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AIR FORCE FY 2000 FINANCIAL REPORTING OF
OPERATING MATERIALS AND SUPPLIES

Report No. D-2001-156

July 5, 2001

Office of the Inspector General
Department of Defense

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Abstract We performed this audit in support of the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. DoD defines operating materials and supplies as tangible personal property that is to be consumed in normal operations. The Air Force operating materials and supplies include two broad categories, investment inventory items and conventional munitions. The Air Force defines an investment inventory item as any article financed by central procurement appropriations. Investment assets include selected aircraft and missile spare parts, time change and depot-directed modification kits, fuel tanks, racks, adapters, pylons, and spare parts for Government-furnished support packages. In general, munitions assets consist of any item containing explosives, excluding self-propelled and guided missiles that are classified as stewardship assets. The Air Force reported \$19.6 billion for operating materials and supplies on their FY 2000 financial statements. The \$19.6 billion consisted of \$12 billion (61 percent) of investment inventory items, and \$7.6 billion (39 percent) of munitions assets.		Monitoring Agency Acronym
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Acronyms

AFEMS	Air Force Equipment Management System
DFAS	Defense Finance and Accounting Service
ERRC	Expendability, Recoverability, Repairability, Category
FIABS	Financial Inventory Accounting and Billing System
GAAP	Generally Accepted Accounting Principles
OMB	Office of Management and Budget
OM&S	Operating Materials and Supplies
PP&E	Property, Plant, and Equipment
SBSS	Standard Base Supply System
SFFAS	Statement of Federal Financial Accounting Standards



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

July 5, 2001

MEMORANDUM FOR DEPUTY CHIEF OF STAFF (INSTALLATIONS AND
LOGISTICS)

SUBJECT: Audit Report on Air Force FY 2000 Financial Reporting of Operating
Materials and Supplies (Report No. D2001-156)

We are providing this report for your review and comment. The Air Force did not respond to the draft report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request the Air Force provide comments by August 6, 2001.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. James L. Kornides at (614) 751-1400, extension 11 (jkornides@dodig.osd.mil), or Mr. John K. Issel at (614) 751-1400, extension 12 (jissel@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

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Acting Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-156
(Project No. D2001FJ-0002)

July 5, 2001

Air Force FY 2000 Financial Reporting of Operating Materials and Supplies

Executive Summary

Introduction. We performed this audit in support of the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. DoD defines operating materials and supplies as tangible personal property that is to be consumed in normal operations. The Air Force operating materials and supplies include two broad categories, investment inventory items and conventional munitions. The Air Force defines an investment inventory item as any article financed by central procurement appropriations. Investment assets include selected aircraft and missile spare parts, time change and depot-directed modification kits, fuel tanks, racks, adapters, pylons, and spare parts for Government-furnished support packages. In general, munitions assets consist of any item containing explosives, excluding self-propelled and guided missiles that are classified as stewardship assets. The Air Force reported \$19.6 billion for operating materials and supplies on their FY 2000 financial statements. The \$19.6 billion consisted of \$12 billion (61 percent) of investment inventory items, and \$7.6 billion (39 percent) of munitions assets.

Objectives. The overall audit objective was to obtain information on the financial reporting of operating materials and supplies and to determine the appropriateness of policies and regulations governing accounting for operating materials and supplies. We focused this part of the audit on the FY 2000 Air Force financial statement disclosure of operating materials and supplies. As part of the audit, we were to assess the internal control structure. We did not assess the internal control structure because the Air Force reported in its prior and FY 2000 financial statements that it lacked the systems and procedures to adequately report operating materials and supplies.

Results. The Air Force reported but qualified the appropriateness of \$19.6 billion of operating materials and supplies on the FY 2000 General Fund financial statements. The Air Force stated that it was unable to implement all elements of the Statement of Federal Financial Accounting Standards because of limitations of its financial management processes and systems, including nonfinancial feeder systems.

