

# An Insider's Guide to Military Equipment Audits in Fiscal Year 2006 and Beyond

*Richard K. Sylvester*

**I**n the July/August issue of *Defense AT&L* (page 48), we warned you that the “Auditors Are Coming!” And they are. Now we’ll give you the inside scoop on how to prepare for the auditors, with a quick look back at why we must.

To respond to emerging national security threats, senior management officials need reliable, accurate data about military equipment—across programs, over time. Using information that has received a “clean” audit opinion from an independent auditor gives leaders confidence in the decisions they make for the warfighter. A clean audit opinion also builds credibility with Congress and the American taxpayer that the Department of Defense is managing its financial resources prudently.

In a team effort between the Property & Equipment (P&E) Policy Office and program management offices across the country, the DoD has established the initial value of every item of military equipment in its inventory after reviewing more than 1,100 military equipment programs. This initial valuation, completed Dec. 31, 2005, is based on such inputs as the average cost of military equipment, total program expenditures, and the useful life of the equipment.

The three-year effort—which is part of the Military Equipment Valuation (MEV) Initiative—marks a change in the way the Department does business. Previously, military equipment was simply expensed when it was acquired. Now it will be treated as a capitalized asset whose value must be tracked over time.

The next step is establishing the military equipment baseline for year-end financial reporting in fiscal year 2006. To make the military equipment program information current as of Sept. 30, 2006, designated component points of contact (POCs) in the acquisition community (mostly program managers) are currently updating the information that was used to complete the initial valuations. Once the updates are completed, the acquisition community (along with the logistics and financial management com-

munities) will validate the numbers, and the baseline will be formed.

## **A Closer Look at the Update Process**

POCs are currently updating program data (budgeted cost, useful life, etc.); asset status (additions, transfers, and disposals); and program expenditures from the initial valuation. Here’s a description of each of the required updates.

### **Updates to Program Data**

Representatives of the P&E Policy Office have been working closely with component POCs to identify changes to the program data, which likely will include changes to program funding and updated linkages to the accounting system. P&E Policy Office personnel will be responsible for ensuring that this updated information is considered as the military equipment baseline is developed.

### **Updates to Asset Status**

By Oct. 5, 2006, component POCs—typically program managers, item managers, or other individuals in the logistics chain who have the most reliable information concerning asset quantity—will have primary responsibility for updating the asset status information. That is, they will identify and record changes in asset quantities, by specific asset.

This asset status update process is no small task, but it’s necessary because of the limitations of the component accountability systems. Until these systems are capable of capturing and reporting accurate, real-time asset status information, the Department will have to rely on these data calls.

### **Updates to Program Expenditures**

Updating the expenditure information is being accomplished through an automated interface to the supporting accounting transactions. As noted above, during the program data update, component POCs were asked to identify the accounting system linkages that relate to their program expenditures. For purposes of the MEV initiative, these accounting linkages are referred to as finan-

---

*Sylvester is deputy director, acquisition resources and analysis (property & equipment policy) in the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics).*

**To respond to emerging national security threats, senior management officials need reliable, accurate data about military equipment—across programs, over time.**

formation they provided during the initial valuation is accurate and make the relative assertions discussed later in this article.

The management assertion process is mandated by Section 1008 of the 2002 National Defense Authorization Act, which directs government agencies to ensure that the resources expended on financial statement preparation are minimized until the reporting entity can demonstrate that it is ready for audit.

Because the law is recent, automated systems of internal controls have not yet been created. In the future, CAMS-ME will calculate military equipment values in an automated way, based on transactional data from DoD receipt, acceptance, and payment systems. But before that happens, the P&E Policy Office had to devise a short-term solution to make sure that the value reported for FY 2006 stands up to the scrutiny of an independent audit.

