Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEBT COLLECTION AND DEPOSIT CONTROLS

Report Number 92-021 December 13, 1991

Department of Defense

The following abbreviations and acronyms are used in this report.

AFAFC.....Air Force Accounting and Finance Center
DFAS.....Defense Finance and Accounting Service
DLA.....Defense Logistics Agency
IRS.....Internal Revenue Service
NFC.....Navy Finance Center
OMB.....Office of Management and Budget
SF.....Standard Form
USAFAC.....U.S. Army Finance and Accounting Center

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December 13, 1991

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Debt Collection and Deposit Controls (Report No. 92-021)

We are providing this final report for your information and use. Comments on a draft of this report were considered in preparing the final report. We concluded that DoD implemented the Cash Management Action Plan initiatives adequately and achieved savings through accelerated collection and deposit of funds to the Department of Treasury. We also concluded, however, that DoD policy and the Debt Collection Act of 1982 had not been uniformly implemented; consequently, delinquent debtors were not pursued promptly and aggressively.

Your comments on the draft of this report conformed to the requirements of DoD Directive 7650.3, leaving no other unresolved issues. No further comments are required.

The courtesies extended to the audit staff during the audit are appreciated. If you have any questions about this audit, please contact Mr. Raymond D. Kidd, Program Director, at (703) 614-1682 (DSN 224-1682) or Mr. Donald Stoll, Project Manager, at (703) 693-0445 (DSN 223-0445). The distribution of this report is listed in Appendix E.

Robert J. Lieberman
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Assistant Inspector General
for Auditing

Enclosure

Office of the Inspector General

AUDIT REPORT NO. 92-021 **December 13, 1991**
(Project No. 0FH-0055)

DEBT COLLECTION AND DEPOSIT CONTROLS

EXECUTIVE SUMMARY

Introduction. DoD Components must establish collection strategies that seek to return debtors to current payment status; failing that, the Components must maximize the collections that can be realized through the use of collection techniques outlined in the Debt Collection Act of 1982. As of September 30, 1989, the Components had $553.0 million in delinquent debt.

Objectives. The objectives of the audit were to evaluate the effectiveness of debt collection activities and to evaluate initiatives cited in DoD's Cash Management Action Plan to accelerate the collection and deposit of monies due the Government. The survey determined that no further audit work was necessary on DoD's Cash Management Action Plan initiatives.

Audit Results. The Components had not implemented prompt or aggressive collection strategies to pursue delinquent debts. Their policies and procedures for collecting delinquent debt were not consistent with Federal laws and regulations, or with DoD directives and instructions. Consequently, the likelihood of collecting $553.0 million of delinquent debt was significantly impaired. We estimated that $226.5 million (41 percent) of the delinquent debts receivable at the end of FY 1989 was uncollectible and should be written off.

Internal Controls. The audit disclosed several nonmaterial internal control deficiencies. Details of the weaknesses are discussed in the finding.

Potential Benefits of Audit. No quantifiable monetary benefits were identified. However, improved operations will result if our recommendations are implemented (see Appendix C).

Summary of Recommendations. We recommended that the Defense Finance and Accounting Service (DFAS) centralize control over DoD's debt collection and develop uniform operating procedures.

Management Comments. Comments from the Director, DFAS were received on September 24, 1991. The Director partially concurred with the finding and concurred with the recommendations. No further comments were requested.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate (202) 693-0340.

PART I: INTRODUCTION

Background

General. On the U.S. Treasury Department Consolidated Agency Detail Report (Standard Form [SF] 220, "Financial Position"), DoD's accounts receivable are categorized as debts due from Federal agencies or the public. Debts owed to DoD by Federal agencies are normally resolved by interagency transfers of funds and cause few problems. However, collecting debts from the public has been a continuing concern of financial managers. In DoD, debts owed by the public consist primarily of amounts owed by either contractors or individuals. Contractor debts result from damages or excess costs related to defaults in performance, expenses of correcting defects, overpayments due to errors in quantity, deficiencies in quality, errors in billing, and erroneous payments. Examples of individual debt include unearned portions of enlistment bonuses, travel advances, transportation costs that exceed allowances, and overpayment of various benefits.

Collection authority, policy, and procedures. Before 1966, the Federal Government had no uniform policies or statutory authority for debt collection. Congress enacted the Federal Claims Collection Act of 1966, Public Law 89-508. The Federal Claims Collection Act provided the legal framework for agency collection activities. The Debt Collection Act of 1982, Public Law 97-365, improved the Government's means of collecting overdue debts. It amended the Federal Claims Collection Act of 1966 by giving Federal agencies the authority to assess interest, penalties, administrative fees, and offsets to salary. The Debt Collection Act also allowed Federal agencies to use credit bureaus to make obtaining additional credit more difficult for delinquent debtors. Federal agencies could also use collection agencies to collect delinquent debts.