In addition to the systems problems, the Air Force General Fund financial statements contained inaccurate and improper disclosures of about \$1.75 billion in operating materials and supplies. Specifically:

- about \$1.35 billion of munitions assets in the Combat Ammunition System were not properly disclosed in the footnotes;
- \$30.5 million of munitions coded assets in the Standard Base Supply System were not disclosed as munitions in the footnotes;
- \$351 million of war reserve property, plant, and equipment assets were not eliminated from the reported balance; and
- \$14.6 million of assets coded as property, plant, and equipment were included in the reported operating materials and supplies balance.

For \$1.38 billion of the munitions assets, accurate footnote disclosures are needed. The remaining \$365.6 million resulted in an overstatement of the operating material and supplies balance. As a result of the systems problems and the inaccurate disclosures, the Air Force General Fund financial statement reporting of operating materials and supplies could not be relied upon. For details of the audit results, see the Finding section of the report.

Summary of Recommendations. We recommend that the Air Force Deputy Chief of Staff (Installations and Logistics) develop procedures to ensure that required data on Air Force munitions assets maintained in the Air Force Combat Ammunition System and also in the Standard Base Supply System are provided to the servicing finance office for appropriate disclosure in the footnotes to operating materials and supplies balances. We also recommend that the Deputy Chief of Staff correct inconsistencies in the Air Force regulations related to maintaining balances for munitions assets and implement procedures to ensure that all property, plant, and equipment coded assets in the Standard Base Supply System are not reported as operating materials and supplies.

Management Comments. We provided a draft of this report on March 23, 2001. The Air Force did not respond to the draft report. Therefore, we request the Air Force provide comments by August 6, 2001.

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Background

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

The Air Force General Fund accounting system records and reports only one category of inventory and related property, Operating Materials and Supplies (OM&S). DoD defines OM&S as tangible personal property that is to be consumed in normal operations. The Air Force reported OM&S valued at \$19.6 billion in its FY 2000 financial statements.

The following table shows the categories of OM&S reported in the FY 2000 Air Force General Fund financial statements.

Categories of OM&S Reported by the Air Force	
(dollars in thousands)	
<u>Category</u>	<u>Value</u>
Held for use	\$ 17,856,490
Held in reserve for future use	1,689,471
Excess, obsolete, and unserviceable	<u>44,267</u>
Total	\$ 19,590,228

The Air Force includes investment inventory items and conventional munitions in OM&S. Total investment inventory items accounted for in the FY 2000 Air Force General Fund financial statements were \$12 billion (61 percent) of the total OM&S reported. The remaining \$7.6 billion (39 percent) were considered conventional munitions.

The Air Force defines an investment inventory item as any article financed by central procurement appropriations. Investment inventory items included in OM&S are identified by alpha budget codes in the Air Force supply systems. These items are normally free issued at base level and maintained in two Air Force systems, the Standard Base Supply System (SBSS) and Financial Inventory Accounting and Billing System (FIABS).

Investment assets include selected aircraft and missile spare parts; time change and depot-directed modification kits; fuel tanks, racks, adapters, and pylons; and spare parts for Government-furnished support packages. In general, conventional munitions consist of any item containing explosives, excluding self-propelled and guided missiles that are classified as stewardship assets.

The Air Force SBSS accounts for supplies, equipment, petroleum, oils and lubricants, munitions, and clothing at Air Force base level. The dollar value of items in SBSS is obtained from the Investment Inventory Reconciliation report (Q06). This reconciliation report is run monthly for all SBSS items at each Air Force base and Air Logistics Center and provided to seven Defense Finance and Accounting Service (DFAS) activities. These seven DFAS activities prepare journal voucher adjustments to the general ledger accounts 1511 (OM&S Held for Use) and 1512 (OM&S Held for Future Use) which are transmitted to DFAS Denver. DFAS Denver is the primary Air Force financial servicing office and prepares the initial General Fund financial statements for Air Force review. SBSS data that were included in the reconciliation reporting process contained both OM&S and property, plant, and equipment (PP&E) coded items.

