

# Inspector General

United States  
Department of Defense



Management of Incremental Funds on the  
Air Force Research, Development, Test  
and Evaluation Contracts

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### **Acronyms**

ACRN	Accounting Classification Reference Number
ADA	Antideficiency Act
AFB	Air Force Base
AFI	Air Force Instruction
APPA	Advance Payment Pool Agreement
BVN	Bureau Voucher Number
CLIN	Contract Line Item Number
DCAA	Defense Contract Audit Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Service
ESC	Electronic Systems Center
FAO	Field Auditing Office
FAR	Federal Acquisition Regulation
FMR	Financial Management Regulation
IAPS	Integrated Accounts Payable System
LOA	Line of Accounting
MIT LL	Massachusetts Institute of Technology's Lincoln Laboratory
MOCAS	Mechanization of Contract Administration Services
OIG	Office of Inspector General
RDT&E	Research, Development, Test, and Evaluation
SAF/AQ	Assistant Secretary of the Air Force (Acquisition)
SAF/AQC	Deputy Assistant Secretary (Contracting), Office of the Assistant Secretary of the Air Force (Acquisition)
SAF/FM	Assistant Secretary of the Air Force (Financial Management and Comptroller)



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

April 8, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (ACQUISITION,  
TECHNOLOGY, AND LOGISTICS)  
ASSISTANT SECRETARY OF THE AIR FORCE  
(ACQUISITION)  
ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT AND COMPTROLLER)  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING  
SERVICE

SUBJECT: Report on Management of Incremental Funds on Air Force Research,  
Development, Test, and Evaluation Contracts  
(Report No. D-2008-079)

We are providing this report for review and comment. We considered comments from management on a draft of this report when we prepared the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The comments from the Deputy Assistant Secretary of the Air Force (Acquisition), the Assistant Secretary of the Air Force (Financial Management and Comptroller), and the Defense Finance and Accounting Service Columbus were partially responsive. We request that the Assistant Secretary of the Air Force (Acquisition) provide comments on Recommendations A.1.c., A.1.e.(1), A.1.e.(2), B.3.b., B.3.c., and B.3.d; the Assistant Secretary of the Air Force (Financial Management and Comptroller) provide comments on Recommendations A.2.a. and A.2.b.; and the Defense Finance and Accounting Service provide comments on Recommendation B.2.b. by June 9, 2008.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to [AudDFS@dodig.mil](mailto:AudDFS@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 Ms. Amy Frontz at (303) 676-7392 (DSN 94-926-7392) or Ms. Priscilla Nelms at (303) 676-7393 (DSN 94-926-7393). See Appendix E for the report distribution. The team members are listed on the back page.

*Patricia A. Marsh*  
Patricia A. Marsh, CPA  
Assistant Inspector General  
Defense Financial Auditing Service



## Department of Defense Office of Inspector General

Report No. D-2008-079

April 8, 2008

(Project No. D2005-D000FD-0208.000)

### Management of Incremental Funds on Air Force Research, Development, Test, and Evaluation Contracts

#### Executive Summary

**Who Should Read This Report and Why?** Air Force and Defense Finance and Accounting Service (DFAS) personnel responsible for the management and financial accounting of contracts should read this report. This report discusses the need to improve the Air Force's formation and management of incrementally funded Research, Development, Test, and Evaluation (RDT&E) contracts and the need for improvement in the procedures used by the DFAS personnel to pay vendor public vouchers submitted for these contracts.

**Background.** A prior DoD Office of Inspector General Report No. D-2006-056, "Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding," March 6, 2006, identified material internal control deficiencies in the formation and management of Air Force RDT&E contracts. Incorrect formation and management of incrementally funded contracts can result in violations of the United States Code, Federal Acquisition Regulations, Defense Federal Acquisition Regulations Supplement, and other DoD regulations.

**Results.** The Air Force's management of incrementally funded RDT&E contracts was not effective to ensure that vendors were paid in accordance with laws and regulations. Specifically, Air Force contracting personnel:

- allowed performance on contracts prior to availability of appropriations (finding A),
- did not record unfunded liabilities as required by the Statement of Federal Financial Accounting Standard No. 1, "Accounting for Selected Assets and Liabilities" (finding A),
- allowed the use of expired appropriations for inappropriate costs (finding A),
- allowed the use of appropriations other than RDT&E for RDT&E-related services (finding A),
- allowed the use of RDT&E appropriations in the second year of availability, although Air Force policy limits its usage (finding A), and
- issued contracts without payment instructions (finding B).

During the audit, Air Force contracting personnel partially agreed with our conclusions and made corrections to some financial transactions.

We also identified problems in the methods used by DFAS personnel to pay for these contracts. Specifically, DFAS personnel:

- disbursed expired appropriations without adequate verification (finding B),
- paid vouchers by spreading costs across all accounting classification reference numbers with available appropriations, known as proration (finding B), and
- did not detect errors in correction vouchers and credit vouchers due to poor implementation of internal controls (finding B).

See the Finding sections for the detailed recommendations.

The internal controls at both Air Force and DFAS were inadequate. We identified material internal control weaknesses in Air Force contract administration. In addition, we identified material internal control weaknesses in how DFAS personnel disbursed appropriations.

**Management Comments and Audit Response.** For Finding A, the Deputy Assistant Secretary for Contracting, Office of the Assistant Secretary of the Air Force (Acquisition) (SAF/AQC) concurred with five of the recommendations, concurred with the intent of one recommendation, and nonconcurred with one recommendation. SAF/AQC nonconcurred with the recommendation to provide Air Force contracting officers guidance on structuring severable multi-year contracts. He stated that the recommendation would cause the Air Force to implement guidance that did not agree with the Defense Federal Acquisition Regulation Supplement (DFARS). We did not recommend that the guidance suggest uniform contract formation that would violate the DFARS. Rather, the guidance should simply provide additional instructions on a uniform contract structure beyond those required by the DFARS. SAF/AQC concurred with the intent of the recommendation to conduct periodic reviews to determine whether the contracting officers exercised their responsibility to protect the interests of the U.S. Government by obtaining and monitoring contract disbursements. However, the SAF/AQC comments were nonresponsive because SAF/AQC stated that the contracting officers are not responsible for reviewing contract disbursements. The FAR and DFARS clearly state that the contracting officer is responsible for the contract during all phases of its existence. SAF/AQC concurred with the recommendation to conduct periodic reviews to determine whether Air Force contracting officers properly obligated appropriations other than RDT&E, but the comments were partially responsive because they did not specifically state how the proposed solution will fix the condition noted in the finding.

The Assistant Secretary of the Air Force (Financial Management and Comptroller) (SAF/FM) concurred with two of the recommendations and concurred with the intent of one recommendation. SAF/FM concurred with the recommendation to conduct preliminary Antideficiency Act investigations for five contracts, but did not provide the results of the reviews in its comments.

For Finding B, the Director, Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics) concurred with one recommendation. We made minor changes to this recommendation based on comments from the Director by making the recommendation applicable to all interim vouchers.

SAF/AQC concurred with three of the recommendations and nonconcurred with one recommendation. SAF/AQC nonconcurred with the recommendation to perform periodic reviews to determine whether Air Force contracting officers monitor contract

disbursements to ensure that the contractors and DFAS comply with the terms of the contract. The DFARS clearly states that the contracting officer is responsible for the contract during all phases of its existence. SAF/AQC concurred with the recommendation regarding establishing guidance requesting close-out audits, but did not specifically address the issue raised in the recommendation.

The Deputy Director, DFAS Columbus concurred with two recommendations and nonconcurred with one recommendation, proposing an alternate solution. The Deputy Director nonconcurred with the recommendation that DFAS provide the Assistant Secretary of the Air Force (Acquisition) (SAF/AQ) copies of contract deficiency reports and, instead, proposed that all contracting officers register with the Electronic Data Access system so that they have access to the contract deficiency report module. Because DFAS uses only the electronic form of contract deficiency reports, we accepted the proposed alternative. The Deputy Director concurred with the recommendation to discontinue proration as the default method for paying contracts that do not have payment instructions; however, the comments were not responsive. The Deputy Director stated that proration has not been used as the default method since 2000 for automated payments and since 2003 for manual payments. During our audit, we identified contracts for which proration had been used as the default method between December 2003 and August 2004. In addition, DFAS Columbus Desk Procedure 401 states that proration is the default method for contract payment when a contract has multiple lines of accounting and no payment instructions.

We request that the SAF/AQ, SAF/FM, and DFAS Columbus reconsider their positions and provide comments by May 8, 2008. See the Finding sections for a discussion of management comments and the Management Comments section for the complete text of the comments.



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## Background

DoD Office of Inspector General Report No. D-2006-056, "Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding," March 6, 2006, identified material internal control deficiencies in the formation and management of Air Force Research, Development, Test, and Evaluation (RDT&E) contracts. Specifically, Air Force contracting personnel:

- used appropriations that were not available when the services were provided and
- incorrectly formed severable services under contracts as nonseverable.

Incorrect formation and management of incrementally funded contracts can result in violations of the United States Code, Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), and other DoD regulations.

## Objectives

The overall objective was to evaluate the adequacy of the management of incremental funds on Air Force RDT&E contracts. Specifically, we evaluated:

- whether incrementally funded modifications for these contracts were obligated and managed in accordance with appropriation law and implementing regulations, and
- whether payments made under the contracts were charged to the appropriate funds.

We also reviewed the management control program as it related to the overall objective.

Appendix A contains a discussion of the scope and methodology, and prior audit coverage related to the objectives.

## Review of Internal Controls

We identified material internal control weaknesses for the Air Force and Defense Finance and Accounting Service (DFAS) as defined by DoD Directive 5010.38, "Management Control Program," August 26, 1996, and DoD Instruction 5010.40,

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“Management Control Program Procedures,” August 28, 1996.<sup>1</sup> The Air Force had inadequate internal controls over the management of RDT&E contracts. DFAS had inadequate controls over contract disbursements. See findings A and B for a discussion of these weaknesses. Recommendations A.1., A.2.b., A.2.c, B.1., and B.2., if implemented, will correct the internal control weaknesses. A copy of the final report will be provided to the senior official responsible for internal controls in Air Force and DFAS.

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<sup>1</sup> Our review of internal controls was done under the auspices of DoD Directive 5010.38, “Management Control (MC) Program,” August 26, 1996, and DoD Instruction 5010.40, “Management Control (MC) Program Procedures,” August 28, 1996. DoD Directive 5010.38 was canceled on April 3, 2006. DoD Instruction 5010.40, “Managers’ Internal Control (MIC) Program Procedures,” was reissued on January 4, 2006.

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## A. Incremental Funding for Research, Development, Test, and Evaluation Contracts

The Air Force did not always obligate and manage incrementally funded contract line item numbers (CLINs) that used Air Force RDT&E appropriations in accordance with applicable laws and regulations. Specifically, RDT&E services valued at:

- \$26.6 million were performed by contractors prior to the availability of appropriations for those services,
- \$6.4 million were charged to expired appropriations,
- \$25.7 million were charged to appropriations other than RDT&E without adequate justification, and
- \$108.9 million were charged to appropriations in the second year of funding availability.

As a result, the Air Force potentially violated the Purpose Statute, the Bona Fide Needs Rule, and the Air Force budgetary policy regarding the use of RDT&E appropriations in the second year of availability. Furthermore, the Air Force potentially violated the Antideficiency Act (ADA).

### Criteria for Incremental Funding of RDT&E Services

**Federal Acquisition Regulations.** Because of uncertain outcomes of research and development activities, FAR 32.705-2, “Clauses for Limitation of Cost or Funds,” February 2000, allows DoD contracting officers to incrementally fund RDT&E contracts. This funding method enables the contracting officer to cease contractor efforts if the results of the work are not proving beneficial to the Government. When funding incrementally, contracting officers obligate portions of the total estimated cost of the services as the contract progresses rather than the total contract amount. The incremental funding clause in the contract notifies the contractor that the U.S. Government will reimburse expenses incurred up to the total amount obligated on the contract.

**DoD Budget Policy for RDT&E.** RDT&E appropriations are usually 2-year appropriations that allow new obligations throughout the period. However, DoD Regulation 7000.14-R, “Financial Management Regulations (FMR),” volume 2A, chapter 1, paragraph 010214, “RDT&E-Incremental Programming and Budgeting Basis,” June 2004, requires incrementally funded RDT&E efforts to be budgeted on a fiscal year basis and only for work required in that fiscal year. The exceptions are circumstances that delay the start of RDT&E efforts from one budget period to the next. These circumstances can be legal, administrative, or

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technical problems. If circumstances delay the start of work until the second year of appropriations availability, documented justification is required.

**Air Force Budget Policy for RDT&E.** Air Force Instruction (AFI) 65-601, “Budget Guidance and Procedures,” March 3, 2005, implements the DoD budget policy for RDT&E contracts. The instruction limits the use of RDT&E appropriations in the second year to specific circumstances, such as cost growth, that do not involve a change to the scope or requirements that were a bona fide need of the appropriation year. The appropriation year is the first year of the 2-year appropriation period, not the second year.

Appendix C contains a list of laws and regulations applicable to the management and use of appropriations for RDT&E contracts.

## **Contract Line Item Numbers Reviewed**

We obtained the universe from the Washington Headquarters Services Individual Contracting Action Form (DD350) database from July 1, 2003, to June 30, 2004. We statistically selected 350 contracting modifications and determined that 305 contract modifications contained Air Force RDT&E appropriations. From the 305 contract modifications, we focused on the CLINs that the Air Force funded incrementally. We then:

- reviewed 365 CLINs that were associated with the 305 contract modifications,
- evaluated the CLINs to determine whether they were severable or nonseverable,<sup>2</sup>
- determined that 153 CLINs were severable and 212 CLINs were nonseverable, and
- analyzed the severable CLINs.

See Appendix A for details.

## **Services Performed Prior to Funding Availability**

Air Force contracting personnel allowed contractors to perform services valued at \$26.6 million prior to the availability of funds for those services. As a result, the

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<sup>2</sup> Severable service: A task that can be separated into components that independently meet a separate and ongoing need of the Government.

Nonseverable service: A single undertaking or a task that is entire in nature and cannot be subdivided without losing its identity.

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Air Force potentially violated the ADA.<sup>3</sup> According to the ADA, agencies may not spend or commit themselves to spend in advance of or in excess of appropriations or apportionments. These provisions help protect the Government from incurring inappropriate or unauthorized costs for goods and services. Section 1342, title 31, United States Code (31 U.S.C. 1342), does not allow U.S. Government employees to accept voluntary services except in certain emergencies.

Contractors may perform services prior to funding at their own risk; however, the Government may not reimburse the contractors for their performance except in certain emergencies. The Government usually considers the services voluntary, and Government officials cannot authorize payment for the contractor's voluntary performance. The Massachusetts Institute of Technology's Lincoln Laboratory (MIT LL) contract is an example.

