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Chief Review Services Chef - Service d'examen

CRS  CS Ex



Audit of Inventory Pricing

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LIST OF ACRONYMS

ADM(Fin CS)	Assistant Deputy Minister (Finance and Corporate Services)
ADM(Mat)	Assistant Deputy Minister (Materiel)
BSD	Business Solution Design
CAEL	Capital Asset Exclusion List
CFSD	Canadian Forces Supply Depot
CFSS	Canadian Forces Supply System
CRS	Chief Review Services
DFA	Director Financial Accounting
DG Fin Ops	Director General Financial Operations
DGMSSC	Director General Materiel Systems and Supply Chain
DMG Compt	Director Materiel Group Comptrollership
DMIS	Director Materiel Information Systems
DMPP	Director Materiel Policy and Procedures
DND	Department of National Defence
DRP	Distribution Resource Planning
DSCO	Director Supply Chain Operations
EPM	Equipment Program Management
ERP	Enterprise Resource Planning
FAR	Financial Accounting and Reporting
FMAS	Financial Managerial Accounting System
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GL	General Ledger
LCMM	Life Cycle Materiel Manager
MASIS	Materiel Acquisition and Support Information System
PO	Purchase Order
RFC	Request For Change
RIM	Repairable Inventory Management
SOH	Stock On Hand
TB	Treasury Board
WMA	Weighted Moving Average



RESULTS IN BRIEF

Chief Review Services (CRS) conducted an audit of consumable inventory pricing to: assess the reasonableness of the consumable inventory valuation methodology; determine the effectiveness of inventory policies, procedures and controls; and verify the accuracy and completeness of the reported consumable inventory value in the departmental financial statements.

Department of National Defence (DND) inventories were reported at \$4.96 billion in fiscal year (FY) 2005/06, which represented 84 percent of government inventory holdings and 15 percent of the total departmental assets reported in DND's published financial statements. The audit examined consumable inventory holdings recorded in the Canadian Forces Supply System (CFSS) for FY 2005/06—representing \$2.86 billion (57 percent) of the reported¹ \$4.96 billion inventory.

Overall Assessment

Consumable inventory system and financial controls require significant improvement before a controls-reliant audit of consumable inventory can be undertaken.

Currently, inventory system controls and reporting processes are insufficient to ensure the integrity and accuracy of reported values.

Designing and implementing a framework for inventory recording and reporting that will withstand the audit of departmental financial statements will require:

- The Assistant Deputy Minister (Materiel) (ADM(Mat)) and the Assistant Deputy Minister (Finance and Corporate Services) (ADM(Fin CS)) organizations to share expertise and knowledge in order to effectively address some of the recommendations made in this report; and
- ADM(Mat) to adjust its business practices so that both material management and financial reporting requirements are attained. This will require a greater emphasis on the importance of data integrity and accuracy for reporting purposes.

The resultant efficiencies will not only ensure more accurate financial statement reporting, they should support more effective and efficient use of resources for decision making.

Findings and Recommendations

Systems Controls and Monitoring. There are insufficient CFSS inventory pricing controls and monitoring activities to ensure the accuracy and integrity of original pricing entries or any subsequent adjustments.

It is recommended that controls be built into the CFSS to improve data accuracy and reliability. Additionally, the ability to modify district level prices should either be centralized or the system should generate price change reports so that price changes can be approved or reversed as required.

¹ Ammunition reported as inventory includes repairable ammunition and stock found in supply customer accounts until the ammunition is actually used.



Reporting Accuracy. There is no stand-alone comprehensive documentation that fully describes all aspects of the complex, semi-automated process to roll up inventory data into a one-line inventory balance on the financial statements.

The process and procedures used to roll up the inventory balance should be completely documented and maintained up to date to ensure the end-to-end methodology is accurate, replicable and auditable.

Valuation Methodology. While policy states that consumable inventory is to be valued at a weighted moving average (WMA) price, due to the extremely low turnover of DND consumable inventory, the majority of consumable items continue to be priced at the global price they were allocated at the time of the opening balance exercise in 2002.

