

November 8, 2005



Financial Management

Report on Compiling and Recording Financial Adjustments Related to DoD Commercial Payments (D-2006-013)

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Acronyms

CRS	Contract Reconciliation System
DFAS	Defense Finance and Accounting Service
MOCAS	Mechanization of Contract Administration Services System
NULO	Negative Unliquidated Obligation
SF 1081	Standard Form 1081



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

November 8, 2005

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Report on Compiling and Recording Financial Adjustments Related to DoD
Commercial Payments (Report No. D-2006-013)

We are providing this report for information and use. We considered management comments on a draft of this report when preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to James L. Kornides at (614) 751-1400 ext. 211 or Mr. Curt W. Malthouse at (614) 751-1400 ext. 230. See Appendix B 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, appearing to read "Paul J. Granetto", is positioned above the typed name.

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

Department of Defense Office of Inspector General

Report No. D-2006-013

November 8, 2005

(Project No. D2004-D000FJ-0212.000)

Compiling and Recording Financial Adjustments Related to DoD Commercial Payments

Executive Summary

Who Should Read This Report and Why? DoD financial managers and contracting officials responsible for compiling and recording financial adjustments associated with contracts processed in the Mechanization of Contract Administration Services system should read this report. It discusses improvements needed in the internal controls over the identification and processing of financial adjustments in the system.

Background. The Defense Finance and Accounting Service Columbus used the Mechanization of Contract Administration Services system to manage and process more than \$115 billion in contractor payments in FY 2004. Defense Finance and Accounting Service Columbus contract reconciliation division personnel made financial adjustments using Standard Form 1081 to correct any errors in payment allocations in its records, and in the applicable Defense Finance and Accounting Service accounting station records. Additionally, when some refunds were received from contractors, Defense Finance and Accounting Service Columbus deposited the monies into a suspense account, subsequently posting them to the correct appropriations using the Standard Form 1081 to complete the financial adjustments. During FY 2004 Defense Finance and Accounting Service Columbus made 187,482 financial adjustments in its Mechanization of Contract Administration Services system data base to correct information concerning \$20.5 billion of its payments.

Results. Although many of the financial adjustments Defense Finance and Accounting Service made to the Mechanization of Contract Administration Services system database were needed, a significant number of those we examined were not necessary or accurately compiled and recorded. A judgmental sample of 185 of the adjustments, valued at \$1.8 billion, showed that 80 of the adjustments (\$924 million) were valid and reasonable. However, 105 adjustments (\$910 million) were either voided prior to being reported, were unnecessary or erroneously compiled and recorded, or corrected prior unnecessary and erroneous adjustments. Additionally, only 4 of 11 Defense Finance and Accounting Service officials who certified the financial adjustments we reviewed were authorized to do so. We concluded that Defense Finance and Accounting Service Columbus needs to improve internal controls over its financial adjustment process to minimize the number of adjustments it makes, ensure the adjustments are accurate, ensure related financial management information is useable, and reduce reconciliation costs. See the Finding section of the report for the detailed recommendations.

Management Comments. The Deputy Director of Defense Finance and Accounting Service, Commercial Pay Services (Columbus, Ohio) concurred with the audit findings and the intent of the recommendations. She stated that DFAS will compile reports on financial adjustments and determine the content, data source, receipts, and frequency of

reports to be generated and any system modifications or queries that will be necessary for such reporting. The Deputy Director stated that she would ensure that all new DFAS employees are given extensive training on the entire reconciliation process, which includes the completing of financial adjustments. The Deputy Director agreed to revise desk procedures to include a checklist to be used by the reviewing/approving official in both the reconciliation and accounts receivable areas. She also stated that DFAS will work with its customers to verify what information they require to ensure compliance with directives. The Deputy Director did not believe that additional detailed reconciliation procedures were needed.

