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Acronyms

DCAA	Defense Contract Audit Agency
DLA	Defense Logistics Agency
DSCP	Defense Supply Center Philadelphia
FMR	Financial Management Regulation
GAO	Government Accountability Office
ODIG-AUD	Office of the Deputy Inspector General for Auditing
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
TMA	TRICARE Management Activity
USD(C)/CFO	Under Secretary of Defense (Comptroller)/Chief Financial Officer



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

July 9, 2007

MEMORANDUM FOR UNDERSECRETARY OF DEFENSE
(COMPTROLLER)/CHIEF FINANCIAL OFFICER

SUBJECT: Report on Identification and Reporting of Improper Payments through
Recovery Auditing (Report No. D-2007-110)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report. The Acting Deputy Chief Financial Officer comments to the draft of this report are partially responsive; however, one recommendation remains unresolved.

DoD Directive 7650.3 requires that all issues be resolved promptly. We request that the Undersecretary of Defense (Comptroller)/Chief Financial Officer provide the comments by August 9, 2007. See the Finding section of this report for the specific comments required on recommendation number one.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to audcol@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the /Signed/symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides at (614) 751-1400, extension 211 or Mr. Curt W. Malthouse at (614) 751-1400, extension 230. See Appendix D for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, reading "Paul J. Granetto", is positioned above the typed name.

Paul J. Granetto, CPA
Assistant Inspector General and Director
Defense Financial Auditing Service

Department of Defense Office of Inspector General

Report No. D-2007-110

July 9, 2007

(Project No. D2006-D000FJ-0156.001)

Identification and Reporting of Improper Payments through Recovery Auditing

Executive Summary

Who Should Read This Report and Why? DoD financial managers and contracting officials responsible for identifying and reducing improper payments should read this report. It discusses efforts and methods for using recovery audits to identify and report overpayments.

Background. Recovery auditing is a post-payment review and analysis of procurement and payment documents that DoD Components use to identify overpayments to contractors. For FY 2006 DoD reported it successfully used recovery audits to identify nearly \$200 million in improper payments. It reported that Defense Financial Accounting Service internal reviews and data mining efforts identified \$170.0 million in improper payments for recovery. Additionally, the Tricare Management Activity used a recovery audit contractor to identify \$25.3 million in FY 2006 improper payments. DoD also took action to improve the focus and management of its program. In November 2006, the Under Secretary of Defense (Comptroller)/Chief Financial Officer established a project officer and working group to oversee, improve, and expand the DoD recovery audit program.

Results. The Under Secretary of Defense (Comptroller)/Chief Financial Officer did not have adequate controls to fully implement a recovery audit program. Efforts to manage recovery audit contracts have been largely unsuccessful. Further, in the FY 2006 Performance and Accountability Report, DoD overstated the amount identified through recovery audits by \$64 million. The Department needs to disseminate guidance to improve contracting for recovery audits and adhere to guidance in reporting recovered funds. Finding and publicizing DoD entities' best practices in recovery auditing could leverage success throughout the Department. For instance, DoD should expand recovery audits in the area of telecommunication payments. In December 2006, the Navy awarded a recovery audit contract and projected it could recover 21 percent of the nearly \$1 billion it paid for telecommunication services in prior years. By expanding this effort to Army, Air Force, and other DoD telecommunication payments, DoD would realize as much as \$837 million in potential monetary benefits. (See the Finding section for the detailed recommendations and Appendix B for summary of potential monetary benefits.)

Management Comments and Audit Response. Although the Acting Deputy Chief Financial Officer concurred with one recommendation and partially concurred with another recommendation, he nonconcurred with one recommendation. He nonconcurred with our recommendation that he develop a plan to remedy recovery auditing impediments encountered by the Defense Logistics Agency and TRICARE Management Activity officials. He believed it was the responsibility of contracting officers to correct impediments. He also did not believe there was excessive oversight by Department officials in pursuing recoveries and did not believe performance metrics were necessary.