It is understood that the auditors will test five assertions relative to military equipment, so the management assertion process addresses each:

- **Valuation.** Auditors will test all contributing factors (useful life, acceptance date, program value, etc.) to ensure that military equipment is reported at appropriate amounts and in accordance with federal accounting standards and generally accepted accounting principles.
- **Completeness.** Auditors will test to ensure that all military equipment programs have been identified and that all military equipment is included in the amounts reported.
- **Rights and Obligations.** Auditors will test to ensure that reported military equipment assets belong to the entity and the entity has the rights to their use.
- **Existence.** Auditors will test to ensure that all assets identified and reported in the financial statements as military equipment actually exist.
- **Presentation and Disclosure.** Auditors will test the footnotes related to military equipment for compliance with accounting standards requirements and will trace the amounts disclosed to general ledger and detailed supporting records.

The key players in the management assertion process include everyone involved with military equipment in the acquisition, logistics, and financial management communities of DoD and applicable defense agencies, including the U.S. Special Operations Command (USSOCOM) and the Defense Threat Reduction Agency (DTRA). Here's how it'll work chronologically.

**By Oct. 16, 2006,** the P&E Policy Office will provide each component financial management office with a report that summarizes the following information:

cial account codes. The FAC is a combination of fields from the accounting line that can be used to associate expenditures with a program.

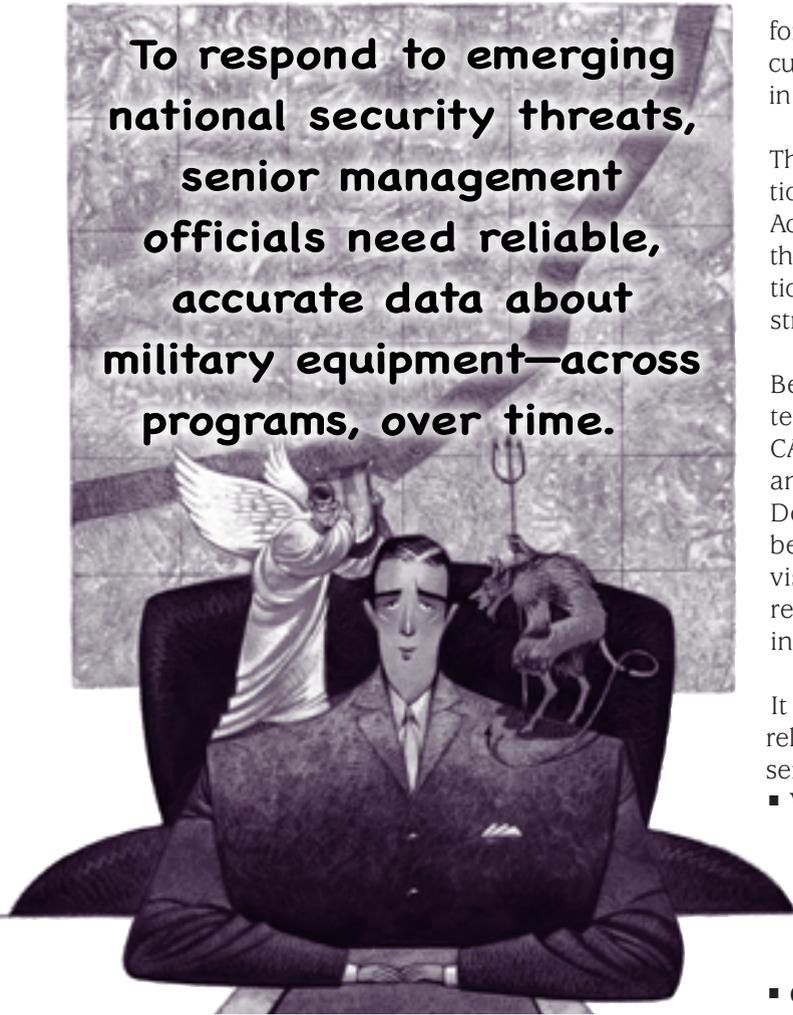
### **Capital Asset Management System—Military Equipment (CAMS-ME)**

Component POCs are making asset status updates in CAMS-ME—a system that the P&E Policy Office has developed to consolidate the average cost of assets, update total program expenditures, depreciate assets over their useful life, and record asset status.