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

Table of Contents

Executive Summary	i
Background	1
Objectives	1
Finding	
Contract Financial Adjustments	3
Appendixes	
A. Scope and Methodology	11
Prior Coverage	12
B. Report Distribution	13
Management Comments	
Defense Finance and Accounting Service, Commercial Pay Services	15

Background

Defense Finance and Accounting Service (DFAS) Columbus, located in Columbus, Ohio, made contract payments on a variety of multi-year DoD contracts in FY 2004. DFAS Columbus paid more than \$115 billion to approximately 16,000 contractors on 330,000 active contracts. It performed this task using a payment module in its Mechanization of Contract Administration Services (MOCAS) system.

Other DFAS locations were involved in performing the official accounting for DoD payments. Depending on the nature and type of procurement, multiple offices carried out DoD accounting functions in widely separated locations using a variety of different tracking systems.

DFAS Columbus uses the MOCAS database to compile and provide information on payments to the locations that maintain the official accounting records, but MOCAS is not the official accounting system and is not integrated with the numerous DoD accounting systems. MOCAS is a contract administration system that contains a payment module. The payment module is used to disburse payments to contractors electronically.

When DFAS Columbus makes a payment to a contractor, it allocates the payments to the appropriate line of accounting based on contractual information provided by the contracting officer. DFAS Columbus maintains a division that performs reconciliations to make adjustments to correct any incorrect payment allocations. The adjustments are identified at DFAS Columbus and the applicable DFAS accounting station adjusts its records using the correct information. Adjustments are completed using a Standard Form 1081, "Voucher and Schedule of Withdrawals and Credits" (SF 1081).

When DFAS Columbus receives funds from a contractor, the monies are deposited into a suspense account. The supporting documentation is forwarded to the accounts receivable division. At that point, DFAS Columbus personnel prepare an SF 1081 adjustment to remove the fund from the suspense account and to post the funds to the proper contract and line of accounting.

For adjustments not referred to the customers, Military Departments, and other DoD Organizations, prior to completion, DoD Regulation 7000.14-R, "Financial Management Regulation" volume 6A, chapter 2 requires DFAS to notify the customer at least once each month of the total amount, by type, and the categories of reasons for adjustments made by DFAS.

Objectives

The audit objective was to determine whether DoD accurately compiled and recorded financial adjustments related to contracts administered in the Mechanization of Contract Administration Services system and whether the results were included in the DoD financial statements. We also assessed

compliance with applicable laws and regulations. See Appendix A for a discussion of the scope and methodology.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of the DFAS management controls over commercial payment financial adjustments. Specifically, we reviewed the DFAS management controls over maintaining supporting documentation, reviewing and certifying financial adjustments, monitoring progress made in reducing the number of adjustments, and reporting adjustments. Because of the limited number of adjustments reviewed, we did not make a judgment on the materiality of the weaknesses identified. Therefore, we did not assess management's self-evaluation.

Adequacy of Management Controls. We identified management control weaknesses in the processing, identification, recording, and reporting of commercial payment financial adjustments. Recommendations 1 and 2, if implemented, will improve the DFAS control procedures. A copy of the report will be provided to the senior official responsible for management control at DFAS.

Contract Financial Adjustments

During FY 2004 DFAS Columbus recorded 187,482 MOCAS financial adjustments valued at \$20.5 billion. A review of 185 judgmentally selected adjustments, valued at \$1.8 billion, indicated DFAS Columbus made 80 adjustments, valued at \$924 million, which were reasonable. The remaining 105, valued at \$910 million, were either voided prior to being reported, were unnecessary or erroneously compiled and recorded, or corrected prior unnecessary and erroneous adjustments. Additionally, only 4 of 11 DFAS officials who certified the financial adjustments were delegated the proper authority. These conditions existed because DFAS did not have adequate procedures in place to comply with DoD policies on the processing, recording, and compiling of financial adjustments. Furthermore, DFAS Columbus personnel did not follow existing policy on the review and certification of financial adjustments. As a result, DFAS Columbus did not provide reliable information on MOCAS contracts that was needed by DoD managers to properly manage contracts and accurately compile DoD financial statement information. Additionally, DFAS Columbus cannot show needed improvement in the future on the amount of adjustments on MOCAS contract payments because it has no baseline to measure from. DFAS Columbus needs to take action to reduce the number of financial adjustments it processes on MOCAS contracts in order to improve the reliability of MOCAS information and reduce the contract reconciliation costs.

