systems are interim solutions until the ERPs are fully deployed and provide comprehensive accountability and financial accounting of Army asset records.

Beginning in March of 2010 and continuing today, the OASA(FM&C) is sending teams to installations to execute the existence and completeness effort. The Army existence and completeness approach incorporates initial site visits to Army installations and organizations maintaining “Quick Win” military equipment. At each installation visited, a complete physical inventory verification of Quick Win military equipment is conducted. The team members work with installation property book officers, hand receipt holders, and internal review staff to verify the serial numbers recorded in PBUSE for each capital asset are substantiated by proper documentation. Furthermore, any additional Quick Win asset found on the installation, but not recorded in the accountable property book, is documented for completeness.

The team members also traveled to Office of the Assistant Secretary of the Army (Acquisition, Logistics and Technology) (OASA(ALT)) – managed Program Executive Office and Program Management offices to gather supporting documentation for the existence and completeness effort. Official Army and DoD forms, such as DD Form 250, Material Inspection and Receiving Report, are used to verify receipt and acceptance of assets, especially in the case of deployed assets. The documentation supports future assertion efforts (e.g., valuation). In addition, existence and completeness teams conduct internal controls analysis, prepare process narratives, flowcharts, and control activities for the various military equipment asset lifecycle events; and execute test plans for military equipment assets for control activities found to be appropriately designed.

The results of the installation site visit are relayed to the installation personnel in a trip report. The trip report, after a quality review by OASA(FM&C), is delivered to the installation. This document provides insight on how prepared the installation is for an audit and recommends corrective actions to mitigate any issues.

In recent installation site reviews, teams have found:

- Military equipment assets without supporting documentation to validate financial reporting information,
- Inaccurate information recorded in data fields (e.g., acquisition date, nomenclature, serial number),
- Property book offices that have not been notified of procurement and receipt of new property on the installation,

- Hand receipt holders unable to locate property that they are custodians of,
- Property system functionality limitations, and
- Difficulty in verifying military equipment deployed in support of the Overseas Contingency Operations (OCO).

The Army is addressing these challenges. For example, alternative methods are being used to verify the existence of OCO deployed military equipment utilizing supporting documentation in lieu of physical inspection. In addition, top down guidance from Army leadership to the field in the form of memorandums and trip reports has communicated the drive for auditability as a high priority and has detailed how the Army plans to achieve the existence and completeness audit readiness initiative.

The Army asserted existence and completeness for military equipment Quick Wins on March 31, 2011. The OASA(FM&C) worked closely with the OUSD(C) and OUSD(AT&L) in advance of the assertion to ensure the Army presented the assertion materials in accordance with the OUSD(C) FIAR Guidance. The Army has expanded its existence and completeness effort to the full universe of military equipment assets. This supports the overall goal of achieving an unqualified audit opinion on the Army's financial statements by September 30, 2017.

General Equipment

Similar to military equipment, Quick Wins were identified for general equipment that could be asserted by Quarter 2 of FY 2011. The OASA(FM&C) and Army G-4 developed a list of Quick Win assessable units by first narrowing the focus to fire and rescue trucks and assets with an acquisition cost of $100,000 or above.

The Army's approach to confirming existence and completeness of general equipment aligns with the military equipment approach, described in the section above. The Army asserted existence and completeness of general equipment Quick Wins on March 31, 2011, and has expanded its existence and completeness effort to the full universe of general equipment assets. This approach supports the overall goal of achieving an unqualified audit opinion on the Army's financial statements by September 30, 2017.

Real Property

During FY 2011, the Office of the Assistant Chief of Staff Installation Management (OACSIM) continued performing real property audit readiness activities. The OACSIM site visit teams are performing real property inventories and have been working to implement the Army Real Property Handbook across Army installations. This handbook serves as a guide for installations and specifically outlines how to conduct real property physical inventories and provides asset folder requirements for supporting documentation.

The OASA(FM&C) is working with OACSIM to develop process flows, narratives, and risk and controls matrices. In addition, the OACSIM and OASA(FM&C) are planning follow-up visits in Quarters 3 and 4 of FY 2011 to evaluate progress, issues, and challenges. The OACSIM and OASA(FM&C) will also validate the effectiveness of real property process controls at the installation level and how the installations' adhere to the Real Property Audit Handbook requirements; assess their status against the Army's audit readiness objectives; and confirm the existence and accuracy of asset supporting documentation that will be required to support the upcoming real property assertion. This approach will result in an assertion for real property, to include existence, completeness, rights and obligations, and valuation, by December 31, 2012.

Inventory

The OASA(FM&C) is developing an approach for inventory audit readiness activities. The approach will emulate that of the other existence and completeness assets, closely follow the approach for Operating Materials and Supplies and be integrated with the Logistics Modernization Program (LMP), which is the Army Working Capital

Fund (AWCF) ERP system. The OASA(FM&C) is working closely with the Army Materiel Command (AMC) to finalize the inventory existence and completeness audit readiness plans, including site visits, along with the broader AWCF audit readiness strategy.

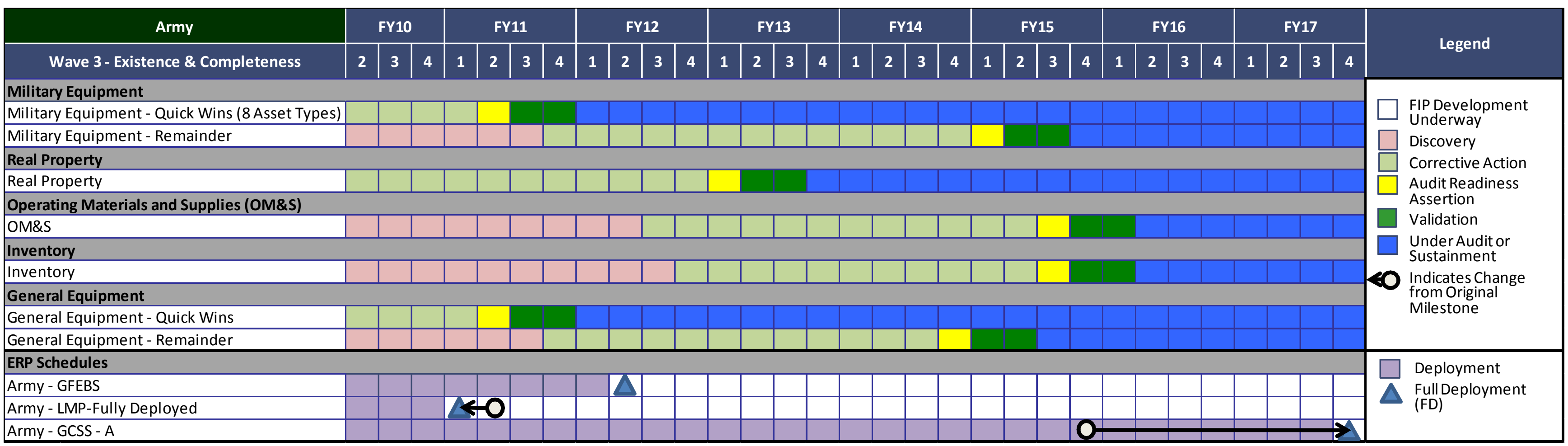
Operating Material and Supplies

The initial Operating Materials and Supplies (OM&S) approach is focused on Class V (ammunition), the largest asset class within OM&S. More specifically, the Army will focus on Quick Win assets, identified by the OASA(FM&C) in conjunction with Army G-4, that include the Hellfire, Javelin and TOW missile programs. These programs were selected because of their per capita high dollar value and the expected strength of existing internal controls in the asset management processes. The OASA(FM&C) produced notional process flows, narratives and internal control assessments for the production and transfer to storage of ammunition, cyclic stockpile inspections, long term storage, physical inventories, shipment preparation/transfer to user, receipt of shipment, re-warehousing and disposal of ammunition. The Army also identified the Quick Win environment by engaging and utilizing the National Level Ammunition Capability system, determined the scope of the Class V environment and built a notional site visit schedule.

Based on the compiled data, the OASA(FM&C) dispatched four field teams to conduct evaluation and discovery efforts. Site visits occur at the installation level. Additionally, site visit teams will perform existence and completeness validation efforts on the OM&S Quick Win assets.

Figure II-4 provides the Army's existence and completeness audit readiness plans and milestones.

Figure II-4. Army Existence and Completion (Wave 3) Audit Readiness and ERP Plans



Audit Readiness Environment Assessments

Army auditability is dependent on establishing an audit ready systems environment that includes successfully deploying Enterprise Resource Planning (ERP) systems and interfacing them with other business and financial systems. The Army ERPs are:

- General Fund Enterprise Business System (GFEBS)
- Logistics Modernization Program (LMP)
- Global Combat Support System – Army (GCSS-A)
- Integrated Personnel Pay System – Army (IPPS-A)

The GFEBS is the Army's General Fund current and future web-enabled accounting, asset management and financial system used to standardize, streamline and share critical data across the active Army, Army National Guard and Army Reserve. The deployment schedule for GFEBS will occur in eight waves to thousands of financial users across the globe. GFEBS will subsume over 80 legacy systems.

The LMP, Army Working Capital Fund ERP, delivers a suite of software and business processes that streamline the maintenance, repair and overhaul; and planning, finance, acquisition and supply of weapon systems, spare parts, services, and material to the Warfighter. Fundamental to the Army's transformation efforts, the LMP replaces a stove-piped legacy systems environment and enables the Army to leverage the power of precise, up to the minute, enterprise-wide data and improved business processes. The Army is finalizing a plan to begin Army Working Capital Fund and LMP discovery, evaluation, and testing audit readiness activities, similar to the Army General Fund and GFEBS activities, by early FY 2012.

The GCSS-A will integrate the Army supply chain, obtain accurate equipment readiness, support split base operations, and get up-to-date status on maintenance actions and supplies in support of the Warfighter. In January 2011, the U.S. Army Acquisition Support Center informed the OASA(FM&C) that GCSS-A would not be fully deployed to the Army until Quarter 4 of FY 2017, which is a change from the previous date of Quarter 4 of FY 2015. The GCSS-A fielding strategy was changed from the Army Force Generation (ARFORGEN) unit focused strategy to one of a two wave fielding and expanded the full fielding window from 42 to 72 months. This change eliminated the operational risk associated with having tactical formations in training and combat in a mixed logistics information system environment. It also allowed the program to remain within its current life cycle costs despite having a 28 percent increase in GCSS-A users driven by Army modularization.

The IPPS-A will be the Army's integrated pay system, replacing the legacy systems and serving as a critical piece of the Army's future state systems environment. The Army is revising the system development strategy and is working toward establishing a Milestone B decision date, originally scheduled for January 2011.

Audit Readiness Assessment of GFEBS

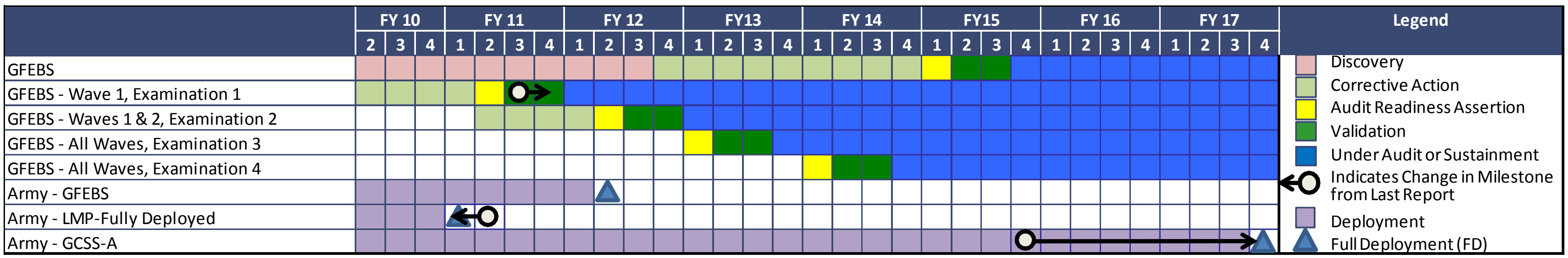
To assess and validate the Army's efforts to achieve audit readiness, the Army plans to contract with an IPA to conduct multiple interim audit readiness examinations at GFEBS sites beginning in FY 2011 and continuing until the General Fund SBR assertion in FY 2015. The Army SBR audit readiness strategy aligns evaluation and discovery activities with the GFEBS implementation schedule. Discovery and initial evaluation have been completed at GFEBS Wave 1 sites. Additional testing at the GFEBS Wave 1 and discovery at the GFEBS Wave 2 sites began in January 2011 and will continue throughout FY 2012.

With an audit readiness strategy centered around the GFEBS deployment schedule, the Army is able to document to-be processes, rather than the legacy environment, and leverage the information and documentation gathered in the early wave deployment schedule to train GFEBS users in the later part of the deployment schedule. In turn, the Army will better prepare GFEBS users to support audit readiness activities while implementing a standardized business environment that supports budget execution and annual audit requirements.

Army audit readiness activities also will include the assessment of information technology controls and compliance requirements. In January 2011, the Army audit readiness team began a comprehensive review of GFEBS against the Federal Information Systems Controls Audit Manual (FISCAM) and Federal Information Security Management Act (FISMA) requirements. The review addresses application security (access controls), automated business process controls, data integrity controls, and information technology general controls. The GFEBS has been implemented using the SAP Governance, Risk and Compliance Access Controls module allowing for a standardized access control framework.

Figure II-5 provides the Army's plans and milestones for assessing the audit readiness of GFEBS and ERP deployments.

Figure II-5. Army ERP and Audit Readiness and Environment Assessment (AREA) Plans



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III. DON Audit Readiness Plans

In previous versions of the FIAR Plan Status Report, Department of the Navy (DON) audit readiness plans were presented in separate sections by Wave. In this Report, all of DON plans to achieve audit readiness are presented and described in this section of the Report.

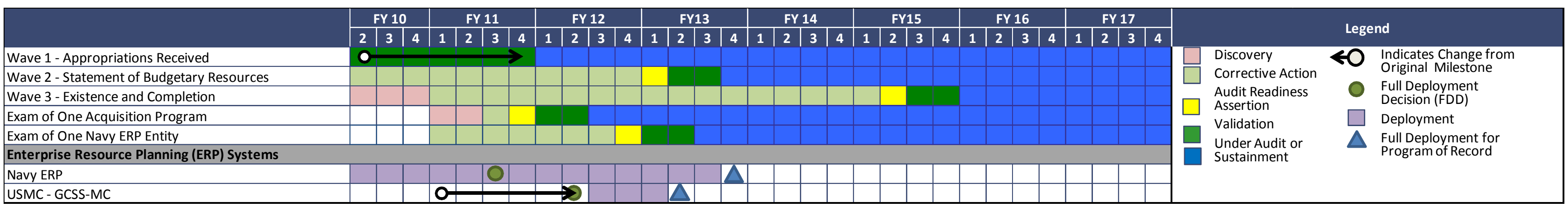
DON is focused on achieving the FIAR priorities – Budgetary Information and Mission Critical Asset Information. As shown in Figure III-1, DON is planning to assert audit readiness of its Statement of Budgetary Resources (SBR) in Quarter 1 of FY 2013. A significant portion of DON military equipment assets were asserted as audit ready for existence and completeness in FY 2010, and the remainder of its mission critical assets will be audit ready, incrementally by type of asset, through Quarter 2 of FY 2015.

A complete summary of DON audit readiness and ERP deployment plans is presented in Figure III-1.

Included in the following subsections are:

- DON FIAR Resources,
- Audit Readiness Status and Plans for Statement of Budgetary Resources (Wave 1 and Wave 2),
- Audit Readiness Status and Plans for Existence and Completeness of Mission Critical Assets (Wave 3), and
- Audit Readiness Validation of an Acquisition Program and Environment Assessments.

Figure III-1. DON Audit Readiness and ERP Plans



DON FIAR Resources

DON FIAR funding is categorized by the following areas: Audit Readiness, Audit Validation and Financial Systems Implementation/ Improvement. Each of these areas is explained below, and the amounts applied to each are presented in Figure III-2.

Audit Readiness includes the resources for evaluation, discovery and corrective actions of DON and its service providers (e.g., Defense Finance and Accounting Service [DFAS]) to include documenting and/or modifying processes and controls, identifying internal control deficiencies through testing and remediation of deficiencies, and evaluating transaction-level evidential matter and ensuring that it is readily available. Also included are the resources for activities to test or verify audit readiness after completing corrective actions and preparation of management assertion packages.

Audit/Validation includes the resources for validations, examinations and financial statement audits conducted by independent public accountants (IPAs).

Financial Systems includes the resources for designing and achieving an audit ready systems environment. This includes ERP deployment costs. It also includes the resources to make needed and cost effective changes to legacy systems that will be part of the audit ready systems environment. Financial System resources include: design, development, deployment, interfaces, data conversion and cleansing, system independent verification and validation and testing, implementation of controls and control testing, and system and process documentation.

Figure III-2. DON FIAR Resources ($ in Millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Audit Readiness	$ 52	$ 68	$ 66	$ 65	$ 63	$ 63	$ 62
Audit/Validation	-	13	15	15	17	17	17
Audit Readiness and Audit Subtotal	52	81	81	80	80	80	79
Financial Systems							
Non-Enterprise Resource Planning Systems (ERPs)	9	2	2	2	2	2	2
Navy ERP	206	232	206	135	112	126	142
Global Combat Support System - Marine Corps	113	138	92	94	97	83	45
Financial Systems Subtotal	328	372	300	231	211	211	189
Total Resources	$ 380	$ 453	$ 381	$ 311	$ 291	$ 291	$ 268

Audit Ready Statement of Budgetary Resources (Wave 1 & Wave 2)

DON continues to make progress in executing its audit readiness plan for its Statement of Budgetary Resources (SBR). DON is working toward achieving the goal of an audit readiness assertion on the combined Navy-Marine Corps SBR by December 31, 2012. In working toward this goal, DON has uncovered challenges that present risk to the assertion date; however, DON is working to mitigate the risk and maintain the assertion target date.

The U.S. Marine Corps (USMC), as a component of DON, has demonstrated leadership in improving its budgetary and other financial information. The FY 2010 audit of the USMC General Fund SBR concluded with a disclaimer of opinion rendered. The USMC FY 2011 SBR is presently being audited. DON has benefitted greatly from the USMC audit experience and has prioritized on several key tenets in preparing the overall DON for an SBR audit.

Appropriations Received (Wave 1)

DON asserted Appropriations Received as audit ready in FY 2009 and is scheduled to complete an examination by an IPA prior to the end of FY 2011.

Statement of Budgetary Resources (Wave 2)

The four tenets that comprise DON SBR Strategy are:

(1) Establish a strengthened array of standard internal controls over DON business processes;

(2) Establish repeatable capabilities that support a controlled financial environment including Fund Balance with Treasury (FBWT)

reconciliation and end-to-end traceability of transactions, demonstrated by supported balances and unadjusted-to-adjusted trial balance reconciliations;

(3) Establish an audit support infrastructure, emphasizing top-level knowledge and control of DON's financial data, as well as the ability to respond efficiently and effectively to an auditor's request for information; and

(4) Standardize business processes, using best-of-breed procedures in legacy environments and identical procedures among Navy ERP users. Standardization will lead to reduced cost in financial management overhead and stronger internal controls.

As the effort proceeds, these tenets have been integrated into DON SBR Plan. The plan components include:

- Establishing the transaction universe and reconciling unadjusted-to-adjusted trial balances,
- Evaluating business process audit readiness,
- Performing attribute sample testing,
- Establishing an audit response infrastructure, and
- Conducting examinations.

In one work stream, DON is establishing the transaction universe and reconciling unadjusted-to-adjusted trial balances. This effort will establish a financial statement audit trail, demonstrating reported financial statement values are supported by detailed transactions and validate the crosswalks used in the compilation of the financial statements. The most significant challenge in this area is DON's ability to provide a detailed transaction history from one of the legacy systems, Standardized Accounting and Reporting System – Field Level (STARS FL), which supports the trial balances fed to DON's financial reporting system, Defense Departmental Reporting System (DDRS). DON and DFAS are developing a solution to address this challenge. Collaboration with DFAS is critical to enabling success in this effort.

A second component of DON SBR Plan focuses on evaluating the audit readiness of key business processes. Business processes that materially impact the SBR include Appropriations Received, Military and Civilian Pay, Contracts, Reimbursables, Requisitions, Travel, and Financial Statement Compilation. The outcome of this component of the plan will be: documented DON business processes; an assessment of management reliance on internal controls associated with a business process, including IT controls assessment; an assessment of DON's ability to support financial transactions; and verification of key reconciliations for materially significant areas (i.e., FBWT, Military Pay, and Civilian Pay).

Business processes are being assessed to determine effectiveness in meeting key control objectives; controls are being enhanced to improve accuracy, timeliness and reliability of financial data and reduce the cost of re-working improperly-executed transactions. Where internal controls are lacking, statistical and non-statistical substantive procedures and other analyses are employed to evaluate the accuracy of the financial transactions. Currently, control weaknesses are prevalent in many of DON's business processes. Assessments of control effectiveness and financial statement impact associated with control weaknesses are ongoing and could require corrective action, where material, prior to DON SBR assertion. DON has identified significant weaknesses that it is focusing effort on correcting, including: lack of FBWT reconciliation, lack of military payroll transaction support, lack of reconciliation of unadjusted to adjusted trial balances in financial reporting, and unsupported bulk obligations for Permanent Change of Station travel.

A plan component complementary to the business process evaluations is attribute sample testing, which DON is currently conducting. In this effort, DON is sampling transactions from key SBR accounts and testing the Department's ability to provide supporting documentation for the transactions. This provides management with evidence, in conjunction with specific substantive evaluations performed in the business process analysis, to assess the accuracy of financial transactions underlying the SBR. This effort also provides DON an opportunity to exercise the process/capabilities required to respond to audit requests. DON has completed two rounds of attribute sample testing and has six additional rounds scheduled prior to DON's forecasted SBR assertion. Upon completion of each round, DON documents lessons learned and begins implementation of corrective actions, as required. To date, some of the specific challenges include the ability to: produce source documents supporting transactions in a timely manner, support transportation transactions, support permanent change of station travel prior to FY 2011, and support supply requisitions. Actions to address these challenges are underway.

A fourth element of DON SBR audit readiness plan is preparing for the audit itself. A key lesson learned through the USMC audit is the need for a robust and timely audit infrastructure to respond to auditor requests. Even if DON business processes and systems are ready for audit, the audit will not be successful unless DON commands, DFAS and other external service providers are ready to respond promptly to audit demands. DON is working to establish data management and communication structures, as well as tools to support the audit. The USMC has achieved this capability in the context of its SBR audit and DON is leveraging the USMC experience to build the audit infrastructure in the Navy's more extensive, complex environment.

Finally, DON will undergo examinations beginning with the Appropriations Received examination to further exercise the audit response infrastructure.

In summary, DON is proceeding in executing its SBR audit readiness plan. To emphasize the significance of financial improvement to DON, the Under Secretary of the Navy and Vice Chief of Naval Operations will require financial improvement goals in SES/Flag Officer FY 2012 performance objectives. Also, DON and its primary service provider, DFAS, have forged a strong partnership and together have made progress in moving closer to an audit ready state for key business processes and reconciliations. Additionally, the USMC SBR audit continues to move forward, providing significant insight and lessons that have led DON to enhance its overall SBR Audit Readiness Plan.

U.S. Marine Corps SBR Audit

The FY 2010 audit of the USMC SBR concluded with a disclaimer of opinion due to the complexities of the USMC operating and systems environment. Audit efforts concentrated primarily on validating beginning balance obligations across key budgetary general ledger accounts and information technology testing across three major systems. The lessons-learned and subsequent process enhancements demonstrate a continued and unwavering commitment to financial improvement and accountability.

Figure III-3 identifies in the first three columns auditor activity associated with testing and validation. The last column identifies USMC remediation activity to address the auditor's testing and validation findings. These activities are described within each focus area section of the figure.

Figure III-3. USMC FY 2010 SBR Audit and Remediation Activity

Focus Area	*Completed*	*Incomplete*	*Not Assessed*	*USMC Remediated*
1. Trial Balances and Reconciliations	**X**			**X**
Audit efforts focused on the validity of transaction-level details in relation to the unadjusted trial balance plus all adjusting journal entries and the resulting SBR statement compilation. The relationship of the core accounting system details to the general ledger that comprise each individual line item of the financial statement was scrutinized for accuracy, validity, cut-off, and completeness. This required the coordinated efforts of the USMC, DFAS, and Business Transformation Agency (BTA) in support of the auditors.				
2. Fund Balance with Treasury			**X**	**X**
Variances relating to disbursement inputs were identified and corrected. These resided outside the functional control of the USMC core accounting system and required additional reconciliation analyses between interface files originating with the Defense Cash Accountability System.				
3. Beginning Balances	**X**			**X**
Beginning balance testing consumed the majority of the audit timeline and USMC remediation focus. The audit concentrated on four key general ledger accounts impacting Undelivered and Delivered Orders and identified instances where procedural outputs and audit trail artifacts were not coincident with estimated and/or actual transaction balances. As a result, auditor assessment of focus areas outside of beginning balances was impacted. However, in order to address audit findings and recommendations associated with beginning balance testing, the USMC enacted comprehensive remediation and reform efforts that concluded prior to the end of the audit engagement. The DoD Inspector General along with its contracted IPA validated USMC corrective actions and concluded that a reasonable expectation of future success could be achieved given the efforts undertaken.				

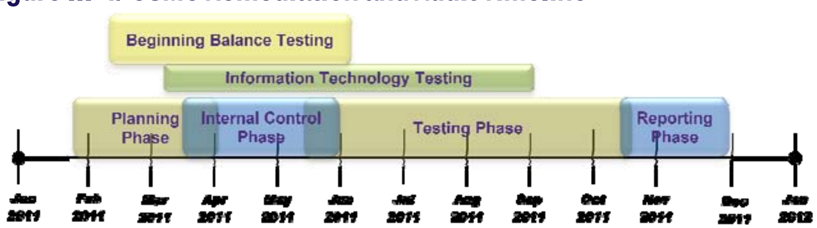
Focus Area	*Completed*	*Incomplete*	*Not Assessed*	*USMC Remediated*
4. Current Year Operations		**X**		
Audit efforts to assess transactions occurring in FY 2010 remained relatively inconclusive. The auditors assessed processes impacting Funds Receipt and Distribution, Recoveries of Prior Year Obligations, Transfers and Non-payroll Outlays. The auditors also performed a cursory review of Military Payroll (Active Duty), but did not render any conclusions or observations. Civilian Pay, Military Pay (Reserves) and Obligations Incurred (Non-pay) were not examined in FY 2010.				
5. Information Systems Testing		**X**		
The USMC business enterprise is an intertwined and interconnected environment of 26 principal systems and applications, many of which are owned and maintained by external service providers. In accordance with their responsibilities to assess compliance with laws and regulations such as the Federal Financial Management Improvement Act (FFMIA) of 1996, the auditors focused on the following three material systems: Standard Accounting, Budgeting and Reporting System; Defense Departmental Reporting System; and Marine Corps Total Force System. The results of these system assessments yielded findings and conclusions that will bolster internal control improvements and garner increased confidence in the accuracy and reliability of system outputs across the DoD.				

The lessons learned and subsequent process enhancements through remediation efforts demonstrate a continued and unwavering commitment to financial improvement and accountability. The USMC remains focused and resolute in its pursuit of a financial statement audit opinion and embraces its role as a catalyst in promoting audit readiness and sustainment across the DoD on behalf of DON.

Next Steps and Timeline

Auditor validation of USMC remediation efforts concluded with a notice from the DoD IG signaling approval for the FY 2011 General Fund SBR audit. Timelines and workflows are notionally depicted in Figure III-4 and represent a concerted effort to build upon the previous audits as consideration is given to scope and requirements familiarity on the part of auditor and auditee. There is a heightened sense of optimism that a financial statement audit opinion is achievable in FY 2011.

Figure III-4. USMC Remediation and Audit Timeline



Missed Milestones, Remedial Actions, and Other Changes

As shown in Figure III-5, there are three changes since the November 2010 Report to DON audit readiness plans for the initial FIAR priorities none of which impact DON plans to achieve an auditable SBR in FY 2013 or to overall auditability in FY 2017.

- Completion of an IPA examination of Appropriations Received was planned for Quarter 2 of FY 2010, but will now be completed in Quarter 4 of FY 2011 due to delays in awarding a contract to the IPA.
- DON submitted an audit readiness assertion for Civilian Pay as planned in Quarter 2 of FY 2010, but because additional corrective actions were required, DON now will reassert in Quarter 2 of FY 2012, and the IPA examination will be completed in Quarter 4 of FY 2012.
- DON submitted an audit readiness assertion for Transportation of People in Quarter 4 of FY 2010; however, additional corrective actions were required. Therefore, DON plans to complete the corrective actions in Quarter 4 of FY 2012 and assert complete SBR audit readiness, which will include Transportation of People in Quarter 1 of FY 2013.

Missed Milestones: Validations of Civilian Pay and Transportation of People

Original Milestone Dates: Quarter 4 of FY 2010 and Quarter 2 of FY 2011, respectively

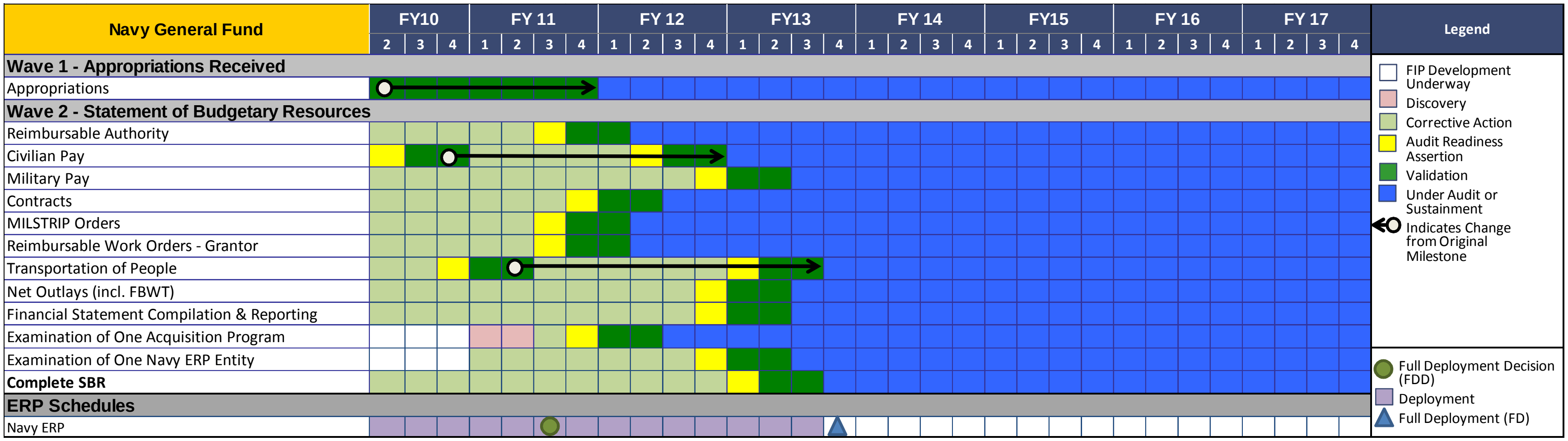
Reason Milestones Were Missed: Additional corrective actions were identified during the OUSD(C) review of assertions; therefore, the IPA examinations were not started.

Impact on Achieving Auditability in FY 2017: None

Revised Milestones: Quarter 4 of FY 2012 and Quarter 3 of FY 2013, respectively

Actions to Ensure Milestones Will Be Met: The revised milestones will be met as part of DON's overall audit readiness strategy and approach to achieving an auditable SBR in FY 2013, which is to evaluate and address deficiencies in SBR business and financial processes in segments or assessable units such as Civilian Pay and Transportation of People.

Figure III-5. DON SBR (Wave 1 & Wave 2) Audit Readiness Plans



Audit Ready Existence and Completeness of Assets (Wave 3)

In September 2010, DON completed existence and completeness assertions for five mission critical asset categories. These mission critical assets were targeted as “Quick Wins” because they typically have a relatively small inventory count with large dollar values, are centrally managed and are essential to DON mission. The existence and completeness assertions consisted of four assessable units of Military Equipment and one assessable unit of Operating Materials and Supplies (OM&S). The audit readiness assertions were submitted to the Office of the Under Secretary of Defense (Comptroller) in accordance with the planned milestone dates. DON accomplished the existence and completeness objectives through the cooperation of responsible operational personnel, achieving leadership buy-in and developing procedures to validate the existence and completeness of mission critical assets deployed around the world.

DON Approach to Existence and Completeness

DON approach to existence and completeness verification focused on three key areas, as described below:

- **Beginning Balances –** The beginning balances in the APSRs were evaluated through the review of previous audit reports, budget data, receipt documents, and spot checks based on publicly available information. Completeness checks were performed by reconciling property records with maintenance records, readiness reports, scheduling records, and movement and transfer records.
- **APSR Additions/Deletions** – The additions/deletions were evaluated based on process discussions with functional personnel. When the processes, risks and controls were documented, a sample was selected, and the asset was supported by visual inspection and source documentation provided by functional personnel. In addition, a 100 percent “virtual inventory” was performed using

maintenance records, readiness reports, scheduling records, and movement and transfer records.

- **APSR Inventory Controls/Procedures –** Inventory results were provided by operational personnel and assessed. In lieu of physical inventories, alternative procedures were employed to assess inventory accuracy. For example, DON utilized the Fleets' online scheduling system, WebSked, to verify the inventory of ships.

A "Test Procedures/Source Document Matrix" was completed for each existence and completeness asset class. This document aligns key control objectives for management assertions to specific test procedures and source documentation requirements. Additionally, this matrix provided a standard testing methodology across asset classes and accountable systems, and standardized the evaluation and reporting of results.

Because of the sensitive nature of mission critical assets, the support systems, documentation, and location of deployed assets were not always available to the validation teams. To address this issue, DON relied upon deployment/scheduling data, maintenance records and other supporting documentation to prove that the asset exists. These alternative procedures were verified through on-site testing of data elements and location codes to prove the accuracy of the data. In some cases, classified data files or source documents were provided to cleared personnel for review, as some assets were not available for visual inspection (e.g., submarines, satellites). Through unprecedented cooperation, functional personnel were often made available to discuss procedures, asset management policies, supporting systems, and data. This buy-in and cooperation was key to completing the existence and completeness audit assertions.

Military Equipment

- **Ships and Submarines –** Ships and Submarines are tracked in one accountable property system of record (APSR) – Naval Vessel Register. There are approximately 350 active in-service and in-commission ships and submarines, all of which are high dollar value mission critical assets. Because of their importance to the mission of the Navy, these assets are closely tracked and managed. Ships and submarines account for approximately $100 billion of the unaudited net book value (NBV) of General Property, Plant and Equipment (GPP&E) on DON Balance Sheet.
- **Aircraft –** Aircraft are accounted for in a single APSR – Aircraft Inventory Readiness and Reporting System. Like ships and submarines, there are relatively few aircraft (approximately 4,000), all of which are high-dollar value mission critical assets. DON Aircraft are closely tracked and managed, accounting for approximately $50 billion of the unaudited NBV of GPP&E on DON Balance Sheet.
- **Intercontinental Ballistic Missiles (ICBMs) –** Due to the relatively low number of Trident missiles (355), coupled with a rigorous internal control environment, these assets are tracked by a monthly inventory report and are not in an APSR. ICBMs account for approximately $6 billion of the unaudited NBV of GPP&E on DON Balance Sheet.
- **Satellites –** Satellites are tracked manually, but due to the small number of satellites (10) and mission critical nature of the assets, strong operational controls exist. Satellites account for approximately $132 million of the unaudited NBV of GPP&E on DON Balance Sheet.

During verification of the ME assertion, OUSD(C) recommended Navy review Aircraft and Ships status codes to ensure these assets are properly classified. Actions to address this issue are underway.

Operating Materials and Supplies

Ordnance – Ordnance is tracked in one APSR – Ordnance Information System (OIS). While there are a very large number of these assets, the mission critical nature of the asset requires strong internal controls over both access and use. DON assessed all Explosive Safety Inspections (ESIs) performed by the Naval Ordnance Safety and Security Activity (NOSSA) in FY 2010 at shore activities and also assessed all Conventional Ordnance Safety Reviews (COSRs) performed by NOSSA in FY 2010 on ships. The ESIs and COSRs included an assessment and formal report of each activity's controls over inventory accuracy. In addition, a Naval Audit Service report on the OIS noted that internal controls over accountability were strong. Ordnance accounts for approximately $31 billion of the unaudited Inventory and Related Property amount reported on DON Balance Sheet.

DON is now working additional assessable units in Military Equipment and Operating Materials and Supplies during FY 2011 and FY 2012 to include: Uninstalled Aircraft Engines, Crafts and Boats, and NAVSEA Sponsor Owned Material (SOM).

Inventory

Inventory consists of relatively high volume assets with varying dollar values. These items will primarily be tracked in the Navy ERP, except for ordnance, which is an assessable unit and tracked in the OIS. Key to DON strategy, therefore, is to align existence and completeness efforts consistent with deployment of Navy ERP, and re-baseline Inventory to ensure accuracy in the target environment.

General Equipment

General equipment is tracked in numerous local systems across a number of Navy commands. Although the Defense Property Accountability System (DPAS) records a significant number of assets, these local systems do not feed DPAS. Thus, the completeness assertion will be difficult to meet until either all general equipment is tracked in one APSR or all general equipment is uniquely identified to assure completeness of asset reporting without duplication. Due to the relative low acquisition value of these assets and the less critical nature when compared to other assessable units, general equipment will be assessed after completion of higher value military equipment assets.

Real Property

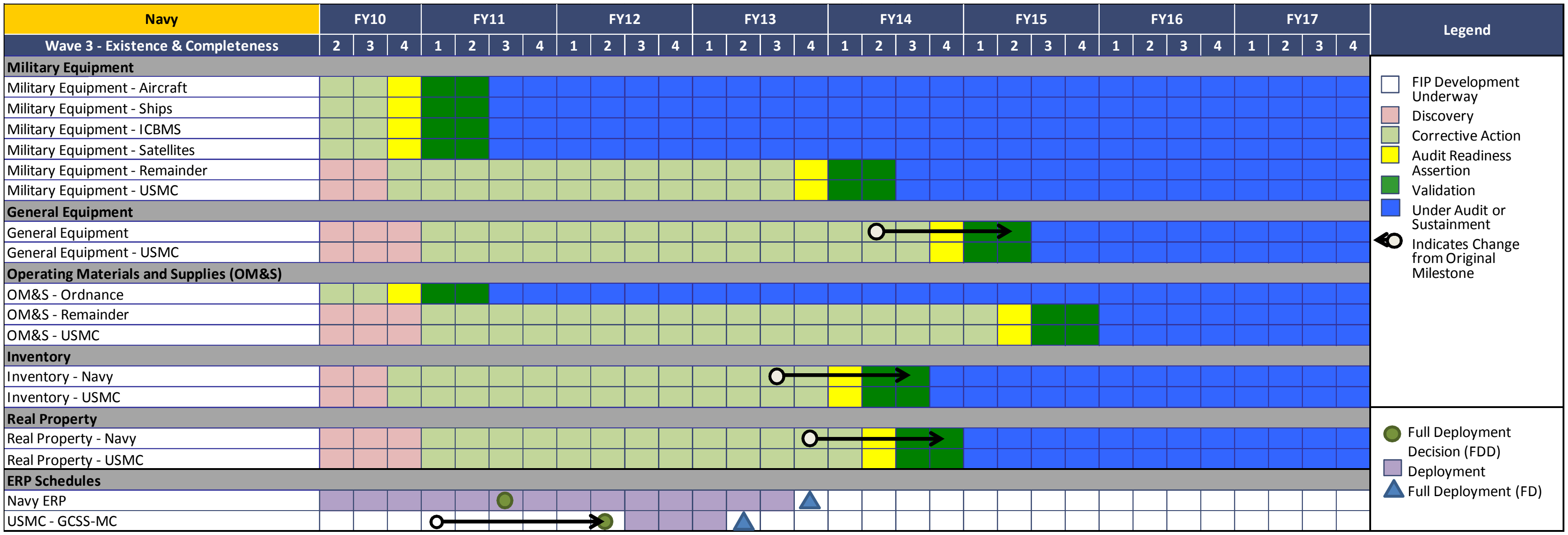
Real property is tracked in a single APSR – Internet Navy Facility Assets Data Store (iNFADS). Since DON is engaged in a full re-engineering of business processes to account for and value real property, DON will execute all real property management assertions (including valuation) together.

