

19951116 013

DOUBLED GOVERNMENT

Millions in Contract Payment Errors Not Detected and Resolved Promptly



S DTIC
ELECTE **D**
NOV 17 1995
F

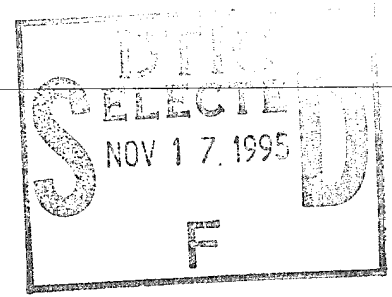
DISTRIBUTION STATEMENT A
Approved for public release;
Distribution Unlimited

DTIC QUALITY INSPECTED 5

**National Security and
International Affairs Division**

B-256249

October 6, 1995



The Honorable John Glenn
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable William V. Roth, Jr.
The Honorable Charles E. Grassley
The Honorable Barbara Boxer
United States Senate

In response to your request, we surveyed a group of large and small defense contractors to identify the amount of outstanding Department of Defense (DOD) overpayments and underpayments identified in contractors' records. We also reviewed selected overpayments to these contractors to determine whether DOD was detecting and recovering contract overpayments promptly. Our review focused on the actions taken to recover overpayments at the Defense Finance and Accounting Service (DFAS) Center in Columbus, Ohio, which in June 1995, made payments on about 373,500 defense contracts. The total value of these contracts is about \$602 billion.

Background

Accession For	
NTIS CRA&I	<input checked="" type="checkbox"/>
DTIC TAB	<input type="checkbox"/>
Unannounced Justification	<input type="checkbox"/>
By _____	
Distribution / _____	
Availability Codes	
Dist	Avail and/or Special
A-1	

Sound financial management operations are critical to ensuring that DOD effectively manages its contracts and that funds are disbursed properly. DOD has recognized that it has serious, long-standing problems in correctly disbursing billions of dollars in payments and providing reliable financial information. In January 1991, DOD created DFAS to strengthen DOD's financial management operations by standardizing, consolidating, and streamlining finance and accounting policies, procedures, and systems. But efforts to improve financial management through DFAS have yet to be successful, and much remains to be done to improve its performance. We have reported on a number of issues related to DOD's financial management problems. A list of our recent products is included at the end of this report.

A dramatic indicator that sound financial management operations are not in place is when contractors are returning overpayments to the paying office and that office is not aware that overpayments were made. In 1994 we reported on such contract overpayments being returned to the DFAS

DISTRIBUTION STATEMENT A

Approved for public release
Distribution Unlimited

Columbus Center.¹ Our examination of \$392 million of the \$751 million in checks processed by the DFAS Columbus Center during a 6-month period in 1993 disclosed that about \$305 million, or about 78 percent, represented overpayments by the government. The overpayments principally occurred because DOD paid invoices without recovering previous progress payments or because it made duplicate payments. Underscoring our concern about such overpayments is the fact that the majority of the overpayments we examined were detected by contractors, rather than by DFAS.

Our August 1994 report identified unresolved payment discrepancies, both overpayments and underpayments, at nine contractor locations and raised questions as to whether such discrepancies were widespread.² As a result of that report, you requested that we obtain data on payment discrepancies from selected large and small contractors. The methodology used to conduct the data request and analyze the contractors' responses is explained in appendix I, and a copy of the data request is shown in appendix II.

Results in Brief

The 374 business units (representing 82 large defense contractors and 57 small contractors) that responded to our request for data as of July 1994 reported about \$231.5 million in outstanding overpayments and about \$625.9 million in underpayments. The evidence suggests and contractors reported that they followed up to collect underpayments and usually notified DOD of overpayments. However, contractors did not always return overpayments unless instructed to do so.

The DFAS Columbus Center cannot readily detect payment discrepancies because of significant errors in its automated payment records. Despite these errors, Center personnel, in accordance with payment procedures, pay contractor invoices as if the payment data were correct. With significant errors in the automated payment records, incorrect payments are likely to continue.

The Center did not properly pursue recovery after overpayments were reported by contractors or identified through contract reconciliation. On the basis of our research of \$84.2 million in overpayments, the Center's delay in collecting overpayments was long and costly. For those

¹DOD Procurement: Millions in Overpayments Returned by DOD Contractors (GAO/NSIAD-94-106, Mar. 14, 1994).

²DOD Procurement: Overpayments and Underpayments at Selected Contractors Show Major Problem (GAO/NSIAD-94-245, Aug. 5, 1994).

overpayments, we estimate that recovery delays cost the government about \$10.6 million in interest. Even after a public accounting firm completed contract reconciliations to identify the amounts owed the government, the Center did not recover overpayments promptly.

In response to our August 1994 recommendation that DOD mobilize resources to identify, verify, and correct payment discrepancies, DOD advised us in May 1995 that various actions were underway or planned to reduce payment discrepancies and to use contractor records to facilitate reconciliations. Also, on July 31, 1995, DFAS requested the Columbus Center to undertake a new effort to identify and resolve payment discrepancies.

Contractors Report Significant Payment Discrepancies

In response to our data request, 374 business units of large and small contractors reported overpayments and underpayments using their accounting records. The business units responding to our request reported payment discrepancies of \$857.4 million—overpayments of \$231.5 million and underpayments of \$625.9 million.