**MIT LL Contract F19628-00-C-0002.**<sup>4</sup> Air Force contracting personnel at the Electronic Systems Center (ESC), Hanscom Air Force Base (AFB) allowed the performance of \$12.8 million of services prior to the obligation of funds for those services. The purpose of this contract was to provide personnel, facilities, services, and materials to accomplish research and development for the Government. ESC contracting personnel stated that it was not necessary for program funding to be obligated prior to performance of services for two reasons:

- the Advance Payment Pool Agreement (APPA) between MIT LL and the Air Force Office of Scientific Research authorized MIT LL to receive advance payments for non-profit cost contracts for direct materials, direct labor, and administrative and overhead expenses allocable and allowable in the contract; and
- program funding would be obligated at or near the time that MIT LL submitted public vouchers for services performed. Therefore, authorizing performance prior to the availability of funds was not a problem.

The Assistant Secretary of the Air Force (Financial Management and Comptroller) (SAF/FM), Financial Operations official who manages the APPA confirmed that the APPA does not authorize the performance of services prior to the availability of funds; it only establishes a pool of funds to pay incurred expenses for services performed after funding is available. MIT LL had to defer invoicing for 14 projects on 3 public vouchers valued at \$2.5 million because funds had not been obligated at the time MIT LL submitted the vouchers. From

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<sup>3</sup> The ADA is codified in a number of sections of title 31 of the United States Code [for example, 31 U.S.C. 1341(a), 1342, 1349-1351, 1511(2), 1512-1519]. The purpose of these statutory provisions, known collectively as the ADA, is to enforce the Congress's right to determine the purpose, time, and amount of expenditures made by the Federal Government.

<sup>4</sup> This contract is a Federal RDT&E contract that involves a number of Federal agencies and funding sources. The Air Force is the designated contracting officer and is responsible for oversight of the contract. MIT LL is a Federally Funded Research and Development Center. We initially selected 34 Air Force RDT&E contract modifications for this contract; however, we focused our review on the 10 with the most funding.

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July 2000 to June 2005, MIT LL deferred invoicing a total of \$48.4 million<sup>5</sup> for services incurred because sufficient funds were not available when it submitted the vouchers.

Additionally, ESC personnel stated that they did not record the deferral charges in the financial systems or monitor the reimbursement for the deferred charges. ESC personnel further stated that when funds became available, MIT LL would take the charge out of the deferred portion and add it to the billing portion of the public voucher. ESC personnel explained that they allowed MIT LL to defer invoicing to avoid the disruption of work for lack of funds. However, the Air Force did not record an unfunded liability as required.

According to the Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," (1993), the Air Force is required to recognize liabilities on its accounts payable when incurred, regardless of whether or not appropriations are available. The Standard defines accounts payable as amounts owed by a Government agency for goods and services received from another entity or, in this case, a contractor. Compliance with the Standard helps ensure accountability within the Government and contributes to achieving accurate and reliable financial statements, thereby assisting the Government in assessing the efficiency and effectiveness of the management of its assets and liabilities. If the Air Force does not recognize deferred charges as Government liabilities, the Air Force cannot produce reliable financial statements. In addition, by allowing MIT LL to perform services prior to funding availability, the Air Force could violate the ADA.

See Appendix B for a list of contracts for which Air Force contracting officers allowed contractors to perform services prior to funding availability.

## Use of Expired Funds

Air Force contracting personnel allowed the disbursement of \$6.4 million against expired appropriations, violating section 1502(a), title 31, United States Code [31 U.S.C. 1502(a)], also known as the Bona Fide Needs Rule. Air Force contracting personnel:

- improperly funded a bona fide need for a subsequent year with current year appropriations,
- did not monitor DFAS contract disbursing activities to ensure that DFAS made payments from proper appropriations, and
- misinterpreted requirements related to contract formation.

If an appropriation is expired, the appropriation is no longer available for new obligations. The Bona Fide Needs Rule limits appropriations expenses occurring during a specified period. Appropriations are available for adjustments within the

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<sup>5</sup> This amount included the \$2.5 million in the preceding sentence.

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scope of the original obligation, and disbursements are authorized for services rendered during the period of availability. Section 2410a, title 10, United States Code [10 U.S.C. 2410(a)], allows Government agencies to enter into contracts for the procurement of severable services that cross fiscal years. The law also allows obligating current appropriations for the total amount of the services acquired if the period of performance does not exceed 1 year.

Although appropriation laws allow the use of expired appropriations in subsequent periods under certain circumstances, we found seven CLINs that did not meet these requirements. Two examples of CLINs that did not meet these requirements include the Tybrin Corporation and MIT LL contracts.

**Tybrin Corporation Contract F08635-02-C-0034.** Air Force contracting personnel at Air Armament Center, Eglin AFB allowed \$381,496.00 in payments for services rendered in subsequent years to be charged against expired appropriations. The purpose of this contract was to provide software engineering support. Eglin contracting personnel stated that exercising Option year 1 on September 29, 2003, made the period of performance September 29, 2003, through September 28, 2004; and that the use of FY 2003 appropriations was within scope of 10 U.S.C. 2410 (a). However, the contract itself established the period of performance for Option year 1 as October 1, 2003, through September 30, 2004 (FY 2004).

Exercising Option year 1 on September 29, 2003, did not change the contractual performance period to make it qualify under the scope of 10 U.S.C. 2410(a), nor did it allow the use of FY 2003 appropriations for a FY 2004 contract.

**MIT LL Contract F19628-00-C-0002.** ESC contracting personnel allowed \$5.2 million for services to be charged against expired appropriations on the MIT LL contract. ESC contracting personnel improperly formed the contract as a nonseverable or single undertaking.<sup>6</sup> The incorrect contract formation resulted in ESC contracting personnel paying for expenses in subsequent years with appropriations available in the prior year.

ESC contracting personnel did not initially agree that services on this contract were severable even though there were more than 300 separate projects. However, in the discussion draft meeting, ESC personnel agreed that the individual projects in and of themselves were severable, but did not agree that an individual project was severable within itself. We believe the individual projects are severable and that ESC contracting personnel should budget for each project and then fund by fiscal period.

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<sup>6</sup> The Government Accountability Office's "Principles of Federal Appropriation Laws," GAO-04-261SP, third edition, volume 1, January 2004, defines nonseverable service as "A contract that is viewed as "entire" is chargeable to the fiscal year in which it was made, notwithstanding that performance may have extended into the following fiscal year. The determining factor for whether services are severable or entire is whether they represent a single undertaking."

DFARS Subpart 204.7101, "Uniform Contract Line Item Numbering System, Definitions," November 9, 1999, states, " 'Nonseverable deliverable,' as used in this subpart means a deliverable item that is a single end product or undertaking, entire in nature, that cannot be feasibly subdivided into discrete elements or phases without losing its identity."

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Appendix B contains a list of the contracts for which the Air Force used expired appropriations instead of current appropriations for services incurred in subsequent years.

## Use of Non-RDT&E Appropriations

Non-RDT&E appropriations include procurement, operation and maintenance, military construction, military personnel, and other appropriations. The Air Force obligated \$25.7 million for RDT&E services using non-RDT&E appropriations. This practice may be acceptable under certain circumstances, with appropriate justification and documentation. However, the Air Force did not follow the correct procedures for the obligations. Air Force contracting personnel:

- relied on sponsoring agencies to interpret and apply appropriation requirements and to make funding decisions,
- did not comply with the DFARS requirement for forming separate line items for each requirement, and
- did not make proper funding determinations or prepare appropriate justification documentation.

Appropriation laws specify when the appropriations should be used, who may use them, and for what purpose. The DoD FMR, volume 2A, chapter 1, paragraph 010213(B) requires DoD entities to pay for RDT&E functions with RDT&E appropriations. RDT&E functions include procurement of end items, weapons, equipment, components, and materials; and services required to develop equipment, materials, or computer application software. Furthermore, the Regulation states that when in doubt as to the proper assignment of costs between appropriations, RDT&E appropriations should be favored. In addition, Comptroller General Decisions<sup>7</sup> have stated that agencies must use the most specific appropriation available to them, in this case, the RDT&E appropriation. One example of the use of non-RDT&E appropriations is the L-3 Communications Corporation contract.

**L-3 Communications Corporation Contract F41624-97-D-5000, Delivery Order 0017.** Air Force contracting personnel at Brooks City Base obligated approximately \$5.4 million of non-RDT&E appropriations consisting of Operation and Maintenance and Reserve Procurement appropriations for RDT&E services. The purpose of this contract was to provide training systems, technology evaluation, and effectiveness research. Air Force personnel stated that they co-mingled non-RDT&E appropriations with RDT&E appropriations on the same line item instead of establishing a separate line item for the non-RDT&E effort, as required by DFARS Subpart 204.7101, “Uniform Contract Line Item

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<sup>7</sup> Comptroller General, B-289209, “Use of Oil Spill Liability Trust Fund for Administrative Costs of Processing Oil Pollution Act Claims,” May 31, 2002, states that the more specific appropriations must be used. Even when the more specific appropriation is exhausted, the more general appropriation cannot be used.

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Numbering System, Definitions,” November 9, 1999. We reviewed the requirements and determined that they were RDT&E in nature, and contracting personnel should have used RDT&E appropriations. As a result, the Air Force violated 31 U.S.C. 1301(a), generally referred to as the Purpose Statute.

See Appendix B for a list of the contracts that used non-RDT&E appropriations for RDT&E work.

## **Second Year Use of Air Force RDT&E Appropriations**

There is confusion among Air Force contracting personnel concerning the use of RDT&E funds in the second year of availability. We identified \$108.9 million of RDT&E appropriations that the Air Force used in the second year of funding availability without supporting the use of these funds in accordance with Air Force policy contained in AFI 65-601. For example, some Air Force contracting personnel indicated that RDT&E appropriations are 2-year funds and they did not have to limit the use of these funds in the second year. In other examples, they acknowledged that AFI 65-601 applied, but were unable to provide any documentation supporting the second year use of funds.

The DoD FMR, volume 2A, chapter 1, paragraph 010214(A), “RDT&E Incremental Programming and Budgeting Basis, Purpose,” June 2004, requires RDT&E efforts to be budgeted separately in order to allow management to prioritize the use of appropriations by fiscal year, instead of reserving appropriations for future years. AFI 65-601, volume 1, chapter 13 “RDT&E Appropriation,” section 13.4.1, March 3, 2005, states:

Limit reapplying of funds in the second year to cost growth within scope or to requirements which are a bona fide need of the appropriation year as defined by DFAS-DE *Interim Guidance on Accounting for Obligations*. Commands should identify funds above programmed requirements to be obligated in the first year to SAF/FMBIZ [Financial Management and Comptroller, Air Force Investments and Integration Division] and SAF/AQXR [Acquisition Program Integration Division], so the Air Force can reapply funds to other priority programs.

According to Section 13.8, “Managing Uncommitted and Unobligated Balances in RDT&E,” Headquarters Air Force is allowed to withdraw uncommitted balances at the end of the first year of availability. Provisions for reprogramming funds are also included in this section. These requirements allow the Air Force to have greater control over appropriated RDT&E funds and reprogram the use of these funds more effectively. However, Section 13.8.4 states:

The RDT&E appropriation is legally available for up to 2 years for new obligations and you may incur obligations at any time during the 2 years, if the related action concerns an item authorized in the program authorization and budget authorization documents issued for the appropriation year.

Some Air Force officials quoted this section to justify the use of RDT&E funds on a 2-year basis without the need to justify the appropriateness of using the funds

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in the second year. This approach negates the attempts of the prior sections of the instruction to gain greater control over the use of funds in the second year.

This section also states:

However, due to its nature, PMA [Program Management Administration] should be budgeted on an annual basis and reflected in the fiscal year during which the requirement is projected to execute.

In the examples we evaluated, the use of RDT&E funds in the second year does not appear to conform to the requirements of AFI 65.601, which limits the second year use of funds to cost growth within scope or to services that are a bona fide need of the appropriations year. The MIT LL contract is an example of the use of RDT&E funds in the second year of availability.

**MIT LL Contract F19628-00-C-0002.** ESC contracting personnel allowed MIT LL to incur costs of \$108.7 million for services in the second year of the RDT&E appropriation's availability. These services do not appear to be cost growth within the scope of the first year or a bona fide need of the appropriations year (the first year of the funds). ESC contracting personnel said they did this because RDT&E is a 2-year appropriation.

This confusion has resulted in differences in appropriated funds management between Air Force funds managers. The Air Force should observe consistency in its approach to ensure that all funds managers are implementing the instructions properly. An official in the Office of the Secretary of the Air Force, Financial Management and Comptroller, Air Force Investments and Integration Division told us that the office is reviewing AFI 65.601 to change the instruction and resolve the confusion within Chapter 13. The current plan is to eliminate the sections that restrict the use of RDT&E funds in the second year.

See Appendix B for a listing of the contracts that appear to have used appropriations in the second year of availability contrary to Air Force policy in AFI 65.601.

## Conclusion

The Air Force did not consistently obligate and manage incremental funding for Air Force RDT&E contracts in accordance with appropriation laws and implementing regulations. Specifically, Air Force contracting personnel allowed:

- contractors to perform services prior to the availability of funds for those services, potentially violating the ADA;
- unfunded liabilities to be incurred without recording them as required by the Statement of Federal Financial Accounting Standard No. 1,
- disbursements against expired appropriations, violating the Bona Fide Needs Rule;

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- the use of non-RDT&E appropriations for RDT&E services, violating the Purpose Statute; and
  - the incremental funding of services with RDT&E appropriations in the second year of the 2-year availability period, potentially violating AFI 65-601.

Based on the responses received from Air Force contracting personnel, many of these potential violations of laws and regulations were due to a lack of familiarity with appropriation laws and implementing regulations and instructions.

## **Recommendations, Management Comments, and Audit Response**

### **A.1. We recommend that the Assistant Secretary of the Air Force (Acquisition):**

#### **a. Establish procedures to prevent contractors from incurring costs prior to the availability of appropriations.**

**Management Comments.** The Deputy Assistant Secretary for Contracting, Office of the Assistant Secretary of the Air Force for Acquisition (SAF/AQC) concurred. He stated that the Assistant Secretary of the Air Force (Acquisition) (SAF/AQ) will issue guidance to ensure that contracting officers clearly understand the Government's risk of liability should a contractor perform work during a period in which the contract is unfunded. The estimated completion date is January 15, 2008.

**Audit Response.** Management comments are responsive to the intent of the recommendation.

#### **b. Provide contracting officers, contracting officer's technical representatives, and others involved in the contract management process specific training on contracting requirements contained in the United States Code, Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Air Force policy.**

**Management Comments.** SAF/AQC concurred and stated that the Air Force has changed portions of the Contracting Core Certification Standards and the "Core Plus Development Guide for Fiscal Year 2008." SAF/AQC does not anticipate making any more changes in training requirements.

**Audit Response.** We reviewed the changes to the Contracting Core Certification Standards and the "Core Plus Development Guide for Fiscal Year 2008" and the comments from SAF/AQC are fully responsive.

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**c. Establish guidance to provide a uniform contract structure for multi-year severable contracts.**

**Management Comments.** SAF/AQC nonconcurred and stated that an alternate or additional uniform contract structure would be inconsistent with the DFARS Subpart 204.70. He also stated that a minority of RDT&E contracts are severable, multi-year RDT&E contracts. SAF/AQC stated that incremental funding does not imply that RDT&E contracts are formed as severable and each contract must be evaluated on a case-by-case basis.