DoD Directive 7045.13, "DoD Credit Management and Debt Collection Program," October 31, 1986, states policy, establishes the credit management program (which includes debt collection and related policies and procedures for DoD), and assigns responsibility for debt collection within DoD. DoD Instruction 7045.18, "Collection of Indebtedness Due the United States," March 13, 1985, states policy, prescribes general procedures, and establishes responsibilities for the collection of debt owed by personnel. Both the Directive and the Instruction require DoD Components to vigorously pursue prompt and economical debt collection. Guidance regarding contract debt is contained in Section 4 of the Federal Acquisition Regulation. Office of Management and Budget (OMB) Circular A-129, "Managing Federal Credit Programs," November 25, 1988, explains the approved procedures for collecting debts, including the assessment of interest, penalties, and administrative fees; the use of collection

agencies and credit bureaus; the litigation process through the U.S. Department of Justice; the use of salary and tax refund offsets; and the reporting of uncollectible debts to the Internal Revenue Service as debtors' income.

Restructured financial management. To improve financial operations, DoD restructured its management functions and effective January 20, 1991, established a single organization for DoD finance and accounting. This DoD organization, under the Comptroller of the Department of Defense, is the Defense Finance and Accounting Service (DFAS). In accordance with DoD Directive 5118.5, "Defense Finance and Accounting Service," November 26, 1990, DFAS assumed operational control of the finance and accounting centers previously operated by the Military Departments, Defense agencies, and other DoD organizations. This report refers to the centers as they had been organized prior to establishing DFAS, since the period reviewed preceded the formation of the new organization.

Objectives

The objectives of the audit were to evaluate the effectiveness of debt collection activities, to evaluate initiatives in DoD's Cash Management Action Plan to accelerate the collection and deposit of monies due the Government, and to review internal controls over collections and deposits. Where applicable, we reviewed the Internal Management Control Program prescribed by the Federal Managers' Financial Integrity Act. Our initial audit effort showed that an evaluation of DoD's Cash Management Action Plan initiatives was not needed, and that objective was dropped.

Scope

Amount due DoD from the public. Standard Form (SF) 220, "Financial Position" for FY 1989, as of September 30, 1989, showed that contractors and individuals owed DoD $1.749 billion. Of the $1.749 billion, $1.196 billion was due or past due; the remaining amount was not yet due (for example, debts with deferred payment plans). The DoD Components had estimated that $97.9 million was uncollectible and had been provided for by an allowance for bad debts. Our audit focused on the $1.196 billion due or past due.

Limitations. Management told us that the accounting systems and procedures did not capture all material items, past or present, that were owed to DoD. Consequently, the financial reports generated from the accounting systems may contain material misstatements. Such reports may not represent amounts actually owed to DoD. The results of this audit are qualified to the extent that we used data from these reports.

At the Defense Logistics Agency (DLA), review was limited to contractor debt, which represented most of the amount owed to DLA. To conserve audit resources, we did not review the Navy's

procedures for collecting contractor debt. Instead, we relied on the conclusion of Naval Audit Service Report No. T18404, "Debt Collection," December 2, 1985. That audit did not identify any deficiencies in the management of collecting contractor debt; the auditors commended management for its outstanding efforts.

Selection of data. For the Navy, Air Force, and DLA, we used statistical sampling methods to randomly select debts for review. When appropriate, we projected the results of the random samples. For the Army, we used judgmental sampling to determine whether conditions in the other DoD Components also existed in the Army. Appendix A describes our statistical sampling plan and methodology for each sample.

Audit period, standards, and locations. This economy and efficiency audit was made from April 1990 through March 1991 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. The activities visited or contacted during the audit are listed in Appendix D.

Technical assistance. Technical experts assigned to the Inspector General, DoD, assisted in planning, evaluating, and projecting the results of statistical samples used during this audit.

Internal Controls

Controls assessed. We assessed the internal controls needed to properly charge interest, penalties, and administrative fees and to take prompt and aggressive collection actions.

Internal control weaknesses. The internal controls applicable to debt collection were deemed effective, since the audit disclosed no material deficiencies as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Several nonmaterial internal control weaknesses were identified and are discussed in Part II. The DoD Components have reported material weaknesses in the accounting systems used to accumulate, classify, and report on the status of accounts receivable in their Annual Assurance Statements.

Prior Audits and Other Reviews

During the last 5 years, the General Accounting Office, the Military Departments' audit components, and the Inspector General, DoD, have issued numerous reports that addressed cash management and debt collection. Our followup showed that with four exceptions, the DoD Components have corrected the previously reported conditions related to this audit. Appendix B summarizes the followup on prior audit reports that addressed findings similar to the conditions identified in this report.

