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United States General Accounting Office  
Washington, DC 20548

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October 24, 2000

The Honorable Helen T. McCoy  
Assistant Secretary of the Army for  
Financial Management and Comptroller

General John G. Coburn, USA  
Commanding General, U.S. Army Materiel Command

Mr. Thomas R. Bloom  
Director, Defense Finance and Accounting Service

Subject: Financial Management: Reporting of Army Conventional Ammunition as  
Operating Materials and Supplies

As part of our audit of the fiscal year 1999 governmentwide financial statements, we evaluated the Army's accounting practices and processes for reporting assets as operating materials and supplies (OM&S) on the Army's General Fund Balance Sheet.<sup>1</sup> Our evaluation identified problems in the financial reporting process for OM&S assets that caused a material understatement of the value of these assets reported on the Army's balance sheet for fiscal year 1999. These problems also resulted in errors in consistently reporting missile quantities as national defense equipment (NDE) in the Army's Supplementary Stewardship Report. In general, these problems can be attributed to the use of undocumented manual procedures for accumulating these balances at fiscal year-end. Such manual procedures are in place because DOD and the Army have not yet developed and implemented automated processes for accumulating these data. The purpose of this letter is to inform you of these issues and provide recommendations for improving the financial reporting of OM&S in the short term and ensuring that these issues are addressed in plans for automating this process in the future.

### **Background**

Virtually all of the \$18.9 billion the Army reported as OM&S assets for fiscal year 1999 consisted of ammunition stored in ammunition depots, on prepositioned ships, at government and contractor-owned production facilities, and at various Army installations worldwide. Assets stored in depots, on prepositioned ships, and at production facilities and managed by Army commodity managers assigned to the Army Materiel Command are referred to in Army terminology as "wholesale-level assets." The Army manages wholesale-level ammunition assets using its wholesale logistics system, the Commodity Command Standard System (CCSS). On a monthly and year-end basis, the Defense Finance and Accounting

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<sup>1</sup>Operating materials and supplies are reported on the Army General Fund Balance Sheet as a component of the Inventory and Related Property, Net line item.

Service (DFAS), which maintains the Army's financial accounting system, obtains from CCSS the value of the Army's wholesale-level ammunition and missile assets and posts the value to the Army's General Ledger OM&S accounts.<sup>2</sup>

In contrast, assets held at Army installations, such as Fort Knox and Fort Hood, are referred to as "retail-level assets." Army units at installations are authorized to hold retail-level ammunition and missile assets for training and related uses and to maintain combat readiness capabilities.<sup>3</sup> Army installations store retail-level ammunition assets at secure storage sites called ammunition supply points, which typically are located in remote areas of installations and use igloos or bunkers for storing munitions and other explosives. These ammunition supply points use the Standard Army Ammunition System-Modified to account for receiving, storing, and issuing these sensitive items. Ammunition supply point personnel issue items to requesting units only upon their planned imminent use. Ammunition supply points periodically report their ammunition and missile asset balances through their major commands to the Worldwide Ammunition Reporting System (WARS), the Army's centralized visibility system for monitoring the location of all ammunition and missile assets located worldwide, including both wholesale- and retail-level assets.

To report the value of retail-level assets, the DFAS Indianapolis Center derives asset balances from WARS. At fiscal year-end, WARS analysts extract certain retail balances from WARS and electronically mail the amount to DFAS Indianapolis, which posts an adjustment to add the value of retail-level ammunition and missile assets to the Army's general ledger OM&S accounts. Statement of Federal Financial Accounting Standards (SFFAS) No. 11, *Amendments to Accounting for PP&E: Definitional Changes*, requires missiles to be reported as a separate class of assets, specifically national defense equipment. Under SFFAS No. 3, *Accounting for Inventory and Related Property*, conventional ammunition assets are to be reported in the OM&S accounts. As a result, DFAS Indianapolis posts an additional fiscal year-end adjustment to deduct from OM&S the value of missiles classified as national defense equipment to be reported on the Army's Supplementary Stewardship Report. The purpose of this adjustment is to avoid double reporting of the same missile assets as both OM&S and national defense equipment in Supplementary Stewardship Reports. For fiscal year 1999, the year-end adjustments to add the value of retail-level assets and deduct the value of national defense equipment affected the reported balance of the OM&S accounts by about \$12 billion.

