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Inspector General

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Memorandum Report on Internal Controls Over the Air Force Military Equipment Baseline Valuation Effort

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Acronyms and Abbreviations

BEIS	Business Enterprise Information System
CAMS-ME	Capital Asset Management System-Military Equipment
GAFS-R	General Accounting and Finance System-Rehost
P&EPO	Property and Equipment Policy Office
REMIS	Reliability and Maintainability Information System
SFFAS	Statement of Federal Financial Accounting Standards

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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April 1, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION, TECHNOLOGY, AND LOGISTICS
UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Memorandum Report on Internal Controls Over the Air Force Military Equipment Baseline Valuation Effort (Report No. D-2008-074)

We are providing this report for information and use. No written response to this report was required. Therefore, we are publishing this report in final form.

We appreciate the courtesies extended to the staff. Please direct questions to Ms. Amy J. Frontz at (303) 676-7392 or Mr. Joel K. Chaney at (614) 751-1400. The team members are listed in the inside back cover.

Patricia A. Marsh

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Report No. D-2008-074 (Project No. D2007-D000FD-0207.000)
April 1, 2008

Results in Brief: Internal Controls Over the Air Force Military Equipment Baseline Valuation Effort

What We Did

The Property and Equipment Policy Office in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics requested that the DoD Office of Inspector General perform procedures to review the military equipment baseline valuation as of September 30, 2006. Officials from both offices discussed and agreed upon objectives for the audit, which included evaluating the reliability of the internal controls over three of the financial statement assertions: valuation, rights and obligations, and completeness. This report addresses two of the assertions: military equipment valuation and rights and obligations for the military equipment. This report is the first in a series. The final report will summarize all findings for the series and recommend corrective actions, as appropriate. We plan to perform additional audit work on military equipment completeness.

What We Found

DoD and the Air Force did not accurately report the historic cost of military equipment in accordance with generally accepted accounting principles. Management controls over the development of the historic cost of military equipment did not compensate for several deficiencies. Specifically, controls over the development of the military equipment baseline values did not:

- exclude initial spares, support and training equipment, and logistics support costs that should not be capitalized;
- exclude advance procurement costs that should have been retained in work-in-process until the related aircraft were delivered;
- exclude costs for repair of military equipment that either did not extend the life or improve the capacity of the equipment;
- exclude modification program costs that did not exceed the capitalization threshold;
- ensure that the Air Force retained documents supporting receipt of assets and that the capitalization date recorded in the equipment inventory records was based on appropriate receipt documentation; and
- ensure that assets were removed from the equipment inventory records in the accounting period that the assets were retired (or removed from service).

Audit Conclusions

The Air Force and the Property and Equipment Policy Office methodology for military equipment baseline valuation as of September 30, 2006, did not result in reasonable estimates of the initial historical cost of the equipment. This report identifies deficiencies in the procedures and controls used. Until corrected, the control deficiencies will result in more than a remote likelihood that a material misstatement in the Air Force financial statements could occur and not be detected.

F/A-22 Raptor

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Introduction

Objectives

Our overall objective was to evaluate the methodology used to develop the Air Force military equipment baseline valuation as of September 30, 2006. Specifically, we assessed the reliability of the Property and Equipment Policy Office (P&EPO) and the Air Force internal controls over the valuation and rights and obligations of Military Equipment.

Background

The P&EPO requested that the DoD Office of Inspector General perform procedures to review the military equipment baseline valuation as of September 30, 2006. Officials in the P&EPO and Office of Inspector General discussed and agreed upon objectives for the audit. The agreed-upon objectives included evaluating the reliability of the internal controls over three of the financial statement assertions: valuation, rights and obligations, and completeness of the Military Equipment Program universe. This report addresses two of the assertions: military equipment baseline valuation and rights and obligations for the military equipment. We plan to perform additional audit work to complete our evaluation of the completeness of the Military Equipment Program universe.

The Statement of Federal Financial Accounting Standards (SFFAS) No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," was issued in May 2003 and was effective for periods after September 30, 2002. The Standard included guidance for capitalizing the value of military equipment including the requirement that the initial capitalization amount for assets previously considered National Defense Property, Plant, and Equipment should be based on historical cost. The historical costs should be in accordance with the asset recognition provisions of SFFAS No. 6, "Accounting for Property, Plant, and Equipment," as amended, and should be the initial historical cost for the items, including any major improvements or modifications. Military equipment is defined as tangible items that are used in the performance of military missions, have a minimum cost of $100,000 ($50,000 for vehicles), are not intended for sale, and have an estimated useful life of 2 years or more.

