October 30, 2002

Financial Management

Naval Ammunition Logistics Center Financial Reporting of Ammunition and Other Ordnance Assets in Operating Materials and Supplies for FY 2002

(D-2003-017)

Office of the Inspector General of the Department of Defense

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Acronyms

CAIMS	Conventional Ammunition Integrated Management System
FFMR	Federal Financial Management Requirements
FMR	Financial Management Regulation
JAMSS	Joint Ammunition Management Standard System
MMR	Materiel Management Regulation
NALC	Naval Ammunition Logistics Center
OM&S	Operating Materials and Supplies
USD(C/CFO)	Under Secretary of Defense (Comptroller/Chief Financial Officer)

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202–4704

October 30, 2002

MEMORANDUM FOR NAVAL INSPECTOR GENERAL

SUBJECT: Report on Naval Ammunition Logistics Center Financial Reporting of Ammunition and Other Ordnance Assets in Operating Materials and Supplies for FY 2002 (Report No. D-2003-017)

We are providing this report for your information and use. We considered management comments on a draft of this report when preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Mr. James L. Kornides at (614) 751-1400, extension 211, (jkornides@dodig.osd.mil) or Mr. John K. Issel at (614) 751-1400, extension 212, (jissel@dodig.osd.mil). See Appendix B for the report distribution. The team members are listed inside the back cover.

for David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General of the Department of Defense

Report No. D-2003-017 **October 30, 2002**
Project No. D2001FJ –0179.001

Naval Ammunition Logistics Center Financial Reporting of Ammunition and Other Ordnance Assets in Operating Materials and Supplies for FY 2002

Executive Summary

Who Should Read This Report and Why? DoD civilians and military financial management personnel who use or are involved in the preparation of financial reports required by the Chief Financial Officers Act should read this report because it provides information concerning the financial reporting of ammunition and ordnance assets.

Background. The audit was performed in support of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994, " October 13, 1994. This report is the second in a series resulting from our audit of the Financial Reporting of Operating Materials and Supplies (OM&S). The first report discussed the Naval Air System Command's financial reporting of non-ordnance OM&S. This report discusses the Navy effort to improve financial reporting of the conventional ordnance portion of its OM&S and to improve its ordnance information management system. The Navy's principal system for reporting ordnance information is the Conventional Ammunition Integrated Management System (CAIMS). CAIMS has been operational since the early 1970s.

Results. The Naval Ammunition Logistics Center was not capturing the data needed to accurately report conventional ordnance in the financial statements, and was not properly presenting and valuing conventional ordnance that is Held for Repair. As a result, the Navy's accuracy in reporting more than $35.6 billion of conventional ordnance for FY 2002 will not be measurable, and the Navy will not be in compliance with Federal accounting standards (finding A). If the Assistant Secretary of the Navy (Financial Management and Comptroller) would require the Naval Ammunition Logistics Center to comply with the Financial Management Regulation and use historical cost data for financial reporting and if the Commander, Naval Ammunition Logistics Center, establishes system interfaces with the Navy weapon system program offices these deficiencies will be corrected and accuracy of Navy financial reporting should improve.

The Naval Ammunition Logistics Center made substantial improvements to the capability and functionality of CAIMS during the past 2 years. However, the Navy did not plan to fix the financial reporting problems in CAIMS for at least 2 more years despite the relatively small cost of the changes needed. As a result, the annual financial reporting of

ordnance will continue to be inaccurate and CAIMS will remain non-compliant with financial reporting requirements until FY 2004 or later (finding B). The Assistant Secretary of the Navy (Financial Management and Comptroller) should take steps to fix the reporting problems as soon as possible to provide a more accurate representation of Naval ordnance in the annual financial statements.

