



OFFICE OF THE SECRETARY OF DEFENSE  
WASHINGTON, DC 20301



NOV - 8 2005

MEMORANDUM FOR UNDER SECRETARY OF THE ARMY  
UNDER SECRETARY OF THE NAVY  
UNDER SECRETARY OF THE AIR FORCE  
DIRECTOR, DEFENSE LOGISTICS AGENCY

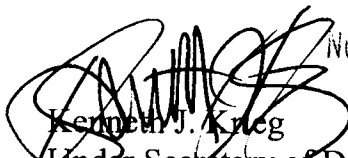
SUBJECT: Baseline Valuation and Certification for Department of Defense (DoD)  
Inventory and Operating Materials and Supplies

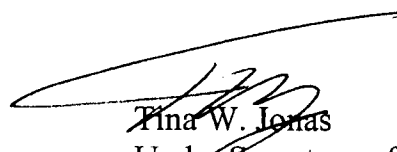
The Under Secretary of Defense (Comptroller) (OUSD(C)) established an Inventory and Operating Materials and Supplies (I&OM&S) Working Group with representatives from the OUSD(C), the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics), the DoD Military Components, and the Office of the Inspector General, DoD. The Working Group reviewed valuation methodologies and criteria and determined which ones would lead to an auditable historical I&OM&S baseline cost for the more than \$200 billion reported in DoD's financial statements.

The Deputy Chief Financial Officer issued a memorandum, dated July 6, 2001, directing the use of moving average cost as the approved historical cost method for DoD. There are several ongoing initiatives to modify existing systems or migrate to commercial systems to calculate historical cost and one of the most critical elements to achieving success is to determine and establish the initial baseline value for on-hand inventories.

Attachments 1 through 3 provide summary and general criteria for addressing I&OM&S baseline valuations, to include the proof-of-principle valuation methods report developed by the Working Group. Attachment 4 summarizes I&OM&S systems that are currently capable of computing moving average cost or are in the process of being implemented at scheduled Component activities. Attachment 5 is the required baseline certification template which must be completed in accordance with the policies stated in Attachments 1 through 3.

If you have questions, you may contact Mr. Wayne Hudson at (703) 697-8281 or by e-mail at wayne.hudson@osd.mil.

  
Kenneth J. Krieger  
Under Secretary of Defense  
(Acquisition, Technology and Logistics)

  
Tina W. Jonas  
Under Secretary of Defense  
(Comptroller)

Attachments:  
As stated



## Policies and Requirements

- All DoD Components and activities reporting material amounts of I&OM&S on their audited financial statements must take action to establish historical moving average cost (MAC) baseline valuations in line with a process that parallels Attachments 2 and 3, verify the physical existence of quantities used in baseline computations, and certify the work completed and the values computed as outlined in Attachment 5.
- All Components and activities must integrate the baselining procedures within their long range plans to provide I&OM&S line item assertions - and within their Enterprise Resource Planning tools or other systems design schedules to compute and maintain moving average cost.
- Components and activities may not continue to convert baseline valuations from one non-compliant value to another non-compliant value, e.g., from latest acquisition cost (LAC) to LAC without completing a reasonable and exhaustive baselining process.

In addition, Attachment 4 lists I&OM&S systems which can currently compute moving average cost, or are in the process of being implemented with or migrated to MAC functionality. Some systems include conversions which have already taken place, but which did not establish acceptable or auditable baselines. These systems represent the first priority for acceptable baseline conversions since they should provide the capability to sustain MAC values. Systems which have been converted from LAC to LAC must be rebaselined as the most immediate priority.

Systems which cannot currently maintain MAC, or which will not have MAC functionality in the near future, represent potential risk and cost in terms of baseline sustainment. For these systems, or for these categories of I&OM&S, addressees should consider possible sustainment alternatives and costs in their action plans. Alternatives may include parallel automated software applications or personal computer based off-line systems. In some instances, where there is a low volume of procurements and issues such as high-dollar, low transactions items, manual based sustainment may be possible. Sustainment alternatives and plans may also be impacted by the potential length of time required for maintenance.

Addressees should review the Attachments to this memorandum and the policies stated above and provide this office with your Plan of Action and Milestones for conducting baseline valuations for all material I&OM&S systems and for your I&OM&S financial statement line item values. Your plans should consider the requirement to:

- Follow the attached baselining process prior to or in conjunction with all MAC systems conversions.