It is recommended that a review of consumable inventory items still valued at the original global price be conducted in order to determine whether or not obsolescence is truly an issue that would require a restatement of inventory value.

Note: For a more detailed list of CRS recommendations and management response please refer to [Annex A](#)—Management Action Plan.



INTRODUCTION

In accordance with the CRS Work Plan, an audit of consumable inventory pricing was conducted. The requirement for this audit was identified during a CRS survey conducted to identify and prioritize potentially high-risk accrual accounting issues in DND.

Background

In April 2001 the Government of Canada implemented the Financial Information Strategy, thereby changing its basis of accounting for financial and management reporting purposes from modified accrual to full accrual. The objective was to promote enhanced decision-making and accountability, and to improve organizational performance through the strategic use of financial information. One of the more significant financial reporting adjustments was the requirement to report the value of non-financial, tangible assets, such as inventory, in the financial statements. In FY 2005/06 DND inventory was reported at \$4.96 billion—representing 84 percent of government inventory holdings and 15 percent of DND's total reported assets. As such, due to its materiality, DND inventory has been highly scrutinized by both internal and external stakeholders.

To meet the new financial reporting requirements, significant changes in departmental accounting practices began to be implemented in FY 2002/03. To better reflect usage, repairable items reported at \$5 billion were re-classified from inventory to capital assets, and \$0.5 billion of contractor-held inventories not accounted for in the CFSS was reported and recognized for the first time. In November 2002, the majority of consumable inventory began to be valued using a WMA price methodology. The WMA methodology is an alternative to the global price, which was based primarily on the Canadian government catalog of materiel, and was used to determine the inventory balance in 2002.

Objectives

The overall objective for the audit was to determine whether the methodology used to value and report the Department's consumable inventory balance generates information that is relevant and reliable for financial reporting purposes. Specifically, the intent of the audit was to:

- Assess the reasonableness of the consumable inventory valuation methodology;
- Determine the effectiveness of inventory policies, procedures and controls in place; and
- Verify the accuracy and completeness of the reported consumable inventory value.

Please refer to [Annex B](#) for a listing of the criteria used to assess the objectives.



Scope

DND-reported inventory includes items such as non-repairable spares, uniforms and clothing, equipment (e.g., communications, electronic, electrical, office, machine tools, medical), bulk fuel, and ammunition (including bombs and missiles).

- The audit examined consumable inventory holdings recorded in the CFSS for FY 2005/06—representing \$2.86 billion (57 percent) of the reported² \$4.96 billion inventory.
- The focus was on nationally procured inventory, which accounts for approximately 97 percent of consumable inventory holdings.

Scope Limitation

The audit scope excluded repairable munitions (\$1.99 billion) as well as other inventory items held outside of the CFSS such as contractor-held inventory (\$150 million) and medical equipment (\$30 million). The processes followed for these items are distinct and are unlike those used for consumable items managed in the CFSS.

Methodology

- Reviewed relevant policies and guidelines with respect to pricing and reporting of inventory, including the Financial Administration Manual 1020-5, the Supply Manual, Treasury Board (TB) Secretariat inventory policies, and Canadian generally accepted accounting principles (GAAP);
- Interviewed key departmental stakeholders within the ADM(Fin CS) organization, including Director Financial Accounting (DFA) and Financial Accounting and Reporting (FAR), formerly known as Accrual Accounting Operations;
- Interviewed key departmental stakeholders within the ADM(Mat) organization, including Director Supply Chain Operations (DSCO), Director Materiel Policy and Procedures (DMPP), and Director Materiel Information Systems (DMIS);
- Interviewed over 20 individuals, including supply managers buying inventory, clerks receipting and paying for inventory at the depots, depot management, as well as staff responsible for administering policies, monitoring data and reporting inventory;
- Completed site visits to both 25 Canadian Forces Supply Depot (CFSD) Montreal and 7 CFSD Edmonton;
- Selected and reviewed in detail a non-statistical sample of 40 consumable inventory transactions to test system controls in the Materiel Acquisition and Support Information System (MASIS), an upfront system used for national procurement purchases that flow into the CFSS; and
- Analyzed consumable inventory data from both MASIS and CFSS using computer-assisted audit/analysis tools and techniques.

