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Inspector General

United States Department *of* Defense

Memorandum Report on Internal Controls Over the U.S. Special Operations Command Military Equipment Baseline Valuation Effort

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Acronyms and Abbreviations

ASDS	Advanced SEAL Delivery System
CAMS-ME	Capital Asset Management System-Military Equipment
MH	Multi-Mission Helicopter
MK V SOC	Mark V Special Operations Craft
MTPS	Mission Training and Planning Systems
OIG	Office of Inspector General
P&EPO	Property and Equipment Policy Office
SAHRV	Semi-Autonomous Hydrographic Reconnaissance Vehicle
SFFAS	Statement of Federal Financial Accounting Standards
SOCOM	Special Operations Command
SOF	Special Operations Forces

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June 13, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION, TECHNOLOGY, AND LOGISTICS
UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER
COMMANDER, U.S. SPECIAL OPERATIONS COMMAND

SUBJECT: Memorandum Report on Internal Controls Over the U.S. Special Operations Command Military Equipment Baseline Valuation Effort (Report No. D-2008-103)

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. Alice F. Carey at (703) 601-5864 or Ms. Lidet K. Negash at (703) 601-5378. If you desire, we will provide a formal briefing on the results.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
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Report No. D-2008-103 (Project No. D2007-D000FH-0188.000)
June 13, 2008

Results in Brief: Internal Controls Over the U.S. Special Operations Command Military Equipment Baseline Valuation Effort

What We Did

The Property and Equipment Policy Office (P&EPO) in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics requested that the DoD Office of Inspector General conduct audits of the military equipment baseline valuation as of September 30, 2006. The overall objective was to evaluate the reliability of the internal controls over valuation and rights and obligations assertions for the military equipment baseline. The objective also included a limited evaluation of the completeness assertion.[*] This report addresses the P&EPO and Special Operations Command's (SOCOM) internal controls over the SOCOM universe of military equipment. This report is the second in a series. The final report will summarize all findings for the series and recommend corrective actions, as appropriate.

What We Found

The P&EPO and SOCOM internal controls over the valuation, rights and obligations, and completeness of the universe of programs for SOCOM's military equipment baseline were not effective. Specifically, the internal controls did not ensure that the SOCOM military equipment baseline included:

- values based on proper documentation and appropriate methodologies,
- capitalization dates reported in accordance with supporting documentation,
- waivers that were appropriately granted and supported, and
- a complete universe of SOCOM military equipment programs.

As a result, SOCOM cannot ensure the accuracy of the military equipment net book value of $4.5 billion presented in its September 30, 2006, financial statements.

Audit Conclusions

The internal controls over valuation, rights and obligations, and completeness of the universe of programs for the SOCOM September 30, 2006, military equipment baseline did not result in reasonable estimates of the historical costs of the equipment. This report identifies deficiencies in the procedures and controls used. Until the identified internal control deficiencies are corrected, there is a risk that a material misstatement in SOCOM's financial statements could occur and not be detected.

Special Operations Forces C-130

[*] Because of previously identified deficiencies over end item quantities, the P&EPO requested the audit team evaluate only the internal controls over the completeness of the SOCOM universe of programs.

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Introduction

Objectives

The overall objective was to evaluate the methodology used to develop the U.S. Special Operations Command (SOCOM) military equipment baseline valuation as of September 30, 2006. Specifically, we assessed the reliability of the Property and Equipment Policy Office (P&EPO) and SOCOM's internal controls over the valuation, rights and obligations, and completeness of the universe of programs for the military equipment baseline. Appendix B is a glossary of technical terms used in this report.

Background

The P&EPO requested that DoD Office of Inspector General (OIG) perform procedures to review the military equipment baseline valuation as of September 30, 2006. Officials in the P&EPO and DoD OIG agreed that the audit would evaluate the reliability of the internal controls over the valuation and rights and obligations financial statement assertions. The objective also included a limited evaluation of the completeness assertion. Because of previously identified deficiencies over end item quantities, the P&EPO requested the audit team evaluate only the internal controls over the completeness of the SOCOM universe of programs. Headquarters, SOCOM expressed concerns with the DoD OIG conducting an audit because of unresolved issues with the military equipment baseline. Headquarters, SOCOM documented concerns with the military equipment baseline in a December 20, 2006, memorandum titled "Request for Resolution on United States Special Operations Command's Military Equipment Valuation Baseline Assertion Issues." Further, Headquarters, SOCOM identified the valuation of military equipment as a material weakness in FY 2005 through FY 2007. This report is the second in the series of reports discussing the internal controls over the military equipment baseline valuation. This report addresses the P&EPO and SOCOM internal controls over the SOCOM military equipment baseline.

