



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

May 9, 2005

MEMORANDUM FOR RICHARD K. SYLVESTER, DEPUTY DIRECTOR, ACQUISITION
RESOURCES AND ANALYSIS (PROPERTY AND EQUIPMENT
POLICY), OFFICE OF THE UNDER SECRETARY OF DEFENSE
FOR ACQUISITION, TECHNOLOGY, AND LOGISTICS

SUBJECT: Termination of the Audit of the DoD Midterm Solution for Military Equipment
Valuation (Report No. D-2005-065)

Audit Update. We announced the above mentioned audit on January 10, 2005. As a result of the limited progress in developing the DoD midterm solution for military equipment valuation, the DoD Office of Inspector General (OIG) has decided to discontinue the audit of the DoD midterm solution. The OIG will revisit the midterm solution when the program has progressed to a point where the OIG audit would be more beneficial to DoD.

Background. DoD began reporting military equipment on its Agency-wide Consolidated Balance Sheet in FY 2003 in response to new guidance issued by the Federal Accounting Standards Advisory Board (FASAB). FASAB issued the Statement of Federal Financial Accounting Standard (SFFAS) No. 23 "Eliminating the Category of National Defense Property, Plant, and Equipment" in May 2003. SFFAS No. 23 required that all assets formerly classified as National Defense Property, Plant, and Equipment be reclassified as military equipment and accounted for in accordance with requirements established for General property, plant, and equipment in SFFAS No. 6, "Accounting for Property, Plant, and Equipment," June 1996. In an effort to comply with SFFAS No. 23, the Office of the Under Secretary of Defense (Comptroller) [OUSD(C)] and the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics) [OUSD (AT&L)] formed the Property and Equipment (P&E) Policy Office. The P&E Policy Office began an initiative to implement the new standard and change the way DoD does business in hopes of attaining an unqualified audit opinion.

Conceptual Model. The P&E Policy Office hired Klynveld, Peat, Marwick, and Goerdeler (KPMG), an accounting and professional service firm, to assist them in implementing the new standard. The P&E Policy Office began by developing a conceptual model, which outlines the business and systems process requirements needed in order for DoD to comply with the SFFAS No. 23. The conceptual model outlined three phases: baseline valuation, midterm solution, and the business enterprise architecture implementation. During the baseline valuation, the P&E Policy Office will determine the historical cost of military equipment as of September 30, 2006. The P&E Policy Office began working on the baseline valuations and anticipated 100 percent completion of Air Force and 95 percent of Army, Navy and Other Defense Agency military equipment program valuations by September 30, 2005.

During the midterm solution, DoD must have a system in place that is capable of maintaining and updating the baseline valuations. The new system must also be capable of relieving the work in process (WIP) account on asset delivery and clearing any residual amounts on contract completion. The P&E Policy Office contacted the Naval Space and Warfare Systems

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Center (SSC) in San Diego, California, to assist in the development of the midterm solution. Specifically, as the developer, SSC San Diego copied and modified the Navy Cabrillo system to form the Capital Asset Management System-Military Equipment (CAMS-ME). The Navy Cabrillo system was chosen because it supported three very important modules to calculate the full cost of military equipment: WIP, military equipment (ME) valuation, and fixed asset accounting.

DoD Military Equipment. With an estimated \$1.1 trillion in military equipment acquisition costs, DoD reported \$324.4 billion (net book value) in military equipment on its FY 2004 DoD Agency-wide Consolidated Balance Sheet. This represented 23 percent of the total Federal Government assets. Military equipment represents approximately 74 percent of the general property, plant, and equipment reported DoD wide.

Costs to Implement SFFAS No. 23. In December 2002, Congress awarded the Office of the Secretary of Defense (OSD) \$18.6 million to implement the changes in accounting requirements for military equipment described in SFFAS No. 23. Costs incurred on the program through February 2005 were \$11.8 million. OSD efforts resulted in a universe of 1,074 DoD military equipment programs, a baseline valuation methodology, and a concept for maintaining and updating the baseline valuation as of February 28, 2005.

Scope and Methodology. To determine the reasonableness of the midterm solution methodology, the OIG initiated an audit in January 2005. Specifically, the audit would evaluate whether the processes and systems the P&E Policy Office developed for maintaining the baseline valuations and accounting and reporting post-baseline transactions were reasonable. The OIG also hoped to evaluate the reasonableness of the proposed processes to transition to the Business Enterprise Architecture.