SFFAS No. 23 recognized that determining initial historical cost may not be practical for items acquired many years prior to the date the Standard became effective. Accordingly, the Standard provided that if obtaining initial historical cost is not practical, estimated historical cost may be used. Other information; such as budget, appropriation, or engineering documents and other reports reflecting amounts expended; may be used as the basis for estimating historical cost.

DoD 7000.14-R, the "DoD Financial Management Regulation," volume 4, chapter 6, dated July 2006, provides that when acquiring a General Property, Plant, and Equipment asset, the purchase cost and other costs necessary to bring the asset to an operable condition are capitalized (capitalizing is recording and carrying forward expenditures for realization of benefits in future periods). DoD Regulation 7000.14-R also provides that depreciation expenses should be calculated and accumulated using the straight-line method, which is a calculation that takes the recorded cost (less salvage value) and divides it equally among accounting periods during the asset's useful life. Salvage value represents the residual value that could be obtained from selling the asset after it has been removed from service and is no longer used for its intended purpose. The event that triggers the calculation of depreciation is the date of receipt shown on the asset receiving document or the date the asset is installed and placed in service (regardless of whether it is actually used). For purposes of computing depreciation, military equipment and real property assets (for example, buildings, facilities, and structures) do not have salvage values.

Review of Internal Controls

We determined that material internal control weaknesses in the Air Force military equipment baseline valuation process existed as defined by DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," January 4, 2006. DoD Instruction 5010.40 states that internal controls are the organization, policies, and procedures that help program and financial managers to achieve results and safeguard the integrity of their programs. Although we identified material weaknesses, we are making no recommendations in this report because the final report will summarize all findings in the series and recommend corrective actions, as appropriate. A copy of the final report will be provided to the Air Force senior officials in charge of management controls.

Valuation of Military Equipment Acquisition and Modification Programs

As of September 30, 2006, Military Equipment was $111.2 billion or approximately 78 percent of General Property, Plant, and Equipment and 41 percent of Total Assets amounts reported in the Air Force financial statements. We reviewed the acquisition and modification programs for five weapons systems. We evaluated the valuation and the rights and obligations assertions. Table 1 lists the reported Military Equipment value as of September 30, 2006, for the programs we reviewed.

Table 1. Reported Military Equipment Value for Programs Reviewed
(in millions)

Military Equipment Program	Acquisition Cost	Less Accumulated Depreciation	Net Book Value
C-130 J	$ 2,892.5	$ 345.4	$ 2,547.1
C-130 J Modifications	30.9	5.3	25.6
F/A-22	13,542.4	975.9	12,566.6
F/A-22 Modifications	5.2	0.2	5.0
F-16	20,746.3	13,557.0	7,189.2
F-16 Modifications	2,176.7	966.0	1,210.7
Predator	1,372.2	861.3	510.9
T-1A Training System	727.3	433.6	293.7
Total	**$41,493.5**	**$17,144.7**	**$24,348.8**

Valuation of Military Equipment Acquisition Programs

The Air Force completed aircraft acquisitions for most Air Force programs prior to the issuance of SFFAS No. 23.[1] We reviewed the valuation for one of these programs, the T-1A Training System. The P&EPO valued the T-1A Training System using expenditure data from the Mechanization of Contract Administrative Services system provided by the Program Office. The expenditure data excluded expenditures for initial spares and support equipment. We concluded that the methodology used to estimate the value of the T-1A Training System was appropriate and that the estimated value assigned was reasonable.

We also reviewed the valuation of the C-130J, F-16, F/A-22, and Predator Programs. The acquisition programs for these aircraft were ongoing when SFFAS No. 23 became effective. Between July 2003 and February 2005, the P&EPO developed estimated unit

[1] Examples of these programs not included in our review are the B-2A, F-117A, KC-135, and E-3.

costs for the C-130J, F/A-22, F-16, and Predator Programs using budgetary information and expenditure data reported by Air Force management information systems. The estimated unit costs were extrapolated to establish the historic acquisition value of the aircraft based on the number of aircraft in service as of September 30, 2006. The P&EPO did not adjust the estimated unit costs based on expenditures recorded after the unit cost estimates were developed. Details on the methodology used to calculate the military equipment values for the programs we reviewed are provided in Appendix B of this report.