In response to our recommendation to conduct recovery audits in all of the Military Departments in the area of telecommunications, he stated that during a May 16, 2007, DoD-wide conference on improper payments and recovery auditing, he notified the Components' lead personnel of the recovery audit potential of the telecommunication area. However, he stated that it would be premature to designate the Navy telecommunication recovery audit as a best practice until the Navy makes recoveries on the contract. He stated that the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer would continue to work with the Navy to identify and disseminate the lessons learned from the Navy recovery audit contract once the Navy reaches a point of developing a proven, successful, and cost-effective approach and related recovery audit plan.

The Acting Deputy's plan to work with the Navy and disseminate lessons learned from the Navy' recovery audit contract satisfies the intent of our recommendation. However, we disagree with the Acting Deputy's response to our recommendation to develop a plan to remedy impediments to recovery auditing encountered by the Defense Logistics Agency and the TRICARE Management Activity. On November 2, 2006, he appointed a project officer for Improper Payment Information Act and Recovery Audits who is responsible for assisting Components with recovery auditing methodologies and processes as needed. Our recommendation is within the scope of the assigned responsibilities of the project officer. We ask that the Acting Deputy reconsider his position and provide comments on the final report by August 9, 2007.

See the Finding section of the report for a discussion of the management comments. See the Management Comments section of the report for the complete text of the comments.

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Background

Title 31, United States Code, sections 3561-3567, and Office of Management and Budget (OMB) memorandum number M-03-07, "Programs to Identify and Recover Erroneous Payments to Contractors," January 16, 2003, include provisions for Government Agencies to establish recovery audit programs. The DoD Financial Management Regulation volume 10, chapter 22, "Recovery Audit," December 2005, (the FMR) established policy for a recovery audit program in DoD.

Chapter 22 of the FMR defines a recovery audit as a post-payment review and analysis of a DoD Component's books, supporting documents, and other available information supporting its payments. It is specifically designed to identify overpayments to contractors that are caused by payment errors. It is not an audit in the traditional sense. It is a management control function.

The FMR allows either Government employees or contractors to perform recovery audits. It requires that any DoD Component with contracts totaling in excess of \$500 million implement a cost-effective recovery audit program as part of its internal controls over contractor payments. At the time of audit the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD[C]/CFO) had not identified the Components in DoD that procured more than \$500 million in FY 2006. However, the Department was using a mixture of internal auditors and contract auditors to perform recovery audits in several areas.

OMB Circular A-136, "Financial Reporting Requirements," August 23, 2005, requires that recovery audit program information be included in the annual Performance and Accountability Report (PAR) along with improper payment information. In FY 2004, FY 2005, and FY 2006, the USD(C)/CFO compiled and provided specific recovery audit program information in its PAR.

Objectives

The overall objective of the audit was to determine whether DoD had adequately identified and reported on programs and activities susceptible to significant improper payments. This report discusses the objective as it relates to DoD efforts to implement a recovery auditing program. We will further cover the objective in a subsequent report on the identification and reporting of erroneous payments in the DoD. See Appendix A for a discussion of the scope and methodology and for prior coverage related to the objectives.

Review of Internal Controls

We identified internal control weaknesses for USD(C)/CFO as defined by DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," January 4, 2006. USD(C)/CFO did not have adequate controls to fully implement

a recovery audit program: Implementing Recommendations 1, 2 and 3 would expand the use of recovery audits and improve oversight of recovery audit contracts.

Recovery Audit Program Results

DoD did not develop a fully effective recovery audit program to identify and recover overpayments to contractors. Further, DoD overstated the amount it reported that its recovery audit program identified. Specifically, the DoD FY 2006 Performance and Accountability Report included \$64 million of unsolicited refunds from contractors in the \$170 million it reported DoD identified in recovery audits. The program was less than fully effective and reporting was inaccurate because USD(C)/CFO personnel did not:

- effectively manage recovery audit contracts;
- develop a plan to remedy impediments for using recovery audit contractors including denials to data access, poor data quality, and excessive oversight;
- follow existing policies for reporting on recovery audits in the DoD Performance and Accountability Report;
- seek out best practices among specific DoD entities' recovery audit efforts to improve overall success of the program.