Missed Milestones and Remedial Actions

DON slipped by 12 months future milestones, including the overall audit readiness assertion dates, for General Equipment, Inventory, and Real Property. This 12 month slip is due to reprioritization of program resources to achieve the aggressive SBR schedule under Wave 2. DON continues to pursue select existence and completeness assessable units and plans to complete all asset evaluations in time for full auditability. There is no impact on achieving auditability by FY 2017.

DON existence and completeness (Wave 3) audit readiness and ERP plans are presented in Figure III-6.

Figure III-6. DON Existence and Completeness (Wave 3) Audit Readiness and ERP Plans



Audit Readiness Validation of an Acquisition Program and Environment Assessments

DON spends a significant amount of its annual resources on the acquisition of mission critical assets and weapons systems. Financial stewardship of acquisition program resources is critical to providing optimal capabilities for DON warfighters. Additionally, DON auditability is dependent on establishing an audit ready systems environment that includes successfully deploying Enterprise Resource Planning (ERP) systems and interfacing them with other business and financial systems. Navy ERP is the centerpiece of DON's target systems environment.

To assess these two critical components of DON audit readiness and to demonstrate progress, DON launched an effort to evaluate a Major Defense Acquisition Program within Navy ERP. The audit readiness milestones for this initiative are shown in Figure III-7 and III-8.

Audit Readiness Assessment of E-2D Advanced Hawkeye Acquisition Program

DON is conducting an effort to assess the financial stewardship of the E-2D Advanced Hawkeye acquisition program, while concurrently evaluating the Navy ERP business processes through which these funds are executed. DON is validating that the information related to the E-2D acquisition program reported on the DD Form 1002 (1002 Report), which provides a detailed summary of program execution to ensure funding levels are appropriate for all programs, is accurate. To evaluate the accuracy of financial transactions that underlie the 1002 report, DON, in coordination with DFAS and Defense Contract Management Agency (DCMA), is assessing the Navy ERP business processes and associated internal controls used to execute the funds. DON is also performing transaction testing of individual financial transactions to evaluate audit support for each transaction.

DON has gathered the transaction universe for the E-2D program for the period under review. The transaction universe was reconciled to the 1002 report and divided into business process areas. Approximately 95 percent of the funds for the E-2D program are placed on contract; therefore, much of the effort is focused on this business process and the use of Mechanization of Control Administration Services (MOCAS). DFAS Columbus, as the accounting activity for MOCAS, has performed a contract reconciliation for the E-2D contract universe to confirm the obligations and disbursements recorded in MOCAS and Navy ERP match and are supported by audit evidence. The reconciliation identified immaterial anomalies that were corrected. The other business processes under review are reimbursable work orders (grantor), travel, and supply purchases.

DON plans to complete its evaluation of the business processes by the end of May and address any findings prior to the end of August in preparation for a September 2011 management assertion. An IPA will conduct an audit readiness examination in FY 2012, as depicted in the milestones in Figures III-7 and III-8.

Figure III-7. DON Audit Readiness Validation of an Acquisition Program and Environment Assessment Plans

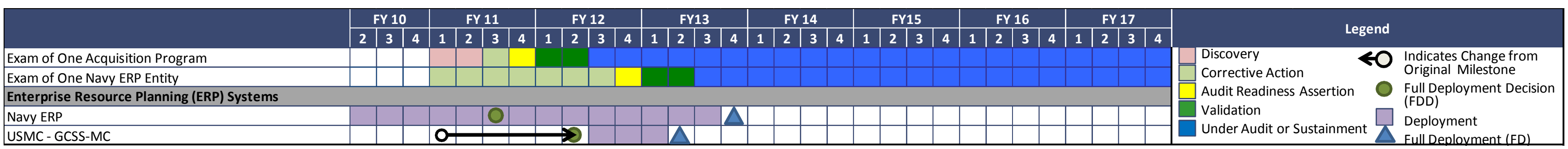


Figure III-8. DON Audit Readiness Validation Milestones for the E-2D Acquisition Program

Completion Date	Milestone Description	Responsible Entity	Status
November 15, 2010	Define scope of effort	Navy FMO	Complete
November 30, 2010	Define/gather transaction/data universe	NAVAIR	Complete
January 31, 2011	Document business processes and inherent risks to include contract reconciliation	Navy FMO, NAVAIR, DFAS, DCMA, DCAA	Complete
January 31, 2011	Identify control activities in place including contract reconciliation	Navy FMO, NAVAIR, DFAS, DCMA, DCAA	Complete
April 30, 2011	Perform dual purpose testing (substantive and control)	Navy FMO, NAVAIR, DFAS	On Schedule
August 30, 2011	Perform corrective actions based on results of testing	NAVAIR, DFAS	On Schedule
September 30, 2011	Audit Readiness Assertion	Navy FMO, NAVAIR	On Schedule
March 31, 2012	IPA Examination	IPA TBD	On Schedule

IV. Air Force Audit Readiness Plans

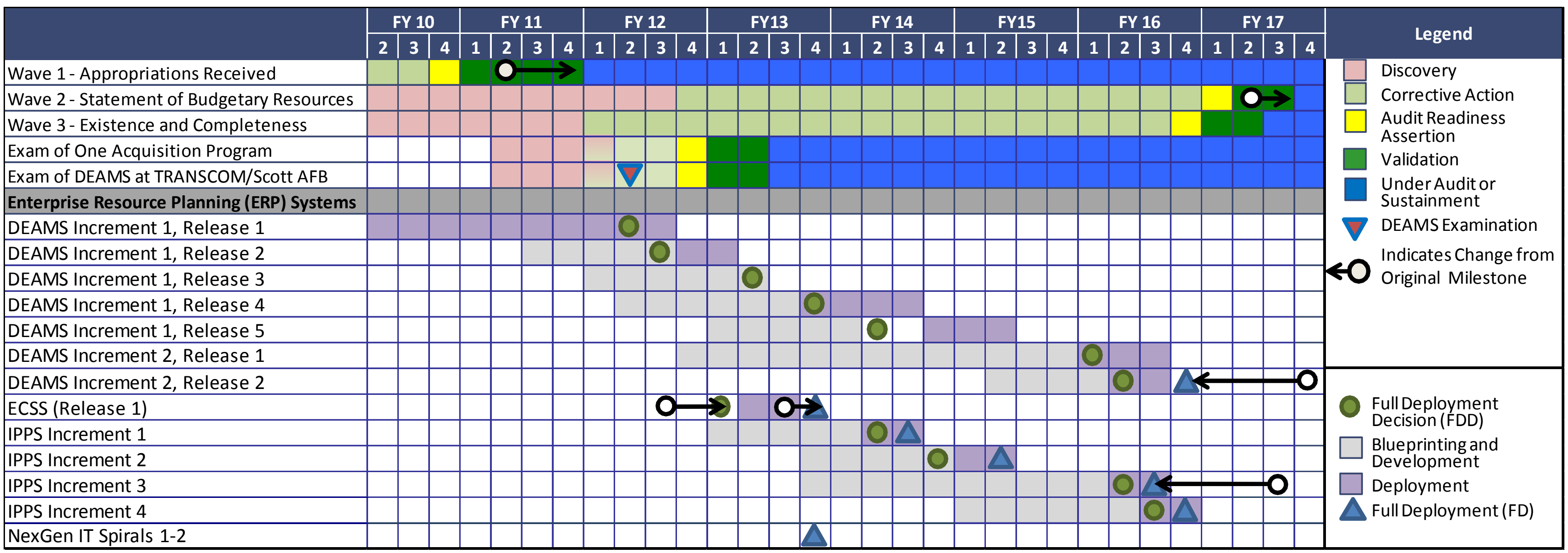
The Department of the Air Force ("Air Force") audit readiness plans were presented in separate sections by Wave in previous versions of this Report. In this Report, all of the Air Force plans to achieve audit readiness are presented and described in this section.

A summary of the Air Force audit readiness and Enterprise Resource Planning (ERP) systems deployment plans are presented in Figure IV-1. The changes to milestones identified in this figure are explained in subsequent subsections.

Included in the following subsections:

- Air Force FIAR Resources,
- Audit Readiness Status and Plans for Statement of Budgetary Resources (Wave 1 and Wave 2),
- Audit Readiness Status and Plans for Existence and Completeness of Mission Critical Assets (Wave 3),
- Audit Readiness Environment Assessments, and
- Audit Readiness Validation of an Acquisition Program.

Figure IV-1. Air Force Audit Readiness and ERP Plans



Air Force FIAR Resources

Air Force FIAR funding is categorized by the following areas: Audit Readiness, Audit Validation and Financial Systems Implementation/ Improvement. Each of these areas is explained below, and the amounts applied to each are presented in Figure IV-2.

The amount of resources applied to FIAR continues to evolve as the Air Force executes its Financial Improvement Plan, evaluates financial and business operations and systems, and engages the functional community. The amount of resources also is impacted by evaluation, testing, and corrective actions to achieve an audit ready systems environment outside the ERPs.

Audit Readiness includes the resources for evaluation, discovery, and corrective actions of the Air Force and its service providers (e.g., DFAS) to include documenting and/or modifying processes and controls, identifying internal control deficiencies through testing and remediation of deficiencies, and evaluating transaction-level evidential matter and ensuring that it is readily available. Also included are the resources for activities to test or verify audit readiness after completing corrective actions and preparation of management assertion packages.

Audit/Validation includes the resources for validations, examinations and financial statement audits conducted by an independent public accounting (IPA) firm.

The Air Force Audit Agency (AFAA) is also dedicating significant resources directly supporting the Air Force FIAR plan. The AFAA staff completed seven audits, is working on 13 and will start 17 additional audits directly supporting audit readiness. These include seven audits testing the existence and completeness of Operating Materials and Supplies (OM&S) supporting management assertions planned for June 2011. The AFAA also is auditing elements of Civilian Pay, identifying weaknesses, and developing recommendations to be incorporated in corrective action plans. The AFAA team members also are testing the Accounts Receivable process in the Defense Enterprise Accounting and Management System (DEAMS) helping to ensure the system supports audit readiness. Finally, the AFAA is conducting a Federal Information System Controls Audit Manual (FISCAM) audit of the Automated Funds Management system that supports Budget Authority and Funds Distribution audit readiness assertions.

Financial Systems includes the resources for designing and achieving an audit ready systems environment. This includes ERP deployment costs. It also includes the resources to make needed and cost effective changes to legacy systems that will be part of the audit ready systems environment. Financial System resources include: design, development, deployment, interfaces, data conversion and cleansing, system independent verification and validation and testing, implementation of controls and control testing, and system and process documentation.

Figure IV-2. Air Force FIAR Resources ($ in Millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Audit Readiness	$ 12	$ 33	$ 36	$ 37	$ 37	$ 37	$ 37
Audit/Validation		3	3	3			
Audit Readiness and Audit Subtotal	12	36	39	40	37	37	$ 37
Financial Systems							
Non-Enterprise Resource Planning Systems (ERPs)	70	73	77	70	59	57	45
Defense Enterprise Accounting Management System	87	68	138	138	144	155	115
Expeditionary Combat Support System	291	322	289	160	89	176	129
Integrated Pay and Personnel System	30	55	103	129	143	140	99
NexGen IT	-	19	13	19	21	22	29
Financial Systems Subtotal	478	537	620	516	456	550	417
Total Resources	$ 490	$ 573	$ 659	$ 556	$ 493	$ 587	$ 454

Audit Ready Statement of Budgetary Resources (Wave 1 & Wave 2)

The Air Force continues to employ a strategy to achieve audit readiness of the Statement of Budgetary Resources (SBR) that is focused on the life-cycle of appropriated funds. The Air Force, in coordination with Defense Finance and Accounting Service (DFAS), developed a methodology for audit readiness of the SBR focused around four assessable units that cover the fund receipt and distribution, obligation, outlays, reimbursement and reconciliation processes that ultimately impact all of the sections of the SBR.

Since the November 2010 FIAR Plan Status Report, the Air Force has made progress toward audit readiness of the SBR. On December 31, 2010, the Air Force asserted audit readiness of the Fund Balance with Treasury (FBWT) Reconciliation assessable unit. Reconciliation of FBWT is a critical first step toward auditability. However, the FBWT reconciliation process is only one control activity among many that will need to be assessed to support a full-scope assertion for the FBWT line-item. This limited scope assertion focuses on the crticial key reconciliation capability that the Air Force must demonstrate in order to assess the remaining control objectives for the FBWT line-item. The Air Force is consistently reconciling over 99.9 percent of FBWT at the detail level each month.

Appropriations Received (Wave 1)

The Air Force asserted the assessable unit of Budget Authority in Quarter 4 of FY 2010. The submission of the Budget Authority assertion affirmed that the internal controls over the reporting of the SBR line items of Appropriations Received, Non-Expenditure Transfers, Rescissions, as well as the Funds Distribution to Major Commands are designed and operating effectively to prevent or detect and correct material misstatements and the respective SBR line items are ready for validation.

Statement of Budgetary Resources (Wave 2)

With Wave 1, Appropriations Received, asserted as audit ready, the Air Force is focusing on the execution of Budgetary Resources and the Funds Distribution process to base-level entities, as noted in the "Status of Budgetary Resources," depicted in Figure IV-3. As discovery and evaluation are conducted, the Air Force expects to shift the assertion dates for these assessable units to the left (i.e., completion earlier than currently planned). However, as noted earlier, some milestone dates are dependent on the successful implementation of the Air Force ERPs. Therefore, any adjustments to the schedules of the Air Force ERPs may impact the milestones for Waves 2-5 of the FIAR Strategy.

The Air Force is making progress in the Reimbursements Assessable Unit, which is comprised of Spending Authority and the reimbursement life-cycle. In January 2011, the Air Force held a week-long workshop with subject matter experts from across the Air Force. Since this was the first workshop with Air Force-wide participation, it served two purposes. First, it helped educate field-level personnel on the requirements for audit readiness, and second, it provided a forum to discuss the reimbursement process and how and why certain organizations conduct the process differently. The information gathered, new contacts made and subsequent action items that were derived from the workshop may result in the acceleration of the assertion for Reimbursable Authority.

Air Force audit readiness of the SBR does not come without challenges. First and foremost, the Air Force does not have a transaction based general ledger or the ability to trace financial transactions from the business event to the financial statements and back. The problem is a direct result of a legacy accounting system based on 1960s accounting policies, processes, and procedures. The Air Force solution is a multi-pronged effort that includes the implementation of two ERPs, Defense Enterprise Accounting and Management System (DEAMS) and Expeditionary Combat Support System (ECSS), as well as instituting business process improvements. Currently, DEAMS is operational at Scott Air Force Base, and the Air Force plans to conduct interim audits to validate the effectiveness of the system and ability to address the key control objectives. Lessons learned and findings will result in corrective actions for the roll out of DEAMS and ECSS to the rest of the Air Force.

Missed Milestones, Remedial Actions, and Other Changes

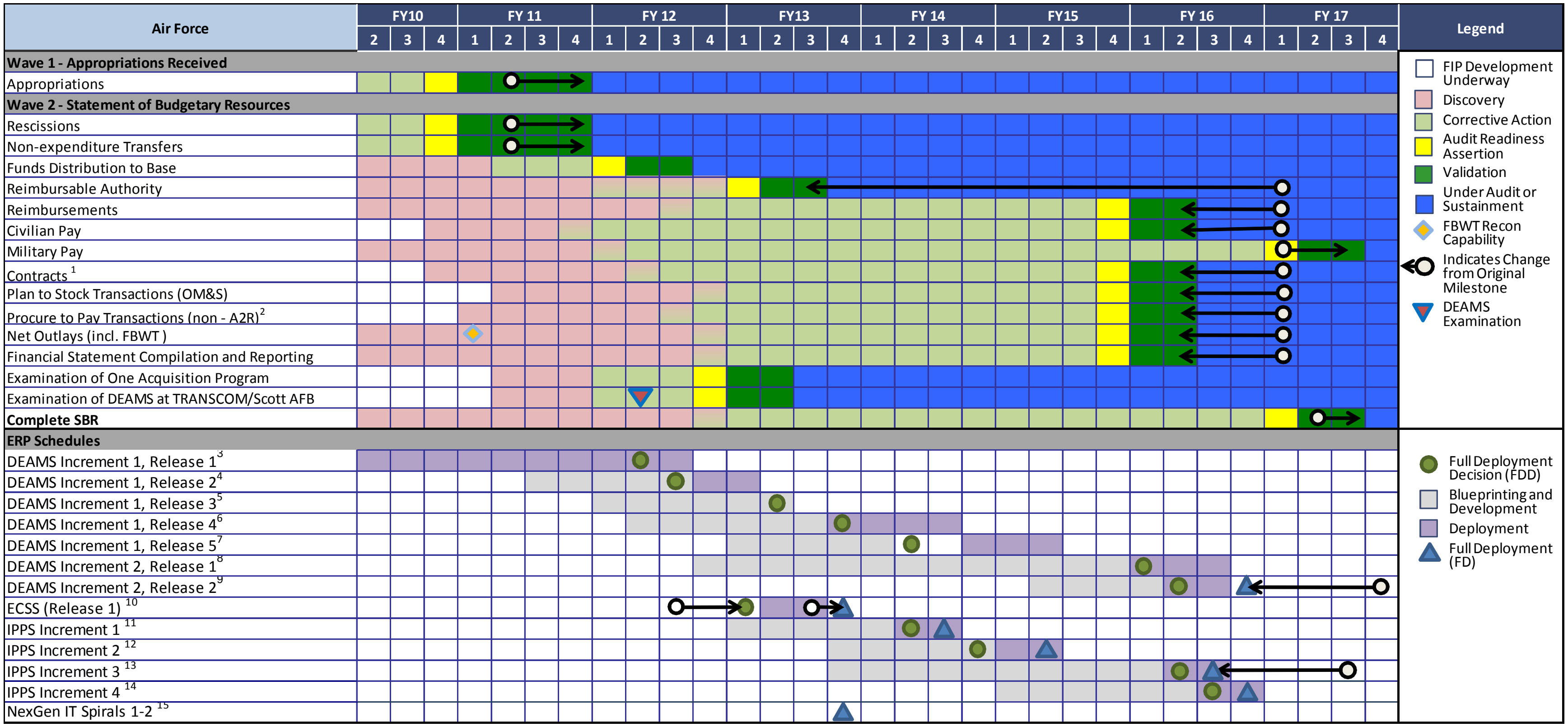
The Air Force has not missed any SBR audit readiness milestones.

As identified in Figure IV-3, seven audit readiness validation completion milestones for assessable units of the SBR were changed from Quarter 1 of FY 2017 to Quarter 2 of FY 2016. These changes were made because they are dependent on the Defense Enterprise Accounting Management System (DEAMS) deployment schedule, which changed since the November 2010 FIAR Plan Status Report. The changes were a direct result of implementing the Office of Management and Budget and Office of the Secretary of Defense Information Technology Acquisition reform policy and guidance. This allows the Air Force to deploy capabilities in small incremental releases and thus shorten the overall implementation time.

The Military Pay audit readiness validation completion milestone was postponed from Quarter 1 of FY 2017 to Quarter 3 of FY 2017. This change was made because audit readiness is dependent on the deployment of the Air Force Integrated Personnel and Pay System (IPPS).

The change to the Military Pay validation milestone impacted the overall audit readiness validation milestone of the Air Force SBR, as shown in Figure IV-3, which moved from Quarter 2 of FY 2016 to Quarter 3 of FY 2017.

Figure IV-3. Air Force SBR (Wave 1 and Wave 2) Audit Readiness and ERP Plans



[1] "Contracts" is an aggregation of Military Equipment, Real Property, General Equipment, and Other Assets (Acquire to Retire - A2R)
[2] Non - Acquire to Retire (A2R) transactions include things such as "Transportation of People", "Transportation of Things", "Rent", etc.
[3] DEAMS Increment 1, Release 1 - Baseline Stablization - Scott AFB and 6 AMC sites without TWCF (full functionality)
[4] DEAMS Increment 1, Release 2 - AMC with TWCF (full functionality)
[5] DEAMS Increment 1, Release 3 - USTC and SDDC (full functionality)
[6] DEAMS Increment 1, Release 4 - AF CONUS (full functionality)
[7] DEAMS Increment 1, Release 5 - PACAF and USAFE (full functionality)
[8] DEAMS Increment 2, Release 1 - AFSPC and AFMC (full functionality)
[9] DEAMS Increment 2, Release 2 - Foreign Military Sales and Contingent Operations
[10] ECSS Release 1 - Tools/Equipment/Vehicle Mgmt and Base-level Materiel Mgmt
Releases 2-4 being restructured for audit readiness impact
[11] IPPS Increment 1 - Leave for all
[12] IPPS Increment 2 - Cadets Personnel and Pay
[13] IPPS Increment 3 - Active/Guard/Reserve Officers Personnel and Pay
[14] IPPS Increment 4 - Active/Guard/Reserve Enlisted Personnel and Pay
[15] NexGenIT - There are 4 more spirals for full NexGen IT deployment

Audit Ready Existence and Completeness of Assets (Wave 3)

The Air Force continues to execute a consistent strategy to achieve existence and completeness audit readiness for mission critical assets, with a specific focus on the validation of physical inventory documentation. Each mission critical asset class is aligned to a single accountable property system of record (APSR). The strategy to align existence and completeness assertions to an APSR allows the Air Force to comply with Wave 3 existence and completeness audit readiness requirements while limiting the scope of existence and completeness audits to focus on a single system and all of the assets within that system. The Air Force is also leveraging existing existence and completeness field work performed by the AFAA to shorten the time required to draft primary assertion documentation and provide supporting physical inventory documentation and working papers.

The successful execution of the Air Force strategy for Wave 3 existence and completeness audit readiness, as well as other audit readiness initiatives, requires close coordination with Air Force functional staff throughout all Air Force Commands. Additionally, for full audit readiness of existence and completeness, the Air Force is dependent on four service providers and these dependencies are discussed in the individual mission critical asset sections.

- U.S. Army Corps of Engineers and Naval Facilities Engineering Command - execute military construction activities in support of the Air Force (approximately 95 percent of all military construction projects).
- Defense Logistics Agency – stores and manages inventory and supplies for the Air Force.
- U.S. Army – is the Single Manager for Conventional Ammunition and has DoD-wide acquisition/production responsibilities for conventional munitions.

Military Equipment

The Air Force submitted the military equipment assertion package in December 2010, asserting two sub-assessable units: Aerospace Vehicles and Externally Carried Pods. The existence and completeness assertion was supported by physical inventory testing of selected aircraft assets. The assertion of military equipment, based on FY 2010 values, covered 28.8 percent of the total assets reported on the Air Force Balance Sheet.

General Equipment

In FY 2010, during the update of the Air Force Annual Statement of Assurance, it was determined that Government Furnished Equipment (GFE), a sub-assessable unit of general equipment, needed to be reported as a material weakness. The Air Force developed a financial improvement plan for general equipment and initiated several efforts to improve the reporting of GFE. These efforts included publishing Air Force policy changes for capturing the value of GFE and identifying policy changes going forward that would need to be implemented to ensure that accountability of GFE is maintained in the future. In addition, the Air Force has been reconciling the value of GFE by weapons system contract to the values contained in the Contract Property Management System. When this effort is complete, the Air Force will populate and validate the data contained in the Air Force Equipment Management System.

Real Property

The Air Force completed a gap analysis between the current real property process documentation and assertion readiness requirements (based on Key Control Objective, Key Source Document and Data Element requirements) to determine the status of Air Force A-123 real property process documentation. The results of the gap analysis have provided the team with an understanding of whether additional process flows, narratives, and internal control assessments are needed to capture material process documentation for the real property lifecycle management. Additional process documentation will be developed in preparation for subsequent entity-level testing initiatives.

Inventory

The Air Force strategy for inventory is to focus resources on analysis of in-transit transactions. The Air Force has started several initiatives to validate the accuracy of the various inventory balances. The primary initiatives include physical inventory counts and in-transit inventory assessments. An analysis by each fiscal year indicates that inventory values meet materiality thresholds, but the internal controls over inventory quantities require continued analysis. The success of the physical inventory strategy is being examined as part of new Joint Service Physical Inventory Working Group. The inventory team has processed $4.1 billion in adjustments. A reinvigoration of the Inventory Integrated Process Team will continue during FY 2011 to support development of corrective actions.

Since the Defense Logistics Agency (DLA) stores and manages a material amount of the inventory and supplies for the Air Force, the DLA is an integral component of the Air Force audit readiness strategy for inventory existence and completeness. The DLA has and will continue to play a key role in the assessment of the key controls and control activities associated with inventory, the systems used in the process, and how information and documentation is shared.

Operating Materials and Supplies (OM&S)

The Air Force increased support with AFAA conducting inventory and control testing for the remaining scheduled existence and completeness assertions for OM&S. In conducting discovery and evaluation for the uninstalled missile motors sub-assessable unit, the Air Force encountered a challenge with the current physical inventory procedures. The Air Force functional communities conducted periodic inventories of the uninstalled missile motors, but the supporting documentation to prove the inventories and the status of the assets was not adequate for Air Force management to prove audit readiness. The Air Force developed corrective actions to improve inventory documentation and other deficiencies associated with uninstalled missile motors. In addition to uninstalled missile motors, corrective actions also were initiated for spare aircraft engines. The result of these corrective actions delayed the previous assertion dates for both areas until June 2011.

The Air Force scheduled sites visits to the Air Force bases that manage cruise missiles and drones to validate physical inventory counts. When existence and completeness process issues are identified during the discovery and evaluation, the Air Force is proactively developing and executing corrective action plans. This allows the Air Force to test the revised processes, thereby limiting the number of corrective actions contained in assertion packages.

A critical component of a successful assertion for existence and completeness audit readiness of OM&S is dependent upon the Army. The Army is the Single Manager for Conventional Ammunition and has DoD-wide acquisition/production responsibilities for conventional munitions. The Air Force will continue to work with the Army to ensure adequate documentation is available to support assertion of munitions (the largest component of Air Force OM&S by quantity).

Missed Milestones and Remedial Actions

The following identifies and describes missed milestones and actions taken or planned to meet the revised milestone.

Missed Milestone: OM&S Missile Motors Assertion

Original Milestone Date: Quarter 1 of FY 2011

Reason Milestone Was Missed: During Discovery and initial inventory testing, the Air Force identified a lack of adequate supporting documentation for physical inventories performed during FY 2009 and FY 2010. The resulting inventory procedural deficiencies required several corrective actions in order for Air Force management to assert audit readiness for missile motors. The AFAA conducted a physical inventory audit of missile motor March – April 2011.

Impact on Achieving Auditability in FY 2017: None

Revised Milestone Date: Quarter 3 of FY 2011

Actions to Ensure Milestone Will Be Met: Guidance has been revised for the retention of documentation supporting annual inventories and a complete physical inventory be performed during Quarter 2 of FY 2011.

Missed Milestone: OM&S Spare Engines

Original milestone Date: Quarter 2 of FY 2011

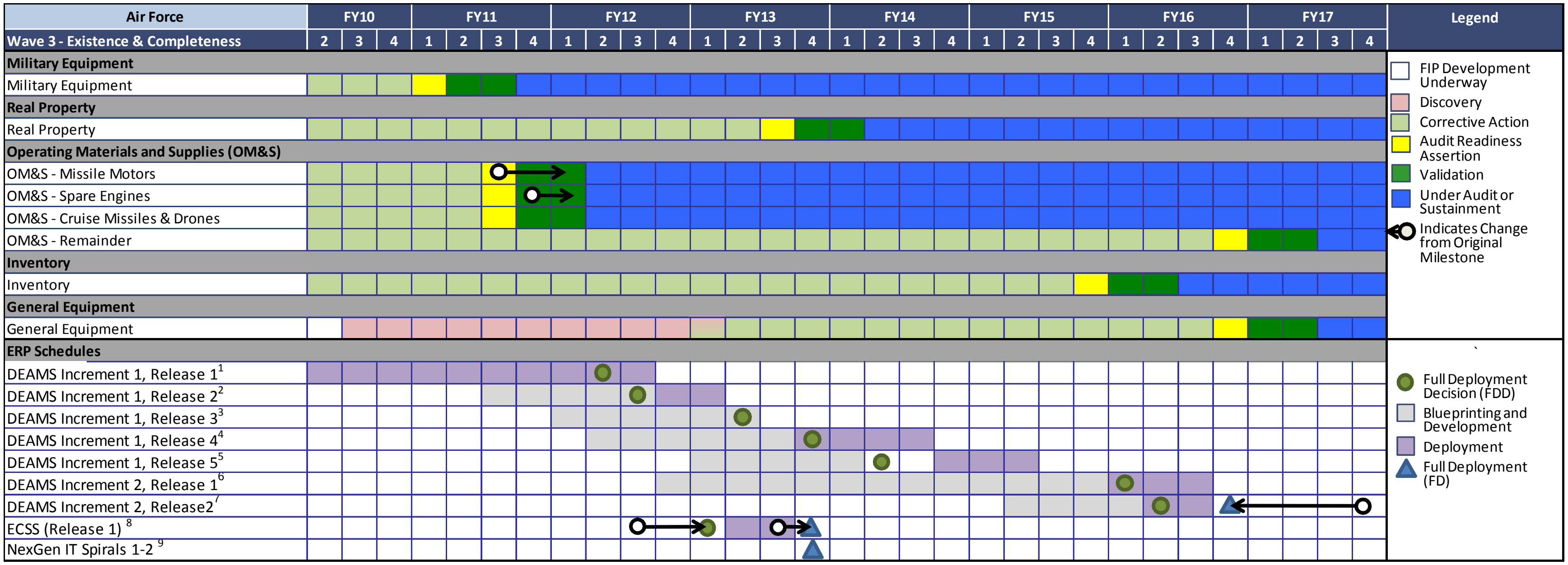
Reason Milestone Was Missed: The milestone was missed due to an Operational Readiness Exercise at Tinker Air Force Base (AFB), which caused a delay in the assertion team meeting with functional staff at Tinker AFB.

Impact on Achieving Auditability in FY 2017: None

Revised Milestone Date: Quarter 3 of FY 2011

Actions to Ensure Milestone Will Be Met: The Air Force Logistics Strategic Initiatives Branch (AF/A4LX) issued a memorandum to the program office for the Comprehensive Engine Management System and other logistics support personnel to request expedited support to the assertion team. The AF/A4LX memorandum requested support included, but was not limited to, development of key supporting documentation and physical inventory validation support. The AFAA is conducting a physical inventory audit of spare engines with results expected in Quarter 3 of FY 2011.

Figure IV-4. Air Force Existence and Completeness (Wave 3) Audit Readiness and ERP Plans



[1] DEAMS Increment 1, Release 1 - Baseline Stablization - Scott AFB and 6 AMC sites without TWCF (full functionality)

[2] DEAMS Increment 1, Release 2 - AMC with TWCF (full functionality)

[3] DEAMS Increment 1, Release 3 - USTC and SDDC (full functionality)

[4] DEAMS Increment 1, Release 4 - AF CONUS (full functionality)

[5] DEAMS Increment 1, Release 5 - PACAF and USAFE (full functionality)

[6] DEAMS Increment 2, Release 1 - AFSPC and AFMC (full functionality)

[7] DEAMS Increment 2, Release 2 - Foreign Military Sales and Contingent Operations

[8] ECSS Release 1 - Tools/Equipment/Vehicle Mgmt and Base-level Materiel Mgmt
Releases 2-4 being restructured for audit readiness impact

[9] NexGenIT - There are 4 more spirals for full NexGen IT deployment

Audit Readiness Environment Assessment

Air Force auditability is dependent on establishing an audit ready systems environment that includes successfully deploying Enterprise Resource Planning (ERP) systems and interfacing them with other business and financial systems. The Air Force ERPs are:

- Defense Enterprise Accounting and Management System (DEAMS)
- Expeditionary Combat Support System (ECSS)
- Air Force – Integrated Personnel Pay System (AF-IPPS)
- NexGenIT

The DEAMS is a joint Air Force and U.S. Transportation Command effort to establish a transaction-based general ledger, which will standardize and streamline processes, improve data quality, and form the foundation of Air Force auditability. The deployment schedule for the DEAMS is planned over two increments that will be released to Major Commands.

The ECSS is the Air Force's future logistics system that includes related financial management, engineering, and contracting functions. The ECSS enables the transformation of Air Force Logistics by replacing the majority of legacy logistics systems with a single solution set of business processes, software applications, and data. The ECSS solution will provide timely, consistent, and accurate information to enhance operations resulting in standardized business processes and tools across the entire enterprise, regardless of program or site. The ECSS will transform the way the Air Force does logistics and allow for the best possible support of the Warfighter. Release 1 of the ECSS includes Air Force-wide base vehicle and equipment management, materials management, and financial functions.

The AF-IPPS is the Air Force's future integrated personnel and pay system that will consolidate Guard, Reserve, and Active Duty Military into a single system for personnel and pay related services. The Air Force and DFAS are working together to ensure when AF-IPPS is implemented the system and processes support audit readiness of the Military Pay assessable unit of the SBR, as well as the other related lines within the Air Force Financial Statements.

The NexGenIT will leverage industry best practices, optimize core business processes, and replace existing information technology capabilities with a commercial off-the-shelf software solution to perform real estate portfolio and lease management, space management (moves, adds and changes), and maintenance management for real property throughout the Air Force.

Audit Readiness Assessments

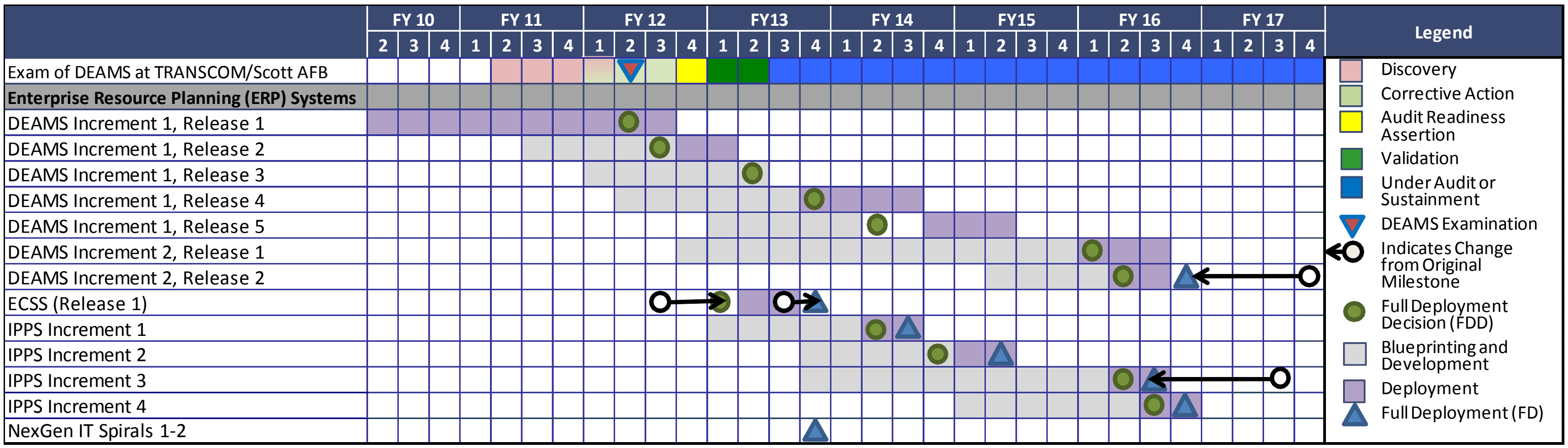
To prepare for the audit readiness assessment of the DEAMS at Scott AFB, the Air Force will focus its OMB A-123, Appendix A program on the financial reporting target environment for FY 2011. The Air Force will assess and test the internal controls implemented at Scott AFB within the DEAMS environment for the end-to-end processes of Order to Cash and Procure to Pay by September 2011. Corrective actions, if needed, will be completed prior to the broader deployment of the DEAMS throughout the Air Force.

In addition to the internal control assessment of the Procure to Pay and Order to Cash end-to-end business process, the AFAA team members also are testing the accounts receivable process in the DEAMS. Together these two assessments will give Air Force senior management an assessment of whether the DEAMS is operating as intended for those processes, if the process is audit ready, and if identified gaps or deficiencies require corrective action before full implementation throughout the entire Air Force.

Before the other ERPs reach the Full Deployment Decision milestone, the Air Force will conduct audit readiness assessments to determine whether the system will support audit readiness. Any gaps or deficiencies will be evaluated and corrective actions will be made to ensure the Air Force meets full audit readiness by Quarter 1 of FY 2017.

Figure IV-5 provides the milestones for assessing the audit readiness of DEAMS at Scott AFB and for deploying DEAMS, ECSS, IPPS, and NexGen IT.

Figure IV-5. Air Force Audit Readiness Environment Assessment and ERP Plans



Audit Readiness Validation of an Acquisition Program

The Air Force is committed to improve its acquisition processes and ensure that such processes are audit ready. In order to establish a benchmark for doing so, the Air Force will develop a plan and approach to assess the audit readiness of the Space Based Infrared System (SBIRS) program. The SBIRS program is a constellation of satellites in Geosynchronous Earth Orbit (GEO) and hosted payloads in Highly Elliptical Orbit (HEO) with an integrated centralized ground station serving all SBIRS space elements. The SBIRS program is a follow-on program to the existing Defense Support Program and a modern acquisition program that has readily available data and documentation. The Air Force believes that assessing this program will provide more benefits than to look at an older, existing major acquisition program, since any corrective actions can be made immediately and be tested almost simultaneously.

Figure IV-6 provides the milestones to assess, assert and audit the SBIRS program. Currently, the Air Force is in the process of defining the scope of the effort. When the scope is defined, it will be vetted with responsible entities to ensure that the milestones are aligned properly and the timeline is achievable.

The remainder of the approach for assessing the audit readiness of the SBIRS program will follow the process the Air Force follows for the current assessable units included in Waves 1 – 3 of the FIAR strategy.

Figure IV-6. Air Force Audit Readiness Validation Milestones for the SBIRS Acquisition Program

Completion Date	Milestone Description	Responsible Entity	Status
June 30, 2011	Define scope	SAF/FMPA	On Schedule
September 30, 2011	Define/gather transaction/data universe	SAF/FMPA, SAF/AQ, DFAS, AF/A4L	Not Started
December 31, 2011	Document business processes and inherent risks to include contract reconciliation	SAF/FMPA, SAF/AQ, DFAS, AF/A4L DCMA, DCAA	Not Started
January 31, 2012	Identify control activities in place including contract reconciliation	SAF/FMPA, SAF/AQ, DFAS, AF/A4L, DCMA, DCAA	Not Started
April 30, 2012	Perform dual purpose testing (substantive and control)	SAF/FMPA, DFAS, AF/A4L	Not Started
August 30, 2012	Perform corrective actions based on results of testing	SAF/FMPA, SAF/AQ, DFAS, AF/A4L	Not Started
September 30, 2012	Audit Readiness Assertion	SAF/FMPA, SAF/AQ, DFAS, AF/A4L	Not Started
March 31, 2013	IPA Examination	IPA TBD	Not Started

V. Other Defense Organizations Audit Readiness Plans

This section of the Report provides the status and plans of the Other Defense Organizations (ODOs). For purposes of the FIAR Plan, the ODOs include:

- U.S. Special Operations Command
- U.S. Transportation Command
- Defense Agencies
- DoD Field Activities
- Chemical Biological Defense Program
- Military Retirement Fund
- Medicare-Eligible Retiree Health Care Fund
- Other various organizations and accounts that receive DoD appropriated funds

Included in the ODOs is the Defense Logistics Agency (DLA), which is the largest Defense Agency. Because of DLA's size and impact on the audit readiness of the Department, a separate subsection following the other ODOs provides the DLA's audit readiness status and plans. Intelligence Community (IC) Defense Agencies are excluded from this Report, as accountability for IC Defense Agency audit readiness has been deferred to the Office of Director for National Intelligence (ODNI). Those agencies are following the IC audit readiness plan. The ODNI provides periodic status and progress updates on auditability to the Department and Congress.

Not all of the ODOs prepare annual financial statements. For those ODOs that do not prepare statements, their financial activity, assets and liabilities are included in the DoD Combined Financial Statements. Several of the ODOs that prepare annual financial statements have achieved unqualified audit opinions. They include:

- Defense Contract Audit Agency
- Defense Commissary Agency
- Defense Finance and Accounting Service
- Office of the Inspector General
- Military Retirement Fund

The ODOs that have not received opinions on their financial statements or on the amounts reported in the DoD Combined Financial Statements have prepared Financial Improvement Plans (FIPs) in accordance with the DoD FIAR Guidance and are working to achieve audit readiness on the FIAR priorities of:

- Budgetary information and
- Mission Critical Asset information.