The historical acquisition cost developed for these four systems was not reasonable because procedures and controls that the P&EPO used to estimate the value of the four programs were not effective. The values were overstated because the P&EPO and the Air Force included costs that should not have been capitalized. These costs included initial spare and repair parts, support equipment, training equipment, contractor logistics support, and advance procurements. In addition, we identified deficiencies in the useful life assigned to the assets reviewed. The incorrect costs are identified in Table 2.

Table 2. Incorrect Costs Included in the Military Equipment Value
(in millions)

Program	Spares	Support/Training Equipment	Contractor Logistics Support	Advance Procurement
C-130J	$ 78.5	$261.4	$ 282.2	$ 78.9
F/A-22	0	0	2,359.4	1,680.0
F-16	2,846.3	0	0	0
Predator	0	0	112.3	0
Total	**$2,924.8**	**$261.4**	**$2,753.9**	**$1,758.9**

In addition, we were not able to evaluate accounting adjustments that increased the program costs for the F/A-22 and Predator Programs. The P&EPO obtained summary financial transactions from the Business Enterprise Information System (BEIS) for each military equipment program and recorded those transactions in the Capital Asset Management System-Military Equipment (CAMS-ME). These transactions summarized expenditures recorded in the Air Force Accounting System through September 30, 2006. The P&EPO recorded a $300.7 million adjustment to the F/A-22 Program costs and an $83.1 million adjustment to the Predator Program costs. When requested, the P&EPO was not able to provide supporting documentation for the adjustments.

Initial Spare and Repair Parts, Support Equipment, and Training Equipment

The P&EPO and the Air Force did not reduce the estimated unit costs of the C-130J and F-16 Acquisition Programs for initial spare and repair parts (referred to as initial spares), support equipment, and training equipment included in program costs. In a recent report on the Air Force military equipment baseline, the Air Force Audit Agency reported that for 4 of 10 programs reviewed, Air Force program managers included costs for initial spares and support equipment in the cost of the program.[2]

The costs of initial spares, peculiar and common support equipment, and training equipment should not be capitalized as military equipment. Air Force activities (depots and bases) are provided initial spare and repair parts, support equipment, and training equipment to support depot and field-level maintenance of the aircraft and aircrew and maintenance training. These Air Force activities record the authorization for and receipt of initial spares in the Standard Base Supply System. They record the authorization and receipt of support and training equipment in the Air Force Equipment Management System. The Standard Base Supply System and the Air Force Equipment Management System are integrated logistics systems that report asset values as Operating Material and Supplies and General Property, Plant, and Equipment for the Air Force financial statements. Including these costs in either the value of Operating Material and Supplies or General Equipment and in the value of the Military Equipment overstates assets reported in the financial statements.

Contractor Logistics Support

The P&EPO and the Air Force did not reduce the estimated unit costs of the C-130J, F/A-22, and Predator Acquisition Programs for contractor logistics support costs included in the program costs. Contractor logistics support; also referred to as Interim Supply Support or Reengineered Supply Support, Performance-Based Agile Logistics Support, and Integrated Logistics Support; is a method of supporting the aircraft that uses the contractor to provide logistics support and maintenance of the aircraft. For example, under the Performance-Based Agile Logistics Support for the F/A-22 Program, the contractor obtained and provided spares, support equipment, and maintenance of the aircraft as a support service. In the case of the Predator Program, the contractor provided logistics and maintenance support of the aircraft and related components using spares and support equipment provided by the Air Force. In either case, the contractor is providing logistics and maintenance support for the aircraft after the aircraft have been placed in service. Therefore, the contract cost should be treated as operating expenses of the current accounting period and should not be capitalized.

Advance Procurement Funding

The P&EPO and the Air Force did not reduce the estimated unit cost of the C-130J and F/A-22 Acquisition Programs for advance procurement funding provided to the manufacturer to acquire long-lead-time material. For the F/A-22 Acquisition Program, the P&EPO included approximately $459.2 million of advance procurement funding provided in FY 2003 in support of 22 aircraft and $1,575.7 million of advance procurement funding provided during FY 2004 through FY 2006 in support of 77 aircraft. Our review indicated that only 17 of the 22 aircraft for which FY 2003 advance procurement funding was provided were delivered before September 30, 2006. In

[2] Air Force Audit Agency Report No. F2007-0009-FB3000, "Air Force Military Equipment Baseline Valuation," May 29, 2007.

addition, none of the 77 aircraft procured using FY 2004 through FY 2006 advance procurement funding were delivered before September 30, 2006. We estimated that $1,680.1 million of the advance procurement funding was erroneously included in the cost used to develop the estimated unit cost of the F/A-22. As a result, approximately $921.3 million was improperly capitalized as of September 30, 2006. The expenditures of advance procurement funding should have remained as work-in-process until the related aircraft were delivered.