**Audit Response.** The comments from SAF/AQC are not responsive. We did not recommend that the Air Force establish a uniform contract structure outside of the structure specified in the DFARS Subpart 204.70. We recommended, instead, that the Assistant Secretary of the Air Force for Acquisition provide guidance to the Air Force contracting officers on how to structure multi-year, severable contracts within the structure specified in DFARS Subpart 204.70.

The Finding did not state that incremental funding makes all incrementally funded RDT&E contracts severable. We agree that the severability should be determined on a case-by-case basis. Once the contracting officer determines that the contract is severable, then the contracting officer should structure the Account Classification Record Number (ACRNs) and CLINs so that everyone involved in the disbursement process can easily and accurately determine when the funds are expired and canceled.

To ensure consistency between Air Force contracting offices, we made this recommendation to address situations in which various contracting officers structured multi-year severable contracts differently. We request the Assistant Secretary of the Air Force for Acquisition (SAF/AQ) reconsider his position and provide additional comments in response to the final report.

**d. Establish separate contract line item numbers for separate requirements in accordance with the Defense Federal Acquisition Regulation Supplement Subpart 204.7103.**

**Management Comments.** SAF/AQC concurred with the recommendation and stated that it already issued a memorandum directing all contracting personnel to complete a Defense Acquisition University course titled Contract Format and Structure for DoD E-Business Environment. SAF/AQC also reported that the Air Force had issued a policy memorandum directing all contracting officers to form contract line items in accordance with the FAR Part 4 and provide vendors with clear payment instructions that enable vendors to invoice correctly to meet the terms of the contract.

**Audit Response.** We reviewed the memoranda identified in the response. The comments from SAF/AQC are responsive to the intent of the recommendation.

**e. Establish periodic reviews of Research, Development, Test, and Evaluation contracts to ensure that the contract formation, execution, and closure comply with laws, regulation, and policy; and correct any noncompliance. Specifically:**

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**(1) Determine whether contracting officers exercised their responsibility to protect the interests of the U.S. Government by obtaining and monitoring contract disbursements in accordance with the Federal Acquisition Regulation Part 1.602.**

**Management Comments.** SAF/AQC concurred with the intent of the recommendation. He stated that contracting officers are not responsible for monitoring the financial execution of the contract. SAF/AQC, however, did agree that contracting officers must ensure that sufficient funds are available for obligation.

**Audit Response.** The comments from SAF/AQC are not responsive because contracting officers are responsible for monitoring disbursements against contracts. FAR subparts 1.602-1 and 1.602-2 describes the responsibilities of contracting officers. It states:

1.602-1 Authority.

(a) Contracting officers have authority to enter into, administer, or terminate contracts and make related determinations and findings. Contracting officers may bind the Government only to the extent of the authority delegated to them. Contracting officers shall receive from the appointing authority (see 1.603-1) clear instructions in writing regarding the limits of their authority. Information on the limits of the contracting officers' authority shall be readily available to the public and agency personnel.

(b) No contract shall be entered into unless the contracting officer ensures that all requirements of law, executive orders, regulations, and all other applicable procedures, including clearances and approvals, have been met.

1.602-2 Responsibilities.

Contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships. In order to perform these responsibilities, contracting officers should be allowed wide latitude to exercise business judgment. Contracting officers shall—

(a) Ensure that the requirements of 1.602-1(b) have been met, and that sufficient funds are available for obligation; (b) Ensure that contractors receive impartial, fair, and equitable treatment; and (c) Request and consider the advice of specialists in audit, law, engineering, information security, transportation, and other fields, as appropriate.

Subparts 1.602-1 and 1.602-2 clearly state that the contracting officer is responsible for the overall management of the contract and safeguarding the interests of the United States Government during all phases of the contract, including execution and closeout. In addition, if additional incremental funds are placed on the contract, FAR Subpart 5.031 states that only the contracting officer

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can amend the contract to reflect the addition of funds. This occurs during the execution phase of the contract and is usually when RDT&E contracts are incrementally funded.

Also, the DCMA manual for close-out processes states that the administrative contracting officer can remove excess funds as part of the administrative closeout of the contract, but:

excess funds does not include 'remaining' funds due to price variance, rounding or cost underrun funding as the ACO does not interface with the official accounting records. These are handled under the Q-Final process in MOCAS [Mechanization of Contract Administrative Services] and final disposition of these funds is a PCO [Procurement Contracting Officer] function at final closeout.

Therefore, only the procurement contracting officer can remove these funds from contracts going through the closeout process.

We request that SAF/AQ reconsider his position on the responsibility of contracting officers and provide comments in response to the final report.

**(2) Determine whether the contracting officers properly obligated appropriations other than Research, Development, Test, and Evaluation in a Research, Development, Test, and Evaluation contract.**

**Management Comments.** SAF/AQC concurred and stated that the Air Force had taken steps to ensure that contracting officers properly obligate funds other than RDT&E in a RDT&E contract in both the pre-award and post-award phase. The SAF/AQC stated that the Air Force has already implemented these procedures and the action is complete.

**Audit Response.** The comments are partially responsive. They do not address the specific condition in the Finding. The non-RDT&E funds were added after the award of the contract. In addition, the use of the unit compliance inspection checklists did not identify the improper use of non-RDT&E funds. As DoD continues to implement policies that encourage the Services to work together in military operations and programs, the use of multiple sources of funds on contracts will increase. We request that SAF/AQ reconsider his position and initiate further steps to strengthen controls over contracts funded by different appropriations.

**(3) Determine whether the contracting officers correctly obligated Research, Development, Test, and Evaluation Air Force appropriations in the second year of availability in accordance with Air Force Instruction 65-601.**

**Management Comments.** SAF/AQC concurred and stated that the Air Force has already implemented additional procedures to ensure that contracting officers properly obligate Air Force RDT&E appropriations in the second year of availability.

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He listed the procedures as:

1. financial management oversight,
2. procuring officer and negotiator training,
3. higher level reviews within the contracting chain, and
4. legal reviews.

In addition, SAF/AQ stated that each buying office is conducting the annual self-inspection in accordance with the Air Force Materiel Command, Directorate of Contracting, Policy Memorandum, "Minimum Standards for Self-Inspection and Post-Award Reviews," May 2, 2005. SAF/AQC stated that the Air Force has already implemented these procedures and the action is complete.

**Audit Response.** Management comments are responsive to the recommendation. However, the samples we reviewed occurred before June 30, 2005. We cannot judge the effectiveness of this memorandum in ensuring compliance. An audit would have to be performed to determine whether implementation of the self-inspection checklist has improved Air Force contracting officers obligating RDT&E funds correctly in the second year of availability.

**A.2. We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller):**

**a. Conduct preliminary Antideficiency Act investigations and implement proper corrections for the following contracts:**

- (1) F08635-02-C-0034
- (2) F19628-00-C-0002
- (3) F04701-01-F-7014
- (4) F41624-97-D-5000, delivery order 0017
- (5) F33615-97-D-5403

**Management Comments.** SAF/FM concurred with the intent of the recommendation and stated that he is directing each financial office to research each issue raised by the report to determine whether a preliminary Antideficiency Act review is necessary.

**Audit Response.** The comments are partially responsive. SAF/FM should not consider the recommendation closed until the financial offices complete the reviews. We request that SAF/FM provide the results of the reviews in response to the final report.

**b. Establish procedures to track and record deferral charges as unfunded liabilities for accounts payable, as required by Statement of Federal Financial Accounting Standard No. 1.**

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**Management Comments.** SAF/FM concurred with the intent of the recommendation and stated that he will not allow the continuation of the deferred billing changes under the Advance Payment Pool Agreement. He also stated that SAF/FM personnel will meet with personnel from the Electronics System Center and MIT LL to discuss the proper posting of invoices and procedures for future payments under the Advance Payment Pool Agreement in accordance with DFARS 232.470. SAF/FM personnel are to report on the status of the meeting with corrective actions no later than November 30, 2007.

**Audit Response.** The comments are responsive. We request SAF/FM provide the results of the corrective actions in response to the final report.

**c. Review the requirements of Air Force Instruction 65.601, chapter 13, to clarify the use of Research, Development, Test, and Evaluation funds in the second year and train resource managers on the proper application of this instruction in the use of Research, Development, Test, and Evaluation appropriations in the second year.**

**Management Comments.** SAF/FM concurred with the intent of the recommendation and stated that the Air Force periodically reviews guidance for clarity. He stated that Air Force Instruction 65.601, chapter 13, is part of the current review. SAF/FM did not provide a schedule of completion.

**Audit Response.** Management comments are responsive to the intent of the recommendation.

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## **B. Payments for Research, Development, Test, and Evaluation Contracts**

DFAS did not ensure that DFAS personnel consistently charged payments for incrementally funded RDT&E contracts to the correct appropriations. Specifically, personnel at DFAS Columbus and DFAS Dayton:

- disbursed expired appropriations without verifying whether the use of those appropriations was applicable,
- prorated disbursements against all available appropriations when contracts did not include payment instructions,
- improperly corrected errors in previous payments,
- did not distribute vendor credits to proper lines of accounting, and
- disbursed against incorrect lines of accounting.

Additionally, the Air Force did not include payment instructions in RDT&E contract documents. As a result, the Air Force potentially violated the Bona Fide Needs Rule and Purpose Statute. In addition, the Air Force potentially violated the ADA. During the audit, Air Force personnel agreed with some of our conclusions and made corrections to some financial transactions.

### **Criteria for Disbursing Government Appropriations**

Numerous laws and implementing regulations address the disbursement of Government appropriations by Government agencies. See Appendix C for the guidance related to this finding.

### **Controls Over Disbursements of Interim Vouchers**

DFAS personnel inappropriately disbursed approximately \$1.2 million of expired appropriations for contractor services under six CLINs. The use of expired appropriations occurred because DFAS personnel did not determine whether the appropriations were proper for disbursing officers as stated in section 3325 (a), title 31, United States Code [31 U.S.C. 3325 (a)] and section 3528 (a), title 31, United States Code [31 U.S.C. 3528 (a)].

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Section 3325 (a) requires disbursing officers to:

- disburse funds based on a certified voucher;
- examine vouchers as needed to determine if they are proper, certified, and computed correctly; and
- be held accountable for carrying out these duties.

Section 3528 (a) requires certifying officers to certify:

- the factual accuracy of vouchers,
- the accuracy of computations on vouchers, and
- the legality of proposed payments under the appropriations or funds involved.

DFAS management implemented these laws by issuing Policy No. 03-CP-03, “Certifying Officer Legislation Instruction for Commercial Pay Business Line,” December 15, 2003, and Policy No. 03-CP-01, “Direct Submission of Cost Reimbursement Type Interim Vouchers,” March 12, 2004. These policies require DFAS certifying officers to validate vouchers prior to making payments. However, the process listed in Policy 03-CP-03, attachment 6, for validating the voucher is insufficient because it does not require the certifying officer to certify the legality of the appropriations involved. As an alternative, DFAS personnel rely on the Mechanization of Contract Administrative Services system (MOCAS) notifications and the Defense Contract Audit Agency (DCAA) contractor reviews to make these determinations for them. One example of DFAS disbursing expired appropriations is the ARINC, Inc. contract.

**ARINC Inc. Contract F04701-01-F-7014.** The purpose of this contract was to provide research and development support for the NAVSTAR Global Positioning System Joint Program Office. DFAS personnel paid \$625,076 in expired appropriations for contractor services because DFAS personnel did not verify whether appropriations were available for the period of performance and purpose indicated on the voucher. The use of expired appropriations is limited to adjustments, not additional work. The MOCAS system notifies DFAS personnel when appropriations are available for disbursement, including expired appropriations. Because DFAS personnel did not compare the period of performance to the availability period for the appropriations, they disbursed expired appropriations incorrectly.

DFAS personnel stated that they relied on DCAA contract reviews as certification that the use of specific appropriations was appropriate. Thus, DFAS personnel verified only that funds were available to cover the amount of the voucher, not whether those funds were appropriate for paying the voucher. DFAS policy states that the implementation of the Direct Billing Program made DFAS the certifying officer for interim vouchers, while DFARS Subpart 242.803 states the administrative contracting officer for the individual contract is the certifying officer for final vouchers.

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Disbursing expired appropriations for services incurred beyond the period of availability is a violation of the Bona Fide Needs Rule (31 U.S.C. 1502) and a potential violation of the ADA.

See Appendix B for a listing of the contracts for which DFAS personnel disbursed expired appropriations.

**FAR and DFARS Guidance.** For cost-reimbursement contracts and time, material, and labor contracts that use FAR clause 52.216-7, “Allowable Cost and Payment,” December 2002, contractors submit interim vouchers to the Government for reimbursement of incurred costs. After contractors finish all work for a contract, they submit a final voucher for payment of any remaining costs not previously reimbursed.

The DFARS treats controls over payments for interim vouchers and final vouchers differently. DFARS Subpart 242.803 “Disallowance of Costs,” November 9, 2005, states that the contractor auditor (DCAA) is the representative of the contracting officer for approving interim vouchers for provisional payment and for sending the interim vouchers to the payment office. DCAA can authorize a contractor to submit interim vouchers directly to a disbursing office if the contractor has an approved billing system. DCAA is to review completion/final vouchers and send these to the administrative contracting officer. Additionally, this subpart requires the administrative contracting officer to approve completion/final invoices and send them to the disbursing office.

However, paragraph 6-1003 (f) of the DCAA Contract Audit Manual describes the purpose of DCAA’s reviews of interim vouchers. It states that reviews of interim vouchers are to provide reasonable assurance that the amounts claimed are not in excess of that which is properly due the contractor. The DCAA Contract Audit Manual also states that the intent is not for DCAA to individually audit these vouchers.

**Direct Bill Program.** DCAA approved all interim vouchers before they went to the disbursing officer prior to the implementation of the Direct Bill Program. The change in process increased DFAS responsibilities because DCAA no longer approves all interim vouchers before they are submitted to the certifying officer. Instead, as noted above, DCAA performs limited reviews of interim vouchers as part of its surveillance of contractors.

When DCAA approves a contractor’s participation in the Direct Bill Program, DCAA is required to do periodic audits. Paragraph 6-1007.6 “Contractor Continued Participation in the Direct Billing Program,” section (a) January 2005, of the DCAA Contract Audit Manual states that Field Auditing Offices (FAOs) should review internal system controls for major contractors’ billing systems based on a documented risk assessment. For nonmajor contractors, DCAA reviews the contractor’s billing system internal controls as part of an annual, incurred-cost audit.

Paragraph 6-1007.6, section (b) requires FAOs to perform annual testing of paid vouchers on a sample basis to determine whether the Government can continue to rely on the contractors’ internal controls for voucher preparation. FAOs are not required to test paid vouchers annually for all nonmajor contractors, but may

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select and review a sample of paid vouchers from the group of nonmajor contractors.