The status and plans of the ODOs follow.

Audit Ready Statement of Budgetary Resources (Wave 1 & Wave 2)

To comply with the FIAR priorities, the ODOs that are not audit ready have expanded the scope of their OMB Circular A-123, Appendix A, Internal Control over Financial Reporting (ICOFR) efforts to achieve audit readiness with a focus first on improving budgetary information. These ODOs are documenting the processes, controls and systems that affect the SBR.

Utilizing an expanded scope of ICOFR documentation and audit remediation work already underway, several of the ODOs plan to assert audit readiness for Appropriations Received (Wave 1) by Quarter 4 of FY 2011. These assertions will be based on the current processes supported by the Program Budget Allocation System. Their financial improvement plans and audit readiness milestones are not expected to change as long as they do not encounter significant issues in converting to the Enterprise Funds Distribution System, which is currently being implemented.

The ODO milestones for achieving the objectives of Wave 1 and Wave 2 are presented in Figure V-1.

Appropriations Received [Wave 1]

The USD(C) established a priority for the larger (in SBR dollar value) ODOs to assert audit readiness of Appropriations Received (Wave 1) in FY 2011, because of their impact on the DoD SBR. These ODOs include TRICARE Management Activity (TMA), Service Medical Activity (SMA), Missile Defense Agency (MDA), and Defense Advanced Research Projects Agency (DARPA). MDA and DARPA are working to timely achieve the Wave 1 priority, and an independent public accountant (IPA) examination is planned in FY 2012. However, an IPA examination of TMA and SMA Appropriations Received will not be performed. Instead, TMA and SMA will focus on the overall SBR assertion, and when completed, an IPA examination will be performed.

Challenges

Both Wave 1, Appropriations Received assertion, and Wave 2, SBR assertion, are dependent on the ODOs being able to successfully negotiate a complicated accounting model. A few of the risks unique to the ODOs are described below.

The ODOs manage funds at a more detailed level than displayed in the current financial statement structure, and therefore, are pursuing financial systems and processes that allow for greater visibility to the underlying data. The Defense Agencies Initiative system (DAI), an Enterprise Resource Planning (ERP) system being deployed for the Defense Agencies, will improve the ODOs' ability to achieve and sustain auditable SBR balances. The ODOs have developed their FIPs to be consistent with the DAI implementation schedule and plans.

The ODO financial improvement efforts are hampered by the complexity of ODO transactions contained in various Military Department accounting systems, which are in the midst of transition to various ERPs. Other challenges the ODOs must address include system constraints that are due to allotments. The ODOs allot/sub-allot material amounts of their funding annually to the Military Departments. The transition to more auditable ERP systems plays a key role in being able to address these issues.

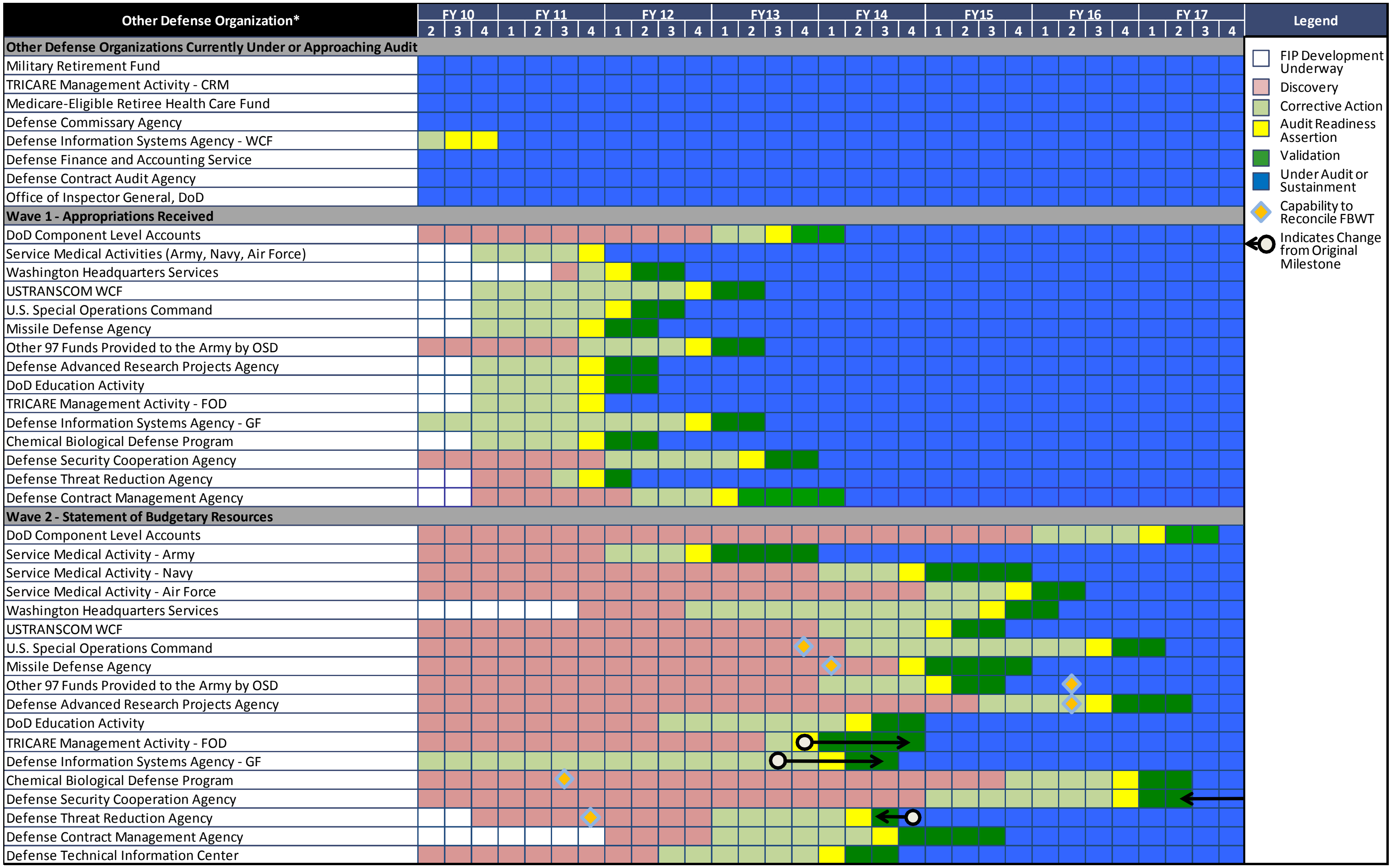
The greatest challenge ODOs face is due to the way they are structured for reporting purposes. Appropriated funding is not identified to the specific ODOs, but rather at the Treasury Account Fund Symbol (TAFS) level; consequently, the U.S. Treasury does not maintain fund balances for each ODO. The DFAS prepares a Cash Management Report (CMR) that provides individual ODO balances and reconciles to the overall ODOs Fund Balance with Treasury (FBWT). Sometimes, transactions are unidentified and must be researched before being reported to a specific ODO, which results in a timing delay before the transactions are reported in the CMR. There also can be other timing delays adding complexity to the ODO reporting process.

Another risk to the FBWT is the necessity to use accounting adjustments when recording funding transactions due to the unique reporting structure of the Defense Agencies. The end-to-end funding process is shared with OUSD(C), adding additional complexity to a reporting structure.

Missed Milestones and Remedial Actions

The ODOs have not missed any audit readiness milestones. Five milestones were changed since they were originally reported, as shown in Figure V-1; however, the changes do not impact DoD audit readiness by September 30, 2017.

Figure V-1. Other Defense Organizations SBR (Wave 1 & Wave 2) Audit Readiness Plans



* All material ODOs (with the exception of DLA and Intelligence Agencies) are presented in this table.

Audit Ready Mission Critical Assets

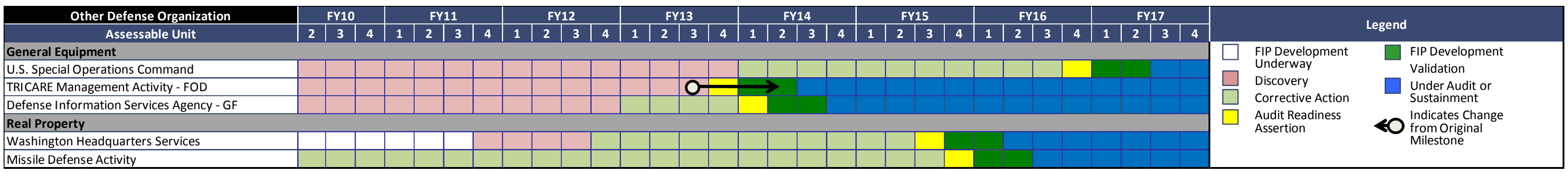
The ODOs that have a material dollar value of mission critical assets are actively working to achieve the priority to improve mission critical asset information by preparing for existence and completeness audits. These ODOs are:

- U.S. Special Operations Command,
- Defense Information Services Agency,
- Missile Defense Agency,
- TRICARE Management Activity, and
- Washington Headquarters Services.

The approach these ODOs are taking is similar to the approach they are using to improve budgetary information, where they are capitalizing on their OMB Circular A-123, Appendix A, work to document processes, risks, controls and systems and to perform corrective actions, as needed, to resolve deficiencies and strengthen controls.

The ODO milestones for achieving the mission critical asset existence and completeness priority are provided in Figure V-2.

Figure V-2. Other Defense Organizations Existence and Completeness (Wave 3) Audit Readiness Plans



Defense Logistics Agency

The Defense Logistics Agency (DLA) approach to audit readiness has evolved over the past few years from strictly a financial line item approach to a comprehensive enterprise business approach. The initial approach was Balance Sheet and line item focused with primarily DLA Headquarters financial personnel attempting to prepare the Agency for audit. While the approach made progress in the financial areas, the DLA recognized that as a Working Capital Fund (WCF) "business," its business processes, with controls performed outside of the finance organization, drive the financial transactions and results, and therefore, its audit readiness. Coupled with the size and complexity of DLA (millions of business transactions monthly in eight major supply chains), and the integration of its business and financial system in an Enterprise Resource Planning (ERP) system, it became clear that the engagement of the entire enterprise was required to achieve sustainable audit readiness.

The DLA "Stewardship Excellence" approach, while focused on enabling operational excellence, builds the foundation for financial excellence and sustainable audit readiness. Using the DoD Business Enterprise Architecture as the starting point, the DLA identified and aligned all of its business processes into ten end-to-end business cycles, each "owned" by a senior executive at the DLA Headquarters. Business Cycle Teams (BCTs) were created to support each of the Enterprise Business Cycle Owners. The BCTs are cross functional teams comprised of business area and financial personnel from Headquarters, Field Activities, internal audit and Defense Finance and Accounting Service (DFAS), as well as independent public accountant (IPA) audit advisory support. The DLA modified approach also incorporates an understanding of how auditors approach the financial statement audit of a commercial business.

Each Enterprise Business Cycle encompasses all processes performed within the cycle, regardless of the type of funds (WCF or General Fund), with differentiation identified where needed. In addition to the Enterprise Business System (EBS), the DLA ERP, the DLA business cycles are supported by over 140 DLA and non-DLA automated systems, adding to the complexity of ensuring process and data controls are effective.

To support this approach, the DLA established and published Standards and Criteria outlining the expected capabilities that enable operational excellence and achieve audit readiness. This enabled a consistent and comprehensive enterprise approach to assessing the status of each business cycle. The BCT's assess the policies, processes, controls, data, systems, and human capital associated with the business events within the business cycle against the Standards and Criteria, identifying deficiencies and taking corrective action.

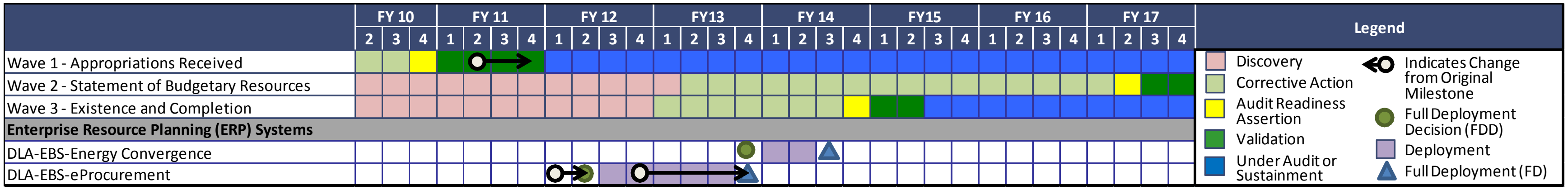
Through improvements to business processes, controls and documentation within these cycles and their supporting systems, the DLA can reduce process variation and improve data integrity and transparency from the point of origin, improving the information available for decision making and financial reporting. This operational or "business" emphasis enables DLA, as a combat support agency, to strongly support the warfighter while also preparing for audit.

In previous versions of this Report, the DLA audit readiness plans were presented in separate sections by Wave. In this report, all of the DLA plans to achieve audit readiness are presented and described in this section of the Report. A complete summary of the DLA audit readiness and ERP deployment plans is presented in Figure V-3.

Included in the following subsections are:

- DLA FIAR Resources,
- Statement of Budgetary Resources (Wave 1 and Wave 2), and
- Existence and Completeness of Assets (Wave 3).

Figure V-3. DLA Audit Readiness and ERP Plans



DLA FIAR Resources

The DLA has used its FIAR funding to obtain knowledgeable contracted support to assist with developing its overall audit readiness strategy as well as to assist DLA in performing specific activities of the discovery and corrective action phases. An IPA was contracted by DLA to provide guidance and support to the Agency in its work in understanding and preparing for a financial statement audit, to include both the operational and the financial portions of the process. The IPA assisted in:

- Familiarization with the audit process and practice; development of guidance and templates for documentation;
- Review of processes, preparation of process flows and process documentation and identification of process areas requiring corrective action;
- Review of select systems following the Federal Information System Controls Audit Manual (FISCAM) guidance, focusing on controls with impact on the financial statements; and
- Performance of the annual OMB Circular A-123 Appendix A, Internal Controls Over Financial Reporting (ICOFR) testing.

The DLA also funded DFAS efforts to define, document and test the processes it performs in support of the DLA. The financial systems reflect funding for Common Food Management System (CFMS), EBS and improvement of documentation for DLA-owned systems, and improvement of DLA-owned system documentation. The CFMS will replace the Military Services' legacy food management systems with a single system. The EBS is the DLA integrated Enterprise Resource Program (ERP) system.

In the future, funding will be used in a similar manner – performing corrective actions, creating and validating process and system documentation and system reviews. As the DLA moves closer to asserting audit readiness, funding will shift toward contracted support to assist the DLA in validating its audit readiness, and eventually to performing audits of the asserted business cycles.

DLA funding is categorized by Audit Readiness, Audit/Validation, and Financial Systems Implementation/Improvement. Each of these areas is explained below, and the amounts applied to each are presented in Figure V-4.

Audit Readiness includes the resources for evaluation, discovery and corrective actions of the DLA and its service providers (e.g. DFAS) to include documenting and/or modifying processes and controls, identifying internal control deficiencies through testing and remediation of deficiencies and evaluating transaction-level evidential matter and ensuring that it is readily available. Also included are the resources for activities to test or verify audit readiness after completing corrective actions and preparation of management assertions.

Audit/Validation includes the resources for validations, examinations and financial statement audits conducted by IPAs.

Financial Systems includes the resources for designing and achieving an audit ready systems environment. This includes ERP deployment costs. It also includes the resources to make needed and cost effective changes to legacy systems that will be part of the audit ready systems environment. Financial System resources include: design, development, deployment, interfaces, data conversion and cleansing, system independent verification and validation and testing, implementation of controls and control testing, and system and process documentation.

Figure V-4. DLA FIAR Resources ($ in Millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Audit Readiness	$ 25	$ 28	$ 44	$ 39	$ 40	$ 40	40
Audit/Validation	-	-	-	-	-	-	-
Audit Readiness and Audit Subtotal	25	28	44	39	40	40	40
Financial Systems							
Non-Enterprise Resource Planning Systems (ERPs)	39	47	34	36	26	18	18
ERPs	90	96	109	110	112	114	114
Financial Systems Subtotal	129	143	143	146	138	132	132
Total Resources	$ 154	$ 171	$ 187	$ 185	$ 178	$ 172	$ 172

Audit Ready Statement of Budgetary Resources (Wave 1 & Wave 2)

As of July 2010, DLA completed substantial discovery for the end to end business cycles associated with the SBR. While discovery tasks still remain and continue to be accomplished, the outcome is that key capabilities identified in the Standards and Criteria have been assessed as effective or deficient. Where key capabilities were assessed to be effective, the controls and processes are incorporated into the annual ICOFR testing activities. Where deficiencies were uncovered, detailed corrective action plans have been developed and responsibilities for actions assigned, resulting in significant changes to the DLA Financial Improvement Plans (FIPs) beyond the first Wave.

The DLA is also reliant upon key Service Providers in order to assert audit readiness; one of these is DFAS. The DLA is closely partnering with DFAS to assess the business processes, controls and documentation for the DFAS activities that support DLA business cycles. The testing of internal controls related to these DFAS processes is incorporated into DLA's annual ICOFR activities. The DFAS has identified the various systems that support the processes it performs in support of DLA and has incorporated them into process flows and documentation.

Other key DLA Service Providers include:

- Defense Information Systems Agency (DISA) – DISA is responsible for the processes and controls within their computing centers which house key DLA systems.

- U.S. Army Corps of Engineers (USACE) – USACE executes military construction activities in support of DLA. The dependency includes the systems and processes USACE uses to perform the support.
- Naval Facilities Engineering Command (NAVFAC) – NAVFAC executes military construction activities in support of DLA. The dependency includes the systems and processes NAVFAC uses to perform the support.

Appropriations Received (Wave 1)

The DLA asserted audit readiness at the end of FY 2010 for Wave 1, Appropriations Received, in accordance with the FIAR Guidance and priorities. The DLA assertion was limited to the processes and controls from the point of receiving a funding document from the OUSD(C), the accurate recording in DLA's financial/reporting systems, through funds distribution to the internal DLA execution level. As part of Defense-Wide Treasury Index 97 appropriation, which includes many other Defense Agencies, the DLA is dependent upon the OUSD(C) for the controls and processes that link the funding documents provided to DLA to the enabling legislation. Those controls and processes must be in place and working properly in order for the Department to assert audit readiness of Defense-Wide Appropriations Received.

The OUSD(C) is reviewing the DLA audit readiness assertion. DLA provided clarification and additional documentation as requested by the reviewers. In the meantime, DLA continues to update its process documentation and prepare for additional testing in accordance with OMB Circular A-123.

Statement of Budgetary Resources (Wave 2)

The Statement of Budgetary Resources (SBR) encompasses the DLA business cycles (and assessable units) of Budget to Execute, Fund Balance with Treasury (FBWT), Hire to Retire, Order to Cash, Procure to Pay and Record to Report. In addition, the DLA Technical Infrastructure and Architecture BCT supports all BCTs by assessing the policies, process, controls, data, systems, and human capital involved in the end-to-end IT Lifecycle Management of DLA owned systems. DLA's ERP, EBS, is key in the support of this wave. The EBS-Energy Convergence and EBS-eProcurment programs are extending and improving the EBS. The EBS-Energy Convergence program is extending the ERP to the Energy business area, which accounts for approximately 40 percent of DLA's WCF sales and is the final DLA supply chain to be incorporated. This moves Energy off of legacy systems which is a key component in the audit readiness for all of the business cycles involved in the SBR. The EBS-eProcurement program is replacing the legacy DLA Pre-Award Contracting System (DPACS) procurement system, with a procurement module that is integrated with the ERP. This primarily impacts the audit readiness of the Procure to Pay business cycle, but has implications for the Budget to Execute, Funds Balance with Treasury, and Order to Cash cycles as well. Currently, the DLA is completing the remainder of its Discovery actions and will complete the majority of the work in 2Q FY 2012. As DLA completes work on the Discovery and corrective action phases, it will identify material segments of a business cycle as checkpoints to ensure progress is being made and move DLA towards assertion of the entire business cycle.

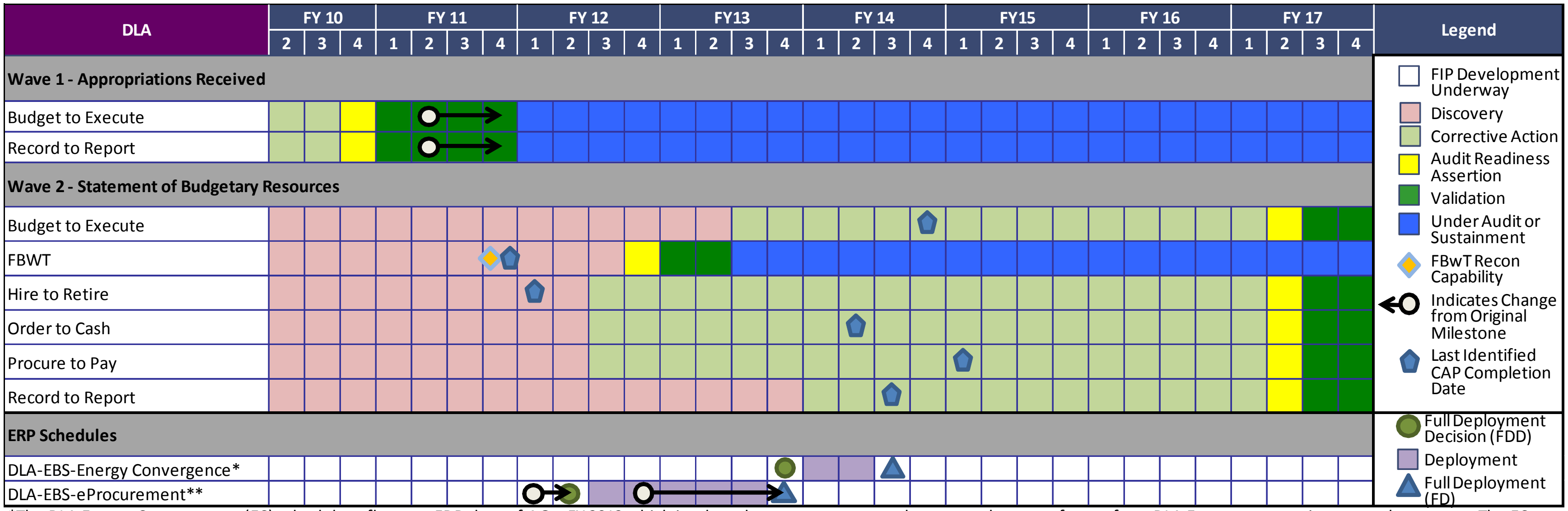
Due to the strong relationship between FBWT and the SBR, DLA has fully engaged its key service provider, DFAS, in preparing this business cycle for audit readiness. The DLA and DFAS have developed a strategy to be able to assert FBWT at the end of FY 2012. Despite the numerous challenges, such as the ability to retrieve transaction data and the corresponding impact on reconciliations, DLA continues to strive forward. The DLA and DFAS continuously review and assess the FBWT strategy to ensure that efforts remain on schedule to accomplish audit readiness. Over time, their efforts have resulted in a decrease in DLA's undistributed amounts.

The DLA is currently focusing on development and/or verification of process documentation in all of its business cycles. Through Process Cycle Memorandums (PCMs), the DLA is documenting its business processes, to include the systems utilized, the controls within the process, as well as the financial impacts of the processes. The PCMs are the foundation upon which internal control test plans are developed to assess the design and effectiveness of the manual and automated controls within the process. The DLA has over 150 PCMs identified to date. To ensure the accuracy of the documentation, the DLA utilizes subject matter experts in DLA, as well as DFAS, to document/update the process. Once the PCM is completed, the DLA performs a walkthrough of the process to ensure what was documented is what is actually happening. Examples of this activity are the work that the H2R BCT has done on documenting the Manage Payroll process. Subject matter experts were brought together to document/validate the process and the manual and automated internal controls identified in the PCM. The P2P BCT is another example. They performed a self assessment of 15 manual controls in DLA Disposition Services and DLA Distribution and are currently assessing the results of the testing.

Missed Milestones and Remedial Actions

Wave 1 validation milestones were moved from Quarter 2 to Quarter 4 of FY 2011 due to additional corrective actions resulting from the OUSD(C) assertion review and the additional time required to award a contract to an IPA.

Figure V-5. DLA SBR (Wave 1 & Wave 2) Audit Readiness and ERP Plans



*The DLA Energy Convergence (EC) schedule reflects an FDD date of 4 Qtr FY 2013 which is when the program expects the preponderance of users from DLA Energy community to use the system. The EC program may update the schedule upon completion of the System Requirement Review (SRR), when the program requirements would be approved. The SRR for EC is scheduled for March, 2011.
**The EProcurement Program revised its implementation strategy to a single increment with multiple releases. The multiple releases will be limited fielding implementations with a single MS C. This shifted the Full Deployment Decision and Full Deployment to the right. The change provided a better alignment with EProcurement and BRAC 2005 (Supply, Storage, & Distribution) and reduced overall program risks.

Notes to Figure V-5. While Figure V-5 displays distinct phases for discovery and corrective action, both activities are occurring simultaneously during the time period. The DLA completed substantial discovery in July 2010, which established the universe of tasks/actions required to enable the DLA to assert audit readiness. Within this universe of tasks/actions, the DLA identified gaps in discovery efforts, which require additional discovery work, and deficiencies that require corrective action plans.

Completion of the additional discovery work is expected by Quarter 2 of FY 2012. Due to the additional discovery efforts required, the DLA conservatively displays assertion occurring for most assessable units as Quarter 2 of FY 2017. At this time, there are detailed corrective actions identified for all of the SBR accessible units. The last completion date for the identified corrective actions is Quarter 1 of FY 2015 which includes individual validation of the effectiveness of the corrective action by the DLA Accountability Office. The DLA assumes a one year internal validation period to ensure a business cycle is ready for assertion; therefore, the latest assertion date, given the current corrective action plans, would be Quarter 1 of FY 2016. These dates may change after discovery work is completed.

As the DLA completes work on the Discovery and Corrective Action phases, it will identify material segments of a business cycle as checkpoints to display in future FIAR Plan Status Reports to show interim progress as the DLA moves toward assertion of the entire business cycle.

Audit Ready Existence and Completeness of Assets (Wave 3)

The DLA strategy and approach, as described in the introduction to this section, also are applicable to Wave 3. The DLA has completed substantial discovery activity for the end-to-end business cycles associated with the existence and completeness of mission critical assets. While some discovery tasks still remain to be accomplished, key capabilities identified in the DLA Standards and Criteria have been assessed as effective or deficient. When key capabilities are assessed as effective, the controls and processes are incorporated into the annual OMB Circular A-123, Appendix A, Internal Controls Over Financial Reporting (ICOFR) activities. When deficiencies were uncovered, detailed corrective action plans have been developed and responsibilities for actions assigned, resulting in significant changes in the DLA Financial Improvement Plans (FIPs). The FIPs reflect the guidance provided by the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) regarding timeframes for completion of General Equipment and Real Property tasks.

Substantial discovery also identified key service providers that the DLA is reliant on to assert audit readiness for this wave:

- Defense Information Systems Agency (DISA) – DISA is responsible for the processes and controls within their computing centers which house key DLA systems.
- U.S. Army Corps of Engineers (USACE) – USACE executes military construction activities for the DLA. The dependency includes the systems and processes the USACE uses to support the DLA.
- Naval Facilities Engineering Command (NAVFAC) – NAVFAC executes military construction activities for the DLA. The dependency includes the systems and processes NAVFAC uses in support of the DLA.

The DLA identified specific business cycles impacting Wave 3 and the tracking and accounting for mission critical assets as follows:

- Plan to Stock (P2S) and
- Acquire to Retire (A2R).

The assessable units and their associated business cycles that the DLA identified for Wave 3 are:

- General Equipment (A2R),
- Real Property (A2R), and
- Inventory (P2S).

Since the DLA ERP, EBS, is an integrated system, it incorporates the processes and accounting for the Wave 3 assessable units. The EBS-Energy Convergence program will extend EBS and the associated processes and accounting for inventory and general equipment to the DLA energy (e.g., aircraft fuels) supply activities. The EBS-eProcurement program impacts the contracting processes involved in obtaining inventory and general equipment. The DLA is incorporating lessons learned from its system and process discovery efforts to improve the documentation of EBS, to include documentation of the capabilities that will be developed during these programs.

General Equipment

The DLA's general equipment is only reported in the Defense Working Capital Fund (DCWF). The General Fund does not include transaction activity associated with general equipment assets. General equipment assets are capitalized when an asset has a useful life of two or more years and the acquisition cost equals or exceeds the capitalization threshold of $100,000. The DLA continues to develop training, policies and standard operating procedures to improve current business practices.

Real Property

In accordance with Title 10 United States Code, Chapter 159, Section 2682, the DLA does not own real property. All real property reported in the DLA financial statements is under the jurisdiction of a Military Department designated by the Secretary of Defense.

The DLA General Fund reported real property assets consist of only construction in progress (CIP). The DLA allocates resources to the U.S. Army Corps of Engineers and Naval Facilities Engineering Command to manage and execute construction projects. These agencies maintain CIP accounts for each construction project and are responsible for facilitating the transfer of completed assets to the applicable real property account. Upon completion of the newly constructed asset or improvement, the acquisition/construction costs that meet the $20,000 capitalization threshold are transferred to the real property account of the DWCF.

The DLA continues to develop training, policies and standard operating procedures to improve current real property practices. Since the November 2010 FIAR Status Report, the DLA has performed Navy and Air Force real property reconciliation visits, Chief Financial Officers Act (CFOA) Audit assistance visits to Army host sites and the U.S. Army Corps of Engineers Real Property Inventory and Condition Assessments Pilot. The results of the reviews will improve the accuracy of DLA real property records and help to accomplish audit readiness.

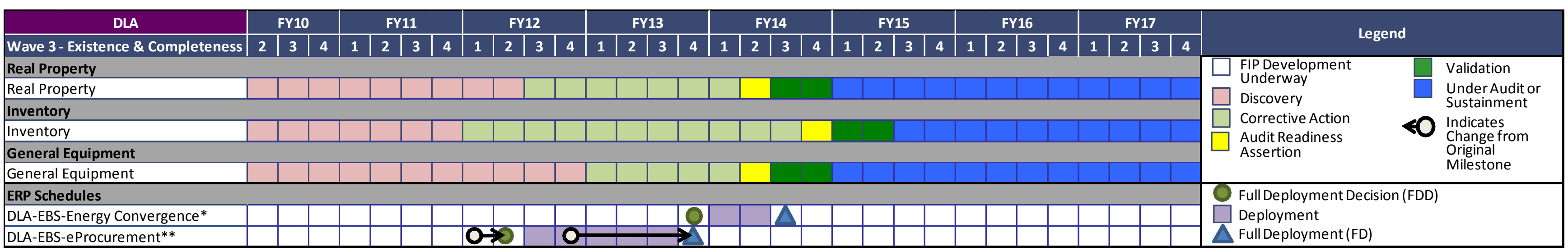
Inventory

The DLA is the integrated material manager for assigned federal supply classes. The DLA holds materiel based on military and authorized customer needs and in support of contingency operations. Inventory spans the DLA supply chains and contains a diverse variety of consumables, and consumable spare and repair parts. The DLA inventory continues to make progress as it completes the remainder of the discovery phase and is well on its way to meeting the established goals in the November 2010 FIAR Plan. Currently, the DLA is working to improve the inventory reconciliation processes at locations with vendor managed inventories, sites managing inventory outside of the Distribution Standard System, which is the DLA authoritative source of inventory quantity and in-transit inventory information.

Missed Milestones and Remedial Actions

The DLA has not missed any existence and completeness audit readiness milestones.

Figure V-6. DLA Existence and Completeness (Wave 3) Audit Readiness Plans



*The DLA Energy Convergence (EC) schedule reflects an FDD date of 4 Qtr FY 2013 which is when the program expects the preponderance of users from DLA Energy community to use the system. The EC program may update the schedule upon completion of the System Requirement Review (SRR), when the program requirements would be approved. The SRR for EC is scheduled for March, 2011.

**The EProcurement Program revised its implementation strategy to a single increment with multiple releases. The multiple releases will be limited fielding implementations with a single MS C. This shifted the Full Deployment Decision and Full Deployment to the right. The change provided a better alignment with EProcurement and BRAC 2005 (Supply, Storage, & Distribution) and reduced overall program risks.

VI. Audit Readiness Progress Metrics

Monitoring DoD Component progress and holding them accountable is essential to success and to achieving the Department's commitment to audit readiness by September 30, 2017. The FIAR governance process employs four types of metrics to monitor progress, as follows:

- Percentage of the Statement of Budgetary Resources (SBR) Validated as Audit Ready,
- Percentage of Mission Critical Assets Validated as Audit Ready,
- Key Control Objectives and Key Supporting Documentation, and
- Operational Improvements Impacting Budgetary Information and Mission Critical Asset Information.

An explanation of each type of metric follows.

Percentage of the SBR Validated as Audit Ready

The percentage of the SBR validated as audit ready provides an overall, high-level measure of the Department's status and goals for achieving the audit readiness of the DoD SBR. DoD Component level information is maintained by the Department and used internally.

Percentage of Mission Critical Assets Validated as Audit Ready

The percentage of mission critical assets validated as audit ready provides an overall, high-level measure of the Department's status and goals for achieving mission critical asset existence and completeness audit readiness. DoD Component level information is maintained by the Department and used internally.

Key Control Objectives and Key Supporting Documentation

Key Control Objectives and Key Supporting Documentation metrics measure progress in achieving audit readiness by tracking the Components' assessment of the Key Control Objectives and Key Supporting Documentation and determining their effectiveness. In other words, these metrics track progress in achieving the end-state outcome of auditability and a strong internal control program that ensures business and financial transactions are timely and accurately recorded and supported by transaction level documentation.

Operational Improvements Impacting Budgetary Information and Mission Critical Asset Information

Operational Improvement metrics measure improvements to business and financial operations that have a direct relationship to budgetary information and the SBR and to mission critical asset information. The metrics either measure outcomes of better budgeting and asset management information (e.g., Abnormal Fund Balances, Inventory Release Denial Rates) or measure progress improvements needed to achieve better budgetary and mission critical asset information.

The above audit readiness progress metrics are provided separately in the remainder of this section of the Report.

PERCENTAGE OF SBR VALIDATED AS AUDIT READY

Figure VI-1 provides the Department's SBR audit readiness status and goals to be accomplished by the end of FY 2012, as well as achieving auditability of the Fund Balance with Treasury (FBWT) line of the Balance Sheet. Achieving FBWT audit readiness is essential to preparing for SBR audits.

As shown in Figure VI-1, 80 percent of the Appropriations Received line of the SBR will be validated through independent public accountant (IPA) examinations as audit ready in FY 2011, and 14 percent of the DoD Combined SBR will be validated as audit ready in FY 2011. These percentages may change for FY 2012 as the Other Defense Organizations continue refining their FIAR work plans and achieve progress.

The percentages in Figure VI-1 are based on the total reported amounts on the Department's FY 2009 financial statements. The significant percentage increase for SBR Appropriations Received Audit Ready from FY 2009 to FY 2010 is for the audit of the U.S. Marine Corps SBR.

Figure VI-1. SBR Priority Status and Interim Goals

	FY 2009	FY 2010	FY 2011	FY 2012
SBR Appropriations Received Audit Ready	19%	53%	80%	83%
SBR Audit Ready	13%	14%	14%	14%
FBWT Audit Ready	7%	8%	9%	9%

PERCENTAGE OF MISSION CRITICAL ASSETS VALIDATED AS AUDIT READY

Figure VI-2 provides the Department's mission critical asset existence and completeness status and goals to be accomplished by the end of FY 2012. It also shows that 40 percent of mission critical assets will be validated through IPA examinations as audit ready by the end of FY 2012.

The percentages are based on asset dollar values reported in the Department's FY 2009 financial statements.

Figure VI-2. Mission Critical Asset Existence and Completeness Priority Status and Interim Goals

	FY 2009	FY 2010	FY 2011	FY 2012
Existence and Completeness Audit Ready	4%	4%	20%	40%
Assessable Units				
Military Equipment	0%	0%	12%	32%
Real Property	4%	4%	4%	4%
Inventory	0%	0%	0%	0%
Operating Material and Supplies	0%	0%	4%	4%
General Equipment	0%	0%	0%	0%

KEY CONTROL OBJECTIVES AND KEY SUPPORTING DOCUMENTATION

This subsection of the Audit Readiness Progress Metrics section provides the Components' status and progress in achieving auditability and a strong internal control environment that ensures business and financial transactions are timely and accurately recorded and supported by transaction level documentation. To achieve auditability, the Components must:

- Support account balances with sufficient control objectives and design and implement control activities to limit the risk of material misstatements by meeting Key Control Objectives (KCOs), and
- Competent audit evidence, Key Supporting Documents (KSDs).

To maximize the efficiency and effectiveness of Component audit readiness efforts, the Department identified standard KCOs to mitigate financial reporting risks and KSDs that are required to substantiate transactions and balances.

The Components are identifying existing control activities for meeting the KCOs, as well as assessing the quality and availability of supporting documentation needed to assert audit readiness. The KCOs and KSDs are contained in the DoD FIAR Guidance document located at: http://comptroller.defense.gov/FIAR/index.html.

The KCO and KSD metrics are presented in Figures VI-3 through VI-18 by DoD Component for the FIAR priorities of:

- Budgetary information and
- Mission Critical Asset information.

Figure VI-3. Army SBR Key Control Objective (KCO) Status and Projections

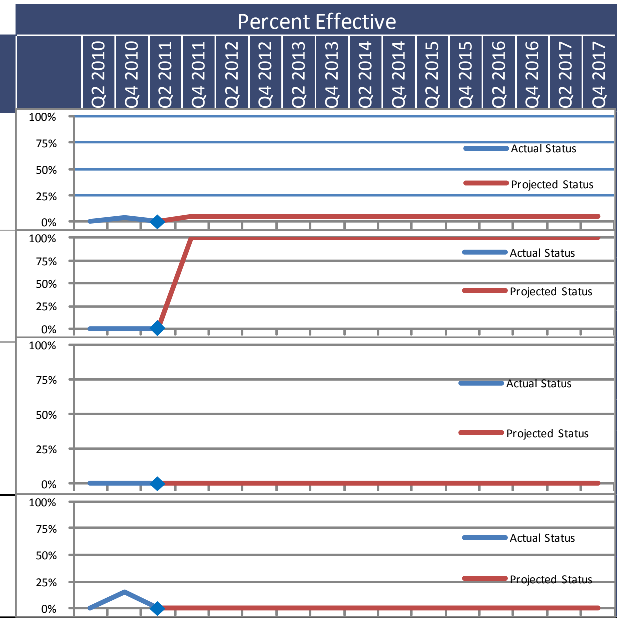
Army Assessable Unit	# KCOs	% Assessed	% Effective
SBR	**76**	**5%**	**0%**
Wave 1: Appropriations Received	**4**	**100%**	**0%**
Appropriations	4	100%	0%
Wave 2: Other Statement of Budgetary Resources	**38**	**0%**	**0%**
Reimbursables	5	0%	0%
Obligations - TDY	33	0%	0%
Civilian Pay	33	0%	0%
Military Pay	33	0%	0%
Obligations - Contracts	33	0%	0%
Obligations - PCS	33	0%	0%
Wave 2: Financial Statement Compilation & Reporting	**14**	**0%**	**0%**
Wave 2: Net Outlays (Incl. FBWT)	**20**	**0%**	**0%**

SBR

Wave 1: Appropriations Received

Wave 2: SBR

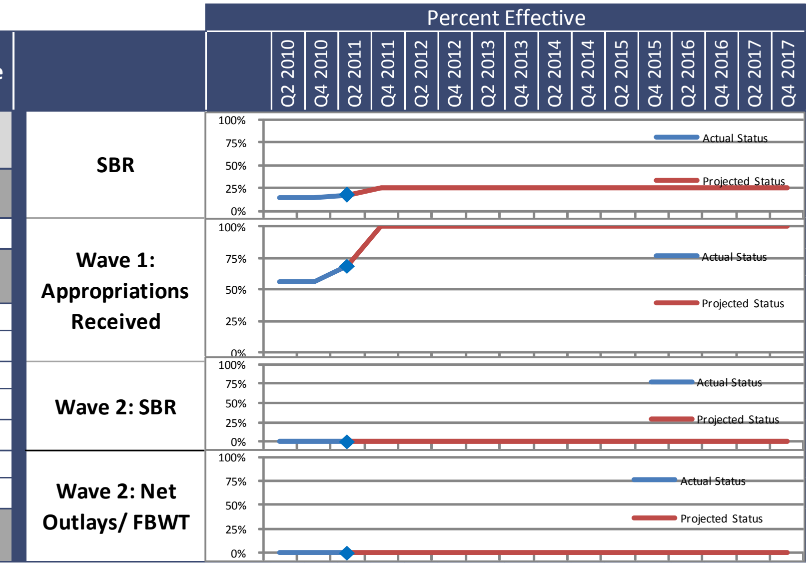
Wave 2: Net Outlays/ FBWT



Note 2: Army is currently performing assessments for Wave 2 SBR and Wave 2 Net Outlays/FBWT. The projected effective status (red line) will increase when assessments are completed and projected effective dates are determined.