² Ammunition reported as inventory includes repairable ammunition and stock found in supply customer accounts until the ammunition is actually used.



FINDINGS AND RECOMMENDATIONS

System Controls and Monitoring

The CFSS and associated inventory recording and monitoring processes lack the basic controls required to prevent or detect pricing errors that could significantly impact consumable inventory value.

There are three major DND corporate systems involved in the recording of consumable inventory, as shown in Figure 1.

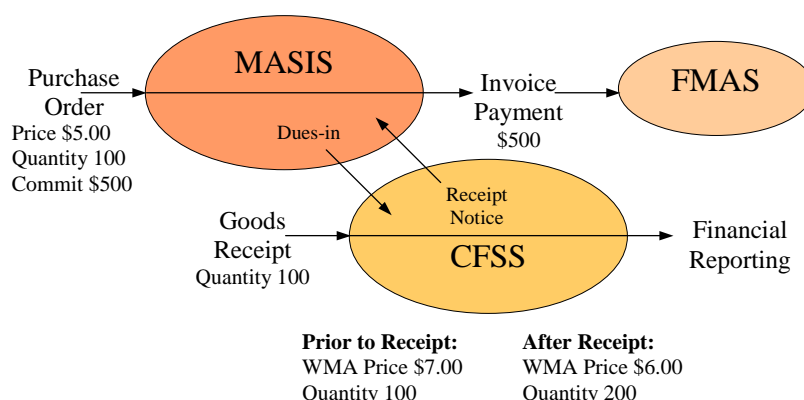


Figure 1. Information Flow—Consumable Inventory. *Inventory-related data flow from MASIS through to CFSS and the Financial Managerial Accounting System (FMAS).*

In the case of nationally procured items, purchase order (PO) data is entered into MASIS at the national inventory control point. Data accuracy in MASIS is integral to the process. The PO price amount is transferred to the CFSS when goods are received at the depot. It is also used to set up the purchase commitment in FMAS and is accepted for invoice payment when matched to the receiving document and tolerance level³. MASIS, as the front-end system for procurement, and CFSS, as the system of record, were both reviewed and tested as part of the audit.

MASIS. Audit testing confirmed that the current system controls in MASIS are working as intended; however, there are system shortcomings that need to be addressed. For instance, when goods are received, payment is issued based on the receiving document. MASIS will only reject payment requests when the amounts are greater than the PO amount plus the built-in tolerance level but it does not reject amounts that are less than the PO amount. If an incorrect price is entered on the PO, the supply manager must amend the PO before a payment exceeding the tolerance level can be processed.

³ A system control in MASIS stops a payment that exceeds the commitment by 1 percent (tolerance level).

MASIS does not automatically update an adjusted purchase price in CFSS; it is left to the discretion of the supply manager whether or not an adjustment is made. Table 1 summarizes the results of automated audit testing carried out on 21,267 invoice transactions in MASIS totalling \$112.5 million. Ten percent of invoices (2,027 transactions) totalling \$10 million were paid at less than the PO amount. In these situations, the Department either realized a discount or the original PO information was incorrectly entered. Less than one percent of invoices (156 transactions), representing approximately \$55,000 were paid at an amount higher than the PO amount with the majority having a price difference below the one percent threshold limit. It was not possible for the audit team to determine if price adjustments made in MASIS due to errors or discounts were being recorded in CFSS since the information was not readily available.

	Number of Transactions	Invoice Amount (M\$)
Invoice price = PO price	19,056	102.4
Invoice price < PO price	2,027	10.0
Invoice price > PO price	9	0.0
Price difference < 1%	147	0.0
Total	21,267	112.5

Table 1. Summary Results of Invoice Pricing Comparison.
Testing confirmed that system edits are working as intended.

CFSS

CFSS lacks basic system controls such as automated input checks to ensure data entered into the system is logical and within reasonable parameters.