PART II: FINDING AND RECOMMENDATIONS

COLLECTION OF DEBTS FROM THE PUBLIC

DoD's debt collection activities did not establish or did not implement effective management controls to ensure prompt and aggressive collection of delinquent public debts. The collection activities had not fully complied with applicable laws, policies, and regulations. Implementing guidance was often incomplete or ignored by operating personnel. Consequently, DoD's $97.9 million allowance for uncollectible accounts was understated by $128.6 million at the end of FY 1989. We estimated that $226.5 million (41 percent) of the $553.0 million that DoD reported as delinquent accounts was uncollectible and should be written off.

DISCUSSION OF DETAILS

Background

General. Collecting debts owed to the Federal Government has been a continuing concern of financial managers. In a June 1990 status report to Congress, the Office of Management and Budget (OMB) reported that $40.0 billion (16.4 percent) of $244.0 billion in nontax receivables was delinquent. OMB also stated, "A large portion of the delinquent Federal receivables is uncollectible." DoD reported in their report on accounts and loans receivable that $553.0 million was delinquent as of September 30, 1989. This represents 32 percent of the $1.749 billion owed to DoD. The debt is considered delinquent if a debtor does not pay or establish a repayment plan by a specified due date (detailed below).

Policy and procedures. DoD Directive 7045.13 and DoD Instruction 7045.18 state, "It is DoD policy that each DoD Component shall manage credit properly and pursue vigorously timely and economical debt collection."

The Debt Collection Act of 1982 allows Federal agencies to charge interest on outstanding debts and to charge administrative fees to cover the costs of processing and handling delinquent claims. The Debt Collection Act of 1982 also allows Federal agencies to charge penalties on debts more than 90 days delinquent. These financially punitive measures are intended to encourage contractors and individuals to make prompt payment to avoid additional costs.

Section 4, Code of Federal Regulations and OMB Circular A-129, "Managing Federal Credit Programs," require collection activities to use the full range of techniques to collect delinquent

debts. Techniques include dunning letters (requests for payment of debt due) interest and penalty charges, offsets to salaries and income tax refunds, reporting to credit bureaus, use of private collection agencies, and litigation by the U.S. Department of Justice when appropriate. The activity that identifies the debt should initiate collection action by notifying the debtor of the amount and reason for the debt, explaining the debtor's rights, and requesting payment within 30 days. If the debtor does not pay or establish a repayment plan by the due date, the debt is considered delinquent. If the debt is disputed, collection action is suspended until the dispute is resolved. When servicing finance centers or headquarters of the debt collection activities are notified of delinquent debts, they are responsible for taking more aggressive collection actions. When all actions have been taken and there is no reasonable assurance of collection, Circular A-129 requires that the debts be written off.

Collection actions. Management did not establish or did not implement controls to ensure that collection actions were initiated promptly. Collection activities did not consistently use the authorized collection techniques of issuing dunning letters; assessing interest, penalties, and administrative fees; and making referrals to collection agencies.

Dunning letters. Collection activities did not follow standardized procedures for sending dunning letters, and the required letters generally were not promptly sent to debtors.

Army. At the U.S. Army Finance and Accounting Center (USAFAC), review of 120 debts owed by personnel no longer affiliated with the Government (out-of-service) showed that USAFAC mailed initial dunning letters to out-of-service debtors; however, internal controls did not ensure that follow-up letters were sent when required. Of the 120 debts reviewed, 101 debtors should have been sent second dunning letters; only 79 letters were mailed. Third dunning letters should have been mailed to 45 debtors; only 29 letters were mailed. The third letter to one former service member was not mailed until a year after the member's discharge.

Navy. Navy activities were not promptly notifying the Navy Finance Center (NFC) of out-of-service debts so that collection actions could be initiated. An analysis of 101 debts showed that Navy activities took an average of 8 months to notify NFC after identifying debts. For example, one Navy activity did not seek collection assistance from NFC until 18 months after a member had separated from active duty. Consequently, required dunning letters were delayed, which decreased the likelihood of collection.

Air Force. Air Force bases that identified out-of-service indebtedness had not requested collection assistance from the Air Force Accounting and Finance Center (AFAFC) on 12,200 of 17,200 delinquent debtors until the debts were 90 or more days delinquent (120 days after the debt was identified). For the debts we sampled, delays ranged from 120 to 1,765 days. Air Force Regulation 177-102, "Commercial Transactions at Base Level," November 15, 1987, made the bases responsible for attempting collection actions during the first 90 days. The bases were to mail three dunning letters at 30-day intervals. If the debt was not collected, the delinquent accounts were to be forwarded to AFAFC. When AFAFC received notification of delinquent accounts, AFAFC personnel mailed three more similar dunning letters at 30-day intervals. This duplication occurred because AFAFC's automated tracking system did not identify whether the debtor had been previously notified, and AFAFC personnel assumed that base personnel had not followed established procedures. Consequently, more aggressive collection actions on out-of-service debts were delayed by 90 days.