DFAS Denver uses data from two Air Force systems and one Army system for financial reporting of Air Force munitions. The Air Force systems are the Combat Ammunition System and the FIABS. The Army provides information on Air Force munitions stored at Army depots through its Standard Depot System.

According to DoD Regulation 7000.14-R, the “DoD Financial Management Regulation,” volume 6B, “Form and Content of the Department of Defense Audited Financial Statements,” chapter 4, “Balance Sheet,” updated October 2000, munitions are classified in three categories.

- Munitions in stock to satisfy training needs are considered to be held for current use,
- Munitions held to satisfy operational or military contingency needs are considered to be held for future use, and
- Any additional quantity is considered to be excess.

Material portions of the amount reported should be disclosed in note 9.B, “Operating Materials and Supplies (OM&S), Net.” Material is defined as any component of OM&S that represents more than 10 percent of the value of OM&S.

Objectives

The overall audit objective was to obtain information on the financial reporting of OM&S and to determine the appropriateness of policies and regulations governing accounting for OM&S. We focused this part of the audit on the FY 2000 Air Force financial statement disclosure of OM&S. Reports on Army

and Navy reporting of OM&S were issued during Calendar Year 2000. As part of the audit, we were to assess the internal control structure. We did not assess the internal control structure because the Air Force reported in FY 2000 and its prior financial statements that it lacked the systems and procedures to adequately report OM&S. See Appendix A for a discussion of the audit scope and methodology.

Air Force Financial Reporting of Operating Materials and Supplies

The Air Force reported but qualified the appropriateness of the \$19.6 billion of OM&S on the FY 2000 General Fund financial statements. The Air Force stated that it was unable to implement all elements of the Statement of Federal Financial Accounting Standards (SFFAS) because of limitations of its financial management processes and systems, including nonfinancial feeder systems.

In addition to the systems problems, the Air Force General Fund financial statements contained inaccurate disclosures of about \$1.75 billion in OM&S. Specifically:

- about \$1.35 billion of munitions in the Combat Ammunition System assets were not properly disclosed in the footnotes;
- \$30.5 million of munitions coded assets in the Standard Base Supply System were not disclosed as munitions in the footnotes;
- \$351 million of war reserve PP&E assets were not eliminated from the reported balances;
- \$14.6 million of assets coded as PP&E were included in the reported OM&S balances.

For \$1.38 billion of the munitions assets, accurate footnote disclosures are needed. The remaining \$365.6 million resulted in an overstatement of the OM&S line. The inaccurate financial statement disclosures were attributed to the lack of effective Air Force procedures to ensure required data on munitions assets are provided to its servicing finance office and to ensure PP&E assets are not included in OM&S balances. As a result of the systems problems and the inaccurate disclosures, the Air Force General Fund financial statement reporting of OM&S could not be relied upon.

Financial Reporting Policy

In SFFAS No. 3, "Accounting for Inventory and Related Property," October 27, 1993, the Federal Accounting Standards Advisory Board issued accounting principles for OM&S. OM&S are reported as an asset on the balance sheet and were defined as tangible personal property to be consumed in normal operations.

Also, the standard excludes certain asset types from being reported as OM&S:

- goods that have been acquired for use in constructing real property or in assembling equipment for the entity to use,
- stockpile materials,
- goods held under price stabilization programs,
- foreclosed property,
- seized and forfeited property, and
- inventory.

The standard requires OM&S to be categorized as the following:

- OM&S held for use;
- OM&S held in reserve for future use; and
- OM&S excess, obsolete, and unserviceable.