Data Input Controls

Inventory can pass between warehouses in different districts, between warehouses within a district, and from an end-user back to the warehouse. During the recording of shipments and receipts functions, it is possible for users to enter incorrect data in either the price or quantity fields. While the price field should not be altered during inventory transfers, it is possible to modify this field.

An example of the errors observed includes one instance where stock code 219063661 (i.e., inner conveying tube) had a stock-on-hand (SOH) quantity of three at year-end, a global price of \$49.31 but a total inventory value of \$657,190,983. In this case the WMA price of this item matched its stock code—\$219,063,661. Fortunately, this error was identified and corrected during the year-end data clean-up exercise. However, this was not a unique case as illustrated by several additional examples included in Table 2. While these may be some of the more extreme examples that are more likely to be detected and corrected, the concern is that less obvious errors could go unnoticed.

Observed errors included:

- Goods being receipted at a price of zero;
- Stock code numbers entered as prices; and
- Prices recorded with transposition errors.

Stock Code	Item Description	SOH	Global Price	WMA Price	Inventory Value
219057512	Cap, Knit	932	\$8.76	\$10,300,435.33	\$9,600,005,726.28
218884113	Housing Assembly	19	\$1,606.10	\$138,243,189.40	\$2,626,620,598.07
218941386	Plug, Pipe Steel	139	\$1.39	\$7,875,590.47	\$1,094,707,075.46
219063661	Inner Conveying Tube	3	\$49.31	\$219,063,661.00	\$657,190,983.00

Table 2. Examples of Recorded CFSS Errors. Pricing errors identified in the CFSS exist due to a lack of system edits and controls.

Data Control Weakness

Clerks at the district level are able to adjust inventory prices in the CFSS. As a result of a policy misinterpretation, over a one-year period, one individual incorrectly adjusted the district prices for 594 consumable items—the net impact of these adjustments was a \$387,000 increase in the inventory value.

District Price Adjustments for FY 2005/06	
Number of adjustments	23,031
Districts involved	101
Stock codes affected	14,747
Net increase in inventory value	\$1.92 billion

Table 3. 2005/06 District Price Adjustments. A summary of all adjustments made over 101 districts.

Adjustments to district prices are not isolated instances; in fact, as Table 3 illustrates, during FY 2005/06 there were 23,031 adjustments made across 101 districts.

Although year-end data monitoring identified and corrected the most significant dollar value adjustments, the vast majority of adjustments fall under the tolerance threshold and will not normally be identified and corrected. Director General Materiel System and Supply Chain (DGMSSC) is aware of the capability to make district price adjustments, and is considering options to mitigate this situation.

Continuous Monitoring

The monthly inventory price monitoring function was transferred from ADM(Fin CS) to ADM(Mat) during the span of the audit. This was seen as positive progress since ADM(Mat) is now monitoring the integrity of inventory price data, which falls under its responsibility. Exception reporting and data review currently takes place at mid-month; while there are two organizations involved, DMIS and DSCO, their roles and responsibilities are very different, yet not well defined. DMIS is the information systems group that has designed and currently runs six monthly tests while DSCO receives the results of these tests for review and follow-up.

Due in part to the relatively low number of CFSS automated controls, these monthly tests continuously identify a large number of anomalies and, as a result, the review process is proving to be very time consuming. Due to the high error rate and the fact that materiality thresholds



have not been set, reviewers have been granted significant discretion regarding the level and extent of follow-up conducted and whether or not to even correct an error. While DSCO is responsible for taking action with the test results, they are not accountable for the extent of follow-up or the correction of anomalies. Errors that were supposed to be corrected in one month have reappeared the following month. Because the error and not the root cause of the error is addressed, the same error types recur on a monthly basis.

The final annual price review is completed prior to year-end, just before compiling the financial statements. This review makes use of resources from both ADM(Mat) and ADM(Fin CS) groups. As a result, it involves a broader price testing approach and identified errors are corrected prior to reporting.