Our analysis of the responses from selected business units showed that (1) the reported information had been drawn from their accounting records and (2) most of the units applied some judgments to extract data from their accounting records. The judgments applied in compiling the information varied among the contractors. For instance, some contractors did not report what they considered to be low-dollar invoices, such as amounts less than \$10,000 or \$50,000. Some contractors did not report unpaid (as opposed to partially paid) invoices and vouchers over 30 days old as underpayments. One contractor that reported \$15 million in overpayments as outstanding on July 31, 1994, did not include a \$7.1 million overpayment that it included in a liability account. The overall effect of the anomalies we identified in the contractors' responses was that the reported overpayments and underpayments were less than the amounts recorded in the contractors' accounts.

Both overpayments and underpayments result in unnecessary costs to the government. Overpayments increase the government's interest costs because funds are needlessly disbursed. Contractors are not assessed interest on overpayments until 30 days after a demand for repayment is made. For underpayments, the Prompt Payment Act requires DOD to pay an interest penalty for an invoice payment made after the due date or 30 days

after the presentation of a valid invoice. The Center's late payment penalties reported for fiscal year 1994 were about \$5 million.

Many contractors notified the government of payment errors but did not always return overpayments until instructed to do so. Table 1 shows that 343 of the 374 business units (92 percent) reported having a policy or practice of notifying the government paying office and/or government contracting officers when payment errors are encountered. Because of the poor state of DOD's accounting records and control systems, overpayments might never be recovered if contractors do not report them.

Table 1: Reported Policy or Practice for Notifying DOD of Errors

Policy	Number of business units
Written notification or telephone contact with paying office	303
Notification of government contracting officer instead of paying office	40
Other, such as sending refund or correcting error on next invoice	20
None or non-applicable	6
Did not respond	5

Errors in Automated Payment Records Cause Payment Discrepancies

Our review of selected payment discrepancies showed that errors in the automated payment records cause payment errors. Center personnel, in accordance with payment procedures, pay contractor invoices as if the payment information in the system were correct, even though the information in the system is known to have a high error rate. A March 15, 1994, audit report by the DOD Inspector General reported obligation errors in 23 percent of the contracts examined and accounting data errors in 39 percent of the contracts examined.³

For overpayments, the most frequent cause of error (45 percent) identified by Columbus Center analysis is the incorrect recovery (liquidation) of progress payments. Progress payments are recovered in accordance with contract financing provisions when paying invoices for delivered items. Correct liquidation requires accurate records of the progress payments made regarding the delivered items. If the automated payment records are in error, the invoice will likely be paid in error unless adequate research is performed before making the payment. Research results in the avoidance of some overpayments. But research is effective only if proper underlying records are kept, and it is time-consuming and costly.

³Funds Control Over Contract Payments at the Defense Finance and Accounting Service—Columbus Center (94-054 Mar. 15, 1994), DOD, Office of Inspector General.

In addition to being time-consuming and costly, research could delay payments beyond the time provisions of the Prompt Payment Act, and the Center would then have to pay the contractor late payment interest. Balancing the need for doing necessary research to make an accurate payment, with the cost of late payment interest is difficult for Center personnel. The Center accounts for the cost of interest on late payments but neither accounts for nor reports on the government's cost of money to finance contract overpayments.

The cost to the government of poor record-keeping and inadequate research can be significant. For example, a \$7.7-million overpayment was made to a contractor because the Center's records of progress payments had been incorrectly recorded. The error was discovered with research after the contractor notified the Center that it had been overpaid. The overpayment, outstanding for over 2 years and costing the government about \$820,000 in interest, could have been avoided if proper records had been kept and adequate research had been done before the contractor was paid.

In another case, a \$7.5-million overpayment was outstanding for 8 years and might not have been recovered if the contractor had not notified DFAS of the overpayment. The records in this case were so error prone that contractor assistance appeared essential to recovering the overpayment. In this case, research was either not done or was totally ineffective. Researching can be a good control technique when used on large and complex contracts, but it is not a substitute for good record-keeping.

DFAS Did Not Promptly Recover Millions in Overpayments

The Federal Acquisition Regulation (FAR) provides for the prompt recovery of contract debt originating from overpayments. The FAR requires that a demand letter be issued as soon as the amount due the government is computed. The regulation also requires that the responsible official establish a control record for tracking the efforts to determine and collect the debt. If not recovered promptly, contract debts increase the government's cost of funds and unnecessarily expose the government to losses because some debts become uncollectible. The Columbus Center did not comply with the FAR. It did not collect overpayments promptly when contractors and auditors reported them.

Overpayments Reported by Contractors Not Recovered Promptly

The Columbus Center did not promptly recover identified overpayments because it did not (1) follow the Center's policy of requesting contractors to immediately return identified overpayments pending a reconciliation

and (2) record and track actions on reported overpayments. To evaluate the Center's recovery actions, we researched overpayments of about \$84.2 million on eight contracts for which contractors had reported large overpayments. Data on these contract overpayments are shown in table 2 and discussed in more detail in appendix III.