For OM&S, the consumption method of accounting is used for the recognition of expenses. The consumption method is a process for recognizing and expense, in the sense that the eventual use (consumption) results in the recognition in the expenditure account. Under the consumption method, the acquisition of OM&S is viewed as the conversion of resources (from cash to OM&S), not the use of resources. Therefore, the entity still has resources to use. Another method for recognizing OM&S is the purchase method. Under the purchase method, the acquisition of OM&S is considered to be the use of resources; therefore, the entity has used up its resources, that is, expended them.

Also, the standard requires OM&S to be valued on the basis of historical cost. The cost that is recognized when consumed (under the consumption method) would be the past cost of the OM&S item. The first-in/first-out, weighted average or moving average cost flow assumptions, were the preferred methods for arriving at the historical cost. However, other reasonable valuation methods could be used if the results reasonably approximated the historical cost methods (for example, a standard cost or latest acquisition cost system).

DoD Policy on OM&S. DoD Regulation 7000.14-R, the “DoD Financial Management Regulation,” volume 4, “Accounting Policy and Procedures,” chapter 4, “Operating Materials and Supplies and Stockpile Materials,” updated January 2001, was published to implement the requirements of SFFAS No. 3 for DoD.

Air Force Financial Statement Disclosures

Even though the Air Force reported \$19.6 billion under OM&S in its FY 2000 financial statements, the data contained material financial reporting limitations. In Footnote 1.A, “Significant Accounting Policies: Basis of Presentation,” the Air Force reported that it:

is unable to fully implement all elements of Generally Accepted Accounting Principles (GAAP) and the Office of Management and Budget (OMB) Bulletin No. 97-01 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. Reported values and information from the Air Force’s major asset and liability categories are derived largely from nonfinancial feeder systems, such as inventory systems and logistics systems. These were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations rather than applying the current emphasis of business-like financial statements. As a result, the Air Force cannot currently implement every aspect of GAAP and the OMB Bulletin No. 97-01. The Air Force continues to implement process and system improvements addressing the limitations of its financial and nonfinancial feeder systems.

Additionally, under Footnote 9.B, “Operating Materials and Supplies (OM&S), Net,” the Air Force stated the following:

OM&S data, as reported on the financial statements, are derived from logistics systems designed for material management purposes. These systems do not maintain the historical cost data necessary to comply with the valuation requirements of SFFAS No. 3, “Accounting for Inventory and Related Property.” In addition, while these logistics systems provide management information on the accountability and visibility over OM&S items, the timeliness at which this information is provided creates issues regarding the completeness and existence of the OM&S quantities used to derive the values reported in the financial statements.

Additional Disclosures Needed

In addition to the systems problems, the Air Force General Fund financial statements contained inadequate disclosures of about \$1.75 billion in OM&S. Specifically:

- about \$1.35 billion of munitions in the Combat Ammunition System assets were not properly disclosed in the footnotes;
- \$30.5 million of munitions coded assets in the Standard Base Supply System were not disclosed as munitions in the footnotes;

-
- \$351 million of war reserve PP&E assets were not eliminated from the reported balances;
 - \$14.6 million of assets coded as PP&E were included in the reported OM&S balances.

Disclosure of Air Force Munitions Assets

About \$1.35 billion of munitions in the Combat Ammunition System assets were not properly disclosed in the footnotes.

War Reserve Munitions Footnote Disclosure. In footnote 9.B, “Operating Materials and Supplies (OM&S), Net,” to the FY 2000 Air Force General Fund financial statements, the Air Force stated the following:

OM&S reported for FY 2000 includes \$7.6 billion in munitions. Of that amount, \$7.3 billion is included as held for use, \$304 million as held for future use, and \$2.2 billion was reduced to net realizable value of \$40 million as excess, obsolete and unserviceable.

However, supporting documentation for this footnote disclosure contained a material inaccuracy. The supporting documentation did not reflect about \$1.35 billion of war reserve munitions.