Figure VI-4. Army SBR Key Supporting Document (KSD) Status and Projection

Army Assessable Unit	# KSDs	% Assessed	% Effective
SBR	**64**	**25%**	**17%**
Wave 1: Appropriations Received	**16**	**100%**	**69%**
Appropriations	16	100%	69%
Wave 2: Other Statement of Budgetary Resources	**27**	**0%**	**0%**
Reimbursables	27	0%	0%
Obligations - TDY	27	0%	0%
Civilian Pay	27	0%	0%
Military Pay	27	0%	0%
Obligations - Contracts	27	0%	0%
Obligations - PCS	27	0%	0%
Financial Statement Compilation & Reporting	15	0%	0%
Wave 2: Net Outlays (Incl. FBWT)	**21**	**0%**	**0%**



Note 1: In Wave 1 and Wave 2, there are 8 KSDs related to Internal Controls applicable to all assesable units. For purposes of metrics reporting, these are only counted once.

Note 2: Army is currently performing assessments for Wave 2 SBR and Wave 2 Net Outlays/FBWT. The projected effective status (red line) will increase when assessments are completed and projected effective dates are determined.

Figure VI-5. DON SBR Key Control Objective (KCO) Status and Projections

Navy Assessable Unit	# KCOs	% Assessed	% Effective
SBR	**76**	**87%**	**4%**
Wave 1: Appropriations Received	**4**	**100%**	**75%**
Appropriations	4	100%	75%
Wave 2: Other Statement of Budgetary Resources	**25**	**92%**	**0%**
Reimbursable Authority	5	100%	0%
Civilian Pay	20	100%	60%
Military Pay	20	100%	0%
Contracts	21	100%	0%
MILSTRIP Orders	21	86%	0%
Reimbursable Work Orders	21	100%	0%
Transportation of People	20	100%	75%
Wave 2: Financial Statement Compilation & Reporting	**25**	**68%**	**0%**
Wave 2: Net Outlays (Incl. FBWT)	**22**	**100%**	**0%**

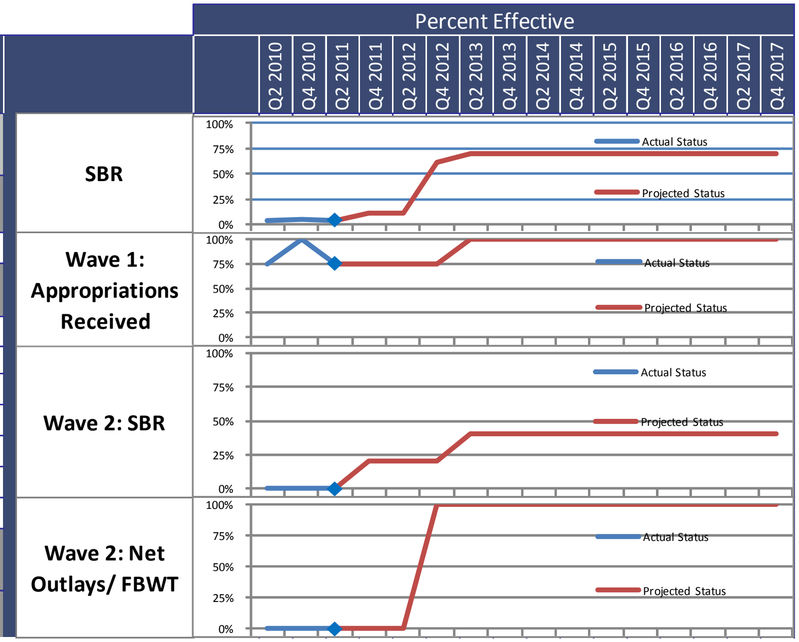
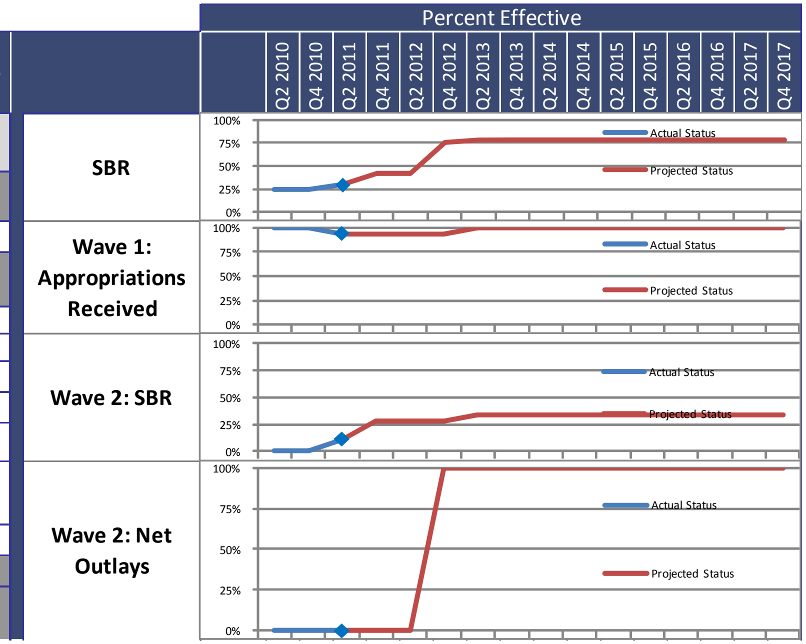


Figure VI-6. DON SBR Key Supporting Document (KSD) Status and Projections

Navy Assessable Unit	# KSDs	% Assessed	% Effective
SBR	**64**	**91%**	**30%**
Wave 1: Appropriations Received	**16**	**100%**	**94%**
Appropriations	16	100%	94%
Wave 2: Other Statement of Budgetary Resources	**18**	**67%**	**11%**
Reimbursable Authority	3	100%	0%
Civilian Pay	12	100%	92%
Military Pay	13	100%	38%
Contracts	15	100%	33%
MILSTRIP Orders	15	60%	13%
Reimbursable Work Orders	7	100%	0%
Transportation of People	13	100%	92%
Wave 2: Financial Statement Compilation & Reporting	**9**	**100%**	**22%**
Wave 2: Net Outlays (Incl. FBWT)	**21**	**100%**	**0%**

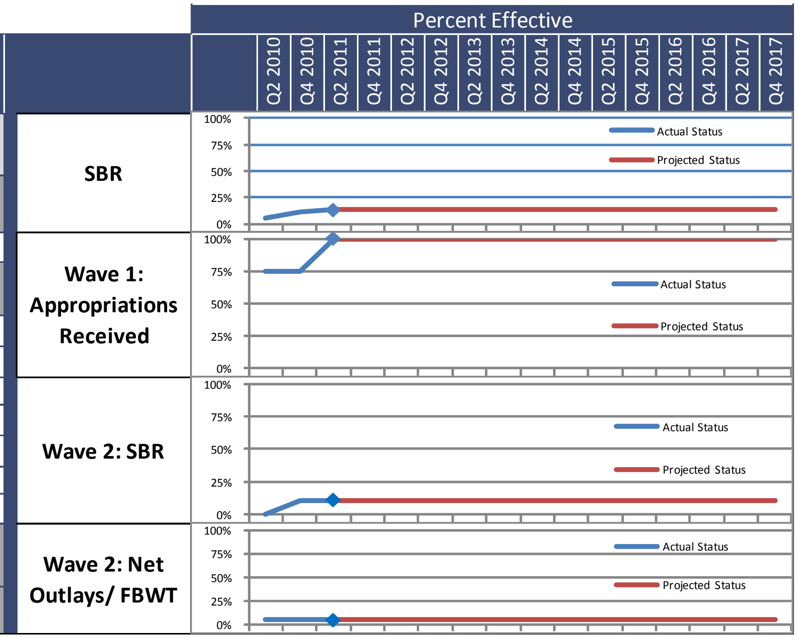


Note 1: In Wave 1 and Wave 2, there are 8 KSDs related to Internal Controls applicable to all assesable units. For purposes of metrics reporting, these are only counted once.

Note 2: Navy is currently performing assessments for Wave 2 SBR. The projected effective status will increase when assessments are completed and projected effective dates are determined.

Figure VI-7. Air Force SBR Key Control Objective (KCO) Status and Projections

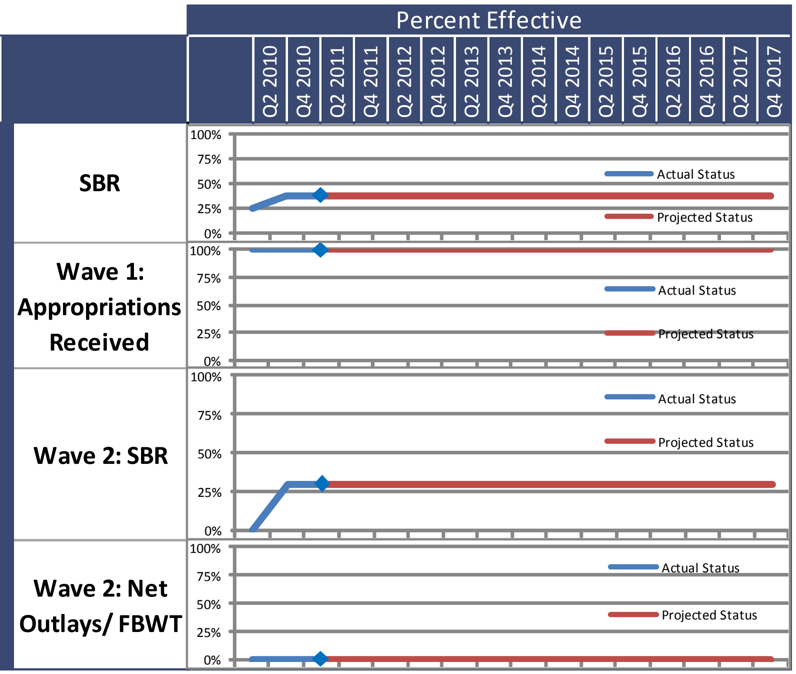
Air Force Assessable Unit	# KCOs	% Assessed	% Effective
SBR	**76**	**13%**	**13%**
Wave 1: Appropriations Received	**4**	**100%**	**100%**
Appropriations	4	100%	100%
Wave 2: Other Statement of Budgetary Resources	**46**	**11%**	**11%**
Reimbursements	38	3%	3%
Budget Authority	8	50%	50%
Obligations - Civilian Pay	24	0%	0%
Obligations - Military Pay	24	0%	0%
Obligations - Contracts (A2R)	33	0%	0%
Obligations - Plan to Stock (OM&S)	33	0%	0%
Obligations - Procure to Pay (Non-A2R)	33	0%	0%
Wave 2: Financial Statement Compilation & Reporting	**6**	**0%**	**0%**
Wave 2: Net Outlays (Incl. FBWT)	**20**	**5%**	**5%**



Air Force is currently performing assessments. The projected effective status (red line) will increase when assessments are completed and projected effective dates are determined.

Figure VI-8. Air Force SBR Key Supporting Document (KSD) Status and Projections

Air Force Assessable Unit	# KSDs	% Assessed	% Effective
SBR	**64**	**38%**	**38%**
Wave 1: Appropriations Received	**16**	**100%**	**100%**
Appropriations	16	100%	100%
Wave 2: Other Statement of Budgetary Resources	**27**	**30%**	**30%**
Reimbursements	20	40%	40%
Budget Authority	20	45%	45%
Obligations - Civilian Pay	7	0%	0%
Obligations - Military Pay	7	0%	0%
Obligations - Contracts (A2R)	7	0%	0%
Obligations - Plan to Stock (OM&S)	7	0%	0%
Obligations - Procure to Pay (Non-A2R)	7	0%	0%
Wave 2: Net Outlays (Incl. FBWT)	**21**	**0%**	**0%**



Note 1: In Wave 1 and Wave 2, there are 8 KSDs related to Internal Controls applicable to all assesable units. For purposes of metrics reporting, these are only counted once.

Note 2: Air Force is currently performing assessments. The projected effective status (red line) will increase when assessments are completed and projected effective dates are determined.

Figure VI-9. DLA SBR Key Control Objective (KCO) Status and Projections

DLA Assessable Unit	# KCOs	% Assessed	% Effective
SBR	**76**	**17%**	**0%**
Wave 1: Appropriations Received	**4**	**25%**	**0%**
Budget to Execute	4	100%	0%
FBWT	2	50%	0%
Record to Report	2	0%	0%
Wave 2: Other Statement of Budgetary Resources	**49**	**18%**	**0%**
Budget to Execute	16	25%	0%
Hire to Retire	33	9%	0%
Order to Cash	17	35%	0%
Procure to Pay	37	46%	0%
Record to Report	5	60%	0%
Wave 2: Net Outlays (Incl. FBWT)	**23**	**13%**	**0%**
Budget to Execute	3	0%	0%
FBWT	16	13%	0%
Hire to Retire	7	0%	0%
Order to Cash	10	80%	0%
Procure to Pay	10	80%	0%
Record to Report	5	100%	0%

SBR

Wave 1: Appropriations Received

Wave 2: SBR

Wave 2: Net Outlays (FBWT)

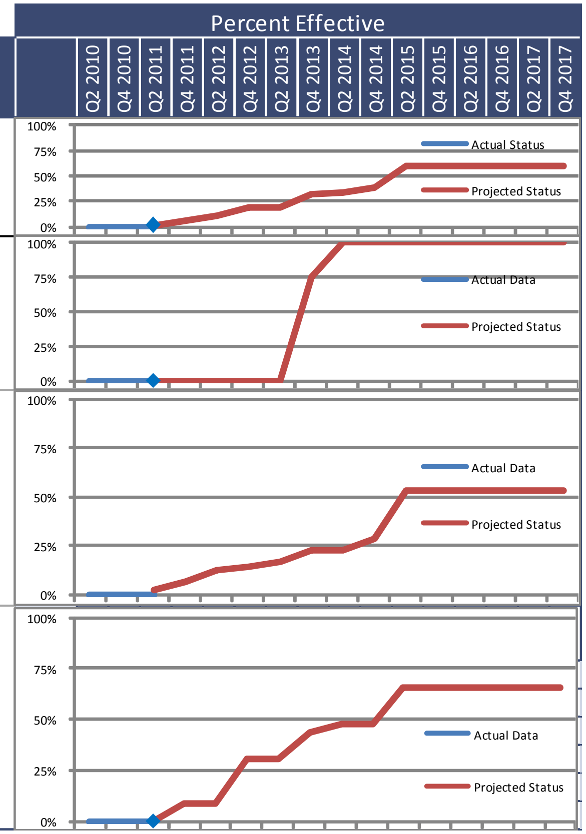


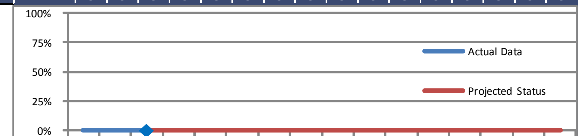
Figure VI-10. DLA SBR Key Supporting Document (KSD) Status and Projections

DLA Assessable Unit	# KSDs	% Assessed	% Effective
SBR	**64**	**0%**	**0%**
Wave 1: Appropriations Received	**16**	**0%**	**0%**
Budget to Execute	16	0%	0%
Wave 2: Other Statement of Budgetary Resources	**27**	**0%**	**0%**
Hire to Retire	27	0%	0%
Order to Cash	27	0%	0%
Procure to Pay	27	0%	0%
Record to Report	27	0%	0%
Wave 2: Net Outlays (Incl. FBWT)	**21**	**0%**	**0%**
FBWT	18	0%	0%
Hire to Retire	8	0%	0%
Order to Cash	8	0%	0%
Procure to Pay	8	0%	0%
Record to Report	8	0%	0%

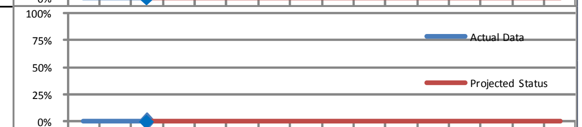
Percent Effective

Q2 2010 | Q4 2010 | Q2 2011 | Q4 2011 | Q2 2012 | Q4 2012 | Q2 2013 | Q4 2013 | Q2 2014 | Q4 2014 | Q2 2015 | Q4 2015 | Q2 2016 | Q4 2016 | Q2 2017 | Q4 2017

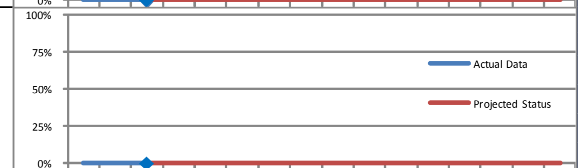
SBR



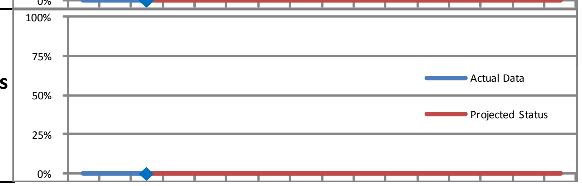
Wave 1: Appropriations Received



Wave 2: SBR



Wave 2: Net Outlays (FBWT)

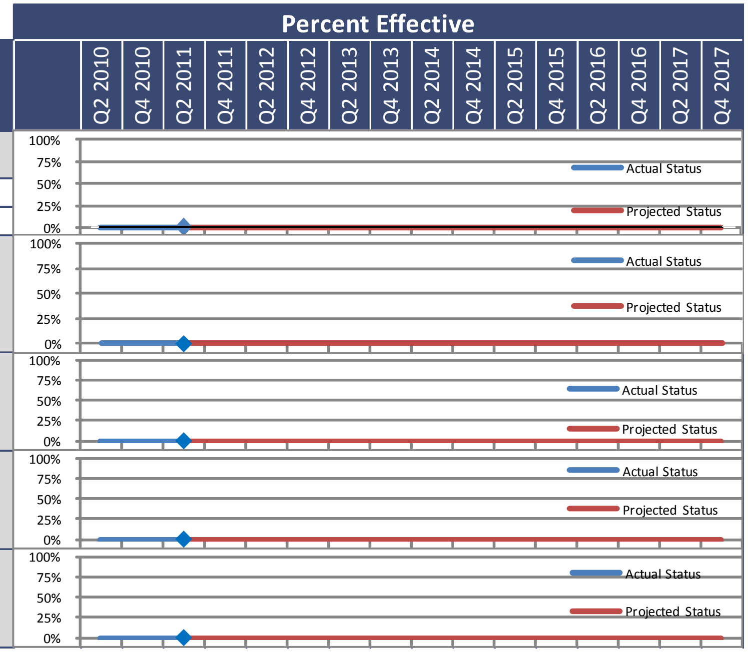


Note 1: In Wave 1 and Wave 2, there are 8 KSDs related to Internal Controls applicable to all assesable units. For purposes of metrics reporting, these are only counted once.

Note 2: In general, DLA's KSDs are projected to be effective along with their corresponding KCOs, but they are not spefically identified and therefore cannont be individually projected.

Figure VI-11. Army Existence and Completeness Key Control Objective (KCO) Status and Projections

Army Assessable Unit	# KCOs	% Assessed	% Effective
Military Equipment	**6**	**0%**	**0%**
8 Asset Types (14% of ME Value)	6	0%	0%
ME Remainder (86% of ME value)	6	0%	0%
Real Property	**6**	**0%**	**0%**
OM&S	**6**	**0%**	**0%**
Inventory	**6**	**0%**	**0%**
General Equipment	**6**	**0%**	**0%**

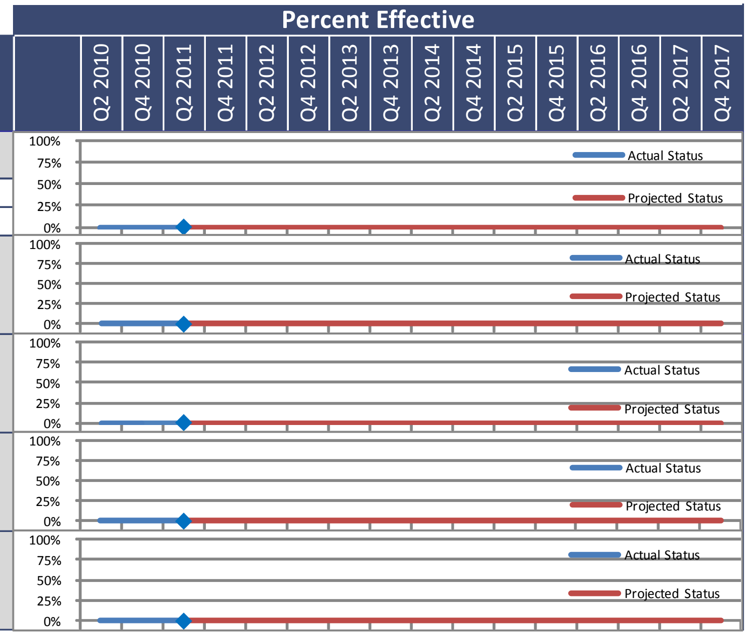


Army is currently performing assessments. The projected effective status will increase when assessments are completed and projected effective dates are determined.

Army did not rely on controls for its assertion for 8 military equipment asset types.

Figure VI-12. Army Existence and Completeness Key Supporting Document (KSD) Status and Projections

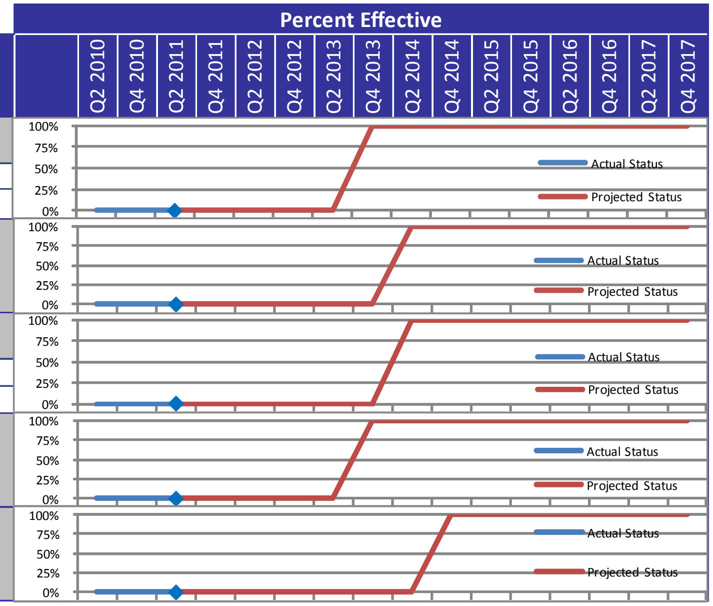
Army Assessable Unit	# KSDs	% Assessed	% Effective
Military Equipment	**4**	**0%**	**0%**
8 Asset Types (14% of ME Value)	6	100%	0%
ME Remainder (86% of ME value)	6	0%	0%
Real Property	**4**	**0%**	**0%**
OM&S	**4**	**0%**	**0%**
Inventory	**4**	**0%**	**0%**
General Equipment	**4**	**0%**	**0%**



Army is currently performing assessments. The projected effective status will increase when assessments are completed and projected effective dates are determined.

Figure VI-13. DON Existence and Completeness Key Control Objective (KCO) Status and Projections

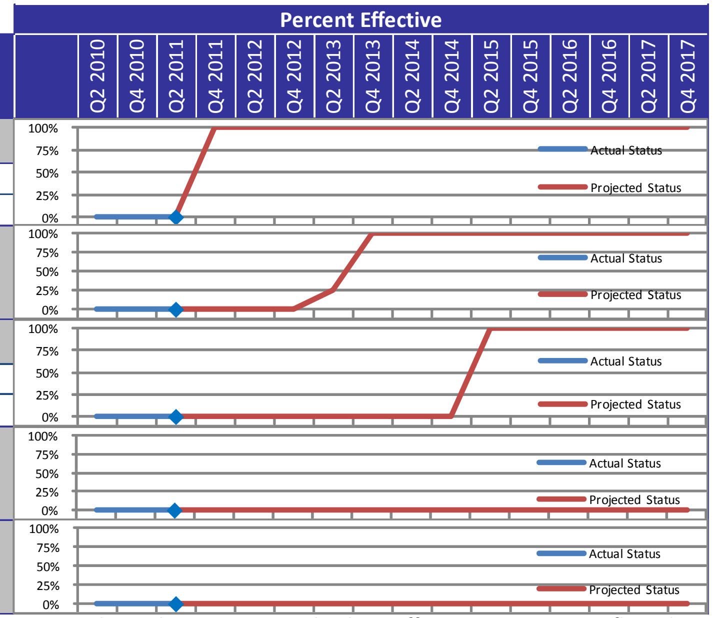
Navy Assessable Unit	# KCOs	% Assessed	% Effective
Military Equipment	**6**	**100%**	**0%**
Ships, Aircraft, ICBMs, Satellites (94% of ME value)	6	100%	60%
ME Remainder (6% of ME value)	6	0%	0%
Real Property	**6**	**100%**	**0%**
OM&S	**6**	**100%**	**0%**
Ordnance (44% of OM&S value)	6	100%	100%
OM&S Remainder (66% of OM&S value)	6	0%	0%
Inventory	**6**	**100%**	**0%**
General Equipment	**6**	**0%**	**0%**



Note: The Percent Effective graph line is based on KCOs being assessed and effective for the entire asset category. As a result, quick win assertions that have effective KCOs are not reflected above.

Figure VI-14. DON Existence and Completeness Key Supporting Document (KSD) Status and Projections

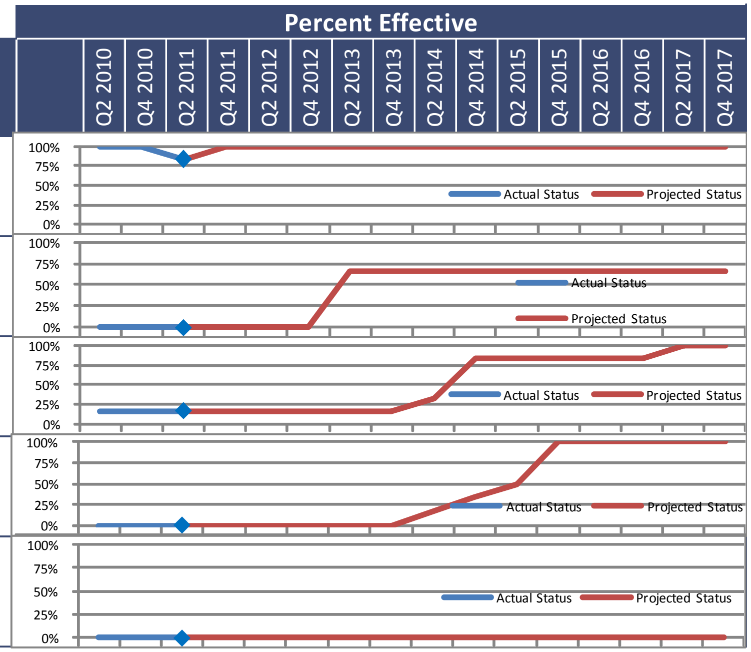
Navy Assessable Unit	# KSDs	% Assessed	% Effective
Military Equipment	**4**	**100%**	**100%**
Ships, Aircraft, ICBMs, Satellites (94% of ME value)	4	100%	100%
ME Remainder (6% of ME value)	4	0%	0%
Real Property	**4**	**100%**	**0%**
OM&S	**4**	**100%**	**0%**
Ordnance (44% of OM&S value)	4	100%	100%
OM&S Remainder (66% of OM&S value)	4	0%	0%
Inventory	**4**	**0%**	**0%**
General Equipment	**4**	**0%**	**0%**



Note 1: The Percent Effective graph line is based on KSDs being assessed and effective for the entire asset category. As a result, quick win assertions that have effective KSDs are not reflected in the graph.
Note 2: DON is currently performing assessments for Inventory and General Equipment. The projected effective status will increase when assessments are completed and projected effective dates are determined.

Figure VI-15. Air Force Existence and Completeness Key Control Objective (KCO) Status and Projections

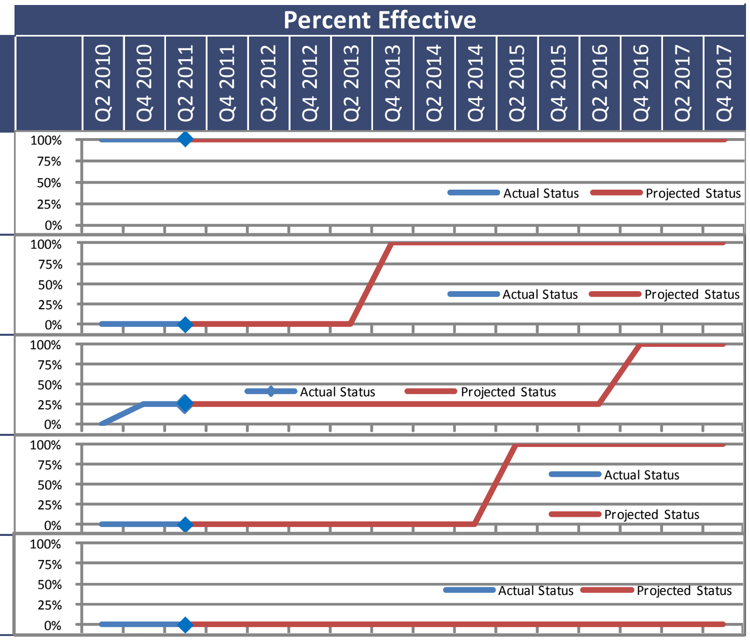
Air Force Assessable Unit	# KCOs	% Assessed	% Effective
Military Equipment	6	100%	83%
Real Property	6	67%	0%
OM&S	6	100%	17%
Inventory	6	100%	0%
General Equipment	6	0%	0%



Air Force is currently performing assessments for General Equipment. The projected effective status (red line) will increase when assessments are completed.

Figure VI-16. Air Force Existence and Completeness Key Supporting Document (KSD) Status and Projections

Air Force Assessable Unit	# KSDs	% Assessed	% Effective
Military Equipment	4	100%	100%
Real Property	4	0%	0%
OM&S	4	100%	25%
Inventory	4	100%	0%
General Equipment	4	0%	0%



Air Force is currently performing assessments for General Equipment. The projected effective status (red line) will increase when assessments are completed.

Figure VI-17. DLA Existence and Completeness Key Control Objective (KCO) Status and Projections

DLA Assessable Unit	# KCOs	% Assessed	% Effective
Real Property	6	100%	0%
Inventory	6	100%	0%
General Equipment	6	100%	0%

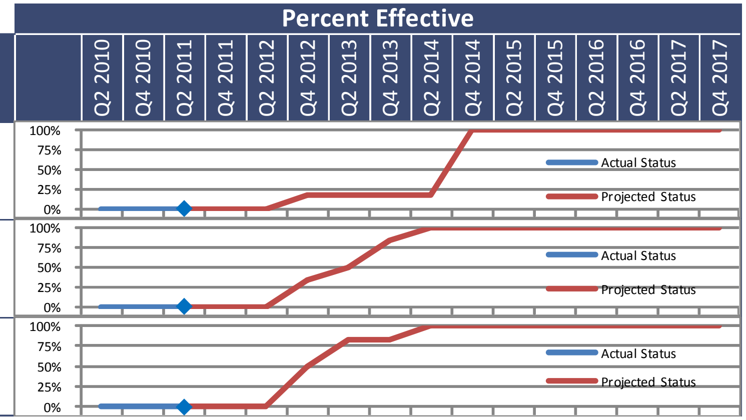
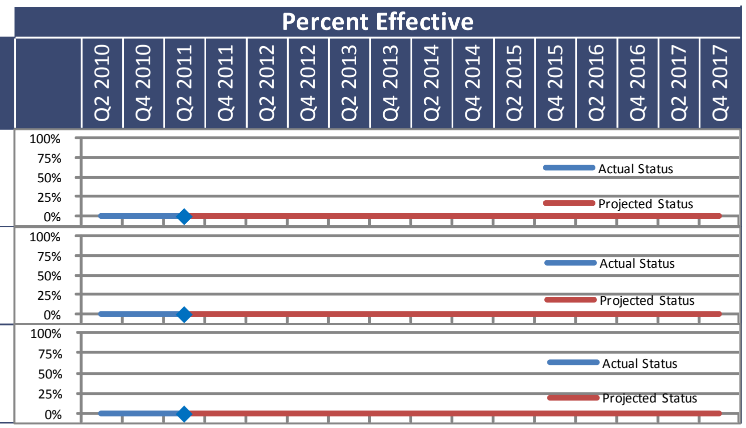


Figure VI-18. DLA Existence and Completeness Key Supporting Document (KSD) Status and Projections

DLA Assessable Unit	# KSDs	% Assessed	% Effective
Real Property	4	0%	0%
Inventory	4	0%	0%
General Equipment	4	0%	0%



Note: In general, DLA's KSDs are projected to be effective along with their corresponding KCOs, but they are not spefically identified and therefore cannont be individually projected.

OPERATIONAL IMPROVEMENTS IMPACTING BUDGETARY INFORMATION

Much of the DoD Components' FIAR activity impacts financial operations and results in operational improvements that have a direct relationship on budgetary information and the audit readiness of the SBR. The Operational Improvement metrics in this subsection of the Report measure progress that improves budgetary information or measure outcomes of better budgeting information (e.g., Abnormal Fund Balances). As Components proceed with discovery, evaluation, and remediation efforts relative to Wave 2 SBR assessable units, we anticipate future positive trends in these metrics. In the interim, results will likely continue to fluctuate due to issues related to legacy business processes and identification and correction of issues during implementation and deployment of enterprise resource planning (ERP) systems.

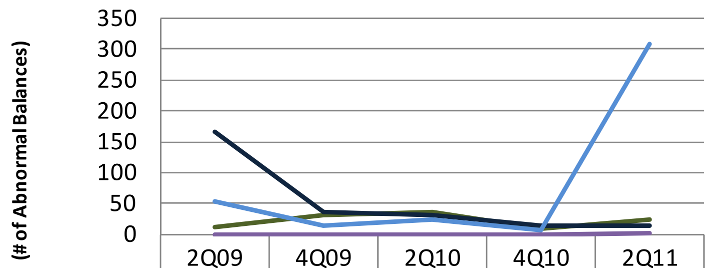
Each metric is accompanied by a description and identifies the goals, benefits and results. These metrics include the following:

- Figure VI-19. Abnormal Fund Balances
- Figure VI-20. In-Transit Disbursements and Collections > 60 Days
- Figure VI-21. Unmatched Disbursements > 120 Days
- Figure VI-22. Negative Unliquidated Obligations > 120 Days
- Figure VI-23. Appropriations with Negative Balances

Figure VI-19

Metric Title: Abstract Fund Balances

Wave 2 - SBR



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	11	31	36	9	24
Navy	165	36	30	13	15
Air Force	54	15	25	7	308
DLA	0	0	0	0	2

Description:
This metric measures the number of abnormal fund balances, at levels lower than the appropriation level, not resolved within 60 days. An abnormal balance exists when a debit balance account has a credit balance or vice versa.

Goal:
0 abnormal balances unresolved in greater than 60 days.

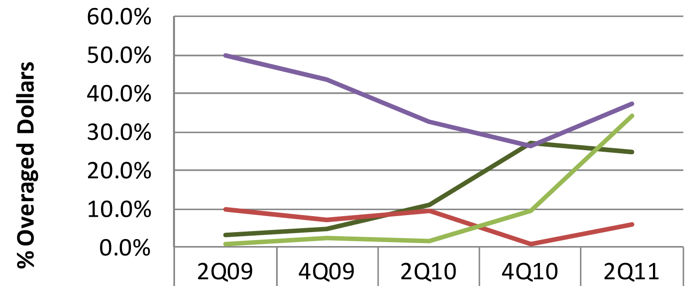
Benefit:
Preventing and/or timely resolution of abnormal fund balances results in more accurate obligation and outlay balances on management reports and the Statement of Budgetary Resources resulting in better utilization of funds in the year appropriated.

Results:
Air Force experienced a significant increase in abnormal fund balances due to internal operational issues while under multiple "Continuing Resolutions" the first 6 months of FY 2011.

Figure VI-20

Metric Title: In-Transit Disbursements & Collections > 60 days

Wave 2 - SBR



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	3.4%	4.9%	11.3%	27.2%	25.0%
Navy	9.8%	7.2%	9.7%	1.0%	6.1%
Air Force	1.1%	2.6%	1.9%	9.4%	34.3%
DLA	49.9%	43.6%	32.8%	26.5%	37.3%

Description:
This metric measures Component timeliness in recording collections and disbursements. An in-transit disbursement or collection is a payment or collection made by one activity on behalf of another accounting activity, but not yet recorded in the general ledger of the accounting entity.

Goal:

To have 5% or less of the prior month's total absolute in-transit balance greater than 60 days old.

Benefit:

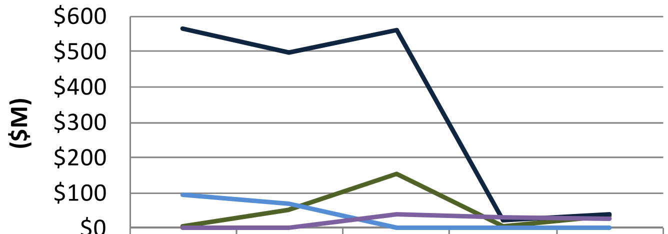
Timely recording of disbursements and collections results in greater accuracy of Components' accounts balances on management reports and the SBR resulting in better utilization of funds.

Results:

Army shows improvement. Air Force experienced increases in overaged in-transit balances due to the implementation of Defense Enterprise Accounting and Management System (DEAMS). Navy experienced increases due to recognizing previously unreported intransits over 360 days old.

Figure VI-21

Metric Title: Unmatched Disbursements (UMD) > 120 days
Wave 2 - SBR



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	$6.55	$54.58	$156.39	$4.81	$36.70
Navy	$565.37	$496.59	$559.40	$23.17	$40.89
Air Force	$94.57	$68.51	$3.43	$0.57	$2.82
DLA	$0.00	$0.00	$40.55	$32.75	$29.20

Description:
This metric measures Component success in correcting UMD amounts that are 120 days old or older. A UMD occurs when a disbursement cannot be matched to an obligation in the accounting system.

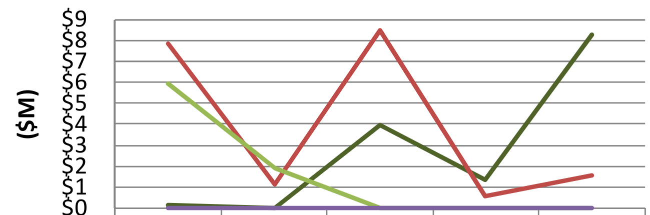
Goal:
No UMD amounts greater than 120 days old.

Benefit:
Preventing and/or timely resolution of UMDs results in greater accuracy of Components' accounts balances on management reports and the SBR resulting in better utilization of funds.

Results:
Navy's lack of transaction level visibility hinders overaged UMD reductions. Appropriate data matching through automated systems is imperative to overcome UMDs. Overaged UMDs have been considerably reduced from a September 1999 level of $2.03B. Army UMDs increased due to systems issues with recording obligations and lines of accounting in the ERPs.

Figure VI-22

Metric Title: Negative Unliquidated Obligations > 120 days
Wave 2 - SBR



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	$0.11	$0.00	$3.98	$1.36	$8.28
Navy	$7.85	$1.11	$8.44	$0.55	$1.54
Air Force	$5.93	$1.93	$0.00	$0.00	$0.00
DLA	$0.00	$0.00	$0.00	$0.00	$0.00

Description:
This metric measures Component payment discrepancies, known as negative unliquidated obligations (NULOs), caused by disbursing amounts greater than the corresponding obligations that are not resolved within 120 days.

Goal:
No NULOs greater than 120 days old.