In October 2001, the Under Secretary of Defense (Acquisition, Technology, and Logistics) issued a memorandum stating that DoD Components were to stop requiring contractors to submit detailed cost information as part of the billing process. The memorandum states that the information is not needed, and DoD Components and contracting officer representatives are performing tasks that are the responsibility of DCAA. This memorandum does not take into consideration that DCAA does not audit interim vouchers submitted through the Direct Bill Program, except for those samples selected during periodic audits.

Auditing all interim cost vouchers is not a required part of DCAA's Direct Bill Program contract surveillance. Additionally, based on the memorandum issued in October 2001, detailed cost information is not required on the interim vouchers. Therefore, as a certifying officer, DFAS personnel cannot rely on DCAA to ensure interim vouchers are correct, or on the information in the interim vouchers to ensure proper disbursements.

DCAA does contract close-out audits<sup>8</sup> at the request of the contracting activity. Without close-out audits, there is little assurance that all of the charges made through direct billing have been adequately supported, especially in complex contracts involving significant dollar amounts.

**DCAA Audits of MIT LL Contracts.** The Air Force awards the RDT&E contracts with MIT LL in 5-year increments. The current contract FA8721-05-C-0002, dated April 1, 2005, is estimated to cost \$3.3 billion. The period covered is April 1, 2005, to March 31, 2010. This contract also contains an option period of April 1, 2010, to March 31, 2015, at an estimated cost of \$3.7 billion. DCAA has authorized MIT LL for direct billing.

The DCAA Resident Office located at MIT LL conducts limited reviews of two vouchers per year for the current contract in addition to the system reviews. These reviews are usually for the May and November vouchers. However, according to DCAA personnel, ESC has not requested DCAA do a close-out audit of the MIT LL contracts since DCAA completed the 1985, 5-year contract close-out, approximately 17 years ago.

This contract is complex as it involves more than 300 projects and multiple funding sources. Close-out audits would provide additional assurance that the amounts charged by the contractor were fully supported and that they have been paid from the correct funding sources because of:

- the limited amount of information that the contractor is required to submit on the direct bill vouchers,
- the limited auditing of interim vouchers, and
- the significant dollar amounts involved in this contract.

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<sup>8</sup> The DCAA Contract Audit Manual refers to contract-close-out audits as contract audit closing statement reports.

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## Contract Payment Instructions

We identified 15 Air Force RDT&E contracts that did not include payment instructions when awarded. According to DFAS personnel, the Air Force awarded numerous contracts without payment instructions. DFAS personnel stated that they have been issuing Contract Deficiency Reports to Air Force contracting personnel since October 11, 2005. However, DFAS personnel stated they if the contracting officer does not provide payment instructions, they follow DFAS Desk Procedure 401 (the Procedure).

The Procedure states that for contracts without payment instructions, payments should be prorated against all accounting classification reference numbers (ACRNs)<sup>9</sup> with available appropriations regardless of the CLIN. The Procedure does not take into consideration that each CLIN has its own specific work requirements and cost estimates, and each ACRN may be funded with a different appropriation. DFARS PGI Subpart 204.7108(d)(11) allows prorating as an approved disbursing method if the contracting officer approves its use. DFAS personnel's decision to use alternative disbursing methods without the approval of contracting officers could violate the ADA and the Purpose Statute.

DFAS personnel used incorrect appropriations for disbursement when they applied the Procedure. DFAS personnel disbursed from ACRNs with available appropriations, rather than the ACRNs established for the purposes or services billed. The Tybrin Corporation contract is an example.

**Tybrin Corporation Contract F08635-02-C-0034.** The purpose of this contract was to provide software engineering support. DFAS personnel used incorrect appropriations on the following disbursements associated with contract F08635-02-C-0034.

- Bureau voucher number (BVN) 27: On October 24, 2003, the Air Force obligated \$1,142,194 for the award fee using FY 2003 RDT&E appropriations. On October 31, 2003, Tybrin invoiced \$1,142,194 for award fees for FY 2003 work. DFAS personnel disbursed only \$183,557 of the invoice total from FY 2003 RDT&E appropriations. They paid the remaining \$985,637 of the award fee from FY 2004 appropriations. FY 2004 appropriations were not available when the contractor performed the work in FY 2003. DFAS personnel said that this occurred because the contract did not contain payment instructions.
- BVN 38: The prorating between ACRNs for BVN 27 left an unliquidated portion of the FY 2003 award fee. On April 16, 2004, DFAS personnel used the unliquidated appropriations intended for the FY 2003 award fees to pay for FY 2004 RDT&E work. DFAS personnel stated that they employed the prorating method by allocating costs against all available ACRNs because the contract did not contain payment instructions. The unliquidated portion of the award fee was available because the award fee payment for BVN 27 did not fully liquidate the amount set aside for award

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<sup>9</sup> An ACRN is an alphanumeric code that represents a specific appropriation or line of accounting.

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fees for FY 2003. DFAS disbursed the unliquidated portion for FY 2004 RDT&E work.

The use of the prorating method violated the Bona Fide Needs Rule, Purpose Statute, and the Air Force's budget policy for use of RDT&E appropriations in the second year of availability.

The Air Force needs to have procedures in place to ensure that payment clauses are included when awarding a contract and to track contracts that DFAS personnel have identified as having missing payment instructions. Appendix B contains a list of the contracts that did not have payment instructions.

## Internal Controls over MIT LL Vendor Payments

DFAS Dayton personnel did not have controls in place to ensure that they made vendor payments for MIT LL Contract F19628-00-C-0002 from the correct appropriations. Our review of 60 payments for 36 projects involving 10 contract modifications showed that DFAS personnel:

- improperly corrected errors made in prior payments,
- did not distribute vendor credits to the proper lines of accounting, and
- disbursed against incorrect lines of accounting.

DFAS personnel were unable to explain how the errors occurred. These errors violated the Bona Fide Needs Rule and potentially violated the ADA.

**Adjustments to Prior Payments.** DFAS Dayton personnel improperly corrected \$359,207 in errors made in previous payments because internal controls did not detect the improper adjustments. In FY 2002, DFAS personnel erroneously disbursed against incorrect lines of accounting (LOA). DFAS personnel attempted to correct the erroneous payments in FY 2005, but did not use the correct LOA. Specifically, DFAS personnel:

- incorrectly paid \$192,792 for project 311 from project 292's LOA 5723400. On April 5, 2005, DFAS personnel attempted to correct the error by returning funds to project 292 and charging project 311. However, DFAS personnel returned the funds to LOA 5733400, rather than 5723400, and incorrectly charged the funds against LOA 5743400, which was not available for disbursement when the contractor performed the services.
- incorrectly paid \$166,415 from project 10011's LOA 5723600 instead of from project 10010's LOA. On April 25, 2005, DFAS personnel attempted to correct the error by returning funds to project 10011 and charging project 10010. However, the charge to project 10010 was against LOA 5743600, which was not available for disbursement when the contractor performed the services.

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The incorrect adjustments occurred because DFAS did not have effective controls to detect these errors. Both of these errors violated the Bona Fide Needs Rule and potentially violated the ADA. Specifically, incorrect adjustments could cause:

- an unauthorized augmentation by returning \$192,792 to LOA 5733400 for project 292, instead of LOA 5723400, and
- a violation of the ADA's Time Statute (31 U.S.C. 1552) by reducing LOA 5743400 by \$192,792 and LOA 5743600 by \$166,415 as they were not available for disbursement during August and February 2002, respectively when the contractor performed the services.

ESC personnel were not aware of the potential violations until we brought the issue to their attention. They agreed with our conclusions and made the proper corrections in FY 2007. Consequently, the Air Force lost the use of the credits to the FY 2004 appropriations because the appropriations had already expired.

**Application of Vendor Credits.**<sup>10</sup> DFAS Dayton personnel applied a vendor credit to an incorrect LOA, potentially augmenting appropriations without Congressional authorization. DFAS Dayton personnel should have applied vendor credits to the LOA from which they made the excess payments. DFAS management is responsible for establishing adequate internal controls to ensure that DFAS personnel properly allocate vendor credits to the appropriate projects and LOAs. For example, in February 2002, the Air Force received a vendor credit of \$7,876 for project 327, resulting from prior excess payments. In July 2002, DFAS personnel applied the vendor credit to a FY 2002 RDT&E LOA (5723600). This LOA was not obligated on this project until May 2002; therefore, it was not available when DFAS Dayton personnel made the original excess payment. ESC and DFAS personnel were unable to explain what caused the improper vendor credit. However, they concurred with our conclusion and made the proper correction.

**Disbursements Against Lines of Accounting.** DFAS Dayton personnel disbursed \$1.91 million against incorrect LOAs because they did not follow the payment instructions specified on the public vouchers. In addition, they did not follow the prevalidation process required by DFAS Instruction 7000.7-I. The instruction requires all personnel managing DoD appropriations to conduct a prevalidation and receive a positive response from applicable accounting offices prior to making payments. ESC contracting personnel provided a spreadsheet to DFAS personnel identifying payments by LOA. In a number of cases, however, DFAS personnel did not disburse according to the spreadsheet. Specifically, DFAS personnel disbursed:

- \$100,000 against LOA 5703600 instead of 5713600 as specified on the spreadsheet, even though there were no funds available under LOA 5703600. DFAS personnel used LOA 5703600 for disbursement under public voucher AV014 for project 1006. They were unable to

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<sup>10</sup> Vendor credits are repayments from vendors for prior excess payments.

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explain how they over liquidated the obligation for LOA 5703600 under project 1006. DFAS personnel corrected the error.

- \$1.36 million against Navy RDT&E appropriations instead of Air Force RDT&E appropriations as specified on the spreadsheet provided by ESC for project 1228. DFAS personnel corrected the error.
- \$450,000 against the FY 2003 LOA for services that occurred in FY 2002 instead of the FY 2002 LOA as specified on the public voucher for project 370. The FY 2003 appropriation was not available in FY 2002 when the contractor performed the work. Hanscom and DFAS personnel were not aware of the error, but made appropriate corrections when we brought it to their attention. They could not explain why they charged the work to the incorrect LOA.

If DFAS personnel had conducted the prevalidations for the examples noted, they would have avoided using incorrect LOAs.

The situation identified is not unique. In DoD Inspector General Report No. D2007-065, "Control Over the Prevalidation of DoD Commercial Payments," March 2, 2007, the DoD Office of Inspector General (OIG) identified similar problems. The report stated that DFAS managers permitted disbursement of vendor payments without ensuring that technicians had properly prevalidated all commercial payment requests. This occurred because DFAS field sites, including Dayton, implemented local procedures that contradicted the DoD prevalidation policy for vendor payments. In addition, the DoD OIG determined that DFAS Dayton management had established procedures allowing technicians to process payments before receiving a positive acknowledgement that an obligation matching the payment request existed. The report further stated that allowing the disbursement of appropriations prior to receiving a positive response could violate public laws, increase the risk of making erroneous payments, and cause additional costs to make corrections.

The DFAS Deputy Director for Standards and Compliance generally concurred with the findings and recommendations made in the report and agreed to make the necessary corrections. Based on this concurrence, we do not plan to make additional recommendations regarding prevalidation.

## **Recommendations, Management Comments, and Audit Response**

**Revised Recommendation.** As a result of a discussion with management, we clarified Recommendation B.1. to apply to all interim vouchers, not just those that pass through the Direct Bill Program.

**B.1. We recommend that the Under Secretary of Defense (Acquisition, Technology, and Logistics) implement procedures requiring that the certifying officer for interim vouchers receive the needed information to**

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**ensure that all disbursements meet fiscal law requirements, including the Bona Fide Needs Rule and Purpose Statute.**

**Management Comments.** The Director, Defense Procurement and Acquisition Policy concurred and added that he had already implemented the recommendation in 2005 with the publication of DFARS Procedures, Guidance, and Information 204.7107 and 204.7108.

**Audit Response.** The comments are responsive. However, the samples we reviewed occurred before June 30, 2005. An audit would have to be performed to determine whether implementation of DFARS Procedures, Guidance, and Information 204.7107 and 204.7108 has improved the quality of information received by the certifying officer for interim vouchers in order to ensure that disbursements meet fiscal law requirements. We accept the Director's response until another audit can be done.

**B.2. We recommend that the Director, Defense Finance and Accounting Services, Columbus:**

**a. Give the Office of the Assistant Secretary of the Air Force (Acquisition) a copy of the contract deficiency report so that they can track and correct errors quickly.**

**Management Comments.** The Deputy Director, DFAS Columbus nonconcurred and stated that the contract deficiency report application in Electronic Data Access did not contain a report function. He added that a report function was under development, pending funding. As an alternative, he suggested that the procurement contracting officers be required to register for the Electronic Data Access application so that they can receive notifications of contract deficiency reports that are more accurate and receive reminders of contract deficiency reports that require their action.

**Audit Response.** Although management nonconcurred with the recommendation, the proposed action satisfies the intent of the recommendation because DFAS Columbus places contract deficiency reports only in Electronic Data Access. DFAS Columbus should continue to work with SAF/AQ to resolve issues with procurement contracting officers who are making repeated errors on contracts and other procurement contracting officers who are not currently correcting errors in contract deficiency reports.

**b. Discontinue using the prorating method as the default method for disbursing appropriations when contracts do not have payment instructions. Instead, consult with the contracting officers to obtain payment instructions on contracts that do not have payment instructions before making a disbursement.**

**Management Comments.** The Deputy Director, DFAS Columbus concurred and agreed that the proration method of liquidating payments should not be used as the default method when a contract does not contain payment instructions. However, he disagreed with the finding that the proration method has recently been used. He stated that since February 2000, MOCAS has not used proration as the default payment method on automatic payments and since May 2003,

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MOCAS has not used proration as the default method on manual payments. The Deputy Director added that current invoices without payment instructions are coded as a contract discrepancy report (DD-1716) and held until the contracting officer adds the required payment instructions to the contract.

**Audit Response.** The comments from DFAS Columbus are nonresponsive. Proration is the default method for liquidating payments when a contract has multiple lines of accounting and does not contain payment instructions according to chapter 12 of Desk Procedure 401. DFAS Columbus has not been able to provide written documents that overrule Desk Procedure 401. They also have not provided us written documentation that states that current invoices without payment instructions are to be held and coded as contract deficiency report (DD-1716) until the contracting officer provides the payment instructions.

During the audit, we identified vouchers that used proration as the default method when the contract does not have contract payment instructions. On December 26, 2006, DFAS Columbus stated that it prorated Public Vouches BVN0037, BVN0038, BVN0039, BVN0040, and BVN0041 on contract F08635-02-C-0004. These public vouchers are dated between April 2, 2004, and May 28, 2004. On December 15, 2006, DFAS Columbus personnel stated that it prorated public vouchers on BVN0004, BVN0017, BVN0018, and BVN0021 on contract F04701-03-F-7043. These public vouchers are dated between December 12, 2003, and August 8, 2004.

We request that DFAS Columbus provide written documentation that shows that proration is no longer a default method and the procedures that DFAS personnel follow when an invoice does not include payment instructions in response to the final report.