Reliability of Adjustments

DFAS Columbus recorded financial adjustments on SF 1081, "Voucher and Schedule of Withdrawals and Credits." Each SF 1081 updated information in MOCAS after it was approved by the certifying officer.

We judgmentally selected 23 SF 1081s for review and those forms included 118 line-item adjustments. The 118 line-item adjustments led to 67 additional line-item adjustments that were related to, but not included in, the SF 1081s for a total of 185 adjustments. Table 1 shows the types of adjustments made and their value. The results of our review are representative only of the sample and should not be generalized to the entire population.

Type of <u>Adjustment</u>	Number of <u>Adjustments</u>	Dollar Value of <u>Adjustments</u>
Credit Voucher	81	\$ 409,166,514
Settlement Voucher	8	13,676,246
Voided Voucher*	51	122,210,388
Payment Voucher	45	1,289,516,976
Total	185	\$1,834,570,124

*Voided vouchers are not reported externally to the accounting station

We did not include the 51 voided adjustments in any further analysis since they did not affect any accounts. We assessed whether the remaining 134 externally reported adjustments valued at \$1.7 billion were appropriate, unnecessary, erroneous, or corrective action. Table 2 shows the results of our assessment.

<u>Category</u>	<u>Number of Adjustments</u>	<u>Percentage of External Adjustments*</u>	<u>Dollar Value of Adjustments</u>
Appropriate	80	59.7%	\$924,004,470
Unnecessary	14	10.45%	557,335,812
Erroneous	14	10.45%	32,727,311
Corrective Action	26	19.4%	198,292,142
Total	134	100%	\$1,712,359,735

*Judgmental sample percentage does not generalize to the population.

Only 80 of the 134 adjustments were appropriate. The others were not needed, were incorrect, or were required corrective action. The details about the remaining adjustments are described below.

Unnecessary Adjustments. We included adjustments in the “unnecessary” category if the adjustments were not needed to correct prior disbursements, collections, or other adjustments. Of the 134 externally reported adjustments,

there were 14 unnecessary adjustments. For example, DFAS Columbus received a refund from a contractor in 1992 and processed the refund to the correct contract. However, in 1995, DFAS Columbus approved 10 unnecessary adjustments relating to the refund, which moved funds between the original contract and a second contract. DFAS Columbus closed the first contract before the unnecessary adjustments were reversed. DFAS Columbus discovered the unnecessary adjustments during the reconciliation of the second contract. As a result, in 2004 DFAS Columbus reversed the 10 unnecessary adjustments that were made in 1995. Extensive research was required to reconcile the contracts. Proper review would have prevented the processing of the unnecessary adjustments in 1995.

Erroneous Adjustments. We defined erroneous adjustments as required adjustments that were posted to the incorrect appropriation or were made for improper amounts. Of the 134 externally reported adjustments, there were 14 erroneous adjustments. For example, DFAS Columbus received a check for \$1.35 million that contained instructions from the Defense Contract Management Agency to adjust six line items on contract N00383-01-G100A. The adjustments should have been processed as a net credit of \$1.35 million. However, DFAS Columbus processed the adjustments in reverse of the Defense Contract Management Agency instructions and recorded a net debit of \$1.35 million, for a total error of \$2.7 million (\$1.35 million plus \$1.35 million). DFAS Columbus later processed an additional adjustment correcting these errors. Improving controls, to ensure that DFAS Columbus personnel perform a proper review and understand the supporting documentation would prevent errors such as the erroneous adjustments.