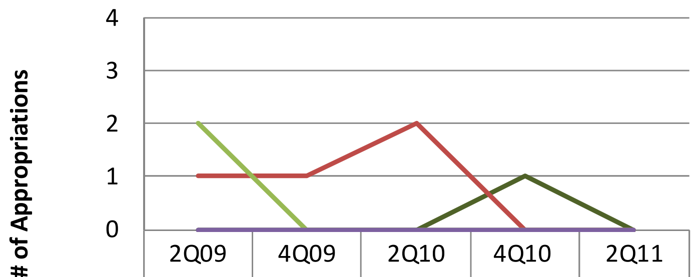
Benefit:
Preventing and/or timely resolution of NULOs results in greater accuracy of Components' accounts balances on management reports and the SBR resulting in better utilization of funds.

Results:
Army NULOs increased significantly due to systems issues with recording obligations and lines of accounting in the ERPs. Air Force and DLA are consisently managing their NULO's at the zero level over the year.

Figure VI-23

Metric Title: Appropriations with Negative Balances

Wave 2 - SBR



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	0	0	0	1	0
Navy	1	1	2	0	0
Air Force	2	0	0	0	0
DLA	0	0	0	0	0

Description:
This metric measures the number of appropriations with negative balances not resolved within three months of expenditures exceeding appropriated amounts.

Goal:
No appropriations with negative balances over 3 months old.

Benefit:
Preventing and/or timely resolution of negative appropriation balances results in greater accuracy of Components' accounts balances on management reports and the SBR resulting in better utilization of funds. It also demonstrates proper stewardship of public funds and adherence to appropriation laws and regulations.

Results:
Components continue to meet this goal on a regular basis.

Operational Improvements Impacting Mission Critical Asset Information

The metrics in this subsection measure improvements to functions and capabilities that impact Mission Critical Asset information. They either measure process improvements needed to achieve better asset information (e.g., Equipment Contracts Compliant with Item Unique Identification (IUID) or outcomes of better asset information (e.g., OM&S Release Denial Rate).

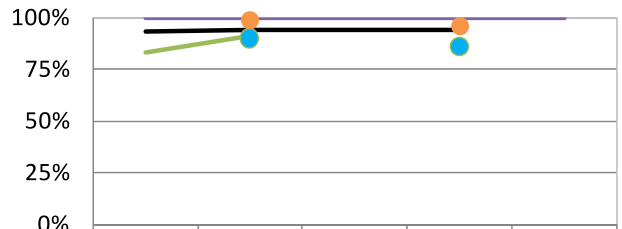
Each of the metrics that follows includes a description, goal, benefits and results. These metrics include the following:

- Figure VI-24 Contracts Compliant with IUID
- Figure VI-25 Proper Financial Accounting Treatment for Military Equipment Compliance
- Figure VI-26 Military Equipment Inventory Completion
- Figure VI-27 General Equipment Inventory Completion
- Figure VI-28 Real Property Asset Reconciliation
- Figure VI-29 Real Property Physical Inventory Completion
- Figure VI-30 Physical Inventory Adjustments – Real Property
- Figure VI-31 Inventory Valued at Moving Average Cost
- Figure VI-32 Inventory Release Denial Rate
- Figure VI-33 Physical Inventory Adjustments – Inventory Quantity
- Figure VI-34 OM&S Valued at Moving Average Cost
- Figure VI-35 Physical Inventory Adjustments – OM&S Quantity

Figure VI-24

Metric Title: Contracts Compliant with Item Unique Identification (IUID)

Wave 3 - Existence and Completeness



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	83%	91%	--	94%	--
Navy	93%	94%	94%	94%	--
Air Force	--	90%	--	86%	--
DLA	100%	100%	100%	100%	100%
USSOCOM	--	99%	--	96%	--

Description:
DoD policy requires that contracts for DoD assets include a requirement for contractors to mark assets with a unique item identifier (UII) upon delivery to the government. A directive was given in December 2007 for Components to report contract compliance in a Score Card to the Defense Procurement and Acquisition Policy (DPAP) Office. This metric tracks the percentage of contracts compliant by Component as reported to DPAP.

Goal:
100% IUID contract compliance.

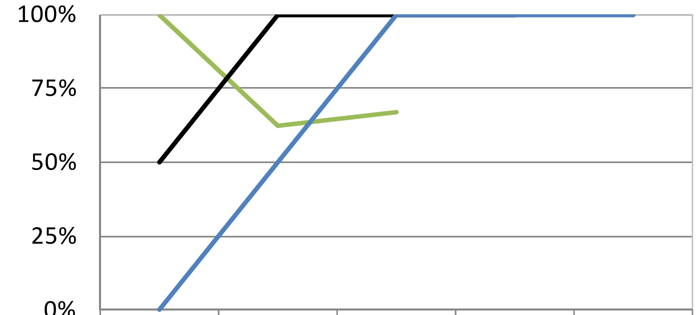
Benefit:
Compliance with this requirement supports audit readiness and the tracking of DoD assets. Improving DoD asset visibility and traceability provides more accurate data to support management decisions for improved readiness for military missions.

Results:
IUID compliance is consistently at a high percentage, but with the exception of DLA, not yet at 100%. 2nd quarter data was not available for the Services.

Figure VI-25

Metric Title: Proper Financial Accounting Treatment for Military Equipment Compliance

Wave 3 - Existence and Completeness / Wave 4 - Valuation



	FY2007	FY2008	FY2009	FY2010	2Q11
Army	100%	63%	67%	--	--
Navy	50%	100%	100%	100%	--
Air Force	0%	50%	100%	100%	100%

Description:
DoD policy requires that Military Equipment (ME) contracts be structured to permit the proper accounting treatments to be applied for determining an accurate full cost, as required by SFFAS No. 6 and DoDI 5000.64.

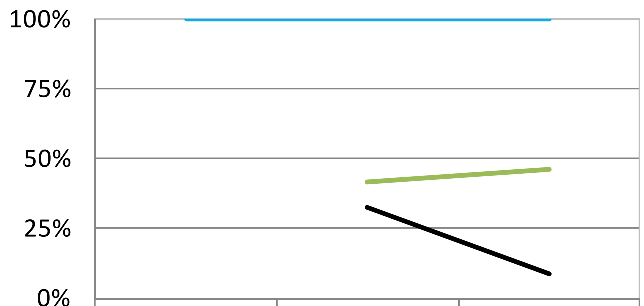
Goal:
100% of new ME procurement contracts and contract modifications comply with the policy beginning in FY 2007.

Benefit:
Compliance with this requirement supports audit readiness and improves information available to decision makers by providing more accurate information to support procurement decisions.

Results:
Compliance with this requirement has been high in recent years. However, only Air Force provided data for this report.

Figure VI-26

Metric Title: Military Equipment Inventory Completion
Wave 3 - Existence and Completeness



	2Q10	4Q10	2Q11
Army	--	42%	46%
Navy	--	33%	9%
Air Force	100%	100%	100%

Description:
DoDI 5000.64 requires Components to inventory all Military Equipment (ME) assets at least every 3 years. This metric shows the percentage of Components' military equipment as of a point in time, that has been inventoried during the previous 3 years.

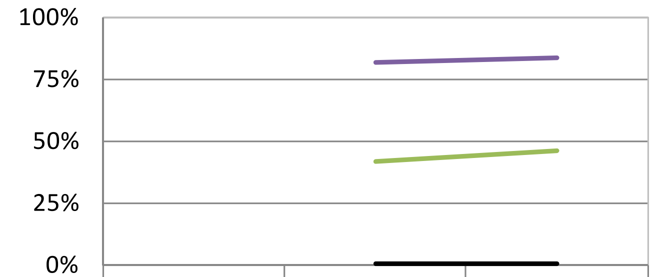
Goal:
100% of ME assets inventoried over a 3 year time span.

Benefit:
Physical inventory is a key control activity and is vital to audit readiness.

Results:
Air Force has inventoried all of its military equipment, and Army is slowly increasing its compliance. Navy has increased the quantity of assets inventoried, but has also identified additional military equipment assessable units, thereby reducing the percentage. Army's percentage includes both military and general equipment.

Figure VI-27

Metric Title: General Equipment Inventory Completion
Wave 3 - Existence and Completeness



	4Q09	2Q10	4Q10
Army	--	42%	46%
Navy	--	1%	0%
Air Force	--	--	--
DLA	--	82%	84%

Description:
DoDI 5000.64 requires Components to inventory all equipment assets at least every 3 years. This metric shows the percentage of Components' general equipment as of a point in time, that has been inventoried during the previous 3 years.

Goal:
100% of general equipment assets are inventoried over a 3 year time span.

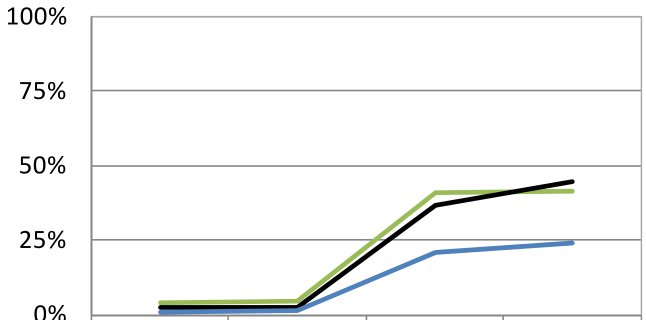
Benefit:

Physical inventory is a key control activity and is vital to audit readiness.

Results:
DLA and Army are slowly increasing compliance. Navy has significantly increased its general equipment population, thereby reducing the percentage. Army's percentage includes both military and general equipment.

Figure VI-28

Metric Title: Real Property Asset Reconciliation
Wave 3 - Existence and Completeness



	4Q09	2Q10	4Q10	2Q11
Army	4%	5%	41%	41%
Navy	2%	2%	36%	44%
Air Force	1%	1%	21%	24%

Description:
In accordance with DoDI 4165.14, all DoD real property data must be reconciled among the Defense Agencies and Military Services. This metric displays the percent of Components' real property meeting this requirement.

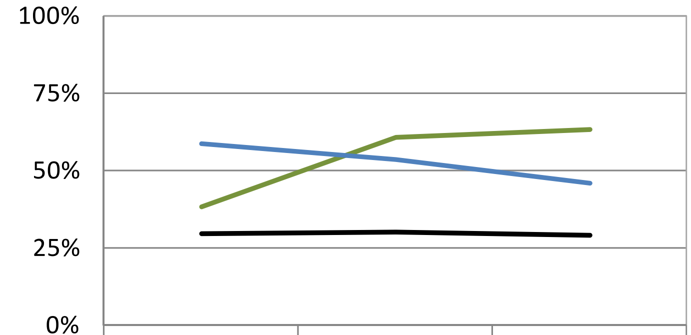
Goal:
100% of Defense Agencies' real property assets reconciled by the end of FY11.

Benefit:
Having real property reconciled will provide management with better access to accurate, complete data which will facilitate better decision making and support audit readiness.

Results:
The real property asset reconciliation has made progress over the past year, but significant work needs to be done to meet the goal of 100% reconciled by the end of FY11. Previous periods have been restated for this report due to revised criteria.

Figure VI-29

Metric Title: Real Property Physical Inventory Completion
Wave 3 - Existence and Completeness



	FY2008	FY2009	FY2010
Army	38%	61%	63%
Navy	29%	30%	29%
Air Force	59%	53%	46%

Description:
DoDI 4165.14 requires Components to inventory all real property assets at least every five years. This metric shows the percentage of Services' real property inventoried within a 5 year time span against the total number of reported assets.

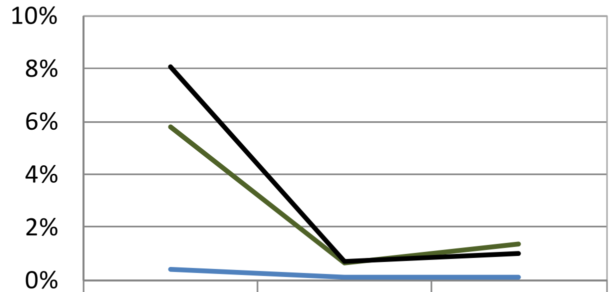
Goal:
Physical inventory of 100% of real property assets over a five year period.

Benefit:
Ensuring that all real property is inventoried is important for audit readiness. It is especially pertinent to completeness, but assists other assertions as well. This metric provides a status on how Services are complying with this important control activity.

Results:
The Services have increased their combined real property inventory compliance by 10% since 2008, but percentages should increase further to support upcoming real property assertions. Previous years have been restated for this report due to revised criteria.

Figure VI-30

Metric Title: Physical Inventory Adjustments - Real Property
Wave 3 - Existence and Completeness



	FY2008	FY2009	FY2010
Army	5.80%	0.64%	1.37%
Navy	8.06%	0.73%	0.99%
Air Force	0.42%	0.12%	0.13%

Description:
DoDI 4165.14 requires Components to inventory all real property assets at least every five years. This metric shows the percentage of a Component's real property asset records that are either added ("found on post", "inventory adjustment") or archived ("loss by inventory") from its real property inventory. Significant additions or deletions as a result of inventory activities may indicate internal control weaknesses.

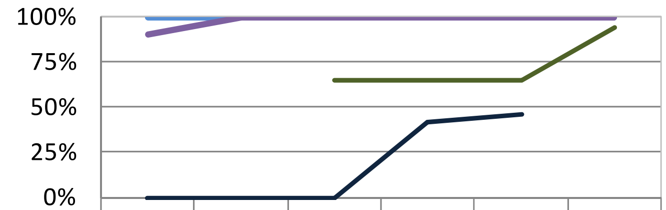
Goal:
Physical inventory process confirms the effectiveness of the acquisition and disposal processes and results in no material adjustments.

Benefit:
Accurate property records enable managers to effectively plan for and execute the DoD mission.

Results:
Adjustments show a positive downward trend over the previous 3 years. Previous years have been restated for this report due to revised criteria.

Figure VI-31

Metric Title: Inventory Valued at Moving Average Cost
Wave 4 - Valuation



	4Q08	2Q09	4Q09	2Q10	4Q10	2Q11
Army	--	--	65%	65%	65%	94%
Navy	0%	0%	0%	41%	46%	--
Air Force	100%	100%	100%	100%	100%	100%
DLA	90%	100%	100%	100%	100%	100%

Description:
This metric shows the Components' status as a percentage of dollars for valuing appropriate inventory at a moving average cost (MAC). This costing method is used in conjunction with a perpetual inventory system. A weighted average cost per unit is recalculated following each purchase. This costing method is required by DoD.

Goal:
100% of Inventory valued at MAC where applicable.

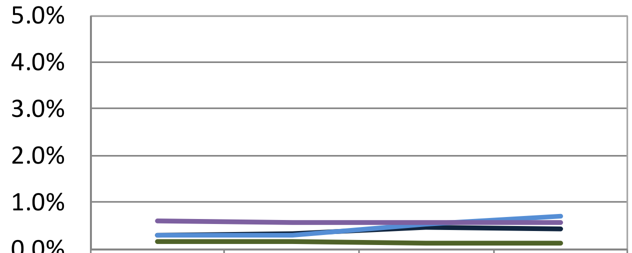
Benefit:
Valuing inventory at MAC will bring DoD into compliance with current Federal accounting standards and DoD regulations. It will also provide users of financial reports the most accurate picture of the actual value of inventory in stock.

Results:
Air Force and DLA are valuing their inventory at MAC. Navy and Army have been increasing their percentages. However, Navy was not able to provide data for this report.

Figure VI-32

Metric Title: Inventory Release Denial Rate

Wave 3 - Existence and Completeness



	2Q09	4Q09	2Q10	4Q10
Army	0.2%	0.2%	0.1%	0.1%
Navy	0.3%	0.3%	0.5%	0.4%
Air Force	0.3%	0.3%	0.5%	0.7%
DLA	0.6%	0.6%	0.6%	0.6%

Description:
This metric displays the percentage of requested Inventory material releases that were not shipped by a warehouse or distribution center due to the requested assets not being of the type, quantity or location indicated in the system. While there are appropriate reasons to deny the release of Inventory, denials as a result of inaccurate records may indicate poor controls related to asset existence.

Goal:
Denial rates due to inaccurate records remain under 1%.

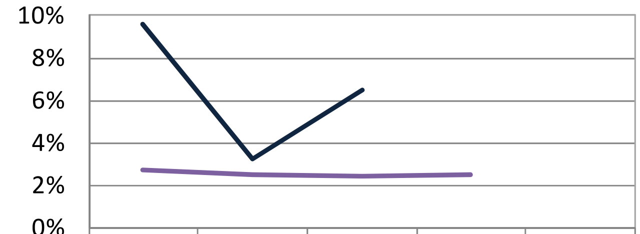
Benefit:
Tracking denial rates provides visibility into a critical function of Inventory management. Inventory records and quantities need to be accurate to ensure that supplies are refreshed and available when needed for missions.

Results:
Army, Navy, Air Force and DLA show consistent denial rates of less than 1%. This is a positive indicator of existence and completeness controls.

Figure VI-33

Metric Title: Physical Inventory Adjustments-Inventory Quantity

Wave 3 - Existence and Completeness



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	--	--	--	--	--
Navy	10%	3%	7%	--	--
Air Force	--	--	--	--	--
DLA	3%	3%	2%	2%	--

Description:
Inventory is periodically counted to ensure stock levels are accurate. This metric shows the percentage of a Component's inventory balance that is adjusted as a result of physical inventory activities during a six month time period. Significant adjustments as a result of inventory activities may indicate internal control weaknesses. Poor acquisition controls can result in positive adjustments, while poor controls over inventory disposal can result in negative adjustments.

Goal:
Have sufficient controls in place so that physical inventories confirm the accuracy of inventory records and result in no material adjustments.

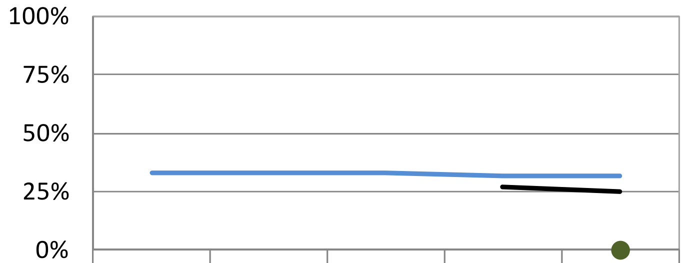
Benefit:
Accurate inventory records enable commanders and managers to effectively plan for and execute the DoD mission.

Results:
DLA maintains a consistently low adjustment rate, which is a positive indicator. The Components did not provide data for this report.

Figure VI-34

Metric Title: OM&S Valued at Moving Average Cost

Wave 4 - Valuation



	2Q09	4Q09	2Q10	4Q10	2Q11
Army	--	--	--	--	0%
Navy	--	--	--	27%	25%
Air Force	33%	33%	33%	31%	32%

Description:
This metric shows the Components' status as a percentage of dollars for valuing appropriate operating material and supplies at a moving average cost (MAC). This costing method is used in conjunction with a perpetual inventory system. A weighted average cost per unit is recalculated following each purchase. This costing method is required by DoD.

Goal:
100% of OM&S valued at MAC.

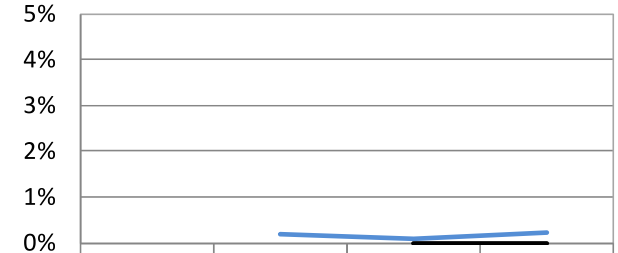
Benefit:
Valuing OM&S at MAC will bring DoD into compliance with current Federal accounting standards and DoD regulations. It will also provide users of financial reports the most accurate picture of the actual value of OM&S in stock.

Results:
OM&S valued at MAC is dependent on system functionality. Currently, the Army does not value OM&S at MAC. The Air Force has valued approximately one third of its OM&S at MAC. Navy's reporting scope is currently limited to ordnance.

Figure VI-35

Metric Title: Physical Inventory Adjustments - OM&S Quantity

Wave 3 - Existence and Completeness



	4Q09	2Q10	4Q10	2Q11
Army	--	--	--	--
Navy	--	--	0%	0%
Air Force	--	0%	0%	0%

Description:
Operating material and supplies are periodically counted to ensure stock levels are accurate. This metric shows the percentage of a Component's OM&S balance that is adjusted as a result of physical inventory activities during a six month time period. Significant adjustments as a result of inventory activities may indicate internal control weaknesses. Poor acquisition controls can result in positive adjustments, while poor controls over OM&S usage can result in negative adjustments.

Goal:
Have sufficient controls in place so that physical inventories confirm the accuracy of OM&S records and result in no material adjustments.

Benefit:
Accurate OM&S records enable commanders and managers to effectively plan for and execute the DoD mission.

Results:
Navy and Air Force report adjustment rates of less than 1%. Army did not submit data for this report.

Appendix 1. FIAR STRATEGY "WAVES"

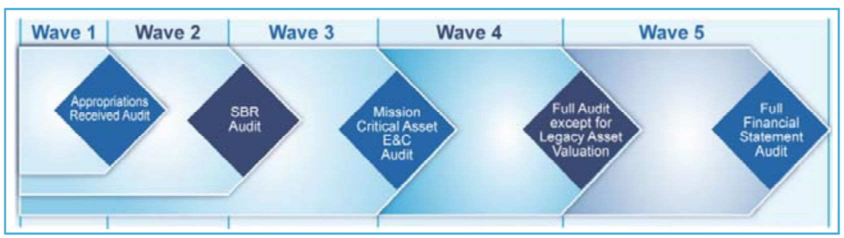
The FIAR Strategy (discussed in Appendix 2) organizes FIAR activities into five distinct "waves" representing significant levels of effort and accomplishments. Wave 1, Wave 2, and Wave 3 are being worked concurrently, as shown in Figure A1-1, and consistent with the initial FIAR priorities.

- Wave 1 – Appropriations Received Audit
- Wave 2 – Statement of Budgetary Resources (SBR) Audit
- Wave 3 – Mission Critical Asset Existence and Completeness Audit

Wave 4 and Wave 5 represent work to achieve the subsequent FIAR priorities and full audit readiness.

- Wave 4 – Full Financial Statement Audit, Except for Legacy Assets (New Asset Valuation)
- Wave 5 – Full Financial Statement Audit

Figure A1-1. FIAR Strategy



Wave 1 – Appropriations Received Audit

Wave 1 focuses on the processes and controls associated with the appropriation and distribution of funds from the Congress to the Department. Completing Wave 2 depends on the successful completion of Wave 1.

Wave 1 is critically important to the Department's overall financial improvement efforts, because it is the first step in receiving, recording, and tracking the funds provided to the Department to accomplish its mission. Recognizing the importance of this critical first step, the Under Secretary of Defense (Comptroller) specifically directed the DoD Components to focus initially on Wave 1 and to prepare it for audit by the DoD Inspector General or an independent public accountant (IPA) by the end of FY 2011.

The financial management benefits of completing Wave 1 are:

- Improves the accuracy and reliability of appropriated funds recorded in DoD systems, and
- Assures accuracy in the prior year funding amounts reported in the Department's annual President's Budget.

Wave 2 – Statement of Budgetary Resources Audit

Wave 2 includes several end-to-end processes that are separated into assessable units each of which must be audit ready before the SBR can be audited. For example, cash disbursements within the Procure-to-Pay process and cash receipts within the Order-to-Cash process must be remediated before the Fund Balance with Treasury (FBWT) Balance Sheet line item can be audit ready. Also, the Procure-to-Pay process must be effective to ensure that Accounts Receivable recorded as a result of reimbursable activity and overpayments (in the Order-to-Cash process) is accurate. Ultimately, successful remediation of the Assessable Units contributes to an audit ready SBR.

The financial management benefits of completing Wave 2 are:

- Improves the visibility of budgetary transactions ensuring a more effective use of limited resources,
- Provides operational efficiencies through more readily available and accurate cost and financial information (e.g., more accurate obligation data for the Planning, Programming, Budgeting, and Execution processes and fewer unmatched disbursements),

- Improves fiscal stewardship through reduced improper payments,
- Improves budget processes and controls thus reducing Anti-deficiency Act violations, and
- Links execution to the President's Budget thus providing more consistency with the financial environment.

Wave 3 – Mission Critical Asset Existence and Completeness Audits

The audit readiness focus of this wave is primarily on the Existence and Completeness assertions, but also includes Rights and Obligations and portions of the Presentation and Disclosure assertions. Interdependencies between remediation of the receipt of goods and services processes included in the Procure-to-Pay process in Wave 2 helps ensure the sustainability of the Existence and Completeness assertions in future periods, especially for assessable units with a high volume of purchasing activity.

The management benefits of completing Wave 3 are:

- Moves the Department closer to achieving its long-standing goal of total asset visibility,
- Improves the reliability and accuracy of the logistics supply chain and inventory systems, which ensures items needed by the warfighter are on-hand when needed and not procured unnecessarily,
- Improves the ability to timely acquire, maintain and retire assets,
- Provides better management information about assets,
- Ensures better control over assets, preventing their misuse, theft, or loss, and
- Reduces unnecessary reordering.

Wave 4 – Full Audit Financial Statements, Except for Legacy Assets (New Asset Valuation)

Wave 4 includes the valuation assertion over new asset acquisitions and depends on the successful completion of Wave 3, requiring the Existence and Completeness assertions to be remediated before the valuation assertion can be completed. Also, proper contract structure for cost accumulation and cost accounting data must be in place prior to completion of the valuation assertion for new acquisitions.

The financial management benefits of completing Wave 4 are:

- Moves the Department closer to achieving its long-standing goal of obtaining an unqualified opinion on all of its financial statements,
- Provides more reliable and accurate logistics supply chain information on the cost of Inventory items and Operating Materials and Supplies (OM&S), and
- Improves the quality of information used by management when making operational decisions about capital investments in Military Equipment and General Equipment.

Wave 5 – Full Financial Statement Audit

Wave 5 focuses on the valuation of legacy assets. Once the Components have asserted effective controls over valuation of new acquisitions of Military Equipment, Real Property, Inventory, OM&S and General Equipment, they will focus on valuing legacy assets. This sequencing of efforts ensures that controls are in place to go forward before addressing legacy assets. Legacy asset valuation depends on the availability of adequate documentation to support appropriate cost accumulation by asset. Successful remediation of assertions related to Existence and Completeness and Valuation will allow the Components to support full-scope financial statement audits.

Appendix 2. FIAR Strategy and Methodology

A clear, comprehensive strategy and methodology for achieving audit readiness is critical to ensuring limited resources are assigned effectively to facilitate measurable and sustainable progress. The FIAR Strategy provides a critical path for the Department while balancing the need to achieve short-term accomplishments with the long-term goal of an unqualified opinion on the Department's financial statements.

The FIAR Methodology provides a phased process and required key tasks for accomplishing FIAR work. It also provides a capability to manage the FIAR Plan by utilizing an organized structure that facilitates oversight of improvement activity and that holds people and organizations accountable for progress.

FIAR STRATEGY

The FIAR Strategy is consistent with, and focuses improvement work on, the objectives and priorities established by the Under Secretary of Defense (Comptroller) (USD(C)), that require the Department to first focus on improving financial and business information most useful to DoD management and warfighters. The USD(C) priorities require improvements to budgetary information and mission critical asset information. Both of these priorities are specifically addressed and prioritized within the FIAR Strategy.

Each of the Department's material financial statement line items have unique and complex accounting and auditing challenges and issues that must be overcome before auditability can ultimately be achieved. The FIAR Strategy groups and prioritizes the material business processes (that result in activity reported on various financial statement line items) within one of five waves, and then summarizes steps each Component should take to address each wave. The waves and steps are prioritized based on USD(C) priorities, known issues, dependencies of financial statements, line items, and business processes on one another.

Figure A2-1. FIAR Strategy

The Department's FIAR Strategy (Figure A2-1) draws from the strengths of several alternative approaches and groups individual end-to-end processes into one or more waves. Efforts are prioritized within each wave by end-to-end processes including corresponding line-items reported on other financial statements, as well as by dependencies.

This strategy provides coverage of all financial statements, while prioritizing and improving first the information most often used by DoD management. Furthermore, the five distinct waves lead to interim audit readiness milestones, and ultimately, to a full-scope financial statement audit. The Components are ensuring appropriate controls are in place and operating effectively for relevant financial reporting processes prior to asserting each wave as complete (e.g., controls over the presentation and disclosure over the SBR must be asserted ready at the end of Wave 2).

The five distinct waves that comprise the FIAR Strategy lead to audit readiness milestones that will be validated by an independent auditor once controls are in place and operating effectively, and the appropriate management assertions have been made.

The Audit Readiness Strategy "waves" representing significant levels of effort and accomplishments are:

- Wave 1 – Appropriations Received Audit
- Wave 2 – Statement of Budgetary Resources (SBR) Audit
- Wave 3 – Mission Critical Asset Existence and Completeness Audit
- Wave 4 – Full Financial Statement Audit, Except for Legacy Assets (New Asset Valuation)
- Wave 5 – Full Financial Statement Audit
- Wave 1, Wave 2 and Wave 3 are being worked concurrently, as shown in Figure A2-1. Additional information on the waves is contained in Appendix 1.

DoD Strategic Management Plan

The DoD Strategic Management Plan (SMP), a requirement of the National Defense Authorization Act for FY 2008, established five top-level priorities for business operations. Business Priority 5, "Strengthen DoD Financial Management," establishes required outcomes, goals, measurements, and key initiatives to ensure DoD leaders have access to timely, relevant, and reliable financial and cost information.

As shown in Figure A2-2, the FIAR Plan provides the strategy and methodology to achieve the outcomes of SMP Business Priority 5 by integrating the Component Financial Improvement Plans (FIPs) with the other key DoD plans, Office of the Under Secretary of Defense for Acquisition, Logistics and Technology (OUSD(AT&L)) Plans, Component Accountability Plans, Defense Enterprise Transition Plan (ETP) and System Implementation Plans. The outcomes, goals, and measures associated with this Business Priority focus on improving financial information for fact-based, actionable management decisions and achieving auditable financial statements.

One of the outcomes of Business Priority 5 is to "Demonstrate good stewardship of public funds." The USD(C) is responsible for achieving this outcome and the associated goal to "Increase the audit readiness of individual DoD Components." The FIAR Plan and Component FIPs have been synchronized with their ETP milestones to achieve the FIAR goals.

FIAR METHODOLOGY

The Department's methodology for achieving improved financial information and auditability has evolved and has been refined since the FIAR Plan was first issued in 2005. The methodology is now more focused, effective, and consistent across the DoD Components. Regardless of this evolution, much of the methodology remains the same, such as:

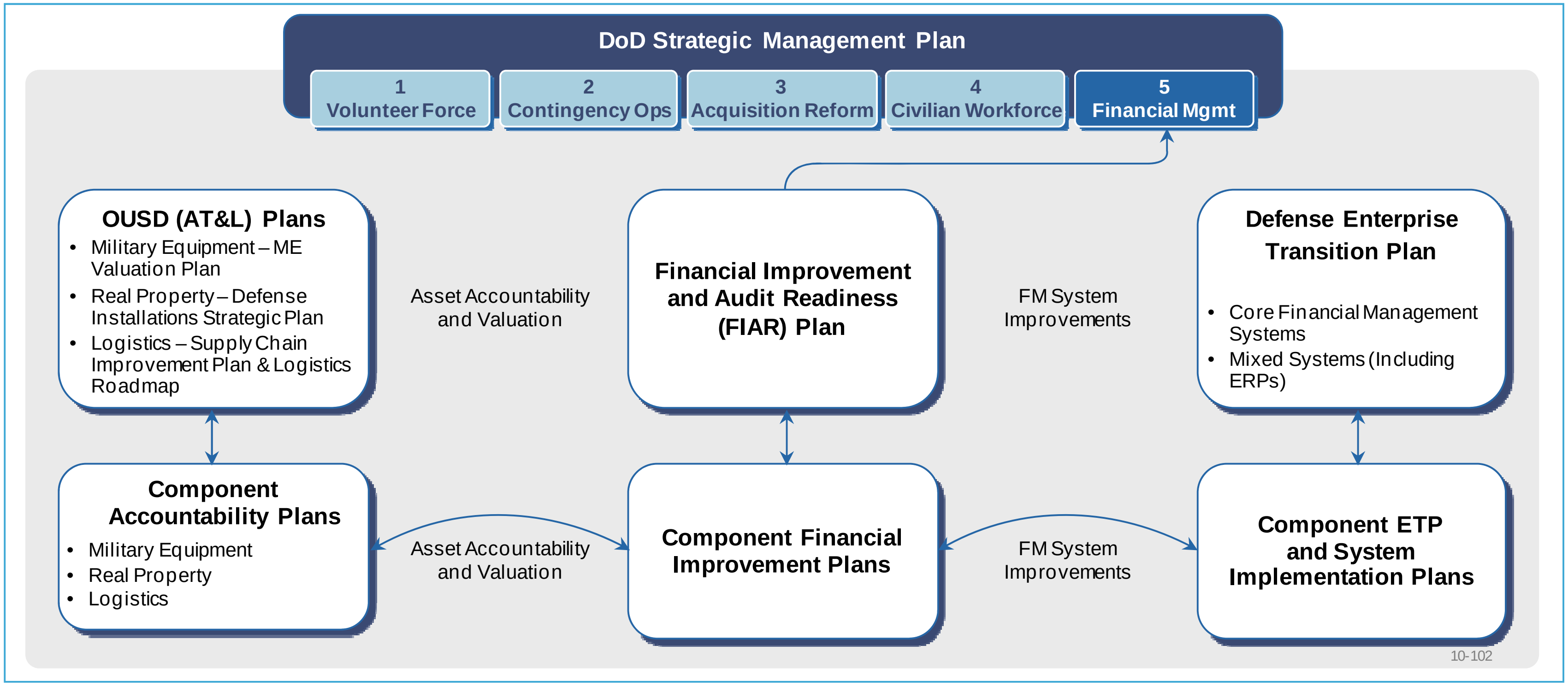
- Guided by Business Rules,
- Integrated with the implementation of OMB Circular A-123, Appendix A,
- Integrated with the modernization of business and financial systems, and
- Comprehensive by focusing improvements on policies, processes, controls, systems, data, audit evidence, and human capital.

The Business Rules, which drive a mandatory, standard step-by-step approach to achieving audit readiness, have been updated to incorporate lessons learned from earlier audit readiness initiatives, and two other important changes to the methodology have been made, as follows:

- Identification of, and focus on, Key Control Objectives (KCOs) and Key Supporting Documents (KSDs) as a primary outcome of financial improvement activities, and
- Use of a standard framework for Component FIPs that incorporates the modified Business Rules.

The modifications to the Business Rules, which are now referred to as the Audit Readiness Phases, and the two above changes are discussed next.

Figure A2-2. FIAR Plan Relationship to the DoD Strategic Management Plan and Other DoD Plans



FIAR Methodology Phases and Key Tasks

Before publication of the FIAR Plan in 2005, the Department developed "Business Rules" that required the Components to execute a phased approach to achieving auditability. The Business Rules also established a process for the OUSD(C) and DoD Inspector General (DoD IG) to evaluate the audit readiness of a Component before a financial statement audit was initiated. This process lessened the risk that the audit would not be successful.

The Business Rules have been refined and are presently referred to as phases within the FIAR Methodology. The methodology provides a step-by-step approach to achieving improved financial information and audit readiness. Figure A2-3 provides a graphical depiction of the phases and the key tasks within each phase.

The phases and key tasks can be applied uniformly regardless of the size, materiality, or scope of an assessable unit, and are as follows:

1. Evaluation and Discovery. Management maps its business and financial environment, assesses risks and tests controls, evaluates supporting documentation, identifies weaknesses and deficiencies, and defines its audit readiness environment.

2. Corrective Action. Management develops and executes corrective action plans/FIPs that include implementation of the audit ready environment, solutions to resolve deficiencies and weaknesses, and tests and strengthens internal controls.

3. Evaluation. Management evaluates corrective action effectiveness through testing and decides if it is ready to assert audit readiness.

4. Assertion. Management asserts audit readiness to the OUSD(C) and DoD IG who evaluate the assertion and decide whether to proceed with an audit.

5. Sustainment. Management maintains audit readiness through risk based periodic testing of internal controls utilizing the OMB Circular A-123, Appendix A, process and procedures, and resolves any identified weaknesses.

6. Validation. The OUSD(C), DoD IG or an independent public accountant (IPA) tests and validates audit readiness.

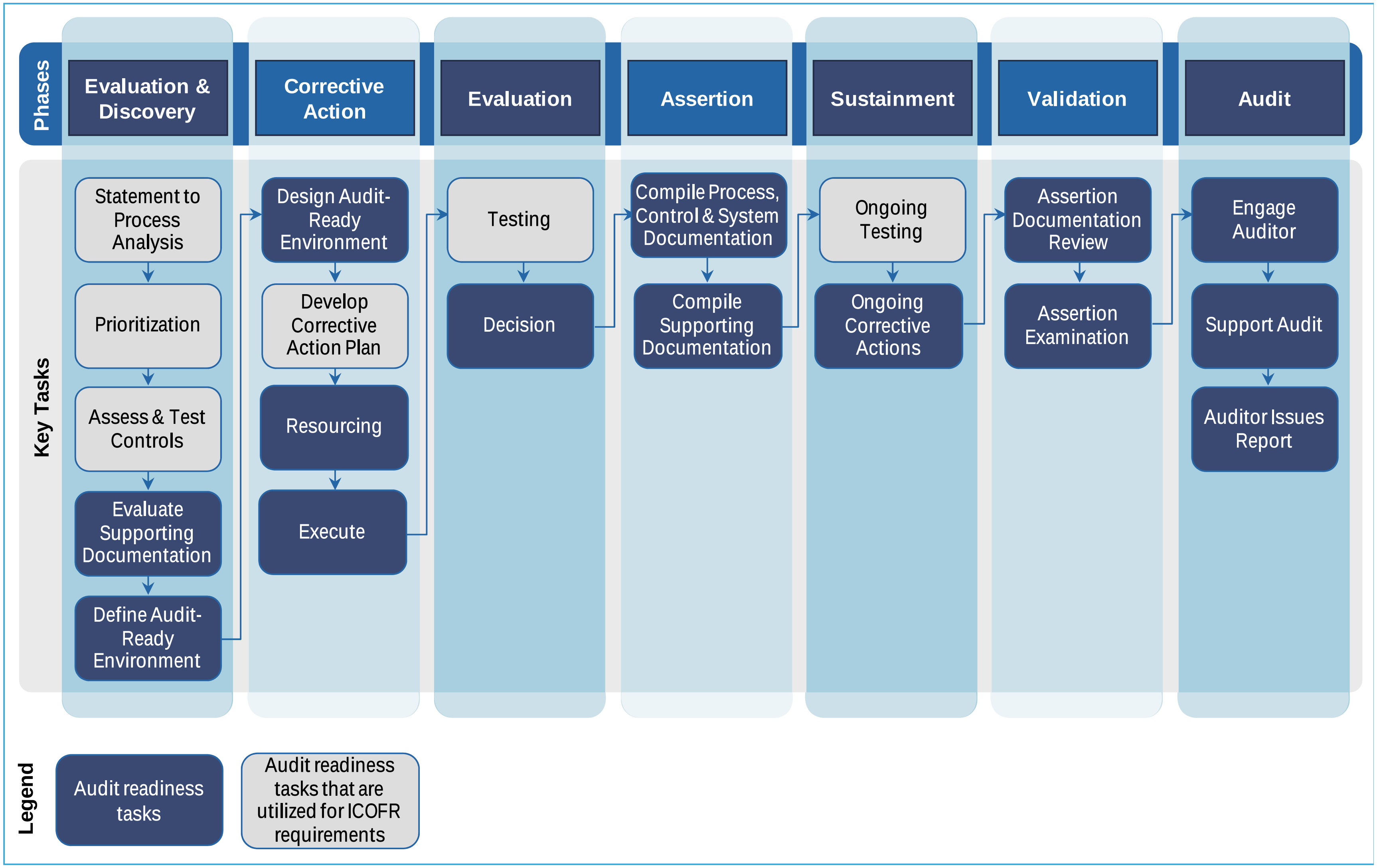
7. Audit. The DoD IG or an IPA audits the assessable unit or financial statements.

This step-by-step phased methodology delineates responsibilities between management and the auditors. Management's responsibilities focus on completing discovery and correction, asserting audit readiness of assessable units or financial statements, sustaining improvements, and asserting audit readiness (Phases 1, 2, 3, 4, and 5). The OUSD(C), DoD IG or independent auditors validate audit readiness (Phase 6), and the DoD IG or an IPA performs the audit of the assessable unit or financial statements (Phase 7).

Detailed information explaining the FIAR Methodology, to include the phases and key tasks, can be found in the FIAR Guidance document issued by the OUSD(C). The FIAR Guidance document is on the Department's FIAR website at:

http://comptroller.defense.gov/FIAR/index.html.