Table 2: Data on Selected Contract Overpayments

Contract number and contractor	Overpayment amount	Estimated days outstanding ^a	Estimated interest cost ^b
F33657-89-C-0082 Hughes Missile	\$35,299,784	63-283	\$1,410,339
DAAB07-92-C-G004 ITT Aerospace/Communications	20,180,209	26-225	943,621
N00039-90-C-0165 ITT Aerospace/Communications	1,701,530	82	31,490
N00024-88-C-5670 ITT Gilfillan	7,693,081	794	820,304
F19628-84-C-0151 Litton Systems	5,254,771	741	878,806
DAAJ09-90-C-0352 McDonnell Douglas Aerospace	5,872,240	143-1,173	1,695,925
DAAE07-84-C-A001 Textron Lycoming	7,505,668	2,837	4,805,843
DAAE07-86-C-A050 Textron Lycoming	667,130	unknown	unknown
Total	\$84,174,413		\$10,586,328

^aBecause overpayments on some contracts occurred on several different dates and overpayments were recovered on several different dates, we show the least number of days and the most number of days an overpayment was outstanding.

^bTo estimate the government's interest cost, we used the period that overpayments were outstanding and the current prompt payment interest rate established by the Secretary of the Treasury.

Although the Center has had a written policy since November 5, 1993, to ask contractors to return overpayments immediately, contractor relations personnel told us they were not aware of the policy and were not asking contractors to return overpayments. For the overpayments we examined, the contractors were not asked to immediately return the overpayments after reporting them to contractor relations personnel at the Center. None of the overpayments we examined became uncollectible because of these delays; however, the delays were costly because the overpayments were outstanding for extended periods. We estimate that delays in recovering the \$84.2 million in overpayments cost the government about \$10.6 million

in interest. Our search for records of actions taken to recover the selected overpayments showed that generally the Center had incomplete records of notifications by contractors and no record to show what collection actions, if any, were taken.

Overpayments Identified by Contract Reconciliation Not Recovered Promptly

In addition to being notified by contractors, the Center also identifies payment discrepancies by auditing or reconciling contracts. As of December 1994, the Center had identified 14,840 contracts that required review or reconciliation. About 4,000 contracts were determined to require complete reconciliation. These reviews and reconciliations will be completed by either Center personnel or a public accounting firm hired for that purpose. Reconciliations completed by the firm are returned to the Center for action—for example, the issuance of demand letters for the amount due the government.

A cumulative report of the firm's activities from October 1990 through April 1995 showed the following:

- About 4,723 contracts had been reconciled by the firm.
- About \$76 billion in accounting adjustments were needed to correct payments that had been made from wrong accounts.
- About \$314 million had been identified as owed to the government.
- About \$94 million had been identified as owed by the government to contractors.
- Demand letters had been issued to contractors for about \$152 million based on the firm's reconciliations, with about \$80 million collected, and about \$17 million disputed and classified as in-process.
- About \$19 million may not be collectable for one or more reasons, including \$8 million due from contractors involved in bankruptcy.

As of May 1995 the accounting firm classified \$178 million of the reported \$314 million due the government as "in-process." The Center did not have debt records or other documents to show what specific collection actions, if any, had been taken to collect the \$178 million. Based on our expressed concern about the status of the \$178 million classified as in-process, Center officials agreed to research this matter. After researching individual contract payment files and accounts receivable files, the Center issued demand letters for \$23 million that had been outstanding for over 60 days and identified other disposition actions. In June 1995, Center officials told us they could not determine what collection action, if any, had been taken on about \$75 million of the \$178 million. The Center continued research

and reported at the end of August that it had determined the status of all but \$11 million.

We reviewed the collection actions on all audits completed by the public accounting firm during an 18-month period ending March 31, 1995, to determine whether the Center was promptly collecting identified overpayments. In total, 160 completed audits identified \$82.1 million as being owed to the government. Records showed that the Center had issued demand letters for \$36.8 million of the \$82.1 million. The demand letters, on average, were sent about 3 to 4 months after the Center was informed of the overpayments and, in one case, was not sent until more than a year after notification. For the remaining \$45.3 million, the Center had either no record of demand letters issued (\$33.1 million) or were considering whether to accept the results of the audit (\$12.2 million). Some of the audits not yet accepted had been under consideration for extended periods.

Center personnel researched the \$45.3 million identified as owed the government for which we were unable to find collection records. Through this additional research, the Center was able to initially identify collection actions for about \$15.8 million of the \$45.3 million—leaving \$29.5 million owed the government for which the Center could identify no collection action.

According to officials, the Center does not have statistical information on the results of audits and reconciliations performed by Center personnel. However, in those few cases where the Center had reconciled the contracts for overpayments that we examined, the Center did not take prompt collection actions.

Delays in recovering identified overpayments compound the problem and suggest management as well as systems and records shortcomings.

Actions to Identify and Resolve Payment Discrepancies

In our August 1994 report we stated that DOD does not have an effective system to identify and resolve payment discrepancies and expeditiously recover amounts owed the government. We recommended that DOD develop a comprehensive plan to mobilize resources to identify and correct payment discrepancies. We reported that such action was necessary to reduce (1) the cost to the government, (2) future payment discrepancies, and (3) the incidence of uncollectable overpayments.

