



## **Council of Logistics Engineering Professionals (CLEP)**

Lunch & Learn  
22 February 2018

**Logistics Ramifications from DoD Financial Compliance  
and Audit Readiness**

# DoD Financial Audit - Scope

---

For more than 20 years, the Comptroller General of the United States has consistently identified the financial management of the Department of Defense as a high-risk area. The Department's inability to track and account for billions of dollars in funding and tangible assets continues to undermine its management approach.

*Source: National Defense Authorization Act for FY18*

*The DoD's annual budget represents almost half of the Federal Government's discretionary budget and it holds more than 70 percent of the Federal government's assets - \$24 Trillion Dollars!*

In compliance with the September 30, 2017 deadline established by the National Defense Authorization Act for Fiscal Year 2010 (Public Law 111-84), the Department has certified that they are ready to undergo a full financial audit...

*We have many challenges to address...*

# Agenda – Objectives for the Brief:

---

- Discussion of notable logistics challenges and initiatives, in progress and planned, that are receiving additional scrutiny because of audit, and:
- Specific logistics issues that have been exacerbated by new, or refocused requirements driven by audit readiness
- Examples from a DoD perspective, but germane to ongoing logistics challenges that other Federal Agencies must still address/manage, even if audit has been accomplished (with a clean, unqualified audit opinion)
- This is not an audit primer
- Bottom Line Up Front (BLUF):

...I am going to make the case that audit has forced a paradigm change on the way we accomplish both accountability and accounting; highlight that accounting/audit requirements are now part of our operational imperative; highlight some of the logistics challenges, and underscore the imperative to understand and address the "why" in order to address; and cover enough material at a high level that should encourage questions and dialog...

*In the beginning: Chief Financial Officer (CFO) Act, and Office of Management and Budget (OMB) Circular A-123....*

# Paradigm shift...

---

- Significant changes in systems, processes, and resources are required  
*Logistics issues that have been exacerbated by new, or refocused requirements...*



*Audit has set in motion a paradigm shift in the way both accounting and accountability must now be accomplished*

# Logistics Equities...

---

*DoD has 70% of the Federal Government's assets - \$24T!*

- Inventory and Related Property (Note 8)
- General Property, Plant and Equipment (Note 9)
- Includes accountability and accounting for things like:
  - Ships and subs...
  - Ordnance
  - Aircraft Engines
  - Operating Materials and Supplies (OM&S)

# What do we have 'on book'? (Navy Balance Sheet)

Department of Defense  
DEPARTMENT OF THE NAVY

## CONSOLIDATED BALANCE SHEET

As of September 30, 2016 and 2015 (\$ in Thousands)

	2016 Consolidated	Restated 2015 Consolidated
<b>ASSETS:</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 145,212,868	\$ 140,494,819
Investments (Note 4)	5,664	6,543
Accounts Receivable (Note 5)	181,481	212,630
Other Assets (Note 6)	580,268	444,466
<b>Total Intragovernmental Assets</b>	<u>145,980,281</u>	<u>141,158,458</u>
Cash and Other Monetary Assets (Note 7)	93,929	106,034
Accounts Receivable, Net (Note 5)	631,548	571,763
Inventories and Related Property, Net (Note 8)	81,577,809	78,851,740
General Property, Plant and Equipment, Net (Note 9)	362,367,317	324,375,957
Other Assets (Note 6)	8,675,162	48,724,034
<b>TOTAL ASSETS</b>	<u>\$ 599,326,046</u>	<u>\$ 593,787,986</u>
<b>Stewardship Property, Plant and Equipment (Note 9) *</b>		
<b>LIABILITIES</b>		
Intragovernmental:		
Accounts Payable (Note 11)	\$ 1,387,186	\$ 1,398,696
Other Liabilities (Note 13)	1,122,166	887,244
<b>Total Intragovernmental Liabilities</b>	<u>2,509,352</u>	<u>2,285,940</u>
Accounts Payable (Note 11)	348,127	725,613
Federal employee and Veteran Benefits (Note 15)	1,460,768	1,537,559
Environmental and Disposal Liabilities (Note 12)	22,717,646	21,120,540
Other Liabilities (Note 13 & Note 14)	7,023,849	9,125,671
<b>TOTAL LIABILITIES</b>	<u>\$ 34,059,742</u>	<u>\$ 34,795,323</u>
<b>Commitments and Contingencies (Note 14) *</b>		
<b>NET POSITION</b>		
Unexpended Appropriations - Other Funds	\$ 148,179,076	\$ 182,429,593
Cumulative Results of Operations - Dedicated Collections	44,228	30,290
Cumulative Results of Operations - Other Funds	417,043,000	376,532,780
<b>TOTAL NET POSITION</b>	<u>\$ 565,266,304</u>	<u>\$ 558,992,663</u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u>\$ 599,326,046</u>	<u>\$ 593,787,986</u>