Figure A2-3. FIAR Methodology Phases and Key Tasks



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Executive Summary

The Department of Defense (DoD) is committed to improving financial information used to manage the Department and to achieving auditable annual financial statements by September 30, 2017, as directed by the Congress. Although the DoD has not produced auditable financial statements, the Department does effectively budget, manage, control, execute, and report the funds appropriated by the Congress.

To achieve the 2017 goal of auditable financial statements, the Department has taken significant actions that include:

DoD is Committed to Achieving Financial Statement Audit Readiness by September 30, 2017

- Engaging DoD-wide senior leaders from the business communities, as well as the financial community, and holding them accountable for progress,
- Executing a DoD-wide financial improvement and audit readiness plan, strategy and methodology and providing the resources needed to execute the plan, and
- Integrating DoD-wide business and financial systems modernization projects, which include the enterprise resource planning (ERP) systems.

The DoD's long-standing and most challenging obstacles to achieve auditable balances for mission critical assets are:

- Validating to the satisfaction of financial statement auditors the costs, recorded in DoD systems of record, for the Department's worldwide inventory of mission critical assets (i.e., military and general equipment, real property, inventory, and operating materials and supplies) reported on the DoD Balance Sheet, and
- Maintaining in repositories readily available acquisition and financial documents needed to validate the reported costs for these assets.
- Reengineering business and financial processes, controls and systems to capture, record, and report the acquisition costs of new assets in accordance with Federal accounting standards.

The Department is in the midst of an extensive business and financial systems modernization through the deployment of ten enterprise resource planning systems. It is through the deployments of these systems that the Department expects to achieve an audit ready systems environment and create the capability to consistently record accurately the asset acquisition costs at the transaction level.

Purpose of the Business Case

Business Case Analysis Directed by Congress to Address Long-Standing Audit Readiness Obstacle

The *Business Case Analysis of Alternatives for Valuing Mission Critical Assets* (Business Case) is required by the FY 2011 National Defense Authorization Act (NDAA), which states:

> "…the Under Secretary of Defense (Comptroller) shall…examine the costs and benefits of alternatives for valuing Department of Defense assets and select an approach to such valuation that is consistent with principles of sound financial management and the conservation of taxpayer resources."

Since the Department is focused on reducing its annual operating budget, as directed by the Secretary of Defense, the NDAA requirement to conduct the BCA provides DoD the opportunity to select an approach to not just resolve this long-standing valuation obstacle to achieving an auditability, but to do so in such a way that is cost effective to conserve DoD and taxpayer resources.

The BCA considered and incorporated the following assumptions:

- The DoD will maintain its current strategy to achieve auditability in waves starting with the priorities of the Statement of Budgetary Resources (SBR) and validating the existence and completeness of mission critical assets, and only after achieving those priorities, will the Department begin to value assets for Balance Sheet reporting. Given this assumption, this BCA only looks at the incremental cost to record and audit asset values in an improved reporting environment that results from changes to business and financial processes, controls and systems needed to achieve the objectives of the SBR and mission critical asset existence and completeness priorities.
- The ERP systems will provide the capability to accurately and timely record business events and financial transactions and post them to DoD accounting ledgers.
- DoD produces audited financial statements for users outside the Department, and the primary purpose of government financial statements is to demonstrate effective stewardship and management of public funds to citizens.

How the BCA Was Performed and the Results

Balance Sheet Asset Cost Information Is Not Used for Decision-making

After selecting three alternatives, which are discussed in the next section, staff from the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) interviewed decision makers at various levels across the Department who make asset acquisition, utilization, maintenance, and disposal decisions. The staff also interviewed the Comptroller of the U.S. Coast Guard and Deputy Chief Financial Officer of National Aeronautics and Space Administration. The interviews were conducted to learn if historical acquisition cost information recorded in accounting systems and other systems of record was being used for decision-making and what, if any, other cost information was used.

With the exception of inventory and operating material and supplies (OM&S), the staff found that historical acquisition cost information recorded in DoD accounting systems was *exclusively used* for financial statement reporting and not for decision-making. Inventory and OM&S decision makers, when making purchases or considering or negotiating acquisitions, reviewed historical acquisition costs in their information management systems to use as a benchmark for evaluating the cost of the new items. However, prior cost is only one factor; they most often used the latest acquisition cost. Without exception, they stated that the historical acquisition cost information in their systems is as reliable as needed for use in their decision-making and audits would not add value.

Value of the Information is Limited to External Stakeholders

Therefore, any benefit to recording and auditing these asset values is to demonstrate to the public through independent audits that DoD has reliable financial management information and, therefore, is a good steward and manager of public funds. The next section discusses the valuation alternatives used to perform the Business Case.

Valuation Alternatives

The Department identified three alternatives for valuing mission critical assets (i.e., military equipment, general equipment, real property, inventory, and operating materials and supplies). The alternatives that were identified and evaluated are:

- Alternative 1: Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support costs of future acquisitions.
- Alternative 2: Accept the recorded historical acquisition costs for existing assets and estimate the costs of future acquisitions.
- Alternative 3: Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards.

Alternative 1 and Alternative 2 both start with "accept the recorded historical acquisition costs for existing assets," because the Department's experience in obtaining auditable historical acquisition costs for its existing assets is:

- Very expensive (e.g., over $18 million on spent on valuing military equipment) and time consuming with unproven results (i.e., not validated or audited by an Independent Public Accounting firm);
- Challenged by the DoD Inspector General in the case of military equipment;
- Not sustainable with DoD Components' existing business and financial processes, controls and systems and while in the midst of significant changes from ERP deployments changes to existing processes and controls supporting existing systems are not cost effective.

Value future Acquisitions but do not Use Resources to Value Past Acquisitions

For the Department to fully comply with the Federal accounting standards and achieve auditability for information not used by the Department other than for financial statement reporting much would need to be done at a significant cost. Regardless, if during the conduct of the Business Case, it became clear that historical acquisition cost information was used for decision-making, Alternative 1 and Alternative 2 would have been modified. However, that was not the outcome of interviews with decision makers, as explained in the next section. Consequently, the DoD will only value assets acquired using improved processes, controls, and systems and will not waste public funds looking back in time to value existing assets.

Selected Alternatives

Wide Consensus on the Selected Alternatives

After conducting the interviews and evaluating the alternatives, the Under Secretary of Defense (Comptroller) selected the appropriate alternative for each Balance Sheet asset category and coordinated the selected alternatives. The alternatives were coordinated with the DoD Chief Management Officer (CMO), Military Department CMOs and Financial Management/Comptrollers, and key executives within the OUSD(AT&L), as well as members of the Defense Audit Advisory Committee. The Department also discussed the selected alternatives with, and received the endorsement from, the Office of Management and Budget, Government Accountability Office, CFO Council and the Chairman of the Federal Accounting Standards Advisory Board.

The following provides the selected alternatives by type of Balance Sheet asset, the reporting approach that will be used, and why the alternative was selected and the way forward.

Real Property, General Equipment, Inventory and OM&S

Report these Assets on the Balance Sheet When Initial FIAR Priorities Are Met and the ERPs Are Capable of Recording and Reporting Transaction Data

Selected Alternative: Alternative 1: Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support costs of future acquisitions of real property, general equipment, inventory, and OM&S.

Reporting Approach:

- Report the costs of newly acquired general equipment, inventory, and OM&S on the Balance Sheet when the ERPs are deployed and capable of reporting auditable acquisition costs and the initial FIAR Priorities are met.
- Report the costs of newly acquired real property on the Balance Sheet when the Components have implemented the Department's requirements that result in the capability to record and report auditable acquisition costs.

Why DoD Selected Alternative 1:

- The Components are presently implementing mandatory process, control, and systems changes that will result in the capability to report auditable real property acquisition costs on the Balance Sheet.
- The ERPs being deployed provide the inherent capability to record and report the cost of newly acquired general equipment, inventory, and OM&S.
- The value and cost of obtaining information are in alignment so it is cost-effective to meet current standards.

Way Forward:

- Accept the recorded costs of general equipment, inventory, and OM&S held before the deployment of the ERPs, continue to deploy the ERPs and incrementally validate that the ERPs are capable of recording and reporting auditable acquisition costs.
- Define the criteria for using of the Purchases Method of accounting for OM&S; thereby, reducing the amount of Balance Sheet reportable OM&S.
- Continue to implement the mandatory requirements for real property and accept the recorded costs of real property held prior to implementation.

Military Equipment

Expense Military Equipment and Report as Required Supplementary Information

Selected alternative: Alternative 3. Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards.

Reporting approach: Expense acquisition costs on the Statement of Net Cost; do not report military equipment on the Balance Sheet; report quantities of military equipment in Required Supplementary Information (RSI).

Why DoD Selected Alternative 3:

Capturing, recording, and reporting auditable costs would be extremely challenging and costly. The most significant reasons are:

- Military equipment assets (i.e., weapons systems) are not acquired like most commercial equipment ("off the shelf"). Instead, the Department acquires the equipment through complex acquisition programs. These programs, often utilizing hundreds of complicated contracts with many contract modifications for configuration or capability changes and upgrades or modifications that extend over the life of the program/weapons systems (e.g., Navy E-2D Aircraft Program involves almost 700 purchase order contract lines in more than 125 contracts that have been modified hundreds of times and this is one Major Defense Acquisition Program (MDAP) out of 98[1] ongoing MDAPs).

- To be auditable the costs of weapons system end items for Balance Sheet reporting and depreciation must include the cost of significant amounts of costly government furnished material (e.g., titanium hardware) and equipment (e.g., aircraft engines, communication equipment – radios) provided from DoD stocks and other acquisition programs.
- Existing business processes (e.g., contract development and management) and systems (e.g., contract management systems) do not support capturing costs in a manner that is consistent with Federal accounting standards and such changes would require significant process changes by the acquisition community.
- The ERPs being deployed by the Military Departments have not been configured, nor have plans been made or funded, to achieve the capability needed to capture acquisition costs at the transaction level to comply with Federal accounting standards.
- Satisfying the objectives of financial reporting (i.e., Budgetary Integrity, Operating Performance, Stewardship and Systems and Controls) of the Congress and Federal concepts for accounting standards, as stated in the Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting,* would be accomplished by achieving the financial improvement and audit readiness priorities established by the Department:
- Audits of the Statement of Budgetary Resources (SBR) will demonstrate budgetary integrity and assurance of financial, stewardship and systems and control over appropriated funds for military equipment acquisitions.
- Existence and completeness audits of military equipment will provide assurance of physical, stewardship, and systems and control of assets.
- Several attempts to value military equipment using estimates have cost approximately $18 million and the estimates have not been proven sustainable.
- In addition to the costs of valuing the equipment, the Department spent approximately $49 million for a system to track the information.
- The approach avoids the costs to audit the capitalized cost of military equipment assets recorded in DoD accounting systems, which are not used for decision-making.

[1] GAO-11-233SP, *Defense Acquisitions*: *Assessments of Selected Weapons Programs*, March 2011

Way Forward:

- Continue efforts to achieve successful audits of the Statement of Budgetary Resources and existence and completeness audits of military equipment.
- Change the definition of military equipment – for acquisition and financial reporting purposes – to better reflect the use of the assets and the mission of the Department.
- Submit a request FASAB to change the accounting standard to allow expensing and report, by count, major end items of military equipment as RSI.
- Expense military equipment and begin reporting quantities as RSI.

I. Background and Requirement

Background

Enacted by Congress in 1990, the Chief Financial Officers Act mandates that Federal agencies annually prepare audited financial statements. While some organizations within the Department of Defense (DoD) have received unqualified audit opinions, significant dollar amounts of the Department's Balance Sheet assets have not received unqualified audit opinions including those assets called *mission critical assets* in the DoD Financial Improvement and Audit Readiness Status Report (FIAR Report). Mission critical assets are defined as military equipment, general equipment, real property, inventory, and operating materials and supplies. The Department has over $783 billion in mission critical assets as shown in Figure I-1.

Figure I-1. DoD Mission Critical Assets

(FY 2010 $ in Millions)

Asset Type	Historical Cost	Accumulated Depreciation	Net Book Value
Military Equipment	$822,317	$408,613	$413,704
General Equipment	90,290	58,283	32,007
Real Property	218,842	112,331	106,511
Inventory	84,625	N/A	84,625
Operating Materials & Supplies	147,011	N/A	147,011
Totals	**$1,363,085**	**$579,227**	**$783,858**

The DoD is committed to having fully auditable financial statements by September 30, 2017, the deadline established by Congress in the *National Defense Authorization Act of 2010*, and the results of this Business Case are expected to assist the Department achieve that date.

Major challenges to reporting and successfully auditing mission critical assets are:

- Incomplete evidence (e.g., acquisition contracts and invoices) to support the reported amounts,
- Existing accountability and accounting systems that were not designed to support financial statement reporting,
- Business and financial processes that do not support capturing acquisition costs in compliance with the Federal accounting standards, and
- Inadequate internal controls,
- Distribution of the assets around the world to include a significant number of assets deployed in warzones.

The Department has initiatives in place to address all but the last of these challenges. In most instances, overcoming these challenges will not correct past errors and deficiencies. This is discussed in more detail in Section II of this Business Case under the heading of Accept the Recorded Historical Acquisition Costs of Existing Assets.

Audit Evidence. Documentary evidence needed to support reported amounts – is incomplete or insufficient to support all of the Department's reported asset costs. An auditor must obtain "Sufficient, competent, and relevant evidence…to provide a reasonable basis for the auditor's findings and conclusions." Absent evidence to support the recorded amounts (historical costs) for mission critical assets, the alternative is to estimate the historical costs (excludes inventory and operating materials and supplies), which is allowed under generally accepted accounting principles (GAAP). Given the number of worldwide existing assets without sufficient evidence to support acquisition cost, this is a daunting and costly challenge.

Existing Systems. Information about mission critical assets is generally stored in non-financial systems often referred to as accountable property systems of record. These systems (feeder systems) were not designed to support financial statement reporting. Challenges include the total number of feeder systems in use. Another challenge is the lack of interfaces among these systems and DoD accounting systems, which requires the information be "moved" manually from one system to another. This invariably results in errors. Successfully implementing enterprise resource planning systems (ERP) will replace the existing plethora of feeder systems, but some replacements are many years away.

Processes and Controls. Inadequate internal controls and process deficiencies are being tackled in more than one way. One way is through the Department's work to establish a strong internal control environment through the DoD *Internal Controls over Financial Reporting Program* that requires DoD organizations to evaluate and test internal controls and to develop remediation plans for material weaknesses identified during testing. Another is during the implementation of ERPs. An ERP, by its nature, drives changes in business processes and often replaces manual controls with automated application controls. Finally, fixing controls and processes is a major focus of the Department's Financial Improvement and Audit Readiness initiative.

Worldwide Asset Dispersion. The last challenge, as noted above, is inherent to the mission of the Department and must be managed – it cannot be fixed. That is, the Department has assets distributed worldwide including those in Iraq and Afghanistan. Knowing what assets the Department has, where those assets are located, and the condition of those assets is part of the audit challenge faced by the Department.

Requirement

The requirement to perform a business case on valuation alternatives for DoD Balance Sheet assets originated with the Honorable Robert F. Hale, Under Secretary of Defense (Comptroller) (USD(C)) and Chief Financial Officer (CFO). Before his confirmation, Mr. Hale began his quest to determine the priorities for his term in office to support the new Administration, the warfighter and the mission of the Department. To develop and shape his priorities for improving financial information and achieving auditable financial statements, Mr. Hale met with senior DoD financial management leaders and key officials of the Office of Management and Budget and Government Accountability Office.

A significant DoD-wide challenge for achieving auditable financial statements is obtaining auditable costs for the Department's mission critical assets (military equipment, general equipment, real property, inventory, and operating materials and supplies). From his previous experience in the Department, Mr. Hale believed the DoD was not using the historical acquisition cost information reported on its Balance Sheet, and therefore, was concerned about the use of taxpayer resources to obtain auditable historical costs and the cost to audit them. Mr. Hale knew the Department needed accurate information on funding availability, obligations and disbursements, as well as accurate information on its mission critical assets. He also thought that historical cost information was only used for Balance Sheet reporting, and this requirement was contrary to his newly defined priority to focus improvement efforts on financial information most often used to manage the Department. Mr. Hale's priorities, which are now the Department's priorities, are explained in a following subsection.

Mr. Hale continues to express his concern about using taxpayer resources to improve information that is not used by the Department in testimony and discussions with the members of the Congress, congressional oversight committees, and staffs. Mr. Hale's concerns and those discussions resonated with members of the Congress, and the result was a requirement in the FY 2011 National Defense Authorization Act (NDAA) to perform this Business Case. The next subsection provides the specific requirement from the FY 2011 NDAA.

FY 2011 National Defense Authorization Act (NDAA)

Section 881(b), *Valuation of Department of Defense Assets*, of the FY 2011 NDAA, states:

> "(1) Requirements. Not later than 120 days after the date of the enactment of this Act, the Under Secretary of Defense (Comptroller) shall, in consultation with other appropriate Federal agencies and officials:
>
> (A) examine the costs and benefits of alternative approaches to the valuation of Department of Defense assets;
>
> (B) select an approach to such valuation that is consistent with principles of sound financial management and the conservation of taxpayer resources; and
>
> (C) begin the preparation of a business case analysis supporting the selected approach.
>
> (2) The Under Secretary shall include information on the alternatives considered, the selected approach, and the business case analysis supporting that approach in the next semiannual report submitted pursuant to section 1003(b) of the FY 2010 NDAA," i.e., *Financial Improvement and Audit Readiness Status Report.*

Priorities for Financial Improvement and Audit Readiness

Following his Senate confirmation, Mr. Hale continued his discussions with DoD senior leaders to help shape his objectives and priorities for the Department's financial improvement activities. Those priorities were coordinated with the Deputy Secretary of Defense, Office of the Inspector General (OIG), Office of Management and Budget (OMB), Government Accountability Office (GAO), and Congress, who approved, endorsed or acknowledged them. In fact, Congress included the same priorities in the FY 2010 NDAA. The Department's financial improvement priorities were officially set forth in a DoD-wide memorandum on August 11, 2009.

The objective of the priorities is to improve processes, controls, and systems that provide the information that is most often used to manage the Department, while continuing to work toward financial improvements that will result in unqualified audit opinions on DoD financial statements. To achieve that objective, the Mr. Hale assigned a high priority to:

- Budgetary information, and
- Mission Critical Asset information.

These priorities are integrated in the Department's Financial Improvement and Audit Readiness (FIAR) Strategy. The FIAR Strategy focuses financial improvement work into five-well defined and distinct "waves" of activity that incrementally lead to audit readiness. The priorities of budgetary information and Mission Critical Asset information are the focus of Waves 2 and 3 and are discussed in the paragraphs following. This Business Case addresses waves 4 and 5. Wave 4 focuses work to achieve a full financial statement audit – except for existing assets. Wave 5 directs efforts to achieve a full financial statement audit. As noted in the Executive Summary, one recommendation of this Business Case is that existing assets not are valued and subsequent sections explain why. Not valuing existing assets eliminates Wave 4 and the current Wave 5 is renumbered to Wave 4.

The next two subsections explain these priorities.

Budgetary Information

Recognizing that many decisions made in the Department are budget related (e.g., status of funds received, obligated and expended), the first priority focuses improvement work on processes, controls and systems that produce budgetary information. By focusing improvement activity on budgetary information and ensuring it is timely and accurately produced, the Department will accomplish the objective to improve information most often used by management and to meet the goal of obtaining auditable financial statements starting with the Statement of Budgetary Resources (SBR).

When the objective of the Budget Information priority has been achieved:

- Business and financial processes related to the SBR will have been changed to conform with generally accepted accounting principles;
- An audit ready systems environment requiring the modernization of business and financial systems will be complete;
- Internal controls will have been documented, tested and strengthened, and a strong internal control programs will sustain audit readiness;
- Audit evidential matter for SBR transactions will have been evaluated and be readily available to support future audits;
- Ability to perform capital and budget planning will improve; and
- Budgetary information contained in accounting systems of record will be reliable and accurate, and the Department-wide SBR will be ready for audit.

Improvements in these areas will not only result in auditable SBRs, but more importantly, will improve the reliability of budget information in management reports used for decision-making and achieve the Budgetary Integrity objective of the Statement of Federal Financial Accounting Concepts (SFFAC) No 1: *Objectives of Federal Financial Reporting*, which states, "The budget is the most widely recognized and used financial report of the federal government." SFFAC No. 1 goes on to note that, "It is a vehicle for the political process to reach agreement on goals and to allocate resources among competing priorities. **It provides a system for controlling expenditures** [emphasis added.] It supplies information necessary for assessing the effect on the economy of the government's fiscal policies.[2]"

Mission Critical Asset Information

The second priority focuses improvement and audit readiness activities on information essential to manage effectively the Department's mission critical assets and to ensure that these assets are properly safeguarded to deter fraud, waste, and abuse[3].

Some of the same information needed to manage the Department's mission critical assets is also needed for future financial statement audits. Such information includes:

- Unique Identifiers (e.g., item unique identification [IUID] number, Real Property UID [RPUID], aircraft tail number, ship number)

[2] Statement of Federal Financial Accounting Concepts 1: *Objectives of Federal Financial Reporting*, paragraph 67.

[3] Statement of Federal Financial Accounting Concepts 1: *Objectives of Federal Financial Reporting*, paragraph 146.

- Location (e.g., military installation/base)
- Condition (e.g., operational status, such as in-service, out of service and awaiting repair)
- Accountable organization (e.g., 374th Tactical Airlift Wing)
- Accountable individual (e.g., SSGT John Smith)

The immediately preceding information, and other management and financial information, is recorded in the Department's official systems of record, referred to as accountable property system of record. Ensuring that management information regarding mission critical assets is accurately recorded in each Component's accountable property system of record is an objective of this priority.

When the Mission Critical Asset priority has been achieved:

- Information (e.g., quantity, location) pertaining to the existence and completeness of mission critical assets will be reliable and accurate,
- Specific management information (e.g., condition, usage) pertaining to mission critical assets will be reliable and accurate,
- Maintenance planning and asset disposition decisions will be improved,
- Ability to perform capital and budget planning will improve, and
- Business and financial processes and controls will have been documented, controls tested and strengthened.

II. Alternatives for Valuing Mission Critical Assets

The FY 2011 National Defense Authorization Act did not identify the alternatives to be examined. Rather, it stated "select an approach to such valuation that is consistent with principles of *sound financial management* and the ***conservation of taxpayer resources***" [emphasis added].

The requirement to consider the cost of any solution is also consistent with the FASAB Concepts 1, Chapter 5, *Balancing Costs and Benefits of Reporting Standards*, and throughout the FASAB standards. These standards require reporting financial information when the value of the information exceeds the cost of collecting and reporting the information.

The asset valuation alternatives that the Department considered are identified and explained in this section of the Business Case.

Alternatives for Valuing Mission Critical Assets

The three alternatives for valuing mission critical assets for DoD Balance Sheet reporting that were identified, coordinated within the Department, evaluated, and addressed in this Business Case are:

Alternative 1: Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support the costs of future acquisitions.

Alternative 2: Accept the recorded historical acquisition costs for existing assets and estimate the costs of future acquisitions.

Alternative 3: Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards.

How the Alternatives Were Identified

The alternatives evolved in a collaborative process, typical in the Department on important policy matters, which involved key representatives from the Office of the Secretary of Defense, Military Departments and a key Defense Agency to identify the most appropriate valuation alternatives. The proposed alternatives were presented to the Under Secretary of Defense (Comptroller)/Chief Financial Officer (CFO) and Deputy CFO, and then, they were briefed to the following organizations during their regularly scheduled meetings in October and November 2010:

- Financial Improvement and Audit Readiness (FIAR) Governance Board
- FIAR Committee
- FIAR Subcommittee

These organizations include senior executives and senior staff members of various offices of the Office of the Secretary of Defense, Military Departments, Defense Agencies, and Office of the DoD Inspector General.

The proposed alternatives also were briefed and discussed with the DoD Audit Advisory Committee, which is comprised of independent representatives from industry and academia. After collaboration and adjusting the alternatives, the USD(C)/CFO approved the alternatives.

The three approved alternatives were presented and described in the November 2010, "FIAR Plan Status Report," that is broadly coordinated throughout the Department and issued to Congress.

The process ensured a DoD-wide consensus on the alternatives that best represent the intentions of Congress when it stated, "*select an approach to such valuation that is consistent with principles of sound financial management and the* ***conservation of taxpayer resources***." [emphasis added] The remainder of this section discusses the valuation of existing assets and the three alternatives used for this Business Case.

Accept Recorded Historical Acquisition Costs

"*Accept the recorded historical acquisition costs of existing assets*" means that for its existing assets, the Department will report on its Balance Sheet the amounts recorded in its accounting, accountability, logistics, supply and other subsidiary systems without additional work to achieve audit ready amounts, to locate supporting acquisition documentation and will disclose appropriate information about these amounts in the notes to the DoD financial statements. For both Alternative 1 and Alternative 2, accepting the recorded historical acquisition costs is a key element.

DoD decision makers, both within the functional and financial communities, at all levels, both senior executives, and working level civilians and military, agreed that historical acquisition cost information for military equipment and general equipment and real property recorded in DoD accounting systems was used exclusively for financial statement reporting. For inventory and operating materials and supplies, historical acquisition cost information was used as one factor of many in making purchase decisions. They also agreed that spending taxpayer resources to obtain auditable values for the Department's worldwide inventory of mission critical assets was not justified unless evidence showed that this information was useful for decision-making. Therefore, as discussed in the Section I of this Business Case, the interviewees were asked whether they used historical acquisition cost information and if they would use this information if it was more reliable and annually audited to ensure its accuracy. As discussed in the subsection on Alternative 3 (below), only limited use of historical acquisition cost information was identified, and that use was limited to some acquisition personnel for inventory and operating materials and supplies.

Figure II-1 is the projected cost to value the Department's existing stock of mission critical assets other than military equipment. As noted earlier the Department has already spent more than $60 million on estimating the cost of military equipment and yet does not have an auditable or sustainable amount for reporting. Because the historical cost of existing assets does not provide valuable information, the Department will instead focus on new acquisitions and achieve a clean opinion as older balances are no longer material.

Figure II-1. Projected Cost to Estimate the Acquisition Cost of Legacy Assets

($ in Millions)

DoD Component	Cost to Value Legacy Assets
Real Property	$12
Inventory/OM&S	433
General Equipment	10
Total Costs	$455

The Department understands the audit opinion implications of "*accept the recorded historical acquisition costs of existing assets*" on the DoD Balance Sheet. Both Alternative 1 and Alternative 2 could result in less than an unqualified Balance Sheet opinion at first. Nevertheless, the Department does not think the benefit of an unqualified opinion justifies the cost of achieving auditable financial statements by first valuing existing assets or the cost of auditing those amounts when such information is not used within the Department. Over time, the existing assets will become fully depreciated or consumed, in the case of inventory and OM&S, and therefore less material to the amounts reported on the financial statements. That is, the existing assets will represent a decreasing percentage of the amounts reported as new assets are purchased and the old assets are depreciated, consumed, or retired. As this happens, the Department will move closer to an unqualified opinion.

The Department is mindful of the perceived benefit of an unqualified Balance Sheet audit opinion by those seeking assurance that the Department has financial and physical control of its resources. The Department will achieve such assurance by:

- Clean audit opinions on the Statement of Budgetary Resources demonstrate financial control over all DoD financial resources and appropriations, and
- Clean audit opinions on mission critical asset existence and completeness audits demonstrate physical control over DoD assets.

The decision to *"Accept the recorded historical acquisition costs of existing assets,"* besides conserving scarce resources also allows the Department to focus its efforts on reengineering its business and financial processes, controls and systems to achieve audit readiness. Accepting these costs will permit the Department to focus on improving future financial information rather than fragmenting its efforts to improve cost information for existing assets at the expense of bringing about the changes necessary to improve future financial management and financial reporting. Alternative 1 and Alternative 2 have been summarized by many in DoD as, "Focus on the Future!" Both Alternatives, which are discussed next, are predicated on accepting the recorded costs of existing assets.

Alternative 1

Alternative 1 states that the Department will "capture and maintain transaction data to support the costs of future acquisitions." Capturing and maintaining transaction data means asset acquisition costs must be timely and accurately recorded in the appropriate general ledger accounts within DoD accounting or mixed systems, as required by the Federal Financial Management Improvement Act (FFMIA) of 1996. FFMIA requires Federal financial management systems to comply with Federal applicable accounting standards and record (post) financial data to the U.S. Standard General Ledger at the transaction level.

> Alternative 1: Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support the costs of future acquisitions.

The Department's financial systems environment is not FFMIA compliant, but the DoD is working to achieve compliance through FIAR and business and financial systems modernization efforts and the ERP deployments. Alternative 1 is substantially dependent on a FFMIA compliant systems environment.

Alternative 2

Alternative 2 states that the Department will record the acquisition cost of newly acquired assets using an estimation method, as permitted by SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23.*

> Alternative 2: Accept the recorded historical acquisition costs for existing assets and estimate the costs of future acquisitions.

Although reasonable estimates are permitted by SFFAS No. 35, it states that federal entities that use estimates to approximate historical cost are encouraged to establish processes and practices, i.e., adequate systems and internal control practices) for future acquisitions that will capture and sustain transaction data that meet the historical cost valuation requirements.

SFFAS No. 35 is only applicable to General PP&E and is not applicable to inventory or Operating Material and Supplies; therefore Alternative 2 applies to only military equipment, general equipment, and real property.

SFFAS No. 3, *Accounting for Inventory and Related Property*, states that inventory may be valued at historical cost or **any other valuation methods that approximate historical cost** [emphasis added]. However, beyond a discussion of the use of LIFO for rapidly cycling inventory the standard does not include appreciable guidance on other valuation methods.

Alternative 3

Alternative 3 proposes to eliminate audits of either:

- A specific Balance Sheet line or lines, or
- Information disclosed in notes to the Balance Sheet, such as military equipment, which is disclosed in Note 10 to the General PP&E line of the Balance Sheet.

Alternative 3 also states that in lieu of Balance Sheet, reported costs would be expensed and FASAB would be asked to change the Federal accounting standards. Expensing costs would be applicable to military equipment, general equipment, real property, and operating materials and supplies, but would not be applicable to inventory, which is expensed only when sold.

> Alternative 3: Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the standards.

The key to understanding Alternative 3 is that the objective of ensuring that assets are properly safeguarded to deter fraud, waste, and abuse will be accomplished without reporting values for these assets on the DoD Balance Sheet through the performance of existence and completeness audits as set forth in the DoD Financial Improvement and Audit Readiness Plan Status Report. In addition, the objective of ensuring that transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized and are recorded in accordance with Federal accounting standards will be demonstrated by audits of the Statement of Budgetary Resources.[4]

Section IV – VIII of this Business Case discuss the alternatives selected by type of assetThe Under Secretary of Defense (Comptroller)/Chief Financial Officer selected Alternative 3 only for military equipment, because:

- Initiatives are already underway to configure the DoD Components' ERPs and modify accountability systems to capture transaction data to support the reporting of Balance Sheet values for
  - General equipment,
  - Real property,
  - Inventory, and
  - Operating materials and supplies.
- Precedent supports not reporting values for military equipment. Prior to SFFAS No. 23, *Eliminating the Category National Defense Property, Plant and Equipment*, the acquisition costs for items classified as National Defense (ND) Property, Plant and Equipment (i.e., military equipment) were expensed in the period incurred and quantities of military equipment were reported as Required Supplementary Stewardship Information (RSSI).

[4] See Statement of Federal Financial Accounting Concepts 1: *Objectives of Federal Financial Reporting*, paragraph 146.

III. Business Case Approach

The DoD Comptroller assigned the responsibility to perform a business case to the Financial Improvement and Audit Readiness Directorate of the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) supported by the OUSD(Acquisition, Technology and Logistics). These offices have extensive experience with the Department's challenges and status in achieving DoD Balance Sheet asset auditability.

How the Business Case Analysis Was Performed

The Business Case Analysis (BCA) was conducted independently by those within the above offices, that is, without day-to-day supervision and direction from management. This was done deliberately to allow for a level of impartiality in the conduct of the business case (e.g., when conducting interviews and evaluating alternatives). However, the approach, status, and progress of the BCA were monitored and reviewed by management.

The following steps were performed for the BCA:

1. Identify, collaboratively with the DoD Components and functional community appropriate alternatives for valuing assets.
2. Achieve DoD-wide consensus on the alternatives and approval by the USD(C).
3. Identify and interview decision makers to determine if and how they use the historical acquisition cost information recorded in DoD accounting systems and reported on the Balance Sheet.
4. Determine whether and how to estimate implementation and audit costs and collect cost estimates, if needed.
5. Evaluate the alternatives by Mission Critical Asset type.
6. Present recommended alternatives to the USD(C).
7. USD(C) selects the alternative(s).
8. Coordinate the selected alternative(s) within the Department to include the Deputy CMO, Military Department CMOs, FIAR Governance Board, and Defense Audit Advisory Committee.
9. "Socialize" the selected alternative(s) with other Federal officials (e.g., OMB, GAO, and CFO Council).
10. Prepare the business case supporting the selected alternative(s).
11. Incorporate the business case results in the May 2011 FIAR Plan Status Report.

Steps 1 and 2, identification of the appropriate alternatives, are discussed in Section II of this report. Step 3, conducting interviews, is discussed in the next subsection. Step 4, estimate implementation and audit costs, is also described below. Step 5, evaluation of alternatives by asset type, is presented in Sections IV – VIII of this report. Steps 6 – 9, alternative(s) selection, is discussed in the next subsection below.

Interviewing Decision Makers

A key step in conducting the BCA was interviewing decision makers about their use of historical acquisition cost information. Due to the size of DoD, its many missions and numerous business and financial operations, a cross-sampling of senior executives and staff-level individuals were interviewed from the Offices of the Secretary of Defense, Military Departments, Defense Logistics Agency, and two other Federal agencies with similar missions and activities.

For each type of Mission Critical Asset, interviews were conducted with individuals that were either responsible in their day-to-day position for making asset related decisions or managing individuals or organizations that did. The individuals and organizations interviewed were responsible for asset planning, programming and budgeting; acquisition; utilization; maintenance and/or upgrades or modifications; replacement; or disposal.

The purpose of the interviews was to obtain answers to the following questions:

1. Do you use the historical acquisition cost information reported on the Balance Sheet for decision-making, and if used, how it is used?
2. What cost information do you use, if historical acquisition cost information is not used?
3. If historical acquisition cost information was auditable, would you use such information, and if yes, for what purpose?

To ensure that the discussions with those interviewed were correctly understood, their responses to the above three questions were documented, summarized, and subsequently provided to them for review, edit, and correction.

The following table identifies the DoD and non-DoD organizations that were interviewed and the type of mission critical assets under their purview.

Figure II-2. Listing of Organizations Interviewed

Organization	Military & General Equipment	Real Property	Inventory/ OM&S
OUSD(AT&L)/Supply Chain Integration			✓
OUSD(AT&L)/I&E/Business Enterprise Integration		✓	
OSD – CAPE Program Evaluation	✓		
OSD – CAPE Cost Assessment	✓		
Army – Working Capital Fund Budget			✓
Army – Program Manager for Apache Program	✓		
Army – Program Manager for Utility Helicopter Program	✓		
Navy – NAVSUP Comptroller			✓
Navy – NAVAIR PMO for E-2D Program	✓		
Air Force – Communications, Installation & Mission Support		✓	
Air Force – A4L			✓
Air Force – Real Property Officer/Langley AFB		✓	
Air Force – AFMC/FM			✓
Air Force – AQX	✓		
Defense Logistics Agency – J3, J7, J8			✓
Logistics Management Institute	✓		✓
NASA – Deputy CFO	✓	✓	✓
U.S. Coast Guard – Comptroller	✓	✓	✓
Australian Department of Defence	✓	✓	✓

The interview results, whether internal or external to DoD, were overwhelmingly similar regardless of individual position, organization, business activity, and asset type. With the exception of historical acquisition cost information recorded in Accountable Property Systems of Record or DoD accounting systems and reported on the Balance Sheet is not used for decision-making. However, the individuals interviewed who purchase inventory and operating material and supplies (OM&S) items or manage those that do stated that they do refer to historical acquisition costs at times as a benchmark when acquiring new items. However, they most heavily rely on is the latest acquisition cost of an item when acquiring another like-kind item or replacement item.

> With the exception of Inventory and OM&S, historical acquisition cost information recorded in functional and accounting systems is not used for decision-making.

Figure II-3 summarizes the responses to the three key questions by type of mission critical asset.

Figure II-3. Interview Questions and Summarized Responses

Mission Critical Asset/ Interviewee Positions or Organizations	Do you use historical acquisition cost information reported on the Balance Sheet for decision-making, and if used, how it is used?	What cost information do you use, if historical acquisition cost information is not used?	If historical acquisition cost information was auditable, would you use such information, and if yes, for what purpose?
MILITARY EQUIPMENT **Acq Execs, PMs, CAPE**	The consistent response was historical acquisition cost information in functional or accounting systems is not used when acquiring new military equipment or when making improvement, replacement or disposal decisions.	Detailed cost data maintained by the Defense Cost and Resource Center (explained in Sec. VI of this report) and provided by contractors (manufacturers and suppliers) in accordance with contract requirements. Obligation and disbursement data maintained in DoD business and accounting systems.	The consistent response was historical acquisition cost information in functional or accounting systems would not be used if auditable.
GENERAL EQUIPMENT **Acq Execs, PMs, FMs**	The consistent response was historical acquisition information in functional or accounting systems is not used when acquiring new general equipment or when making improvement, replacement or disposal decisions.	For general equipment acquired as part of MDAPs, detailed cost data maintained by the Defense Cost and Resource Center (explained in Sec. VI of this report) and provided by contractors (manufacturers and suppliers) in accordance with contract requirements. For most general equipment, latest acquisition cost is occasionally used as a benchmark, but most often the current acquisition cost from catalogs and other commercial price listings is used.	The consistent response was historical acquisition cost information in functional or accounting systems would not be used if auditable.
REAL PROPERTY **Policy Official, Acq Exec, RP Manager**	The consistent response was historical acquisition information in functional or accounting systems is not used when acquiring new real property or when making improvement, replacement or disposal decisions.	Plant Replacement Value (PRV) is most often used when making real property improvement, replacement or disposal decisions. The “cost of ownership” is often used and is comprised of such costs as operational, maintenance and utility costs.	The consistent response was historical acquisition cost information in functional or accounting systems would not be used if auditable.

Mission Critical Asset/ Interviewee Positions or Organizations	Do you use historical acquisition cost information reported on the Balance Sheet for decision-making, and if used, how it is used?	What cost information do you use, if historical acquisition cost information is not used?	If historical acquisition cost information was auditable, would you use such information, and if yes, for what purpose?
INVENTORY **Policy Official, Logistics Execs, Logistics Acq Personnel**	The consistent response was historical acquisition costs in logistics systems is occasionally used as a benchmark when acquiring the same item or a replacement item. It also occasionally used when stock retain or disposal decisions are made.	Latest acquisition cost is most often used when acquiring inventory items.	The consistent response was the historical costs in logistics systems is good enough to be used a benchmark or when making retain or dispose decisions, and that auditing such amounts would not make it more useful.
OPERATING MATERIALS & SUPPLIES **Policy Official, Logistics Execs, Logistics Acq Personnel**	The consistent response was historical acquisition costs in logistics systems is occasionally used as a benchmark when acquiring the same item or a replacement item. It also occasionally used when stock retain or disposal decisions are made.	Latest acquisition cost is most often used when acquiring OM&S items.	The consistent response was the historical costs in logistics systems is good enough to be used a benchmark or when making retain or dispose decisions, and that auditing such amounts would not make it more useful.

Estimating Costs

Estimating the cost of the alternatives under consideration is typically a key element of a business case that addresses cost versus benefits. Two costs were considered when evaluating the alternatives. They were the:

- Cost to implement the alternatives, and
- Incremental cost for auditing the reported Balance Sheet amounts for each alternative, as part of an audit of a full set of financial statements.

This section explains how these costs were estimated and used in the evaluations of the alternatives by asset type.

Costs to Implement the Alternatives

The following paragraphs address the cost of implementation by each mission critical asset type.