Corrective Action. We defined adjustments as corrective action when the adjustments were made to correct prior unnecessary or erroneous adjustments. DFAS processed 26 adjustments to reverse or correct the unnecessary and erroneous adjustments. Table 3 shows the split in the amounts of corrective actions for unnecessary and erroneous adjustments.

<u>Adjustment Corrects</u>	<u>Number of Adjustments</u>	<u>Dollar Value of Adjustments</u>
Unnecessary	10	\$161,335,812
Erroneous	16	36,956,330
Total	26	\$198,292,142

Processing corrective action adjustments required reconciliations from current and past contracts. The Military Departments and other DoD organizations are billed by DFAS for the reconciliations and adjustments completed on their contracts. Presently, the DFAS Columbus reconciliation division charges its DoD customers \$74.55 per hour for reconciliations and processing of adjustments. Unnecessary and erroneous adjustments can result in significant costs to the

Military Departments or other DoD organizations. Demonstrating proper internal control over financial adjustments may result in significant savings by reducing the number of unnecessary, erroneous, and corrective action adjustments needed.

Improving Internal Control over Financial Adjustments

DFAS Columbus personnel made unnecessary, erroneous, and corrective financial adjustments primarily because they did not always adhere to the DoD policy on the review, approval, documentation, and reporting of adjustments.

Review and Approval of Adjustments. DoD Regulation 7000.14-R, volume 5, chapter 33 states that certifying officers are responsible for the accuracy of facts stated on a voucher and in the supporting documentation and records. DFAS 7000.8-I requires all certifying officers, including those certifying SF 1081s, to complete training prior to assuming the certifying officer duties. According to DFAS Columbus Interim Guidance 01-PRO-007, the Deputy Director of Contract Pay Services must appoint all certifying officers, including those certifying SF 1081s. Finally, DoD Regulation 7000.14-R, volume 10, chapter 20 requires those who approve financial adjustments to ensure that all adjustments are properly documented, the adjustments fully correct all affected systems, and adjustments are accurately posted to all disbursement and accounting systems.

We examined the qualifications of 11 certifying officers and determined that only 4 received proper delegations of authority in accordance with the guidance at the time of their appointment. Additionally, DFAS Columbus was unable to verify that any of the 11 certifying officers received the training required to perform the certification. If the certifying officers are properly trained and perform appropriate reviews when certifying SF 1081s for processing, it is more probable that DFAS Columbus can show improvement in reducing the number of financial adjustments processed.

Supporting Documentation. DoD Regulation 7000.14-R, volume 10, chapter 20 requires the retention of accurate and complete supporting documentation, including documentation on financial adjustments. Although a majority of the documents we reviewed accurately reflected the adjustments, the supporting documentation for three large financial adjustments did not reflect what DFAS Columbus processed. For example, in FY 2003 DFAS Columbus received an invoice from a vendor that returned money to the Government. DFAS Columbus incorrectly recorded the refund as a charge to the Navy. DFAS Columbus used an SF 1081 to reverse the error. The SF 1081 showed that DFAS returned the funds (\$5.7 million) to the National Guard instead of the Navy. However, the documentation within MOCAS and the Navy accounting system showed that DFAS did in fact return the money to the Navy. DFAS Columbus personnel could not explain why the SF 1081 did not match the MOCAS information or the Navy accounting data. In this instance, the audit trail for the transactions did not accurately represent the transactions that were posted in MOCAS and the official accounting records. Certifying officers should ensure supporting documentation accurately reflects the actions taken by the reconciler or accountant.

Financial Reports on Contract Financial Adjustments. DoD

Regulation 7000.14-R, volume 6A, chapter 2 requires DFAS to notify its customers at least once each month of the total amount of financial adjustments by type, and the reason for the adjustments. According to DFAS Columbus personnel, the reporting requirement is not their responsibility because they are in charge of the DFAS Commercial Pay Business Line. They indicated the Regulation's reporting requirements were the responsibility of personnel in the offices of the DFAS Accounting Business Line.