Management Comments. The Principal Deputy Assistant Secretary of the Navy (Financial Management and Comptroller), in coordination with the Commander, Naval Supply Systems Command and the Commander, Naval Ammunition Logistics Center concurred with the findings and recommendations. She stated that the Navy would defer taking immediate corrective action because of the open status of the Financial Management Enterprise Architecture effort and the pending Under Secretary of Defense (Comptroller)/Chief Financial Officer policy governing inventory and related materials. She indicated that the Navy will align its efforts with those DoD-wide initiatives in addressing the recommendations and correcting the weaknesses noted in the report.

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Background

Introduction. The audit was performed in support of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994, " October 13, 1994.

This report is the second in a series resulting from our audit of the financial reporting of operating material and supplies (OM&S). The first report discussed the Naval Air System Command's financial reporting of non-ordnance OM&S. This report addresses Navy efforts to improve the financial reporting of its conventional ordnance portion of OM&S and its conventional ordnance information system.

Ordnance inventory is a Chief of Naval Operations special interest item, and the General Accounting Office considers control over inventory a high-risk area. Improved financial management, especially linking operational and financial systems to produce accurate and timely information, is one of President Bush's recently emphasized management initiatives.

Location and Composition of Navy Ordnance. The Department of the Navy conventional ordnance inventory is distributed among approximately 1,300 commands, activities, and storage facilities within the United States, as well as overseas and on board ships.

The inventory is made up of all expendable elements of Navy weapons, including precision guided missiles, torpedoes, mines and depth charges, small arms, bombs, rockets, and sonobuoys.

The Naval Ammunition Logistics Center (NALC), which is located in Mechanicsburg, Pennsylvania, is responsible for tracking the movement, location, and condition of the ordnance stockpile.

Information Management System. Since the early 1970s, the NALC has used the Conventional Ammunition Integrated Management System (CAIMS) to monitor the amount and location of conventional ordnance. CAIMS was designed to provide the Navy the ability to manage its ordnance from the time an asset was received from a contractor until it was expended.

CAIMS is the single repository for data on worldwide status of Navy conventional ordnance requirements, assets on-hand, production, expenditures, costs, and technical inventory management data. Also, the ordnance information in CAIMS is used for Navy financial reporting.

Objectives

The overall objective of the audit was to evaluate management assertions pertaining to valuation, completeness, and existence of DoD OM&S accounts and

to determine whether these accounts are presented fairly on the financial statements in accordance with Office of Management and Budget requirements. We focused this part of the audit on Navy actions needed to improve FY 2002 and future year financial reporting of its ordnance portion of OM&S. We also assessed management controls related to the audit objective. See appendix A for a discussion of the scope, methodology, and management control program review.

A. Financial Reporting of Navy Ordnance

The NALC had not taken action to accurately capture and report historical cost data of ordnance assets for inclusion in the Navy's financial statements. In addition, conventional ordnance Held for Repair values were reported inaccurately. The NALC cited the following reasons for not taking action to appropriately value ordnance:

- a perceived conflict between the Financial Management Regulation and the Materiel Management Regulation and
- inadequate repair cost information because of the lack of interface between reporting systems.

Unless significant changes are made, Navy accuracy in reporting more than $35.6 billion of conventional ordnance for FY 2002 will not be measurable, and the Navy will not be in compliance with Federal accounting standards.

Financial Reporting Policy

Financial reporting policy requires ordnance values to be included in the OM&S amounts reported on the Balance Sheet of the financial statements. The following policies guide the collection, presentation, and valuation of that information.

Federal Financial Policy. Statement of Federal Financial Accounting Standard Number 3, "Accounting for Inventory and Related Property," October 1993, outlines the Federal financial reporting standards for inventory and related property.

- Paragraph 36 defines OM&S as tangible personal property to be consumed in normal operations. OM&S is considered "free issue" to the end-user whereas inventory is "sold" to the end-user. OM&S does not include (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.
- Paragraph 37 specifies that OM&S is to be reported in one of three categories—Held For Use; Held in Reserve for Future Use; and Excess, Unserviceable, and Obsolete.
- Paragraph 42 requires that OM&S be valued on the basis of historical cost.

- Paragraph 43 directs that historical cost shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location.