**c. Improve quality control procedures to prevent incorrect adjustments to contract payments and incorrect distribution of vendor credits.**

**Management Comments.** The Deputy Director, DFAS Columbus concurred and stated that DFAS Columbus will develop new procedures to prevent incorrect adjustments to contract payments and incorrect distribution of vendor credits. In addition, DFAS Columbus will review current guidance for the Integrated Accounts Payable System and the new guidance for the Database Expansion and Restructuring Release for Integrated Accounts Payable System. Estimated completion date is December 1, 2008.

**Audit Response.** Management comments are responsive to the intent of the recommendation.

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**B.3. We recommend that the Assistant Secretary of the Air Force (Acquisition):**

**a. Establish quality control procedures to confirm that contracting officers include payment instructions in every contract.**

**Management Comments.** SAF/AQC concurred and stated that on February 26, 2007, it issued additional guidance on contract payment instructions. He also stated that the Air Contracting Compliance Inspection Checklist, a quality assurance document under development, will include an item on including in each contract payment instructions to the disbursing office. The SAF/AQC estimates that the new checklist will be issued on January 31, 2008.

**Audit Response.** Management comments are responsive to the intent of the recommendation.

**b. Establish procedures to track and correct items in the Defense Finance and Accounting Service contract deficiency report.**

**Management Comments.** SAF/AQC concurred with the recommendation and stated that the contract deficiency report is currently deployed in the field, but the tracking portion still needs to be funded and developed. He also noted that contracting officers did not traditionally have accounts in the Electronic Data Access, the application that houses the module for the contract deficiency report.

**Audit Response.** Management's comments are partially responsive. DFAS uses the contract deficiency report module in the Electronic Data Application module as the primary method to communicate the issues with the contracts to the acquisition community, as DFAS no longer produces hardcopies of the contract deficiency report (Form DD 1716). A contracting officer must have access to Electronic Data Access to receive contract deficiency reports from DFAS. If SAF/AQ does not require contracting officers to register in Electronic Data Access, they will not be registered. Therefore, SAF/AQ needs to require that contracting officers register in Electronic Data Access. For example, on March 31, 2006, DCMA required all of its administrative contracting officers to obtain access to Electronic Data Access.

Oversight of the contracting process is an important task for SAF/AQ. If the SAF/AQ personnel do not have access to at least a summary of the contract deficiency reports in Electronic Data Access, they cannot identify systemic issues or issues applicable to a specific contract office. Although the contract deficiency report module of Electronic Data Access does not have a management report function, it does have a specific query function that allows information to be gathered by data elements including, contract number, procurement contracting office code, and administrative contract office code.

We request that SAF/AQ reconsider his position on both required procurement contracting officer registration in Electronic Data Access and obtaining and reviewing at least a summary of contract deficiency reports in Electronic Data Access and provide comments in response to the final report.

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**c. Perform periodic reviews to determine whether contracting officers monitor contractor vouchers, including interim vouchers, to determine whether the contractors and Defense Finance and Accounting Service personnel comply with contract payment instructions.**

**Management Comments.** SAF/AQC nonconcurred and stated that the recommendation was not needed as monitoring contract vouchers is not a contracting officer responsibility. SAF/AQC cited DFARS Subpart 242.803 as support for his position.

**Audit Response.** Management's comments are nonresponsive. Because DFARS Subpart 242.803 gives authority to DCAA to act as a representative of the contracting officer for auditing and submission of interim vouchers, the contracting officer must have the original authority to perform this task. The DFARS does not relieve the contracting officer of the responsibility to audit and submit interim vouchers to the disbursing office. It merely extends the authority to the DCAA. The contracting officer is still ultimately responsible. In addition, DCAA does not ensure that the funds cited on interim vouchers comply with fiscal and appropriation law. We request that SAF/AQ reconsider his position and provide comments in response to the final report.

**d. Establish guidance specifying the circumstances under which contracting officers are to request contract close-out audits.**

**Management Comments.** SAF/AQC concurred and stated that Air Force Materiel Command FAR Supplement Subpart 5304.804-5, "Procedures for Closing Out Contract Files," includes the "MOCAS Contract Closeout Guide" dated December 2005, that clearly explains the roles and responsibilities in the close-out process. In addition, the Air Contracting Compliance Inspection Checklist, a quality assurance document under development, will include an item on including payment instructions in each contract for the disbursing office contract. SAF/AQC estimates that the new checklist will be issued on January 31, 2008.

**Audit Response.** Although management concurred, the citation provided does not contain the requirements that address the recommendation. The cited guidance "MOCAS Contract Closeout Guide" specifies the duties of various agencies in contract closeouts, but it does not provide guidance to the administrative contracting officer on the circumstances that should trigger a request for a DCAA contract close-out audit.<sup>11</sup> The DCAA contract close-out audit is in addition to the DCAA audit of allowable and allocable costs in the final voucher. We request that SAF/AQ reconsider his position and provide comments in response to the final report.

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<sup>11</sup> The DCAA Contract Audit Manual refers to contract close-out audits as contract audit closing statements.

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## Appendix A. Scope and Methodology

We conducted this performance audit from June 29, 2005 through May 21, 2007, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit focused on selected incremental funding for Air Force RDT&E contracts involving 573600 appropriations. The incremental funds reviewed occurred from July 1, 2003, to June 30, 2004.

We initially identified an audit universe of 7,242 contract modifications totaling \$11.35 billion. We obtained the universe from the Washington Headquarters Service Individual Contracting Action Form (DD350) database. Of the 7,242 contract modifications, the DoD OIG Quantitative Methods Directorate statistically selected 350 contract modifications totaling \$6.96 billion. We screened these contract modifications to ensure that they contained Air Force RDT&E appropriations. We replaced contract modifications that contained appropriations other than the Air Force RDT&E appropriation as its funding source. This screening resulted in a final group of 305 contract modifications, valued at \$4.94 billion, for further evaluation.

We then:

- obtained the basic contracts for the selected transactions either from the Electronic Document Access database or from the appropriate contracting officers,
- obtained the individual contract modifications selected for review,
- reviewed 365 CLINs that were associated with the 305 contract modifications,
- evaluated whether the CLINs appeared to be severable or nonseverable and whether the Air Force properly formed them,
- reviewed the Statement of Work, Statement of Objectives, and other essential documents that described the work to be performed,
- discussed the contracts with the contracting officers,
- did not evaluate the severability of the basic contracts, but limited our severability determinations to the selected CLINs, and
- determined that 212 CLINs were nonseverable and 153 CLINs were severable.

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Based on this analysis, we did further evaluations for 153 incrementally funded CLINs that were severable. These transactions had a total value of \$1.55 billion. We focused on these 153 transactions because prior work in DoD IG Report No. D-2006-056, "Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding," March 6, 2006, indicated that severable contracting actions, especially those improperly formed as nonseverable, exhibited a greater chance of funding improprieties than those properly formed as nonseverable. We discontinued further detailed work on the remaining 212 CLINs that Air Force had correctly formed as nonseverable.

We did not project the results of our work to the universe of transactions for the period.

We made site visits to the following locations:

- Aeronautical Systems Center, Wright-Patterson AFB;
- Air Force Research Laboratory, Wright-Patterson AFB;
- Space and Missile Systems Center, Los Angeles AFB;
- Electronic Systems Center, Hanscom AFB; and
- Air Force Research Laboratory-Electromagnetic Technology Division, Sensors Directorate, Hanscom AFB.

We also conducted audit work at DFAS Columbus and Dayton. Specifically, we obtained public vouchers and payment vouchers from DFAS locations.

We were unable to evaluate fully all of the 153 severable CLINs primarily due to the lack of available information needed to match transaction documents. For example, we were unable to perform full analyses for transactions paid through the Integrated Accounts Payable System (IAPS) because this system uses the line of accounting to determine payment instead of using the CLIN/ACRN.<sup>1</sup> We also found that contractors were not including information such as the period of performance on their billing statements, making it difficult to determine if the transaction violated the Bona Fide Needs Rule. Some billing statements contained no information with which to identify the funding source to use in making the payments.

**Use of Computer-Processed Data.** Technical Support Center personnel obtained the audit universe from the DD350 database and provided to Quantitative Methods Directorate. We did not perform a formal reliability assessment of the computer-process data.

**Use of Technical Assistance.** Quantitative Methods Directorate personnel assisted in the statistical analysis used to identify the incrementally funded transactions evaluated. In addition, the Inspector General DoD, Office of Legal

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<sup>1</sup> CLIN information identifies the major segments of work performed on the contract, while ACRN information identifies the appropriations obligated for specific tasks under the CLIN.

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Counsel assisted in the review of the legality of the contracting actions and appropriations used to pay vendors.

**Government Accountability Office High-Risk Area.** The Government Accountability Office has identified several high-risk areas in DoD. This report relates to the Defense Financial Management high-risk areas.

## Prior Coverage

The only prior coverage of the Air Force General Fund vendor pay disbursement cycle was a series of reports issued by the DoD OIG. However, these reports did not specifically address the management of incremental funding of Air Force RDT&E contracts.

Report No. D2007-065, "Controls over the Prevalidation of DoD Commercial Payments," March 2, 2007

Report No. D-2007-059, "Vendor Pay Disbursement Cycle, Air Force General Fund: Financial Accounting," February 9, 2007

Report No. D-2007-027, "Vendor Pay Disbursement Cycle, Air Force General Fund: Payments to Vendors," November 24, 2006

Report No. D-2006-085, "Vendor Pay Disbursement Cycle, Air Force General Fund: Funds Control," May 15, 2006

Report No. D-2006-056, "Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding," March 6, 2006

## Appendix B. Contract Line Item Numbers Reviewed

Contracting Office	Contract/Delivery Order Number	Modification	CLIN Reviewed	Management of Incremental Funding	Contract Payments	Partial Financial Analysis
325 CONS/CC	F0863703C6015	P00012	0001, 0003, 0004			11
		P00011				11
	F0863703C6006	P00003	0001, 0002, 0003, 0006			11
45 CONS/LGC	F0865099D0007/ DO 0017	05	1006		6	
AAC/PKZ	F0863597C0002	P00057	0035			11
		P00057	0038, 0041, 0044, 0047, 0050			11
	F0863502C0034	P00007	0007, 1001, 1002, 1003	1,2,3	5,6	
	F0863501C0102	P00017	0001	1, 2, 4	5,6	
	F0863501C0002	P00035	0006, 0008, 0009, 0011, 0013, 0014, 0022, 0034, 0035			11
	F0863500C0041	P00032	0005			11
AAC/YVK	F0862696C0002	P00171	1027		6	
AEDC/PKM	F4060003C0001	P00004	0002			11
		P00002				11
		P00011				11
		P00010				11
		P00008				11
		P00006				11
		P00016				11
	F4060095C0016	P00383	0004			11

### Legend:

**Management of Incremental Funding**

- 1--Services performed prior to funding availability.
- 2--Use of expired appropriations for subsequent year services.
- 3--Use of non-RDT&E appropriations.
- 4--Use of RDT&E appropriations in the second year.

**Contract Payments**

- 5--Disbursement of expired appropriations for new services.
- 6--Payment instructions not in the contracts.
- 7--Incorrect adjustments to prior payments.
- 8--Improper application of vendor credit.
- 9--Inconsistency in application of payment prevalidation.

**Partial Financial Analysis**

- 10--MIT--We initially selected 34 contracting actions from contract F19628-00-C-0002. However, we focused our analysis on the 10 contracting actions that had largest funding values.
- 11--Contract paid out of IAPS. See Appendix D for details.
- 12--Withdrawal/Credits on contracts. See Appendix D for details.

Contracting Office	Contract/Delivery Order Number	Modification	CLIN Reviewed	Management of Incremental Funding*	Contract Payments*	Partial Financial Analysis*
AFFTC/PKRB	F0461100C0001	P00056	1000			11
		P00071				11
		P00062				11
		P00075				11
		P00064				11
AFRL/IFKRD	F3060202D0004/ DO 0001	23	0001			
AFRL/MLKH	F3361500C6060	P00012	0001			12
AFRL/MLKM	F3361597D5403/ DO 0023	16	0001	2	5	
	F3361501D5801/ DO 0031	03	0003			
AFRL/PRKB	F3361502D2299/ DO 0007	07	0001			
AFRL/SNKE	F3361501D1822/ DO 0003	000306	0001			
AFRL/SNKR	FA865004C1609	P00004	0001			
ASC/LPK	F3365799D2051/ DO 0011	01	0007		6	
	F3365799D2051/ DO 0012	03	0001		6	
	F3365799D2051/ DO 0010	08	0001			
ASC/RWKR	F3365700G4029/ DO 0318	33	0003			
ASC/VFK	F3365701D0026/ DO 0001	Mod 06	0701, 0702, 0703, 0704, 0707, 0709, 0710, 0711, 0715, 0716			12
ASC/YCK	F3365701D2000/ DO 0015	03	0006, 0007			
ASC/YSK	F3365799D0028/ DO 0016	Mod 31	2000		6	
Det 8 AFRL/PK	F2960101C0242	P00020	0002, 0003, 0004			12
		P00031				12
	F2960103C0203	P00007	0001, 0002			12
		P00009				12
	F2960199D0168/ DO 0027	09	0001			

\*See legend on page 32 for details.

Contracting Office	Contract/Delivery Order Number	Modification	CLIN Reviewed	Management of Incremental Funding*	Contract Payments*	Partial Financial Analysis *	
Det 8 AFRL/PK	F2960101C0050	P00047	0001, 0003, 0004				
		P00045					
	F2960102C0308	P00069	0001			12	
ESC/CXK	GS35F4514G/ F1962803F8043	P00006	0001, 0003, 0004			12	
ESC/DIK	FA872104C0001	P00002	0604, 0801, 1153, 1351, 1552, 1556, 2302, 2351, 2451, 4005, 4152, 4162, 5051, 2352, 2353, 2354, 2453, 2454, 2455, 2456, 2457, 2458, 4170, 4171, 5052			11	
	F1962800C0002	P00187	0001			10	
					1, 2, 4	7	
							10
							10
							10
							10
							10
					1, 3, 4	9	
							10
							10
					4		
							10
							10
							10
					1, 2, 3, 4	9	
					4		
							10
							10
							10
					2, 3, 4		
					3, 4	9	
							10
			10				
			10				
	1, 2, 3, 4	7					

\*See legend on page 32 for details.