DFAS Columbus was providing the DFAS Accounting Business Line office information it had on expenditure, collection, and adjustment transactions processed by MOCAS and the Contract Reconciliation System (CRS) at DFAS Columbus. However, the information was not compiled in accordance with DoD 7000.14-R. Specifically DFAS did not provide the information on a monthly basis and did not summarize it by the total amount, type, and the categories of reasons for adjustments made by DFAS.

We met with senior DFAS officials in July 2005. Officials from the Commercial Pay Business Line and the Accounting Business Line agreed that they need to work together with DFAS customers to produce meaningful management reports. Management agreed that the reports will facilitate progress toward reducing the number of adjustments by allowing DFAS Columbus to focus its attention on why the adjustments occur and how they can be avoided. Ultimately, by producing the management reports, DFAS Columbus can demonstrate it is focused on reducing problems that result in the need for adjustments and can provide accurate information to its customers.

Effects on Financial Information

Of the 134 financial adjustments, 53 adjustments valued at \$1.4 billion made corrections to transactions from a previous fiscal year. Of those, 10, valued at \$7.5 million, changed the appropriation charged. Additionally, the accounting stations provided 4 examples (totaling \$1.3 million) of adjustments processed by DFAS Columbus internally but not reported to the accounting stations.

These unreported adjustments had a direct effect on the DoD financial records as follows.

Adjustments that Affect Prior Year Financial Transactions. Payments DFAS Columbus personnel processed incorrectly in one fiscal year resulted in the need for adjustments that often were not made until the next fiscal year. The adjustments affected contract information and administration and financial reporting for prior years. For example, an SF 1081 that DFAS Columbus used to adjust contract number F33657-97-C0030, involved 15 line item adjustments. The adjustments, which were processed in FY 2004, corrected the posting of a FY 2003 disbursement. In making the FY 2003 disbursement, DFAS Columbus failed to post \$198 million of a FY 2003 invoice in MOCAS until FY 2004. This included \$99 million of the payment and \$99 million of the recoupment amount. Additionally, DFAS Columbus provided this inaccurate posting data to the

accounting station. As a result, the FY 2003 accounting records did not contain all of the relevant payment and recoupment amounts. The correction in FY 2004 resulted from DFAS attempts to correct an improper allocation. In the process of correcting the allocation, DFAS Columbus personnel unknowingly posted the \$198 million from the FY 2003 disbursement.

Adjustments that Affect Appropriations. When DFAS Columbus makes payments or adjustments and does not allocate them to the correct appropriation, there is an increased risk of creating or masking problem disbursements that DFAS is required to report. For example, in FY 2004 a DFAS Columbus certifying officer did not properly review two adjustments on a contract (F08635-01-C0027) valued at \$2.2 million. The adjustments moved funds between two service codes and two appropriations on the contract. If the correct adjustments were made in accordance with the invoices, MOCAS would have reported a negative unliquidated obligation (NULO) on the contract. However, the erroneous adjustments masked the reportable problem disbursement.

After we notified the certifying officer of the erroneous adjustments, the reconciler and the certifying officer agreed that the adjustments needed to be reversed and a more extensive reconciliation completed. The reconciler was able to process the reversing adjustment in coordination with other adjustments so that the NULO could be resolved.

Internal Adjustments Versus External Adjustments. Internal adjustments are used to process corrections that are internal to MOCAS only and are not reported to the accounting stations. Prior to approving the adjustments, the certifying officers are required to ensure the adjustments correct data in all appropriate systems.

According to personnel at the DFAS accounting stations in Charleston, South Carolina, and Dayton, Ohio, DFAS Columbus personnel frequently process internal adjustments that should be reported externally. The accounting stations provided four examples of internal adjustments, processed by both the reconciliation division and accounts receivable division that should have been reported to the accounting station. For example, DFAS Columbus processed one payment twice and sent the information to the accounting station in Dayton. After the duplicate payment was discovered and the collection received, DFAS Columbus processed an internal adjustment to post the collection to the MOCAS records. However, DFAS Columbus did not report the credit to the accounting station. The accounting stations are unable to adjust the records without DFAS Columbus processing the external adjustments.