- Paragraph 44 notes that Federal entities can value OM&S using any number of valuation methods if the results reasonably approximate historical costs.

DoD Financial Policy. The Financial Management Regulation (FMR), DoD 7000.14-R, outlines the policy, regulation, and procedures that all DoD Components must follow.

The FMR, volume 4 "Accounting Policy and Procedures," chapter 4, "Operating Materials and Supplies," August 2000, implements and follows the standards outlined in the Statement of Federal Financial Accounting Standard No. 3. Chapter 4, paragraph 040107 requires OM&S to be valued at historical cost, which shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location. Also, OM&S is to be reported in one of three categories—Held for Use; Held in Reserve for Future Use; and Excess, Obsolete, and Unserviceable.

DoD consolidated the OM&S Held for Use and the OM&S Held in Reserve for Future Use reporting categories into a single OM&S Held for Use reporting category for the FY 2001 financial statements. DoD also reported its OM&S that is Held for Repair as a separate line item for the first time in the FY 2001 financial statements.

Valuation of Ordnance in Financial Statements

The NALC provides data to the Assistant Secretary of the Navy (Financial Management and Comptroller) on the ordnance values to be incorporated into the financial statements. However, NALC was using latest acquisition cost to value its ordnance data and did not plan to change. NALC personnel told us that NALC did not plan to provide the data on the historical cost of ordnance for inclusion in the financial statements even though it plans on adding a field to CAIMS to capture those data (see finding B).

NALC personnel said they believed that there was a conflict between the FMR and the Materiel Management Regulation (MMR) regarding the valuation of ordnance. As such, NALC planned to continue providing data to the Navy using the latest acquisition cost instead of the historical cost of ordnance until the perceived conflict is resolved.

Comparison of the Regulations. The FMR requires that OM&S assets be valued on the basis of historical cost for financial statement purposes. The MMR, chapter 4, "Asset Management," May 1998, paragraph C4.7.1.2, requires inventory to be valued using the latest acquisition cost method.

The MMR addresses cost data for DoD Supply System Inventory Reports that provide summary statistics on the status of DoD supply system inventories.

Although latest acquisition cost data is preferred for DoD supply or logistics management purposes, historical cost data is required for financial reporting purposes.

Discussions with Under Secretary of Defense for Acquisition, Technology, and Logistics and the Under Secretary of Defense (Comptroller)/Chief Financial Officer. Although NALC officials believed that there was a conflict between the FMR and the MMR on the proper valuation of ordnance; authorities who made those policies did not support that position. We discussed the perceived conflict in the regulations with senior management in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics and the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD[C/CFO]) and determined that there was no conflict in the guidance.

Ordnance Held For Repair

In addition to not capturing the historic cost of serviceable ordnance for financial reporting, the NALC will not properly present or value conventional ordnance that is Held for Repair in FY 2002 and future year financial reports.

Presentation and Valuation. The Navy, in footnotes to the FY 2001 financial statements, disclosed that 45 percent ($15.3 billion) of Held for Use ordnance was actually classified as unserviceable but repairable. We asked NALC personnel why the unserviceable ordnance assets were not being presented as Held for Repair in the Navy financial statements. NALC personnel indicated that the primary reason was that the maintenance repair cost data needed to properly value Held for Repair ordnance were not readily available. Repair cost data are needed because the proper value of an unserviceable ordnance asset is derived by reducing the cost of the asset by the cost needed to bring the asset to a fully serviceable condition.

Repair Cost Data. NALC personnel advised us that maintenance repair cost data are not currently available in the Navy ordnance management system, CAIMS. Generally, data on the cost of a repair are maintained in information systems that are owned and operated by Navy weapon system program offices. Therefore, for CAIMS to appropriately value unserviceable ordnance, it must interface with those systems and capture the appropriate data from them.

NALC can only properly report its unserviceable ordnance as Held for Repair and appropriately value its unserviceable ordnance if it has the repair cost data available from those feeder systems.