Both DOD and DFAS Columbus Center officials have said that they are taking significant steps to resolve specific problems identified in our reports. For example, Center officials advised us of corrective actions being taken to improve the detection and collection process, including

- changes to ensure that the Center's policy of asking contractors to immediately return overpayments is implemented, including an August 1995 pilot installation of telephone and computer equipment to establish a historical record, by contract, of payment problems identified by customers;
- changes to prevent overpayments that occur because of incorrect progress payment liquidations, including both procedural and systems changes that are expected to improve payment research and progress payment records;
- changes in monitoring and reporting practices to ensure that all reconciliations that identify amounts owed the government are resolved promptly; and
- increases in the resources directed toward reducing the backlog of contracts requiring reconciliation by December 1995.

Also, after discussing the results in this report with DOD and DFAS officials, DFAS, on July 31, 1995, directed the Columbus Center to begin surveying contractors to identify and resolve payment discrepancies. Also, the on-site personnel from the Defense Contract Management Command and the Defense Contract Audit Agency will continue to assist in the identification and resolution of payment problems.

In addition to resolving specific payment problems, DOD stated it is implementing systemic solutions to prevent the types of payment problems identified in our reports. DOD said that it is making coordinated improvements in its contract writing, contract management, contract payment, and accounting systems to ensure that all payments are computed, issued, and accounted for properly.

Although the actions reported by DOD and DFAS appear to be a positive step toward addressing contract payment discrepancies, we remain concerned about DOD's ability to eliminate contract payment discrepancies, make coordinated improvements in all aspects of contract payment processes, and incorporate leading-edge business practices. We have ongoing and planned work to further evaluate DOD's plans for improving financial management operations and will periodically monitor DOD's progress in eliminating contract payment discrepancies.

Agency Comments

In commenting on a draft of this report, DOD said that it generally concurred with the report and offered a clarification regarding actions by the Defense Contract Management Command and the Defense Contract Audit Agency. The clarification has been incorporated. DOD's comments are reprinted in their entirety in appendix IV.

As agreed with your offices, we plan no further distribution of this report until 30 days from its issue date unless you publicly announce its contents earlier. At that time, we will send copies to the Secretary of Defense; the Director, Office of Management and Budget; and other interested congressional committees. Copies will also be made available to others upon request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix V.



David E. Cooper
Director, Acquisition Policy, Technology,
and Competitiveness Issues

Contents

Letter	1
Appendix I Scope and Methodology	14
Appendix II Reporting Format for Information Requested by the U.S. General Accounting Office	17
Appendix III Examples of Selected Overpayments	19
Appendix IV Comments From the Department of Defense	24
Appendix V Major Contributors to This Report	26
Related GAO Products	27
Tables	
Table 1: Reported Policy or Practice for Notifying DOD of Errors	4
Table 2: Data on Selected Contract Overpayments	6
Table I.1: Amount of Overpayments and Underpayments Reported by 374 Business Units	15
Table I.2: Number of Business Units Reporting Overpayments	15
Table I.3: Number of Business Units Reporting Underpayments	15

Contents

Abbreviations

DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
FAR	Federal Acquisition Regulation

Scope and Methodology

We requested business units of 204 large and small contractors to provide information on the status of their open accounts receivable with the Department of Defense (DOD) as of July 1994. The large contractors were 96 of the top 100 defense contractors as measured by DOD contract award data published by DOD's Directorate for Information Operations and Reports.¹ According to published DOD data, the top 100 contractors received about 62 percent of the DOD prime contracts awarded in fiscal year 1993. The 108 small contractors included the contractors classified as small businesses that had the largest amounts of contract awards as reported by the Federal Procurement Data Center.²

We used mailing addresses identified in a Federal Procurement Data System listing that was extracted from government contract awards. This listing contained 1,287 addresses for these 204 contractors. Since we were unable to determine which of these addresses were appropriate for contacting the accounts receivable sections for business units that had DOD contracts, we mailed data requests to all available addresses. For example, we sent data requests to six addresses in Orlando, Florida, for the same contractor because we did not know which addresses maintained the accounts receivable data. Also, we were unable to determine whether all business units with DOD contracts were included in these addresses.

Each data request asked the recipient to return the request form if the recipient did not maintain accounts receivable for the business unit and to provide the address for that business unit's accounts receivable section. We mailed an additional 75 data requests to addresses identified. We also sent follow-up reminders to addresses that did not respond to the initial mailing.

Using this approach, we received 374 data responses, which included responses from at least one business unit of 139 contractors—82 large contractors and 57 small contractors. However, we did not receive responses from all business units of these contractors. This report presents the data obtained from the 374 business units and cannot be projected or generalized to about 26,000 business units paid by the DFAS Columbus Center.

¹Four contractors were not mailed data requests because addresses were not in the Federal Procurement Data System.

²Of the 120 contractors in this category, 12 were not mailed data requests because addresses were not in the Federal Procurement Data System, 4 other small contractors were excluded because they were included in the top 100 large contractor listing, and 4 were included in the survey because their names were similar to other contractor business units searched in the Federal Procurement Data System.

**Appendix I
Scope and Methodology**

As shown in table I.1, business units of large contractors accounted for \$223.6 million (97 percent) of the \$231.5 million reported overpayments and \$611.5 million (98 percent) of the \$625.9 million reported underpayments.