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. On September 30, 2007, the Department reported on its financial statements that Military Equipment had a net book value of $346.3 billion, which is 73 percent of DoD General Property, Plant, and Equipment.

Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards (SFFAS) No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," May 2003, was effective after September 30, 2002. The Standard required that the initial capitalization of military equipment assets, including any major improvements and modifications, be based on historical cost in accordance with the asset recognition provisions of SFFAS No. 6, "Accounting for Property, Plant, and Equipment," June 1996, as amended.

SFFAS No. 23 recognizes that determining historical cost may not be practical for items acquired many years before the date the Standard became effective. Accordingly, the Standard provides that if obtaining 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 historical costs.

DoD Financial Management Regulation

The DoD Financial Management Regulation, volume 4, chapter 6, "Property, Plant, and Equipment," July 2006, requires that the organization capitalize the purchase cost and other costs necessary to bring the asset to an operable condition when acquiring a General Property, Plant, and Equipment asset. The Regulation also requires that the organization calculate and accumulate depreciation expenses using the straight-line method based on the recorded cost, less salvage value, and divided equally among accounting periods during the asset's useful life. 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 over the valuation, rights and obligations, and completeness of the universe of programs for SOCOM military equipment 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. We will provide a copy of this report and the final report to the senior official responsible for internal controls in the P&EPO and Headquarters, SOCOM.

Internal Controls Over the Valuation, Rights and Obligations, and Completeness of the Universe of Programs

The P&EPO and SOCOM internal controls over the valuation, rights and obligations, and completeness of the universe of programs for the SOCOM military equipment baseline were not effective. Specifically, the internal controls did not ensure that the SOCOM military equipment baseline included:

- values based on proper documentation and appropriate methodologies,
- capitalization dates reported in accordance with supporting documentation,
- waivers that were appropriately granted and supported, and
- a complete universe of SOCOM military equipment programs.

As a result, SOCOM cannot ensure the accuracy of the military equipment net book value of $4.5 billion presented in its September 30, 2006, financial statements.

Valuation of Military Equipment Programs

On September 30, 2006, SOCOM reported a universe of 28 military equipment programs and subprograms, with an acquisition value of $8.5 billion, and a net book value of $4.5 billion. However, the P&EPO and SOCOM internal controls did not ensure that valuations were based on appropriate supporting documentation, methodologies, and useful life estimates. Table 1 lists the military equipment value as of September 30, 2006, for the program valuations reviewed.

Table 1. Program Valuations Reviewed
(in millions)

Program Name	Valuation Methodology	Acquisition Value	Net Book Value
Communication Equipment and Electronics	Group and Composite[1]	$ 653.6	$ 325.0
MH-47	Average[2]	753.0	714.8
MTPS	Group and Composite	170.1	164.5
SAHRV Modifications	Average	1.3	0.9
SOF Combatant Craft	Group and Composite	94.9	41.1
SOF C-130	Average	2,839.5	508.6
SOF C-130 Modifications	Average	1,221.8	783.2
Total		**$5,734.2**	**$2,538.1**

MH	Multi-Mission Helicopter
MTPS	Mission Training and Planning Systems
SAHRV	Semi-Autonomous Hydrographic Reconnaissance Vehicle
SOF	Special Operations Forces

[1]The P&EPO used the Group and Composite Methodology when program data were not available at the end item level. Expenditure transactions were accumulated by year and treated as a single asset.
[2] The average cost methodology is defined as calculating an estimated average cost by summing program budgetary data and dividing it by the quantity of end items procured.

Types of Support

SFFAS No. 23 allows the use of estimated historical costs. The P&EPO used budgetary documents and system data to support the SFFAS No. 23 requirement to capitalize military equipment based on historical cost. However, the P&EPO did not always use the best available information.