Improvements in contract oversight procedures will reduce delays and increase the timeliness and effectiveness of contracted recovery audits. Improvements in reporting will make information more reliable. Identifying successful recovery audit practices among DoD entities and disseminating information on those programs to other DoD entities could leverage the success. For instance we estimate that DoD may realize as much as an additional \$837 million in potential monetary benefits through use of recovery auditing in the area of telecommunication payments. (See the heading, Expanding the Opportunity, on page 8.)

Significant Management Actions

In August 2005, the DoD Inspector General recommended that USD(C)/CFO issue policy to implement a cost-effective recovery audit program and that it establish a program manager to oversee the program and its implementation.¹ In response to the recommendations, DoD issued Financial Management Regulation volume 10, chapter 22, "Recovery Audit," December 2005, which officially established the DoD recovery audit program and requires DoD Components to implement a cost-effective program if they enter into contracts valued at \$500 million annually.

The USD(C)/CFO also issued a memorandum in November 2006 that established a DoD project officer (instead of a program manager as recommended) for

¹ DoD IG Report No. D-2005-101, "DoD Recovery Audit Program," August 17, 2005.

Improper Payments and Recovery Auditing. According to the memorandum, the project officer will review the Department's statistical methodologies and processes for capturing and reporting recovery audit information to verify DoD reporting is accurate and complete and that it meets OMB reporting requirements. The project officer is still in the process of establishing and coordinating a working group that will consist of representatives from major DoD Components to assist in the review and to help modify the methodologies and processes as needed.

We expect the recent establishment of a project officer to result in recovery auditors having greater access to contract files and in expansion of the program to DoD General Fund activities.

Management of Recovery Audit Contracts

DoD procedures for oversight of recovery audit contracts are ineffective and need attention from the working group the new project officer is forming. For instance, a recovery audit contract managed by TRICARE Management Activity (TMA) was in jeopardy because of poor contract administrative procedures that, according to a recent audit report, did not comply with Federal Acquisition Regulations. Additionally, personnel in the Defense Logistics Agency (DLA) told us that contract administration problems have impeded their attempts to enter into a new contract. A summary of the TMA and the DLA issues follows.

TMA. TMA awarded a 4-year contract to a private recovery audit firm in FY 2003 to review medical education costs. Although the recovery audit contractor identified \$25.3 million in overpayments in FY 2006, a recent audit by the Office of Inspector General, DoD,² identified problems with the management of the contract. Specifically, the auditors determined that the contingency fees paid to the contractor were overstated by \$4.7 million and the contract was extended without legal authority and approval. The auditors also determined that poor contract administrative procedures caused the problems. The specific deficiencies follow.

- The TMA contract file did not support Federal Acquisition Regulation (FAR) requirements for unsolicited proposals.
- The unsolicited proposal did not include sufficient technical information as required by the FAR.
- TMA commenced negotiations without a favorable technical evaluation as required by the FAR.
- TMA did not adequately justify issuing the contract as a sole-source award under the authority of the FAR.

² "TRICARE Contract Award for the Audit of Capital and Direct Medical Education Costs," Report No. D-2007-6-002, October 11, 2006.

Our audit report recommended that TMA terminate the contract. At the time of this audit the future of the contract was uncertain.

Defense Logistics Agency. DLA awarded its first recovery audit contract in FY 1996. DLA personnel responsible for managing their recovery audit program told us they did not renew the most recent recovery audit contract and have not had one in place since the end of FY 2004. In FY 2004, the DLA contractor was successful in identifying \$5 million of recoveries in overpayments.

A DLA recovery auditing specialist told us that DLA was planning to solicit a new contract in FY 2006. However, as of March 2007, DLA was still resolving data access issues and a new contract had not been awarded. The Defense Supply Center Philadelphia (DSCP) will administer the new contract because of its experience managing the prior DLA recovery audit contracts.