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<sup>2</sup>CCSS programming automatically computes a monthly and fiscal year-end balance for financial reporting to DFAS Indianapolis. This CCSS reporting program, called Application 431, extracts from logistics records the quantity of items on hand and due in from other depots and multiplies the quantity of each item by its standard price. The application also automatically reports items needing repair at their value net of estimated repair cost and reports those deemed excess at their estimated salvage value.

<sup>3</sup>Army units are required to have on hand or on requisition certain ammunition assets for readiness purposes. The requirements are referred to as "basic load" requirements. As a general rule, a unit's basic load assets are stored at installation ammunition supply points in the same manner as is ammunition stored for all other purposes. Units requisition and are issued ammunition from retail-level storage when needed for their authorized purpose.

## **Objective, Scope, and Methodology**

Our objective was to assess the Army's accounting practices and processes for reporting operating materials and supplies for fiscal year 1999. We analyzed computerized logistic and financial system data maintained by the DFAS Indianapolis Center and Saint Louis Operating Location; the Army's Aviation and Missile Command, Huntsville, Alabama; the Army's Operations Support Command, Rock Island, Illinois; and the Army Materiel Command's Logistics Support Activity, Huntsville, Alabama. We held discussions with officials at these locations and with ammunition management officials assigned to tactical and storage units at Fort Hood, Texas, and at the Army's Forces Command, Atlanta, Georgia. We discussed results of our findings with officials of the Army's Office of the Deputy Chief of Staff for Logistics and Office of the Assistant Secretary of the Army for Financial Management and Comptroller, Washington, D.C. We performed our work at the above locations from August 1999 through May 2000 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Secretary of Defense or his designee. On October 18, 2000, the Assistant Secretary of the Army (Financial Management and Comptroller) provided us with comments, which are discussed in the "Agency Comments and Our Evaluation" section and are reprinted in the enclosure.

## **Improvements Needed in Year-end Adjustments**

In our review of the process that Army and DFAS organizations used to compile and report values for OM&S, we found problems in how the year-end adjustments to the financial records were computed that affected the reported balance for OM&S. Misstatements occurred in the reported asset balances for wholesale-level OM&S because adjustments to the OM&S balances were computed using inconsistent methods and criteria. The major factor contributing to the use of inconsistent methods and criteria for calculating the year-end adjustments was that Army analysts had no written procedures on how to make appropriate computations. Other misstatements occurred in the reported asset balances for retail-level OM&S due to a disagreement regarding the application of certain provisions in SFFAS No.3, *Accounting for Inventory and Related Property*.

Table 1 shows the dollar values that constituted the reported OM&S balances for fiscal year 1999.

**Table 1: Compilation of Army OM&S Balances for Fiscal Year 1999**

(Dollars in billions)

	<u>Fiscal year 1999</u>
Wholesale-level values	
Conventional ammunition	\$ 15.1
Missiles	<u>10.2</u>
	\$ 25.3
Add: retail-level values	
Conventional ammunition	\$ 1.0
Missiles	<u>1.8</u>
	\$ 2.8
Total wholesale and retail values	
Conventional ammunition	\$ 16.1
Missiles	<u>12.0</u>
	\$ 28.1
Less: missiles reported as NDE	
Wholesale-level	\$ (7.4)
Retail-level	<u>(1.8)</u>
Total	\$ 9.2 <sup>a</sup>
Reported OM&S balance	<u>\$ 18.9</u>

<sup>a</sup>The remaining missile amount (about \$2.8 billion) represents items that the Army determined did not meet the criteria for national defense equipment and therefore were reported as OM&S.

### Wholesale-Level NDE Missile Adjustments Calculated Incorrectly

The fiscal year 1999 OM&S reported balance was understated by at least \$1.5 billion because the \$7.4 billion adjustment to remove the value for national defense equipment missile assets from the OM&S account was not calculated correctly. This can be attributed to the lack of specific written procedures for calculating the accounting adjustments to the OM&S balances.