During the survey phase, the OIG met with the P&E Policy Office and received briefings on their proposed execution of the midterm solution. The OIG team also attended integrated planning team (IPT) and working groups meetings with the P&E Policy Office, KPMG, the developer, and the services. We traveled to San Diego, California, to attend meetings regarding the development of the CAMS-ME and interviewed the development staff. The scope of our audit was limited because OSD had not finalized or prepared documentation or the OIG considered the documentation that OSD had completed to be inadequate. For example, the functional requirements document and memorandums of understanding (MOU) with the services and the Defense Finance and Accounting Service (DFAS) were not available for OIG review because the P&E Policy Office was awaiting input from DFAS and the services. We requested and reviewed available program planning and acquisition documentation, including the conceptual model, proposed baseline update document, the Initial Capabilities Document¹ and the Capabilities Development Document².

¹The Initial Capabilities Document describes required capabilities and includes broad, time-phased, operational goals. It should be developed after examination of multiple concepts and materiel approaches to optimize the way DoD provides these capabilities. The examination should include robust analyses that consider affordability, technology maturity, and responsiveness.

² The Capabilities Development Document supports program initiation, refines the integrated architecture, and clarifies how the program will lead to joint war fighting capability. It should build on the Initial Capabilities Document and provide the detailed operational performance parameters necessary to design the proposed system.

Survey Results. The success of the midterm solution was at risk because of the:

- lack of communication,
- lack of a functional requirements document,
- lack of documented roles and responsibilities, and
- aggressive implementation schedule.

Communication. The lack of communication between the P&E Policy Office, the developer, DFAS, and the services was a significant issue. The baseline valuation team within the P&E Policy Office had not provided adequate guidance or input to the CAMS-ME development efforts. Further, the P&E Policy Office had not provided guidance or documented expectations of the roles of DFAS and the services throughout the midterm solution. Additionally, DFAS and the services were unclear about their roles in the midterm solution. The lack of communication and documented expectations left performance gaps in the overall plan to achieve a system capable of valuing DoD military equipment and may result in unexpected expenditures to fill these gaps. Ultimately, the lack of communication influences the success or failure of the midterm solution and the business enterprise architecture implementation.

Further, the baseline valuation team had not communicated how they gathered the baseline valuation data to the SSC San Diego development team (the developer). The baseline valuation team was extremely busy trying to complete the baseline valuations for military equipment. As a result, it was difficult for them to attend important meetings with the developer. Consequently, the developer was not familiar with the baseline valuation methodology and may not have been able to design the system the baseline team has envisioned. For example, the developers did not understand the KPMG rationale for the inclusion of appropriations data in CAMS-ME. Specifically, the baseline valuation team had not explained the purpose and impact of having the appropriation data in the valuation process. Further, the developer did not seem to have a clear understanding of the need and purpose of an audit trail or supporting documentation. For example, the developer referred to the systems of record as an audit trail. This would be sufficient to some extent. However, if all of the reporting systems produce cumulative totals, DoD must ensure that the source documentation explaining the make-up of the reported totals is available.

As of February 10, 2005, the OSD decision makers had not made firm decisions about the project development. The lack of timely decisions could cost the program up to \$100,000 per week in development costs and force performance “trade offs” on what capabilities CAMS-ME and the proposed interfaces will have. Further, the decision-makers did not attend important meetings with the developers and relied on subordinate staff to report the status of the system development efforts to headquarters. This delay in delivery of developers concerns caused a loss in development time. In addition, the subordinate staff may not have adequately conveyed information that was very valuable to this program. As a result, the lack of guidance hindered the efforts to continue development of the CAMS-ME.

Functional Requirements. The P&E Policy Office was attempting to document the acquisition strategy and develop the CAMS-ME concurrently. Because of the time involved in each of these concurrent efforts, the P&E Policy Office had not been able to provide the developers with finalized functional requirements³ for CAMS-ME. The lack of requirements, in conjunction with the lack of timely decisions, would leave the developer to assume responsibility for making key decisions to keep development on schedule. If this happened, the system may lack important steps in the valuation methodology. If the developer develops a system that is not in line with the baseline valuation methodology, DoD will be required to expend additional funds to correct problems that may have been avoided had decision-makers and the baseline valuation team been available to provide the necessary input and guidance. The inability of the baseline valuation team to effectively communicate their needs and requirements to the developers can have lasting effects on the overall midterm solution. Finally, the lack of requirements increased the risks to the program schedule and costs for the development of the CAMS-ME.