DoD Regulation 7000.14-R, the “DoD Financial Management Regulation,” volume 6B, “Form and Content of the Department of Defense Audited Financial Statements,” chapter 4, “Balance Sheet,” dated October 2000, provides guidance on OM&S. It requires that:

- munitions in stock to satisfy training needs are considered to be held for current use,
- munitions held to satisfy operational or military contingency needs are considered to be held for future use, and
- any additional quantities are considered to be excess.

Volume 6B, chapter 6B, “Notes to the Financial Statements,” December 2000, provides detailed guidance on how the notes to the financial statements are derived. Line 1.B. of the notes states that, “OM&S Held in Reserve for Future Use,” consists of stocks maintained because they are not readily available in the market or because there is more than a remote chance they eventually will be needed. It further states that these assets should be considered war reserve requirements.

Information on the munitions balance was primarily derived from data provided to DFAS Denver from the Air Force Combat Ammunition System. Those data did not reflect munitions held for war reserve requirements. Prior year financial statements showed that the Air Force generally reflected about \$1.35 billion of war reserve munitions held for future use. The amount of war reserve assets in

the Combat Ammunition System should have been disclosed in the financial statements as held for future use.

On Hand Munitions Footnote Disclosure. In addition to the above understatement of munitions held for future use, the SBSS data for November 2000 showed that \$30.5 million of munitions coded items were shown as on hand in SBSS, but those assets were not reflected as munitions in the footnote. We determined that the assets were not included in the footnotes because of confusion concerning the overall definition of which assets should be considered munitions assets. In addition, there was conflicting guidance between two separate Air Force regulations. Air Force Instruction 21-201, "Management and Maintenance of Non-Nuclear Munitions," December 1, 2000, required monthly reviews of SBSS to ensure that munitions assets were not maintained on base supply records. However, Air Force Manual 23-110, "U.S. Air Force Supply Manual," July 1, 2000, states that the SBSS provides base activities with their supply needs and accounts for supplies, equipment, petroleum, oils and lubricants, munitions, and clothing. The Air Force needs to determine whether munitions should be maintained in SBSS and if so, ensure that the data on munitions assets in SBSS were provided to its servicing finance office so that the assets are properly reflected in financial statement disclosures.

War Reserve Property Plant and Equipment. During FY 2000, the Air Force and its servicing DFAS Denver office adjusted OM&S balances to remove \$172 million of PP&E assets recorded in SBSS and shown as OM&S on the financial statements. However, additional adjustments were needed. About \$351 million of war reserve PP&E assets were not eliminated from the reported balances.

Coding of SBSS Items. Items in SBSS are classified as either OM&S or PP&E based on the item's assigned alphanumeric code. This alphanumeric code is defined as an Expendability, Recoverability, Repairability, Category (ERRC) designator. The Air Force use of ERRC designators provides for categorization of its assets into various management groupings. These groupings determine the type of management used throughout the logistics cycle, designate the methodology to be employed in computing requirements, and are used in the accumulation and reporting of asset and usage data. According to Air Force Manual 23-110, Volume 1, Part Four, it is extremely important that the ERRC designators be correctly assigned, since they are the key element in determining whether an item will be managed as an expense cost or an investment cost item.

The ERRC designator begins with either an "X" or an "N." An item beginning with an ERRC designator of "X" is considered an expendable item that is either consumed in use or will become a part of a higher assembly during its period of use. These types of items should be classified as OM&S for financial reporting purposes. Items having an ERRC designator that begins with an "N" are considered nonexpendable, that is, they are neither consumed in use nor do they lose their identity by installation on a higher assembly during their periods of use. An item that has an ERRC designator that begins with an "N" should be considered PP&E for financial reporting purposes and either expensed or capitalized depending on its value. See Appendix C for a listing and description of the ERRC designators.