# What do we have 'on book'?, continued

## NOTE 8. INVENTORY AND RELATED PROPERTY

As of September 30	2016	2015
<i>(Amounts in thousands)</i>		
<b>Inventory, Net</b>	\$ -	\$ -
<b>Operating Material &amp; Supplies, Net</b>	81,577,809	78,851,740
<b>Total</b>	\$ 81,577,809	\$ 78,851,740

As of September 30	2016			Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	
<i>(Amounts in thousands)</i>				
<b>OM&amp;S Categories</b>				
Held for Use	\$ 65,582,218	\$ 25,286	\$ 65,607,504	SP, LAC, MAC
Held for Repair	15,970,305	-	15,970,305	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,004,675	(1,004,675)	-	NRV
<b>Total</b>	\$ 82,557,198	\$ (979,389)	\$ 81,577,809	

### Legend for Valuation Methods:

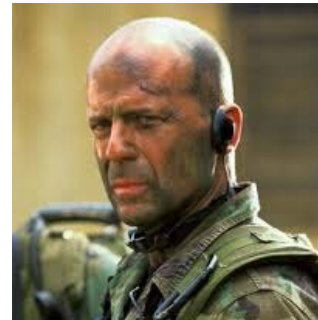
LAC = Latest Acquisition Cost    NRV = Net Realizable Value    SP = Standard Price    MAC = Moving Average Cost

OM&S includes the related spares and repair parts for materiel. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, support equipment, etc. OM&S also includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The DON assigns OM&S to a category based upon the type and condition of the asset in accordance with SFFAS No. 3 "Accounting for Inventory and Related Property." DON categorizes its OM&S as Held for Use and Held for Repair, and Excess, Obsolete, and Unserviceable. OM&S Held for Use includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal.

# Just a little bit about Audit...

---

- **GAAP:**  
Generally Accepted Accounting Principles
- **SFFAS:**  
Statement of Federal Financial Accounting Standards are GAAP developed/  
revised specifically for Federal entities.
- **FASAB:**  
The Federal Accounting Standards Advisory Board – they develop Standards



*Requires standard processes that are well-documented and auditable, systems that feed our financials, and solid controls and testing to maintain a sustainable way ahead*



# Many Challenges

---

*Editorial –*

- APSRs not being used
  - Disparate systems
- Contracts that don't fully support audit requirements
- Expensing material upon receipt
- Lack of Standard Processes and Support
- Passive management of Excess/Obsolete Material



*Why?...*

# Operations and Sustainment - Procurement

---

## Procuring and transacting in an approved APSR:

- There are many different ways we procure assets and material, some pose additional risk to financial compliance
  - Lack of material visibility
  - Insufficient accounting functionality
  - Decentralized procurement- accountability
- What are some of the reasons approved APSRs are not consistently used?
- What contracting efforts can improve upon the challenge?

# Operations and Sustainment – Receipt and Inventory

---

**Expense material (only) when it is consumed – Account for assets accordingly:**

- Purchase method vs the Consumption method of accounting
  - Improper accounting leads to accountability deficiencies – and vice versa
- Both assets and material must be accounted for
- What are the conditions that dissuade from proper receipt accounting?