Alternative 1 was selected for real property, general equipment, inventory and OM&S because there is ongoing and planned work that is required for reasons other than Balance Sheet reporting that will result in compliance with Federal accounting standards and reporting requirements; therefore, the marginal cost of implementation was not estimated. The Department is the process of deploying enterprise resource planning (ERP) systems to replace numerous existing systems that have been used to manage and report these costs on the Balance Sheet. The ERPs are in different stages of deployment within the Army, Navy, Air Force, and Defense Logistics Agency. When fully deployed, they will provide the capability to record and report historical acquisition costs, with the exception of military equipment. However, for military equipment, the Military Departments have not started planning, configuring, or deploying the ERPs to capture, record, and report auditable acquisition costs at the transaction level. Since this was an important factor for determining the appropriate selection for military equipment, these costs were projected and collected from the Military Departments. These costs are provided in Figure III-4.

Figure III-4. ERP Deployment Costs for Military Equipment

($ in Millions)

DoD Component	Estimated ERP Deployment Costs for Military Equipment
Army	$72
Navy	83
Air Force	73
U.S Marine Corps	29
Total Costs	$257

Costs to Audit

Along with the costs to implement each alternative there are associated audit costs. Because most of the DoD Financial Statements have never been audited by an Independent Public Accounting firm (IPA), alternate methods of estimating this cost had to be used. There are significant challenges to estimating the audit costs:

- Only relatively small DoD Components have undergone full financial statement audits. As a result, there is no direct experience on which to base the estimate for a Military Department or large Defense Agency.
- There is no other organization in the world that matches both the size and scope of DoD's operations.
- There are unknowns involved in the estimating costs to audit for an organization as large and complex as the DoD, particularly a first year audit. The unknowns are so great that a fixed price contract to audit the Military Departments is highly unlikely.

Despite these challenges, audit cost estimates were completed using two approaches:

- Audit sample buildup approach, and
- Comparative approach

Audit Sample Buildup Approach (See Figure III-5 Method A)

- The DoD FY 2010 financial statements were the source of the total asset balances.
- Asset additions per year for each asset type were estimated based on the FY 2011 DoD President's Budget appropriation documents (e.g., P-1, MILCON) and other working capital fund budget documentation.
- GAO Financial Audit Manual guidance was used to determine likely sample sizes.
- A range of labor hours per sample was estimated based on discussions with audit professionals.
- Labor costs per hour were estimated based on GSA labor rates submitted by audit firms
- The labor rates and hours were then applied to the samples to estimate the incremental cost of auditing valuation.

Limitations of this approach:

- Sample size can grow exponentially based on auditor judgment or if errors are discovered in the initial sample.
- Labor hours per sample can vary greatly depending on the complexity of the asset and the availability of supporting documentation. Some assets, such as a bus may have a single invoice to serve as valuation support. Others, such as an aircraft carrier or aircraft will take far more time to audit.

Comparison Approach (See Figure III-5 Method B**)**

- Known facts such as revenue, total assets, and number of employees were obtained for top Fortune 500 companies and compared to annual audit costs reported to the Security and Exchange Commission.
- A similar analysis was performed for audited Federal Departments and Agencies, substituting appropriations for revenue.
- The U.S. Army Corps of Engineers audit experience was used to estimate the percentage of audit costs related to PP&E and inventory.
- The incremental cost of auditing valuation as a portion of the entire sample was estimated.

Limitations of this approach:

- Many variables affecting audit cost are assessed to determine risk based on auditor judgment.
- There are no private sector or Federal organizations that are good comparisons to the DoD.

Figure III-5. Audit Cost Estimates

($ in Millions)

Mission Critical Assets	Selected Alternative	Valuation Audit of Existing Assets	Method	Valuation Audit Cost	Sustainment
Military Equipment	Alternative 3	Not Performed	A	$1.5	$2.9
			B	1.7	2.8
General Equipment	Alternative 1	Not Performed	A	.6	1.3
			B	1.1	1.8
Real Property	Alternative 1	Not Performed	A	.2	.5
			B	.3	.4
Inventory	Alternative 1	Not Performed	A	.7	1.5
			B	1.2	1.9
OM&S	Alternative 1	Not Performed	A	.0	.1
			B	.2	.3
Total Estimated Range			**A**	**$3.0**	**$6.3**
			B	**$4.5**	**$7.2**

Selecting the Appropriate Alternative(s)

The process for selecting the appropriate alternative or alternatives for the different types of mission critical assets began immediately after the three alternatives were determined, coordinated, and approved.

Process was as follows:

1. Conduct interviews and document the interviews.
2. Research appropriate authoritative literature, standards, and laws (e.g., SFFAS No. 1, various National Defense Authorization Acts).
3. Evaluate the alternatives based on the information gathered, past experience and meetings and discussions with subject matter experts (e.g., Certified Public Accounts, Certified Acquisition Managers, and SAP ERP Integrators).
4. Propose alternative(s) to the USD(C).
5. USD(C) selects the alternative(s).
6. Coordinate the selected alternative(s) with the Deputy CMO, FIAR Governance Board, and Defense Audit Advisory Committee.
7. “Socialize” the selected alternative(s) with other Federal officials (e.g., OMB, GAO CFO Council).

IV. Military Equipment

Background

Military equipment is unique to the Department of Defense and is held primarily by the three Military Departments. The DoD currently owns over $413 billion (unaudited net book value) of military equipment assets located worldwide and deployed in warzones. Military equipment represents approximately 70 percent of the General Property, Plant and Equipment (PP&E) amount reported on the DoD Balance Sheet. Examples of military equipment include ships, submarines, aircraft, satellites, combat vehicles, missile launchers, command and control systems, and intercontinental ballistic missiles (ICBMs).

Figure IV-1 provides the unaudited cost of military equipment owned and reported by DoD.

Figure IV-1. DoD Military Equipment Assets

(FY 2010 $ in Millions)

DoD Component	Historical Cost	Accumulated Depreciation	Net Book Value
Army	$164,281	$49,152	$115,129
Navy	353,216	161,790	191,426
Air Force	297,764	195,041	102,723
Other	7,056	2,630	4,426
DoD Total	**$822,317**	**$408,613**	**$413,704**

Military equipment was not reported as General PP&E on the DoD Balance Sheet until FY 2003, after the Federal Accounting Standards Advisory Board (FASAB) issued the Statement of Federal Financial Accounting Standards (SSFAS) No. 23, *Eliminating the Category National Defense Property, Plant and Equipment*. Prior to SFFAS No. 23, military equipment was named National Defense PP&E and was reported in the Departments financial statements by count as Required Supplementary Stewardship Information (RSSI) instead of dollar amounts. As stated in the Federal Accounting Standards Advisory Board (FASAB) General PP&E accounting standard (SFFAS No. 6), military equipment was excluded from Balance Sheet reporting because:

- Military equipment does not have a periodic output against which to match costs. For example, the existence of an Intercontinental Ballistic Missile supports national defense regardless of its actual use on a period by period basis.
  - Military equipment has no planned use outside of the military.
  - Its useful life is less predictable than other PP&E, being subject to the operational tempo of the nation's defense activities at any particular time.
  - During periods of war, military equipment is at high risk of being destroyed during use.
  - Military equipment is repeatedly recapitalized for modifications, upgrades, and service life extensions.

The FASAB states in SFFAS No. 23 that the decision to eliminate the National Defense PP&E category and require military equipment to be capitalized and reported on the Balance Sheet was made based on "an increasing government-wide focus on the cost of operations and operating performance in relation to the implications of the Government Performance and Results (GPRA) Act, combined with the Board's and Department of Defense's extensive study and greater understanding about National Defense PP&E."

The "extensive DoD study" referred to by the FASAB in SFFAS No. 23 did not recommend the capitalization and depreciation of individual military equipment assets and was widely accepted throughout the Department and by the FASAB, who issued an Exposure Draft supporting the outcome of the study. After issuing the Exposure Draft for public comment, the Administration changed and the Congress confirmed a new DoD Comptroller. It was the decision of the new DoD Comptroller to reject the proposed accounting and reporting treatment in the Exposure Draft and to respond to the FASAB that the DoD should treat military equipment like other Federal agencies and commercial entities, (i.e., military equipment assets should be capitalized and depreciated.)

Complying with the accounting and reporting requirements of SFFAS No. 23 requiring DoD to report military equipment on the Balance Sheet is extremely challenging and costly. The most significant reasons include:

- Military equipment assets (i.e., weapons systems) are not acquired like most commercial equipment ("off the shelf"), they are acquired through complex, long-term acquisition programs most often utilizing hundreds of complicated contracts with an equal, if not more, number of contract modifications for configuration or capability changes and later, upgrades or modifications that extend over the life of the program/weapons systems. For example, the current purchase order for the Navy E-2D Aircraft Program involves almost 700 contract lines in more than 125 contracts. This is a relatively new and modest Major Defense Acquisition Program (MDAP) out of nearly 100 ongoing MDAPs.
- To be auditable, the costs of weapons system end items for Balance Sheet reporting and depreciation must include the cost of significant amounts of government furnished material (e.g., special metals and other materials such as titanium), government furnished equipment (e.g., aircraft engines, communication equipment – radios, radar systems) provided from DoD stocks or other acquisition programs and amounts paid to contractors. Additionally, for modifications to existing systems, there is often a significant amount of government labor that should be capitalized.
- Capturing indirect costs (e.g., the costs of the Program Management Office, transportation from the vendor to the DoD, preparation of the asset for its intended operational use) and accumulating the cost transactions to assign or allocate them to the military equipment assets.
- Existing business processes (e.g., contract development and management) and systems (e.g., contract management systems) do not support capturing costs in a manner that is consistent with the Federal accounting standards.
- The ERPs that the Military Departments are deploying have neither been configured nor have plans been made or funded to achieve the capability needed to capture the full cost of military equipment at the transaction level.

Recognizing this significant challenge, the FASAB issued SFFAS No. 35 in October 2009 that allows the use of acquisition cost estimates for General PP&E, rather than require the use of costs based on transaction-level information, which is the preferred method, as stated in the standard. Accordingly, Alternative 2 considers the use of estimates. The use of estimates was also evaluated as part of this BCA in Section III and later in this section. Using estimates is costly including the cost to document the estimates in a manner that meets audit standards.[5] For example, the Department has spent nearly $68 million dollars to estimate the value of its military equipment and to provide a repository for those values.

[5] Auditors have specific standards they use for evaluating estimates in AU Section 342, *Auditing Accounting Estimates*. Management must ensure that its actions can meet the auditor standards.

Initiatives Impacting Military Equipment Audit Readiness

As discussed in Section I of this Business Case, the Department established two financial improvement and audit readiness priorities that are being executed by the DoD Components and were endorsed by the Congress in the FY 2010 National Defense Authorization Act. The primary objective of the priorities is to focus financial improvement work on the processes, controls, and systems supporting information that is most often used to manage the Department, while continuing financial improvement to achieve unqualified audit opinions on DoD financial statements. To achieve that objective, the USD(C) assigned a high priority to:

- Budgetary information, and
- Mission critical asset information.

Budgetary Information

The benefits of achieving this priority, as noted in Section I of this Business Case, include ensuring that the Department spends amounts appropriated for military equipment acquisitions consistent with the purpose of the appropriations and records and reports accurately and timely. Accomplishing this priority satisfies the three of the four objectives of federal financial reporting (i.e., Budgetary Integrity, Stewardship – of funds, and Systems and Control) stated in the FASAB Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, *Objectives of Federal Financial Reporting*.[6]

Most military equipment acquisition programs are designated as Major Defense Acquisition Programs (MDAP). An acquisition program is designated as an MDAP either by USD(AT&L) designation or when the USD(AT&L) estimates that the program will require an eventual total expenditure for research, development, test, and evaluation of more than $365 million in FY 2000 constant dollars or more than $2.190 billion in procurement in FY 2000 constant dollars.

The MDAPs are subject to additional DoD and congressional oversight. This oversight includes monitoring budgetary information (obligations and outlays/disbursements). Improving the reliability of this information is the objective of the budgetary information priority. To validate improvements to budgetary information, the Department is evaluating and assessing the processes, controls, and systems used to manage military equipment MDAP programs. The first MDAP subject to such validations is the Navy E-2D Aircraft program, which will be validated as audit ready by an IPA early in FY 2012. Following this first MDAP audit readiness validation, the Department will perform similar validations in the Army and Air Force, as well as other Navy MDAPs.

Mission Critical Asset Information

To achieve the existence and completeness priority for military equipment, the Military Departments have many ongoing initiatives to test the records and controls for military equipment recorded in official accountable property systems of record. When deficiencies are discovered, corrective actions are taken and retesting takes place. For some of these initiatives, they include reengineering business processes and deploying new systems (e.g., ERP systems).

The ongoing military equipment existence and completeness audit readiness priority initiatives includes:

- Army is executing its financial improvement plan to assert existence and completeness audit readiness for several types of rotary aircraft and small tugs in FY 2011. The Army has also begun existence and completeness readiness work on the remainder of its military equipment and will assert in FY 2015.

[6] Paragraph 110

- Navy recently asserted existence and completeness audit readiness for the majority of its military equipment (ships, aircraft, ICBMs, and satellites). The Navy will assert the remainder of its military equipment in FY 2013.
- Air Force asserted existence and completeness audit readiness for all of its military equipment during the first quarter of FY 2011. This assertion is currently being reviewed. The type and quantity of military equipment assets the Air Force is asserting is shown in Figure IV-2.

Figure IV-2. Air Force Military Equipment Auditability Assertion

Aerospace Vehicle	Weapon System Type	Number of Assets
Satellites		75
Intercontinental Ballistic Missiles		450
Remotely Piloted Aircraft	Global Hawk	43
	Predator/Reaper	359
Aircraft	Attack	540
	Bomber	197
	Transport	1726
	Electronic	58
	Fighter	2628
	Trainer	1397
	Helicopter	204
	Vertical Take Off & Landing	17
	Utility	79
	Glider	4
	Miscellaneous	109
Pods		5015
Total Assets Asserted		12,901

Improving the budgetary information and existence and completeness audit readiness priorities will demonstrate stewardship and enhance public trust and confidence in the Department's use of public funds and will significantly improve the accuracy and reliability of the military equipment information used by the warfighter and other DoD decision makers.

Cost Information Used for Management Decisions

Representatives from the following organizations were interviewed to identify the financial or cost information they use when making decisions pertaining to military equipment:

- Program Manager, Apache Helicopter Program
- Deputy Director, Cost Assessment, Cost Assessment Program Evaluation, Office of the Secretary of Defense
- Deputy Director, Program Evaluation, Office of the Secretary of Defense

- Program Manager, Utility Helicopter Program, Department of the Army
- Director of Army Audit Readiness, Department of the Army
- Business Officer, E-2D Aircraft Program, Department of the Navy
- Deputy Assistant Secretary for Acquisition Integration, Department of the Air Force
- Comptroller, U.S. Coast Guard
- Deputy CFO and Director for Policy, National Aeronautical and Space Administration
- Finance and Business Liaison, Australian Department of Defence

None of the individuals interviewed use historical acquisition cost information recorded in DoD accounting systems and reported on DoD financial statements, nor would they use such information if it was auditable. Conversely, existence, location, and condition information is critically important. The interviews clearly established that historical acquisition cost information recorded in DoD accounting systems is used exclusively for financial reporting and not for decision-making.

Nevertheless, the interviews did confirm that other financial or cost information is important and is regularly used for making military equipment decisions. The financial and cost information that used by the interviewees includes:

- Detailed actual cost information[7] provided by contractors (e.g., weapons system manufactures) in Cost and Software Data Reports (CSDR) provided to the Defense Cost and Resource Center (DCRC). The DCRC provides CSDR cost information to appropriate decision makers, such as acquisition program managers and other program management staff, cost analysts, and cost estimators. Contract clauses require CSDR cost information and contractors submit on a monthly basis or more or less frequently depending on the contract.
- CSDR cost information is audited by the Defense Contract Audit Agency (DCAA). CSDR cost information conforms to program and contract specific work breakdown structures that provide the cost of various elements of an end time, such as for aircraft the cost of the airframe or the avionics. The CSDR cost information also provides the cost of parts, materials, labor, and overhead along with costs for weapons systems support equipment, special tooling, test equipment, and other contract deliverables.
- CSDR cost information is used for program and contract management, contract negotiations and projecting future acquisition costs. CSDR cost information is produced by contractor cost accounting systems approved by the Defense Contract Management Agency. DoD does not record the CSDR cost information in its accounting systems.
- The information provided by these reports is different from that recorded in the Department’s accounting systems. An analogy could be the purchase of an automobile by a business. The buyer records the cost of the automobile in his general ledger at the purchase price. Were the costs of the automobile to be reported in the CSDR format, the cost of the engine, starter, transmission, etc. would be reported. Such detailed cost information can only be derived from the manufacture’s cost accounting system and not the buyers accounting system.
- Obligation and disbursement information is routinely used by acquisition Program Management Offices (PMOs) to monitor costs incurred for their acquisition programs.

[7] DoD 5000.04-M-1, April 18, 2007, *Cost and Software Data Reporting (CSDR) Manual*, contains detailed information about this program. The information is accumulated because, “[A]ctual cost experiences on past and current acquisition programs form the basis of projections of the costs of current and future systems. Actual costs are essential in developing credible cost estimates on which to base appropriate levels of funding.”

  - Program Executive Offices (PEOs) that oversee and manage PMOs use obligation and disbursement information. This same information is also used by the comptroller functions within Military Department headquarters and commands, as well as the Procurement Directorate within Office of the Under Secretary of Defense (Comptroller) and the acquisition oversight offices within the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) to include the Defense Acquisition Board.
  - This critically important financial information will be made audit ready through the Department's efforts to achieve an auditable Statement of Budgetary Resources, which satisfies three of the objectives for financial reporting (i.e., Budgetary Integrity, Stewardship – of funds and Systems and Control) of SFFAC No. 1.

- Estimated costs of proposed new military equipment acquisitions and modifications/upgrades to military equipment are used for analyses of alternatives and budget projections. Professional cost estimators utilizing the CSDR cost information conduct the cost estimates. As indicated above, this is not acquisition cost information in DoD accounting systems, but cost information maintained in the DCRC and DoD Component cost databases. DCAA audits ensure the reliability of this information.
- Lifecycle cost information is the cost of operating and maintaining military equipment assets over their operating life and is important information used by DoD decision makers. Although the acquisition cost of military equipment is considered part of lifecycle costs, it is not nearly as important as the operation, maintenance, or replacement costs. When acquisition costs are used in lifecycle analyses, they are not derived from DoD accounting systems, but rather from CSDR cost reports and other cost databases, which provide the detailed costs needed to ensure configuration and capability is properly valued and considered.

Analysis of Asset Valuation Alternatives

Figure IV-3 provides the key factors, by alternative, that were identified, considered, and evaluated during the business case for military equipment. Not addressed is whether military equipment historical acquisition costs recorded in DoD systems should be validated and work performed to locate supporting documentation, because, as discussed in Section II, the Department determined that such costly activity was not justified because of the lack of any quantifiable business benefit.

The information summarized in Figure IV-3 supports the selected alternative in the concluding subsection. Included, by alternative, are the key factors considered and whether the factor supports the selected alternative.

Figure IV-3. Analysis of Alternatives

Alternatives	Key Factors	Impact on Alternative
Alternative 1: Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support the costs of future acquisitions.	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet, nor would such information be used if was auditable.	Con
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be met by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Con
	• Accepting the recorded values of existing assets eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• The ERPs being deployed by the Military Departments have not been configured, nor have plans been made or funded, to achieve the capability needed to capture acquisition costs at the transaction-level to comply with the Federal accounting standards.	Con
	• Reengineering business processes and configuring the ERPs to capture the full cost of military equipment will be extremely challenging and costly because of many data sources and transactions spread over several years. This includes a combination of refurbished and new components being assembled to create new military equipment assets.	Con
	• The estimated cost to reengineer business processes, configure and deploy the DoD Components' ERPs to capture military equipment acquisition costs at the transaction level is estimated to be $257 million dollars.	Con
Alternative 2: Accept the recorded historical acquisition costs for existing assets and estimate the costs of future acquisitions.	• Decision makers do not use the historical cost information that is recorded in DoD accounting systems and would not use this information if it was based on budget or contract based estimation methodologies.	Con
	• Accepting the recorded values of existing assets eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• The Department has spent approximately $15 million to estimate the values for existing military equipment with limited success, and these efforts have not resulted in all of the needed changes to business processes, controls and systems to sustain the values or report the cost of new acquisitions.	Con
	• Not included in the $15 million is the Air Force initiative to value its military equipment using an estimating method based on acquisition contracts. To date, the estimated acquisition costs have not been audited, have not been proven to be sustainable, cost approximately $3 million to perform and implement, and may not be applicable DoD-wide because of the availability of supporting contracts and how such contracts are written.	Con
Alternative 3: Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards.	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet and would be less inclined to use this information if it was based on budget or contract based estimation methodologies, nor would such information be used if was auditable.	Pro
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be satisfied by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Pro

Alternatives	Key Factors	Impact on Alternative
	• The reasons stated by FASAB for excluding military equipment from Balance Sheet reporting in the original General PP&E accounting standard (SFFAS No. 6) are still valid today. That is, Military equipment does not have a periodic output against which to match costs. For example, the existence of an ICBM supports national defense regardless of its actual use on a period-by-period basis. o Military equipment has no planned use outside of the military. o Its useful life is less predictable than other PP&E, being subject to the operational tempo of the nation's defense activities at any particular time. o During periods of war, military equipment is at high risk of being destroyed during use. o Military equipment is repeatedly recapitalized for modifications, upgrades, and service life extension, eliminating the value of depreciation.	Pro
	• The ERPs being deployed by the Military Departments have not been configured, nor have plans been made or funded, to achieve the capability needed to capture acquisition costs at the transaction-level to comply with the Federal accounting standards.	Pro
	• Reengineering business processes and configuring the ERPs to capture the full cost of military equipment will be extremely challenging and costly due because transactions spread over many years would have to be aggregated to obtain a unit cost.	Pro
	• Capturing and capitalizing the cost of refurbishments, upgrades and modifications, as well as capturing the costs of disassembling military equipment assets and reassembling them with used and new parts is very complex and is not supported by current ERP systems.	Pro
	• The Department will propose to the FASAB that military equipment be expensed and Reported as Required Supplementary Information (RSI).	Con
	• Reporting military equipment quantities as RSI subject to audit will provide assurance to the Congress and public that military equipment assets are accurately recorded and controlled in accountability systems.	Pro
	• Interviews confirmed that successful existence and completeness audits are critical for making decisions, asset utilization, maintenance scheduling and planning, control and stewardship.	Pro
	• If not distracted by military equipment valuation challenges, the Department would be able to focus better on its financial improvement efforts and limited resources to achieve auditable SBRs and existence and completeness audits by September 30, 2017, as directed by Congress.	Pro
	• Significant DoD and taxpayer resources, as identified in the above alternatives, would be saved if military equipment was not reported and audited on the Balance Sheet.	Pro
	• Removing military equipment from the Balance Sheet would not make the Department's statements inconsistent with other Federal Agencies because they do not report military equipment.	Pro

Selected Alternative

Alternative 3, Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards, was selected by the Department for military equipment. The selection was based on:

- Decision makers do not use historical acquisition cost information recorded in DoD accounting systems and reported on the Balance Sheet.
- The objectives of financial accounting (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be achieved by the ongoing work by the DoD Components to achieve auditable Statements of Budgetary Resources and existence and completeness audits of military equipment.
- Reporting military equipment as RSI will assure the Congress and public of physical control, record accuracy, and asset accountability.
- The ERPs being deployed by the Military Departments have neither been configured nor have plans been made or funded, to achieve the capability needed to capture and report acquisition costs in compliance with the current Federal accounting standards. To configure the ERPs to achieve the capability would cost more than the benefits derived.
- Expensing military equipment acquisition costs will significantly "conserve taxpayer resources" over the next six years that can be spent to achieve audit readiness by 2017, as well as conserve taxpayer resources by reducing future annual audit costs of the DoD Balance Sheet.

Implementation of Alternative 3

Alternative 3 will be implemented as follows:

1. With the assistance of the Congress and Office of Management and Budget, DoD will propose by the end of FY 2011 to the FASAB the following changes be made to SFFAS No. 6:
   a. Military equipment acquisition costs will be expensed and current asset amounts now reported will be removed from the General PP&E line of the Balance Sheet as of September 30, 2012.
   b. Military equipment will be reported as RSI in the financial statements beginning the year ending September 30, 2013.
   c. A proposed format for presenting military equipment information as RSI information.
2. By September 30, 2017, DoD:
   a. Will modify its policies, regulations, processes, controls and systems to comply with the (above) FASAB changes to SFFAS No. 6 for General PP&E.
   b. Will achieve audit readiness of the DoD-wide Statement of Budgetary Resources validating Budgetary Integrity, Stewardship – of funds, and System Controls.
   c. Will achieve audit readiness for the existence and completeness of mission critical assets, thus validating Stewardship – physical control and accountability – and Systems and Control.
3. In addition to previously required FIAR reported actions, DoD will report planned actions (milestones) and the status to implement the selected alternatives in the semiannual FIAR Plan Status Report.

V. General Equipment

Background

The Department of Defense owns general equipment assets costing over $32 billion (unaudited net book value), which constitutes approximately five percent of the General Property, Plant and Equipment (PP&E) reported on the DoD Balance Sheet. General equipment reported on the Balance Sheet has a unit cost $100,000 or higher, which is the DoD capitalization threshold. Examples of general equipment include automated data processing (ADP) equipment; general purpose vehicles such as heavy duty trucks, buses and fire engines; high tech medical equipment such as CT scanners; shipside gantry cranes; machinery such as computer driven lathes and drill presses in depots; inventory conveyor systems in supplies center; railroad locomotives and cargo rail vehicles; and radio and television broadcasting equipment.

Figure V-1 provides the value of general equipment by Component.

Figure V-1. DoD General Equipment Assets

(FY 2010 $ in Millions)

DoD Component	Historical Cost	Accumulated Depreciation	Net Book Value
Army	$15,598	$5,500	$10,098
Navy	17,565	8,559	9,006
Air Force	45,803	36,289	9,514
Other	11,324	7,935	3,389
DoD Totals	**$90,290**	**$58,283**	**$32,007**

Reporting auditable general equipment values on the DoD Balance Sheet is an auditor identified material weakness, and a DoD-wide challenge to overcome for many reasons, the most significant of which are:

- General equipment is often centrally procured, distributed to various installations, and then recorded in local accountability systems for control and management, but without knowledge of the acquisition cost and without supporting acquisition documentation required for audits.
- Sizeable amounts of general equipment are furnished to, or constructed and held by, contractors but owned by the Department. Contractors maintain property accountability systems as required by their contracts, which are audited by the Defense Contract Audit Agency, but not for the purpose of capturing and reporting financial statement auditable acquisition costs, rather for accountability and control purposes.
- General equipment accountability is maintained in numerous disparate, property systems within the Military Departments and Defense Agencies that are not interfaced with DoD accounting systems. These existing systems were designed for accountability and control purposes, not for financial statement cost reporting. Many of these existing systems will be replaced by new systems to include enterprise resource planning (ERP) systems, but today many of these systems remain.
- Significant quantities (unknown) of general equipment, although controlled in property systems, do not have accurately recorded acquisition costs or do not have the supporting

acquisition documentation to support recorded amounts readily available, or at all, to validate the recorded costs.

Initiatives Impacting General Equipment Audit Readiness

Several DoD Components, including the U.S. Army Corps of Engineers – Civil Works, Defense Commissary Agency, Defense Finance and Accounting Service and Defense Contract Audit Agency have achieved general equipment audit readiness. However, the challenge is far greater for the three Military Departments and the Defense Logistics Agency (DLA) all of whom have significantly more general equipment, which is dispersed geographically and organizationally.

The Military Departments and DLA are working to achieve general equipment audit readiness by first ensuring general equipment is accurately recorded for accountability, control, and visibility purposes. They are doing this through the existence and completeness financial improvement and audit readiness priority established in August 2009. This priority focuses improvement and audit readiness work on information essential to manage effectively the Department's mission critical assets (i.e., accountability for the existence and completeness.)

Some of the same information needed to manage the Department's general equipment also is needed for financial statement audits. Such information includes:

- Unique Identifiers (e.g., item unique identification [IUID] number)
- Location (e.g., military installation, building number)
- Condition (e.g., operational status/in-service)
- Accountable organization (e.g., 374th Tactical Airlift Wing)
- Accountable individual (e.g., Col. Ron T. Smith)

This information, and other management and financial information, is recorded in the Department's property and logistics systems. Ensuring that important management information regarding general equipment is accurately recorded in DoD property and logistics systems is the objective of this priority.

Accomplishing this priority will not only improve important general equipment management information, it will also move the Department closer to auditability since existence and completeness of assets are two of the five financial statement assertions (Existence, Completeness, Valuation, Rights and Obligations, Disclosure and Presentation) that auditors test in a full financial statement audit. Accomplishing this priority satisfies two of the four objectives of financial reporting (i.e., Stewardship – of assets and Systems and Control) set forth in the FASAB SFFAC No. 1, *Objectives of Federal Financial Reporting*.

To achieve the existence and completeness priority for general equipment, the Military Departments and DLA have many ongoing initiatives to test the records and controls for general equipment recorded in official accountable property systems of record. When deficiencies are discovered, corrective actions are taken and retesting takes place. For some of these initiatives, reengineering business processes and deploying new systems, e.g., enterprise resource planning (ERP) systems are necessary.

To improve accountability for government property and material in the hands of contractors, which includes general equipment, the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (OUSD(AT&L)) is revising its policy and regulations. Key regulations currently under revision are DoD Directive 4140.1, *DoD Supply Chain Materiel Management Regula*tion, DoD Instruction 4161.2, *Management, Control and Disposal of Government Property in the Possession of Contractors*, and DoD Instruction 5000.64, *Defense Property Accountability*. When implemented, these changes will improve the Department's ability to accurately report general equipment on its Balance Sheet.

Cost Information Used for Management Decisions

Representatives from the following organizations were interviewed to identify the financial or cost information they use when making decisions concerning general equipment:

- Deputy Director, Cost Assessment, Cost Assessment Program Evaluation, Office of the Secretary of Defense
- Deputy Director, Program Evaluation, Office of the Secretary of Defense
- Director of Army Audit Readiness, Department of the Army
- Deputy Assistant Secretary for Acquisition Integration, Department of the Air Force
- Comptroller, U.S. Coast Guard
- Deputy CFO and Director for Policy, National Aeronautical and Space Administration
- Finance and Business Liaison, Australian Department of Defence

When discussing the use of general equipment historical acquisition cost information during the interviews, the individuals stated that this information is not used for making management decisions, such as planning, programming, and budgeting for the acquisition, modification, maintenance, or disposal. These discussions established that historical acquisition cost information is used exclusively for financial statement reporting.

These discussions also confirmed that cost information is important and routinely used in general equipment decision-making, but the cost information used is not the acquisition cost information residing in DoD accounting systems. The cost information used for business decisions, as identified by the above interviewees, includes replacement cost and latest acquisition cost.

Analysis of Asset Valuation Alternatives

Figure V-2 presents the key factors, by alternative, that were identified, considered, and evaluated during the business case for general equipment. Not addressed in Figure V-2 is whether existing general equipment historical costs recorded in DoD systems should be validated and work performed to locate supporting documentation, because, as discussed in Section II of this Business Case, the Department decided that such a costly activity is not justified because of the lack of any quantifiable business benefit.

The information summarized in Figure V-2 supports the selected alternative in the concluding subsection.

Figure V-2. Summary of Analysis of Alternatives

Alternatives	Key Factors	Impact on Alternative
Alternative 1: Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support the costs of future acquisitions.	• Accepting the recorded values of existing assets eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet, nor would such information be used if was auditable.	Con
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be satisfied by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Con
	• The Military Departments and most Defense Agencies have plans, and in some instances have started, to use their ERPs for general equipment. When fully implemented, the ERPs will have the capability to record and report auditable values for general equipment at the transaction level.	Pro
	• The OUSD(AT&L) is working with the DoD Components to improve the accountability of general equipment.	Pro
Alternative 2: Accept the recorded historical acquisition costs for existing assets and estimate the costs of future acquisitions.	• Accepting the recorded values of existing assets eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• The use of estimates for general equipment is acceptable per SFFAS No. 35.	Pro
	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet, nor would such information be used if was auditable.	Con
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be satisfied by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Con
	• The ERPs being deployed by the DoD Components, when configured, have the automated capability to record general equipment acquisitions at the transaction level and estimates require manual processes and controls.	Con
Alternative 3: Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards.	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet, nor would such information be used if was auditable.	Pro
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be satisfied by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Pro
	• Eliminating Balance Sheet reporting was discussed in Section II of this Business Case.	N/A

Selected Alternative

Alternative 1, “Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support the costs of future acquisitions,” the Department selected alternative 1 for general equipment. This selection was based on the following factors:

- Accepting the recorded historical costs of existing assets avoids spending significant resources to validate the costs and locate supporting documentation. It also eliminates the cost to audit these amounts on the DoD Balance Sheet.
- The Department will achieve successful existence and completeness general equipment audits through its ongoing financial improvement and audit readiness activities. This is an important and essential step toward achieving full auditability for general equipment and is needed to prepare for the migration of general equipment data to the ERPs.
- The ERPs, when fully implemented, will provide the capability to record acquisition costs and account for general equipment within asset management modules.

Alternative 2 was not selected, although allowable under FASAB SFFAS No. 35, because this is a manual, labor-intensive process, and the ERPs will provide an automated capability at the transaction level to record and report auditable general equipment acquisition costs.

Alternative 3 was not selected because the ERPs being deployed will provide the capability to comply with the Federal accounting standards as further explained in Section II of this Business Case.

Implementation of Alternative 1

The Alternative 3 will be implemented as follows:

1. Continue SBR audit readiness corrective action activities and audits to ensure adequate financial accountability.
2. Continue executing financial improvement plans for correcting deficiencies in controls and processes.
3. Continue ongoing examinations to validate audit readiness for existence and completeness of general equipment.
4. Continue with the implementation of ERPs.
5. Accept the recorded costs of general equipment migrated into the ERPs from existing systems.
6. Begin audits of current year general equipment acquisitions when the ERPs have been fully implemented at 95 percent of the relevant commands within a Military Department.

VI. Real Property

Background

The Department of Defense owns over $106 billion (unaudited net book value) in real property assets, which is over 5 percent of the assets reported on the DoD Balance Sheet. The Department's real estate portfolio is one of the largest and most diverse in the world with properties such as airports, shipyards, rail links, schools, universities, individual training centers, battalion training ranges, barracks, housing complexes, mess halls, stockrooms, warehouses, maintenance facilities, aircraft depots, and various other types of military facilities including support infrastructure such as utilities, water treatment facilities, roads and bridges throughout the United States and 40 other countries. At today's construction costs, it would require over $800 billion to replace these assets and that does not include the cost of the land.

Figure VI-1 provides the unaudited amounts reported for real property owned on the FY 2010 DoD Balance Sheet by the Military Departments and Washington Headquarters Services (WHS), the only DoD entities that by law have jurisdiction over real property. DoD real property inventory includes more than 539,000 buildings, structures, linear structures, and approximately 28 million acres of land on over 5,500 worldwide sites.

Figure VI-1. DoD Real Property Assets

(FY 2010 $ in Millions)

DoD Component	Acquisition Cost	Accumulated Depreciation	Net Book Value
Army	$64,311	$34,959	$29,352
Navy	43,333	25,919	17,414
Air Force	59,007	31,561	27,446
USACE	38,670	14,931	23,739
WHS*	13,521	4,961	8,560
DoD Totals**	**$218,842**	**$112,331**	**$106,511**

* *WHS includes real property currently reported by multiple defense agencies*

** *Does not include $38.6B in Construction in Progress*

Reporting auditable real property values on DoD financial statements is another auditor identified material weaknesses. One reason for the weakness is that the Department's real property assets were acquired or constructed over the history of the nation, and the Department does not have much of the supporting documentation necessary for the auditors to verify the reported cost. For example, the construction of Fort Monroe, which is located on the eastern shore of Virginia and is the headquarters of the Army Training and Doctrine Command, began in 1839, Since that time, major new construction and many capital improvements have been made to support its use today, but much of the documentation supporting the recorded costs that is required by financial statement auditors is not available.

Fort Monroe is just one example. The Department owns many hundreds, possibly thousands, of worldwide real property assets without documentation to support its reported cost, depreciation and placed in service date. Such documentation is required for financial reporting purposes and audited (at a cost to the taxpayer), but never used by DoD or any other known government purpose.

Initiatives Impacting Real Property Audit Readiness

Managing the Department's worldwide real property assets is a huge endeavor. To effectively manage this inventory of real property, decision makers require quick access to accurate and reliable real property management and financial information. To improve real property information and to support achieving audit readiness, several years ago the Department initiated significant business process reengineering initiatives. These initiatives included reengineering business and financial processes, identifying and designating standard data elements, implementing and testing controls, and modifying or deploying new systems (e.g., ERP systems) improve business operations, while providing the capability to capture the cost of newly acquired real property. When fully implemented, the auditor identified material weakness will be resolved. These initiatives continue and will not be fully implemented until FY 2013.

The real property initiatives are:

- Real Property Assets Database (RPAD). The RPAD provides a single authoritative source/data warehouse for real property information. The RPAD is available today to authorized users via standardized Web Services.
- Real Property Inventory Requirements (RPIR). Initiated in 2003, RIPR improves real property technology infrastructure, processes, and information. RIPR will achieve real property efficiencies by standardizing data, processes, and systems.
- Real Property Acceptance Requirements (RPAR). The RPAR initiative was initiated in 2005 to address the real property acceptance, which is the process of accepting accountability for a real property asset at the time the Department obtains legal interest in a property, and when the asset must be capitalized and reported on the Balance Sheet if the cost exceeds the capitalization threshold.
- Construction in Progress Requirements (CIPR). The CIPR initiative, when fully implemented, will improve the accuracy and timeliness of recording and reporting construction in progress (CIP) costs from construction agents. To integrate financial management and business operations, the CIPR initiative is establishing sustainable business processes, management controls, and standardized data elements.
- Real Property Unique Identification (RPUID). To improve the accessibility and consistency of real property data across the Department, RPUIDs were developed. RPUIDs are issued by and maintained in a centralized database, called the real property Unique Identifier Registry, providing 24x7 access to core real property site and asset data. An RPUID is a code used to permanently and uniquely identify a real property asset.

These initiatives significantly affect the accuracy and availability of reliable real property management information. When fully implemented by the Components, they will provide the capability to report auditable acquisition costs for newly acquired real property, as well as capital improvements, in DoD financial statements. However, these initiatives do not address or resolve the long-standing problem of a lack of documentation for supporting the historical cost of existing assets.

Cost Information Used for Management Decisions

Representatives from the following organizations were interviewed to identify the financial or cost information they use when making real property decisions:

- Director for Business Integration, Office of the Deputy Under Secretary of Defense for Installations and Environment
- Assistant Secretary of Air Force for Force Communications, Installations and Mission Support
- Installation Real Property Officer, Langley Air Force Base
- Comptroller, U.S. Coast Guard
- Deputy CFO and Director for Policy, National Aeronautical and Space Administration

In every interview, when discussing the use of real property historical acquisition cost information, the individuals stated that historical acquisition cost information about real property is not used for making management decisions, such as planning, programming and budgeting for the acquisition, construction, modification, maintenance or disposal of real property assets. From discussions with these individuals, it was established that historical acquisition cost information is used solely for financial statement reporting purposes.

One interviewee used an example that stated that the “cost to paint a building exceeded its original construction cost, and therefore, the cost of the building was of no use when making maintenance decisions.” Another interviewee stated that he “needed accurate plant replacement costs or estimated costs to construct a replacement facility, when deciding whether to build a new facility or incur the costs to improve or modify an existing facility, and that the original construction (historical) cost of the building to be replaced was not used in the decision process.”

These discussions also confirmed that cost information is extremely important and routinely used in real property decision-making, but the cost information used is not the acquisition cost information residing in DoD General Ledgers/accounting systems. The cost information used for business decisions, as identified by the above interviewees, includes the following:

- Plant Replacement Value
- Cost of ownership (e.g., costs of maintenance, repairs, utilities)
- Construction cost estimates by architects and civil engineers
- Lease (Rental) costs

Analysis of Asset Valuation Alternatives

Figure VI-2 provides the key factors, by alternative, that were identified, considered, and evaluated for real property. Not addressed is whether the historical acquisition costs recorded in DoD systems for real property assets should be validated and work performed to locate supporting documentation for the recorded cost, because, as discussed in Section II of this Business Case, the Department determined that such expense was not justified because of the lack of any quantifiable business benefit.

The information summarized in Figure VI-2 supports the selected alternative in the concluding subsection.