Budgetary Documents

The P&EPO generally used budgetary documents to support the values of military equipment acquired before October 1, 2002. Although SFFAS No. 23 provides for the use of budgetary documents, the P&EPO did not always ensure that it used the best available budgetary document to support acquisition values. For example, the P&EPO used a February 2000 Budget Item Justification Sheet to support the SOF Combatant Craft estimated expenditures of $18.6 million for FY 2000. However, the February 2002 Budget Item Justification Sheet identified that estimated expenditures for FY 2000 had decreased to $12.4 million. As a result, the value assigned to this program was overstated by $6.2 million.

System Data

The P&EPO used data from financial systems to support the historical cost of the SOCOM military equipment programs. However, using data from those systems did not ensure that the resulting valuations were accurate and consistent with primary source documents. The Government Accountability Office and DoD OIG have issued reports that question the accuracy of DoD financial system data. In addition, the FY 2007 DoD Agency Financial Report included the following statement:

> Many of the Department’s legacy systems do not comply with the wide range of requirements for systems compliance and, therefore, do not provide the necessary assurances to rely on information contained in either the legacy (source) system or those systems that were fed information from the legacy systems.

Consequently, accepting financial system data without further verification compromises the reliability of SOCOM’s program valuations.

Support for Valuations

The P&EPO did not ensure that the SOF C-130, SOF C-130 Modifications, MH-47, and MTPS[3] Programs were valued based on the appropriate supporting documents.

SOF C-130

The P&EPO included $1,175 million in budgetary expenditures in the SOF C-130 valuation. However, the P&EPO provided documentation that indicated it should have reported $949 million of the budgetary expenditures under the SOF C-130 Modifications Program. The P&EPO provided no support for the remaining $226 million. Additionally,

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[3] On January 24, 2007, the Director, Acquisition Resources and Analysis changed the definition of military equipment to exclude training systems. Therefore, the P&EPO and SOCOM granted the MTPS program a waiver on March 7, 2007. However, we have included it in this report as an example of a potential systemic issue.

the P&EPO incorrectly calculated the average cost for the SOF C-130 Program. Specifically, supporting documentation indicated that the average cost computation:

- included a miscalculation that resulted in a $117 million error in the total estimated cost,
- excluded an EC-130J[4] end item in the calculation, and
- used an overstated acquisition cost for the C-130J[5] to calculate the residual value of the EC-130J.

SOF C-130 Modifications

The P&EPO recorded an unsupported manual adjustment valued at $407 million. In addition, as stated previously, the SOF C-130 Modifications Program excluded $949 million in budgetary expenditures. As a result, the P&EPO understated the value reported for the SOF C-130 Modifications Program by $542 million.

MH-47

The P&EPO recorded an unsupported manual adjustment valued at $305 million. However, the P&EPO provided documentation that indicated it should have reported $269 million in additional budgetary expenditures. Additionally, the P&EPO included $146 million in duplicate expenditure transactions in the valuation. As a result, the P&EPO overstated the value reported for the MH-47 Program by $182 million.

MTPS

The P&EPO overstated the value reported for the MTPS Program by $2 million. It recorded expenditures for FY 2002 that did not correspond to the supporting documentation.

Group and Composite Methodology

Although SFFAS No. 23 allows the use of the Group and Composite Methodology, the methodology the P&EPO used did not always provide reliable values for group and composite expenditures. If expenditures could be applied to an end item, the P&EPO would capitalize expenditures at the asset level. Otherwise, in accordance with the Group and Composite Methodology the P&EPO would capitalize the expenditures for each fiscal year as a single asset. The use of this methodology increased the likelihood that expenditures may have been capitalized in a different period than the asset was actually placed into service. As a result, expenditures may be inaccurately reported on the financial statement.

Specifically, the methodology that the P&EPO used did not ensure that valuations were accurate for the MTPS and the Communication Equipment and Electronics Programs.

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[4] SOF C-130 valuation should include all SOCOM variants of the C-130, such as the EC-130J.
[5] The Air Force C-130J program was reviewed during the audit of Internal Controls Over the Air Force Military Equipment Baseline Valuation Effort.