Training on CAMS-ME for POCs is now being offered online, accessible from the Quick Links menu on the P&E Policy Office's new Military Equipment Valuation & Accountability Web site < [www.acq.osd.mil/me](http://www.acq.osd.mil/me) >. The training will remain accessible online because designated component POCs will be required to make updates on a quarterly basis from here on out.

### **A Closer Look at the Validation Process (Management Assertion)**

Once the update process has been completed, the validation, or "management assertion" process begins. In this process, components attest to the fact that the in-



For the Valuation Assertion—Budget authority through FY 2006; projected number of end items associated with this budget authority; program useful life; program FACs; and, if applicable, waiver category (military equipment programs that are not subject to military equipment valuation at this time).

For the Completeness Assertion—List of programs by program manager.

For the Existence Assertion—List of assets by program, along with their acquisition and disposal dates.

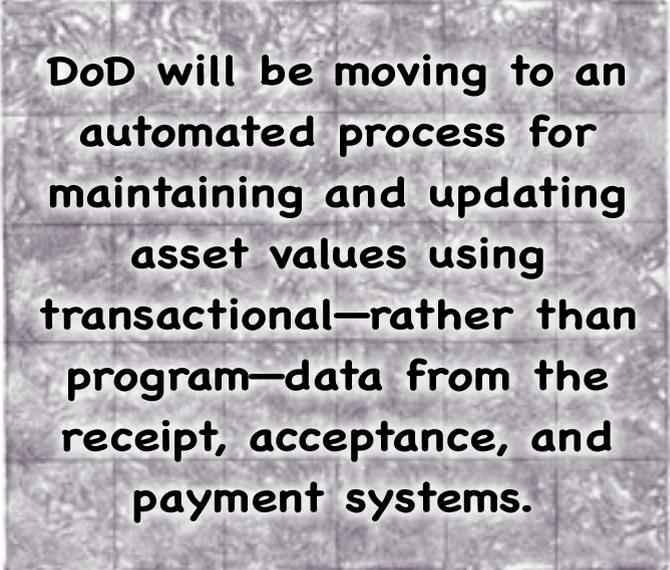
**By Nov. 10, 2006**, the components will provide the P&E Policy Office with an attestation as to the accuracy of the information in the report that was received on or after Oct. 16, 2006.

To complete the attestation, the components will have a process in place to validate the information or identify required changes. In a joint memo, the under secretary of defense (comptroller) and the under secretary of defense (acquisition, technology and logistics) recommend a process that puts the onus of the attestation on the people who are closest to the data—program managers in the acquisition community and item managers in the logistics community. These individuals should be asked to identify required adjustments and to attest that to the best of their knowledge, the information (revised as needed) is accurate. The program managers and item managers then complete the five relative assertions and forward the assertion packages up the chain of command for validation, until ultimately the component acquisition executives validate the information and forward it to their respective component assistant secretaries for financial management and comptroller.

**By Dec. 1, 2006**, the P&E Policy Office will recompute the program values based on the components' attestations. Using the recomputed values, the deputy director of the P&E Policy Office will assert to the military department assistant secretaries for financial management and comptroller; the director of management, special operations acquisition and logistics center for USSOCOM; and the director of DTRA that the military equipment reported for their respective component was valued properly.

The components are responsible for the other four assertions the auditors will be testing: completeness, ownership and rights, existence, and presentation and disclosure. At the same time, they are also responsible for validating their own accounting and payment systems.

**By Dec. 31, 2006**, the military department assistant secretaries for financial management and comptroller, or the comptroller for affected defense agencies, will represent that the values for military equipment are auditable, that



**DoD will be moving to an automated process for maintaining and updating asset values using transactional—rather than program—data from the receipt, acceptance, and payment systems.**

the military equipment exists, that all military equipment assets owned by the components have been included, and that the military equipment has been reported in accordance with applicable accounting standards. The representation will be based on input from the internal auditors in each component, who will have conducted a review to assess the work that was completed and the documentation that was compiled to support the military equipment valuations.