To comply with Federal and DoD financial reporting requirements, the Navy needs to build an interface between CAIMS and the Navy weapons systems containing the repair cost data. However, prior to starting the interface efforts

NALC needs to obtain approval and agreement from the USD(C/CFO) and the Assistant Secretary of the Navy (Financial Management and Comptroller). Specifically, NALC needs to obtain approval for necessary system changes and to obtain agreement on the methodology that will be used to properly value ordnance Held For Repair.

Effect on Financial Reports

To adequately report its ordnance information in the financial statements, the Navy must:

- comply with the FMR and report the historical costs of its ordnance and
- present and properly value ordnance Held for Repair.

Until these issues are addressed, Navy FY 2002 financial reporting of approximately $35.6 billion of ordnance assets will not be in compliance with Federal and DoD financial reporting requirements.

Recommendations and Management Comments

A.1. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) require the Naval Ammunition Logistics Center to comply with the Financial Management Regulation and use historic cost data for financial statement reporting.

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments. The Navy concurred with the recommendation. The Navy stated that the programming costs needed to make CAIMS compliant appear to be minimal, however, programming CAIMS without a plan to convert inventory and related materials (IRM) to historic costs cannot ensure financial auditability. The Navy noted that the USD(C/CFO) contracted with a consulting firm to develop a plan to convert existing IRM values to a historical-based methodology. The Navy stated that the USD(C/CFO) is in the process of formulating implementation guidance, policies, and procedures, and when issued, the Navy would coordinate with the Naval Supply Systems Command and the Naval Ammunition Logistics Center to comply with the requirements.

A.2. We recommend that the Commander, Naval Ammunition Logistics Center work with the Under Secretary of Defense (Comptroller)/Chief Financial Officer and Assistant Secretary of the Navy (Financial Management and Comptroller) to establish a plan for developing system interfaces between the Navy ordnance reporting system and systems used by Navy weapon system program offices so that needed repair cost data can be accessed for the proper valuation of ordnance that is Held for Repair.

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments. The Navy concurred with the recommendation. The Navy stated that it is working with the USD(C/CFO) to achieve the objectives of the DoD Financial Management Enterprise Architecture and when completed, the architecture will provide the plan for system interface design, and the Navy will implement it at that time. The Navy noted that there is no DoD-wide method for valuing IRM Held for Repair, and a consulting firm is developing a DoD-wide approach for valuing IRM Held for Repair. The Navy stated that when a DoD-wide methodology is promulgated, the system data requirements will be known and can be considered during the USD(C/CFO) overall system interface plan.

B. Navy Ordnance Reporting System

The NALC substantially improved the capability and functionality of its ordnance information system during the past two years. However, NALC did not plan to fix the financial reporting capability deficiencies of CAIMS for at least two more years despite the relatively small cost of changes needed. The NALC decided not to request the estimated $300,000 needed to correct identified financial compliance deficiencies in CAIMS until FY 2004. NALC believed that additional functional improvements were more important than the financial compliance issues. As a result, the annual financial reporting of ordnance will continue to be inaccurate and CAIMS will remain non-compliant with financial reporting requirements until FY 2004 or later.

Navy Ordnance System

CAIMS was designed in the early 1970s to provide the Navy the ability to manage its ordnance from the time an asset was received from a contractor until it was expended.

Standard Ordnance System. In the early 1990s, DoD began a concerted effort to standardize its logistical systems, including the Military Departments' ordnance information management systems. Initially, DoD chose CAIMS as the best ammunition system among the Military Departments. The DoD attempted to redesign CAIMS for use as the joint standard ammunition system. However, because CAIMS had a mainframe database structure with little flexibility, DoD believed that incorporating the system throughout DoD would be difficult. In 1996, DoD decided to develop a new standard DoD-wide system, the Joint Ammunition Management Standard System (JAMSS). However, the JAMSS program encountered development problems and, in March 2000, DoD suspended work on the system and began considering other alternatives for development of a standard system. The alternatives considered were all new systems rather than adaptation of an existing operational system to satisfy the requirement.