MTPS

The P&EPO could not provide support for the fiscal years used to calculate the net book value for the MTPS Program. It used a budgetary document that identified a cumulative amount of $25.1 million for years before FY 1998. Then, using FY 2006 as the base year and a 15-year useful life estimate, the P&EPO determined that expenditures might have begun in FY 1992. It evenly allocated the $25.1 million over FY 1992 through FY 1997. However, the MTPS Program may not have incurred those costs in FY 1992 through FY 1997 or in identical amounts.

Additionally, the Group and Composite Methodology required capitalizing the expenditures for each fiscal year as a single asset. However, the P&EPO used a single capitalization date of September 30, 2006, for all acquisition costs even though its supporting documentation indicated 99 percent of the costs were incurred before FY 2006. The MTPS Program net book value only recorded 6 months of depreciation, even though expenditures may have occurred as far back as FY 1992. As a result, the MTPS accumulated depreciation and net book value may be understated or overstated.

Communication Equipment and Electronics

For group and composite programs, the P&EPO generally applied a weighted average useful life estimate that did not represent the entire program. For example, the Communication Equipment and Electronics Program valuation included 13 subprograms. The P&EPO and SOCOM granted waivers[6] for nine of those subprograms that did not meet the criteria for valuation. Using the weighted average of the remaining four subprograms that met the criteria for valuation, SOCOM calculated an estimated useful life of 7.65 years. However, system limitations required the P&EPO to report the value of all group and composite subprograms, even if they did not meet the criteria for valuation. Consequently, the reported value for the Communication Equipment and Electronics Program included all 13 subprograms, but used an estimated useful life based on only 4 subprograms. Without including all subprograms, the useful life estimate does not accurately represent the life of the 13 subprograms included in the program valuation. As a result, the value of the program was overstated on September 30, 2006.

Contract Closeout Methodology

The P&EPO created a business rule for handling programs that were in contract closeout. The methodology for this business rule required the P&EPO to:

- capitalize material adjustments across all program end items or as a separate item (dummy asset) and
- expense immaterial adjustments.

The P&EPO did not always properly apply the contract closeout methodology. For the MH-47 Program, the P&EPO created a dummy asset to report $640 million (85 percent of the total acquisition costs). The P&EPO created the dummy asset because revisions to

[6] Programs that did not meet the criteria for valuation were granted temporary or permanent waivers.

the MH-47 valuation affected their ability to allocate expenditures across all end items. The P&EPO should have allocated the $640 million across the program end items.

Useful Life Estimates

SFFAS No. 6 requires that depreciation expenses on General, Property, Plant, and Equipment be allocated across the asset's estimated useful life. It further requires that the estimated useful life consider factors such as physical wear and tear and technological change or obsolescence.

The P&EPO business rule on modifications, modernizations, upgrades, and improvements stated that the cost of modifications that enhance or improve the capacity of an end item, but do not extend its useful life, should be capitalized by:

- adding the modification cost to the end item's net book value and depreciating the resulting cost over the remaining useful life of the end item or
- capitalizing the modification as a separate item and depreciating the modification over the lesser of the life of the modification or the remaining useful life of the end item.

The P&EPO did not always properly apply the business rule. For the SAHRV Modification Program, the SOCOM Program Office useful life memorandum stated that the modification did not extend the useful life, and that the effective life of the modification was equal to the remaining useful life of the SAHRV parent program. In accordance with its business rule, the P&EPO should have depreciated the resulting cost of the modification over the remaining useful life of each end item. However, the P&EPO calculated the SAHRV Modification Program baseline valuation based on a useful life estimate of 6 years. As a result, the net book value may be overstated.

Rights and Obligations

SFFAS No. 6 states that property, plant, and equipment should be recognized when the title passes to the acquiring entity or when the property, plant, and equipment item was delivered to the entity or an agent of the entity. Constructed property, plant, and equipment should be recorded as work in process until it is placed in service, at which time the balance should be transferred to General Property, Plant, and Equipment. Additionally, the P&EPO business rule on the capitalization date stated that the date in the DD-250, Material Inspection and Receiving Report, block 22 "Receiver's Use," would be used to establish the end item acquisition date.