First, the automated year-end financial balance for OM&S provided by CCSS to DFAS Indianapolis included a \$1.4 billion amount, essentially a reserve, for the estimated cost to repair missile assets in unserviceable condition, which reduced the balance in OM&S. This year-end balance also included a \$91 million amount to reflect the value of missile items deemed to be economically unrepairable at their estimated salvage value. However, when the adjustment was made to deduct missiles from OM&S, the related amounts for repairs and salvage values were not also removed. As a result, the balance of OM&S was understated by the amounts of these missile-related reductions.

Second, timing errors affected the accuracy of the reported value for OM&S because the adjustment calculation to remove national defense equipment missiles included transactions that were recorded in CCSS after the end of the fiscal year. In attempting to provide the best information available, the Office of the Deputy Chief of Staff for Logistics requested that commodity managers at the Army Aviation and Missile Command provide information on missile balances to remove these balances from OM&S. The commodity managers reported

balances as of the date of the request instead of the fiscal year-end. As a result, the adjustment was inaccurate. For example, the adjustment improperly included 275 Stinger missiles valued at \$38,300 per unit that were received after September 30. These missiles were not in the reported September 30 balance. As a result, their inclusion in the adjustment inappropriately reduced the balance of OM&S.

Finally, the national defense equipment adjustment included a value for missiles in transit that was much greater than the comparable in-transit values reported to DFAS by CCSS at the end of the fiscal year. Specifically, the adjustment data included values for all in-transit assets, while CCSS's automated financial reporting process only reported those due in from wholesale-level storage activities. For example, in-transit items excluded from CCSS included 28 TOW missiles valued at \$19,145 each and 38 advanced-version Stinger missiles valued at \$48,393 each. Because such items were included in the national defense equipment adjustment and not in the September 30 reported balance, the Army's OM&S was understated by the amounts of these in-transit missile-related reductions.

### Understatement of Retail-Level Inventory

The Army's long-standing accounting policy for reporting OM&S has been to report a portion of the retail ammunition using the consumption method, whereby the cost of goods is removed from the OM&S account in the accounting period they are issued to an end user for consumption in normal operations, and report another portion using the purchase method, whereby the items are expensed when purchased. Because of recognized accounting system inadequacies, the Army and DFAS-Indianapolis currently use manual work-around procedures to post a year-end adjustment to the OM&S accounts to "recapitalize" the value of ammunition and missile assets held for combat readiness purposes at the end of the fiscal year, thus reporting these assets until they are consumed. The assets held at the end of the year for future training and other purposes are not "recapitalized" and are therefore treated as expensed when purchased. Use of these inconsistent methods to report the values of items held in storage at fiscal year-end understates the value of ammunition held in storage. For example, the 1999 fiscal year-end OM&S balance did not include approximately \$1 billion in ammunition stocks held in retail-level storage pending use in training exercises.

SFFAS No. 3, *Accounting for Inventory and Related Property*, specifies that the cost of goods shall be removed from the OM&S account in the accounting period they are issued to an end user for consumption in normal operations, under the consumption method of accounting. However, SFFAS No. 3 provides that OM&S may be expensed when purchased (using the purchase method of accounting) if (1) OM&S balances are not significant amounts, (2) the items are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method of accounting.

The Army stated in the notes to its financial statements that current financial and logistics systems cannot fully support the consumption method of accounting—that is, expensing OM&S when items are actually provided to end users. However, the notes stated that the Army is moving to the consumption method of accounting for OM&S for future years. For fiscal year 1999, the notes stated that significant portions of the Army's OM&S were reported under the purchase method because either the systems could not support the consumption method of accounting or there is disagreement with the auditing community on what constitutes an item being in the hands of an end user. With regard to items held for

training, there appears to be little disagreement that these ammunition items were held in warehouses at the end of the fiscal year. Items held in warehouses for further distribution are, by definition, not in the possession of the end users.<sup>4</sup> Furthermore, the lack of adequate systems does not appear to be an impediment to reporting training ammunition because the manual work-around procedures the Army uses to capitalize assets held for combat readiness purposes could also be applied to training ammunition.