Further, firm functional requirements were essential to the “blueprinting” process the developers use. Blueprinting is the process of incorporating the business processes developed by the P&E Policy Office into the CAMS-ME. The P&E Policy Office stated that the final functional requirements, including input from the services, would be available by March 18, 2005. As of the date of this memorandum, the P&E Policy Office had not finalized their functional requirements document for the CAMS-ME.

Roles and Responsibilities. The P&E Policy Office had not provided guidance or documented expectations of the roles of DFAS and the services throughout the midterm solution.

DFAS Specific Roles and Responsibilities. The P&E Policy Office had not explained to DFAS the logistics of the role the DFAS Corporate Database (DCD) will have in the midterm solution. Specifically, they did not identify any additional responsibilities or work for DFAS. During our observations at SSC San Diego developer, DFAS appeared to be unclear on their role in the midterm solution. DFAS understood their role to be that DCD would gather information and pass it along to the CAMS-ME. However, during working group meetings, the P&E Policy Office made the assumption that the DCD would serve as a data warehouse for the military equipment data. In addition, reconciliations would need to be performed to ensure that the data transferred to CAMS-ME matches the DCD records. However, the determination of who would assume this responsibility had not been decided.

Additionally, DFAS voiced concerns over the:

- ability of the CAMS-ME to retrieve the required information from DCD;
- reliability of the information in DCD; and
- complexity of the accounting codes used not only between each of the services but within the services as well.

³ Functional requirements are system level requirements for loading and maintaining the previously defined business rules in the CAMS-ME.

The baseline valuation team has been unable to define common data elements in accounting codes in order to gather the required data. This inconsistency in gathering data for baseline values increased difficulties in “marrying” DCD interface data with baseline program valuations.

Service Specific Roles and Responsibilities. The P&E Policy Office had not thoroughly explained to the services their role in the midterm solution and the importance of establishing interfaces with the service accountability systems. According to the P&E Policy Office, the services had the responsibility of identifying the accountability systems they want to interface with the CAMS-ME. However, the P&E Policy Office had not established a due date for the services to make their decision. As a result, the developer could not perform the blueprinting process needed in the development of the CAMS-ME. Blueprinting was dependent on the identification of interfacing systems because the developers needed to know what types of data were available in order to design CAMS-ME to present this information in a non-ambiguous format.

Additional Responsibilities. The lack of adequate communication between the P&E Policy Office and the services lead to frustration for the services. For example, the P&E Policy Office hosted monthly IPT meetings to provide a status report of all parties involved in the midterm solution (P&E Policy Office, DFAS, and services). During these meetings, the services continued to voice concerns about their required roles throughout the midterm solution and into the business enterprise architecture (long-term solution). Specifically, the services were concerned about being able to have an auditable WIP account balance. However, the P&E Policy Office had been unable to explain how the CAMS-ME would acquire and release amounts for government furnished materials and maintain the WIP balance. In response, a P&E Policy Office contractor working on the midterm solution commented about the possibility of maintaining the WIP account manually until a viable solution could be found.

Further, the P&E Policy Office asked that the services designate a person to serve as subject matter experts for CAMS-ME development. These individuals would be on “temporary duty” status in San Diego for one year. The services were unaware of this requirement and voiced concerns over having to pay for the designated person as well as a “new hire” or replacement for that person. However, documenting these requirements early on in the planning process may have prevented some of the resistance the services exhibited at the IPT meetings.