Similarly, base contracting offices were not promptly notifying AFAFC of delinquent contract debt. Air Force Regulation 177-102 requires that contract debts not collected within 30 days after billing be forwarded to AFAFC for collection assistance. Air Force records showed that at the end of FY 1989, the amount owed on 369 contract debts had been identified. AFAFC had not been notified promptly that the debts were delinquent on 145 of the 369 contract debts so that aggressive collection actions could be initiated. For the contract debts we sampled, delays in notifying AFAFC ranged from 33 to 1,446 days. Adherence to established procedures would enhance the collectibility of the debts.

Defense Logistics Agency. An analysis of 33 of the DLA contract debts determined that an average of 2 months elapsed between the first and second dunning letters, and an average of 7 months elapsed between the second and third dunning letters. DLA's procedures provided for a 30-day period between the first and second dunning letters, which were the responsibility of DLA field offices. If a field office did not receive a response within 15 days of the second letter, the debt was to be referred to the headquarters debt collection activity for further action. After being notified of the delinquent debt, headquarters personnel were to send the final dunning letter within 45 days. Controls had not been established at headquarters to ensure that the established procedure was followed.

Interest, penalties, and administrative fees. Interest, penalties, and administrative fees were not assessed as required by the Debt Collection Act of 1982 and DoD Instruction 7045.18.

Contract Debt. DoD Components were generally assessing interest on contract debt as required. However, the Army and Air Force Finance Centers were not assessing penalties and administrative fees on contract debt. DLA assessed penalties and administrative fees on delinquent contract debt only if the debts were referred to a collection agency.

Army. Army employees were following the procedures in the Federal Acquisition Regulation. The procedures neither required nor prohibited assessing penalties and administrative fees. Since the Debt Collection Act of 1982 requires assessing penalties and administrative fees unless prohibited by other laws or regulations, the assessments should have been made. A review of 15 delinquent Army contracts identified three contracts that should have been assessed total penalties of $14,400 and administrative fees of $600.

Air Force. Air Force personnel responsible for collecting debts from contractors inappropriately followed the procedures of the Contract Disputes Act of 1978. This Act establishes the rules that the Government must follow when it owes money to contractors. The guidance in the 1982 Debt Collection Act should be followed when the amount that contractors owe the Government has been determined. Air Force records showed that contractors owed the Air Force $331.1 million. Based on that figure, we calculated that the Air Force failed to assess $19.9 million in penalties and $74,200 in administrative fees.

DLA. DLA's operating procedures inappropriately required that penalties and administrative costs be charged only when the debts were referred to collection agencies. As discussed below, referral to credit agencies was infrequent. Based on sample results, we estimated that DLA failed to assess $1.7 million in penalties and $192,000 in administrative fees.

DLA's collection procedures were hampered by a lack of current addresses for the indebted contractors. We randomly selected 119 contract debts, valued at $17 million, owed by 104 contractors. Review of DLA's files and responses from the U.S. Postal Service showed that DLA had incomplete or inaccurate addresses for 71 (68 percent) of the 104 contractors. The 71 contractors had 86 debts valued at $9.6 million. DLA's managers had failed to establish the control needed to maintain current addresses.

Individual Debt. The DoD Components were effectively using salary offsets to collect amounts owed by active duty and retired personnel and personnel working for non-DoD Federal agencies. Interest, penalties, and administrative fees were being appropriately assessed on out-of-service debt. However, the Navy generally did not assess interest on debts owed by active duty (in-service) members, and the Air Force did not assess interest on either in-service debts or debts owed by retired personnel.

Navy. The Navy assessed interest on only 176 of 40,262 indebted in-service members who were making monthly payments. In effect, the other 40,086 members received interest-free loans. NFC provided us with a stratified random sample of 90 indebted in-service members; the sample identified the amounts of members' debts and their payment schedules. Using the Navy's data, we calculated that as of September 30, 1989, the Navy failed to assess in-service members $1.3 million of interest on $23.4 million of in-service debts. Although operating personnel knew that interest should be charged, the NFC had not established procedures because Navy instructions did not require that in-service members be assessed interest.