Termination of JAMSS. The Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) eventually officially terminated the effort to develop JAMSS as the standard DoD-wide ordnance system. At that point, improvements were still needed in the existing ordnance information systems to ensure those systems could capture adequate management information for each of the Military Departments. To achieve this purpose, the Deputy Under Secretary of Defense (Logistics) decided to allow each of the Military Departments to independently improve their own unique systems for the management and financial reporting of ordnance. To improve the systems, the funds originally budgeted for JAMSS were divided among the Military Departments. The Navy received $3.4 million in FY 2002 and is expecting to get an additional $16 million over the next 5 years.

System Improvements. While awaiting development of a standard DoD-wide system, NALC continued to improve CAIMS and spent $7.9 million on CAIMS

improvements over a period of 3 years. NALC personnel indicated the improvements gave the system more flexibility and utility. The improvements included changing the system from a mainframe database structure to an open system or relational environment. The improvements were designed to lower the annual maintenance costs of the system and to provide any potential CAIMS user with greater capability and functionality. The NALC planned additional improvements to CAIMS in the future. Specifically, NALC planned to transform CAIMS to a much-improved management system that would permit ordnance managers access through a central web entry point.

Federal Financial Management System Requirements

Despite extensive modifications to improve capability and functionality, CAIMS continued to lack key components needed to satisfy Federal financial system reporting requirements.

Federal Financial Compliance Review. NALC personnel recognized the financial reporting deficiencies in the system. To determine specifically which functions should be changed to make CAIMS compliant, the Navy contracted with KPMG Consulting to review CAIMS for compliance with Federal reporting requirements.

KPMG used a DoD publication, "Guide to Federal Requirements for Financial Management Systems," to make the assessment. The publication lists financial management system requirements for accounting and finance systems. The Federal Financial Management Requirements (FFMRs) listed in the guide are derived from various Federal laws and regulations relevant to financial reporting.

KPMG reviewed 84 FFMRs that they determined were applicable to CAIMS. KPMG reported that CAIMS was compliant with 75 FFMRs and non-compliant with the remaining nine.

1. capability to value ordnance at historical cost
2. capability to use historical costs that may be derived using either first-in, first-out, weighted average, or moving average
3. capability to value excess, obsolete, and unserviceable ordnance at net realizable value
4. capability to record the loss or gain between purchase price and net realizable value
5. audit trails to source documents
6. integration with acquisition and core financial systems
7. capability to provide financial information in appropriate formats

8. capability to send information to core financial and cost accounting systems

9. capability to perform integrity checks on batches received

The results of the KPMG review were provided to NALC in September 2001. However, no action was taken.

Defense Financial Management Modernization Program—System Initiatives. The Secretary of Defense established a new Financial Management Modernization Program to provide policy direction and oversight for all management modernization efforts. To implement the program, the USD(C/CFO) provided guidance on October 12, 2001, for all DoD Components concerning on-going and new system initiatives.

The USD(C/CFO) stated that although prudent investments in operational, developmental, and new system initiatives are important to maintain and improve the Department's business operations, the overall impact on the Department's pending financial management enterprise architecture must first be assessed. Therefore, any system changes needed to satisfy a financial compliance requirement alone may not be funded or implemented without prior written approval of the USD(C/CFO).

This policy prevented the Navy from improving CAIMS without written approval. However, if the Navy wanted to make CAIMS compliant with the Federal reporting requirements, the Navy could seek written approval. At the time of audit, despite the relatively low cost of the needed changes, NALC had not requested approval.

Actions Needed for System Compliance

NALC Actions. Based on the results of the system compliance review, NALC estimated that it would require approximately $300,000 to correct the identified financial reporting deficiencies. The projected cost was based primarily on the number of programming hours needed to make the required system changes. The Chief Information Officer at NALC told us that it would take about 2 and 1/2 months to make the necessary changes.

We asked the Deputy Director of NALC Operations why the financial requirement system changes were not made earlier. He stated that all available funding, including the reprogrammed funds from the JAMSS program ($3.4 million for FY 2002), was designated to be used for additional functionality improvements in CAIMS and not programmed for improving the financial reporting functions of the system.

