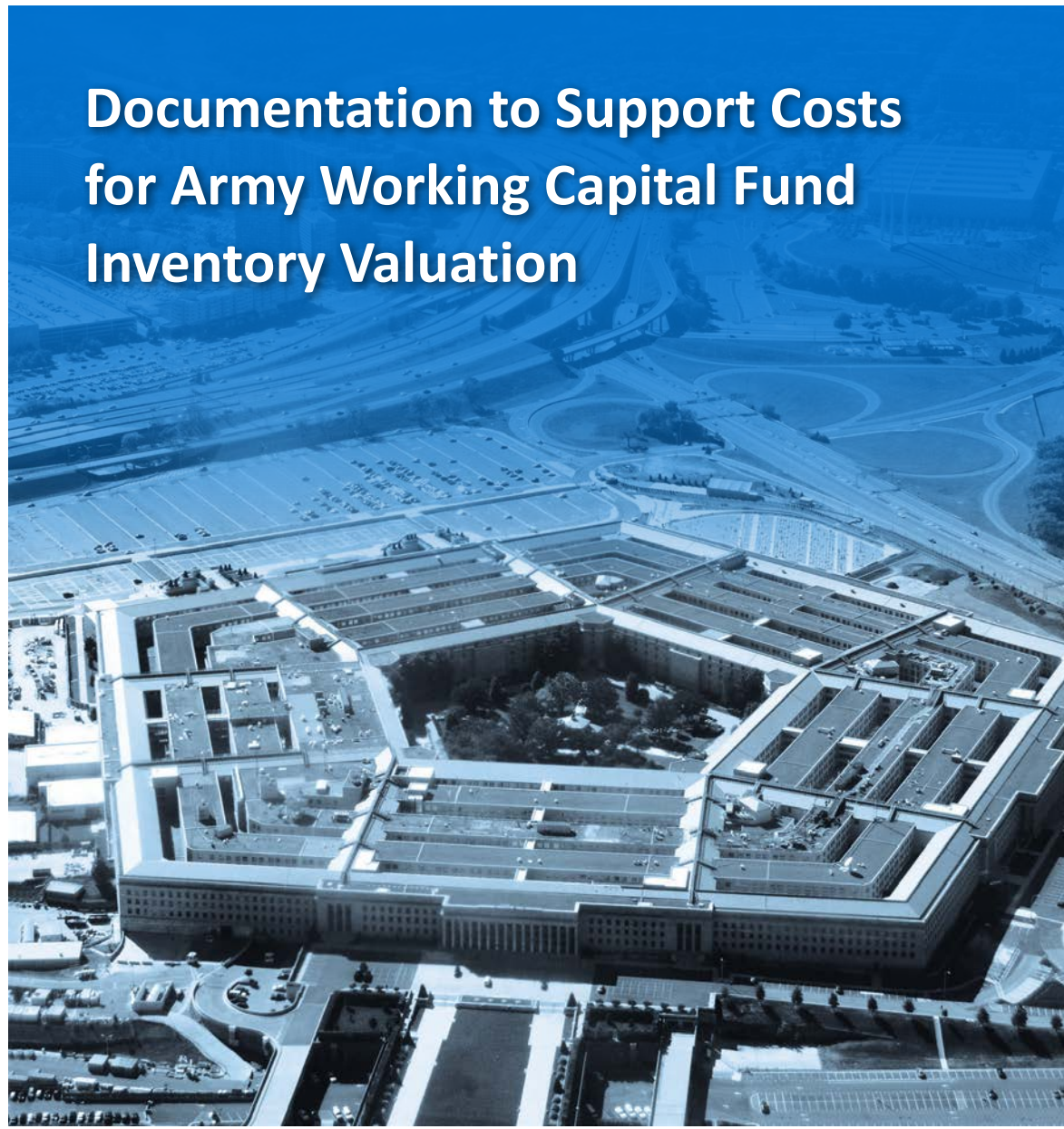




INSPECTOR GENERAL

U.S. Department of Defense

AUGUST 24, 2017



Documentation to Support Costs for Army Working Capital Fund Inventory Valuation

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

Mission

Our mission is to provide independent, relevant, and timely oversight of the Department of Defense that supports the warfighter; promotes accountability, integrity, and efficiency; advises the Secretary of Defense and Congress; and informs the public.

Vision

Our vision is to be a model oversight organization in the Federal Government by leading change, speaking truth, and promoting excellence—a diverse organization, working together as one professional team, recognized as leaders in our field.



Fraud, Waste, & Abuse

HOTLINE

Department of Defense

dodig.mil/hotline | 800.424.9098

For more information about whistleblower protection, please see the inside back cover.



Results in Brief

Documentation to Support Costs for Army Working Capital Fund Inventory Valuation

August 24, 2017

Objective

We determined whether sufficient, accurate, and appropriate documentation existed to support costs for Army Working Capital Fund (AWCF) inventory valuation.

We statistically sampled 970 of 296,839 inventory transactions, valued at \$870.2 million, which were based on historical costs recorded in the Logistics Modernization Program system during the second quarter FY 2016.

Finding

Assistant Secretary of the Army (Financial Management and Comptroller) (ASA[FM&C]) personnel did not provide sufficient, accurate, and appropriate documentation to support the costs recorded for 818 of 970 statistically sampled AWCF inventory transactions. We project that the ASA(FM&C) cannot support at least 291,408 AWCF inventory transactions, valued at \$690.8 million of the \$870.2 million in AWCF inventory items acquired in the second quarter FY 2016. This occurred because the ASA(FM&C) ineffectively performed discovery and

Finding (cont'd)

corrective action phase activities of the financial environment related to AWCF inventory business processes.¹ Specifically, the ASA(FM&C) did not:

- develop detailed standard operating procedures, flowcharts, and narratives describing the AWCF inventory business processes;
- identify the key positions that needed to be contacted to identify, maintain, and provide key supporting documentation for the transactions associated with AWCF inventory processes; and
- develop corrective action plans to remediate known documentation deficiencies.

In addition, the U.S. Army Materiel Command did not design the Logistics Modernization Program system with the functionality to identify receiving and invoice documents stored in another system. Finally, ASA(FM&C) personnel could not identify the amounts it previously credited to customers for inventory items returned for credit or repair.

As a result, the Army is not ready for an AWCF financial statement audit and will likely not be audit ready by the mandatory deadline on September 30, 2017. The Army's inability to provide supporting documentation for AWCF inventory transactions is one reason it receives an annual disclaimer of opinion. Consequently, the Army is unable to support the \$10.6 billion value of its Inventory, Available and Purchased for Resale, reported on the AWCF balance sheet as of September 30, 2016, as reflected in the Army's disclaimer of opinion.²

¹ During the discovery phase, the reporting entity defines and documents its business processes and financial environment; identifies the key supporting documentation needed for its business processes and financial environment; identifies and classifies any deficiencies with its supporting documentation; and defines its strategy for achieving audit readiness. The corrective action phase is the second phase and is designed to correct deficiencies identified during the discovery phase.

² Report No. DODIG-2017-009, "Independent Auditor's Report on the Army Working Capital FY 2016 and FY 2015 Basic Financial Statements," November 9, 2016.



Results in Brief

Documentation to Support Costs for Army Working Capital Fund Inventory Valuation

Recommendations

We recommend that the ASA(FM&C):

- establish detailed standard operating procedures, flowcharts, and narratives for each inventory business process (1.a);
- identify key supporting documentation for each inventory process (1.b);
- develop a “perfect package” of supporting documentation for transactions associated with AWCF inventory processes (1.c);³
- identify and document key positions for each business process (1.d);
- ensure memorandums of understanding with service providers clearly identify who would maintain the documentation, where the documentation would be stored, protocols for requesting and providing documentation, and documentation retention policies (1.e);
- develop corrective action plans and milestones to correct the problems (1.f); and
- develop a process to maintain credit values given for returns for credit and unserviceable credit transactions (1.g).

In addition, the ASA(FM&C), in coordination with U.S. Army Materiel Command, should incorporate data fields within the Logistics Modernization Program system to identify the goods receipt and invoice documents in the Invoicing, Receipt, Acceptance, and Property Transfer system.

³ “Perfect packages” include all requested journal vouchers and supporting documentation necessary to support a transaction.

Management Comments and Our Response

The Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), partially agreed with our finding and agreed with our recommendations.

The Deputy Assistant Secretary of the Army (Financial Operations) stated that the Army implemented Recommendations 1.d and 1.e and has begun to implement Recommendations 1.a, 1.b, 1.c, 1.f, and 1.g. However, the Deputy Assistant Secretary of the Army (Financial Operations) did not describe the actions taken to implement Recommendations 1.d and 1.e or elaborate on how or when Recommendations 1.a, 1.b, 1.c, 1.f, and 1.g would be implemented. Therefore, these recommendations are unresolved and remain open. We request that the ASA(FM&C) provide the details on how and when the recommendations would be implemented by September 25, 2017. We will close the recommendations once we receive and verify that the ASA(FM&C) has implemented the recommendations.

The Deputy Assistant Secretary of the Army (Financial Operations) agreed to incorporate data fields within the Logistics Modernization Program system to identify the goods receipt and invoice documents, stating that a system change request was implemented in the Logistics Modernization Program on May 22, 2017. Therefore, the recommendation is resolved but remains open. We will close the recommendation once we receive evidence of system implementation and verify that the ASA(FM&C) and U.S. Army Materiel Command have the ability to trace the receiving reports and invoice documents from the Logistics Modernization Program system to the Invoicing, Receipt, Acceptance, and Property Transfer system.

Please see the Recommendations Table on the next page for the status of recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Assistant Secretary of the Army (Financial Management and Comptroller)	1.a, 1.b, 1.c, 1.d, 1.e, 1.f, 1.g	2	None

Please provide Management Comments by September 25, 2017.

Note: The following categories are used to describe agency management’s comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.



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

August 24, 2017

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER, DOD

DIRECTOR, DEFENSE LOGISTICS AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Documentation to Support Costs for Army Working Capital Fund Inventory Valuation (Report No. DODIG-2017-114)

We are providing this report for review and comment. The Assistant Secretary of the Army (Financial Management and Comptroller) did not provide sufficient, accurate, and appropriate documentation to support the costs recorded for 818 of the 970 statistically sampled Army Working Capital Fund inventory items acquired in the second quarter FY 2016. As a result, the Army is unlikely to be audit ready by the mandatory deadline on September 30, 2017. We conducted this audit in accordance with generally accepted government auditing standards.

We considered management comments on a draft of this report when preparing the final report. Comments from the Deputy Assistant Secretary of the Army (Financial Operations), responding for the Assistant Secretary of the Army (Financial Management and Comptroller), on Recommendation 2 addressed all specifics of the recommendation and conformed to the requirements of DoD Instruction 7650.03; therefore, we do not require additional comments. We request that the Assistant Secretary of the Army (Financial Management and Comptroller) provide additional comments on Recommendations 1.a, 1.b, 1.c, 1.d, 1.e, 1.f, and 1.g by September 25, 2017.