Recommendations

OPI	RECOMMENDATION
DGMSSC DGMSSC	CFSS <ul style="list-style-type: none"> • CFSS Controls. Identify and implement more rigorous automated system controls in order to improve data accuracy and reliability. • Data Control Weakness. Restrict and centralize the ability to modify district level prices to adequately safeguard data integrity or at least ensure the system automatically provides DSCO with a notification of district price changes as they occur.
DGMSSC	Continuous Monitoring. Place a greater emphasis on the inventory continuous monitoring function and determine and define a clear purpose, an accountability structure, and an error identification and correction strategy that will address the root cause of the errors.

Reporting Accuracy

Limited reasonableness testing and insufficiently documented inventory roll-up procedures could result in material misstatements of reported consumable inventory balances.

Documentation of Reporting Process

Each month ADM(Mat) staff roll up the CFSS inventory general ledger (GL) balances and pass this information on to DFA/FAR within ADM(Fin CS). The extracted GL balances are compared to prior periods and, provided there are no obvious discrepancies, the GL balances are aggregated into one inventory balance for inclusion in the monthly financial statements.

Additionally, 10 summary lines of inventory information are included in the notes to the financial statements. There is no documentation detailing why certain information is rolled up or how the roll-up is conducted. Documentation of the process was initiated with the development of an In-Service Support Group document; however, this document is not complete, nor is it up to date in terms of current methodology. It was also noted that while DSCO did provide the document, it appears that a DFA contractor is in fact the corporate memory regarding current and historical CFSS extract procedures. Further complicating matters is the fact that each year, the process and content are changed, thereby making year-to-year comparisons more difficult and increasing the chances that errors could go unnoticed.

- **Example of a change to reporting methodology.** Until recently, stock codes with a negative district holding totalling \$45 million were excluded from inventory valuation.
- **Solution.** Negative holdings will now be included in the value of the reported inventory. While refining the reporting process is supported, in this case there is no documented evidence detailing the reasons for the negative balances, nor has it been confirmed that there are offsetting positive holdings somewhere else in the CFSS.
- **Risk.** Making changes of this nature without fully understanding why the problem has occurred may be masking a more serious reporting issue and could result in a material misstatement of financial statement balances.

Until recently, DFA/FAR was the only organization reviewing the overall integrity of inventory balances before they were included in the financial statements. The process for requesting and reviewing data has since been changed so that DSCO, who owns the data, is now completing the initial data review. Once reviewed, the information is provided to DFA/FAR where a final cursory review is conducted prior to including the balances in the financial statements.



Categorizing Assets

While the CFSS stores information on both capital assets and inventory items (Figure 2), there are no automated flags or field identifiers that facilitate the valuation of specific asset types for financial reporting purposes. For financial statement reporting purposes, non-repairable capital assets recorded in the CFSS are manually tracked using a Capital Asset Exclusion List (CAEL) that is maintained by Director Materiel Group Comptrollership (DMG Compt). Items are added or removed from this list periodically as DMG Compt deems necessary. This approach is inherently risky since the accuracy of reported assets is based on whether the CAEL is up to date. There is also a risk of double counting or excluding assets for reporting purposes since some assets are tracked in both MASIS and CFSS simultaneously.

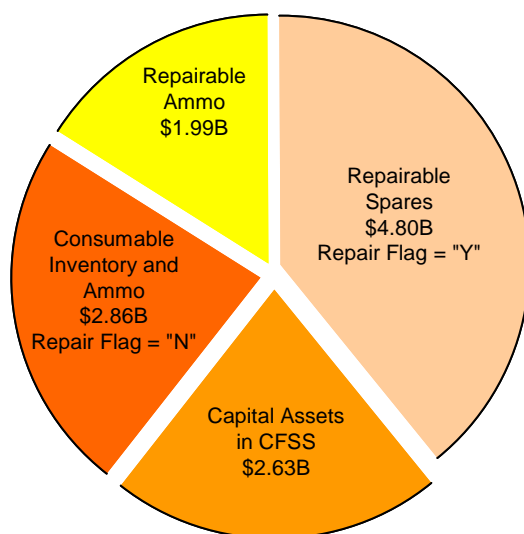


Figure 2. CFSS Asset Valuations at 31 March 2006. Repairable ammo and consumables form the inventory balance, while repairable spares and capital assets make up a small portion of the total reported capital assets.