Additionally, the Deputy Director stated that ongoing initiatives to improve the CAIMS functions needed to be completed in order to maintain the level of services NALC provides, because staffing had been reduced. Also, he believed that the functionality improvements took priority over compliance with Federal financial requirements. The Deputy Director added that NALC did plan to make

the system compliant by using $300,000 of the funds budgeted for FY 2004 to correct the reported deficiencies.

Navy Department Actions. In addition to the funding issue, NALC personnel advised us that they could correct only seven of the nine identified financial compliance issues. The integration with acquisition and core financial systems, and the sending of information to core financial systems and cost accounting systems cannot be corrected without input from many other Navy Department activities. However, NALC had not taken action to identify, in conjunction with the other Navy activities, those core systems with which CAIMS must interface before it can be fully compliant with Federal financial management system requirements.

Conclusion

The Navy's primary ordnance system, CAIMS, will not be able to capture and record the data that are needed for financial reporting of ordnance until FY 2004 or later. As a result, the Navy's financial reporting of ordnance for FYs 2002 and 2003 will continue to be inaccurate.

We believe the Navy needs to pursue additional actions. The Navy should initiate efforts to fix the CAIMS financial reporting deficiencies by seeking a waiver from the USD(C/CFO) restrictions on modification of systems. We also believe the Navy should allocate funds in FY 2002 to make financial compliance improvements.

Recommendations and Management Comments

B.1. We recommend the Assistant Secretary of the Navy (Financial Management and Comptroller) request a waiver from the Under Secretary of Defense (Comptroller)/Chief Financial Officer restrictions on systems improvements to permit reprogramming of funds to correct the Conventional Ammunition Integrated Management System financial compliance deficiencies.

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments. The Navy concurred with the recommendation. The Navy noted that the USD(C/CFO) contracted with a consulting firm to devise a strategy that will ensure proper valuation of IRM and the USD (C/CFO) is developing policies and procedures resulting from the consulting firm's study. The Navy stated that the new policy would enable DoD Components to implement a uniform methodology for valuing IRM Held for Repair and Excess, Obsolete, and Unserviceable IRM. The Navy asserted that when USD(C/CFO) promulgates the policies and procedures for valuation it will be coordinated with NAVSUP and the NALC. The Navy stated that, if necessary, it would request a waiver from USD(C/CFO) to make systems improvements to correct the deficiencies (with respect to valuation).

B.2. We recommend the Assistant Secretary of the Navy (Financial Management and Comptroller) provide the funds needed to make the Conventional Ammunition Integrated Management System compliant with Federal financial management requirements in FY 2002.

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments. The Navy concurred with the recommendation. The Navy stated that its compliance is predicated on USD(C/CFO) developing methodologies for valuing IRM and conversion of baseline IRM amount to historical cost. The Navy stated that when USD(C/CFO) promulgates the necessary methodologies and policies it would coordinate with NAVSUP and the NALC to ensure that the necessary funding is made available to correct the compliance deficiencies and implement USD(C/CFO) policies and procedures for valuation.

B.3. We recommend the Assistant Secretary of the Navy (Financial Management and Comptroller), in conjunction with the Naval Ammunition Logistics Center, identify and develop the interface between the core systems and the Conventional Ammunition Integrated Management Systems.

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments. The Navy concurred with the recommendation. The Navy stated that a completed DoD Financial Management Enterprise Architecture would provide the plan for interfacing feeder systems with the core systems.

Appendix A. Scope and Methodology

We audited information related to the Navy financial reporting of ordnance assets. We examined financial information related to $35.6 billion of Navy conventional ammunition, which was on record at the beginning of FY 2002. We also reviewed the Navy's plans to improve its ordnance information system and the financial reporting of ordnance. Additionally, we reviewed reports produced by KPMG Consulting.