Contracting Office	Contract/Delivery Order Number	Modification	CLIN Reviewed	Management of Incremental Funding*	Contract Payments*	Partial Financial Analysis*
ESC/DIK	F1962800C0002 (cont'd)	P00252	0001			10
		P00254		1, 3, 4		
		P00256				10
		P00257				10
		P00263				10
		P00267				10
		P00268				10
		P00270				10
		P00272				10
		P00273		1, 2, 4	8,9	
ESC/IYK	GS35F4668G/ F1962802F8197	P00010	'0005, 0006, 0014, 0015, 0017, 0018, 0020, 0021, 0023, 0024, 0032, 0033, 0150, 0151			12
		P00016				12
	GS35F4712G/ F1962802F8198	P00014	0002, 0003, 0011, 0012			12
	GS35F4668G/ F1962802F8200	P00021	0002	2	5	
ESC/JSK	F1962899D0001/ DO 1005	22	1500, 1505, 1520, 1525, 1534			12
ESC/NDK	GS35F4712G/ F1962802F8174	P00019	0101, 0108			12
HQ AFOTEC/RMC	FA704600D0002/ DO 0001	28	0001, 0002			12
	FA704600D0002/ DO 0175	09	0001		6	
HSW/PKR	F4162497D5000/ DO 17	23	0003	3		
	F4162497D6004 DO 27	17	0001	4		
OC-ALC/LKD	F3460102C0001	P00019	2001AG, 2002AG, 2003AG, 2001AF, 2002AF, 2003AF		6	
	F3460100C0111	P00164	0402EA, 0403EA		6	
	F3460103C0155	P00009	0005AC		6	

\*See legend on page 32 for details.

<b>Contracting Office</b>	<b>Contract/Delivery Order Number</b>	<b>Modification</b>	<b>CLIN Reviewed</b>	<b>Management of Incremental Funds*</b>	<b>Contract Payments*</b>	<b>Partial Financial Analysis*</b>
SMC/MR	GS35F4461G/ F0470103F7043	P00010	0001, 0002	1	6	
SMC/PKJ Los Angeles AFB	F0470101C0012	P00033	0010, 0013, 0017			12
SMC/PKR Los Angeles AFB	FA880204C0001	P00005	0001			11
		P00010				11
		P00006				11
		P00012				11
		P00008				11
		P00001				11
	F0470100C0009	P00031	0005			11
		P00032				11
	F0470100C8029	P00149	5501, 5551			12
	F0470100C8028	P00114	0112, 0115	1, 4	6	
GS35F0306J/ FA8802-04-F-7044	P00001	0001, 0002		6		
GS35F4825G/ F04701-01-F-7014	P00032	0004	1, 2	5,6		
SMC/PKS Los Angeles AFB	F0470195C0029	P00173	3101			12
	F0470195C0029	P00184				12
	F0470101C0001	P00158	0100, 1001			
SMC/PKU Kirtland AFB	F2960197C0018	P00019	0018			12

\*See legend on page 32 for details.

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## Appendix C. Laws and Regulations

### United States Code

Subsection 2410 (a), title 10, United States Code [10 U.S.C. 2410 (a)], “Severable services contract for periods crossing fiscal years,” January 6, 2003:

The Secretary of Defense, the Secretary of a military department, or the Secretary of Homeland Security with respect to the Coast Guard when it is not operating as a service in the Navy, may enter into a contract for procurement of severable services for a period that begins in one fiscal year and ends in the next fiscal year if (without regard to any option to extend the period of the contract) the contract period does not exceed one year.

Subsection 1301 (a), title 31, United States Code [31 U.S.C. 1301 (a)], “Application,” January 6, 2003:

Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by laws.

Subsection 1301 (c), title 31, United States Code [31 U.S.C. 1301 (c)], “Application,” January 6, 2003:

An appropriation in a regular, annual appropriation law may be construed to be permanent or available continuously only if the appropriation--expressly provides that it is available after the fiscal year covered by the law in which it appears.

Subsection 1341 (a), title 31, United States Code [31 U.S.C. 1341 (a)], “Limitation on Expending and Obligating Amounts,” January 7, 2003:

An officer or employee of the United States Government or of the District of Columbia government may not (a) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation, or (b) involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.

Section 1342, title 31, United States Code (31 U.S.C. 1342), “Limitation on Voluntary Services,” January 6, 2003:

An officer or employee of the United States Government or of the District of Columbia government may not accept voluntary services for either government or employ personal services exceeding that authorized by law except for emergencies involving the safety of human life or the protection of property.

Subsection 1502 (a), title 31, United States Code [31 U.S.C. 1502 (a)], “Balance Available,” January 16, 2003:

The balance of an appropriation of fund limited for obligation to a definite period is available only for payment of expenses properly incurred during the period of availability

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or to complete contracts properly made within that period of availability and obligated consistent with section 1501 of this title. However, the appropriation or fund is not available for expenditure for a period beyond the period otherwise authorized by law.

Subsection 3528 (a), title 31, United States Code [31 U.S.C. 3528 (a)],  
“Responsibilities and Relief from Liability of Certifying Officials,” January 6,  
2003:

A certifying official is responsible for (1) information stated in the certificate, voucher, and supporting records; (2) the computation of certified voucher under this section and section 3325 of this title; (3) the legality of proposed payment under the appropriation or fund involved.

Subsection 3325 (a), title 31, United States Code [31 U.S.C. 3325 (a)],  
“Vouchers,” January 6, 2003:

A disbursing official in the executive branch of the United States Government shall (1) distribute money only as provided by a voucher certified by (A) the head of the executive agency concerned; or (B) an officer or employee of the executive agency having written authorization from the head of the agency to certify vouchers; (2) examine a voucher if necessary to decide if it is (A) in proper form; (B) certified and (C) computed correctly on the facts certified; (3) except for the correctness of computations on a voucher or pursuant to payment intercept or offsets pursuant to section 3716 or 3720A of this title, be held accountable for carrying out clauses (1) and (2) of this subsection.

## **Statement of Federal Financial Accounting Standard**

Statement of Federal Financial Accounting Standards No.1, version 5,  
“Accounting for Selected Assets and Liabilities,” March 30, 1993:

Paragraph 74. Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rent due to other entities.

Paragraph 80. The reporting entity should disclose accounts payable not covered by budgetary resources.

## **Federal Acquisition Regulation**

FAR Subpart 1.602-2, “Contracting Officers, Responsibilities” September 28,  
2006:

Contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships. In order to perform these responsibilities, contracting officers should be allowed wide latitude to exercise business judgment. Contracting officers shall --

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- (a) Ensure that the requirements of 1.602-1(b) have been met, and that sufficient funds are available for obligation;
  - (b) Ensure that contractors receive impartial, fair, and equitable treatment; and
  - (c) Request and consider the advice of specialists in audit, law, engineering, information security, transportation, and other fields, as appropriate.

FAR Subpart 4.10, "Contract Line Items," November 22, 2006:

Contracts may identify the items or services to be acquired as separately identified line items. Contract line items should provide unit prices or lump sum prices for separately identifiable contract deliverables, and associated delivery schedules or performance periods. Line items may be further subdivided or stratified for administrative purposes.

FAR 52.232-22, "Limitation of Funds," April 1984:

- (a) The parties estimate that performance of this contract will not cost the Government more than
  - (1) the estimated cost specified in the Schedule or,
  - (2) if this is a cost-sharing contract, the Government's share of the estimated cost specified in the Schedule.

The Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within the estimated cost, which, if this is a cost-sharing contract, includes both the Government's and the Contractor's share of the cost.

- (c) The Contractor shall notify the Contracting Officer in writing whenever it has reason to believe that the costs it expects to incur under this contract in the next 60 days, when added to all costs previously incurred, will exceed 75 percent of
  - (1) the total amount so far allotted to the contract by the Government or,
  - (2) if this is a cost-sharing contract, the amount then allotted to the contract by the Government plus the Contractor's corresponding share.

The notice shall state the estimated amount of additional funds required to continue performance for the period specified in the Schedule.

- (i) When and to the extent that the amount allotted by the Government to the contract is increased, any costs the Contractor incurs before the increase that are in excess of—(1) the amount previously allotted by the Government or (2) If the this is a cost-sharing contract, the amount previously allotted by the Government to the contract plus the Contractor's corresponding share, shall be allowable to the same extent as if incurred afterward, unless the Contracting Officer issues a termination or other notice and directs that the increase is solely to cover termination or other specific expenses.

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## Defense Federal Acquisition Regulation Supplement

DFARS Subpart 204.7101 “Uniform Contract Line Item Numbering System, Definitions,” November 9, 1999:

“Accounting classification reference number (ACRN)” means a two position alpha or alpha/numeric control code used as a method of relating the accounting classification citation to detailed line item information contained in the schedule

“Nonseverable deliverable,” as used in this subpart, means a deliverable item that is a single end product or undertaking, entire in nature, that cannot be feasibly subdivided into discrete element or phases without losing its identity.

DFARS Subpart 204.7107, “Uniform Contract Line Item Numbering System, Contract Accounting Classification Reference Number (ACRN),” November 9, 1999:

3) Payment instructions.

(i) When a contract line item is funded by multiple accounting classification citations, the contracting officer shall provide adequate instructions in section G (Contract Administration Data), under the heading “Payment Instructions for Multiple Accounting Classification Citations,” to permit the paying office to charge the accounting classification citations assigned to that contract line item (see 204.7104-1(a)) in a manner that reflects the performance of work on the contract. If additional accounting classification citations are subsequently added, the payment instructions must be modified to include the additional accounting classification citations.

(ii) Payment instructions shall provide a methodology for the paying office to assign payments to the appropriate accounting classification citation(s), based on anticipated contract work performance. The method established should be consistent with the reasons for the establishment of the line items. The payment method may be based upon a unique distribution profile devised to reflect how the funds represented by each of the accounting classification citations support contract performance. Payment methods that direct that payments be made from the earliest available fiscal year funding sources, or that provide for proration across accounting classification citations assigned to the line item, or a combination thereof, may be used if that methodology reasonably reflects how each of the accounting classification citations supports contract performance.

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## DoD Regulation 7000.14-R Financial Management Regulation

DoD FMR, volume 2A, chapter 1, paragraph 010213, “Research, Development, Test and Evaluation (RDT&E)-Definitions and Criteria,” June 2004:

A. Definitions: The term “Research and Development (R&D)” is intended broadly to include the work performed by a government agency or by private individuals or organizations under a contractual or grant arrangement with the government. It includes R&D in all fields, including the physical sciences, engineering, etc.

B. General Criteria When, after considering the following criteria, there is doubt as to the proper assignment of costs between appropriations, the issue should be resolved in favor of using RDT&E funding. In general, the types of costs to be financed by RDT&E and related appropriations are:

1. RDT&E Appropriation.

a. RDT&E will finance research, development, test and evaluation efforts performed by contractors and government installations, including procurement of end items, weapons, equipment, components, materials and services required for development of equipment, material, or computer application software; its Development Test and Evaluation (DT&E); and its Operational Test and Evaluation (OT&E) as provided for in paragraph C.5. (Test Articles and Test Support) below.

b. The operation of R&D installations and activities engaged in the conduct of R&D programs, including direct and indirect efforts, expense and investment costs.

c. The acquisition or construction of industrial facilities costing less than \$750,000 at government owned, government operated facilities under the criteria of DoD Directive 4275.5 as provided for under 10 U.S.C. 2805 (unspecified minor construction). Use of RDT&E funds for acquisition and construction at contractor owned or contractor operated facilities is authorized under 10 U.S.C. 2353, Contracts; Acquisition, Construction or Furnishings of Test Facilities and Equipment.

DoD FMR, volume 2A, chapter 1, paragraph 010214 (A), “RDT&E-Incremental Programming and Budgeting Basis, Purpose,” June 2004, specifies the principles to be followed and establishes the criteria and definitions to be used in the preparation of the annual RDT&E budget estimates on an incrementally funded basis. The incremental budgeting policy provides that only those appropriations required for work in a given fiscal year shall be included in the RDT&E budget request for that fiscal year for most classes of effort.

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## **Air Force Regulations**

Air Force Instruction 65-601, volume 1, “Budget Guidance and Procedures,” Chapter 13- RDT&E Appropriation, March 3, 2005:

Section 13.4. Limit reapplying of funds in the second year to cost growth within scope or to requirements which are a bona fide need of the appropriation year as defined by DFAS-DE Interim Guidance on Accounting for Obligations.

Section 13.8.4. The RDT&E appropriation is legally available for up to 2 years for new obligations and you may incur obligations at any time during the 2 years, if the related action concerns an item authorized in the program authorization and budget authorization documents issued for the appropriation year.

## **Defense Finance and Accounting Service**

DFAS Columbus Policy 03-CP-01, “Direct Submission of Cost Reimbursement (SF1034/SF1035) Type Interim Vouchers,” March 12, 2004, provides that:

All vouchers will be certified by a duly appointed DFAS certifying official prior to payment. Additionally, for sites using Electronic Document Management (EDI), authorization memoranda may be scanned into the contract folder for viewing purposes.

DFAS Columbus Instruction 70001.7-I, “Policy No. 03-CP-02, Payment Prevalidation Instruction for Commercial Pay Business Line,” March 2003, requires all personnel managing DoD appropriations to conduct a prevalidation and receive positive response from applicable accounting offices prior to making payments.

DFAS Columbus Desk Procedure 401, “Contract Entitlement, Processing a Manual Payment for BVNs,” June 1996, states:

If an invoice does not contain a breakout of the amount to be paid by ACRN and/or country, then disbursement shall be prorated against all ACRNs unless specifically stated otherwise in the contract.

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## Appendix D. Other Matters of Interest

**IAPS Documents.** We were unable to complete our analysis of 53 CLINs paid through IAPS. The complexity of the payment vouchers and the amount of time required to associate ACRNs<sup>1</sup> with their respective LOAs was further complicated by the fact that the same LOA could be associated with more than one ACRN. Contracting officers establish CLINs for specific requirements and assign ACRNs to those CLINs. Thus, the CLIN/ACRN combination is vital to ensure that the appropriation disbursement parallels the specific work elements that contractors perform. Payment vouchers from IAPS frequently did not contain the data necessary to make the correct CLIN/ACRN associations. Instead, many contained only the LOA and purchase request numbers.

Without the correct CLIN/ACRN associations, we could not complete the analysis of many IAPS samples within a reasonable amount of time. The MIT contract was paid through IAPS. However, we were able to complete the analysis of these samples because there was only one CLIN, even though the contract involved more than 300 projects.

In January 2007, DFAS implemented new procedures to link systematically CLINs to their respective LOAs. According to DFAS personnel, the procedures will allow DFAS to control payments at the CLIN level. Because our sample universe of transactions occurred before the effective date of the new procedures, we did not verify whether the procedures would actually provide the data linkage needed.

**Withdrawal/Credits.**<sup>2</sup> A withdrawal/credit corrects or changes an ACRN after the original disbursement has occurred. These entries can occur months or even years after the original entries. It is time-consuming to match the corrections to the original CLINs/ACRNs. Of our selected contracts, 15 had extensive numbers of withdrawal/credits, some of which occurred outside of our target timeframe. Therefore, we did not conduct a detailed evaluation of those samples.

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<sup>1</sup> An ACRN is an alphanumeric code that represents a specific LOA.

<sup>2</sup> The withdrawal/credit form is called the SF 1081, "Voucher and Schedule of Withdrawals and Credits."