Military Equipment Useful Life

SFFAS No. 6 requires that depreciation expenses be calculated on General Property, Plant, and Equipment over the asset's estimated useful life. It further provides that the estimated useful life consider factors such as physical wear and tear and technological change or obsolescence. The business rule established by the P&EPO provides that DoD Components consider the following factors when determining the useful life of military equipment:

- estimated useful life of the equipment that was used for acquisition planning,
- engineering estimates,
- historical knowledge of an asset's utility or usage, and
- related information on equipment recovery periods.

Miscommunication between the P&EPO and the Air Force program managers caused the estimated useful life of the F/A-22 aircraft to be inaccurate. The Air Force and the P&EPO initially assigned a 20-year useful life to the aircraft. However, the engineering estimate of the useful life for the F/A-22 aircraft was 23.8 years. The engineering estimate was based on the aircraft's design life of 8,000 flying hours and a planned usage of 336 flying hours per year.

The P&EPO "Internal Validation and Verification Report" on military equipment valuation, June 13, 2006, recognized the increased useful life. However, the P&EPO did not revise the depreciation schedule prior to issuing the financial statements for FY 2006. If the depreciation schedule had been revised, the related depreciation expense for FY 2006 would have been reduced by $155.8 million.

Valuation of Military Equipment Modification Programs

The Air Force incurs substantial costs to enhance military equipment after the equipment has been placed in service. Military equipment may be modified to enhance performance or extend the useful life. Typically, performance-enhancing modifications are made as a result of new or improved technologies, changes in mission requirements, or in response to new or modified threats. The FY 2006 President's Budget included approximately $2.2 billion (approximately 18.5 percent of the Aircraft Procurement Appropriation) for modification of in-service aircraft.

DoD Regulation 7000.14-R, volume 4, chapter 6, provides guidance for recognizing improvements to existing General Property, Plant, and Equipment. The Regulation specifies that improvements should be capitalized when the costs of the improvement modify functionality or increase the asset's capability, size, efficiency, or useful life. However, the cost of an improvement should be capitalized only when the cost of the improvement equals or exceeds DoD capitalization threshold. The Regulation also provides that maintenance and repair costs are not considered capital improvements, regardless of whether the cost equals or exceeds DoD capitalization threshold. Maintenance is defined as the work required to preserve and maintain equipment or real property in such condition that it may be effectively used for its designated functional purpose.

Capitalization Threshold

The P&EPO methodology did not exclude modifications that did not equal or exceed the $100,000 capitalization threshold. Six of the 35 F-16 modification programs in the February 2005 "Budget Item Justification" did not exceed the threshold. For example, the advance weapon integration modification involved expenditures totaling $50.9 million for the modification installed in 1,047 F-16 aircraft. The average cost per aircraft, approximately $48,000, did not exceed the capitalization threshold. Accordingly, the modification should not have been capitalized.

Capitalization of Structural Repair Expenditures

The P&EPO erroneously capitalized expenditures for repair of the F-16 aircraft. For the F-16 modification program, the P&EPO used expenditure data from multiple systems to estimate the value reported for the program from May 19, 2004, through September 30, 2006. The P&EPO used expenditures reported in the System Program Office Management Information System as of May 18, 2004, and expenditure data that BEIS extracted from the Air Force accounting system, General Accounting and Finance System-Rehost (GAFS-R). However, the expenditure data included expenditures for modifications that neither extended the useful life nor enhanced the capability of the aircraft. We estimated that expenditures, totaling $339.4 million, were for structural repairs to the aircraft and should not have been capitalized as military equipment.