Recommendations

OPI	RECOMMENDATION
DGMSSC & DG Fin Ops	Documentation of Reporting Process. Develop and maintain comprehensive and clear documentation of the roll-up procedures used to determine the consumable inventory balance. Perform periodic reconciliations of CFSS and MASIS to ensure that differences are identified, explained and corrected.
DGMSSC	Categorizing Assets. Improve CFSS functionality to facilitate identification and valuation of capital and other non-consumable assets.

Valuation Methodology

Notes to the financial statements do not adequately disclose potentially significant pricing and obsolescence issues related to reported consumable inventory amounts.

Inventory Valuation. TB Accounting Standard 3.4 defines inventory for the Government of Canada and provides options on how to cost inventory from a financial statement perspective. DND has been refining its inventory processes in order to be compliant with this standard. Some items previously defined as inventory have been redefined as capital assets, and in November 2002, a WMA price methodology was implemented for the majority of consumable items. The WMA methodology is comparable to the methodology used by the Australian Department of Defence⁴ and is an acceptable approach in accordance with both TB accounting standards and Canadian GAAP.

Inventory and Global Price. Before accrual accounting was introduced in the federal government, there was very little emphasis placed on the value of inventory. The vast majority of inventory items in CFSS did not include prices and there was little documentation available to confirm historical prices. In order to populate the consumable inventory price field and to implement the WMA methodology, a global price, which represented the best unit price information available at the time, was used for items without a price. Although there was a concern that the global price may not accurately reflect the actual price, it was deemed too costly to manually identify more accurate values for more than 420,000 consumable stock codes. Besides, it was felt that as inventory turned over, the WMA price methodology would reduce or eliminate the gap between global and actual average prices. Unfortunately, there is little evidence to indicate that this has occurred. Based on FY 2005/06 data, global price differs from the WMA price in only 21 percent (90,000 stock codes) of consumable items, with an average price variance of approximately 40 percent.

Inventory Turnover

Previous CRS work with respect to CFSS stock turnover has identified concerns with regards to low inventory turnover rates. An internal audit of National Procurement—Materiel Reprovisioning (November 2000) identified 30 years of excess stock and low turnover while a CRS evaluation of the Ammunition Program (October 2002) calculated that 63 percent of ammunition was between 6 and 15 years old. Furthermore, at an interdepartmental meeting, DFA/FAR presented the results of an inventory costing methodologies impact analysis, which identified DND's item turnover as less than 7 percent per year.⁵

An examination of inventory turnover to determine how it might affect consumable inventory valuation showed that 79 percent (330,000 stock codes) of consumable items are still priced at the global price established in 2002—a strong indication of low inventory turnover rates.

⁴ Australian Department of Defence—Chapter Seven Budgeted Financial Statements (2005-06).

⁵ Minutes of DND Interdepartmental Meeting on Asset Valuation and Inventory, December 13, 2004.



Reporting—Disclosure

The low inventory turnover rates raises concerns about inventory obsolescence and the impact this might have on reported inventory value. While there may not be a quick and easy solution to this issue, it is important that the users of the financial statements be aware of the potential impact this may have on current inventory valuation.

Finally, the inventory balance of \$4.682 billion reported in DND's departmental financial statements for FY 2004/05 was adjusted and restated to \$4.9 billion in the published financial statements the following year. No disclosure explaining the opening balance restatement was provided, which is contrary to GAAP.

Reporting—Policy

Further impacting the inventory valuation and contrary to TB Accounting Standard 3-4, DND inventory value does not factor in "laid-down" costs. Costs of bringing items on charge such as freight, shipping and duty are currently not factored into the value of DND inventory. This is partly due to DND policy, which stipulates that these costs "may be" included rather than being definitive as is the TB standard. Excluding these costs when valuing inventory results in understated inventory values and overstated expenses.