Table I.1: Amount of Overpayments and Underpayments Reported by 374 Business Units

Reporting business unit	Overpayment	Underpayment	Total
Large contractors	\$223,613,745	\$611,463,842	\$835,077,587
Small contractors	7,890,931	14,470,671	22,361,602
Total	\$231,504,676	\$625,934,513	\$857,439,189

As shown in table I.2, 134 (43 percent) of the 315 large contractor business units reported overpayments of more than \$1,000 and 14 (24 percent) of the small contractor business units reported overpayments of more than \$1,000. These 148 business units accounted for more than 99 percent of the \$231.5 million in overpayments reported.

Table I.2: Number of Business Units Reporting Overpayments

Reported amount of overpayment	Large contractors		Small contractors	
	Total overpayment	Number of units	Total overpayment	Number of units
0 to \$1,000	\$3,132	181	\$0	45
More than \$1,000	223,610,613	134	7,890,931	14
Total	\$223,613,745	315	\$7,890,931	59

As shown in Table I.3, 185 (59 percent) large contractor business units reported underpayments of more than \$1,000, and 25 (42 percent) of the small business units reported underpayments of more than \$1,000. These 210 business units accounted for more than 99 percent of the \$611.5 million in underpayments reported.

Table I.3: Number of Business Units Reporting Underpayments

Reported amount of underpayment	Large contractors		Small contractors	
	Total underpayment	Number of units	Total underpayment	Number of units
0 to \$1,000	\$512	130	\$460	34
More than \$1,000	611,463,330	185	14,470,211	25
Total	\$611,463,842	315	\$14,470,671	59

The reported data may be affected by erroneous contractor records or by contractors' misstatement of facts in their responses. We visited 12 business units to verify that the payment data reported in response to our

data request was extracted from the business units' accounting records. These 12 units reported \$83.6 million of overpayments (36 percent of the reported total), and \$62.3 million of underpayments (10 percent of the reported total). The business units visited were selected based on geographic dispersion and the amount of reported payment discrepancies, including reports of "zero" payment discrepancies. We also had telephone discussions with contractor officials at a number of other business units to help ensure complete responses to our data request.

We also researched overpayments on eight contracts presented in detail in appendix III. We examined the actions taken at the Columbus Center to resolve these overpayments. We collected information on underpayments, but we did not review the resolution of underpayments. We conducted our research of selected overpayments at the Columbus Center and used all available contract records. We also interviewed payment personnel, contractor relations personnel, and supervisors (including division chiefs and directors) at the Center. We also obtained information and contract records from DOD contracting officers and discussed payment issues with them. Data obtained from contractors and contracting officers were compared with the Columbus Center records.

In addition, we reviewed laws and regulations pertaining to the administration and management of contracts and contract payments, including those related to collection of contract debts. We also discussed payment errors with the Defense Logistics Agency, the Defense Contract Management Command, and the Defense Finance and Accounting Service (DFAS) officials.

We conducted our review between August 1994 and June 1995 in accordance with generally accepted government auditing standards.

Reporting Format for Information Requested by the U.S. General Accounting Office



REPORTING FORMAT FOR INFORMATION REQUESTED BY THE U. S. GENERAL ACCOUNTING OFFICE

The Chairman of the Senate Governmental Affairs Committee has asked the U. S. General Accounting Office to obtain data from contractors on the extent of underpayments and overpayments outstanding on contracts with the Department of Defense (DOD). This data will be used as part of an ongoing assignment (GAO code 705074) to evaluate DOD's contract payments system. Please follow the attached instructions when accumulating the requested information and return it in the enclosed envelope by **September 30, 1994**. The mailing address for this request is:

U.S. General Accounting Office
Suite 1500
1445 Ross Avenue
Dallas, TX 75202-2783.

Any questions should be directed to: Seth Taylor, Jeff Knott, or Joe Quicksall in our Dallas Regional Office at (214) 777-5600.

I. GENERAL INFORMATION

The business unit for which the information is being requested is (please make any corrections needed to business unit identification):

Person to be contacted if additional information is needed:

NAME:

TELEPHONE NUMBER:

PARENT COMPANY (Name and Address)

II. CONTRACT INFORMATION

1. Does your business unit prepare contract billings and maintain accounts receivable for contracts with

the DOD?

- Yes (**SKIP TO QUESTION 2**)
 No

STOP -- If you answered No to question 1 above, please do not continue but return this request in the enclosed envelope. Please do not forward to the business unit that does your billings and maintains your accounts receivable. However, please provide the address for the business unit that maintains your accounts receivables so we can verify that the unit has been included in the initial mailing of this data request.

NAME:

2. Do some of your contracts with DOD provide for progress payments?

- Yes
 No

**Appendix II
Reporting Format for Information
Requested by the U.S. General Accounting
Office**

3. From your accounts receivable or other appropriate accounting record, provide total dollar amounts of existing overpayments and underpayments (billed amounts versus payments received) for all DOD contracts as of July 31, 1994 (or if July 31 is impracticable, specify the alternative July as of date used). Note: We expect overpayments or underpayments caused by incorrect liquidation of progress payments to be included in the summary totals provided in response to this question.

(July as of Date Used: _____)

OVERPAYMENTS

UNDERPAYMENTS

Provide a list of the DOD contracts to which the above overpayments and underpayments apply. (Attach the list to this form.)