Air Force. The Air Force did not assess interest on in-service or retired members' debts. Based on sample results, we estimated that for the in-service and retired members who were making payments as of September 30, 1989, the Air Force failed to assess interest amounting to $16.8 million. Air Force Regulation 170-30, "Debt Collection," November 15, 1987, inappropriately exempted these members from interest charges. The Air Force Audit Agency identified this problem in Report of Audit 100-0-14, "Interest Assessed on Debts Owed to the Air Force, Air Force Accounting and Finance Center," January 22, 1990 (see Appendix B). As recommended, a revised regulation was published on June 9, 1990. However, by late March 1991, interest was still not being assessed.

Collection agencies. The Army had discontinued the use of collection agencies. Management advised us that, in previous years, the agencies did not collect enough money to justify continued use. DLA referred debts to collection agencies infrequently. Debts that were referred were very delinquent and had little likelihood of being collected. Of the debt items reviewed, those sent to collection agencies were sent from 3 to 5 years after a final demand letter was sent to the debtor. Additionally, a file drawer, "Pending Collection Agency," was filled with files of delinquent debts identified prior to FY 1988. Operating personnel had overlooked these files because the control binders containing summaries of the debts had been misplaced for 2 years. Although the binders were found,

operating personnel had neither referred the debts to a collection agency nor taken any other action to resolve the indebtedness.

Army and DLA. Army and DLA practices concerning the use of collection agencies were contrary to the collection procedures established by OMB Circular A-129. The Circular states that collection agencies can be used at any time to collect delinquent debt, and that:

> ...all accounts that are six months or more past due must be turned over to a collection contractor unless the accounts have been referred to an internal workout group or to the Department of Justice for litigation, or are eligible for the Federal salary offset program or administrative offset.

Neither organization's operating personnel considered this collection technique to be useful.

Air Force. Air Force data showed that in FY 1990, 11.3 percent of the total $2.6 million collected by the Air Force resulted from referrals to collection agencies. The Air Force automatically refers delinquent individual debtors to collection agencies before debts become so old that the likelihood of collection is remote. Air Force management had not established similar procedures to refer delinquent contract debt to collection agencies. We believe that all delinquent debtors should automatically be referred to collection agencies in accordance with OMB Circular A-129.

Reporting uncollectible debts as income. The Army, Air Force, and DLA were not reporting uncollectible contract debts to the Internal Revenue Service (IRS), as required by OMB Circular A-129, so that income taxes could be assessed on amounts written off. Based on a tax rate of 15 percent, we estimated that the IRS was prevented from assessing $5.1 million in income taxes. Similarly, the Navy did not report defaulted individual debtors to the IRS, and about $1.8 million in income taxes could not be assessed. In making this computation, we assumed that taxes had not been assessed on the amounts owed.

Collectibility of debts. The chances of collecting a debt are directly related to the age of the debt. According to the Commercial Collection Agency Section of the Commercial Law League of America, the chances of collecting overdue debts that are 30 days old are about 93.8 percent. After 30 days, the probability drops sharply. After 90 days, the probability drops to 73.6 percent; after 180 days, to 57.8 percent; and after a

year, to 26.6 percent. The following aging of DoD's delinquent debt shows that $339.4 million (61 percent) was over 6 months delinquent.

Aging of DoD's Delinquent Debt as of September 30, 1989

Days Outstanding	Amount (Thousands)	Percentage
1 to 90	$122,687	22.2
91 to 180	91,032	16.5
181 to 360	173,365	31.3
Over 360	165,882	30.0
Totals	$552,966	100.0

Using the probabilities from the Commercial Law League of America, we estimated that about $226.5 million (41 percent) of the delinquent accounts will be uncollectible. The estimated amounts of uncollectible debt held by the Military Departments and Defense agencies are shown below.

Uncollectible Debts

Activity	Delinquent Debt (Thousands)	Estimated Uncollectible (Thousands)	Percentage Uncollectible
Army	$ 61,426	$ 25,847	42.08
Navy	161,900	49,639	30.66
Air Force	238,145	110,416	46.37
Defense Agencies	91,495	40,654	44.43
Totals	$552,966	$226,556	40.97

At the end of FY 1989, the Military Departments and Defense agencies had established a $97.9 million allowance for uncollectible accounts. Based on our analysis, the allowance for uncollectible accounts was understated by about $128.6 million.

This understatement of potential loss prevented DoD's financial managers from being fully aware of major deficiencies in DoD's debt collection procedures.

MANAGEMENT COMMENTS ON THE FINDING AND AUDIT RESPONSE

Management Comment. The Director, Defense Finance and Accounting Service, partially concurred with the finding. Management stated that the draft of this report incorrectly provided information that DoD Instruction 7045.18 provides guidance for collection of public debt. This Instruction applies to personnel debt; guidance for the collection of contract debt is contained in the Federal Acquisition Regulation.