Rights and Obligations

To evaluate Air Force rights and obligations for the Military Equipment reported in the FY 2006 financial statements, we obtained and reviewed the applicable "Material Inspection and Receiving Report" (receiving report) and equipment inventory records for the C-130J, F/A-22, and Predator Programs. We also reviewed equipment retirement dates recorded for the F-16 Program. We did not attempt to obtain and review receiving reports for the F-16 and T-1A training system programs because aircraft deliveries were substantially completed before SFFAS No. 23 was issued and because the Air Force did not retain the documents.

Receiving Reports

The Air Force did not have procedures and controls to maintain evidence of ownership in a central location to document the acceptance of the military equipment. Air Force Materiel Command personnel responsible for recording receipt and acceptance in the Reliability and Maintainability Information System (REMIS) did not retain the receiving reports for the C-130J, F/A-22, and Predator Programs. REMIS is the Air Force military equipment accountability system. To verify rights and obligations to the equipment, we requested the receiving reports from the Defense Contract Management Agency and Air Force program offices.

The responsible program office provided 184 of the 194 receiving reports for the major components of the Predator Program, and all 53 receiving reports for the C-130J Program. The Defense Contract Management Agency provided receiving reports for the F/A-22 aircraft. The receiving reports provided evidence of Air Force ownership. However, we were not able to obtain the documents within a reasonable time period. For example, it took 26 days for the responsible Defense Contract Management Agency office to provide the requested receiving reports for the 69 F/A-22 aircraft delivered between November 2002 and August 2006. This type of delay could impair the auditor's ability to complete audit tests in a reasonable time in order to render an audit opinion. While the receiving reports confirmed Air Force ownership and rights to the military equipment, the reports also confirmed errors in the military equipment inventory records.

Equipment Inventory Records

Depreciation schedules for the C-130J and F/A-22 aircraft were understated by approximately $46 million because the P&EPO and the Air Force did not have procedures and controls in place to ensure that the military equipment inventory data used in calculating the initial historical cost were accurate. As discussed previously, the Air Force Materiel Command did not retain the receiving reports evidencing the acceptance and ownership of the assets. Personnel responsible for maintaining the equipment inventory records indicated that, in many cases, the acceptance dates were based on e-mails from the activities the aircraft were assigned to.

Our review identified erroneous acceptance dates (capitalization dates) and disposal dates (retirement dates) recorded in REMIS and CAMS-ME. Between February 2005 and September 30, 2006, the Air Force provided the P&EPO revised acceptance dates and recorded receipt of additional aircraft in CAMS-ME. We compared the receipt date in the receiving report to the acceptance dates in REMIS and CAMS-ME as of September 30, 2006. REMIS acceptance dates were incorrect for 28 of the 46 C-130J aircraft, and CAMS-ME dates were incorrect for 5 of the aircraft. The depreciation schedules were also incorrect for three of the aircraft. Although the P&EPO revised the acceptance date in CAMS-ME based on information the Air Force provided, the P&EPO did not revise the depreciation schedules for the three aircraft. The impact of erroneous acceptance dates is illustrated in Table 3.

Table 3. Impact of Erroneous Acceptance Dates (in millions)				
Acquisition Program	Assets Received	Erroneous Acceptance Date	Valuation Impacted by Date Error	Understated Depreciation
C-130 J	53	5	3	$ 6.2
F/A-22	69	7	4	39.8
Total				**$46.0**

The P&EPO used the Group and Composite Methodology to arrive at the military equipment value for the Predator Program. Using this methodology, the P&EPO did not establish equipment inventory records in CAMS-ME or assign costs to individual assets received. Instead, the P&EPO established a single asset record to capture the total cost of the Predator Program. Accordingly, we did not compare the acceptance dates on the applicable receiving reports to the CAMS-ME capitalization date. Instead, we compared the acceptance dates on the receiving reports to those in REMIS. This comparison indicated that the acceptance date in REMIS was incorrect for 29 assets and the acceptance date was in the incorrect fiscal year for 8 assets. Our review also indicated that one ground control station and three Predator aircraft were not recorded in REMIS.

In addition, the controls over the maintenance of CAMS-ME inventory did not ensure that equipment was deleted from the inventory in the accounting period that the assets were retired or removed from service. The P&EPO and the Air Force initially used equipment inventory information recorded in REMIS to establish the CAMS-ME inventory records. Subsequently, the Air Force attempted to adjust the disposal date in CAMS-ME to more accurately reflect the date that aircraft were retired or removed from service. While this action was appropriate, it did not result in accurate inventory records.