DLA personnel stated that contract administration problems had delayed DLA's plan to issue a contract in FY 2006. Problems encountered on the previous contract included:

- controlling data access. DSCP contracting officials sanitized contract files to protect sensitive and proprietary data before allowing access by recovery audit contractors.
- inadequate documentation. The recovery audit contractors did not always provide sufficient information to successfully recover alleged overpayments.
- time consuming oversight. DSCP contracting officials often performed lengthy reviews to authenticate alleged improper payments identified by the recovery audit contractor.

DSCP terminated the previous recovery audit contract after problems in managing the contract and in resolving discrepancies with the recovery audit contractor were disclosed. One such problem occurred in FY 2000 after the recovery auditor identified overpayments on pharmaceuticals (affecting five vendors) and submitted it to DSCP for collection.

DSCP initiated collection actions but discontinued them after the pharmaceutical vendors disagreed that they were overpaid. DSCP officials told us that they did not have enough information to force the collections and that the recovery auditor should have provided more detailed information.

We provided the same data to a Defense Contract Audit Agency (DCAA) official with expertise in pharmaceutical pricing and received confirmation that the overpayments were valid. We concluded that DSCP should have worked with the recovery auditor, the pharmaceutical vendors, and DCAA to collect the overpayments rather than discontinue the recovery efforts. Enhanced procedures will ensure recovery audit efforts are not wasted.

Reporting FY 2006 Recovery Audit Program Results

In FY 2004, USD(C)/CFO began sending DoD Components an improper payments survey that included a request for recovery audit information. The surveys have been used each year since FY 2004. USD(C)/CFO used the returned survey results to compile information about recovery audits for inclusion in its PAR.

Surveys returned in FY 2006 showed that the DoD recovery audit program was limited in scope and consisted primarily of the results of DFAS recovery efforts and internal data mining efforts. According to information shown in the FY 2006 DoD PAR, the DFAS internal recovery efforts and other internal efforts were applied to \$299.4 billion of DoD payments. The efforts identified \$170.0 million for recovery.

In addition to the internal efforts, the Tricare Management Activity awarded and administered a recovery audit contract with an independent firm. In FY 2006, the contractor identified \$25.3 million in overpayments that the DoD could recover.

The FY 2006 PAR included a two page summary of DoD efforts to identify and collect its improper payments. The PAR showed that internal efforts³ that identified the \$170 million in improper payments for recovery was \$8.1 million more than reported in FY 2005 as recoverable. However, the reporting was misleading. DFAS survey documents show that DoD vendors and payees voluntarily identified and returned \$64 million of the \$170 million for FY 2006.

The following table shows the origination of the data used to compile the amount reported in the PAR.

FY 2006 PAR Reporting	
(\$ in millions)	
<u>Identification Source</u>	<u>Overpayments</u>
DFAS Site	\$86.04
Vendor/Payee	\$64.04
Predator data mining software	\$9.05
Mongoose data mining software	\$4.78
Internal Review	\$3.79
Accounting Activity	\$1.99
<u>Post Payment Audit</u>	<u>\$0.26</u>
Total Overpayments Identified	\$169.95

The amounts reported for Vendor/Payee should not be included in the amount reported in the PAR. The Vendor/Payee category consists of amounts returned

³ According to the PAR overpayments identified for recovery are primarily attributable to internal recovery audit efforts, contract reconciliations, statistical sampling, and voluntary refunds. Dollar amounts attributable to each are not provided.

from vendors. The amounts were identified by the vendors and did not originate from recovery audit efforts.

USD(C)/CFO included verbiage in the PAR that some of the amounts identified for recovery include voluntary refunds. However, voluntary refunds are not appropriately reported under recovery audits because they are amounts the vendor returns without any recovery audit in place.