Please send a PDF file containing your comments to audfmr@dodig.mil. Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

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

A handwritten signature in cursive script that reads "Lorin T. Venable".

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



Contents

Introduction

Objective.....	1
Background	1
Review of Internal Controls.....	5

Finding. The Army Lacked Supporting Documentation for Its Working Capital Fund Inventory Valuation.....

Army Did Not Provide Documentation to Support Inventory Values	7
ASA(FM&C) Did Not Effectively Perform the Discovery and Corrective Action Phases	13
Logistics Modernization Program Was Not Properly Configured to Support Commercial and Vendor Purchases.....	18
ASA(FM&C) Did Not Maintain Prior Credit Values	19
Army Working Capital Fund Will Likely Not Meet Audit Readiness Date.....	19
Management Comments on the Finding and Our Response.....	20
Recommendations, Management Comments, and Our Response.....	24

Appendixes

Appendix A. Scope and Methodology.....	27
Use of Computer-Processed Data.....	28
Use of Technical Assistance.....	29
Appendix B. Prior Coverage.....	30
Appendix C . Key Tasks in the DoD Financial Improvement and Audit Readiness Guidance	32
Appendix D. Approach for Reviewing Key Supporting Documents	34
Appendix E. Statistical Sampling and Projection Methodology	35

Management Comments

Office of the Assistant Secretary of the Army (Financial Management and Comptroller).....	37
--	----

Acronyms and Abbreviations.....

Introduction

Objective

We determined whether sufficient, accurate, and appropriate documentation existed to support costs for Army Working Capital Fund (AWCF) inventory valuation.⁴ Specifically, we determined how the Army managed the documentation supporting the inventory values entered into the Logistics Modernization Program (LMP) system in the second quarter FY 2016. See Appendix A for a discussion of the scope and methodology.

This report is the second in a series on the AWCF inventory valuation. In the first audit report, we identified that the Army did not properly record AWCF inventory valuation at Moving Average Cost (MAC) in the LMP system.^{5,6} See Appendix B for prior audit coverage.

Background

The Army uses the AWCF to purchase its inventory. Inventory is defined as tangible personal property that is: 1) held for sale, 2) in the process of production for sale, or 3) to be consumed in the production of goods for sale or in the provisions of services for a fee. A working capital fund provides a way to purchase common goods and services and is designed to provide a more effective means for controlling the costs of goods and services required, produced, or furnished by AWCF activities. The AWCF operates more like a business than a Government entity. The AWCF's customers include the Army General Fund, DoD Components, other Government agencies, and private parties when authorized by law, including foreign governments. The U.S. Army Materiel Command (AMC) manages the AWCF for the Army.

The AWCF consists of two activity groups: Industrial Operations and Supply Management. AMC's Life-Cycle Management Commands manage the two activity groups. The Industrial Operations activity group provides the Army with the in-house capability to maintain, repair, and upgrade military equipment and

⁴ The Army could not provide sufficient documentation to determine the accuracy and appropriateness for the majority of inventory transactions. Therefore, unless otherwise noted, subsequent references will only be made to the sufficiency of supporting documentation. Sufficiency is defined as enough documentation to fully support the transaction. See Appendix D for additional information related to our approach for reviewing key supporting documents.

⁵ Report No. DODIG-2016-108, "Army Needs Greater Emphasis on Inventory Valuation," July 12, 2016.

⁶ The LMP system is an Enterprise Resource Planning system used to record Army logistical and financial transactions. The LMP system records inventory transactions within its general ledger and interfaces inventory sales with the Army General Funds through the General Fund Enterprise Business System. The Army reported to Congress that the LMP system would be used to develop auditable financial statements for the AWCF.

materials. The Supply Management activity group buys spare and repair parts for sale primarily to Army operating units located worldwide, Army Industrial Operations activities, and other DoD Components.

In anticipation of customer demands, the Supply Management activity group buys new inventory items from contractors or places orders with the Defense Logistics Agency (DLA) and DoD depots for repaired and remanufactured items. In addition, Supply Management activities may also procure items returned from Army operating units for credit. The Supply Management activity group arranges for inventory items to be shipped directly to the customers or stored for future use. The customers are billed for the purchase once customer orders are filled. The Supply Management activity group then uses the revenue received from customers to replenish its inventory.

The Inventory, Available and Purchased for Resale, account is used by the Army to record the value of inventory, which consists of procured, manufactured, and remanufactured items that are in a usable condition and available for immediate resale to customers.⁷ As of March 31, 2016, AWCF reported \$19.5 billion in Net Inventory (82 percent of \$23.6 billion in total assets), of which \$12.0 billion was Inventory, Available and Purchased for Resale (Inventory). When the Supply Management activity group sells inventory, the sale is reported in a revenue account (U.S. Standard General Ledger [USSGL] 510000) and in the cost of goods sold account (USSGL 650000) at the cost of purchasing, producing, and shipping an item, also known as its historical cost. The cost of AWCF's ending inventory and the cost of goods sold are calculated using MAC.

Moving Average Cost

Statement of Federal Financial Accounting Standards (SFFAS) No. 48 states that inventory must be valued at either historical cost or a method that reasonably approximates historical cost, such as the MAC valuation method.^{8, 9} MAC is determined each time costs are incurred for a purchase or when a reparable item is repaired or remanufactured. According to DoD Financial Management Regulation (FMR), MAC is calculated by dividing the total cost of all units of an inventory item on hand by the total number of units.¹⁰ The use of MAC requires

⁷ The Army records these transactions in the LMP system using U.S. Standard General Ledger 152100, "Inventory, Available and Purchased for Resale."

⁸ SFFAS No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials," January 27, 2016, updated SFFAS No. 3, "Accounting for Inventory and Related Property," October 27, 1993, which stated that inventory must be valued at either historical cost or latest acquisition cost.

⁹ SFFAS No. 3, "Accounting for Inventory and Related Property," October 27, 1993, states that first-in–first-out, weighted average, or MAC flow assumptions may be applied in arriving at the historical cost of ending inventory and cost of goods sold.

¹⁰ DoD FMR, volume 4, chapter 4, "Inventory and Related Property."

the LMP system to recalculate inventory values after each inventory transaction. MAC must be used with a perpetual inventory system, such as the LMP system. A perpetual inventory system maintains detailed, continuous records of the cost of each inventory item purchased and sold to show the inventory that should be on hand for every item. A perpetual inventory system keeps track of both quantities and costs. Inventory valuation is a critical component for AWCF audit readiness.

Roles and Responsibilities

The Assistant Secretary of the Army (Financial Management and Comptroller) (ASA[FM&C]) is responsible for modernizing Army financial management systems and processes; integrating financial data and cost information; developing associated policies, procedures, programs, and systems; and monitoring internal control and audit compliance.

The ASA(FM&C) Army Accountability and Audit Readiness Directorate coordinates with commands and service providers to obtain supporting documentation and to develop and implement corrective actions associated with adequacy, availability, and retention of supporting documentation. The directorate also updates and disseminates policies and procedures regarding documentation retention requirements. Through the use of civilians and contractors, the directorate performs audit readiness activities detailed in the DoD Financial Improvement and Audit Readiness (FIAR) guidance issued by the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. The AWCF Audit Readiness Directorate is responsible for audit readiness activities related to the AWCF.¹¹ The AMC is responsible for managing AWCF installations where inventory is received as well as managing the process by which prices and credit values are established.

As the DoD's largest logistics support agency, the DLA sources and provides nearly all military consumables (food, fuel, medical supplies, and construction materials) and 86 percent of all military spare parts. The DLA also operates distribution field activities, which store most Army inventory items.

The Defense Finance and Accounting Service (DFAS), in coordination with the ASA(FM&C), performs finance and accounting services for the Army. It also prepares annually audited financial statements for the AWCF, which are reported separately from the Army General Fund. These statements include the balance sheet (where inventory is reported) and statement of net cost (where the cost of goods sold is reported). The DLA and DFAS also support the Army by obtaining and maintaining key documentation needed to support inventory valuation.

¹¹ Throughout the report, we refer to AWCF Audit Readiness Directorate personnel as ASA(FM&C) personnel.

Audit Readiness Documentation

The April 2016 DoD FIAR guidance states that amounts reported on the financial statements must be accurate and supportable, and methodologies used to value the inventory must be appropriate, reasonable, and well documented.¹² The guidance also requires reporting entities to ensure that documentation is readily available to support all applicable assertions for each financial statement line item.^{13, 14} The DoD FIAR audit readiness methodology includes discovery of business processes in which the Army should identify processes, process owners, controls, risks, and systems for material transactions.¹⁵ DoD FIAR guidance states that DoD Components must be able to assert the audit readiness of all business processes and sub-processes associated with recording and classifying inventory, including the proper value of inventory.¹⁶

Key supporting documentation needed to support the historical cost of an inventory item recorded within the LMP system should match in quantity, amount, and description. The DoD FIAR guidance states that key supporting documents for inventory transactions should include obligating documents that support asset acquisition cost, such as contracts (including statements of work), work orders, reimbursable agreements, military interdepartmental purchase requests, and purchase orders; receiving reports; invoices; and appraisal reports for donated assets.¹⁷ The DoD FMR states that DoD Components must ensure that appropriate payment documentation is established and retained to support payment of invoices, which includes a contract and purchase order, receipt and acceptance report, and proper invoice.¹⁸ See Appendix C for key tasks in DoD FIAR guidance, which include establishing a good infrastructure for supporting documentation. Appendix D identifies our approach for reviewing key supporting documents.

¹² DoD FIAR guidance, chapter 2.B, “Priorities,” April 2016.

¹³ DoD FIAR guidance, chapter 5.A, “Introduction,” April 2016.

¹⁴ Financial statement auditors use assertions to consider the different types of potential misstatements that may occur. Assertions about account balances at the period-end include valuation, which means that assets are included in the financial statements at appropriate amounts.

¹⁵ DoD FIAR guidance, chapter 4.B, “Methodology—Service Providers,” April 2016.

¹⁶ DoD FIAR guidance, chapter 5.D, “Wave 4—Proprietary Statements,” April 2016.

¹⁷ DoD FIAR guidance, chapter 5.D.

¹⁸ DoD FMR, volume 10, chapter 8, “Commercial Payment Vouchers and Supporting Documents.”

Review of Internal Controls

DoD Instruction 5010.40 requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls.¹⁹ We identified internal control weaknesses in the Army's business process to support the historical costs of AWCF inventory in the LMP system financial and accountability records. Specifically, the ASA(FM&C), in conjunction with AMC, DLA, and DFAS, did not implement adequate controls to ensure that sufficient, accurate, and appropriate documentation was readily available to support AWCF inventory costs in the LMP system. We will provide a copy of the report to the senior official responsible for internal controls in the Department of the Army.

¹⁹ DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013.