Retirement Dates

We reviewed the retirement date used in valuing the F-16 aircraft program. Our limited testing identified 55 aircraft for which the retirement date recorded in CAMS-ME was erroneous. These aircraft were removed from service as early as 5 years before the date recorded in CAMS-ME. The aircraft were either transferred to a school or museum, converted to ground-based maintenance training equipment, reclaimed for parts, transferred to a non-Air Force activity, or destroyed in an accident or during testing prior to the date recorded in CAMS-ME. The erroneous weapon system inventory data caused the F-16 aircraft acquisition value to be overstated by $14.5 million, and the F-16 aircraft modification value to be understated by $4.8 million.

Conclusion

The P&EPO and the Air Force Military Equipment valuation as of September 30, 2006, did not result in reasonable estimates of the initial historical cost of the equipment.

Specifically, procedures and controls the P&EPO and the Air Force used resulted in an Air Force Military Equipment valuation that includes:

- significant costs that should not be capitalized and

- information from inventory records that was not always accurate.

Until corrected, the control deficiencies discussed in this memorandum report will result in more than a remote likelihood that a material misstatement in the Air Force financial statements could occur and not be detected. The deficiencies prevent the Air Force from having assurance that the General Property, Plant, and Equipment balance and disclosures concerning military equipment in its financial statements are reported in accordance with accounting principles generally accepted in the United States. Because of the likelihood of material misstatement, the Air Force must continue to report its material weakness in internal controls for General Property, Plant, and Equipment until it makes the necessary improvements. Air Force managers will not be able to obtain a cost-effective audit of the Air Force financial statements or an individual line item; such as General Property, Plant, and Equipment; until they implement appropriate internal controls.

Appendix A. Scope and Methodology

We conducted this financial-related audit from June 2007 through March 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The P&EPO requested that DoD Office of Inspector General perform procedures to review the military equipment baseline valuation as of September 30, 2006. Officials from both offices discussed and agreed upon objectives for the audit. The agreed-upon objectives included evaluating the reliability of the internal controls over three of the financial statement assertions: valuation, rights and obligations, and completeness of the Military Equipment Program universe. Specifically, we reviewed the reasonableness and reliability of the estimated historical acquisition costs that were developed using numerous sources including budget documents, financial reports, and equipment inventory reports. As part of the audit, we also followed up on relevant problems identified in our prior agreed-upon procedures effort focusing on military equipment.

We limited our audit scope and judgmentally selected and reviewed eight military equipment acquisition and modification programs. The review was not intended to address the existence of the assets represented by reported program values. We also limited our completeness assertion review to the aircraft population for eight of the military equipment acquisition and modification programs versus the entire military equipment universe. We plan to perform additional audit work to complete our evaluation of the completeness of the Military Equipment Program universe.

We met with representatives from the P&EPO; the Office of the Assistant Secretary of the Air Force, Financial Management and Comptroller; the Office of the Assistant Secretary of the Air Force, Acquisition; the Office of the Deputy Chief of Staff Installations and Logistics; and Air Force Materiel Command. We also met with program offices at the Aeronautical Systems Center at Wright Patterson Air Force Base. We identified deficiencies previously reported by DoD Office of the Inspector General and the Air Force Audit Agency, inquired with responsible management officials as to the status of improvements and corrections, and tested controls in place as of September 30, 2006.

Use of Computer-Processed Data

We relied on computer-processed data provided by the P&EPO and its support contractor, public accounting firm Klynveld, Peat, Marwick, and Goerdeler. The Air Force Materiel Command and Aeronautical Systems Center also provided computer-processed data. The program offices extracted data from numerous DoD financial, acquisition, and logistics systems. These systems included CAMS-ME, REMIS, BEIS, GAFS-R, the Commander’s Resource Integration System, the System Program Office

Management Information System, the Mechanization of Contract Administrative Services, and the Central Procurement Accounting System. Specifically, we used the computer-processed data to review program valuation calculations and evaluate supporting documentation adequacy. We did not determine the reliability of the computer-processed data. Not evaluating the controls did not affect the results of the applications of the agreed-upon procedures.

Prior Coverage

During the last 5 years, the Department of Defense Inspector General (DoD IG) and the Air Force Audit Agency have issued three reports discussing the financial reporting of Air Force Military Equipment. Unrestricted DoD IG reports can be accessed at http://www.dodig.mil/audit/reports. Air Force Audit Agency reports can be accessed at http://www.afaa.hq.af.mil.