The Group and Composite Methodology the P&EPO used did not allow for the testing of the rights and obligations assertion. The Group and Composite Methodology reported expenditures by fiscal year as a single asset, rather than reporting expenditures by end item. Further, SOCOM explained that it had only compiled the rights and obligations documentation for the group and composite subprograms that met the criteria for valuing military equipment. However, the value reported for some group and composite programs included assets that did not meet the criteria for valuing military equipment.

To test the rights and obligations assertion, we conducted a limited review of a sample of average cost programs. SOCOM provided documentation to support the capitalization date for a judgmental sample of 22 end items. However, the P&EPO and SOCOM internal controls did not ensure that the baseline accurately reported the capitalization date for seven of those end items. The variance between the supporting documentation and the date reported in the baseline ranged from 1 to 43 days. Errors that crossed fiscal years may have a financial impact on the values reported in the baseline. For example, for the MH-47 Program, end item number 9200470, the Capital Asset Management System-Military Equipment (CAMS-ME) reported a capitalization date of September 30, 1994; however, the supporting documentation identified a capitalization date of October 7, 1994. Because the variance between CAMS-ME and the supporting documentation crossed fiscal years, the net book value may have been overstated for the MH-47 Program. Table 2 identifies the specific sampled end items that SOCOM did not correctly report in the baseline.

Table 2. Capitalization Date Errors

Program Name	End Item #	Variance	Crosses FY
MK V SOC	953	1 day	No
ASDS	Not Applicable	3 days	No
MH-47	2160	3 days	No
MH-47	9200470	7 days	Yes
MH-47	503760	14 days	No
SOF C-130	6300009817	43 days	No
SOF C-130	100001935	1 day	No

ASDS Advanced SEAL Delivery System
MK V SOC Mark V Special Operations Craft

Completeness of the Universe of Programs

The P&EPO provided a universe that included 50 programs and subprograms for SOCOM. The P&EPO valued 28 of those 50 programs and subprograms, and the P&EPO and SOCOM granted waivers for the remaining 22 programs and subprograms that did not meet the criteria for valuation. However, the internal controls did not ensure that the SOCOM military equipment baseline included:

- properly prepared and supported waivers and
- all appropriate programs in the universe.

Waivers

The internal controls over program completeness did not ensure that SOCOM and the P&EPO appropriately granted and supported waivers for 8 of the 22 programs and subprograms. Specifically, the P&EPO and SOCOM inappropriately granted waivers for two programs: the Forward Area Manifold Cart and Raven Unmanned Aircraft System. The P&EPO should have prepared valuations for the programs.

Forward Area Manifold Cart

The P&EPO and SOCOM granted the Forward Area Manifold Cart Program an "Other" waiver. The Forward Area Manifold Cart Program is SOCOM military equipment. The P&EPO and SOCOM granted a waiver to avoid duplicate reporting of the Forward Area Manifold Cart Program because the Air Force reports the program as general equipment.

Raven Unmanned Aircraft System

The P&EPO and SOCOM granted the Raven Unmanned Aircraft System a "Price" waiver. Each Raven Unmanned Aircraft System is composed of three aircraft systems, one ground control unit, one remote video terminal, and a field repair kit. The P&EPO and SOCOM granted the waiver because each component of the program was below the $100,000 military equipment capitalization threshold. However, the P&EPO position paper on "Componentization" defines the combination of distinguishable parts as a functional unit. The position paper states that the Department should generally capitalize the full cost of a functional unit. Further, it states that Military Department management may capitalize subparts of functional units as components when:

- the subpart is acquired through a separate acquisition program,
- the estimated cost of the subpart is significant in relation to the estimated total cost of the end item, and
- the estimated useful life of the subpart differs significantly from the estimated useful life of the end item.

SOCOM acquired the Raven Unmanned Aircraft System as a program, with a unit price of $168,000, which is over the military equipment capitalization threshold. As a result, the P&EPO should have prepared a valuation for the Raven Unmanned Aircraft System.

In addition, the P&EPO did not include adequate documentation to allow an independent assessment of the waivers for six programs: Collateral Equipment, Pointer, Special Operations Forces Laser Marker, Integrated Survey Program, Rucksack Portable Unmanned Aircraft System, and Neptune. SOCOM provided us with additional documentation to clarify and support the granted waivers. However, the P&EPO should have ensured that proper documentation was available before determining that the waivers were appropriate.