# Disposal

---

## Why is disposal a challenge?

### Holding Costs in DoD:

- Not applicable in many operations decision-making, why?
- What if the cost to dispose is higher than the cost to hold?
- How to ensure disposal is accomplished?
  - Incentives
  - Resources



# What are the Auditors going to check?

## E&C and Valuation

---

### Existence and Completion (E&C):

All assets/material recorded in the Accountable Property System of Record (APSR) exist (Existence), and all assets/material are recorded in their APSR (Completeness).

### Valuation:

The process of valuing assets/material for financial-reporting purposes. Several accounting-valuation methods are being used by DoD.

October 1, 1996 at 10:22 a.m. Page 1

PARTNO	SPEC	DESC	PRICE	QTY	LOC
#4FLAT	#4FLAT	WASHER	0.03	500	D-114-C
#6LOCK	#6LOCK	WASHER LOCK	0.04	350	D-114-E
.0012UF 1000V 5%	.0012UF 1000V 5%	CAPACITOR DISC	0.00	23	E-65-B
.0015UF 1000V	.0015UF 1000V	CAPACITOR DISC	0.00	99	E-29-G
.0015UF 100V	.0015UF 100V	CAPACITOR PAPER	0.00	106	C-35-C
.0015UF 600V	.0015UF 600V	CAPACITOR PAPER	0.00	11	C-35-B
.0015UF 6KV	.0015UF 6KV	CAPACITOR PAPER	0.00	6	E-45-C
.001UF 1000V	.001UF 1KV	CAPACITOR PAPER	0.00	58	G-16-A
.001UF 100V	.001UF 100V	CAPACITOR	0.00	100	C13B
.001UF 600V	.001UF 600V	CAPACITOR PAPER	0.00	9	G-2-F
.0022UF 1000V	.0022UF 1000V	CAPACITOR DISC	0.00	7	D-105-C
.0022UF 100V	.0022UF 100V	CAPACITOR PAPER	0.00	108	C-35-I

# Valuation Case: How do we value a ship?!

---

- Audit requires appropriate valuation of all assets
- Valuation from receipts, DD250s, accounting of actual procurement cost at the transaction level is difficult from our current systems and processes
- SFFAS Deemed Cost allows for 'latest acquisition cost', like-item value, historical cost, and/or other selected methods
- One Example:  
Valuing an Aircraft Carrier
  - SCN costs
  - Capitalization/Depreciation
  - Modernization
  - CIP
  - Documentation



# Summary:

---

- Audit Readiness presents a significant paradigm shift in the way we do things both in accountability and accounting – particularly with regards to assets and materials in operational logistics
- We must address the systems, processes, and resources to accomplish logistics requirements, now, in a GAAP-compliant way
- Decision makers need to understand the ‘why’s’ to our challenges in order to effect change that works for all stakeholders
- We must modify day-to-day logistics activities to achieve and maintain audit readiness
- DoD will succeed, and will be even more ready – and financially sound - due to audit readiness!



## About the Speaker

---

Steven D. MacDonald is a retired Navy Supply Corps Officer, currently serving as President/CEO of DWBHCORP, Federal Contractor based in the DC-metropolitan area. He also serves as the Managing Member for three Joint Ventures supporting DoD and other Federal Agencies. Prior to establishing DWBHCORP in 2013, he served as Vice President, Corporate Development, then as Chief Operating Officer (COO) at Logistics Support, Inc for approximately seven years.

Mr. MacDonald is a Certified Professional Logistician (CPL) from SOLE - The International Society of Logistics, an active Project Management Professional (PMP®) and Member of the Project Management Institute (PMI). He was a Defense Acquisition DAWIA III and Member of the Acquisition Professional Community (APC). He held Navy Subspecialty Codes in Operations Research (OR), Inventory Management, Transportation Logistics, and as a Joint-Qualified Staff Officer (JSO). He is an enthusiastic proponent of advancing accountability initiatives that lead to audit readiness, and is actively supporting Navy FIAR (Financial Improvement and Audit Readiness).