Audit Response. We agree, and we have revised Part I of this report accordingly.

Management Comment. Management expressed concern about our estimate of the amount of delinquent debts that are uncollectible stating that the "... probabilities are based on the timeliness of debt recoveries in the private sector and are not applicable to DoD debts." Management pointed out that the time to collect debts using administrative offsets of future Federal payments of salaries and benefits exceeds 1 year. Additionally, collection through offsets of refunds of tax overpayments can be pursued by the IRS for 10 years from the date the debt becomes delinquent.

Audit Response. We continue to believe that the experience of the private sector concerning the probability of collecting delinquent debts based on the age of the delinquency is relative to the collection of delinquent Federal debt. Debts that are being recovered over a period of time by means of administrative salary or benefit offsets are not considered to be delinquent. According to the Treasury Financial Manual Bulletin 89-03, May 31, 1989, the term "delinquent" refers to the failure of the debtor to pay the debt by the date specified in the agency's initial written notification or applicable contractual agreement, or when the debtor fails to satisfy the obligation under a payment agreement. When DoD's efforts show that it is unlikely to collect the debts, they should be written off and should not be considered valid accounts receivable. This write-off action does not preclude continuing collection action by means of tax refund offsets through the IRS. Written-off receivables may be retained for possible future offset or collection. Should all attempts to collect prove unsuccessful, the uncollected amount should be closed out and reported to the IRS as income if taxes have not been previously withheld.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Director, Defense Finance and Accounting Service:

1. Centralize management over DoD's debt collection functions.

2. Develop uniform operating procedures that:

a. Establish time frames for carrying out each procedure in the debt collection strategy.

b. Require collection activities to periodically report on whether they meet the time frames.

c. Identify and write off all delinquent debts that are unlikely to be collected.

d. Require aggressive pursuit of all delinquent accounts receivable.

e. Standardize the implementation of all procedures required by laws and regulations, including procedures for assessing interest, penalties, and administrative fees and for reporting uncollectible debts to the Internal Revenue Service.

MANAGEMENT COMMENTS

The Director, Defense Finance and Accounting Service, concurred with the recommendations and has taken or plans to take corrective action (see Part IV, Management Comments).

PART III: ADDITIONAL INFORMATION

APPENDIX A - Statistical Sampling Plan and Methodology

APPENDIX B - Followup on Prior Audit Reports

APPENDIX C - Summary of Potential Monetary and Other Benefits Resulting from Audit

APPENDIX D - Activities Visited or Contacted

APPENDIX E - Report Distribution

APPENDIX A. STATISTICAL SAMPLING PLAN AND METHODOLOGY

Defense Logistics Agency (DLA) contract debts. DLA's records of contract debts were maintained on both manual and automated files. We obtained statistical samples from each set of records. For the sample from the manual file, we used simple random sampling methods. We organized the sample from the automated file into three strata of dollar values. The overall design is thus a mixture of a stratified random sample and a simple random sample.

Air Force in-service and retired personnel debts. The Air Force classified individual debt in two groups, based on whether the debt was incurred during active duty or after retirement (e.g., costs of moves for retirees). The audit teams drew a simple random sample from each group. The Quantitative Methods Division computed mean interest cost and its associated margin of error. They also computed the number of debts subject to debt collection based on the ratio of collectible debts in the sample to all debts in the sample.

Confidence level. The sample design and the estimates are based on a 90-percent confidence level.

Results of Statistical Sampling

Activity	Point Estimate (Dollars in Millions)	Precision of the Estimate (Plus and Minus) (Dollars in Millions)
DLA contracts (administrative costs and penalties)		
Administrative costs	$ .192	$ 0.000 1/
Penalties	$ 1.679	$ 1.280
Number of debts	962	98
Air Force in-service personnel debts (interest)		
Value of interest	$ 13.902	$1.428
Number of individuals	137,851	4,490
Air Force retired personnel debts (interest)		
Value of interest	$ 2.917	$1.506
Number of individuals	8,839	0.000 2/

1/ Administrative cost is a fixed value of $200 per transaction. Therefore, the precision is ± $0.00.

2/ The number of retired individuals is an actual count, not an estimate. Therefore, the precision is ± 0.00.

APPENDIX B. FOLLOWUP ON PRIOR AUDIT REPORTS

OFFICE OF THE INSPECTOR GENERAL, DOD, REPORTS

Audit Report No. 88-183, "Reimbursements Due from Contractors for Discrepant Materiel Deliveries to the Defense Logistics Agency," July 15, 1988.