Figure VI-2. Summary of Analysis of Alternatives

Alternatives	Key Factors	Impact on Alternative
Alternative 1: Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support the costs of future acquisitions.	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet, nor would such information be used if was auditable.	Con
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be satisfied by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Con
	• Accepting the recorded values of existing assets eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• The OUSD(AT&L) required implementation of RPAD, RIPR, RAPR, CIPR and RPUID is bringing about changes to business and financial processes, controls and systems and has begun to provide the capability to timely record and report real property costs in accordance with Federal accounting standards.	Pro
	• The OUSD(AT&L) also reengineered, with the Components, the process, that facilitates and ensures that supporting documentation is retained for future audits.	Pro
	• Per the November 2010 FIAR Plan Status Report, the Army, Navy, and Air Force project that this will be accomplished and auditable in FY 2013.	N/A
Alternative 2: Accept the recorded historical acquisition costs for existing assets and estimate the costs of future acquisitions.	• The use of estimates for real property is acceptable per SFFAS No. 35.	Pro
	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet, nor would such information be used if was auditable.	Con
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be satisfied by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Con
	• Accepting the recorded values of existing assets eliminates the significant cost to validate recorded costs and to locate supporting documentation. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• The use of estimates is not needed for real property, because the mandatory implementation of the OUSD(AT&L) requirements (i.e.; RPAD, RIPR, RAPR, CIPR and RPUID) will result in accurate transaction-level recording and reporting of real property acquisition costs in accordance with Federal accounting standards.	Con
Alternative 3: Eliminate Balance Sheet reporting by expensing costs or request FASAB to change the Federal accounting standards.	• Decision makers do not use historical acquisition costs recorded in DoD accounting systems and reported on the Balance Sheet, nor would such information be used if was auditable.	Pro
	• Three of the four objectives (i.e., Budgetary Integrity, Stewardship, and Systems and Control) of the FASAB SFFAC No. 1, *Concepts for Financial Reporting*, will be satisfied by the ongoing DoD work to achieve the financial improvement and audit readiness priorities of budgetary information and mission critical asset information.	Pro
	• Because the recorded costs of existing assets would be accepted, as discussed in Section II of this Business Case, and auditable acquisition costs would be achieved through the implementation of the OUSD(AT&L) requirements, eliminating Balance Sheet reporting is not necessary.	Con
	• Eliminating Balance Sheet reporting was discussed in Section II of this Business Case.	N/A

Selected Alternative

Alternative 1, "Accept the recorded historical acquisition costs for existing assets and capture and maintain transaction data to support the costs of future acquisitions," was the Department's selection for real property assets. The selection was made based on:

- Accepting the recorded historical costs of existing assets avoids spending significant resources to validate the recorded historical costs and to locate supporting documentation. It also eliminates the cost to audit such amounts on the Department's Balance Sheet.
- The Department will achieve the capability to accurately and timely record and report the acquisition and improvement costs of real property assets as a result of implementing the business process and data improvements mandated by the OUSD(AT&L), and the DoD Components are presently working to complete the implementation of these requirements and achieve auditability for real property in FY 2013.
- At a relatively small cost, the Department can enhance the public trust and confidence in the use of their resources.
- Alternative 2 was not selected, although acceptable under SFFAS No. 35, because estimating future real property acquisition costs is not necessary because actual cost information will be available through the reengineered processes, controls, and system changes that are being made by the Components.
- Alternative 3 was not selected because of the availability of actual cost information, and because the Department has decided not to expend resources to document real property opening balances, as explained in Section II of this Business Case.

Implementation of Alternative 1

As reported in the November 2010 FIAR Plan Status Report, the Components are presently working to implement the mandatory OUSD(AT&L) real property requirements (RPAD, RIPR, RAPR, CIPR and RPUID) that, when fully implemented, will improve its business operations while achieving the capability to produce, record and report auditable real property Balance Sheet amounts. Implementation of the OUSD(AT&L) requirements is planned to be completed by the Army, Navy and Air Force in FY 2013, at which time they will submit a management assertion indicating audit readiness. After review of the management assertion by the OUSD(C) and DoD Inspector General, an examination conducted by an Independent Public Accounting firm will validate auditability.

VII. Inventory

Background

The Department of Defense (DoD) reports over $84 billion in inventory on the DoD Balance Sheet. Nearly all of the Department's inventory is held by its Working Capital entities. Depending on circumstances, an item can be reported as inventory or operating materials and supplies (OM&S). Statement of Federal Financial Accounting Standards (SFFAS) No. 3, *Accounting for Inventory and Related Property*, defines inventory as items held for sale. An inventory item is reclassified as OM&S following its sale to a customer who will consume the item in its normal operations. That is, whether an item is classified as inventory or OM&S is not an inherent characteristic of the item, but rather of the purpose for which the item is held (i.e., sale or use).

Figure VII-1 provides the unaudited values of inventory by DoD Component that was reported on the DoD FY 2010 Balance Sheet.

Figure VII-I. DoD Inventory

(FY 2010 $ in Millions)

DoD Component	Inventory, Net
Army	$22,310
Navy	14,046
Air Force	28,171
Other	20,098
DoD Total	**$84,625**

The Department's inventory is comprised of approximately 4.6 million types of items. This number is a mix of items that are classified as consumable or reparable, with approximately 4.1 million types of items classified as consumables and the remainder as reparables.[8] Expressed in percent based on dollar amounts, approximately 28 percent of the reported inventory amounts are consumables and 72 percent are reparables. The Department has over 100,000 suppliers and uses over 2,000 existing systems to manage its inventory. The DoD has 19 maintenance depots, 25 distribution depots, and over 30,000 customer sites. By number of items, the Defense Logistics Agency manages 83 percent of the total DoD inventory.

Reporting auditable inventory values on DoD financial statements is one of the Department's long-standing material weaknesses. As is true with several other material weaknesses, this weakness is linked to the Financial Management Systems material weakness. As noted in the Department's FY 2010 Agency Financial Report, "Most DoD financial systems were developed decades ago to meet the requirements of budgetary accounting and do not provide the capability to record costs and assets in compliance with current accounting standards. Improvements to the current systems environment also are complicated by the use of and reliance upon many mixed (feeder) systems that are not well integrated with each other or the core financial system." However, the need for replacement systems does not represent the only challenge. Many of the reported items were acquired long ago and sufficient evidence is often not available to support the amounts recorded and reported to the satisfaction of the auditors.

Another challenge affecting the valuation of inventory is a large amount of the reported inventory has a low turnover rate.[9] Absent evidence to support amounts for inventory acquired well past the present creates a challenge to support the reported amounts on the Balance Sheet. Obviously, many inventory items have a rapid turnover rate and for those items without adequate supporting evidence, the high

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[8] The cost of inventory reported on the Department's financial statements is a mix of inventory valued at moving average cost and latest acquisition cost. The Department's policy is that it should be reported at moving average cost; however, full adoption of moving average cost depend on either modification of existing systems or fielding of ERPs. The Supply System Inventory Report (SSIR) from which the information on inventory statistics on the other reports inventory cost at latest acquisition cost, hence, the amount reported on the financial statements is different that the amounts reported on in the SSIR.

[9] The SSIR for FY 2009, the latest version currently available, reports that 15.5 percent of the inventory is inactive. Inactive inventory is defined as, a national stock numbered item of supply for which no current or future requirements are recognized by any registered user or the material manager.

turnover rate solves the problem of missing supporting documentation. That is not the case for many inventory items that do not regularly turnover and are held for many years.

Initiatives Impacting Inventory Audit Readiness

As reported in the FY 2010 Agency Financial Statements, “Most DoD Components have embarked on an effort to implement a compliant end-to-end financial management system, anchored by an ERP system that provides the core financial system as well as replacing many of the mixed (feeder) systems.” When deployed, the ERPs will provide a key tool for managing and reporting the acquisition cost of inventory on the DoD Balance Sheet. Accepting the recorded values of existing inventory assets discussed in Section II of this Business Case addresses the challenge of not being able to support the recorded values of existing inventory items.

The DoD Components are executing financial improvement plans to achieve audit readiness for the inventory existence and completeness. Once the Components have executed their plans, they will assert audit readiness, and an examination (i.e., an audit) will be performed to validate that audit readiness has been achieved. Successful examination results will establish that the Components have effective physical control of their inventory. When the ERPs are fully and successfully deployed, the Components will assert audit readiness for valuation, which will then be verified by complete and extensive audits.

The preceding initiatives will significantly affect the accuracy and availability of reliable inventory management information and will result in the capability to report auditable acquisition costs for newly acquired inventory in the DoD Balance Sheet. These initiatives do not address or resolve the long-standing problem of a lack of supporting documentation for historical costs of existing inventory that also must be reported.

In the meantime, the DoD Components have the means of meeting three of four of the objectives of financial reporting. The Department’s strategy of focusing on the Statement of Budgetary Resources and existence and completeness audits addresses the budgetary integrity, physical stewardship of assets and control over assets. Additional information on the objectives of financial reporting is included in Section II of this report.

Cost Information Used for Management Decisions

Representatives from the following organizations were interviewed to identify the financial or cost information they use when making inventory decisions:

- Deputy Assistant Secretary of Defense for Supply Chain Management, Office of the Under Secretary of Defense (Acquisition, Technology and Logistics)
- Director of Army Audit Readiness, Department of the Army
- Deputy Director of Business Resources, Office of the Assistant Secretary of the Army (Financial Management and Comptroller)
- Chief Supply Management, Office of the Assistant Secretary of the Army (Office of the Assistant Secretary of the Army (Financial Management and Comptroller)
- Comptroller, Navy Supply Command, Department of the Navy
- Defense Logistics Agency, Deputy Executive Director, Material Policy, Process & Assessment
- Comptroller, U.S. Coast Guard
- Deputy CFO and Director for Policy, National Aeronautical and Space Administration

In each instance, when discussing the use of inventory cost information, the interviewee stated that historical acquisition cost of inventory might be used as one factor in purchase decisions – primarily as a benchmark. Beyond using it as a benchmark, historical cost is not used for management decision-making. However, these discussions generally confirmed that cost information is extremely important and routinely used in inventory decision-making, but the cost information used is not the historical acquisition cost information residing in DoD accounting systems. The cost information used for business decisions, as identified by the above interviewees, includes:

- Latest acquisition cost
- Catalogue prices
- Commercial market quotations

Analysis of Asset Valuation Alternatives

Figure VII-2 provides the key factors, by alternative, which were identified, considered, and evaluated during the business case for inventory. Not addressed in Figure VII-2 is whether historical acquisition costs recorded in DoD systems should be validated and work performed to locate supporting documentation, because, as discussed in Section II of this report, the Department determined that such costly activity was not justified because of the lack of any quantifiable business benefit.

The information summarized in Figure VII-2 supports the selected alternative in the concluding subsection. Included in Figure VII-2, by alternative, are the key factors considered and whether the factor supports the selected alternative.

Figure VII-2. Analysis of Alternatives

Alternatives	Key Factors	Impact on Alternative
Alternative 1: Accept recorded values for existing assets and capture and maintain transaction data to support costs for future acquisitions.	• Accepting the recorded values of existing inventory eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• Decision makers do not use the historical cost information recorded in DoD accounting or accountability systems except as a benchmark and even the use as a benchmark is only one factor in decisions to purchase and manage inventory.	Con
	• The ERPs when configured and deployed will provide the automated capability to capture, record and report the cost of inventory at the transaction level. The Defense Logistics Agency is effectively using its ERP to manage its inventory, record acquisition transaction data and report the cost of its inventory on its Balance Sheet.	Pro
	o The Army has deployed an ERP (Logistics Modernization Program [LMP]) for inventory that is operational. The Army financial improvement plans include hiring an IPA to validate that the ERP as audit ready.	Pro
	o The Navy has deployed Navy ERP at the Navy Supply Command (NAVSUP). The Navy financial improvement plans include hiring an IPA to validate that the ERP as audit ready.	Pro
	o The Air Force is in the early stages of implementing an ERP (Expeditionary Combat Support System) for inventory.	Pro
Alternative 2: Accept recorded values for existing assets and	• Accepting the recorded values of existing inventory eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro

Alternatives	Key Factors	Impact on Alternative
estimate costs for future acquisitions.	• Decision makers do not use the historical cost information recorded in DoD accounting and accountability systems except as a benchmark and even the use as a benchmark is only one factor in decisions to purchase and manage inventory.	Con
	• Federal accounting standards do not permit the use of estimates for reporting the cost of inventory on the Balance Sheet. The standards (SFFAS No. 35) only permit estimates for property, plant, and equipment, but not inventory.	Con
Alternative 3: Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards.	• Decision makers do not use the historical cost information recorded in DoD accounting or accountability systems except as a benchmark and even the use as a benchmark is only one factor in decisions to purchase and manage inventory.	Pro
	• The ERPs that have been and are being deployed provide the capability to capture, record and report acquisition costs of inventory at the transaction.	Con
	• Eliminating Balance Sheet reporting was discussed in Section II of this report.	N/A

Selected Alternative

The Department selected Alternative 1, "Accept recorded values for existing assets and capture and maintain transaction data to support costs for future acquisitions."

The selection was made based on:

- Accepting the recorded historical costs of existing assets avoids spending significant resources to validate the recorded historical costs and to locate supporting documentation. It also eliminates the cost to audit such amounts on the DoD Balance Sheet.
- Achieving successful existence and completeness inventory audits through its ongoing financial improvement and audit readiness activities. This is an important and essential step toward achieving full auditability for inventory and is needed to prepare for the migration of inventory data to the ERPs
- The Department will achieve the capability to report accurately the acquisition costs of inventory on the DoD Balance Sheet as an outcome of deploying the DoD Components' ERPs.
- Alternative 2 was not selected, because it is not allowable under FASAB SFFAS No. 35.
- Alternative 3 was not selected because the ERPs being deployed will provide the capability to comply with the Federal accounting standards as further explained in Section II of this Business Case.

Implementation of Alternative 1

Alternative 1 will be implemented as follows:

1. Continue Statement of Budgetary Resources audit readiness activities and audits to ensure adequate financial accountability.
2. Continue executing financial improvement plans for correcting deficiencies in controls and processes.
3. Continue scheduled examinations to validate audit readiness for existence and completeness of inventory.

4. Continue the deployment of the ERPs.
5. Accept the recorded costs of inventory migrated into the ERPs from existing systems.
6. Begin audits of current year acquisitions when the Component ERPs have been fully deployed.

VIII. Operating Materials and Supplies

Background

The Department of Defense owns over $147 billion in operating materials and supplies (OM&S), which is over 7 percent of the Department's assets reported on the DoD Balance Sheet. The Department's OM&S is comprised of many types of consumable items such as rations, fuel, ammunition, aircraft engines, spare parts, and missiles. Depending on the circumstances, an item can be reported as inventory or OM&S. Statement of Federal Financial Accounting Standards (SFFAS) No. 3: *Accounting for Inventory and Related Property* defines OM&S as tangible personnel property to be consumed in normal operations. An inventory item (explained in Section VII of this report) that is held for sale in a Working Capital Fund entity is reclassified as OM&S following the sale to a customer who will consume the item in its normal operations. The OM&S amounts reported on the Balance Sheet will be expensed in the period they are issued to an end user for consumption in normal operations.

Figure VIII-1 provides the unaudited values of OM&S by DoD Component that was reported on the FY 2010 DoD Balance Sheet.

Figure VIII-1. DoD OM&S

(FY 2010 $ in Millions)

DoD Component	OM&S, Net
Army	$34,114
Navy	62,273
Air Force	49,822
Other	802
DoD Total	**$147,011**

Reporting auditable OM&S values on the DoD Balance Sheet is yet another auditor identified long-standing material weakness. As is true with several other material weaknesses, this weakness is linked to the Financial Management Systems material weakness. In this regard, the Department's FY 2010 Agency Financial Report notes that, "Most DoD financial systems were developed decades ago to meet the requirements of budgetary accounting and do not provide the capability to record costs and assets in compliance with current accounting standards. Improvements to the current systems environment also are complicated by the use of and reliance upon many mixed (feeder) systems that are not well integrated with each other or the core financial system." However, the need for replacement systems does not represent the only challenge. Many of the items being valued were acquired long ago (e.g., F-16 engine) and sufficient evidence may not be available to support the amounts recorded.

Another challenge is timely expensing OM&S in the period of consumption. This requires a means to determine if the OM&S items are in the hands of the end user, and if it was used during the accounting period. When using the Consumption Method of accounting, SFFAS No. 3 requires an adjustment for the costs of OM&S items previously expensed, when issued to the end user, and returned to inventory (i.e., not used by the end user.)

The SFFAS No. 3 allows the use of the purchases method of accounting, which permits expensing OM&S items when purchased, if certain conditions are met. Those conditions are:

- OM&S are not significant in amount,
- OM&S are in the hands of the end users, or
- It is not cost beneficial to apply the consumption method of accounting.

Initiatives Impacting OM&S Audit Readiness

As reported in the FY 2010 DoD Agency Financial Statements, "Most DoD Components have embarked on an effort to implement a compliant end-to-end financial management system, anchored by an enterprise resource planning (ERP) system that provides the core financial system as well as replacing many of the mixed (feeder) systems." When deployed, the ERPs will provide the capability to manage OM&S, timely record the acquisition cost of newly acquired OM&S items at the transaction level and report such costs on the Balance Sheet.

Additionally, the DoD Components are executing financial improvement plans to achieve existence and completeness audit readiness of OM&S. As explained in Section I, this is one of the Department's Financial Improvement and Audit Readiness priorities. When the Components have executed their plans, they will assert audit readiness and an examination (audit by an Independent Public Accounting firm) will be performed to validate that audit readiness. Successful examination results will establish that the Components have effective physical control of their OM&S. When the ERPs are fully and successfully deployed, the Components will assert audit readiness for valuation, which also will be verified by examination.

These initiatives affect the accuracy and reliability of OM&S management information and will provide the capability to report auditable acquisition costs for newly acquired OM&S. These initiatives do not address or resolve the long-standing problem of a lack of supporting documentation for historical costs that also must be reported on the DoD Balance Sheet.

In the meantime, the DoD Components have the means of meeting three of four of the objectives of financial reporting. The Department's strategy of focusing on the Statement of Budgetary Resources and existence and completeness audits address budgetary integrity, physical stewardship of assets and control over assets. Additional information on the objectives of financial reporting is included in Section II.

Cost Information Used for Management Decisions

Representatives from the following organizations were interviewed to identify the financial or cost information they use when making OM&S decisions:

- Deputy Assistant Secretary of Defense for Supply Chain Management, Office of the Under Secretary of Defense (Acquisition, Technology and Logistics)
- Director of Army Audit Readiness, Department of the Army
- Comptroller, U.S. Coast Guard
- Deputy CFO and Director for Policy, National Aeronautical and Space Administration

In each instance, when discussing the use of OM&S cost information, the interviewee stated that historical acquisition cost might be used as one factor in purchase decisions – primarily as a benchmark. Beyond using it as a benchmark, historical cost is not used for management decision-making. However, these discussions generally confirmed that cost information is extremely important and routinely used in OM&S decision-making, but the cost information used is not the historical acquisition cost information residing in DoD accounting systems. The cost information used for business decisions, as identified by the above interviewees, includes:

- Latest acquisition cost
- Catalogue prices
- Commercial market quotations

Analysis of Asset Valuation Alternatives

Figure VIII-2 provides the key factors, by alternative, which were identified, considered, and evaluated during the business case for OM&S. Not addressed in Figure VIII-2 is whether OM&S historical acquisition costs recorded in DoD systems should be validated and work performed to locate supporting documentation, because, as discussed in Section II of this report, the Department determined that such costly activity was not justified because of the lack of any quantifiable business benefit.

The information summarized in Figure VIII-2 supports the selected alternative in the concluding subsection. Included in Figure VIII-2, by alternative, are the key factors and whether the factor supports the selected alternative or not.

Figure VIII-2. Analysis of Alternatives

Alternatives	Key Factors	Impact on Alternative
Alternative 1: Accept recorded values for existing assets and capture and maintain transaction data to support costs for future acquisitions.	• Accepting the recorded values of existing OM&S eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• Decision makers do not use the historical cost information recorded in DoD accounting or accountability systems except as a benchmark and even the use as a benchmark is only one factor in decisions to purchase and manage OM&S.	Con
	• The ERPs when configured and deployed will provide the automated capability to capture, record, and report the cost of inventory at the transaction level.	Pro
	• The Department plans to review and revise its policy and regulations for the use of the Purchases Method of accounting for OM&S and use it to the maximum extent permitted by SFFAS No. 3.	Pro
Alternative 2: Accept recorded values for existing assets and estimate costs for future acquisitions.	• Accepting the recorded values of existing OM&S eliminates the significant cost to locate supporting documentation necessary to validate recorded costs. It also eliminates the cost to audit such amounts on the Balance Sheet.	Pro
	• Decision makers do not use the historical cost information recorded in DoD accounting and accountability systems except as a benchmark and even the use as a benchmark is only one factor in decisions to purchase and manage OM&S.	Con
	• Federal accounting standards do not permit the use of estimates for reporting the cost of OM&S on the Balance Sheet. The standards (SFFAS No. 35) only permit estimates for property, plant, and equipment, but not inventory.	Con
Alternative 3: Eliminate Balance Sheet reporting by expensing costs and request FASAB to change the Federal accounting standards.	• Decision makers do not use the historical cost information recorded in DoD accounting or accountability systems except as a benchmark and even the use as a benchmark is only one factor in decisions to purchase and manage OM&S.	Pro
	• The ERPs that are being deployed provide the capability to capture, record, and report OM&S acquisition costs at the transaction.	Con
	• Eliminating Balance Sheet reporting was discussed in Section II of this report.	N/A

Selected Alternative

The Department selected Alternative 1, "Accept recorded values for existing assets and capture and maintain transaction data to support costs for future acquisitions."

The selection was made based on:

- Accepting the recorded historical costs of existing assets avoids spending significant resources to validate the recorded historical costs and to locate supporting documentation. It also eliminates the cost to audit such amounts on the DoD Balance Sheet.
- The Department plans to review and revise its policy and regulations for the use of the Purchases Method of accounting for OM&S and use it to the maximum extent permitted by SFFAS No. 3.
- The Department will achieve the capability to report accurately the acquisition costs of OM&S on the DoD Balance Sheet as an outcome of deploying the DoD Components' ERPs.

Implementation of Alternative 1

Alternative 1 will be implemented as follows:

1. Continue Statement of Budgetary Resources audit readiness activities and audits to ensure adequate financial accountability.
2. Continue executing financial improvement plans for correcting deficiencies in controls and processes.
3. Continue scheduled examinations to validate audit readiness for existence and completeness of OM&S.
4. Continue the deployment of the ERPs.
5. Revise DoD policy and regulations for the use of the Purchases Method of accounting as was done by the National Aeronautics and Space Administration in FY 2010.
6. Accept the recorded costs of OM&S migrated into the ERPs from older systems.
7. Begin audits of current year OM&S acquisitions when the Component ERPs have been fully deployed.

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Appendix 4. FIAR Governance

The Department established and is using a governance structure that engages all key stakeholders. Figure A4-1 provides a graphical representation of the governance structure, the participants, and their roles.

The Under Secretary of Defense (Comptroller) (USD(C)) provides the vision, goals, and priorities of the FIAR Plan, which are coordinated with stakeholders within the Department (e.g., Military Departments), as well as outside the Department (Office of Management and Budget and Congress). The Deputy Secretary of Defense /Chief Management Officer (CMO) approves the vision, goals and priorities.

FIAR Governance Board

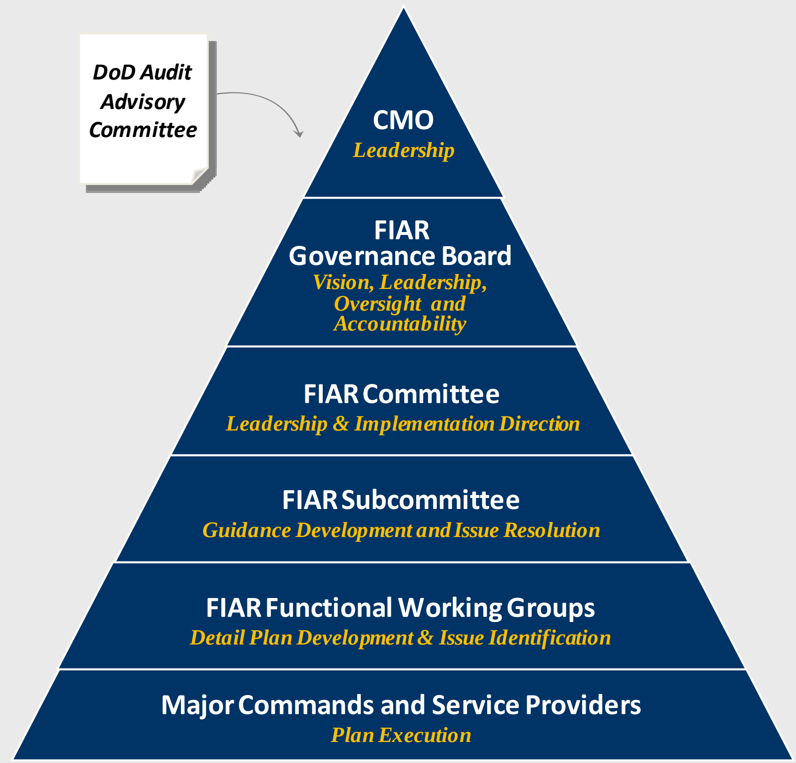
The FIAR Governance Board is chaired by the USD(C) and includes the DoD Deputy CMO (DCMO) and Military Department DCMOs. The FIAR Governance Board engages the Department's most senior leaders from the financial management community along with the DCMOs and senior representatives from the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) (OUSD(AT&L)). The DCMOs have cross-community (business and financial) responsibilities and authority to transform budget, finance and accounting operations, and to eliminate or replace financial management systems that are inconsistent with transformation.

The FIAR Governance Board meets quarterly and reviews Component progress. Accountability for progress begins at the top and is a key role of the Board. The Board's governance role also provides the Department with a visible leadership commitment, which is critical to achieving the FIAR goals and objectives.

FIAR Committee and Subcommittee

The Department also looks to the FIAR Committee, which meets monthly, to oversee the management of the FIAR Plan. The FIAR

Figure A4-1. FIAR Governance



Leadership	• CMO
Vision, Leadership, Oversight & Accountability	• USD(C)/CFO, DoD DCMO, MILDEP DCMOs, MILDEP FM/C Asst Secretaries, DCFO, DFAS Director, DLA DepDir
Leadership & Implementation Direction	• DCFO, FIAR Director, AT&L Directors, MILDEP FM/C Deputy Asst Secretaries, DFAS DepDir, DLA Compt, DoD IG (Advisory Member)
Guidance Development & Issue Resolution	• FIAR Director, Senior Staff of AT&L, Component FM and Functional Offices, DoDIG (Advisory Member)
Detail Plan Development & Issue Identification	• FIAR Staff, Staff of AT&L, Component FM and Functional Offices
Plan Execution	• Major Commands, Service Providers

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Committee leads the implementation of the FIAR Plan priorities. Chaired by the Deputy Chief Financial Officer (DCFO), the Committee is comprised of executive-level representatives of the OUSD(AT&L), Military Departments, Defense Logistics Agency and Defense Finance and Accounting Service (DFAS). The Deputy Inspector General for Auditing acts as an adviser to the FIAR Committee. An active FIAR Subcommittee of senior accountants, financial managers, management analysts, and auditors support the FIAR Committee. The Subcommittee assists the OUSD(C) in developing detailed guidance and solutions to issues. This collaborative management structure ensures the FIAR Plan is comprehensive with regard to DoD-wide organizations, issues, and solutions.

FIAR Directorate and Functional Working Groups

To provide day-to-day management of the FIAR Plan and ensure that DoD-wide financial improvement efforts are integrated with functional community improvement activities, the OUSD(C) established the FIAR Directorate, a program management office. The FIAR Directorate:

- Recommends strategic direction to the DCFO and USD(C),
- Assists the DoD Components by evaluating FIAR plans, products and deliverables, as well as providing subject matter experts to assist in Component FIAR activities,
- Develops and issues detailed financial improvement and audit preparation methodologies and guidance,
- Organizes and convenes cross-Component financial and functional working groups to address issues and develop solutions,
- Utilizing experienced financial, accounting and auditing personnel, embeds teams to develop, improve, and execute Financial Improvement Plans (FIPs) and provide training to the Components,
- Biannually, publishes the FIAR Plan Status Report,
- Maintains the FIAR Planning Tool, which is used by the Components to manage their FIPs,
- Monthly, performs detail reviews of the Component FIPs supported by the OUSD(AT&L) and provides feedback to the Components, as needed, and
- Develops metrics for monitoring and reporting progress.

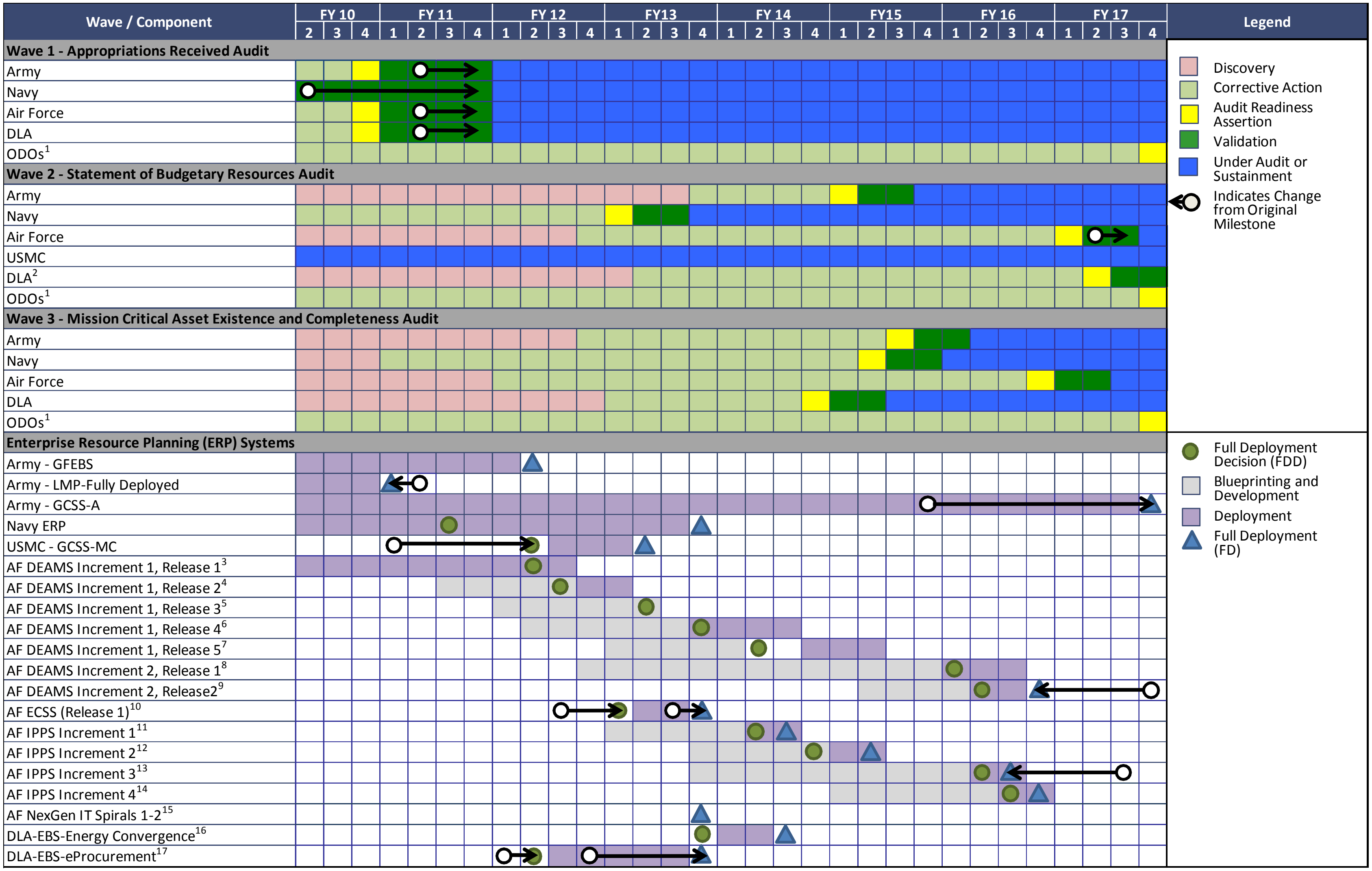
Major Commands and Service Providers

It is Components' major commands and service providers, such as the Army Materiel Command and DFAS, where the FIPs are executed. The major commands and service providers perform the evaluation and discovery work, test and strengthen internal controls, and correct deficiencies. It is within the major commands where business events occur that trigger financial transactions, and where the functional community engages with the financial community to achieve the vision, goals, and priorities of the FIAR Plan.

DoD Audit Advisory Committee

The DoD Audit Advisory Committee, established under the provisions of the Federal Advisory Committee Act of 1972, provides the Secretary of Defense, through the USD(C), independent advice and recommendations on DoD financial management, to include financial reporting processes, internal controls, audit processes, and processes for monitoring compliance with relevant laws and regulations. The Committee is comprised of five members, who are distinguished members of the audit, accounting, and financial communities. The members are not DoD employees.

Appendix 5. Audit Readiness and ERP Milestones (Figure I-4 and Endnotes)



No.	Endnote
1	ODOs are Other Defense Organizations comprising the remainder of DoD material reporting entities. For the purposes of this report, ODOs do not include intelligence agencies.
2	DLA's plan reflects the Quarter 2 of FY 2017 pending completion of the Discovery phase of its end-to-end business processes
3	DEAMS Increment 1 - Baseline Stablization - Scott AFB and 6 AMC sites without TWCF (full functionality)
4	DEAMS Increment 2 - AMC with TWCF (full functionality)
5	DEAMS Increment 3 - USTC and SDDC (full functionality)
6	DEAMS Increment 4 - AF CONUS (full functionality)
7	DEAMS Increment 5 - PACAF and USAFE (full functionality)
8	DEAMS Increment 6 - AFSPC and AFMC (full functionality)
9	DEAMS Increment 7 - Foreign Military Sales and Contingent Operations
10	ECSS Release 1 - Tools/Equipment/Vehicle Management and Base-level Materiel Managment. Releases 2-4 are being restructured for audit readiness.
11	IPPS Increment 1 - Leave for All
12	IPPS Increment 2 - Cadets Personnel and Pay
13	IPPS Increment 3 - Active/Guard/Reserve Officers Personnel and Pay
14	IPPS Increment 4 - Active/Guard/Reserve Enlisted Personnel and Pay
15	NexGenIT - There are 4 more spirals for full NexGen IT deployment.
16	DLA Energy Convergence (EC) schedule reflects an FDD date of Quarter 4 of FY 2013 which is when the program expects the preponderance of users from DLA Energy community to use the system. The EC program may update the schedule upon completion of the System Requirement Review (SRR), when the program requirements would be approved. The SRR for EC was scheduled for March 2011.
17	eProcurement program revised its implementation strategy to a single increment with multiple releases. The multiple releases will be limited fielding implementations with a single Milestone C. This shifted the Full Deployment Decision and Full Deployment to the right. The change provided a better alignment of eProcurement and BRAC 2005 (Supply, Storage, & Distribution) and reduced overall program risks.

Appendix 6. Commonly Used Acronyms

Acronym	Definition
AAA	Army Audit Agency
AFAA	Air Force Audit Agency
AFB	Air Force Base
AF-IPPS	Air Force – Integrated Personnel Pay System
AMC	Army Materiel Command
APSR	Accountable Property System of Record
AREA	Audit Readiness Environment Assessment
ARFORGEN	Army Force Generation
AT&L	Acquisition, Technology and Logistics
AWCF	Army Working Capital Fund
A2R	Acquire to Retire
BCA	Business Case Analysis
BCT	Business Cycle Team
BRAC	Defense Base Closure and Realignment Commission
BTA	Business Transformation Agency

Acronym	Definition
CAMS-ME	Capital Asset Management System for Military Equipment
CAP	Corrective Action Plan
CCAS-AF	Columbus Cash Accountability System – Air Force
CFMS	Common Food Management System
CFO	Chief Financial Officer
CIP	Construction in Progress
CIPR	Construction in Progress Requirements
CMO	Chief Management Officer
CMR	Cash Management Report
COSR	Conventional Ordnance Safety Reviews
DAI	Defense Agency Initiative
DARPA	Defense Advanced Research Projects Agency
DCAA	Defense Contract Audit Agency
DCFO	Deputy Chief Financial Officer
DCMA	Defense Contract Management Agency

Acronym	Definition
DCMO	Deputy Chief Management Officer
DCS	Deputy Chief of Staff
DCWF	Defense Working Capital Fund
DDRS	Defense Departmental Reporting System
DEAMS	Defense Enterprise Accounting and Management System
DeCA	Defense Commissary Agency
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DLA	Defense Logistics Agency
DoD	Department of Defense
DoD IG	Department of Defense Inspector General
DON	Department of the Navy
DPACS	Defense Logistics Agency Pre-Award Contracting System
DPAP	Defense Procurement and Acquisition Policy
DPAS	Defense Property Accountability System
EBS	Enterprise Business System
ECSS	Expeditionary Combat Support System

Acronym	Definition
EFD	Enterprise Funds Distribution System
ERC	Equipment Readiness Codes
ERP	Enterprise Resource Planning
ESI	Explosive Safety Inspections
ETP	Enterprise Transition Plan
E&C	Existence and Completeness
FASAB	Federal Accounting Standard Advisory Board
FBWT	Fund Balance with Treasury
FD	Full Deployment
FDD	Full Deployment Decision
FFMIA	Federal Financial Management Improvement Act of 1996
FIAR	Financial Improvement and Audit Readiness
FIP	Financial Improvement Plan
FISCAM	Federal Information System Controls Audit Manual
FM	Financial Management
FPPS	Federal Personnel Payroll System
FY	Fiscal Year

Acronym	Definition
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GCSS	Global Combat Support System
GE	General Equipment
GEO	Geosynchronous Earth Orbit
GFE	Government Furnished Equipment
GFEBS	General Fund Enterprise Business System
GPP&E	General Property, Plant and Equipment
HEO	Highly Elliptical Orbit
ICBM	Intercontinental Ballistic Missiles
ICOFR	Internal Control Over Financial Reporting
iNFADS	Internet Navy Facility Assets Data Store
INV	Inventory
IPA	Independent Public Accountant (or Accounting Firm)
IPPS	Integrated Personnel Pay System
IT	Information Technology
IUID	Item Unique Identification

Acronym	Definition
KCO	Key Control Objective
KSD	Key Supporting Documentation
LIW	Logistics Information Warehouse
LMP	Logistics Modernization Program
MAC	Moving Average Cost
MDA	Missile Defense Agency
ME	Military Equipment
MILSTRIP	Military Standard Requisitioning and Issue Procedures
MOCAS	Mechanization of Contract Administration Services
NAVAIR	United States Navy Naval Air Systems Command
NAVFAC	Naval Facilities Engineering Command
NBV	Net Book Value
NDAA	National Defense Authorization Act
NOSSA	Naval Ordnance Safety and Security Activity
NULO	Negative Unliquidated Obligations
OACSIM	Office of Assistant Chief of Staff Installation Management
OASA(ALT)	Office of the Assistant Secretary of the Army (Acquisition, Logistics and Technology)

Acronym	Definition
OASA(FM&C)	Office of the Assistant Secretary of the Army (Financial Management and Comptroller)
OCO	Overseas Contingency Operations
ODOs	Other Defense Organizations
OIS	Ordnance Information System
OM&S	Operating Materials and Supplies
OMB	Office of Management and Budget
OUSD	Office of the Under Secretary of Defense
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
P&R	Personnel and Readiness
PBUSE	Property Book Unit Supply Enhanced
P2S	Plan to Stock
RP	Real Property
RPAD	Real Property Assets Database
RPAR	Real Property Acceptance Requirements
RPIR	Real Property Inventory Requirements
RPUID	Real Property Unique Identification
SBR	Statement of Budgetary Resources

Acronym	Definition
SBIRS	Space Based Infrared System
SES	Senior Executive Service
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SMP	Strategic Management Plan
SMA	Service Medical Activity
SRR	System Requirement Review
STARS-FL	Standardized Accounting and Reporting System-Field Level
TAFS	Treasury Accounts Funds Symbol
TBD	To Be Determined
TMA	TRICARE Management Activity
UII	Unique Item Identifier
UMD	Unmatched Disbursements
USACE	United States Army Corps of Engineers
USD	Under Secretary of Defense
USD(C)	Under Secretary of Defense (Comptroller)
USMC	United States Marine Corps

Acronym	Definition
USSOCOM	United States Special Operations Command
WCF	Working Capital Fund
WHS	Washington Headquarters Services

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