DoD IG

DoD IG Report No. D-2005-114, "Report on Development of the DoD Baseline for Military Equipment," September 30, 2005

DoD IG Report No. D-2005-112, "Report on the Review of the Development of the DoD Baseline for Military Equipment," September 30, 2005

Air Force

Air Force Audit Agency Report No. F2007-0009-FB3000, "Air Force Military Equipment Baseline Valuation," May 29, 2007

Appendix B. Methodology Used to Calculate the Military Equipment Valuation

The P&EPO developed the estimated historic cost for each of the military equipment acquisition and modification programs. The budgetary and financial data supporting the estimates were different for each weapon system. With the exception of the Predator Program, which was valued using the Group and Composite Methodology, the historic cost was based on average aircraft unit costs developed between July 9, 2003, and February 28, 2005. Use of the average aircraft unit cost enables the P&EPO to remove costs when aircraft are retired or removed from service.

C-130J Aircraft

The P&EPO used budget authority, obligation, and expenditure data reported in the Commander's Resource Integration System as of February 28, 2005, and the planned C-130J deliveries through September 30, 2005, to calculate the average unit cost of the aircraft. The average unit cost was then multiplied by aircraft population as of September 30, 2006, to establish the acquisition value.

C-130J Modifications

The P&EPO calculated the average cost per equipment item that was in service at the end of each fiscal year using expenditure data for each appropriation year. A separate asset record was created for each aircraft for each year. The P&EPO used expenditure data reported in the Commander's Resource Integration System as of February 28, 2005, and expenditure data BEIS extracted from GAFS-R from March 1, 2005, through September 30, 2006.

F-16 Aircraft

The P&EPO used the weapon system program cost reported in the Budget Item Justification (exhibit P-40) to derive program expenditures as of September 30, 1996, and expenditure data reported in the System Program Office Management Information System from October 1, 1997, through May 18, 2004, to establish total program costs. Total program costs were divided by the number of aircraft placed in service to establish the average aircraft cost. The average aircraft cost was then multiplied by aircraft population as of September 30, 2006, to establish the acquisition value.

F-16 Modifications

Prior to FY 2006, the P&EPO calculated the average modification cost for F-16 aircraft in service at the end of the year. The average modification cost was then multiplied by aircraft population as of September 30, 2006, to establish the total value. The P&EPO

used expenditure data reported in the System Program Office Management Information System's Appropriation Status Summary Report as of May 18, 2004, and expenditure data BEIS extracted from GAFS-R from May 19, 2004, through September 30, 2006. The P&EPO erroneously excluded modification costs of $16.8 million from October 1, 2003, to May 18, 2004, from their calculations. For expenditures during FY 2006, the P&EPO established a single asset record under the Group and Composite Methodology based on expenditures BEIS extracted from GAFS-R. Personnel at the Air Force Program Management Office and Office of the Assistant Secretary of the Air Force, Financial Management and Comptroller adjusted the aircraft population data initially extracted from REMIS.

F/A-22 Aircraft

The P&EPO used the forecast total weapon system program cost and aircraft population as of September 30, 2006, as reported in the Budget Item Justification (exhibit P-40), dated February 2005, to calculate the average aircraft cost. The average aircraft cost was then multiplied by aircraft population as of September 30, 2006, to establish the acquisition value.

F/A-22 Modifications

The P&EPO calculated the average modification cost per aircraft that was in service at the end of the fiscal year using expenditure data reported in the System Program Office Management Information System's Status of Appropriations Report as of December 30, 2003, and data BEIS extracted from GAFS-R from December 31, 2003, through September 30, 2006. The aircraft population data were extracted from REMIS.

T-1A Training System

The P&EPO used the expenditure data from the Mechanization of Contract Administrative Services as of June 1, 2004. The expenditure data included both acquisition and modification costs. The T-1A training system aircraft population information recorded in REMIS was used to calculate the average aircraft cost. The average aircraft cost was then multiplied by aircraft population as of September 30, 2006, to establish the acquisition value.

Predator Program

P&EPO computed the value of the Predator Program using the Group and Composite Methodology. Expenditure data for the Predator Program acquisition and system modifications were combined to calculate a single asset value for each fiscal year. The expenditure data were reported in the Central Procurement Accounting System and System Program Office Management Information System reports as of July 9, 2003, and in GAFS-R from July 10, 2003, through September 30, 2006.

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