Prior audit recommendations. Although the audit identified a need for DLA to identify and pursue debts more promptly, no recommendations were made because DLA was implementing corrective actions in response to Audit Report No. 86-042 (see below).

Repeat finding. The headquarters debt collection activity still needed to identify and pursue debts more promptly.

Audit Report No. 86-042, "Debt Collection Practices at the Defense Logistics Agency," November 18, 1985.

Prior audit recommendations. The auditors recommended that DLA revise DLA Manual 7000.1, chapter 12, to comply with the Federal Claims Collection Standards; identify a senior debt collection official to oversee collection functions; and strengthen internal controls to ensure that all debts are properly recorded and collection actions are promptly taken.

Corrective action taken. DLA revised DLA Manual 7000.1, chapter 12; designated the DLA Comptroller as the senior agency official responsible for debt collection; and implemented internal controls to ensure that field activities properly record debts and take prompt collection actions.

No corrective action. The headquarters debt collection activity had not implemented the same internal control procedures as the field activities.

Repeat finding. The DLA headquarters debt collection activity still needed to identify and pursue debts more promptly.

OTHER AUDIT AGENCY REPORTS

Air Force Audit Agency Report No. 100-0-14, "Interest Assessed on Debts Owed the Air Force, Air Force Accounting and Finance Center," January 22, 1990.

Prior audit recommendations. The auditors recommended that Air Force Regulation 170-30 be revised to clarify when interest should be charged; define "few pay periods"; and require that interest be assessed on nonroutine pay adjustments, interest on out-of-service debts be properly assessed, and interest charges be included on debts referred to the Office of Personnel Management for collection.

Corrective action taken. Air Force Regulation 170-130 was revised and published in June 1990, incorporating the recommended changes.

No corrective action. As of March 1991, the Air Force Accounting and Finance Center (AFAFC) had not implemented the revised procedures and did not have a schedule for implementation.

Repeat finding. AFAFC did not assess interest when necessary.

Air Force Audit Agency Report No. 4265336, "DoD-Wide Audit of Debt Collection," August 26, 1986.

Prior audit recommendations. The auditors recommended that interest be charged on in-service, out-of-service, and retired debt; the cost of debt processing be determined; out-of-service debtors be charged administrative fees; penalties be assessed on delinquent out-of-service debts; maximum amounts be collected from retired debtors; and that only three dunning letters be sent to debtors so that AFAFC did not duplicate the efforts of Air Force bases.

Corrective action taken. The cost of debt processing had been determined, and out-of-service debtors were assessed administrative fees and penalties on delinquent debts. Maximum amounts were generally collected from retired debtors.

No corrective action. Interest was not being charged on in-service and retired debt, and AFAFC was duplicating the efforts of Air Force bases.

Repeat finding. AFAFC was not charging interest on in-service and retired debt, and was duplicating the efforts of Air Force bases by sending additional dunning letters.

APPENDIX C. SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefits	Type of Benefit
1.	Economy and Efficiency. Implementation of the recommendation should result in improved economy and and efficiency by centralizing management of DoD's debt collection activities.	Nonmonetary.
2.	Internal Controls. Implementation of the recommendations should result in improved internal controls and compliance with laws and regulations by establishing standard operating procedures.	Not quantifiable. Improved internal controls should result in more aggressive collection action, thereby reducing the amount of uncollectible debt. However, we know of no basis to support a reasonable estimate of the potential monetary benefits that will accrue from this this improved management.

APPENDIX D. ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Comptroller of the Department of Defense, Director of Financial Services Policy, Washington, DC

Department of the Army

U.S. Army Finance and Accounting Center, Indianapolis, IN

Department of the Navy

Comptroller of the Navy, Washington, DC
Military Sealift Command, Washington, DC
U.S. Navy Finance Center, Cleveland, OH

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
U.S. Air Force Accounting and Finance Center, Denver, CO
2750th Air Base Group, Comptroller Squadron, Accounting and Finance Office, Wright-Patterson Air Force Base, OH
2851st Air Base Group, Comptroller Squadron, Accounting and Finance Office, Kelly Air Force Base, TX
2852d Air Base Group, Comptroller Squadron, Accounting and Finance Office, McClellan Air Force Base, CA
2853d Air Base Group, Comptroller Squadron, Accounting and Finance Office, Robins Air Force Base, GA
2854th Air Base Group, Comptroller Squadron, Accounting and Finance Office, Tinker Air Force Base, OK

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Arlington, VA
Headquarters, Defense Logistics Agency, Accounting and Finance Division, Cameron Station, Alexandria, VA
Defense Personnel Support Center (Clothing and Textiles), Philadelphia, PA