Financial reporting guidance for recovery audits does not include voluntary refunds from vendors. Specifically, the FMR section 2201, paragraph 220102, "Applicability" requires that recovery audit results displayed in the PAR be reported in accordance with OMB Circular No. A-136, "Financial Reporting Requirements," which requires that agencies report on the results of their recovery audit effort and the amounts identified for recovery. OMB Circular No. A-136 does not mention refunds. Voluntary refunds also are not included in FMR guidance on recovery audit reporting.

We concluded the amount identified by internal recovery efforts that DoD should have reported was \$106 million. Correcting the reported amount also changes the percentages reported. The \$106 million reduces the percentage of improper payments identified by internal efforts to .04 percent of the payments reviewed rather than the reported .06 percent.⁴ The new DoD project officer needs to exclude voluntary refunds from the FY 2007 PAR.

Recovery Audit Best Practices

The Navy identified telecommunication payments as a prospective area for recovery auditing in FY 2006 and awarded a recovery audit contract in FY 2007. The contract award was the result of a Navy plan to improve its telecommunication management. In FY 2003 the Inspector General, DoD, found payment certification problems and recommended⁵ that the Defense Information Systems Agency (DISA) improve its payment process for certain telecommunication services. In FY 2004 the Government Accountability Office⁶ (GAO) recommended that the Navy develop a plan to integrate its telecommunications policy and strategic efforts.

As a result, in a July 16, 2004, memorandum, the Secretary of the Navy emphasized improving managerial oversight of Navy telecommunications. To accomplish the improvements he tasked the Department of the Navy Chief Information Officer (Navy CIO) to develop a management action plan to ensure integration of telecommunication policy and strategy efforts across the Navy.

⁴ The percentage of .06 was inadvertently presented in the PAR as .0006 percent. The reported amount-: \$170 million (identified for recovery) divided by \$299.4 billion (amount reviewed) -equates to .0006 or .06 percent.

⁵ DoD IG Report No. D-2003-124, "Certification of a DoD Payment for Telecommunication Services," August 22, 2003.

⁶ GAO Report No. 04-671, "Vendor Payments: Inadequate Management Oversight Hampers the Navy's Ability to Effectively Manage its Telecommunication Program, June 2004.

The Navy CIO completed the action plan in October 2004—before the FMR required recovery auditing—and a recovery audit was not included in the plan.

USD(C)/CFO subsequently issued new DoD policy⁷ for implementing recovery auditing. This policy dovetailed with the Navy management action plan. As a result the Navy CIO undertook a pilot project in FY 2006 to assess the feasibility of using recovery audits to identify telecommunication payment errors.

The Navy performed feasibility studies at four locations and identified potential recoveries and the possibility of savings of approximately 21 percent of the amount paid for telecommunication services. The Navy studies indicated the problems with telecommunication payments were widespread in that industry. As a result, the Navy CIO concluded that a recovery audit of its telecommunication contracts would be a cost-effective method to recover overpayments.

On December 26, 2006, the Naval Inventory Control Point awarded a contract for the Navy CIO to Avysion IT, Inc. to conduct a cost recovery audit of telecommunication expenses for the Navy. The contract includes recovery audit tests at all Navy and Marine Corps installations within the United States and, according to a Navy official, will include payments made over the last 3 years.

Expanding the Opportunity

The Navy and Marine Corps combined expenditures during FYs 2005 through 2007 will total about \$951.6 million for telecommunication services. Similarly, the Air Force, Army and other DoD Components collectively spend another \$1.64 billion annually. Defense Working Capital Fund budget estimates show that these Components will spend about \$4.7 billion for telecommunication services for FYs 2005 through 2007.