Finding

The Army Lacked Supporting Documentation for Its Working Capital Fund Inventory Valuation

ASA(FM&C) personnel did not provide sufficient, accurate, and appropriate documentation to support the costs recorded for 818 of 970 statistically sampled AWCF inventory transactions. We project that the ASA(FM&C) cannot support at least 291,408 AWCF inventory transactions, valued at \$690.8 million of the \$870.2 million in AWCF inventory items acquired in the second quarter FY 2016. This occurred because the ASA(FM&C) ineffectively performed discovery and corrective action phase activities of the financial environment related to AWCF inventory business processes. Specifically, the ASA(FM&C) did not:

- develop detailed standard operating procedures, flowcharts, and narratives describing the AWCF inventory business processes;
- identify the key positions that needed to be contacted to identify, maintain, and provide key supporting documentation for the transactions associated with AWCF inventory processes; and
- develop corrective action plans to remediate known documentation deficiencies.

In addition, the AMC did not design the LMP system with the functionality to identify receiving and invoice documents stored in the Invoicing, Receipt, Acceptance, and Property Transfer (iRAPT) system. Finally, the ASA(FM&C) could not identify the amounts AMC previously credited to customers for inventory items returned for credit or repair.

As a result, the Army is not ready for an AWCF financial statement audit and will likely not be ready by the mandatory deadline on September 30, 2017. The Army could not support the value of its Inventory, Available and Purchased for Resale, reported on the AWCF balance sheet with a balance of \$10.6 billion as of September 30, 2016. The Army's inability to provide supporting documentation for AWCF inventory transactions is one of the reasons that the Army continues to report AWCF inventory as a material weakness and annually receives a disclaimer of opinion on the AWCF financial statements.

Army Did Not Provide Documentation to Support Inventory Values

The ASA(FM&C) did not provide sufficient, accurate, and appropriate documentation to support inventory values recorded in the LMP system. For 818 of 970 statistically sampled inventory items, the ASA(FM&C) did not provide, in a timely manner, the key supporting documentation to substantiate the historical costs of the AWCf inventory reviewed for the following four inventory processes.²⁰

- Military Standard Requisitioning and Issue Procedures (MILSTRIP) and National Maintenance Program (NMP)—MILSTRIP is an intragovernmental process to requisition items from the stock system or supply source. The NMP distributes the sustainment maintenance workload across depot and non-depot activities based on need through a requirements determination process.
- Returns from Repair—the repaired items the Army depots send to the supply system as serviceable items (Inventory, Available and Purchased for Resale) for reissuance.
- Returns for Credit—the serviceable items not needed by the field and returned to the supply system for a Life-Cycle Management Command-determined credit to be applied towards the purchase of other items.
- Commercial and Vendor Purchases—purchases of new items from contractors or vendors.

Office of Management and Budget Circular A-123, “Management’s Responsibility for Internal Control,” December 21, 2004, requires that key supporting documentation be readily available. DoD FIAR guidance states that key supporting documents for inventory transactions include obligating documents supporting asset acquisition cost, such as contracts (including statements of work), work orders, reimbursable agreements, military interdepartmental purchase requests, and purchase orders; receiving reports; invoices; and appraisal reports for donated assets.²¹

The ASA(FM&C) did not provide sufficient supporting documentation for 818 of 970 statistically sampled inventory items. For 812 of the 818 inventory items reviewed, the ASA(FM&C) did not provide all the documentation needed to support the amount of the items’ historical costs that were recorded in the LMP

²⁰ DoD FIAR guidance, chapter 2.C, “Strategy,” April 2016, cites that, as a general rule, reporting entities must ensure they respond to audit team requests within 5 business days. Expected response times may vary depending on the nature, timing, and extent of the request. We initially requested documentation from the ASA(FM&C) on July 15, 2016. After several discussions with ASA(FM&C) personnel, they agreed to provide us the documentation supporting the cost recorded in the LMP system for each of the inventory transactions associated with three of the four inventory processes by August 17, 2016. We obtained supporting documentation from DoD systems for the commercial and vendor purchases. See Appendix A for additional details on our methodology.

²¹ DoD FIAR guidance, chapter 5.D.

system. Although the ASA(FM&C) provided supporting documentation for the remaining six inventory items acquired through commercial and vendor purchases, the documentation did not support the quantity recorded in the LMP system or lacked proper authoritative signatures. Table 1 provides a summary of the results of the inventory transactions tested by inventory process.

Table 1. AWCF Transaction Testing Results and Quantitative Projections by Inventory Process

Inventory Process	Total Sample Items	Sample Items Unsupported by Documentation	Unsupported Amount (in millions)	Projected Sample Items Unsupported by Documentation	Projected Unsupported Amount (in millions)
MILSTRIP and NMP ¹	322	322	\$11.3	283,194	\$322.0
Returns for Credit	182	182	9.0	2,295	22.7
Returns from Repair	<u>235</u>	<u>235</u>	<u>62.2</u>	<u>4,546</u>	<u>258.6</u>
Intra-governmental subtotal	739	739	\$82.5	290,147²	\$610.8²
Commercial and Vendor Purchases	231	79	21.3	954	71.6
Total	970	818	\$103.8	291,408²	\$690.8²

Source: The DoD OIG.

¹ Although MILSTRIP and NMP have separate business processes, we combined the two processes into the same sampling strata, but will report separately on each process. There were 25 NMP sample items.

² The DoD Office of Inspector General (DoD OIG) used lower bounds due to some of the projections exceeding the universe value. Please see Appendix E for sample projections performed by the DoD OIG.

DoD systems contained sufficient supporting documentation for 152 of the 231 commercial and vendor purchase transactions. However, the ASA(FM&C) did not provide sufficient documentation to support the costs recorded in the LMP system for the 739 intragovernmental transactions associated with the other inventory processes (MILSTRIP, NMP, returns for credit, and returns from repair).²² We project that the ASA(FM&C) cannot support at least 291,408 AWCF inventory items, valued at \$690.8 million of the \$870.2 million in AWCF inventory items acquired in the second quarter FY 2016.

We project that the ASA(FM&C) cannot support at least 291,408 AWCF inventory items, valued at \$690.8 million of the \$870.2 million in AWCF inventory items acquired in the second quarter FY 2016.

²² Intragovernmental transactions represent business activities between governmental entities. Unlike commercial and vendor purchases, intragovernmental inventory transactions associated with these business processes occurred between DoD and federal entities.

Support Not Available for Inventory Items Acquired Through Military Standard Requisitioning and Issue Procedures

The ASA(FM&C) did not provide sufficient documentation to support the total cost for the 297 statistically sampled MILSTRIP inventory items reviewed. Documentation needed to support inventory valuation should include obligating documents, receiving reports, invoices, billing statements, and disbursing vouchers. MILSTRIP is an intragovernmental process to requisition items from the stock system or supply source. The Army supply system uses MILSTRIP to obtain DLA-held inventory and provide it to supply activities. The DLA receives a MILSTRIP purchase order from the Army for goods and, upon acceptance, bills the Army activity using the Defense Automatic Addressing System. When DFAS receives the bill from the DLA, DFAS transfers the funds from the Army to the DLA.

The ASA(FM&C) provided LMP system screen prints of the purchase orders associated with each of the 297 inventory items as evidence for the purchase price of the items. However, the screen prints did not include the unit price and total purchase price of the purchase order or DLA's agreement to the terms of the purchase order or the unit price and total purchase price of the purchase order. Figure 1 is a screen print of the MILSTRIP purchase order for one of our sample items.

Figure 1. LMP System Screen Print of MILSTRIP Purchase Order

MILSTRIP Purch Ord 4513744233 Created by LMP@PROD_API (CONTROL-M)										
Document Overview On		Print Preview		Messages		Personal Setting				
MILSTRIP Purch Ord		4513744233		Vendor		RSMS HQ DEFENSE LOGISTICS...		Doc. date 11.09.2015		
Contract Number		Call Order No		Find		Find Next				
Header										
S	Item	A	I	Material	Short Text	PO Quantity	O...	C	Deliv. Date	Net
	10			014170133	BEARING,PLAIN,ROD E	1	EA	D	14.09.2015	
	20			014170133	BEARING,PLAIN,ROD E	19	EA	D	07.01.2016	

Source: ASA(FM&C).

The screen prints were also not acceptable evidence because the Army had not established effective LMP system general and application controls. According to DoD FIAR guidance:

Information technology general controls (ITGCs) and application controls must be designed effectively and tested for operating effectiveness in order for management to rely on the automated controls and system generated reports (i.e., [key supporting documents] KSDs). Supporting documentation testing (i.e., substantive testing) cannot overcome ineffective or missing ITGCs and application controls when transaction evidence is electronic and only maintained within a system, or the key supporting evidence is system-generated reports.²³

The Army FY 2016 Statement of Assurance stated that the LMP system had significant data integrity and system integration problems. External audits have also identified the lack of effective LMP system general and application controls. Because the Army provided electronic documentation as support without having sufficient internal controls within the LMP system, we could not rely on the electronic documentation as the purchase order.

The ASA(FM&C) provided receiving reports from the Army field activities for 204 of the 297 MILSTRIP inventory items. DFAS-Columbus personnel provided the billing and disbursing voucher information associated with the 297 transactions. However, the ASA(FM&C) did not provide sufficient purchase order and receiving report information for each of the inventory items necessary to support the accuracy of the billing and disbursing voucher information.

Support Not Available for Inventory Items Acquired Through National Maintenance Program

The ASA(FM&C) did not provide sufficient documentation to support the value of 25 NMP inventory items reviewed.²⁴ The NMP is an AMC program that provides repaired items to Army supplying activities. The ASA(FM&C) provided the accepted Military Interdepartmental Purchase Requests (DD Form 448-2) as the obligating document, establishing the agreed to price to be paid for each of the NMP inventory items. However, the ASA(FM&C) did not provide receiving reports, or billing or disbursing documentation for any of the inventory items. As a result, the ASA(FM&C) was unable to support the value recorded in the LMP system for each of the 25 NMP inventory items.

²³ DoD FIAR guidance, chapter 1.B, "Purpose of the FIAR Methodology," April 2016.

²⁴ Projections for NMP inventory items are included within the MILSTRIP projections.

Support Not Available for Inventory Returned for Credit

The ASA(FM&C) did not provide sufficient documentation to support the inventory value of the 182 statistically sampled inventory items that customers returned for credit. When the AWCF Supply Management determines that it will not have enough inventory to fulfill customer orders for a specific item, it offers the customer a credit towards a future purchase in exchange for turning in a like item in functioning condition. The AWCF records these returned items in the LMP system at the credited amount.

While the ASA(FM&C) provided some turn-in forms, issuance and receipt forms, LMP system screen prints, and warehouse tickets, it did not provide any documentation supporting how it determined the amount of the credit given to a customer for each of the 182 returned inventory items reviewed.^{25, 26} As a result, the ASA(FM&C) could not support the value recorded in the LMP system for the 182 inventory items, valued at \$9.0 million, that customers returned for credit.

In addition, the Army erroneously included a commercial payment for gas masks in the universe of return for credit transactions. The accounting in the LMP system for this transaction was the same as a return for credit transaction and resulted from the same weak internal control environment that we described in Report No. DODIG-2016-108. Specifically, the Army purchased 2,872 gas masks for \$735,174.56 (\$255.98 each) on January 4, 2016, and received them at Blue Grass Army Depot on February 8, 2016. On February 22, 2016, when the Blue Grass Army Depot personnel entered the transaction in the LMP system, the credit value (\$18.22) was the same as the MAC. Table 2 summarizes the details of these events.