In addition, the fiscal year 1999 adjustments to add certain retail-level assets to the OM&S account and deduct retail-level national defense equipment missile assets were computed using different criteria. The computation of the adjustment to add a value for retail-level assets included only those on-hand assets required to maintain readiness requirements while the computations to deduct from the OM&S account the value of retail-level national defense equipment included assets held for all requirements, including those held for training and other operational purposes. Not consistently including assets held at year-end for all authorized purposes when computing the two adjustments resulted in an understatement of the reported OM&S balance by about \$128 million for fiscal year 1999. This amount is a part of the approximately \$1 billion of unreported training assets held in retail-level storage at the end of fiscal year 1999.

### **Conclusions**

The Army's current accounting practices and manual procedures for computing OM&S balances caused compilation errors resulting in at least a \$1.5 billion understatement of the Army's fiscal year 1999 OM&S balance. Further, OM&S was understated by approximately \$1 billion of ammunition held at retail-level installations for training purposes that was excluded from the financial reports. In the short term, written policies and procedures for identifying the population of assets that is to be reported and for compiling year-end balances for OM&S would help ensure that these assets are properly reported. These issues will also be important to consider in the development of long-term systems solutions for accounting for OM&S to help ensure that the problems encountered in the manual process are not perpetuated in future automated procedures.

### **Recommendations for Executive Action**

To improve the current manual processes for the financial reporting of OM&S, we recommend that the Army's Assistant Secretary for Financial Management and Comptroller, in coordination with the Commanding General of the U.S. Army Material Command and the Director of the Defense Finance and Accounting Service, develop and implement formal written policies and procedures to properly calculate and record year-end adjustments to the OM&S account. Such policies and procedures should address properly and consistently calculating the adjustment to remove national defense equipment missiles, including reducing the value for reparable and salvage items, eliminating timing errors, and including in-transit assets.

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<sup>4</sup>According to SFFAS No. 3, "[a]n end user is any component of a reporting entity that obtains goods for direct use in the component's normal operations. Any component of a reporting entity, including contractors, that maintains or stocks operating materials and supplies for future issuance shall **not** be considered an end user."

In addition, we recommend that your offices collaboratively address two additional matters. First, we recommend that as the Army moves toward implementing the consumption method of accounting for OM&S, you apply the manual work-around procedures used to capitalize assets held for combat readiness purposes to items held for training as well. Second, we recommend that you consider the issues discussed in this letter in the development and implementation of the long-term system solutions for proper accounting of the Army's OM&S.

### **Agency Comments and Our Evaluation**

In written comments on a draft of this letter (see enclosure), DOD concurred with our recommendations. Specifically, the response stated that the Army's Assistant Secretary for Financial Management and Comptroller will work with the staffs of the Director of the Defense Finance and Accounting Service, Deputy Chief of Staff for Logistics, and Army Materiel Command to develop procedures to properly calculate and record year-end adjustments to the OM&S account beginning with the fiscal year 2000 financial statements. DOD also agreed to address (1) the application of procedures to capitalize assets held for training until these items are placed in the possession of end users and (2) ensuring that the procedures for reporting these assets are considered in the development and implementation of long-term system solutions.

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Within 30 days of the date of this letter, we would appreciate receiving a written statement on actions taken to address the recommendations included in this letter.

We are sending copies of this letter to Nelson Toye, Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller); Major General Charles C. Cannon, USA, Acting Deputy Chief of Staff for Logistics; and interested congressional committees. Copies will be made available to others upon request.

Please contact me at (202) 512-9095 or Gayle Fischer, Assistant Director, at (202) 512-9577, if you or your staffs have any questions concerning this letter. James D. Berry and Ronald M. Haun were major contributors to this assignment.