The Navy feasibility studies of telecommunication payments indicate a potential to realize considerable savings Department-wide. The Navy pilot study showed that recoverable charges included those costs not charged in accordance with the contract, billing from multiple vendors, billing for disconnected lines, incorrect charges, double billing, not using alternative service, and unauthorized tax charges. The problems with telecommunication payments are not unique to the Navy. Navy personnel familiar with telecommunications payments, indicated contracts for telecommunications services are similar in all three Military Departments and each likely would have similar payment errors or overcharges. They also indicated that surveys in industry by telecommunications expense management experts conservatively estimate that there is potential for a significant savings in telecommunications expenses by leveraging technology to manage costs and using automated telecommunications expense management systems. We calculate that—using the Navy estimate of 21 percent in potential savings, less 15 percent of recoveries paid to the contractor—the Army, Air Force

⁷ USD(C)/CFO Memorandum Subject “Programs to Identify and Recover Erroneous Payments,” October 17, 2005 and the DoD Financial Management Regulation volume 10, chapter 22, “Recovery Audit,” December 2005.

and other DoD Components could expect potential savings of \$837 million. We therefore conclude that the project officer should aggressively pursue implementation of recovery audits for all DoD telecommunication contracts.

Recommendations, Management Comments and Audit Response

We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer:

1. Develop a plan to remedy recovery auditing impediments encountered by Defense Logistics Agency and Tricare Management Activity officials. The plan should include procedures that:

a. Improve data access by increasing recovery auditor access to contract files, removing impediments caused by proprietary records, and allowing timely access to data.

Management Comments. The Acting Deputy Chief Financial Officer nonconcurred and stated that impediments with data access, contract files, and proprietary records need to be addressed by the Contracting Officer and the recovery audit contractor on a case-by-case basis.

Audit Response. The Acting Deputy Chief Financial Officer comments are nonresponsive and inconsistent with the duties he assigned to the Project Officer for Improper Payments and Recovery Audits. Specifically, his November 2, 2006, memorandum, "Project Officer for Improper Payment Information Act and Recovery Audits," requires the Project Officer to assist the Components and help modify methodologies and processes as needed. We concede that some impediments may be unique to Components and not under the purview of the Project Officer. However, our recommendation is within the scope of the assigned responsibilities of the Project Officer, and he needs to develop a plan that helps reduce commonplace obstacles and improves recovery auditor access to needed data and files while protecting sensitive records. We request that the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer reconsider its position and provide additional comments.

b. Assure the recovery auditor provides quality data to the Department by including provisions in recovery audit contracts to penalize recovery auditors for referrals that require the Department to spend large amounts of time and resources to research but do not have a high probability of recovery.

Management Comments. The Acting Deputy Chief Financial Officer nonconcurred and stated that the Contracting Officer is responsible for establishing appropriate terms and conditions in the recovery audit contract to ensure the contractor delivers a high quality product.

Audit Response. The Acting Deputy Chief Financial Officer comments are nonresponsive and, again, are inconsistent with the duties he assigned to the Project Officer for Improper Payments and Recovery Audits. Specifically, his November 2, 2006, memorandum requires the Project Officer to assist the Components and help modify methodologies and processes as needed. The Contracting Officer is responsible for ensuring a quality product from its recovery auditor. However, we believe helping Components to hold contractors accountable for a deliverable they can use is within the scope of the Project Officer's duties. Recovery audit contracts are not yet commonplace in the Department and many lessons and practices have yet to be learned. Navy telecommunications are one example of this evolution. The Project Officer needs to develop a plan that helps Contracting Officers from across the Department share information and ensure that recovery audit contracts include quality assurance provisions. We request that the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer reconsider its position and provide additional comments.

c. Minimize delays from excessive oversight by officials in the Department by establishing performance metrics that ensure recoveries are pursued as expeditiously as possible.

Management Comments. The Acting Deputy Chief Financial Officer nonconcurred and disagreed that there is excessive oversight by Department officials in pursuing recoveries. He also stated that establishing performance metrics is not practical because of unique circumstances encountered in the pursuit of recoveries. He further stated that one of the best incentives to ensure Component personnel are expeditiously working recoveries is the availability of the recovered funds for the Component to use to offset its operating expenses for administration of the recovery audit program.