Table 2. Gas Masks Purchased and Recorded Amounts at Blue Grass Army Depot

Inventory Transaction	Date	Quantity	Unit Price	Amount
Purchase Amount	February 8, 2016	2,872	\$255.98	\$735,174.56
Recorded Amount	February 22, 2016	2,872	<u>18.22*</u>	<u>52,314.93</u>
Difference			\$237.76	\$682,859.63

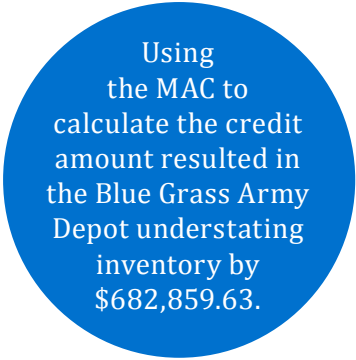
Source: The DoD OIG.

* Unit Price rounded.

²⁵ DA Form 2765, "Request for Issue or Turn-In," April 1976, or an equivalent turn-in form.

²⁶ DD Form 1348-1A, "Issue Release/Receipt Document," July 1991.

The transaction history for the item showed that the MAC had significantly decreased by February 2016 to \$18.22 due to numerous reclassification transactions.²⁷ Using the MAC to calculate the credit amount resulted in the Blue Grass Army Depot understating inventory by \$682,859.63.



Using the MAC to calculate the credit amount resulted in the Blue Grass Army Depot understating inventory by \$682,859.63.

Support Not Available for Inventory Returned From Repair

The ASA(FM&C) did not provide sufficient documentation to support the value for the 235 statistically sampled inventory items returned from repair. Returns from repair occur when an AWCF depot sends a repaired asset to the AWCF supply system for reissuance. ASA(FM&C) personnel explained that the transaction amount for returns from repair inventory items included the current value of the item yet to be repaired (carcass) plus the cost of parts and labor to repair that item (known as the unit funded cost). As support for the unserviceable credits and unit funded cost values, the ASA(FM&C) provided receiving reports for 213 of 235 inventory items and LMP system screen prints for 157 of 235 inventory items. However, the ASA(FM&C) did not provide the supporting documentation for the values shown on the LMP system screen prints for the unserviceable credit and unit funded cost values.

Documentation Available to Support Some Commercial and Vendor Purchases

DoD systems contained sufficient, accurate, and appropriate documentation to support the inventory value of 152 of 231 statistically sampled commercial and vendor purchases reviewed. DoD agencies used the iRAPT system for processing and maintaining receiving report and invoice information and the Electronic Document Access system to electronically store contracts. However, the ASA(FM&C) did not provide sufficient documentation to support the remaining 79 inventory items acquired through the DoD commercial and vendor purchase process.

Contractors must submit a proper receiving report into the iRAPT system for approval by a Government official. Generally, after the contractor generates the invoice in the system, DFAS performs a three-way-match of the contract, receiving

²⁷ The LMP system's transaction history report showed from August 2014 to February 2016 that the Army recorded numerous reclassification transactions, using Movement Code 309. Specifically, the reclassification transactions moved items from a "NOVAL" (No Value) to a "Serviceable" status. Each "NOVAL" reclassification transaction increased the number of items (quantity) without increasing the value of the items because "NOVAL" items have a zero value. Therefore, each reclassification transaction reduced the MAC value.

report, and invoice. Once the payment package is certified, DFAS makes the payment. However, for 3 of the 79 inventory items, documentation showed that the total price or quantities recorded on the receiving report, on the invoice, and in the LMP system did not match. The documentation did not support the cost recorded in the LMP system. Documentation for three additional inventory items lacked proper government receiving official signatures on the receipt and acceptance documents. Each of the three inventory items would have been supported if the receipt and acceptance documents were properly signed.

In addition, the ASA(FM&C) could not provide the receiving and the invoice documents for 73 of the 79 inventory items needed to support the recorded values in the LMP system. For 2 of the 73 inventory items, the ASA(FM&C) could not provide the receiving reports and invoices because the Army inappropriately included contract termination payments when computing the inventory costs. For example, on January 20, 2016, Army officials, on behalf of the DLA New Cumberland Army Depot, manually entered into the LMP system that they had received one navigation set control unit, valued at \$1.8 million. However, no inventory item was delivered because the contract termination settlement was in March 2013. The contractor submitted an invoice for the termination cost of \$3.1 million. When DFAS processed the invoice, the LMP system created an inventory delivery due-in for the item.²⁸ When Army personnel manually entered a transaction to clear the inventory due-in from the LMP system, they should have expensed the termination costs. Instead, they incorrectly recorded \$1.8 million of the termination costs as the inventory cost. The Army should not have included terminated contract costs in the inventory accounts, which caused the Army to overstate its inventory by \$1.8 million.

ASA(FM&C) Did Not Effectively Perform the Discovery and Corrective Action Phases

The ASA(FM&C) ineffectively performed discovery and corrective action phase activities of the financial environment related to AWCF inventory business processes. Specifically, the ASA(FM&C) did not develop detailed standard operating procedures, flowcharts, and narratives describing the AWCF inventory business processes. The ASA(FM&C) also did not identify the key positions that needed to be contacted to identify, maintain, and provide key supporting documentation for the transactions associated with AWCF inventory processes. Appendix D identifies our approach for reviewing key supporting documentation.

²⁸ An inventory due-in represents quantities of materiel scheduled to be received from vendors, repair facilities, assembly operations, inter-depot transfers, and other sources.

DoD FIAR guidance provides a methodology for DoD agencies to follow, consisting of a series of phases (discovery, corrective action, assertion and examination, validation, and full financial statement audit), key tasks, and underlying activities to improve financial information and achieve audit readiness.²⁹ The

The discovery phase identifies the key tasks and underlying activities that establish the foundation for the subsequent phases.

discovery phase is the first of five phases. When completed properly, the discovery phase identifies the key tasks and underlying activities that establish the foundation for the subsequent phases. Specifically, during the discovery phase, the reporting entity:

- defines and documents its business processes and financial environment,
- identifies the key supporting documentation needed for its business processes and financial environment,
- identifies and classifies any deficiencies with its supporting documentation, and
- defines its strategy for achieving audit readiness.

The corrective action phase is the second phase and is designed to correct deficiencies identified during the discovery phase. Specifically, during the corrective action phase, the reporting entity develops corrective action plans to address the supporting documentation deficiencies identified during the discovery phase and corrects the deficiencies.

The ASA(FM&C) reported that the AWCF audit readiness team completed its discovery efforts in December 2013. However, the ASA(FM&C)'s ineffective performance of its discovery phase activities resulted in incomplete corrective action phase activities. Specifically, after concluding its discovery phase, the ASA(FM&C) did not develop a comprehensive audit readiness strategy to effectively coordinate with key personnel and respond in a timely manner to documentation requests for AWCF inventory business processes. To effectively document AWCF inventory valuation processes, the ASA(FM&C) must complete the key tasks and underlying activities associated with the discovery and corrective action phases, including establishing policies and procedures, flowcharts and narratives, and identifying key positions and key supporting documentation for the various types of AWCF inventory transactions. See Appendix C for key tasks as identified in the DoD FIAR guidance.

²⁹ DoD FIAR guidance, chapter 4.A, "Methodology—Reporting Entity," April 2016.

Army Lacked Detailed Business Narratives Describing Inventory Business Processes

The ASA(FM&C) did not develop detailed standard operating procedures, flowcharts, and narratives describing the AWCF inventory business processes, including identifying the key supporting documents required for each stage of the inventory acquisition, entitlement, payment, and accounting processes. The ASA(FM&C) and AMC also did not identify how to maintain and access the key supporting documents. DoD FIAR guidance requires the Army to create detailed standard operating procedures and processes, including flowcharts and narratives for the inventory business processes.³⁰ DoD FIAR guidance also requires the Army to identify key supporting documents for significant inventory processes and specify where those documents are located.³¹

Instead, in response to our questions during the audit, the ASA(FM&C) described portions of the inventory processes, often providing inaccurate information, during meetings or in e-mails. In addition, ASA(FM&C) personnel could not sufficiently describe the intragovernmental business processes it used to acquire AWCF inventory, including identifying the key documents required to support the inventory value recorded in the LMP system. The ASA(FM&C) should establish standard operating procedures, flowcharts, and narratives for each significant inventory process, including how to maintain and access key supporting documentation that key personnel and service providers are responsible for retaining and providing in response to audit requests. The ASA(FM&C) should also identify key supporting documentation for each inventory process and the location of the documentation.

In addition, the ASA(FM&C) did not develop a complete package that included all required supporting documentation for its AWCF inventory, also known as a “perfect package.” DoD FIAR guidance identifies the development of the “perfect package” of supporting documentation as a key task for audit readiness.³² The “perfect package” should describe the methodology used to value the inventory and include examples of all documents required to support the AWCF inventory items, such as journal vouchers, obligation, receipt and acceptance, billing, and disbursement documents. “Perfect packages” should be shared so personnel can become familiar with the quality and type of documentation that could be requested by the audit team. The ASA(FM&C) should develop a “perfect package” of supporting documentation for transactions associated with significant AWCF inventory processes, providing examples of all documents required to support the AWCF inventory value recorded in the financial system of record (the LMP system).

³⁰ DoD FIAR guidance, chapter 6.B, “Audit Process—Overview,” April 2016.

³¹ DoD FIAR guidance, chapters 4.A, 5.D, and 6.B.

³² DoD FIAR guidance, chapter 6.B.

Army Lacked Key Contact Points for Obtaining Documentation

The ASA(FM&C) did not identify the key positions that needed to be contacted to identify, maintain, and provide key supporting documentation for the transactions associated with AWCF inventory processes. The ASA(FM&C) also did not have supporting documentation readily available or establish a repository for the key documents needed to support the inventory values.

DoD FIAR guidance states that, generally, management must respond to documentation requests by auditors within 5 business days.³³ DoD FIAR guidance also states that, if necessary, reporting entities should establish a key supporting document repository to enable management to retrieve and provide documentation upon request in a timely manner.³⁴ In addition, DoD FIAR guidance requires the Army to establish an infrastructure for managing auditor's requests for documentation.³⁵ DoD FIAR guidance states that this should include how the ASA(FM&C) coordinates with personnel at Army commands and installations, as well as service providers such as the DLA and DFAS, to collect and submit the documentation auditors requested within the established timeframe.³⁶ Although the ASA(FM&C) had a memorandum of understanding with both the DLA and DFAS, the memorandum of understanding did not specifically identify:

- who would maintain the documentation that supported the inventory value,
- where the documentation would be stored,
- how the ASA(FM&C) would request the documentation,
- what documentation to provide to the ASA(FM&C), or
- how long it should take the DLA and DFAS to provide the documentation to the ASA(FM&C).