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## **Appendix E. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
  Director Acquisition Resources and Analysis  
Under Secretary of Defense (Comptroller)/Chief Financial Officer  
  Deputy Chief Financial Officer  
  Deputy Comptroller (Program/Budget)  
  Director Program Analysis and Evaluation  
Director, Defense Procurement and Acquisition Policy

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Assistant Secretary of the Air Force (Acquisition)  
Auditor General, Department of the Air Force

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Finance and Accounting Service, Columbus  
Director, Defense Contract Management Agency

### **Non-Defense Federal Organization**

Office of Management and Budget

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Homeland Security and Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Oversight and Government Reform  
House Subcommittee on Government Management, Organization, and Procurement,  
Committee on Oversight and Government Reform  
House Subcommittee on National Security and Foreign Affairs,  
Committee on Oversight and Government Reform



# Under Secretary of Defense for Acquisition, Technology, and Logistics Comments

Final Report  
Reference



OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

JAN 17 2008

ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL AND DIRECTOR,  
DEFENSE FINANCIAL AUDITING SERVICE, DoDIG

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS *WS 1/22/08*

SUBJECT: Response to DoDIG Draft Report on Management of Incremental Funds on  
Air Force Research, Development, Test, and Evaluation Contracts (Project  
No. D-2005-D000FD-0208)

Thank you for the opportunity to comment on the subject draft report. I am providing the response to recommendation B.1 and comments on the related content of the report. We concur with the recommendation subject to the condition that the reference to the direct billing program be deleted from the recommendation. The subject condition was agreed-to during a January 10, 2008 meeting involving Ms. Amy Frontz of your office, and representative from the Defense Contract Audit Agency and Defense Procurement and Acquisition Policy. In addition, we have comments and clarifications on other parts of the report.

**Recommendation B.1:**

We recommend that the Under Secretary of Defense for Acquisition, Technology, and Logistics implement procedures for the Direct Bill Program requiring that the certifying officer for interim vouchers receive the needed information to ensure that all disbursements will meet fiscal law requirements, including the Bona Fide Needs Rule and Purpose Statute.

**Response:**

Concur. We agree that any payment system should require information to ensure disbursements meet fiscal law requirements. Effective October 11, 2005, we implemented policies that require:

- Unique accounting classification reference numbers (ACRNs) for each accounting classification citation funding the contract, and
- Payment instruction that permit the paying office to charge the accounting classification citations assigned to that contract line item in a manner that reflects the performance of work on the contract.

1



Revised

We believe our revised policies are sufficient to ensure disbursing officials have the appropriate information to ensure disbursements meet fiscal law requirements. These policies are located at Defense Federal Acquisition Regulations Supplement (DFARS) Procedures, Guidance, and Information (PGI) 204.7107 and 204.7108.

**Comments and Clarifications**

**Draft report (page 14):**

“These policies require DFAS certifying officers to validate vouchers prior to making payments. However, the process listed in Policy 03-CP-03, attachment 6, for validating the voucher is insufficient because it does not require the certifying officer to certify the legality of the appropriations involved. As an alternative, DFAS personnel rely on the Mechanization of Contract Administrative Services system (MOCAS) notifications and the Defense Contract Audit Agency (DCAA) contractor reviews to make these determinations for them.” (underscoring added)

**Response:**

The primary purpose of DCAA’s examination and approval of interim public vouchers is to provide reasonable assurance that the amounts claimed are not in excess of that which is properly due the contractor in accordance with the terms of the contract. DCAA does not review vouchers to validate the legality of the appropriations. Therefore, it is not appropriate for DFAS to rely on DCAA reviews as certification that the use of specific appropriations is legal.

**Draft report (page 14):**

“DFAS personnel stated that they relied on DCAA contract reviews as certification that the use of specific appropriations was appropriate.”

**Response:**

DCAA is responsible for verification of costs, not for assignment or verification of ACRNs. Accordingly, it is not appropriate for DFAS to rely on DCAA reviews as certification that the use of specific appropriations was appropriate.

**Draft report (page 14):**

“... while DFARS Subpart 242.803 states the administrative contracting officer for the individual contract is the certifying officer for final vouchers.” (underscoring added)

**Response:**

The cited DFARS subpart does not state the administrative contracting officer (ACO) is the certifying official for final vouchers. Instead, it states the ACO approves all completion/final vouchers.

Page 18

Page 18

Page 18

**Draft report (page 15):**

“However, paragraph 6-1003(f) of the DCAA Contract Audit Manual limits DCAA’s reviews of interim vouchers. It states that reviews of interim vouchers are to provide reasonable assurance that the amounts claimed are not in excess of that which is properly due the contractor. However, the intent is not that these vouchers be individually audited.”

Page 19

**Response:**

We believe a more accurate and neutral presentation of the content of the DCAA Contract Audit Manual would be to quote the actual content which states:

“The primary purpose of the examination and approval of interim public vouchers is to provide reasonable assurance that the amounts claimed are not in excess of that which is properly due the contractor in accordance with the terms of the contract. The extent of audits of individual interim vouchers is based upon the adequacy of the contractor’s management controls and procedures. It is not intended that interim public vouchers submitted by contractors under cost-reimbursable type contracts be individually audited.”

**Draft report (page 15):**

“The implementation of the Direct Bill Program limited DCAA’s review of interim vouchers and increased DFAS responsibilities.” (underscoring added)

Page 19

**Response:**

The direct billing program does not result in the reduction of contract payment information and has no relationship to DFAS responsibilities.

**Draft report (page 15):**

“Paragraph 6-107.6 “Contractor Continued Participation in the Direct Billing Program,” section (a) January 2005, of the DCAA Contract Audit Manual states that Field Auditing Offices (FAOs) should review internal system controls for major contractors’ billing systems based on documented risk assessment.” (underscoring added)

Page 19

**Response:**

We believe a more accurate presentation of the content of the DCAA Contract Audit Manual would be to quote the actual content which states:

“A contractor’s continued participation in the direct billing program will be based on the results of our ongoing surveillance of a contractor’s billing systems. Auditors will continue to audit major contractors’ billing system internal controls based on documented risk assessments.”

**Draft report (page 15):**

“In October 2001, the Under Secretary of Defense (Acquisition, Technology, and Logistics) issued a memorandum stating that DoD Components were to stop requiring contractors to submit detailed cost information as part of the billing process. The memorandum states that the information is not needed, and DoD Components and contracting officer representatives are performing tasks that are the responsibility of DCAA. This memorandum does not take into consideration that DCAA does not audit interim vouchers submitted through the Direct Bill Program, except for those samples selected during periodic audits.” (underscoring added)

**Response:**

The memorandum and policy do take into consideration the fact that DCAA does not audit all interim vouchers, but rather performs a review of a sample of vouchers based on risk to ensure provisional payments are in accordance with contract terms. We believe the inaccurate assumption is based on a misunderstanding of the direct billing program.

**Draft report (page 16):**

“Therefore, as a certifying officer, DFAS personnel cannot rely on DCAA to ensure interim vouchers are correct, or on the information in the interim vouchers to ensure proper disbursement.”

**Response:**

DFAS can, and does, rely on DCAA to provide reasonable assurance that interim vouchers are correct, i.e., the amounts are not in excess of that which is properly due the contractor in accordance with the terms of the contract.

**Draft report (page 16):**

“DCAA does contract close-out audits at the request of the contracting activity. Without close-out audits, there is little assurance that all of the charges made through direct billing have been adequately supported, especially in complex contracts involving significant dollar amounts.” (underscoring added)

**Response:**

DCAA performs annual audits of contractors’ incurred cost proposals to verify contractor’s claimed/reimbursed costs. When a contract close-out audit is requested, DCAA verifies that the final contract costs reconcile to the costs examined in DCAA’s annual audits of incurred cost. In other instances, ACOs properly rely on DCAA’s Cumulative Allowable Cost Worksheets (CACWS) to close-out contracts. The CACWS is a summary schedule of cumulative allowable contractor costs for each open flexibly priced contract through the last contractor fiscal year for which indirect cost rates have been settled.

**Draft report (page 16):**

“However, according to DCAA personnel, ESC has not requested DCAA do a close-out audit of the MIT LL contracts since DCAA completed the 1985, 5-year contract close-out, approximately 17 years ago.”

Page 20

**Response:**

The contractor has outstanding cost issues. Therefore, the contractor has not submitted a final voucher. A close-out audit cannot be performed until the outstanding cost issues are resolved and the contractor submits the final voucher.

**Draft report (page 16):**

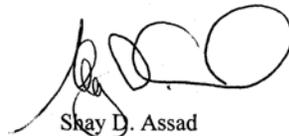
“Close-out audits would provide additional assurance that the amounts charged by the contractor were fully supported and that they have been paid from the correct funding sources because of ... the limited auditing of interim vouchers ...” (underscoring added)

Page 20

**Response:**

DCAA has performed annual audits of costs incurred under this contract. Once an audit is completed and the contracting officer settles the cost for the time period, the contractor should submit a voucher to reflect the final settled rates. These annual audits of incurred costs provide reasonable assurance that the amounts charged by the contractor are not in excess of that which is properly due the contractor in accordance with the terms of the contract.

Please contact Robin Schulze, 703.602.0326, robin.schulze@osd.mil if additional information is required.



Shay D. Assad  
Director, Defense Procurement  
and Acquisition Policy

# Assistant Secretary of the Air Force for Acquisition Comments



DEPARTMENT OF THE AIR FORCE  
WASHINGTON, DC



OFFICE OF THE ASSISTANT SECRETARY

NOV 13 2007

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL  
ATTN: DEPUTY INSPECTOR GENERAL FOR AUDITING

FROM: SAF/AQC

SUBJECT: Air Force Response to Department of Defense Inspector General (DoDIG)  
Draft Report, Project No. D2005-D000FD-0208, Management of  
Incremental Funds on Air Force Research, Development, Test, and  
Evaluation Contracts

This is in reply to your memorandum requesting that the Assistant Secretary of the Air Force provide comments on the subject draft report dated 14 September 2007. We have reviewed the subject report, which contains recommendations that cover financial and contracting areas. This memorandum does not address recommendations that are the responsibility of the Assistant Secretary of the Air Force (Financial Management and Comptroller), the Under Secretary of Defense (Acquisition, Technology, and Logistics) or the Defense Finance and Accounting Service (DFAS). Responses to recommendations A.1. and B.3 for the Assistant Secretary of the Air Force for Acquisition are found below:

**DoDIG Recommendation A.1.: The Assistant Secretary of the Air Force for Acquisition should:**

**a. Establish procedures to prevent contractors from incurring costs prior to the availability of appropriations**

Air Force Response: Concur. Procedures to prevent contractors from incurring costs prior to the availability of appropriations are established by the Federal Acquisition Regulation (FAR) 52.232-22, "Limitation of Funds" clause. However, the Deputy Assistant Secretary (Contracting) will issue guidance to ensure that Contracting Officers clearly understand the Government's risk of liability should a contractor perform at risk during a period in which the contract is unfunded.

Estimated Completion Date: 15 January 2008

**b. Provide contracting officers, contracting officer's technical representatives, and others involved in the contract management process specific training on contracting requirements contained in the United States Code, Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Air Force Policy.**

Air Force Response: Concur. A structure to provide mandatory and desired

training for acquisition professionals exists and has recently been enhanced. On 24 August 2007, prior to issuance of the DoDIG draft report, the Office of Under Secretary of Defense (OUSD), Director, Defense Procurement and Acquisition Policy (D,DPAP) issued a memo highlighting the implementation of changes in the Contracting Core Certification Standards and Core Plus Development Guide for Fiscal Year 2008. In addition, the Air Force Materiel Command (AFMC) has a continuing education program that addresses fiscal law/contract funding issues. This program is designed for Air Force personnel responsible for contracting, financial management, and program management. Training monitors assigned to individual Air Force contracting units have the responsibility to ensure contracting personnel comply with the mandatory and desired training standards. We will continue to rely on the existing structure to train acquisition professionals. Action completed.

**c. Establish guidance to provide a uniform contract structure for multi-year severable contracts.**

Air Force Response: Non-Concur. The uniform contract structure is mandated in the Defense Federal Acquisition Regulation Supplement (DFARS) Subpart 204.70. Air Force establishment of an alternative or additional uniform contract structure for “multi-year severable contracts” would be inconsistent with such regulation. The majority of Research, Development, Test and Evaluation (RDT&E) programs are nonseverable “single undertakings” that are incrementally funded with annual amounts needed for the effort in each fiscal year, in accordance with DoD and Air Force Financial Management Regulations. This method of funding does not imply severability. Program severability is evaluated on a case-by-case basis at the onset of every RDT&E acquisition planning effort to, (1) ensure an appropriate contract structure is tailored to the effort, and (2) ensure correct management of appropriations throughout the life of the program. In most of Air Force research and development programs, the only deliverable is at the end of the program – the final technical report detailing the results of the entire program. In addition, oversight procedures during the various phases of an acquisition are discussed in the response to A.1.(e)(1).

**d. Establish separate contract line item numbers for separate requirements in accordance with the Defense Federal Acquisition Regulation Supplement Subpart 204.7103.**

Air Force Response: Concur. Prior to issuance of the draft DoDIG report, on 29 December 2006, OUSD (D,DPAP) issued a memorandum directing all contracting personnel serving in acquisition positions complete Defense Acquisition University (DAU) training entitled “Contract Format and Structure for the DoD e-Business Environment.” In addition, on 26 February 2007, the Deputy Assistant Secretary (Contracting) issued a policy memorandum entitled “Proper Contract and Line Item Format, Structure and Execution.” This memorandum states that contracting officers must, (1) form contract line items in accordance with FAR Part 4 and its supplements; and (2) provide vendors with clear payment instructions that enable vendors to invoice correctly to meet the terms of the contract. Action completed.

**e. Establish periodic reviews of RDT&E contracts to ensure that the contract formation, execution, and closure comply with laws, regulation, and policy; and correct any noncompliance. Specifically:**

**(1) Determine whether the contracting officers exercised their responsibility to protect the interest of the U.S. government by obtaining and monitoring contract disbursements in accordance with the FAR Part 1.602**

Air Force Response: Concur with intent. FAR 1.602-2 states that the contracting officer must ensure that sufficient funds are available for obligation. However, the requirement for monitoring contract disbursements does not lie with the contracting officer. Once the contract is awarded, disbursement activities are normally under the auspices of DFAS or other cognizant payment offices. Adequate Air Force review policies and procedures have been installed to comply with the FAR. First, Air Force FAR Supplement (AFFARS) 5301.602-2 requires contracting officers to obtain legal advice during the various phases of an acquisition. While the contracting officer has some discretion as to when to obtain such review, the contracting officer must obtain legal review for any contract action above one million dollars (\$1M) for any AFMC non-operational contract action. In addition to the requirement for legal review, AFFARS 5301.9001 establishes a business and contract clearance process which specifies review and approval requirements for all contractual actions over five-hundred thousand dollars (\$500K). These reviews, in addition to the normal oversight provided by the contracting officer, (1) provide a real-time, pre-award assessment of each contract action; and (2) ensure that contract formation and execution complies with laws and regulations. While the contracting officer always obtains the funds via the cognizant Air Force financial management office, this action is not taken in a vacuum. The contracting officer and the financial management point of contact both work to understand the requirement and ensure proper funds are used. Additionally, the procedures discussed at A.1.(e)(2) below have been implemented. Action completed.