Audit Response. The Acting Deputy Chief Financial Officer comments are partially responsive. We agree that offsetting program expenses with recovered funds is an incentive to collect overpayments identified by the recovery auditor. Departmental requirements call for a cost-effective recovery audit program. However, DSCP discontinued its recovery audit contract due in part to excessive oversight. Additionally, excessive oversight costs further diminish the recovered amounts that can be returned to the originating fund or appropriation. We request that the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer reconsider its position and provide additional comments on developing a plan to reduce excessive Departmental oversight.

2. Comply with existing audit recovery reporting policies and discontinue the practice of reporting unsolicited returns as recovered overpayments in the DoD Performance and Accountability Report.

Management Comments. The Acting Deputy Chief Financial Officer concurred and stated that voluntary refunds from vendors will be appropriately addressed in the DoD Performance and Accountability Report.

3. Designate the Navy telecommunication recovery audit as a best practices model and direct the Components with telecommunication contracts to

conduct pilot programs to determine the feasibility of awarding a similar recovery audit contract.

Management Comments. The Acting Deputy Chief Financial Officer partially concurred and stated that it is premature to designate the Navy recovery audit as a best practice since it has not yet made any recoveries. He stated that during the May 16, 2007, Improper Payments and Recovery Audit conference he notified the Components' lead personnel of the recovery audit potential of the telecommunication area. He further stated that he will continue to work with the Navy to identify and disseminate the lessons learned from its recovery audit.

Audit Response. The Acting Deputy Chief Financial Officer comments and alternative actions are responsive and satisfy the intent of the recommendation.

Appendix A. Scope and Methodology

We determined whether DoD complied with the requirements of Title 31, United States Code, sections 3561-3567, "Identification of Errors Made by Executive Agencies in Payments to Contractors and Recovery of Amounts Erroneously Paid" and the related Office of Management and Budget (OMB) memorandum number M-03-07, "Programs to Identify and Recover Erroneous Payments to Contractors," January 16, 2003. We analyzed survey information on improper payments to determine whether DoD identified all erroneous payments recovered by DFAS and recovery audit contractors. We also analyzed Defense Working Capital Fund budget excerpts to estimate the cost of annual telecommunication services. We interviewed DoD Component personnel responsible for managing and administering recovery audit contracts.

We performed this audit from May 2006 through March 2007 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We did not use computer-processed data to perform this audit.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the contract payment and financial management high-risk areas.

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO), the Department of Defense Inspector General (DoD IG), and the U.S. Army Audit Agency (AAA) issued 6 reports on the DoD recovery audit program. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

GAO

GAO Report No. GAO-02-635, "Contract Management: Overpayments Continue and Management and Accounting Issues Remain," May 2002.

GAO Report No. 04-671, "Vendor Payments: Inadequate Management Oversight Hampers the Navy's Ability to Effectively Manage its Telecommunication Program," June 2004.

DoD IG

DoD IG Report No. D-2003-124, "Certification of a DoD Payment for Telecommunication Services," August 22, 2003.

DoD IG Report No. D-2005-101, "DoD Recovery Audit Program," August 17, 2005.

DoD IG Report No. D 2007-6-002, TRICARE Contract Award for the Audit of Capital and Direct Medical Education Costs," October 11, 2006.

Army Audit Agency (AAA)

AAA Report No. A-2006-0129-FFM, "The Army's Recovery Audit Initiative," June 9, 2006.

Appendix B. Summary of Potential Monetary Benefits

Recommendation Reference	Type of Benefit	Amount of Benefit	Account(s)
3	Cost recovery of improper payments made to telecommunication contractors.	\$837 million. The benefit amount will be revised as Components recover telecommunication overpayments.	Army, Air Force, and Defense Operations and Maintenance Accounts

Appendix C. Report Distribution

Office of the Secretary of Defense

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Under Secretary of Defense Comments



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

COMPTROLLER

MEMORANDUM FOR PROGRAM DIRECTOR, DEFENSE FINANCIAL
AUDITING SERVICE, OFFICE OF THE
INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Comments to Draft Audit Report, "Report on Identification and Reporting of
Improper Payments through Recovery Auditing"
(Project No. D2006-D000FJ-0156 001)