The ASA(FM&C) should have established a process to identify the key positions to contact to provide the supporting documentation needed to substantiate the recorded cost of AWCF inventory items. By not establishing business processes and procedures to include identification of key positions for each business process, the ASA(FM&C) lacked the ability to provide documentation in a timely manner to support its transactions tested during a financial statement audit. As a result, the Army's response was uncoordinated and often incomplete. The ASA(FM&C) should identify and document key positions for each business process that can provide key supporting documentation in response to audit requests within the established

³³ DoD FIAR guidance, chapter 6.A, "Necessary Infrastructure," April 2016.

³⁴ DoD FIAR guidance, chapter 6.B.

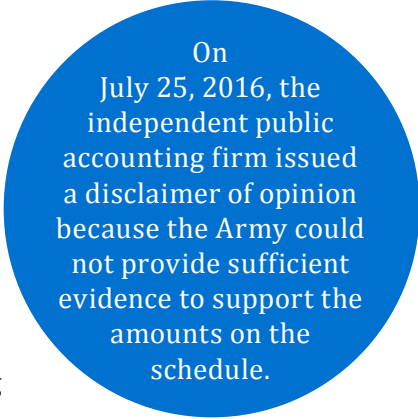
³⁵ DoD FIAR guidance, chapter 6.A.

³⁶ DoD FIAR guidance, chapter 4.B.

timeframe. In addition, the ASA(FM&C) should ensure that memorandums of understanding with service providers clearly identify what office would maintain the documentation, where the documentation would be stored, protocols for requesting and providing documentation, and documentation retention policies.

No Corrective Action Plan to Address Previously Identified Problems

The ASA(FM&C) did not develop corrective action plans to remediate previously identified problems with key supporting documentation for AWCF inventory transactions. The Army contracted with an independent public accounting firm to perform a limited scope audit of selected FY 2016 financial information and related notes of the AWCF, including the inventory balances at seven Army and three contractor plants. On July 25, 2016, the independent public accounting firm issued a disclaimer of opinion because the Army could not provide sufficient evidence to support the amounts on the schedule.³⁷



On July 25, 2016, the independent public accounting firm issued a disclaimer of opinion because the Army could not provide sufficient evidence to support the amounts on the schedule.

Among its findings, the independent public accounting firm reported that the Army did not implement standard operating procedures requiring the maintenance of documentation related to inventory transactions. The independent public accounting firm recommended that the Army:

- develop and implement standard operating procedures to define key supporting documentation for various transactions and to provide training on the evidential matter standard operating procedures to personnel responsible for maintaining supporting documentation and service providers;
- establish, document, and implement procedures to ensure key supporting documentation is properly retained and readily available; and
- establish, document, and implement procedures to ensure that the MAC is properly recorded based on the inventory activity and that cost of goods sold is recorded based on the documented valuation of the inventory item.

As of April 10, 2017, the ASA(FM&C) had not developed a detailed corrective action plan to correct these problems. The ASA(FM&C) should develop and implement detailed corrective action plans and milestones to correct the problems identified by the independent public accounting firm, as well as the problems identified in this report.

³⁷ The schedule covered selected FY 2016 financial information for the Army Working Capital Fund.

Logistics Modernization Program Was Not Properly Configured to Support Commercial and Vendor Purchases

The AMC did not design the LMP system with the functionality to identify receiving and invoice documents stored in the iRAPT system for the AWCF’s commercial and vendor purchase inventory items. Specifically, the ASA(FM&C) did not provide receiving reports and invoices for 73 of 231 commercial and vendor purchase inventory transactions reviewed because the LMP system did not have data fields to identify the receiving reports (shipment) and invoice numbers from the iRAPT system that supported the transactions reviewed. The DoD FMR requires DoD Components to maintain sufficient detail to track transactions and balances from the source documents to amounts reported in their Enterprise Resource Planning systems.³⁸ Supporting documentation is necessary to demonstrate the accuracy, completeness, and timeliness of a transaction.

Without the data fields, a LMP system transaction cannot be traced to the proper shipment or invoice within the iRAPT system, leaving the transaction without the appropriate source documents to support the transaction. However, the iRAPT system often contained multiple receiving reports (shipments) and invoices that could support the inventory items. An example of this is shown in Figure 2.

Figure 2. Listing of Several Similar Shipments (Good Receipts) and Invoices Supporting One Contract in the iRAPT System

Contract Number ▲	Delivery Order	Shipment Number	Submitted	Shipped	Accepted	Status	Invoice Number	Submitted	Received	Status	Amount
SPRDL114D0029	0004	HUT0064	2016-03-22	2016-03-29	2016-03-20	Processed	47669	2016-03-22	2016-03-22	Paid	\$ 179,104.80
SPRDL114D0029	0004	HUT0065	2016-03-22	2016-03-29	2016-03-28	Processed	47670	2016-03-22	2016-03-22	Paid	\$ 179,104.80
SPRDL114D0029	0004	HUT0066	2016-03-30	2016-03-31	2016-03-31	Processed	47699	2016-03-30	2016-03-30	Paid	\$ 179,104.80
SPRDL114D0029	0004	HUT0067	2016-03-30	2016-03-31	2016-03-31	Processed	47700	2016-03-30	2016-03-30	Paid	\$ 179,104.80
SPRDL114D0029	0004	HUT0068	2016-03-31	2016-04-04	2016-04-04	Processed	47716	2016-03-31	2016-03-31	Paid	\$ 179,104.80
SPRDL114D0029	0004	HUT0069	2016-03-31	2016-04-04	2016-04-04	Processed	47717	2016-03-31	2016-03-31	Paid	\$ 179,104.80
SPRDL114D0029	0004	HUT0070	2016-04-05	2016-04-05	2016-04-05	Processed	47742	2016-04-05	2016-04-05	Paid	\$ 179,104.80
SPRDL114D0029	0004	HUT0071	2016-04-05	2016-04-05	2016-04-05	Processed	47743	2016-04-05	2016-04-05	Paid	\$ 179,104.80

Source: iRAPT screen print.

As shown in Figure 2, the Army processed eight transactions for the same dollar amount on this contract. The transactions were supported by receiving reports (shipments) and invoices that were processed within a few days of each other. Without the receiving reports (shipment) and invoice from the LMP system, the ASA(FM&C) could not identify in the iRAPT system the documentation that supported 73 commercial and vendor purchase transactions. The AMC did not configure the LMP system to maintain a unique number for the shipment and invoice number. As the office responsible for modernizing Army financial

³⁸ DoD FMR, volume 6A, chapter 2, “Financial Roles and Responsibilities.”

management systems, the ASA(FM&C), in coordination with the AMC, should incorporate data fields within the LMP system to identify the receiving reports (shipment) and invoice documents in the iRAPT system.

ASA(FM&C) Did Not Maintain Prior Credit Values

ASA(FM&C) personnel could not identify the amounts AMC previously credited to customers for inventory items returned for credit or repair. The AMC calculates the approved credit values for returns at least annually and each time updates the LMP system with the newly approved credit values. However, for 94 of the 235 returns from repair inventory items reviewed, the approved credit value given did not match the approved credit value in the LMP system for the unserviceable inventory. ASA(FM&C) personnel stated that the approved credit values for those inventory items had been recalculated and updated in the LMP system and that they could not retrieve the previously approved credit values from the LMP system.

By not maintaining the approved prior credit values, the ASA(FM&C) could not provide documentation to support the approved credit values given to the customers for the inventory items reviewed. The ASA(FM&C) should develop a process to maintain credit values given for returns for credit and unserviceable credit transactions.

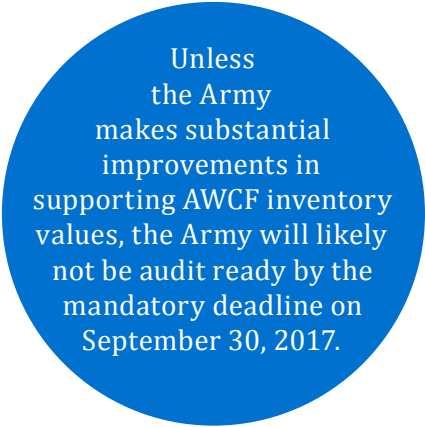
Army Working Capital Fund Will Likely Not Meet Audit Readiness Date

Because of the lack of documentation to support the historical cost of AWCF inventory, the Army is not ready for an AWCF financial statement audit. The Army's inability to provide supporting documentation for AWCF inventory transactions is one reason it receives an annual disclaimer of opinion. Consequently, the Army is unable to support the \$10.6 billion value of its Inventory, Available and Purchased for Resale, reported on the AWCF balance sheet as of September 30, 2016, as reflected in the Army's disclaimer of opinion. The documentation is essential evidence to support transactions and the valuation amounts assigned to Army inventory. Readily available documentation also improves the efficiency and effectiveness of audits.

For more than 20 years, auditors have issued disclaimers of opinion on the AWCF financial statements and the Army has reported a material weakness associated with AWCF inventory. The National Defense Authorization Act of 2010 requires DoD financial statements to be audit ready by September 30, 2017.³⁹

³⁹ Public Law 111-84, "The National Defense Authorization Act for Fiscal Year 2010," October 28, 2009.

The Army has little time to implement needed corrective actions to be able to support the value of AWCF inventory transactions before it asserts audit readiness. Consequently, unless the Army makes substantial improvements in supporting AWCF inventory values, the Army will likely not be audit ready by the mandatory deadline on September 30, 2017.



Unless the Army makes substantial improvements in supporting AWCF inventory values, the Army will likely not be audit ready by the mandatory deadline on September 30, 2017.

Management Comments on the Finding and Our Response

The Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), non-concurred with the finding described in the report as it pertains to audit readiness, along with some factual information, and provided the following comments on the finding. For the full text of the Deputy Assistant Secretary of the Army (Financial Operations) comments, see the Management Comments section of the report.

Management Comments on Army Not Being Ready for a Financial Statement Audit

The Deputy Assistant Secretary of the Army (Financial Operations) disagreed that the Army is not ready for a financial statement audit. The Deputy Assistant Secretary of the Army (Financial Operations) stated that the Army is currently undergoing multiple financial statement audits and that the DoD OIG's conclusion is inconsistent with the criteria the DoD is using to determine audit readiness. He mentioned that the Under Secretary of Defense (Comptroller) has prepared a template for an assertion letter for the Secretary of the Army to sign, notifying the Secretary of Defense that the Army's financial statements are ready for audit. The draft letter states that this notification of audit readiness is based on overall progress against critical capabilities defined by the Under Secretary of Defense (Comptroller), but is not a representation that the Army expects an unmodified opinion. In addition, the Deputy Assistant Secretary of the Army (Financial Operations) stated that the Army's inability to provide supporting documentation for historical transactions does not have an impact on its ability to go to full financial statement audit in FY 2018, due to the implementation of SFFAS No. 48.