4. List the current top 3 DOD paying offices, based on dollar amount, that pay contract billings submitted by your business unit (exclude classified paying offices). Provide an estimate of the percentage of your dollar billings paid by each of these paying offices.

List top 3 paying offices' name and address

1.

2.

3.

5. What is your business unit's current policy or practice regarding notifying DOD when your records indicate an error has been made in paying an invoice or progress payment request? (Briefly describe below or attach your response to this form.)

6. List the most recent annual gross dollar amount of contract billings to DOD by your business unit.

YEAR
ENDING

DOLLAR AMOUNT OF
BILLINGS TO DOD

Please attach any additional information or specific comments and issues concerning your DOD contract payment experiences that you believe we should consider.

Thank you for your prompt response. Please retain any work sheets or records used to prepare this response.

Examples of Selected Overpayments

We reviewed over \$84 million in overpayments on eight contracts to determine why the overpayments were made and to evaluate the efforts of the DFAS Center in Columbus, Ohio, to recover the overpayments. Most of the overpayments were outstanding more than 180 days, and one was outstanding about 7 years. Overpayments occurred mostly because prior progress payments were not properly considered when paying invoices. In general, the root of the problems could be traced to errors in the government's payment record.

For each example, we attempted to identify the dates the overpayments occurred, the reason they occurred, the date the Center was notified of them by the contractor, and the date the money was recovered. Where these dates could not be clearly determined, we estimated the dates using available records and/or interviews with the government and contractor personnel involved.

1. Contract F33657-89-C-0082 with Hughes Missile Systems, Tucson, Arizona

The DFAS Center overpaid this contract by about \$24.7 million in January 1994 because an invoice was paid without fully liquidating progress payments. The contractor notified the Center of the overpayment in April 1994, about 3 months after the invoice was paid incorrectly. The Center and contractor agreed to eliminate the \$24.7 million overpayment by a setoff to other contractual debts rather than by a cash collection. To collect by contract setoff, the Center did not pay \$24.7 million of other payment requests. The recovery by setoff was completed in October 1994, about 10 months after the overpayment was made, and 6 months after the Center was notified.

Shortly after recovering the \$24.7 million overpayment, the Center again overpaid this contract by \$10.5 million because invoices were paid out of the sequence expected by the contractor. The out-of-sequence payment, in turn, caused an overpayment because the Center did not adequately research the payments before responding to the contractor's refund request. The Center recovered this overpayment in about 60 days by another setoff.

The overpayments and the delay in recovering the overpayment after they were identified cost the government about \$1.4 million. Our review indicated that reliance on inaccurate payment records without further research was a primary cause of overpayments. The Center is researching

the underlying cause of errors in the payment records. A recently completed reconciliation of this contract's payment records showed 68 errors. The errors included 44 payments from the wrong funds, 6 overpayments, 3 duplicate payments, and 2 underpayments. In addition, the records contained six posting errors and three extension errors. Any of these errors could cause additional payment errors.

2. Contract DAAB07-92-C-G004 with ITT Aerospace, Fort Wayne, Indiana

The DFAS Center overpaid about \$20 million on this contract because progress payments were not liquidated at the contract rate. The incorrect liquidation began in September 1993 and continued at least through April 1994. The contractor advised the government contracting officer and Center contract relations personnel of the overpayments in November 1993. At that time, the overpayments totaled about \$4.5 million. We found no record of any Center action to recover the overpayments identified in the November 1993 notification. In a January 1994 letter, the contractor requested a meeting with Center officials to resolve the continuing overpayment problem on this contract. By then, the overpayments had increased to \$18.9 million, but again no action was taken to recover the overpayments. In March 1994, the Center began a limited scope examination to verify the overpayment amount that had increased to \$19 million according to the contractor. Finally, in May 1994, the contractor asked the Center to issue a demand letter for the overpayment, which the contractor reported as \$19.5 million.

The Center issued a demand letter for about \$18 million in June 1994 and recovered that amount in July 1994. The contractor returned an additional \$2.1 million in October 1994.

3. Contract N00039-90-C-0165 with ITT Aerospace, Fort Wayne, Indiana

The Center overpaid this contract by about \$1.7 million because it did not liquidate progress payments at the contract level on invoices between May 1993 and July 1994. The contractor notified the cognizant government contracting officer in August 1994 of the overpayments. The contracting officer issued a demand letter for the \$1.7 million overpayment in September 1994, and the contractor returned the overpayment the following month. The Center apparently was not aware of the payment errors until after receipt of the contractor's check.

4. Contract N00024-88-C-5670 with ITT Gilfillan, Van Nuys, California

This contractor was overpaid about \$7.7 million on a December 1992 invoice because progress payments were incorrectly liquidated. The incorrect liquidation resulted from posting errors to the automated payment system. Rather than demanding return of the overpayment, the Center decided to recover the overpayment by contract setoff. When we examined the payment records in March 1995, over 2 years after the overpayment, the contractor still owed the government about \$4.5 million. The recovery by setoff was approved by the reconciliation clerk, reconciliation supervisor, division chief, and associate director without research to determine whether the amount could be promptly recovered through setoff. After we questioned the wisdom of this, the Center issued a demand letter for about \$4.5 million. The final collection was made in April 1995—over 2 years after the Center made the overpayment.