Recommendations

OPI	RECOMMENDATION
DGMSSC	Inventory Turnover. Conduct a review of consumable inventory items still valued at the original global price in order to determine whether or not obsolescence is truly an issue that would require a restatement of inventory value.
DG Fin Ops	Reporting—Disclosure. Improve notes to financial statements to address issues such as restated inventory balances and potentially significant inventory obsolescence concerns.
DG Fin Ops & DGMSSC	Reporting—Policy. Amend DND policy and practices regarding the inclusion of "laid-down" costs in inventory unit prices to ensure compliance with TB policy and standards.

ANNEX A—MANAGEMENT ACTION PLAN

Ser	CRS Recommendation	OPI	Management Action	Target Completion Date
System Controls and Monitoring				
1.	CFSS <ul style="list-style-type: none"> CFSS Controls. Identify and implement more rigorous automated system controls in order to improve data accuracy and reliability. Data Control Weakness. Restrict and centralize the ability to modify district level prices to adequately safeguard data integrity or at least ensure the system automatically provides DSCO with a notification of district price changes as they occur. 	DGMSSC	<p>CFSS Controls. A number of system change proposals, referred to as Requests for Change (RFC), are either under development or in the implementation stage to enhance reliability.</p> <p>DSCO is in the process of constructing a new cell that will monitor CFSS data to identify where the data input trends are not standard or in compliance with current policies. These trends or anomalies will be passed on to other DGMSSC directorates and applicable stakeholders to review and initiate corrective action. This will also aid in identifying critical processing gaps.</p> <p>DMPP has revamped its staff assistance and inspection visit checklists to ensure emphasis is being applied to the overall procurement process in order to advise district management of any compliance shortcomings that may cause unreliable records within the CFSS.</p> <p>Data Control Weakness. DGMSSC has removed the authority and system access that allowed price changes at the district level and has centralized this task.</p> <p>DMPP, in conjunction with DSCO and DMG Compt staff, is developing a new policy that will govern the process for actioning price changes in both Enterprise Resource Planning (ERP) systems. This new policy will be published in the Canadian Forces Supply Manual.</p>	<p>September 2009</p> <p>April 2009</p> <p>Complete</p> <p>Complete</p> <p>September 2007</p>



ANNEX A

Ser	CRS Recommendation	OPI	Management Action	Target Completion Date
System Controls and Monitoring (cont'd)				
2.	Continuous Monitoring. Place a greater emphasis on the inventory continuous monitoring function and determine and define a clear purpose, an accountability structure, and an error identification and correction strategy that will address the root cause of the errors.	DGMSSC	The introduction of the DSCO monitoring cell, identified in Serial 1, will provide this capability. This information will be used to educate DGMSSC, Equipment Program Management (EPM) and ECS staffs to develop strategies that will not only correct data anomalies, but also address the root cause of the anomaly or identified gap. In addition, a price change exception report will be available by late 2007 to monitor global price changes. A coordinated DMPP and DSCO policy directive governing global standard unit prices will be released followed by an update to the Canadian Forces Supply Manual.	September 2007
Reporting Accuracy				
3.	Documentation of Reporting Process. Develop and maintain comprehensive and clear documentation of the roll-up procedures used to determine the consumable inventory balance. Perform periodic reconciliations of CFSS and MASIS to ensure that differences are identified, explained and corrected.	DG Fin Ops & DGMSSC	DG Fin Ops agrees and where required, will document/enhance procedures for the 2007/08 financial statements. DGMSSC and DG Fin Ops staffs are developing a Business Solution Design (BSD) D4530E – Accrual Accounting that will provide the reporting process for accrual accounting within DND.	By March 31, 2008 March 2010
4.	Categorizing Assets. Improve CFSS functionality to facilitate identification and valuation of capital and other non-consumable assets.	DGMSSC	Categorizing Assets. The partial automated flagging of repairables will commence with the implementation of RFC159, currently awaiting approval.	December 2009