Our Response

The Army is undergoing multiple audits of single financial statements and specific elements of a financial statement, which are not the same as audits of a full set of financial statements. In accordance with the Office of Management and Budget Bulletin No. A-136, the DoD prepares a consolidated balance sheet, consolidated

statement of net cost, consolidated statement of changes in net position, and a combined statement of budgetary resources.⁴⁰ The National Defense Authorization Act of 2014 mandates that the DoD financial statements are validated as ready for audit by not later than September 30, 2017, and that the DoD FY 2018 financial statements are audited.⁴¹ Office of Management and Budget Bulletin No. 15-02 designates the AWCF as one of the DoD reporting entities required to prepare and issue audited financial statements annually.⁴² In representing that the financial statements are presented fairly in conformity with generally accepted accounting principles, Army management implicitly or explicitly would need to make assertions regarding the recognition, measurement, presentation, and disclosure of the various elements of financial statements and related disclosures. These assertions include existence, completeness, valuation, rights and obligations, and presentation and disclosure. If an agency is representing that it is ready for audit, the agency is representing it can support these assertions. If an agency is unable to support these assertions, it is not ready for audit, and the auditors will not be able to obtain sufficient appropriate evidence to provide a basis for an audit opinion. The results of this audit demonstrated that the Army cannot support the valuation assertion. Previous completed Army audits have resulted in disclaimers of opinion based on the inability of Army management to provide sufficient appropriate evidence.

Although we recognize that the Army has made progress against the critical capabilities defined by the Office of the Under Secretary of Defense (Comptroller) and needs to comply with the National Defense Authorization Act of 2014, the Army continues to be challenged in its ability to provide auditors, in a timely manner, sufficient adequate documentation to support inventory valuation. The assertion template memorandum implies that management does not intend to represent that the financial statements are presented in conformity with generally accepted accounting principles or that management is able to support the requirements associated with financial statement assertions. The memorandum also implies that management will use the financial statement audits as an audit readiness function and acknowledges that the reporting entity cannot support an audit that will result in an audit opinion.

⁴⁰ Office of Management and Budget Bulletin Circular No. A-136, "Financial Reporting Requirements," September 18, 2014.

⁴¹ Public Law 113-66, "The National Defense Authorization Act for Fiscal Year 2014," December 2013.

⁴² Office of Management and Budget Bulletin No. 15-02, "Audit Requirements for Federal Financial Statements," August 4, 2015.

On a one-time basis, SFFAS No. 48 allows the Army to revalue its existing AWCF inventory using a method other than MAC when support for historical cost is not available.⁴³ However, SFFAS No. 48 requires the Army to make an unreserved assertion regarding its go-forward methodology for valuing inventory and supporting historical costs before implementing an alternative methodology for valuing existing inventory. The Army's inability to assert on a go-forward methodology for valuing inventory will impede a financial statement audit in FY 2018. Army management needs to develop the infrastructure to support inventory valuation with supporting documentation for historical transactions. The lack of capabilities to support historical costs in the future will lead to more disclaimers of opinion on the financial statement audits. Implementing the recommendations of this report will assist the Army in developing the infrastructure needed to support inventory valuation and provide the basis for making an unreserved assertion.

Management Comments on Roles and Responsibilities

The Deputy Assistant Secretary of the Army (Financial Operations) raised concerns with how the report addresses the roles and responsibilities of the AMC, DFAS, and DLA. Specifically, he stated that the report makes no mention of the AMC in the roles and responsibilities section of the report and mischaracterizes the responsibilities of the ASA(FM&C) as it relates to implementing controls for ensuring that documentation was readily available. He also stated that the report makes no mention of the controls performed by the AMC, DFAS, and DLA, which are the activities responsible for performing business processes related to inventory.

Our Response

We agree with the Deputy Assistant Secretary of the Army (Financial Operations) that the AMC is responsible for managing AWCF installations where inventory is received, as well as managing the process by which prices and credit values are established. In the draft report, we referenced the ASA(FM&C) role in coordinating with Army commands and service providers to obtain supporting documentation and to develop and implement corrective actions associated with supporting documentation. To more clearly articulate AMC roles and responsibilities, we have added them in the Roles and Responsibilities section of this report. The report addresses the support the DLA and DFAS provide the Army in obtaining and maintaining key documentation needed to support inventory valuation. Ultimately, the ASA(FM&C) is responsible for Army audit readiness and ensuring the AMC and other service providers establish controls over documentation supporting Army transactions.

⁴³ SFFAS No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials," January 27, 2016.

Management Comments on Existence of Process Documentation

The Deputy Assistant Secretary of the Army (Financial Operations) stated that the existence of process narratives and flowcharts, or lack thereof, would in no way support the value of inventory. He also stated that the Army has identified key points of contact used to coordinate requests, and that the lack of timely or sufficient responses by organizations either within the Army or by service providers is not due to a lack of knowing the key personnel.

Our Response

We disagree with the importance that the Deputy Assistant Secretary of the Army (Financial Operations) places on having complete and accurate process narratives and flowcharts as well as accurately identifying key personnel. Discovery phase activities, which include the development of narratives describing the AWCF inventory business processes and key supporting documents, are essential to supporting inventory valuation. The audit team experienced multiple instances where the Army identified a process but could not describe the process in detail, identify key supporting documents, or identify who maintained the key supporting documents. This contributed to the lack of timely or sufficient responses by organizations within the Army and its service providers.

Management Comments on Credit Given to the Army General Fund

The Deputy Assistant Secretary of the Army (Financial Operations) disagreed with the scenario describing how Blue Grass Army Depot recorded a purchase of gas masks. He stated that this transaction was not a return for credit, thus the Army General Fund did not receive any credits.

Our Response

Based upon evidence subsequently provided by the ASA(FM&C), we acknowledge that the Blue Grass Army Depot transaction did not result in an understatement of the credit given to the Army General Fund customer. We determined that the transaction was a commercial payment that the Army erroneously included in the universe of return for credit transactions. However, the data processing in the LMP system for this transaction was similar to a return for credit transaction, which resulted from a weak internal control environment that we described in Report No. DODIG-2016-108. Consequently, instead of an understatement of credit given to an Army General Fund customer, the transaction resulted in the Blue Grass Army Depot understating AWCF inventory by \$682,859.63. We updated the information in the report to better describe the scenario with the purchase of gas masks.

Management Comments on DLA Making Manual Adjustments

The Deputy Assistant Secretary of the Army (Financial Operations) stated that the report incorrectly attributed actions taken on transactions at the DLA New Cumberland Army Depot to DLA personnel. The Deputy Assistant Secretary of the Army (Financial Operations) stated that DLA staff at the DLA New Cumberland Army Depot does not have system access to enter transactions into LMP, and it was a U.S. Army Aviation and Missile Command employee who performed the transaction that resulted in contract termination costs being recorded in the system.

Our Response

We agree with the Deputy Assistant Secretary of the Army (Financial Operations) that the user who manually entered the transaction was a U.S. Army Aviation and Missile Command employee and we have adjusted the wording in the report to reflect that Army personnel recorded the transaction.

Recommendations, Management Comments, and Our Response

Recommendation 1

We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller):

- a. Establish detailed standard operating procedures, flowcharts, and narratives for each significant inventory process, including how to maintain and access key supporting documentation that key personnel and service providers are responsible for retaining and providing in response to audit requests.**
- b. Identify key supporting documentation for each inventory process and the location of the documentation.**
- c. Develop a “perfect package” of supporting documentation for transactions associated with significant Army Working Capital Fund inventory processes, providing examples of all documents required to support the Army Working Capital Fund inventory value recorded in the financial system of record (the Logistics Modernization Program system).**
- d. Identify and document key positions for each business process that can provide key supporting documentation in response to audit requests within the established timeframe.**

- e. **Ensure that memorandums of understanding with service providers clearly identify what office would maintain the documentation, where the documentation would be stored, protocols for requesting and providing documentation, and documentation retention policies.**
- f. **Develop and implement detailed corrective action plans and milestones to correct the problems identified by the independent public accounting firm, as well as the problems identified in this report.**
- g. **Develop a process to maintain credit values given for returns for credit and unserviceable credit transactions.**

Assistant Secretary of the Army (Financial Management and Comptroller) Comments

The Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), agreed with the recommendations, stating that the Army has initiated actions to implement Recommendations 1.a, 1.b, 1.c, 1.f, and 1.g and has completed actions on Recommendations 1.d and 1.e.

Our Response

Comments from the Deputy Assistant Secretary of the Army (Financial Operations) on Recommendations 1.a, 1.b, 1.c, 1.d, 1.e, 1.f, and 1.g partially addressed the recommendations. The Deputy Assistant Secretary of the Army (Financial Operations) did not describe the actions taken to identify key positions for each business process or establish memorandums of understanding with service providers. In addition, he did not elaborate on how or when ASA(FM&C) would work with the process owners to:

- establish detailed standard operating procedures, flowcharts, and narratives for each significant inventory process;
- identify key supporting documentation for each inventory process;
- develop a “perfect package” of supporting documentation for each inventory process;
- implement corrective action plans and milestones to correct the problems identified; and
- develop a process to maintain credit values.

Therefore, these recommendations are unresolved and remain open. We request that the ASA(FM&C) provide the details on how and when the recommendations would be implemented. We will close the recommendations once we receive and verify that the ASA(FM&C) has implemented the recommendations.

Recommendation 2

We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), in coordination with the U.S. Army Materiel Command, incorporate data fields within the Logistics Modernization Program system to identify the receiving reports (shipment) and invoice documents in the Invoicing, Receipt, Acceptance, and Property Transfer system.

Assistant Secretary of the Army (Financial Management and Comptroller) Comments

The Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), agreed with the recommendation, stating that a system change request was implemented in the LMP system on May 22, 2017.

Our Response

Comments from the Deputy Assistant Secretary of the Army (Financial Operations) addressed all specifics of the recommendation; therefore, the recommendation is resolved but will remain open. We will close the recommendation once we receive evidence of system implementation and verify the Army's ability to trace the receiving reports and invoice documents from the LMP system to the iRAPT system.

Appendix A

Scope and Methodology

We conducted this performance audit from May 2016 through June 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We reviewed the following applicable guidance to understand the documentation required to support inventory transactions; how valuation of inventory is determined and recorded; the goals, priorities, strategy, and methodology for becoming audit ready; and roles and responsibilities of reporting entities and service providers.

- SFFAS No. 3, “Accounting for Inventory and Related Property,” October 27, 1993
- SFFAS No. 48, “Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials,” January 27, 2016
- DoD FIAR guidance, April 2016
- DoD Regulation 7000.14-R, “DoD Financial Management Regulation”

We focused on inventory movement transactions recorded in the LMP system in USSGL 152100.⁴⁴ Inventory movement transactions included inventory that was acquired by MILSTRIP, NMP, commercial and vendor purchases, and when inventory was added to the supply system by returns for credit and returns from repair. During second quarter FY 2016, the Army recorded \$2.7 billion in AWCF inventory transactions in the LMP system using USSGL 152100 (Inventory, Purchased for Resale). Of the \$2.7 billion, \$1.8 billion represented transactions that the Army valued at the MAC within the LMP system at the time the transactions occurred and whose values could not be supported by historical costs from supporting documentation. Consequently, we excluded these transactions from the universe.⁴⁵ Only the remaining \$871.4 million in the account was based on transactions that the Army recorded at historical costs and supported by documentation substantiating the quantities acquired and total cost.