Universe of SOCOM Programs

The SOCOM program universe did not include 86 programs. The Marine Corps Forces Special Operations Command became a Component of SOCOM in February 2006. However, the SOCOM baseline program universe did not report the 84 Marine Corps Forces Special Operations Command programs because it only reported programs procured with SOCOM Major Force Program-11 funds. As noted in the December 20, 2006, memorandum, the SOCOM military equipment baseline did not comply with preponderance of use requirements. Instead, the P&EPO reported those programs as part of the Marine Corps baseline universe. For the 84 Marine Corps Forces Special Operations Command programs, the Marine Corps granted waivers for 81 programs, and the P&EPO valued 3 programs at approximately $40 million.

The baseline program universe also did not include a waiver or valuation to support two SOCOM programs. According to the Unmanned Aerial Vehicles Program Office, the universe should have included the Medium Altitude Long Endurance Tactical, valued at approximately $6 million, and the Aqua Puma program, valued at approximately $3.5 million.

Conclusion

The P&EPO and SOCOM internal controls over valuation, rights and obligations, and completeness of the universe of programs for the $4.5 billion presented in the September 30, 2006, financial statements did not result in reasonable estimates of the historical cost of military equipment. Specifically, the P&EPO and SOCOM procedures and controls did not ensure that the SOCOM military equipment program valuations were appropriate and supportable. The procedures and controls prevent SOCOM 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 generally accepted accounting principles. Until the identified internal control deficiencies are corrected, SOCOM risks that a material misstatement in its financial statements could occur and not be detected. Consequently, SOCOM will not be able to obtain a cost-effective audit of its financial statements or an individual line item, such as General Property, Plant, and Equipment, until they implement effective internal controls.

Appendix A. Scope and Methodology

We conducted this financial-related audit from May 2007 through April 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 the DoD OIG conduct an audit to assess the reliability of the internal controls over valuation, rights and obligations, and completeness of the universe of programs for SOCOM's military equipment baseline. Headquarters, SOCOM identified concerns with conducting an audit on the military equipment baseline because of outstanding issues, which SOCOM discusses in the December 20, 2006, memorandum titled "Request for Resolution on United States Special Operations Command's Military Equipment Valuation Baseline Assertion Issues." The memorandum identified concerns that the military equipment baseline did not comply with preponderant use requirements and that the baseline excluded classified programs.[*] The memorandum also stated that SOCOM could not assert to the accuracy of military equipment valuation until the issuance of improved guidance for group and composite and modification programs and accreditation of CAMS-ME.

The P&EPO had SOCOM attest to the completeness of the FY 2006 military equipment universe and the program valuation data. Based on SOCOM's attestation, the P&EPO adjustments to the baseline had a $1.5 billion net change in the first quarter FY 2007 financial statements acquisition value.

We performed our review at the P&EPO and Headquarters, SOCOM in Tampa, Florida. We analyzed and reviewed supporting documentation to assess the internal controls over the military equipment baseline valuation effort. The SOCOM universe included 50 programs and subprograms. The P&EPO valued 28 of those 50 programs and subprograms, and the P&EPO and SOCOM waived the remaining 22. As of September 30, 2006, the 28 military equipment programs and subprograms had an acquisition value of $8.5 billion, and a net book value of $4.5 billion. The Quantitative Methods Directorate generated a probability proportional to size sample of 10 programs that had a net book value of approximately $3.4 billion. After reviewing the preliminary documentation to support the valuation, rights and obligations, and completeness of the universe of programs, we determined that the internal controls over military equipment were not effective. As a result, we judgmentally selected a sample of nine programs to conduct a limited internal control review over the valuations, rights and obligations, or both. The nine programs represented $2.9 billion of the $4.5 billion reported as SOCOM military equipment in FY 2006. Because we identified internal control weaknesses that

[*] The Special Access Programs Office, Acquisition, Technology, and Logistics will conduct the valuations for classified military equipment programs.

substantiated Headquarters, SOCOM's concerns with its military equipment baseline, we did not complete all planned audit steps. The table shows the programs that were used to review the internal controls over valuations, rights and obligations, or both.