Conclusion

It is essential that DFAS processes only required financial adjustments and does so in a timely and accurate manner. The lack of comprehensive internal control over financial adjustments and DFAS noncompliance with current policies and procedures has increased the risk of DFAS Columbus processing unnecessary and erroneous adjustments and of DoD activities maintaining erroneous accounting records.

Reconcilers and certifying officers need training to more accurately process financial adjustments. Proper review and approval of financial adjustments, increased emphasis on supporting documentation, and proper internal and external reporting, will decrease the risk that DFAS Columbus will make unnecessary and erroneous adjustments, thereby decreasing the number of reconciliations required to correct the adjustments.

Finally, accurate reporting of financial adjustments can demonstrate progress toward reducing adjustments on prior payments, collections, and adjustments.

Management Actions

As of July 2005, DFAS Columbus management stated it was planning to emphasize training the reconcilers and certifying officers, and is constructing a new training class for both. The class will also be offered to non-DFAS employees. Reconcilers and certifying officers should receive periodic training to stay current on changing policies and systems.

Additionally, DFAS Columbus is presently in the process of issuing delegations of authority to all certifying officers. The delegations are being issued in accordance with current DFAS guidance. As a result of this ongoing action, we are not making recommendations in this area.

Recommendations and Management Comments

Deleted and Renumbered Recommendation. The Director of Defense Finance and Accounting Service coordinated and deferred all comments and responses to the recommendations to the Deputy Director, Defense Finance and Accounting Service, Commercial Pay Services (Columbus, Ohio). As a result of management comments we deleted recommendation 1.b. Management comments on our other audit recommendations met the intent originally stated as recommendation 1.b. We renumbered draft recommendation 1.c. as 1.b.

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

1. Issue comprehensive policy and guidance to establish consistent processes to identify, process, compile, and record adjustments. The policy should, at a minimum:

a. Require a periodic compilation and report providing the number of adjustments and the total effect on current and prior year financial records.

Management Comments. The Deputy Director of Defense Finance and Accounting Service, Commercial Pay Services (Columbus, Ohio) concurred with the recommendation. She stated that DFAS will compile reports on financial

adjustments and determine the content, data source, receipts, and frequency of reports to be generated and any system modifications or queries that will be necessary for such reporting. The Deputy Director provided an estimated completion date of February 28, 2006.

b. Require periodic training of reconcilers and certifying officers on policies, procedures, and responsibilities in reviewing Standard Form 1081 financial adjustments.

Management Comments. The Deputy Director of Defense Finance and Accounting Service, Commercial Pay Services (Columbus, Ohio) concurred with the recommendation and stated that a revised Responsible Contract Reconciliation Agent training class is in process. The Deputy Director stated that she would ensure that all new employees are given extensive training on the entire reconciliation process, which includes the completing of financial adjustments. She stated that this training is scheduled for completion by January 31, 2006.

2. Provide a thorough checklist of items certifying officers should review prior to approving the adjustment. The checklist should, at a minimum, include:

a. Reviewing all supporting documentation to ensure the adjustments are completed in the most efficient manner possible.

b. Reviewing the appropriateness and amount of the adjustment.

c. Ensuring the necessity of the adjustment.

d. Ensuring all affected systems will be accurately adjusted.

Management Comments. The Deputy Director of Defense Finance and Accounting Service, Commercial Pay Services (Columbus, Ohio) concurred with the recommendation. She agreed to revise desk procedures to include a checklist to be used by the reviewing/approving official in both the reconciliation and accounts receivable areas. She provided an estimated completion date of January 31, 2006.