- Include the process as a part of your Financial Improvement Business Rules for corrective actions, validations, and assertions.
- Take priority action to perform baseline valuations for those systems addressed in Attachment 4 and to re-baseline those systems that were not originally converted in accordance with this policy.
- Determine baseline sustainment alternatives and estimated costs for systems which cannot maintain moving average cost as discussed above.
- Provide evidence and your certification of supported and estimated values, to include verification of the physical existence of quantities used, as outlined in Attachment 2 and in Attachment 5. Baseline certifications must be signed by addressees' Assistant Secretaries or Deputy Assistant Secretaries for Financial Management or Component Comptrollers or Deputy Comptrollers.

## **Critical Steps for Inventory and Operating Materials & Supplies** **Baseline Valuation**

Verification of Physical Existence of Quantities. The following baseline valuation steps are primarily predicated on an iterative and information gathering process utilizing data in stock control, logistics, and inventory accounting systems which support and maintain reportable on-hand quantities for Inventories and Operating Materials and Supplies (I&OM&S). However, in order for baseline valuations to have audit creditability, quantities used in the baseline valuation process must be verifiable to actual physical existence. The actual physical existence and verification of quantities should be performed at the beginning stage of the process, e.g., in conjunction with or after Steps 1 or 2. Early verification is necessary in order to preclude the potential for expending significant resources going to the end of the process utilizing unsupported quantities.

Step 1 - Review all managed or held I&OM&S items with National Stock Numbers, Manufacture's Part Numbers or other identifying item numbers in supporting I&OM&S stock/logistics systems. Determine items which have quantities reported as "on-hand" by the supporting system(s). Verify the accuracy and integrity of supporting systems that compute and maintain quantities. Establish a workable database for all items being baselined which had reported on-hand quantities.

Step 2 - Determine and include in the database all available acquisition histories related to items being baselined which had reported on-hand quantities. (Acquisition history includes information and data elements in supporting logistics or management systems indicating procurement action, such as last representative buy quantity and price.)

Step 3 - Determine initial baseline historical values for those items with reported on-hand quantities using quantities for the most recent acquisition histories. Use the next most recent acquisition data (and etc.) until all reported on-hand quantities being baselined have been identified to an initial historical baseline value.

Step 4 - Validate reported on-hand quantities with acquisition histories to supporting source documentation, e.g., hardcopy contracts, contract data repositories, contract data databases, or other supporting documentation such as delivery orders, purchase orders, and receipt documentation.

Step 5 - Validate reported on-hand quantities with acquisition histories, but with no supporting contract information, to corroborative information such as commercial sources (for example, the IHS Corporation Federal Logistics Information System HAYSTACK web-based database or other commercial pricing sources) or other similar and multiple acquisition histories (e.g., with similar dollar values).

Step 6 - For reported on-hand quantities with acquisition histories, but no supporting contract information and no acceptable corroborative information, determine the availability of corroborative information for like items (for example, items classified as interchangeable items and substitutable items).

Step 7 - For reported on-hand quantities with no acquisition histories and no supporting contract information or corroborative information, determine alternative corroborative correlations, e.g., standard price (less surcharges) comparisons to commercial price catalogs.

Step 8 - For reported on-hand quantities with no acquisition histories and no supporting contract information or corroborative or alternative corroborative information, determine values of like items as defined by item managers. Use values for like items when like items have supporting documentation or corroborative information.

Step 9 - For reported on-hand quantities with no acquisition histories and no acceptable supporting contract or corroborative information, determine actual repair costs incurred for on-hand quantities with repair histories as alternative corroborative information or as an alternative item valuation. Validate repair costs to supporting documentation for repair costs, e.g., depot maintenance work orders and commercial repair contracts.

Step 10 - For reported on-hand repairable item quantities found in Step 9 above (with no acquisition histories and no procurement or corroborative information) that cannot be corroborated to repair cost, use systems repair data as the alternative baseline valuation.

Step 11 - Determine the materiality to the financial statements of any reported on-hand quantities which have not been assigned a supportable or corroborative baseline value subsequent to completion of Steps 1 through 10. (In general, if materiality relative to the total financial statement values is not significant, use the current catalog price for Step 11 items minus surcharges.)

Step 12 - Assess the demand history or the probability of items being sold or issued for use. Items which have no demand history, support obsolete and retired weapons systems, or which have an otherwise remote chance of sale or issue should be baselined to a net realizable value unless item managers can provide reasonable evidence to the contrary.

Step 13 - For items which represent material values, and which will potentially have continued demand, determine alternative valuations for any items not valued subsequent to Steps 1 through 12. Alternative valuations include information based on expertise of item managers, Program Management Offices, budget programs for items in question, cost or engineering estimates, price deflators, or alternative data bases. All alternative baseline valuations should be documented for audit purposes.