ANNEX A

Ser	CRS Recommendation	OPI	Management Action	Target Completion Date
Reporting Accuracy (cont'd)				
			<p>This new process will set each item's repairable flag to either "Y" (Yes) for all items subject to the Repairable Inventory Management (RIM) module of the CFSS, classed as "Repairables" on the financial report and "N" (No) for all items not subject to the RIM process, items classed as "Inventory." This RFC is one of the many related to the Accrual Accounting BSD requirement stated in Serial 3.</p> <p>A process to improve CFSS and MASIS automated capabilities to identify capital assets and items to be added to specific exclusion lists has been initiated as part of the AA BSD. The necessary investigations required to develop the new process will not commence until FY 2008/09 due to current FY priority commitments.</p>	<p>March 2010</p> <p>March 2010</p>
Valuation Methodology				
5.	Inventory Turnover. Conduct a review of consumable inventory items still valued at the original global price in order to determine whether or not obsolescence is truly an issue that would require a restatement of inventory value.	DGMSSC	<p>Inventory Turnover. The implementation of a Distribution Resource Planning (DRP) application over this FY will address this requirement by reviewing and providing a status of all asset dispositions to the applicable EPM/LCMM. This will allow the EPM/LCMMs to make informed decisions about any required disposal actions.</p> <p>The DRP application will start its validation phase in October 2007 and should commence general roll-out in the spring of 2008. Although the excess stock review capability will be available at the general roll-out, the LCMM training phase will delay full implementation of this capability until winter FY 2008/09 because the supply managers are being trained first.</p>	March 2010



ANNEX A

Ser	CRS Recommendation	OPI	Management Action	Target Completion Date
Valuation Methodology (cont'd)				
			The MASOP sponsored Blue 42 will be used to provide an interim capability.	
6.	Reporting—Disclosure. Improve notes to financial statements to address issues such as restated inventory balances and potentially significant inventory obsolescence concerns.	DG Fin Ops	DG Fin Ops agrees. It is understood that DND has weaknesses in its accounting for inventory and DG Fin Ops will work with DGMSSC on the steps being taken to strengthen these weaknesses and to address the concern raised.	Ongoing
7.	Reporting—Policy. Amend DND policy and practices regarding the inclusion of “laid-down” costs in inventory unit prices to ensure compliance with TB policy and standards.	DG Fin Ops & DGMSSC	DG Fin Ops agrees and will work to having an amended Financial Accounting Manual and direction for FY 2008/09. DGMSSC—The requirement to include these “laid-down” costs will be examined with DG Fin Ops to determine the best way ahead to either modify current policies and procedures or develop a new business process to ensure DND is compliant with this TB directive. The necessary investigations required to revise or develop new processes will not be finalized until early FY 2009/10; therefore, full completion is targeted for mid- to end FY 2009/10.	March 2008 March 2010



ANNEX B—AUDIT CRITERIA

Objective	Criteria
Assess the reasonableness of the consumable inventory valuation methodology.	Consumable inventory valuation methodology is in accordance with Central Agency direction and GAAP.
	Inventory valuation methodology applied is appropriate considering: <ul style="list-style-type: none"> • DND categories/types of inventory; • Dollar value of inventory movements and physical movements; and • Allies and other comparable industry or government departments.
Determine the effectiveness of inventory policies, procedures and controls in place.	DND policy framework and procedural guidelines applied are adequate for the pricing of departmental consumable inventory.
	Consistent approach is taken to input prices in the systems, specifically MASIS and supply managers.
	Sufficient and relevant information is identified, communicated and maintained to support: <ul style="list-style-type: none"> • Consumable inventory transactions recorded; • Key system processes for pricing of inventory; and • Roles and responsibilities clearly established.
Verify the accuracy and completeness of the reported consumable inventory value.	Consumable inventory purchase amounts are recorded accurately.
	Consumable inventory is reported using an accurate WMA amount in accordance with the WMA methodology.
	Inventory is properly and consistently classified for reporting purposes (consumable inventory as opposed to capital assets and repairable spares).
	Appropriate system controls, data validation checks and continuous monitoring are in place to: <ul style="list-style-type: none"> • Prevent/detect anomalies on a timely basis; and • Take appropriate action, when required.