3. Direct the Director of the Contract Pay Business Line and the Director of the Accounting Business Line to coordinate the compilation of periodic monthly reports to Defense Finance and Accounting Service customers in accordance with DoD 7000.14-R, volume 6A, chapter 2.

Management Comments. The Deputy Director of Defense Finance and Accounting Service, Commercial Pay Services (Columbus, Ohio) concurred with the recommendation. She stated that DFAS will work with its customers to verify what information they require to ensure compliance with directives. She provided an estimated completion date of February 28, 2006.

Appendix A. Scope and Methodology

We assessed whether DoD complied with the requirements of DoD Regulation 7000.14-R, "DoD Financial Management Regulation," volume 6a, chapter 2, March 2002; volume 10, chapter 1, March 2002; and volume 10, chapter 20, May 2001. Additionally, we assessed DFAS compliance with internal guidance implementing the Regulation and discussing the accrual of accounts payable adjustments. We obtained FY 2004 transactions processed using MOCAS and FY 2004 transactions processed using CRS. We analyzed the data to determine the total dollar value of the external adjustments. Additionally, with the help of the Quantitative Methods Division (QMD) of the DoD OIG, we analyzed the completeness of the data. Finally, we obtained examples of the September 30, 2004, accrual adjustments from DFAS Indianapolis and DFAS Cleveland.

We selected our sample from the data provided by DFAS Columbus. We ensured that we selected adjustments for contracts administered by the Army, Navy, Air Force, and other DoD agencies. Additionally, we selected transactions that appeared in only the MOCAS data, only the CRS data, and in both sets of data. We selected both older and newer contracts by ensuring that our limited sample included both pre- and post-1999 contracts. We selected high-dollar value vouchers. Finally, we ensured we selected at least one SF 1081 with a holding Accounting Classification Reference Number on the voucher.

We obtained all supporting documentation for each of the samples selected. Sample documentation included the reason for the adjustment, how the adjustment was processed at DFAS Columbus, and how the adjustment was posted at the accounting stations. We reviewed the trail of documentation to the original disbursement or collection, including all previous and subsequent adjustments. We evaluated the documentation for necessity, appropriateness, and timeliness. Additionally, we ensured the documentation supported the actions taken to process the adjustment.

In a statistical sense, the representativeness of a sample is determined by whether the method of its selection was random or involved human judgment. Our sample was judgmental. The results of our review discussed in this report are representative only of the sample and should not be generalized to the entire population.

We performed this audit from September 2004 through August 2005 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We relied on computer-processed data from the MOCAS, CRS, and various other accounting systems. After assessing the reliability of the data, we could not verify the completeness of the MOCAS or CRS data. Because we completed a judgmental sample, the completeness and reliability of the MOCAS and CRS data were not relevant to the audit results.

We completed limited testing on the reliability of the data we received from the accounting systems. We determined the data we received was accurate. We only reviewed accuracy of the data obtained and not the reliability of each system.

Use of Technical Assistance. Personnel from the Quantitative Methods Division (QMD) of the DoD OIG assisted in assessing the completeness of the computer processed data. Additionally, QMD personnel assisted in determining the sampling methodology.

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

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) has issued four reports discussing financial adjustments on contracts administered in the Mechanization of Contract Administration Services system. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>.

GAO

GAO Report No. 03-727, "Management Action Needed to Reduce Billions in Adjustments to Contract Payment Records," August 2003

GAO Report No. 02-747, "Improvements Made but More Corrective Actions Are Needed," July 2002

GAO Report No. 01-697, "\$615 Million of Illegal or Otherwise Improper Adjustments," July 2001

GAO Report No. 00-20, "Differences in Army and Air Force Disbursing and Accounting Records," March 2000

Appendix B. Report Distribution

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Defense Finance and Accounting Service Commercial Pay Services Comments



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DFAS-CS/CO

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

SUBJECT: Management Comments to DoDIG Draft Audit Report "Compiling and
Recording Financial Adjustments Related to DoD Commercial Payments,"
Project No. D2004-D000FJ-0212, dated August 24, 2005

Management comments to Recommendations 1a, 1b, 1c, 2 and 3 in the subject draft audit
report are provided. Recommendation 1b is considered closed.