The under secretary of defense (comptroller) will then make a representation to the DoD inspector general that military equipment is ready for audit. Based on the assertions, the DoD inspector general will award a contract to an independent public accounting firm for the audit of the military equipment baseline value.

The independent public accounting firm or the DoD inspector general will make an independent assessment of the available information to determine whether it appears likely that the component will receive an unqualified audit opinion on the military equipment balance. If so, the audit will be initiated. If not, a report will be written that describes what has prevented the audit and what needs to be done to remedy the problems.

### **Changes Afoot**

As stated earlier, the DoD will be moving to an automated process for maintaining and updating asset values using transactional—rather than program—data from the receipt, acceptance, and payment systems. The P&E Policy Office has already identified and is implementing the needed process and policy changes. These changes will require significant alterations to existing acquisition business processes, as well as improvements to financial systems, including the way assets are associated with programs, contracts are written, individual items are identified, items are classified, and expenditure information is captured. Here's a description of each change.

### Changes to Contract Structuring

Contract line items must be structured so that the cost for items that should be capitalized (e.g., planes) can easily be segregated from the cost of items that should not be capitalized (e.g., spare parts). We will soon be offering training on contract restructuring to ensure that those who are responsible for formulating and executing contracts clearly understand the objective of these changes and the related contract writing requirements.

### Changes to Item Identification

The Department now requires the use of the item unique identifiers (IUID) for items that meet established criteria, such as those having a unit cost in excess of \$5,000 and those requiring serialized item management. The IUIDs, which associate a unique number with these military equipment assets, will make it easier to track and account for items as they move between programs and reporting organizations.

### Changes to the Association of Assets with Programs

For associating assets and related expenditures with individual programs, the Department plans to establish individual acquisition program unique identifiers (APUID). These program identifiers already exist for major acquisition programs, while current plans call for extending this requirement to all acquisition programs, thereby improving the Department's ability to link assets and related expenditures with every acquisition program.

### Changes to Item Classification

The Department plans to develop a new demand unique identifier (DUID), which will be used to distinguish how an item will be classified for financial reporting purposes. Given that some contract expenditures should be capi-

talized as military equipment, some should be reported as operating material and supplies, and some should be expensed, this identifier will provide the visibility to distinguish the appropriate classification and accounting treatment in an automated way.

### Changes to the Capture of Expenditure Information

The Department is establishing an automated receipt, acceptance, and entitlement tracking system known as Wide Area Work Flow (WAWF), which will help in associating expenditure information with programs.

Some of these process changes, such as IUID and WAWF, are already in the process of being implemented; others, such as the APUID and the DUID, should be established within the next two years.

Once all of the process changes have been fully implemented—which is estimated to take from five to seven years—the Department will have the tools it needs to implement a fully automated military equipment valuation approach.

### Keeping the Momentum Strong—You Are Key

With the help of program management offices, the DoD has already accomplished a great deal. Together we've completed an initial valuation of all military equipment programs; we've begun updating and asserting to these values; and we've mapped out a feasible long-term plan for refining the values in the future.

Now we need your help in keeping the momentum of this initiative strong. Your commitment to securing accurate, consistent, and comparable data across programs over time will give decision makers the best possible information to support our warfighters. It will also move the Department forward in its effort to obtain a clean audit opinion and secure the trust of Congress and the American taxpayer.

Assistance and training are available. The P&E Policy Office has launched the Military Equipment Valuation & Accountability Web site at <[www.acq.osd.mil/me/](http://www.acq.osd.mil/me/)>. The site features an overview video presentation for those new to MEV; help-desk assistance; a resource library; and online training, including MEV Basics, Management Assertion for Military Equipment, and CAMS-ME Portal.

The auditors are coming, so be prepared!

The author welcomes comments and questions. Contact him at [richard.sylvester@osd.mil](mailto:richard.sylvester@osd.mil).