We asked the P&E Policy Office midterm solutions team for documentation of roles and responsibilities for the services and DFAS (i.e. memorandums of agreement/understanding). On April 19, 2005, the P&E Policy Office provided the MOUs for DFAS and the services. The DFAS MOU discussed the requirement that DFAS establish expenditure interfaces between the CAMS-ME and core accounting/entitlement systems via the DCD. However, the DFAS MOU did not discuss DCD serving as a data warehouse or the performance of data reconciliations. The service MOUs indicated that the services must identify, evaluate, and select accountability systems to provide CAMS-ME with the required

accountability data. If an interface with accountability systems is not available, the services are responsible for developing manual processes to provide the data. The MOUs did not establish a required completion date for the identification of interfaces and processes. The MOUs further explained that each service must provide a subject matter expert and Domain representative to the developer of the CAMS-ME to ensure that service requirements are identified and addressed. The MOUs did not identify a decision date or time requirements for the subject matter experts.

Implementation Schedule. The P&E Policy Office established a very aggressive schedule. The P&E Policy Office anticipated the baseline valuation automation spreadsheet for calculating and updating the baseline valuation at the program level by October 2005. The first system interface (with DCD), which automates the collection of expenditure data, had an April 2006 deployment date. In October 2006, the CAMS-ME was scheduled to be deployed and would include functionality to calculate asset and WIP values. The WIP values would be derived using data obtained from contracts and values for certain identifiable government furnished material items embedded in military equipment items. This functionality only covered what the P&E Policy Office referred to as Increments 1 and 2 of the midterm solution. This did not include the long-term functionality or Business Enterprise Architecture. However, as of the date of this memo, no physical system existed; this was still a “concept.” Because the CAMS-ME was still being developed, its requirements and processes may have changed during these working group meetings. As a result, the program is not auditable at this time.

The P&E Policy Office indicated that CAMS-ME is not planned to replace any of the legacy systems within the services once it is functioning properly. Further, the P&E Policy Office had not determined whether the CAMS-ME will serve as the DoD enterprise resource planning solution. The overall benefit of the CAMS-ME to DoD was not apparent to the OIG. CAMS-ME would not alleviate issues presented by legacy systems such as redundancy and lack of consistent and reliable financial data.

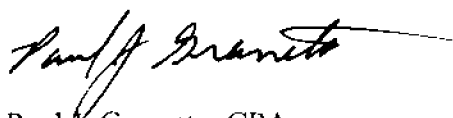
Schedule Update. Since the conclusion of our survey phase, the P&E Policy Office has experienced “down time” in project development and has revised the schedule for implementing the proposed Increments. For example, Increment 1 will not be fully operational until September 30, 2006.

Conclusion: The lack of communication, functional requirements, and documented roles and responsibilities appeared to be a result of inadequate planning. Further, the lack of guidance and documented expectations for all parties involved left several performance gaps in the overall plan to achieve a system capable of valuing DoD military equipment. These gaps may result in the shuffling of workloads or increasing the work of parties involved. The gaps may also result in unexpected expenditures to hire another contractor to fill the gaps. These issues may threaten the execution of a viable midterm solution to valuing military equipment.

Further, the P&E Policy Office established an aggressive target date for an unqualified audit opinion. The P&E Policy Office should reconsider that target date. During their reassessment, they should consider the concerns of the services and work to address issues identified through the OIG review. By developing a more reasonable timeline for the development of the CAMS-ME, the P&E Policy Office will be able to prevent any performance trade offs that could adversely affect the overall Business Enterprise Architecture. Furthermore, the P&E Policy Office must work to ensure the best product for the DoD by developing a system that will eliminate the redundancy and inaccuracy of current legacy systems and produce more efficiency in the DoD business processes. As a result of the limited progress that the P&E Policy Office has made on the midterm solution, the OIG has decided to discontinue the audit of the DoD midterm solution. The OIG will revisit the midterm solution when the P&E Policy Office has progressed to the point where the OIG audit would be more beneficial to DoD.

Recommendations:

- We recommend that the P&E Policy Office have at least one representative who is very familiar with the baseline valuation methodology and is empowered to make decisions present at meetings with the developer, specifically, meetings discussing system requirements and performance.
- We recommend that the P&E Policy Office make the necessary arrangements to ensure that key development issues and decisions are handled in a timely manner.
- We recommend that the P&E Policy Office explain and outline in detail the roles and responsibilities of all parties involved. The P&E Policy Office must set firm deadlines for information and decisions needed from third parties, i.e. the services.
- We recommend that the P&E Policy Office reassess their midterm solution efforts in order to review their status and plan of action as it relates to their aggressive timeline.



Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing Service