My point of contact for additional information is Ms. Lisa Levy, DFAS-CSQA/CO. She
may be reached at 614-693-7398 or DSN 869-7398.

A handwritten signature in black ink, appearing to read "Martha J. Stearns".

Martha J. Stearns
Deputy Director
Commercial Pay Services

Attachment:
As stated

Management Comments to DoDIG Draft Audit Report, "Report on Compiling and Recording Financial Adjustments Related to DoD Commercial Payments (Project No. D2004-D000FJ-0212)," dated August 24, 2005

The Director of the Defense Finance and Accounting Service should issue comprehensive policy and guidance to establish consistent processes to identify, process, compile, and record adjustments. The policy should, at a minimum:

Recommendation 1a: Require a periodic compilation and report providing the number of adjustments, and the total effect on current and prior year financial records.

Management Comments: Concur. DFAS will determine the content, data source, receipts and frequency that the reports need to be generated and any system modifications or queries that will be necessary for such reporting.

Estimated Completion Date: February 28, 2006.

Recommendation 1b: Provide consistent procedures for reconciliation and accounts receivable divisions to use when processing Standard Form 1081 adjustments.

Management Comments: Non-concur. Reconciliation personnel process Standard Form (SF) 1081 adjustments to correct out of balance conditions; Accounts Receivable personnel process SF 1081 adjustments to post collections and/or offsets for money owed the Government. Desk Procedure 607, Contract Reconciliation, and Desk Procedure 901, Accounts Receivable Procedures, outline when a SF1081 should be processed. Desk Procedure 808, Coding of Adjustments, and the Contract Reconciliation System User Manuals (referenced in both the Contract Reconciliation and Accounts Receivable procedures) provide standard instructions for the preparation of SF 1081s.

Estimated Completion Date: This recommendation is considered closed.

Recommendation 1c: Require periodic training of reconcilers and certifying officers on policies, procedures, and responsibilities in reviewing SF 1081 financial adjustments.

Management Comments: Concur. All new employees are given extensive training of the entire Reconciliation process, which includes the completion of SF 1081 financial adjustments. In addition, the Policy and Training Branch, with assistance from the Reconciliation Division, is in the process of completing a revised Responsible Contract Reconciliation Agent training class. This training is scheduled to be completed by January 2006. All reviewing/approving officials will be required to complete this training course.

Estimated Completion Date: January 31, 2006.

Deleted

Renumbered
as
Recommendation 1.b. in
final report.

Recommendation 2: The Director of the Defense Finance and Accounting Service should provide a thorough checklist of items certifying officers should review prior to approving the adjustment. The checklist, at a minimum, should include:

- A. Reviewing all supporting documentation to ensure the adjustments are completed in the most efficient manner possible.
- B. Reviewing the appropriateness and amount of the adjustment.
- C. Ensuring the necessity of the adjustment.
- D. Ensuring all affected systems will be accurately adjusted.

Management Comments: Concur. A checklist currently exists in Desk Procedure 607, Contract Reconciliation. Desk Procedure 808, Coding of Adjustments, will be revised to include a checklist to be used by the reviewing/approving officials in both the Reconciliation and Accounts Receivable areas.

Estimated Completion Date: January 31, 2006.

Recommendation 3: Direct the Director of the Contract Pay Business Line and the Director of the Accounting Business Line to coordinate the compilation of periodical monthly reports to Defense Finance and Accounting Service customers in accordance with DoD 7000.14-R, Volume 6A, Chapter 2.

Management Comments: Concur. DFAS will work with the customers to verify what information they require to ensure compliance with directives. When that is determined, DFAS will establish the necessary data source, recipients, distribution points, and system modifications.

Estimated Completion Date: February 28, 2006.

Team Members

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