Lisa G. Jacobson  
Director, Defense Audits

Enclosure

Comments From the Department of the Army



REPLY TO  
ATTENTION OF

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

**OCT 18 2000**

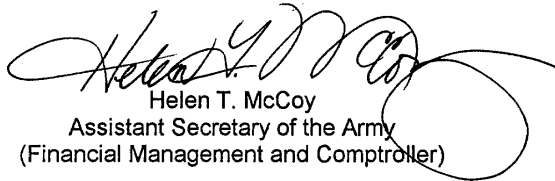
**MEMORANDUM FOR ASSISTANT COMPTROLLER GENERAL,  
ACCOUNTING AND INFORMATION  
MANAGEMENT DIVISION, U.S. GENERAL  
ACCOUNTING OFFICE,  
WASHINGTON, D.C. 20548**

**SUBJECT: General Accounting Office Report "FINANCIAL  
MANAGEMENT: Reporting of Army Conventional  
Ammunition as Operating Materials," (GAO Code  
919530/OSD Case 2085)**

This is the Department of Defense (DOD) response to the GAO draft report, FINANCIAL MANAGEMENT: Reporting of Army Conventional Ammunition as Operating Materials and Supplies, dated September 15, 2000 (GAO Code 919530/OSD Case 2085).

We have reviewed and analyzed the recommendations in the draft GAO report on the Army's reporting of Conventional Ammunition as Operating Materials in its financial statements. Attached is the DOD response.

My point of contact for this action is Mr. Jeffrey Rubin, (703) 697-3971 or e-mail rubinjm@hqda.army.mil.

  
Helen T. McCoy  
Assistant Secretary of the Army  
(Financial Management and Comptroller)

Attachment



GAO DRAFT REPORT DATED SEPTEMBER 15, 2000  
(GAO CODE 919530) OSD CASE 2085

"FINANCIAL MANAGEMENT: REPORTING OF ARMY  
CONVENTIONAL AMMUNITION AS OPERATING  
MATERIALS AND SUPPLIES"

DEPARTMENT OF DEFENSE COMMENTS  
TO THE GAO RECOMMENDATION

RECOMMENDATION 1: The GAO recommended that the Army's Assistant Secretary for Financial Management and Comptroller, in coordination with the Commanding General of the U.S. Army Materiel Command and the Director of the Defense Finance and Accounting Service, develop and implement formal written policies and procedures to properly calculate and record year-end adjustments to the OM&S account. Such policies and procedures should address properly and consistently calculating the adjustment to remove national defense equipment missiles, including reducing the value for reparable and salvage items, eliminating timing errors, and including in-transit assets. (p. 11/Draft Report)

DOD RESPONSE:

Concur: The Army's Assistant Secretary for Financial Management and Comptroller will work with the staffs of the Director of Defense Finance and Accounting Service, Deputy Chief of Staff for Logistics, and Army Materiel Command to develop procedures to properly calculate and record year-end adjustments to the OM&S account beginning with the FY00 financial statements. We will also work to improve the data collection and reporting process.

RECOMMENDATION 2: The GAO recommended that the Army's Assistant Secretary for Financial Management and Comptroller, the Commanding General of the U.S. Army Materiel Command and the Director of the Defense Finance and Accounting Service collaboratively address two additional matters. The GAO recommended that as the Army moves toward implementing the consumption method of accounting for OM&S, that application of the manual workaround procedures be used to capitalize assets held for combat readiness purposes to items held for training as well. Second, the GAO recommended that you consider the issues discussed in this letter in the development and implementation of the long-term system solutions for proper accounting of the Army's OM&S. (p. 12/Draft Report)

DOD RESPONSE:

Concur: The Army's Assistant Secretary for Financial Management and Comptroller will work with the staffs of the Director of Defense Finance and Accounting Service, Deputy Chief of Staff for Logistics, and Army Materiel Command to address these two additional matters beginning with the FY00 financial statements.

Attachment to Memo,  
GAO Draft Report,  
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Enclosure

This includes the application of procedures to capitalize assets held for training until these items are placed in the possession of end users and ensuring that the procedures for reporting these assets are considered in the development and implementation of long term system solutions.

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GAO Draft Report,  
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