This memorandum is in response to your request for comments on the audit
recommendations contained in the subject audit report, issued March 29, 2007

Recommendation 1. We recommend that the Under Secretary of Defense
(Comptroller)/Chief Financial Officer, develop a plan to remedy recovery auditing
impediments encountered by Defense Logistics Agency and Tricare Management
Activity officials. The plan should include procedures that:

- a. Improve data access by increasing recovery auditor access to contract files,
removing impediments caused by proprietary records, and allowing timely access to data.
- b. Assure the recovery auditor provides quality data to the Department by
including provisions in recovery audit contracts to penalize recovery auditors for referrals
that require the Department to spend large amounts of time and resources to research but
do not have a high probability of recovery.
- c. Minimize delays from excessive oversight by officials in the Department by
establishing performance metrics that ensure recoveries are pursued as expeditiously as
possible.

OUSD(C) Comments:

1a Nonconcur Impediments with data access, contract files, and proprietary
records that may arise during contract performance need to be addressed by the
Contracting Officer and the recovery audit contractor on a case-by-case basis. The
recovery audit contract includes a bilaterally negotiated statement of work and contract
clauses that best address these impediments and allow the issues to be resolved within
existing contract laws and regulations.

1b. Nonconcur The Contracting Officer is responsible for establishing appropriate terms and conditions in the recovery audit contract, as they do with any other type of service contract, to ensure the contractor delivers a high quality product. The proper selection of a qualified and experienced recovery audit contractor, the inclusion of specific and clearly defined contract deliverables, and appropriate oversight of the contractor ensure the recovery audit contractor provides quality data. If deemed appropriate, the Contracting Officer has the authority to include a penalty clause within the terms of the contract.

1c. Nonconcur We do not believe that there is excessive oversight by Department officials in pursuing recoveries. The proper review and validation of the recovery auditor's claim is essential to ensure the claim is adequately supported, defensible, and the identity of all funds to be recovered are matched to the correct appropriation.

Establishing performance metrics, including a realistic baseline to measure the expeditious pursuit of recoveries, is not practical. The unique circumstances encountered in the pursuit of recoveries including the type of cost area being audited, the documents and data sources needed to establish a proper and valid overpayment claim, and the rights and appeal processes that are available to the recovery audit contractor and vendor, do not lend themselves to a practical measure. We believe one of the best incentives to ensure Component personnel are expeditiously working recoveries is the ability of the Component to use the recovered funds to offset current operating expenses for the administration of the recovery audit program, and to pay for other obligations within the identified appropriation for the purposes and period for which the appropriation is available.

Recommendation 2. Comply with existing audit recovery reporting policies and discontinue the practice of reporting unsolicited returns as recovered overpayments in the DoD Performance and Accountability Report.

OUSD(C) comments: Concur. Voluntary refunds from vendors will be addressed in more appropriate sections of the PAR, in lieu of the recovery audit section.

Recommendation 3. Designate the Navy telecommunication recovery audit as a best practice model and direct the Components with telecommunication contracts to conduct pilot programs to determine the feasibility of awarding a similar recovery audit contract.

OUSD(C) comments: Partially Concur. The Navy telecommunications recovery audit contract was awarded on December 26, 2006, and to date, no recoveries have been identified and collected. As a result, we believe it would be premature to designate this recovery audit and the related contract terms and conditions as a best practice model for other Components to use. We notified the Components' Improper Payments and Recovery Auditing (IPRA) lead personnel of the recovery audit potential of the

telecommunication area at our May 16, 2007 IPRA conference. We will continue to work with the Navy to identify and disseminate the lessons learned from the Navy's recovery audit to the IPRA working group members once the Navy completes its work to a point of developing a proven, successful, and cost effective approach and related recovery audit plan.

We appreciate the opportunity to respond to your request for comments on the audit report. My point of contact is Mr. Wayne Goff, who can be contacted by telephone at 703-697-0831 or e-mail at wayne.goff@osd.mil.



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