Program Sample
(in millions)

Program Name	Valuation Methodology	Acquisition Value	Net Book Value
ASDS	Average	$415.1	$367.1
Communication Equipment and Electronics	Group and Composite	653.6	325.0
MH-47	Average	753.0	714.8
MK V SOC	Average	132.5	49.5
MTPS	Group and Composite	170.1	164.5
SAHRV Modifications	Average	1.3	0.9
SOF Combatant Craft	Group and Composite	94.9	41.1
SOF C-130	Average	2,839.5	508.6
SOF C-130 Modifications	Average	1,221.8	783.2
Total		**$6,281.8**	**$2,954.7**

Use of Computer-Processed Data

To achieve the audit objective, the P&EPO and SOCOM provided computer-processed data extracted from numerous DoD financial systems to evaluate program valuations. These systems included the General Accounting and Finance System-Rehost, the Standard Accounting and Reporting System, the Standard Operation and Maintenance Army Research and Development System, the SOCOM Financial Information System, and CAMS-ME. We did not perform a reliability assessment of the computer-processed data. Not evaluating the controls did not affect the results of the audit because our audit was over the internal controls over the SOCOM military equipment baseline valuation effort.

Use of Technical Assistance

The Quantitative Methods Directorate of the DoD OIG provided assistance for the audit.

Prior Coverage

During the last 5 years, the DoD IG has issued two reports addressing the SOCOM military equipment baseline. Unrestricted DoD IG reports can be accessed at http://www.dodig.mil/audit/reports.

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

Appendix B. Glossary of Technical Terms

Average Cost Methodology. The average cost methodology calculates asset values by summing program budgetary data and dividing it by the quantity of items procured to yield an estimated average cost per end item at the program level.

CAMS-ME. CAMS-ME is the information technology system that was developed to maintain and update military equipment valuation data. CAMS-ME supports the DoD Enterprise Transition Plan.

Capitalization Criteria. All General Property, Plant, and Equipment designated as military equipment and meeting certain criteria must be capitalized. The criteria are: (1) has useful life of 2 or more years, (2) is not intended for sale, and (3) exceeds capitalization threshold (in DoD, that threshold is $100,000 or $50,000 for self-propelled vehicles).

End Item. Final combinations of component parts or materials that are ready for its intended use (for example, ship, tank, aircraft, and mobile machine shop).

Group and Composite Methodology. The Group and Composite Methodology was used when program data were not available at the end item level. The Group and Composite Methodology was applied when: some of the assets being acquired had a unit cost in excess of the capitalization threshold; costs could not be directly associated with specific assets; and no single item was significant enough to serve as a surrogate for the entire program. Expenditure transactions were accumulated by year at the program level and treated as a single asset.

Military Equipment.[*] Military equipment consists of tangible assets that meet the following criteria: (1) have an estimated useful life of 2 or more years, (2) are not intended for sale, and (3) are intended to be used or available for use in the performance of military missions to include equipment used in training.

Waiver. Programs that did not meet the criteria for valuation were granted temporary or permanent waivers. The P&EPO granted temporary waivers to programs that were using research and development funding but were expected to receive procurement funding in the future. Permanent waivers included:

- Classified Waiver: Classified programs were not valued.
- Deactivated Waiver: Program end items were fully deactivated by June 30, 2006.
- Entity Waiver: End items produced will be reported by another entity because of funding or preponderance of use requirements.

[*] This definition was applicable during the military equipment baseline valuation effort; however, on January 24, 2007, the Director, Acquisition Resources and Analysis changed the definition to exclude equipment used in training.

- Foreign Military Status Waiver: Program is intended for foreign military sales.
- Net Book Value Waiver: Program is fully depreciated and the net book value is zero.
- Other Waiver: Program is a study program; in perpetual research, development, test, and evaluation; or the end item is not considered military equipment.
- Price Waiver: Program where the cost per end item is less than the capitalization threshold of $100,000 ($50,000 for self-propelled vehicles).
- Real Property Waiver: Program is considered real property according to SFFAS No. 6.
- Software Waiver: Software integrated into weapons systems is capitalized as part of the cost of the related military equipment program. Internal use software is reported as General Property, Plant, and Equipment.

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