5. Contract F19628-84-C-0151 with Litton Systems, College Park, Maryland

This contract was overpaid because invoices were paid at estimated prices until the prices were definitized in March 1993, about 8 years after deliveries started. The contract prices were definitized at less than the estimated prices used by the Center to pay the contract. Both the contracting officer and the contractor should have known that the contract was overpaid as soon as the price was definitized. The contractor began discussing the amount of overpayment with the contracting officer in August 1993. In October 1993, the contractor provided the Center with the results of its reconciliation showing the contract overpayment to be about \$5.2 million. From October 1993 until at least June 1994, the contractor and Center personnel exchanged letters and telephone calls concerning the exact amount of the overpayment.

When we reviewed the contract records in February 1995, we questioned the wisdom of continuing to leave the reported overpayment of \$5.2 million outstanding for over 16 months while efforts were underway to research a disputed difference of about \$63,000. In March 1995, the Center issued a demand letter for the \$5.2 million the contractor agreed was overpaid. The contractor returned the \$5.2 million 30 days after receiving the demand letter. The disputed amount will ultimately be demanded, if sufficient records are available to support the claim.

6. Contract DAAJ09-90-C-0352 with McDonnell Douglas Aerospace, Huntington Beach, California

This contractor notified the DFAS Center in November 1992 of overpayments on the contract caused by not properly liquidating progress payments. The Center has no record of efforts to recover the overpayments identified in this notification or subsequent notifications by the contractor of continuing overpayments on this contract. The contractor determined the amount of overpayment was about \$5.8 million and refunded that amount to the Center in March 1994. The Center's initial review of payment records for this contract found no overpayments, and the Center returned the \$5.8 million refund to the contractor in August 1994. The return of this refund was specifically approved by the reconciliation clerk, reconciliation supervisor, and the division chief. The contractor's disagreement with this action resulted in the government contracting officer requesting the Center to reconcile the contract. The Center's reconciliation identified an error in posting progress payments that caused the overpayment. The Center issued a demand letter for \$5.8 million in November 1994. The Center received the contractor's refund check in December 1994, over 2 years after the overpayment.

7. Contract DAAE07-84-C-A001 with Textron Lycoming, Stratford, Connecticut

According to this contractor, it notified the Center in November 1993 of a \$7.5 million overpayment on a completed contract. The overpayment resulted from both duplicate payments and incorrect liquidation of progress payments. The Center had no record of this notification and no record of efforts to recover the amount identified in this notification. The contractor again notified the Center in June 1994 of the overpayment. A record of this notification was in the Center's contract file. Shortly after we visited the company in December 1994 to verify reported data, the company returned \$7.5 million as a refund of the overpayment on this contract. The contractor had retained most of this amount for about 8 years—since the last shipment on the contract in January 1987.

A November 1994 reconciliation disclosed that the payment records on this contract contained 125 errors. Most of the errors, 67 of 125, were contract payments made from the wrong fund control citations. In addition, there were 22 underpayments, 10 invoice payments with incorrectly liquidated progress payments, 13 overpayments, and 3 duplicate payments. The remaining errors were erroneous postings of contract entries, such as cash collections or modifications. Using these

payment records without adequate research is the likely cause of the overpayment.

8. Contract DAAE07-86-C-A050 with Textron Lycoming,
Stratford, Connecticut

The contractor reported an overpayment of \$667,130 as of July 1994 that was subsequently resolved, according to the contractor, by contract setoff in August 1994. While the contractor believes this contract is settled, the government agencies involved have been unable to reach agreement on the payment status of the contract. In December 1994, the funding station (U.S. Army Tank-Automotive and Armaments Command) believed the contract was overpaid by \$10 million and requested the Columbus Center to take immediate action to collect money due from the contractor. However, as of May 1995, the Center's automated payment records showed the contract to be underpaid by about \$2.7 million. While this contract had been in and out of reconciliation during the prior 4 years by the public accounting firm employed by the Center, the reconciliation results had been inconclusive. In late May 1995, the Center and government funding station personnel initiated meetings to resolve differences in their contract records and to reach agreement on the payment status of the contract.

According to a September 10, 1994, Audit Report of Errors prepared by the public accounting firm, the firm's reconciliation disclosed that the payment records on this contract contained 1,123 errors. Most of the errors, 885 of 1,123, were contract payments made from the wrong fund control citations. The remaining errors identified during reconciliation included 197 posting errors.

Comments From the Department of Defense



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



AUG 31 1995

Mr. David E. Cooper
Director, Acquisition Policy, Technology,
and Competitiveness Issues
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DOD PROCUREMENT: Millions in Contractor Overpayments Not Detected and Recovered Promptly," dated August 2, 1995 (GAO Code 705074).

The Department generally concurs with the report, with one exception. The Department requests clarification of the statement in the concluding paragraph beginning on page 13 with respect to actions by the Defense Contract Management Command (DCMC) and the Defense Contract Audit Agency (DCAA). The enclosure provides the Department's suggested wording.

With regard to the discussion on page 11, the DFAS-Columbus Center has continued its research on the status of in-process receivables. As a result, the Center so far has determined the status of \$167 million of the \$178 million of receivables that were classified as in-process.

The Department appreciates the opportunity to comment on the draft report.

Sincerely,

Alvin Tucker
Deputy Chief Financial Officer

Enclosure

Now on p. 9.