We also made inquires of personnel from the Offices of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, Assistant Secretary of the Navy (Financial Management and Comptroller), and NALC to determine the processes and policies that the Navy used to report OM&S. We included tests of management controls considered necessary.

We performed this audit from August 2001 through April 2002 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We relied on computer-processed data from CAIMS to determine the value of the beginning of FY 2002 ordnance balances. Although we did not perform a formal reliability assessment of the computer processed data, we did not find errors that would preclude use of computer-processed data to meet the audit objectives or that would change the conclusions in this report.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the financial management high-risk area.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of Navy management controls over OM&S. Specifically, we reviewed the Navy self-evaluation of control over the collection and reporting of information on the amount of ammunition and other ordnance assets reported in OM&S.

Adequacy of Management Controls. We identified material management control weaknesses for the Navy as identified in DoD Instruction 5010.40. Navy management controls were not adequate to ensure that the Navy complied with the Financial Management Regulation to correctly capture, report, and value its ordnance at historical cost on its financial statements. All recommendations in

the report, if implemented, will correct the weaknesses. A copy of the report will be provided to senior officials within the Navy responsible for management control.

Adequacy of Management's Self Evaluation. Management's self-evaluation was not adequate. The Navy identified compliance with CFO Act requirements as an assessable unit; however, they did not specifically report the material management control weaknesses identified during the audit.

Prior Coverage

The General Accounting Office, the Inspector General of the Department of Defense, and the Naval Audit Service have conducted multiple reviews related to Navy financial statement issues. General Accounting Office reports may be accessed on the Internet at http://www.gao.gov. Inspector General of the Department of Defense reports may be accessed on the Internet at http://www.dodig.osd.mil/audit/reports. Naval Audit Service reports may be accessed on the Internet at http://www.hq.navy.mil/NavalAudit.

Appendix B. Report Distribution

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Department of the Navy Comments

DEPARTMENT OF THE NAVY
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AUG 2 2 2002

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Subj: DRAFT AUDIT REPORT ON THE NAVAL AMMUNITION LOGISTICS CENTER FINANCIAL REPORTING OF AMMUNITION AND OTHER ORDNANCE ASSETS IN OPERATING MATERIALS AND SUPPLIES FOR FISCAL YEAR 2002 (PROJECT NO. D2001FJ-0179.001)

Ref: (a) DoDIG memo of 21 Jun 02

Encl: (1) DON Comments on DODIG Draft Report D2001FJ-0179.001

By reference (a), you requested comments regarding the subject audit. Overall, we concur with the findings and conclusions presented in the report. However, taking immediate action to resolve the recommendations does not, in our judgment, seem prudent given the current status of the Financial Management Enterprise Architecture (FMEA) effort and the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) policy governing inventory and related materials. We will align our efforts with these DoD-wide initiatives in addressing your recommendations and correcting the weaknesses noted in the report. Specific comments are provided in enclosure (1) and were prepared in coordination with the Commander, Naval Supply Systems Command (COMNAVSUPSYSCOM) and the Commander, Naval Ammunition Logistics Center (NALC).

My point of contact for this action is Mr. Ed Johnson who may be reached at (202) 685-6703 or johnson.edward@fmo.navy.mil.

Gladys J. Commons
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Principal Deputy
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Department of the Navy
Comments on
DODIG DRAFT AUDIT REPORT "NAVAL AMMUNITION LOGISTICS CENTER FINANCIAL REPORTING OF AMMUNITION AND OTHER ORDNANCE ASSETS IN OPERATING MATERIALS AND SUPPLIES FOR FY 2002"
Project No. D2001FJ-0179.001 of 21 June 02

Recommendations

A.1. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) require the Naval Ammunition Logistics Center (NALC) to comply with the Financial Management Regulation and use historic cost data for financial reporting.