Non-DoD Federal Organizations

Department of the Treasury, Washington, DC

APPENDIX E. REPORT DISTRIBUTION

Office of the Secretary of Defense

Comptroller of the Department of Defense
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Secretary of the Army
Department of the Army, Inspector General
Assistant Secretary of the Army (Financial Management)
Auditor General, U.S. Army Audit Agency

Department of the Navy

Secretary of the Navy
Comptroller of the Navy
Assistant Secretary of the Navy (Financial Management)
Auditor General, Naval Audit Service

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Air Force Audit Agency

Defense Agencies

Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency

Non-DoD Federal Organizations

Office of Management and Budget
Department of the Treasury, Office of the Inspector General
U.S. General Accounting Office
NSIAD Technical Information Center

Congressional Committees:
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

PART IV: MANAGEMENT COMMENTS

Director, Defense Finance and Accounting Service Comments

MANAGEMENT COMMENTS: DEFENSE FINANCE AND ACCOUNTING SERVICE

DEFENSE FINANCE AND ACCOUNTING SERVICE

WASHINGTON DC 20376 5001

SEP 24 1991

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTN: DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE

SUBJECT: Draft Audit Report on Debt Collection and Deposit Controls (Project No. OFH-0055)

In response to your memorandum of June 28, attached are comments on the finding and recommendations contained in the subject report.

Thank you for giving me the opportunity to comment on the draft report. I look forward to reviewing the final report.

Albert V. Conte
Director

Attachment

DRAFT AUDIT REPORT ON DEBT
COLLECTION AND DEPOSIT CONTROLS
PROJECT NO. OFH-0055

COMMENTS ON RECOMMENDATIONS

RECOMMENDATION: Centralize management over DoD's debt collection functions.

COMMENT: Concur. With the establishment of the Defense Finance and Accounting Service, the Military Finance Centers became a part of the new organization. Therefore, the centralization of management has already been accomplished. In March 1991, a task force was created to review DoD's debt collection efforts, including the consolidation and standardization of debt operations, policies, and procedures. A review of their findings is scheduled for October of this year with implementation of the recommended changes, where feasible, shortly thereafter.

RECOMMENDATION: Develop uniform operating procedures that:

a. Establish time frames for carrying out each procedure in the debt collection strategy.
b. Require collection activities to periodically report on whether they meet the time frames.
c. Identify and write off all delinquent debts that are unlikely to be collected.
d. Require aggressive pursuit of all delinquent accounts receivable.
e. Standardize the implementation of all procedures required by law and regulations, including procedures for assessing interest, penalties, and administrative fees and for reporting uncollectible debts to the Internal Revenue Service.

COMMENT: Concur. Upon completion of the work of the task force on debt collection later this year and review of their findings, we will begin staffing of the proposed recommendations. The development of the uniform operating procedures should be completed by the end of FY 1992.

DRAFT AUDIT REPORT ON DEBT
COLLECTION AND DEPOSIT CONTROLS
PROJECT NO. OFH-0055

COMMENTS ON FINDING

FINDING: DoD's debt collection activities did not establish or did not implement effective management controls to ensure prompt and aggressive collection of delinquent public debts. The collection activities had not fully complied with applicable laws, policies, and regulations. Implementing guidance was often incomplete or ignored by operating personnel. Consequently, DoD's $97.9 million allowance for uncollectible accounts was understated by $128.6 million at the end of FY 1989. We (IG) estimated that $226.5 million (41 percent) of the $553.0 million that DoD reported as delinquent accounts was uncollectible and should be written off.

COMMENTS: Partially concur. The degree and effectiveness of management control varied within the individual Military Finance Centers. Now that the Centers are under DFAS, we have established a task force to explore consolidation of operations where feasible and standardization of systems and procedures. The task force will report on its findings and recommendations later this year.

DoD's debt collection instruction, DODI 7045.18, applies to personnel rather than contract debts. Guidance regarding contract debts is contained in the Federal Acquisition Regulations. Individual Finance Centers adhered to the policies and regulations of the governing military department, which generally followed DoD directives and instructions. Standardized policy and regulations will be developed following review of the task force report.

Your estimate of the amount to be written off as uncollectible is predicated on probabilities from the Commercial Law League of America. These probabilities are based on the timeliness of debt recoveries in the private sector and are not applicable to DoD debts. DoD debts result primarily from overpayments and advance payments. DoD may collect debts through the administrative offset of future Federal payments of salaries and benefits to debtors who are or have been Government employees and through the offset of refunds by the Internal Revenue Service of tax overpayments. The time involved in recovering debts employing these measures in most cases exceeds one year. In fact, the collection of debts through the Internal Revenue Service may be pursued for ten years from the date the debt becomes delinquent. These procedures are in addition to the measures employed in the private sector (use of private collection agencies and legal action).

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