Now on p. 7.

Appendix IV
Comments From the Department of Defense

GAO DRAFT REPORT -- DATED AUGUST 1995
"DOD PROCUREMENT: MILLIONS IN CONTRACT OVERPAYMENTS
NOT DETECTED AND RECOVERED PROMPTLY"

DEPARTMENT OF DEFENSE COMMENTS

Now on p. 9.

DOD CONCERN: The paragraph beginning at the bottom of Page 13 of the draft report reads as follows:

"Also, after discussing the results in this report with DoD and DFAS officials, DFAS, on July 31, 1995, directed the Columbus Center to begin surveying contractors to identify and resolve payment discrepancies. If this effort uses the on-site personnel from the Defense Contract Management Command and the Defense Contract Audit Agency to verify and validate contractor reported data, we believe it is a positive step toward addressing payment discrepancies. Because the effort is just starting, we are not making further recommendations at this time. However, we will periodically monitor the Center's progress in detecting and recovering overpayments."

DOD COMMENT: In discussions with the GAO representatives, it appears that the GAO intention is that the Defense Contract Management Command (DCMC) and the Defense Contract Audit Agency (DCAA) continue to provide the current level of assistance in the resolution of payment discrepancies. Neither of these organizations has the staff resources that would be required to verify and validate each contractor's accounts receivables records in addition to existing requirements. In order to avoid any misinterpretation in terms of the level of involvement of DCMC and DCAA, the DoD recommends that the above paragraph be revised as follows:

Also, after discussing the results in this report with DoD and DFAS officials, DFAS, on July 31, 1995, directed the Columbus Center to begin surveying contractors to identify and resolve payment discrepancies. To facilitate this effort, on-site personnel from the Defense Contract Management Command and the Defense Contract Audit Agency should continue to assist in the identification and resolution of payment problems. We believe such actions are positive steps toward addressing payment discrepancies. Because the effort to survey contractors is just starting, we are not making further recommendations at this time. However, we will periodically monitor the Center's progress in detecting and recovering overpayments.

Enclosure

Major Contributors to This Report

National Security and
International Affairs
Division, Washington,
D.C.

David Childress

Dallas Regional Office

Jeffrey L. Knott
Joe D. Quicksall
Seth D. Taylor
James W. Turkett

Related GAO Products

DOD Infrastructure: DOD's Planned Finance and Accounting Structure Is Not Well Justified (GAO/NSIAD-95-127, Sept. 18, 1995).

Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-146, May 23, 1995).

Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-143, May 16, 1995).

Defense Infrastructure: Enhancing Performance Through Better Business Practices (GAO/T-NSIAD/AIMD-95-126, Mar. 23, 1995).

DOD Procurement: Overpayments and Underpayments at Selected Contractors Show Major Problem (GAO/NSIAD-94-245, Aug. 5, 1994).

Defense Business Operations Fund: Improved Pricing Practices and Financial Reports Are Needed to Set Accurate Prices (GAO/AIMD-94-132, June 22, 1994).

Financial Management: DOD's Efforts to Improve Operations of the Defense Business Operations Fund (GAO/T-AIMD/NSIAD-94-146, Mar. 24, 1994).

DOD Procurement: Millions in Overpayments Returned by DOD Contractors (GAO/NSIAD-94-106, Mar. 14, 1994).

Financial Management: Status of the Defense Business Operations Fund (GAO/AIMD-94-80, Mar. 9, 1994).

Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, Dec. 22, 1993).

Letter to the Deputy Secretary of Defense (GAO/AIMD-94-7R, Oct. 12, 1993).

Financial Management: DOD Has Not Responded Effectively to Serious, Long-standing Problems (GAO/T-AIMD-93-1, July 1, 1993).

Financial Management: Opportunities to Strengthen Management of the Defense Business Operations Fund (GAO/T-AFMD-93-6, June 16, 1993).

Financial Management: Navy Records Contain Billions of Dollars in Unmatched Disbursements (GAO/AFMD-93-21, June 9, 1993).

Military Bases: Analysis of DOD's Recommendations and Selection Process for Closures and Realignments (GAO/NSIAD-93-173, Apr. 15, 1993).

Financial Audit: Examination of Army's Financial Statements for Fiscal Year 1991 (GAO/AFMD-92-83, Aug. 7, 1992).

Financial Management: Immediate Actions Needed to Improve Army Financial Operations and Controls (GAO/AFMD-92-82, Aug. 7, 1992).

Financial Management: Defense Business Operations Fund Implementation Status (GAO/T-AFMD-92-8, Apr. 30, 1992).

Financial Audit: Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act (GAO/AFMD-92-12, Feb. 19, 1992).

Financial Audit: Status of Air Force Actions to Correct Deficiencies in Financial Management Systems (GAO/AFMD-91-55, May 16, 1991).

Defense's Planned Implementation of the \$77 Billion Defense Business Operations Fund (GAO/T-AFMD-91-5, Apr. 30, 1991).

Financial Audit: Financial Reporting and Internal Controls at the Air Logistics Centers (GAO/AFMD-91-34, Apr. 5, 1991).

Financial Audit: Financial Reporting and Internal Controls at the Air Force Systems Command (GAO/AFMD-91-22, Jan. 23, 1991).

Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, Feb. 23, 1990).