Response: Concur. Though programming costs to make the Conventional Ammunition Integrated Management System (CAIMS) compliant with Federal Financial Management Requirements (FFMRs) appear to be minimal, reprogramming efforts alone cannot ensure financial auditability without a simultaneous plan to convert existing (i.e., baseline) inventories to historical cost valuation. To address valuation that includes converting existing inventory values to an historical cost based methodology, the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) contracted with a consulting firm to develop a strategy that would leverage available data and provide for an auditable solution. OUSD(C) is in the process of formulating implementation guidance, policies, and procedures using the results of the study. Once issued, we will coordinate with the COMNAVSUPSYSCOM and the NALC to ensure compliance with OUSD(C) requirements that will include the baseline inventory valuation methodology.

A.2. We recommend that the Commander, Naval Ammunition Logistics Center, work with the Under Secretary of Defense (Comptroller) and Assistant Secretary of the Navy (Financial Management and Comptroller) to establish a plan for developing system interfaces between the Navy ordnance reporting system and systems used by Navy weapon system program offices so that needed repair cost data can be accessed for the proper valuation of ordnance that is Held for Repair.

Response: Concur. Repair cost data is required for proper valuation of Ordnance that is Held for Repair. The DON is working with the OUSD(C) to achieve the objectives of the DoD Financial Management Enterprise Architecture (FMEA). Once

Enclosure (1)

completed the architecture will provide the plan for system interface design and we will implement at that time. There is currently no DoD-wide method for valuing inventory and related materials held for repair. The methodology and application of either the allowance method or the direct method provided for in Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property" will have a direct effect on how repair cost data is used, and thus how system interfaces should be used to extract repair cost data. Valuation of Ordnance as well as all inventory and related material Held for Repair are issues that OUSD(C) had their contractor consider when developing a DoD-wide approach to valuing items Held for Repair. Once the DoD-wide methodology is promulgated, the requisite system data requirements will be known and can be considered during implementation of the OUSD(C)'s overall systems interface plan.

B.1. We recommend the Assistant Secretary of the Navy (Financial Management and Comptroller) request a waiver from the Under Secretary of Defense (Comptroller) restrictions on systems improvements to permit reprogramming of funding to correct the Conventional Ammunition Integrated Management System financial compliance deficiencies.

Response: Concur in principle. In our judgment, seeking a waiver request at a time when the requisite underlying DoD-level policies designed to address many of the compliance deficiencies have not been fully developed seems ineffectual. With respect to valuation compliance deficiencies, the OUSD(C) contracted with a consulting firm to devise a strategy that will ensure proper valuation of inventory and related materials. OUSD(C) is currently formulating policies and procedures using the results of the independent contractor study. The new policy will enable DoD components to 1) implement a uniform methodology for valuing Held for Repair, Excess, Obsolete, and Unserviceable, and 2) convert baseline inventories to historical cost: a key component of instituting historical cost valuation. Once OUSD(C) promulgates policies and procedures for valuation, they will be coordinated with COMNAVSUPSYSCOM and the NALC. If necessary, a waiver to make system improvements to correct the FFMR deficiencies with respect to valuation will be requested from OUSD(C).

B.2. We recommend the Assistant Secretary of the Navy (Financial Management and Comptroller) provide the funds needed to make the Conventional Ammunition Integrated Management System compliant with Federal financial management requirements in FY 2002.

Response: Concur. Compliance is predicated on the OUSD(C) developing methodologies for valuing inventory, specifically items Held for Repair; Excess, Obsolete, and Unserviceable; and conversion of baseline line inventory amounts to historical cost. Once recommended methodologies and policies are promulgated by the OUSD(C), we will coordinate with the COMNAVSUPSYSCOM and the NALC to ensure that the necessary funding is made available to correct the compliance deficiencies and to implement OUSD(C) policy and procedures for valuation.

B.3. We recommend the Assistant Secretary of the Navy (Financial Management and Comptroller), in conjunction with the Naval Ammunition Logistics Center, identify and develop the interface between the core systems and the Conventional Ammunition Integrated Management System.

Response: Concur. The DON is working with the OUSD(C) to achieve the objectives of the DoD Financial Management Enterprise Architecture (FMEA). Once completed the architecture will provide the plan for interfacing feeder systems with the core systems.

Team Members

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