**(2) Determine whether the contracting officers properly obligated appropriations other than RDT&E in a RDT&E contract**

Air Force Response: Concur. Additional procedures have been implemented to ensure that contracting officers properly obligate appropriations other than RDT&E in an RDT&E contract. These procedures include both pre-award and post-award activities. Preaward: (1) financial management oversight; (2) procuring contracting officer and negotiator training; (3) higher level reviews within the contracting chain; and (4) legal reviews. Post-award: Annual self inspections are conducted by each buying office in accordance AFMC/PK Policy Memorandum, dated 2 May 2005, entitled "Minimum Standards for Self Inspection." Unit compliance inspection checklists, addressing items verifying proper obligation of appropriations are already used by contracting officers, and contracting officers are provided refresher training on this topic. Action completed.

**(3) Determine whether the contracting officers correctly obligated RDT&E AF appropriations in the second year of availability in accordance with AFI 65.601.**

Air Force Response: Concur. Additional procedures have been implemented to ensure that contracting officers properly obligate RDT&E AF appropriations in the second year of availability in accordance with AFR 65-601. These procedures include: (1) financial management oversight; (2) procuring contracting officer and negotiator training; (3) higher level reviews within the contracting chain; and (4) legal reviews. In addition, annual self inspections are conducted by each buying office in accordance AFMC/PK Policy Memorandum, dated 2 May 2005, entitled "Minimum Standards for Self Inspection." Unit compliance inspection checklists, addressing items verifying proper obligation of appropriations are already used by contracting officers, and contracting officers are provided refresher training on this topic. Action completed.

**DoDIG Recommendation B.3.: The Assistant Secretary of the Air Force for Acquisition should:**

**a. Establish quality control procedures to confirm that contracting officers include payment instructions in every contract.**

Air Force Response: Concur. Prior to issuance of the DoDIG draft report, these procedures were addressed in the Deputy Assistant Secretary (Contracting) Policy Memorandum, dated 26 February 2007. To ensure that contracting officers include payment instructions in every contract the procedures will be included on the Air Force Contracting Compliance Inspection Checklist that is currently being developed. This checklist will be used Air Force-wide for all compliance inspections. It will also serve as the basis for all self-inspection checklists.

Estimated Completion Date: 31 January 2008

**b. Establish procedures to track and correct items in the Defense Finance and Accounting Service contract deficiency report.**

Air Force Response: Concur. The Department of Defense (DoD), using its Electronic Document Access (EDA) System, has been developing an electronic version of the DD Form 1716, Contract Deficiency Report (CDR). Traditionally in the Air Force, the DD Form 1716 was used between DFAS and AFMC for contract problems as they arose. The electronic system in EDA will broaden the capability and allow DFAS to create and transit CDRs on any contract action it is processing for payment. The system is currently under spiral development and, although implemented in the field, requires specific development and funding to fully make it a viable tracking system for DFAS to notify Administrative Contracting Officers (ACOs) and Procuring Contracting Officers (PCOs) of contract issues effecting payment. Currently, the CDR system in EDA allows a DFAS pay clerk to establish a CDR and send it with supervisory approval, providing the recipient has an active EDA account. Because the Standard Procurement System (SPS) transmits the contract information in batches to DFAS daily, the PCOs in the Air

Force and the ACOs in Defense Contract Management Agency have not traditionally had accounts in EDA. The changes planned for the system in FY 2008, when funded by the Business Transformation Agency (BTA), will establish a hierarchical structure for each military service so they can manage, monitor and close out the CDRs created by DFAS. The DoD BTA is responsible for implementing this EDA enhancement. Action completed.

**c. Perform periodic reviews to determine whether contracting officers monitor contractor vouchers, including interim vouchers, to determine whether the contractors and DFAS personnel comply with contract payment instructions.**

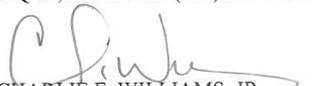
Air Force Response: Non-Concur. Monitoring contractor vouchers, including interim vouchers, to determine whether the contractors and DFAS personnel comply with contract payment instructions, is not a contracting officer responsibility. In accordance with DFARS Subpart 242.803, DCAA has been given the authority to act as the Contracting Officer's Representative for auditing and submission of interim vouchers. The decision of an individual Contracting Officer is not required or sought from DCAA prior to conducting any of the functions listed in DFARS Subpart 242.803, including the authorization for direct submission of vouchers to the payment office. Action completed.

**d. Establish guidance specifying the circumstances under which contracting officers are to request contract closeout audits.**

Air Force Response: Concur. The requirements and procedures for contract closeout are established by the FAR Subpart 4.804-5, "Procedures for Closing Out Contract Files" and DFARS Subpart 204.804, "Closeout of Contract Files." In addition, AFMC FAR Supplement (AFMCFARS) Subpart 5304.804-5, "Procedures for closing out contract files" includes a Contract Closeout Guide, dated December 2005 that clearly explains the roles and responsibilities in the closeout process. To ensure that contracting officers comply with the requirements and procedures for closeout of contracts, "closeout" will be included on the Air Force Contracting Compliance Inspection Checklist that is currently being developed. This checklist will be used Air Force-wide for all compliance inspections. It will also serve as the basis for all self-inspection checklists.

Estimated Completion Date: 31 January 2008

Questions your staff may have concerning the responses to recommendations A.1 and B.3 may be directed to Ms. Karen Fischetti, SAF/AQCP, commercial (703) 588-7071 or DSN 425-7071.

  
 CHARLIE E. WILLIAMS, JR.  
 Deputy Assistant Secretary (Contracting)  
 Assistant Secretary (Acquisition)

# Principal Deputy Assistant Secretary of the Air Force for Financial Management and Comptroller - Budget Comments



OFFICE OF THE ASSISTANT SECRETARY

DEPARTMENT OF THE AIR FORCE  
WASHINGTON, DC



NOV 07 2007

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDITING  
OFFICE OF THE INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE

FROM: SAF/FM

SUBJECT: Department of Defense Inspector General Draft Audit Report, Management of Incremental Funds on Air Force Research, Development, Test, and Evaluation Contracts (Project D2005-D000FD-0208)

This is in reply to your memorandum requesting the Assistant Secretary of the Air Force (Financial Management and Comptroller) provide Air Force comments on subject report. The draft report recommends:

A.2.a. Conduct preliminary Antideficiency Act investigations and implement proper corrections for the following contracts:

- (1) F08635-02-C-0034
- (2) F19628-00-C-0002
- (3) F04701-01-F-7014
- (4) F41624-97-D-5000, delivery order 0017
- (5) F33615-97-D-5403

*Proposed Management Comment: Concur with intent. As an alternative, I have directed each financial management office with contracts identified with this audit, to thoroughly research each issue to determine if a preliminary review is necessary. Based on the results of their research and our legal review, I will consider the matter closed or direct those offices to begin preliminary ADA reviews.*

A.2.b. Establish procedures to track and record deferral charges as unfunded liabilities for accounts payable, as required by Statement of Federal Financial Accounting Standard No.1.

*Proposed Management Comment: Concur with intent. The Air Force does not plan to continue the process of allowing deferred charges under the Advance Payment Pool Agreement. My staff will meet with personnel at the Electronic Systems Center and the Massachusetts Institute of Technology-Lincoln Laboratory to discuss the proper posting of invoices and procedures for future payments under the Advance Pool Agreement in accordance with DFARS 232.470. They are to provide me the status of this meeting with corrective actions no later than 30 November 2007.*

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A.2.c. Review the requirements of Air Force Instruction 65.601, chapter 13, to clarify the use of Research, Development, Test, and Evaluation funds in the second year and train resource managers on the proper application of this instruction in the use of Research, Development, Test, and Evaluation appropriations in the second year.

*Proposed Management Comment: Concur with intent. We endeavor to provide clear guidance to Air Force personnel. The Air Force periodically reviews Air Force Instructions for clarity and currency. We are currently in the process of this review and will ensure a thorough review of chapter 13 to determine what changes would be necessary for clarification, commensurate with statutory and regulatory guidance. Additionally, resource managers are extensively trained upon their initial assignment and receive annual training to maintain currency.*

These comments address the recommendations directed to SAF/FM. The SAF/FM point of contact is Ms. Jennifer Morgan, 703-695-4536.



JOHN G. VONGLIS  
Principal Deputy Assistant Secretary  
of the Air Force (Financial Management)

# Deputy Assistant Secretary of the Air Force, Financial Management and Comptroller - Financial Operations Comments



OFFICE OF THE ASSISTANT SECRETARY

DEPARTMENT OF THE AIR FORCE  
WASHINGTON, DC

OCT 3 2007

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDITING OFFICE OF  
THE INSPECTOR GENERAL DEPARTMENT OF DEFENSE

FROM: SAF/FMP  
1130 Air Force Pentagon  
Washington, DC 20330-1130

SUBJECT: DoDIG Draft Audit Report, Management of Incremental Funds in Air Force  
Research, Development, Test, and Evaluation Contracts, (Projects D2005FD-0208)

This is in reply to your memorandum requesting Assistant Secretary of the Air Force  
(Financial Management and Comptroller) to provide Air Force comments on subject report.

Recommendation A.2.a., Concur with intent. As an alternative, I have directed each  
financial management office with contracts identified with this audit, to thoroughly research each  
issue to determine if a preliminary review is necessary. They are to provide me the results of  
these reviews no later than 4 October 2007. Based on the results of their research and our legal  
review, I will consider the matter closed or direct those offices to begin preliminary ADA  
reviews.

Recommendation A.2.b., Concur with intent. The Air Force does not plan to continue the  
process of allowing deferred charges under the Advance Payment Pool Agreement. My staff  
will meet with personnel at the Electronic Systems Center and the Massachusetts Institute of  
Technology-Lincoln Laboratory to discuss the proper posting of invoices and procedures for  
future payments under the Advance Pool Agreement in accordance with DFARS 232.470. They  
are to provide me the status of this meeting with corrective actions no later than 30 November  
2007.

Thank you for the opportunity to comment on this report. If you have any questions or  
require additional information, please contact Mr. Johnny Lipscomb, SAF/FMPS, 703-697-4638,  
DSN, 227-4638, [Johnny.lipscomb@pentagon.af.mil](mailto:Johnny.lipscomb@pentagon.af.mil).

  
RICHARD P. GUSTAFSON  
Deputy Assistant Secretary  
Financial Operations  
(Financial Management)

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# Defense Finance and Accounting Service Columbus Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE  
P.O. BOX 182317  
COLUMBUS, OHIO 43218-2317

DFAS-JBI/CO

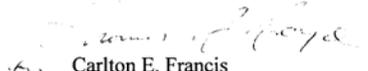
NOV 28 2007

MEMORANDUM FOR DIRECTOR, DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Management Comments to DoDIG Draft Audit Report, "Management of Incremental Funds on Air Force Research, Development, Test, and Evaluation Contracts," Project Number D2005-D000FD-0208, dated September 14, 2007

In accordance with subject audit, management comments to the draft audit report are provided. The estimated completion dates for Recommendations B.2.a and B.2.c are September 1, 2008 and December 1, 2008 respectively. Recommendation B.2.b is considered closed.

My point of contact for additional information is Mr. John Yerkey, DFAS-JBI/CO, at 614-693-1375 or DSN 869-1375.

  
Carlton E. Francis  
Deputy Director, DFAS Columbus

Attachment:  
As stated

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**Management Comments to DoDIG Draft Audit Report "Management of Incremental Funds on Air Force Research, Development, Test, and Evaluation Contracts," Project Number D2005-D000FD-0208, dated September 14, 2007**

**Recommendation B.2.a:** We recommend that the Director, Defense Finance and Accounting Services, Columbus give the Office of the Assistant Secretary of the Air Force (Acquisition) a copy of the contract deficiency report so that they can track and correct errors quickly.

**Current Management Comments:** Non-Concur. Currently there are no reporting capabilities within the Contract Deficiency Report (CDR) application in EDA. However the CDR does have the capability of being queried by the Department of Defense Activity Address Code (DODAAC), which can be used by a representative of the Assistant Secretary of the Air Force Office (Acquisition) to monitor CDRs applicable to their service/command. This will ascertain required action is being taken to issue correcting contract modifications that the Air Force is responsible for.

The Joint EDA community Organizational Review Committee (ORC) has requested that the CDR application be modified to include canned reports that can be used for monitoring the CDRs and an error code field be added to the advanced query capabilities. These enhancements will allow the PCOs to query the CDRs by the error code and/or any other pertinent fields. Engineering Change Proposals (ECPs) have been submitted to the Business Transformation Agency (BTA) in order to implement the future changes to the CDR application. The completion of these changes is not known at this time due to the required funding to implement the requested changes. Currently, funding has not been authorized to implement these changes. DFAS will continue to monitor the progress of the funding issue and will follow-up on the system changes when the funding has been provided. It is estimated that if funding were to be made available by January 2008 the system changes could be completed by July 1, 2008. To follow-up on the status of the system changes and validate they have been made or additional time will be required, the estimated completion date is September 1, 2008.

The current system can also be better utilized by mandating that Procurement Contracting Officers (PCOs) register in the EDA application. This access will allow more accurate assignment of CDRs and provide the PCOs with systematic notifications of the CDRs, which require their actions.

**Estimated Completion Date:** September 1, 2008

**Recommendation B.2.b:** We recommend that the Director, Defense Finance and Accounting Services, Columbus discontinue using the prorating method as the default method for disbursing appropriations when contracts do not have payment instructions. Instead, consult with the contracting officers to obtain payment instructions on contracts that do not have payment instructions before making a disbursement.

**Current Management Comments:** Partially Concur. DFAS Columbus management agrees that proration should not be used as the default method of payment when a contract does not contain specific payment instructions. Since February 2000 and May 2003 MOCAS has not

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used proration as the default payment method on automatic or manual payments respectively. Payments are made on invoices based on the criteria established in the contract per the Defense Federal Acquisition Regulation Supplement (DFARS) Procedures, Guidance and Information (PGI) 204.7108, Payment Instructions. Current invoices without payment instructions are coded as a D-1716 until the contract modification is completed to add the required payment instructions to the contract. These payment procedures are being used for payments on all new contracts that are input into the MOCAS system. DFAS management has determined that it is cost prohibitive to perform reconciliations on old contracts and make corrections on those contracts that were paid using the proration method in the past.

**Estimated Completion Date:** This recommendation is considered closed

**Recommendation B.2.c:** We recommend that the Director, Defense Finance and Accounting Services, Columbus improve quality control procedures to prevent incorrect adjustments to contract payments and incorrect distribution of vendor credits.

**Current Management Comments:** Concur. New procedures will be developed to prevent incorrect adjustments to contract payments and incorrect distribution of vendor credits. Prior to the development of new procedures by the Training and Procedures Office, a review of the current guidance along with a comparison to the new Database Expansion and Restructuring (DEAR) release will be conducted for the Integrated Accounts Payable System (IAPS). The ECD for the development of the procedures is September 30, 2008. To validate the completion of the new procedures, the estimated completion date is December 1, 2008.

**Estimated Completion Date:** December 1, 2008

## **Team Members**

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Financial Auditing Services prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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# Inspector General Department of Defense