Adjustments Made. In an attempt to eliminate duplicate reporting of assets in SBSS as both PP&E and OM&S, the OM&S balance shown in SBSS was reduced by \$172 million. Because the Air Force was not able to provide DFAS Denver with an accurate SBSS database at year's end that identified all "N" coded assets, DFAS Denver developed an alternative method to identify PP&E assets in the SBSS. The alternative method entailed the use of the Air Force Equipment Management System (AFEMS). Because AFEMS interfaced with SBSS, it should have reflected all PP&E carried in SBSS. Air Force and DFAS Denver personnel believed that reducing the OM&S balance by the \$172 million adjustment would result in more accurate reporting of OM&S.

Additional Adjustments Needed. The \$172 million adjustment made to the OM&S balances carried in SBSS did not result in the elimination of all PP&E assets. Our review of the AFEMS data provided to DFAS Denver disclosed that \$172 million of PP&E assets were held for current use, and an additional \$351 million of PP&E assets were held as war reserve materials. However, DFAS Denver personnel did not appropriately reduce the reported OM&S balance by the \$351 million. DFAS Denver personnel acknowledged that they made an error in not adjusting the OM&S balance by the \$351 million of war reserve PP&E. They believed it was simply an oversight in the manual processing of the FY 2000 statements. The error caused the OM&S balance on the FY 2000 Air Force financial statements to be overstated by \$351 million. DFAS Denver and Air Force personnel stated that this condition would be corrected when a systems change planned to correct the reconciliation reporting for the SBSS is completed. The estimated completion date was June 1, 2001. We are not making a recommendation on this issue because of the planned corrective action by the Air Force.

In addition to not adjusting for the war reserve materials, the AFEMS data only included information on 4 of the 10 possible "N" coded items. Specifically, the AFEMS data showed values for only ERRC designators ND4 and 5, and NF4 and 5. When we asked DFAS Denver why their adjustment was based only on those "N" coded assets, they stated that those items were selected because they were valued over \$100,000. PP&E assets valued over \$100,00 are capitalized and reported on the Air Force balance sheet as PP&E. DFAS Denver took this action to ensure that the same assets would not be included on the financial statement as both OM&S and PP&E. However, SBSS data provided to us by the Air Force during November 2000 showed that there was a substantial number (961 items valued at \$14.6 million) of "N" coded assets with a 1, 2, or 3 numeric designator. Although \$14.6 million of PP&E reported as OM&S is not material to the financial statements, these assets need to be properly accounted for and reflected correctly on the Air Force financial statements.

Conclusion

The information about Air Force OM&S reported in the Air Force FY 2000 General Fund financial statements was not reliable. The Air Force General Fund financial statements contained inaccurate disclosures of about \$1.75 billion in OM&S. The Air Force needs to develop a consistent process to provide data

to DFAS Denver for accurate disclosure and presentation in the financial statements for munitions assets maintained in both the Combat Ammunition System and SBSS. In addition, the Air Force needs to develop effective procedures to ensure that PP&E assets in the SBSS database were not reported on its financial statements as OM&S. The inadequate reporting of the PP&E caused the OM&S line item on the Air Force FY 2000 General Fund financial statements to be overstated by \$365.6 million.

Recommendations

We recommend that the Air Force Deputy Chief of Staff (Installations and Logistics):

1. Develop procedures to ensure that required data on Air Force munitions assets maintained in the Air Force Combat Ammunition System and also in the Standard Base Supply System are provided to the servicing finance office for appropriate disclosure in the footnotes to operating materials and supplies balances.
2. Correct the inconsistencies between the two Air Force regulations as they relate to whether munitions assets will or will not be maintained in the Standard Base Supply system.
3. Implement procedures to ensure that all property, plant, and equipment coded assets in the Standard Base Supply System are not reported as operating materials and supplies.

Management Comments Required

The Air Force did not comment on a draft of this report. We request that the Air force provide comments on the final report.