⁴⁴ Inventory movement transactions include receipt, transfer, or sale of inventory, among many others. There are also reversing transactions to offset previous transactions. The LMP system uses a three-digit, alpha-numeric code to process the inventory movement transactions.

⁴⁵ Report No. DODIG-2016-108, “Army Needs Greater Emphasis on Inventory Valuation,” July 12, 2016, addresses some of the primary problems with these inventory transactions.

ASA(FM&C) and LMP system personnel provided a universe of 585,758 AWCF inventory transactions, valued at \$871.4 million, which were recorded in the LMP system during the second quarter FY 2016 in USSGL 152100. We determined that the transactions were generated from four AWCF inventory processes.⁴⁶ When selecting the statistical sample, Quantitative Methods Division (QMD) personnel from the DoD Office of Inspector General (DoD OIG) removed all transactions (288,919 transactions) from the universe that were less than or equal to \$100, leaving 296,839 transactions, valued at \$870.2 million. Personnel from the QMD selected a statistical sample of 970 inventory items for our review.

We requested that the ASA(FM&C) provide documentation supporting the AWCF inventory transactions recorded in the LMP system. See Appendix D for information on the four inventory processes and the types of documentation needed to support the recorded cost in the LMP system. For commercial and vendor purchases, ASA(FM&C) and DFAS personnel explained that the documentation to support inventory transactions was held within the Electronic Document Access and iRAPT databases. We obtained the documentation to support commercial and vendor purchases. The documentation we obtained or that was provided to us for the inventory processes were the basis for determining whether AWCF inventory transactions in the LMP system were sufficiently, accurately, and appropriately supported.

We interviewed ASA(FM&C) personnel to understand the four inventory processes and requested the standard operating procedures for each business process as well as the flowcharts and narratives that described each process. Additionally, we requested narratives on how the Army maintained and retrieved key supporting documentation from DoD and Army systems.

We met with DFAS personnel in Columbus, Ohio, to understand the Military Standard Billing system and discuss the commercial and vendor purchase process. We held discussions with DLA, AMC, U.S. Army Forces Command, and LMP Product Office personnel about the AWCF inventory processes.

Use of Computer-Processed Data

We used computer-processed data extracted from the LMP system. The LMP Product Office personnel provided a universe of transactions from the LMP system in Excel spreadsheets. We reviewed the supporting documentation the Army provided to support the historical cost recorded in the LMP system for the sampled inventory items. We also reviewed the supporting documentation from

⁴⁶ Although MILSTRIP and NMP have separate business processes, we combined the two processes into the same sampling strata.

the Electronic Document Access and iRAPT databases. To the extent possible, we verified the quantities and total cost of the AWCF inventory items using the documentation and compared it to what was recorded in the LMP system. However, the ASA(FM&C) could not provide all the documentation to support the historical costs in the LMP system. The computer-processed data we used were sufficiently reliable for reaching our audit conclusions and supporting the finding in this report.

Use of Technical Assistance

Personnel from the QMD, DoD OIG, assisted us in selecting a statistical sample of transactions for testing the four inventory processes. QMD personnel also projected the results of our analysis to the universe of transactions. See Appendix E for the QMD support provided for the audit.

Appendix B

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO), the DoD OIG, and the Army Audit Agency (AAA) issued six reports discussing the LMP system and inventory valuation. Unrestricted GAO reports can be accessed at <http://www.gao.gov>. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>. Unrestricted AAA reports can be accessed from .mil and gao.gov domains at <https://www.aaa.army.mil/>.

GAO

Report No. GAO-15-350, “Services Generally Have Reduced Excess Inventory, but Additional Actions Are Needed,” April 20, 2015

GAO evaluated inventory management practices of the Army, Navy, and Air Force. The Navy and Air Force reported meeting DoD’s goal of reducing on-hand excess inventory, but the Army had not reduced on-hand excess inventory. The Army also was challenged to accurately report the amount of inventory it retained. GAO determined that, without accurate information, it will be difficult to measure the success of the Army’s efforts to reduce its level of on-hand excess inventory.

Report No. GAO-14-182, “Actions Needed to Improve Department-Wide Management of Conventional Ammunition Inventory,” March 31, 2014

GAO determined whether the Military Services’ information systems facilitated efficient management of the conventional ammunition inventory and evaluated how the Military Services collect and share inventory data to meet their stated requirements. The Army’s LMP system used the standard DoD format for exchanging ammunition; however, the other services did not use the DoD format, requiring extra effort to ensure efficient data exchange between the other Military Services’ systems and the LMP system.

DoD OIG

Report No. DODIG-2016-108 “Army Needs Greater Emphasis on Inventory Valuation,” July 12, 2016

Despite the LMP system having the functionality to compute MAC, AMC personnel did not properly record some inventory transactions in a manner that reasonably approximated historical cost. As a result, the Army materially misstated its inventory on the FY 2015 AWCF Financial Statements and is at increased risk of not meeting the FY 2017 audit readiness milestone.

Report No. DODIG-2012-087, "Logistics Modernization Program System Procure-to-Pay Process Did Not Correct Material Weaknesses," May 29, 2012

Despite spending about \$1.8 billion, Army managers did not accomplish the reengineering needed to integrate the Procure-to-Pay functions to comply with DoD Business Enterprise Architecture requirements and correct material weaknesses. Army managers continued the use of costly business processes and the LMP system failed to provide reliable financial data. As of August 31, 2011, LMP system activities reported more than \$10.6 billion in abnormal balances within the Procure-to-Pay general ledger accounts.

AAA

Report No. A-2016-0052-ALC, "Audit of Invoicing, Receipt, Acceptance, and Property Transfer Invoice Approval Process for U.S. Army Contracting Command," March 8, 2016

Contracting officer's representatives did not sufficiently review service and supply invoices and receiving reports. As a result, the Army had minimal assurance that it received the required level, quality, and timeliness of delivery for goods and services it paid for. Furthermore, it did not have sufficient controls over contract management.

Report No. A-2016-0030-ALC, "Audit of Invoicing, Receipt, Acceptance, and Property Transfer Invoice Approval Process," February 10, 2016

Contracting officer's representatives did not sufficiently review service and supply invoices and cost vouchers submitted through the iRAPT system before payment. The Army was not assured that it received the required amounts, quality, and timely delivery of the goods and services it paid for. In addition, the contracting officer's representatives did not provide sufficient contract management.

Appendix C

Key Tasks in the DoD Financial Improvement and Audit Readiness Guidance

The April 2016 DoD FIAR guidance states that the Army must be able to assert the audit readiness of all business processes and sub-processes associated with recording and classifying of inventory, including the use of proper valuation.⁴⁷ DoD FIAR guidance states that reporting entities should have the necessary infrastructure to manage requests for supporting documentation before beginning an audit.⁴⁸ Reporting entities must demonstrate that their infrastructure includes robust retention, storage, and retrieval capabilities for supporting documentation. If necessary, reporting entities should establish a key supporting document repository to enable management to retrieve and provide documentation in a timely manner upon auditor request. Auditors spend a significant amount of time gaining an understanding of the reporting entity under audit, which is typically accomplished through reviews of standard operating procedures, business process flowcharts, and narratives and interviews with key personnel. Table 3 identifies some of the key audit readiness tasks to be completed before and during a financial statement audit.

⁴⁷ DoD FIAR guidance, chapter 5.D.

⁴⁸ DoD FIAR guidance, chapter 6.A.

Table 3. Key Tasks to be Completed for a Financial Statement Audit*

	Task	Description	Documents Needed
1	Identify Points of Contact	Points of contact at the reporting entity, service provider, and functional level should be identified. Audit liaisons should ensure functional level points of contact have a clear understanding of audit requests.	Point of contact lists for reporting entity, service provider, and functional levels.
2	Identify Key Supporting Documents	Documents supporting asset acquisition cost and any related asset improvement.	Contracts (including Statements of Work), work orders, reimbursable agreements, military interdepartmental purchase requests, purchase orders, receiving reports, and invoices.
3	Establish Data Repository	Audit liaisons should be able to locate where key supporting documents are maintained and, if necessary, establish a repository to ensure documentation can be provided quickly.	Key supporting documents and data repository.
4	Identify End-to-End Processes and Standard Operating Procedures	Reporting entities and service providers should review and maintain Standard Operating Procedures and End-to-End processes to ensure narratives and flowcharts are current and accurate.	Standard Operating Procedures and process documents needed to explain processes under audit.
5	Prepare "Perfect Packages"	Packages provided to auditors that include all the requested supporting documentation.	Examples of all the documentation to support the sample item.

Source: DoD FIAR guidance.

*DoD FIAR guidance, chapters 4.A, 5.D, and 6.B.

Appendix D

Approach for Reviewing Key Supporting Documents

We determined whether the sampled inventory items were supported by determining whether sufficient and accurate documentation existed for the recorded inventory value. Sufficiency is defined as enough documentation to fully support the transaction; accurate documentation is free from mistakes or errors. If there was not sufficient documentation to review, then we did not perform further testing of the accuracy of the recorded value. Appropriate documentation is a function of whether or not there is sufficient and accurate documentation. Table 4 describes the type of documents that can be used to support AWCF inventory transactions, along with examples of each.

*Table 4. Description and Examples of Key Supporting Documents**

Type of Document	Purpose of Document	Examples
Obligating	A legally binding agreement or action that will result in outlays, immediately or in the future.	Contracts (including Statements of Work), Purchase Orders, Work Orders, Reimbursable Agreements, or Military Interdepartmental Purchase Requests
Receipt and Acceptance	Written evidence that indicates Government acceptance of supplies delivered or services performed.	iRAPT Receiving Reports; DoD Forms 250, 1149, 1348, and 1155; Standard Forms 44 and 1449; or a Bill of Lading
Invoice	A contractor’s bill or written request for payment under the contract for supplies delivered or services performed.	iRAPT Invoices, DoD Form 250, Standard Forms 44 and 1449, or a Delivery Ticket
Billing	Intragovernmental transactions between or within DoD Components for the purchase of goods.	Bills from the Military Standard Billing System or Intragovernmental Payment and Collection system
Disbursing Voucher	Documents the payment for services and supplies.	DoD Form 1155 and Standard Forms 44, 1034, 1080, and 1081

Source: The DoD OIG.

* DoD FMR, volume 3, chapter 8, “Standards for Recording and Reviewing Commitments and Obligations;” volume 10, chapter 8, “Commercial Payment Vouchers and Supporting Documentation;” volume 10, chapter 10, “Payment Vouchers–Special Applications;” and DoD FIAR guidance, Chapter 5, “Auditing the Financial Statements,” April 2016.

Appendix E

Statistical Sampling and Projection Methodology

Universe

We obtained a universe of 585,758 inventory transactions valued at \$871.4 million. The universe consisted of four inventory categories:

1. MILSTRIP and NMP,
2. Returns for Credit,
3. Returns from Repair, and
4. Commercial and Vendor Purchases.

When selecting the statistical sample, QMD personnel removed all transactions from the universe that were less than or equal to \$100, leaving 296,839 transactions, valued at \$870.2 million.