Appendix A. Audit Process

Scope and Methodology

We concentrated our audit effort on the Air Force General Fund financial reporting of \$19.6 billion of OM&S. This included a review of all relevant supporting documentation used in the preparation of the FY 2000 Air Force General Fund financial statements at its servicing DFAS Denver office. We also reviewed related information in reports produced by the Air Force from financial and logistics systems. The work included examining data from the Air Force SBSS and AFEM systems. Additionally, we made inquiries of Air Force comptroller and logistics staff and DFAS Denver personnel to determine the processes and policies that were used to report OM&S.

Audit Type, Dates, and Standards. This financial-related audit of the Air Force reported \$19.6 billion of OM&S was conducted from September 2000 through January 2001 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did our work in accordance with generally accepted Government auditing standards except that we were unable to obtain an opinion on our system of quality control. The most recent external quality control review was withdrawn on March 15, 2001, and we will undergo a new review.

Use of Computer-Processed Data. We relied on computer-processed data from the Air Force SBSS and AFEMS systems to determine the amounts and values of assets (that is, munitions and PP&E assets). Although we did not perform a formal reliability assessment of the computer-processed data, we did not find errors that would preclude use of the computer-processed data to meet the audit objectives or that would change the conclusions of the audit.

Contacts During the Audit. We visited or contacted individuals or organizations within DoD and the Air Force. Further details are available on request.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure.

-
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
 - **FY 2001 Subordinate Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. **(01-DoD-2.5.1.)**
 - **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal:

- **Financial Management Functional Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

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

Management Control Program. We did not assess the internal control structure because the Air Force reported in its prior year financial statements that it lacked the systems and procedures to adequately report operating materials and supplies.

Appendix B. Prior Coverage

Air Force Audit Agency

Air Force Audit Agency Report No. 99053003, "Inventory and Related Property, Fiscal Year 1999," September 20, 2000

Air Force Audit Agency Report No. 98053003, "Inventory and Related Property, Fiscal Year 1998," May 14, 1999

Air Force Audit Agency Report No. 97053003, "Inventory and Related Property, Fiscal Year 1997, Air Force Consolidated Financial Statements," August 20, 1998

Air Force Audit Agency Report No. 96053005, "Operating Materials and Supplies, Fiscal Year 1996, Air Force Consolidated Financial Statements," May 30, 1997

Air Force Audit Agency Report No. 96054009, "Combat Ammunition System," January 17, 1997

Air Force Audit Agency Report No. 95053005, "Operating Materials and Supplies, Fiscal Year 1995, Air Force Consolidated Financial Statements," August 29, 1996

Appendix C. Expendability, Recoverability, Repairability, Category Codes

The following table shows ERRC designators.

Position of ERRC Designator	Code	Conditions
First	N	When the item retains its own identity when in use—that is, it is not incorporated into, installed on, or attached to another assembly AND the item is not consumed in use AND the unit price is over \$10. Nonexpendable Item.
First	X	When the item loses its own identity in use or is installed in, or is attached to, another assembly. Also applies when the item is consumed in use. Expendable Item.
Second	B	When the item is not subject to repair and is consumed in use. Will always include but is not limited to items costing \$10 or less.
Second	F	When the item is of such a composition that it is economical to repair, but not economical to return to a specialized repair activity for repair AND the capability exists within field/contract maintenance to repair.
Second	D	When the item is subject to repair, but beyond the scope of field level maintenance, and should be returned to a depot or specialized repair activity for repair.
Third	1	When the first two positions are XD and the Air Force Logistics Command Item Manager has determined that the item will be managed under Serialized Control and Reporting System procedures.
Third	2	When the first two positions are XD, and the item is not Category 1
Third	3	When the first two positions are XF or XB.
Third	4	Other centrally procured items.
Third	5	Vehicles identified by registration or serial number.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Under Secretary of Defense (Comptroller)
Deputy Comptroller (Program/Budget)
Deputy Chief Financial Officer

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Deputy Chief of Staff (Installations and Logistics)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service, Denver Office

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

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