Measures and Parameters

For the 970 inventory transactions valued at \$157.6 million that were sampled and reviewed, we determined whether sufficient, accurate, and appropriate documentation existed to support costs for AWCF inventory valuation. QMD personnel used a 90 percent confidence interval.

Sample Plan

QMD personnel designed a stratified sampling plan based on dollar amount for each of the four inventory processes, as shown in Table 5.

Table 5. Universe and Sample

Inventory Process	Universe	Universe Amount (in millions)	Sample	Sample Amounts (in millions)
MILSTRIP and NMP	286,222	\$335.4	322	\$11.3
Returns for Credit	2,336	24.0	182	9.0
Returns from Repair	4,618	271.0	235	62.2
Commercial and Vendor Purchases	<u>3,663</u>	<u>239.8</u>	<u>231</u>	<u>75.1</u>
Total	296,839	\$870.2	970	\$157.6

Source: The DoD OIG.

Statistical Analysis and Interpretation

Based on the audit results for the inventory transactions sampled and reviewed, the QMD calculated statistical projections for the unsupported transactions in each inventory process. See Table 6 for detailed projections on each inventory process.

Table 6. Projections for Inventory Process Transactions

Inventory Process	Errors	Projection
MILSTRIP and NMP	Number	283,194
	Dollar Value	\$321,972,737
 		
Returns for Credit	Number	2,295
	Dollar Value	\$22,734,158
 		
Returns from Repair	Number	4,546
	Dollar Value	\$258,609,319
 		
Intragovernmental Subtotal	Number	290,147
	Dollar Value	\$610,840,085
 		
Commercial and Vendor Purchases	Number	954
	Dollar Value	\$71,621,934
 		
Total	Number	291,408
	Dollar Value	\$690,782,038

Source: The DoD OIG

For all four inventory processes, the QMD is 90 percent confident that at least 291,408 inventory transactions, valued at \$690.8 million, were unsupported by documentation. QMD personnel reported lower bounds because some of the projections exceed the universe value.

Management Comments

Office of the Assistant Secretary of the Army (Financial Management and Comptroller)



DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
FINANCIAL MANAGEMENT AND COMPTROLLER
109 ARMY PENTAGON
WASHINGTON DC 20310-0109

SAFM-FO

7 July 2017

MEMORANDUM FOR Inspector General, Department of Defense Inspector General,
4800 Mark Center Drive, Alexandria, VA 22350-1500

SUBJECT: Response to The Army Did Not Have a Sufficient Documentation
Infrastructure to Support Costs for Inventory Valuation (Project No. D2016-D000FI-
0145.000)

1. The Army non-concurs with the finding described in the report as it pertains to audit readiness. The Army also non-concurs with a significant amount of factual information presented in the report, as detailed in the enclosure. This memorandum provides a response to the findings and recommendations for the subject audit.
2. The Department of Defense Inspector General report includes two recommendations for the Assistant Secretary of the Army (Financial Management and Comptroller). The Army concurs with comment on the two recommendations and its sub-parts. Implementation of recommendations 1a, 1b, 1c, 1f, and 1g have already begun. Recommendations 1d and 1e are already complete. The system change request created to implement recommendation 2 was placed into production in Logistics Modernization Program on May 22, 2017. For clarity, the roles and responsibilities as addressed in the enclosure should also be updated and directed to the Army Materiel Command as the business process owner for the Army Working Capital Fund. Additional details are included in the enclosure.
3. The Army point of contact for this action is [REDACTED]. He can be reached by e-mail at [REDACTED] or by telephone at [REDACTED].

Encl
as

MILLER.WESLEY.
C.1104827051
Wesley C. Miller
Deputy Assistant Secretary of the Army
(Financial Operations)

Digitally signed by MILLER.WESLEY.C.1104827051
DN: c=US, o=U.S. Government, ou=DoD, ou=PKI,
ou=USA, cn=MILLER.WESLEY.C.1104827051
Date: 2017.07.07 10:29:40 -0400'

Office of the Assistant Secretary of the Army (Financial Management and Comptroller) (cont'd)

**Enclosure: Follow Up Comments to
The Army Did Not Have a Sufficient Documentation Infrastructure to Support
Costs for Inventory Valuation (Project No. D2016-D000FI-0145.000)**

1. On page 20, the report states the "Army is not ready for a financial statement audit" and on page 20 states "the Army will likely not be audit-ready by September 30, 2017." The Army is currently undergoing multiple financial statement audits including the General Fund and Working Capital Fund Fiscal Year (FY) 2017 Statement of Budgetary Resources, General Fund General Equipment, and General Fund Operating Materials & Supplies. Therefore, to state that the Army is not ready for a financial statement audit is false. The Department of Defense Inspector General (DoDIG) did not take into consideration accounting standards published by the Federal Accounting Standards Advisory Board, specifically Statement of Federal Financial Statement 48, which allows for DoD Services to perform a revaluation of inventory using a method other than moving average cost where support for historical costs is not available. As such, the Army's inability to provide supporting documentations for historical transactions does not have an impact on the Army's ability to go to full financial statement audits in FY 2018. The Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) has also prepared the template for an assertion letter for the Secretary of the Army to sign notifying the Secretary of Defense that the Army's financial statements are ready for audit. The draft letter states that this notification of audit readiness is based on overall progress against critical capabilities defined by the OUSD(C), but is not a representation that the Army expects an unmodified audit opinion. The DoDIG's conclusion is inconsistent with the criteria the DoD is using to determine audit readiness.

2. On page 3 – Roles and Responsibilities – The DoDIG states in the background section on page 1 of the report that Army Materiel Command (AMC) manages the Army Working Capital Fund (AWCF). However, the DoDIG does not make any mention of AMC in the roles and responsibilities section. The AMC staff is responsible for managing AWCF installations where inventory is received, as well as managing the process by which prices and credit values are established. Specifically, on Page 4, the report states "ASA (FM&C) did not implement adequate controls to ensure that sufficient, accurate and appropriate documentation was readily available..." ASA (FM&C) helps design controls, however, it is the responsibility of the process owners to implement the controls. The ASA (FM&C) staff does not procure, receive, repair, manufacture, or issue inventory, nor does it receive and accept invoices related to the procurement of inventory. There are no processes or procedures carried out by ASA (FM&C) related to the management of inventory, and as such, there can be no controls performed by ASA (FM&C) related to maintaining documentation. The ASA (FM&C) staff is responsible for the audit readiness of the Army, however, it is the responsibility of the business owners to implement internal controls related to the processes they perform. Additionally, ASA (FM&C) provides recommended corrective actions that are still the responsibility of the process owners to implement. The DoDIG makes no mention of the controls performed by AMC, the Defense Logistics Agency (DLA), or the Defense Finance and Accounting Services, who are the activities responsible for performing business processes related to inventory.

**Final Report
Reference**

Revised page 19

Revised page 5

Office of the Assistant Secretary of the Army (Financial Management and Comptroller) (cont'd)

**Enclosure: Follow Up Comments to
The Army Did Not Have a Sufficient Documentation Infrastructure to Support
Costs for Inventory Valuation (Project No. D2016-D000FI-0145.000)**

**Final Report
Reference**

Page 13

3. On page 14, the report states that AWCF inventory could not be supported "because the ASA (FM&C) ineffectively performed discovery phase activities of the financial environment related to AWCF business processes." The existence of process narratives and flow charts, or lack thereof, would in no way support the value of inventory. The report also states that ASA (FM&C), "did not identify the key positions that needed to be contacted to identify, maintain, and provide key supporting documentation for transactions associated with AWCF inventory processes." That statement is false. The ASA (FM&C) staff has key points of contact and official e-mail inboxes of service providers that are used to coordinate requests. The lack of timely or sufficient responses by organizations either within the Army or by service providers is not due to a lack of knowing the key personnel.

4. On page 11, the report references a scenario in which Blue Grass Army Depot purchased gas masks at one price and later returned them for credit at a different price. The paragraph also makes reference to a statement by, "Army officials" that returns are recorded at LAC, but that BGAD recorded items at MAC. The DoDIG also references an understatement in credit given to the Army General Fund. The description of this scenario is not accurate. These gas masks were purchased by a Program Management Office using Army General Funds and shipped to BGAD. They were received by BGAD personnel in Logistics Modernization Program (LMP) using a Z53 inventory movement type using the appropriate transaction code ZIGO. The error was when they were received using the SERV valuation type and Ownership Purpose Code (OPC) A. They should have been received using the NOVAL valuation type and OPC 9. These items were not returns for credit, thus the general fund did not receive any credits. The receipts are just done with the same inventory movement type as returns for credit. The Z53 movement type can be a return for credit or it can be a goods receipt for a material with paperwork including a document number no due-in matching the document number. Therefore, the conclusion that BGAD understated the credit amount given to the Army General Fund customer is incorrect.

5. On page 12, the report refers to a scenario where DLA performed transactions at the DLA New Cumberland Army Depot within LMP and consequently recorded contract termination costs in the Army inventory account rather than as expense. The DLA personnel on DLA distribution depots perform logistics transactions in DLA's DSS system, which are then interfaced to LMP. The DLA staff only uses DSS at this location and therefore the scenario described is impossible. The DLA staff does not have access to enter transactions manually into LMP at New Cumberland. The person that performed the sampled transaction worked for AMCOM LCMC. Army Contracting Personnel requested AMCOM reverse goods receipts on a purchase order so that they could modify a PADDs contract. The person realized that the transaction caused the inventory to increase so they offset the increases in subsequent transactions.

Revised page 13

Acronyms and Abbreviations

AMC	Army Materiel Command
ASA(FM&C)	Assistant Secretary of the Army (Financial Management and Comptroller)
AWCF	Army Working Capital Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
FIAR	Financial Improvement and Audit Readiness
FMR	Financial Management Regulation
iRAPT	Invoicing, Receipt, Acceptance, and Property Transfer
LMP	Logistics Modernization Program
MAC	Moving Average Cost
MILSTRIP	Military Standard Requisitioning and Issue Procedures
NMP	National Maintenance Program
QMD	Quantitative Methods Division
SFFAS	Statements of Federal Financial Accounting Standards
USSGL	U.S. Standard General Ledger

Whistleblower Protection

U.S. DEPARTMENT OF DEFENSE

The Whistleblower Protection Ombudsman's role is to educate agency employees about prohibitions on retaliation and employees' rights and remedies available for reprisal. The DoD Hotline Director is the designated ombudsman. For more information, please visit the Whistleblower webpage at www.dodig.mil/programs/whistleblower.

For more information about DoD OIG reports or activities, please contact us:

Congressional Liaison

congressional@dodig.mil; 703.604.8324

Media Contact

public.affairs@dodig.mil; 703.604.8324

For Report Notifications

www.dodig.mil/pubs/email_update.cfm

Twitter

www.twitter.com/DoD_IG

DoD Hotline

www.dodig.mil/hotline



DEPARTMENT OF DEFENSE | INSPECTOR GENERAL

4800 Mark Center Drive
Alexandria, VA 22350-1500
www.dodig.mil
Defense Hotline 1.800.424.9098

