

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**PROGRESS PAYMENTS FOR THE M1 TANK
AND PATRIOT MISSILE PROGRAMS**

Report No. 95-240

June 19, 1995

Department of Defense

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Acronyms

ACRN	Accounting Classification Reference Number
CLIN	Contract Line Item Number
DCASR	Defense Contract Administration Services Region
DFAS	Defense Finance and Accounting Service
FMS	Foreign Military Sales
MICOM	U.S. Army Missile Command
MOCAS	Mechanization of Contract Administration Services
RDT&E	Research, Development, Test, and Evaluation
TACOM	U.S. Army Tank-automotive and Armaments Command



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**



June 19 , 1995

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE SECURITY ASSISTANCE
AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on Progress Payments for the M1 Tank and Patriot Missile
Programs (Report No. 95-240)

We are providing this final report for management's information and use. The audit was requested by the Comptroller, Defense Security Assistance Agency.

We considered management comments from the Defense Finance and Accounting Service and the Department of the Army in preparing this report. Management comments from the Defense Finance and Accounting Service were fully responsive. Management comments from the Department of the Army were partially responsive. We ask the Army to reconsider its position regarding the separation of contract line item numbers for DoD and foreign military sales. DoD Directive 7650.3 requires that all audit recommendation be resolved promptly in the event of nonconcurrence or failure to comment. We request that the Army provide additional comments by August 21, 1995.

The courtesies extended to the audit staff are appreciated. Questions about the audit should be directed to Mr. David C. Funk, Audit Program Director, at (303) 926-7445 (DSN 926-7405), or Mr. Byron B. Harbert, Audit Project Manager, at (303) 926-7405 (DSN 926-7405). The distribution of this report is listed in Appendix C. The audit team members are listed on the inside back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 95-240
(Project Number 4FD-5014)

June 19, 1995

PROGRESS PAYMENTS FOR THE M1 TANK AND PATRIOT MISSILE PROGRAMS

EXECUTIVE SUMMARY

Introduction. When DoD signs contracts to purchase goods and services for foreign military sales customers, the contracts often include purchases for DoD customers. For large contracts that require several years to complete, the contractor may be entitled to progress payments for work accomplished. Those payments must be accurately allocated between DoD and foreign military sales customers. The Army contracted for the development of the M1A2 upgrade version of the M1 Tank, and included in the contract an order from the Kingdom of Saudi Arabia for the development of unique Saudi Arabian requirements and for providing funds for a portion of the development effort common to both the United States and Saudi Arabia. The Patriot Missile contract was an Army contract for the production of Patriot Missiles that included an order from the Kingdom of Saudi Arabia. This audit was requested by the Comptroller, Defense Security Assistance Agency.

Objectives. Our overall audit objective was to determine whether progress payments for the M1A2 research, development, test, and evaluation contract and the Patriot missile production contract were allocated accurately between DoD and foreign military sales funds. We also reviewed implementation of the DoD management control program as applicable to the audit objective.

Audit Results. Progress payments were allocated accurately for the Patriot missile production contract, but were not always allocated accurately for the M1A2 research, development, test, and evaluation contract. Specifically, 60 of 69 progress payments contained 98 erroneous charges. Of the 60, 39 progress payments contained foreign military sales requirements of \$49.5 million that were paid with DoD appropriations; 10 payments contained DoD requirements of \$4.9 million that were paid with foreign military sales funds; and 49 payments contained \$82 million of joint requirements that were not correctly allocated to either customer. The following conditions caused the misallocations:

- o Although the contractor billed by contract line item number, the paying offices disregarded this information, which resulted in erroneous charges to some DoD and foreign military sales funds.

- o The U.S. Army Tank-automotive and Armaments Command did not provide adequate guidance to allow paying offices to accurately allocate the charges for work billed to contract line item numbers that were funded by DoD and foreign military sales.

The U.S. Treasury incurred unnecessary interest from the time the erroneous charges were made until the time the charges should have been made. Foreign military sales customers may also have incurred interest because of premature charges.

Management Controls. Erroneously charging DoD and foreign military sales customers when making progress payments is a material management control weakness. Not providing the paying office with sufficient information to correctly allocate

progress payments is the primary cause of the material management control weakness identified. See Part I for the management controls reviewed and Part II for a discussion of the material management control weaknesses.

Potential Benefits of Audit. Recommendations in this report, if implemented, will result in more effective management controls over the allocation of progress payments, and more accurate charges to DoD and foreign military sales customers. We did not quantify the potential monetary benefits of this audit. However, proper accounting should ensure that funds are accurately charged and that the U.S. Treasury and foreign military sales customers do not incur undue interest.

Summary of Recommendations. We recommended that the Director, Defense Finance and Accounting Service Columbus Center, establish procedures to charge the correct funds when progress payments are made, and reconcile allocation of payments on the M1A2 contract. We also recommended that the Commander, U.S. Army Tank-automotive and Armaments Command, require future contracts to have separate contract line item numbers for DoD and foreign military sales. When compelling reasons exist to commingle DoD and foreign military sales requirements on the same contract line item number, the Commander, U.S. Army Tank-automotive and Armaments Command, should provide criteria allowing the Defense Finance and Accounting Service Columbus Center to correctly allocate the amount of each progress payment to DoD and foreign military sales funds.

Management Comments. The Defense Finance and Accounting Service concurred with the finding and recommendations to issue guidance for making payments on the basis of contract line item numbers or account classification reference numbers when the contractor's request for payment cites these numbers, and when payment on that basis meets the terms of the contract.

The Army nonconcurred with the recommendation addressed to the U.S. Army Tank-automotive and Armaments Command. The Army stated that, when both DoD and foreign military sales customers benefit from work done on a single contract, any separation of that work will result in unnecessary administrative costs to both DoD and foreign military sales customers, and will require contractors to make arbitrary decisions in accumulating and recording costs. Separating DoD and foreign military sales work into two contract line item numbers would require additional administrative costs, since contractors would be required to establish accounts, accumulate costs, and prepare and submit multiple reports. The Army Tank-automotive and Armaments Command issued payment instructions to the paying office and will continue to provide appropriate payment instructions to the Defense Finance and Accounting Service.

Audit Response. The Army's comments were partially responsive to the recommendation. We agree that the Army should provide payment instructions to the paying office when DoD and foreign country funds are placed on the same contract line item number. However, we do not agree that the Army should place DoD and foreign country requirements on the same contract line item number in the absence of compelling reasons, even if separating the requirements would result in additional administrative costs. The wrong appropriation must not be charged for the sake of administrative expediency, with the expectation of subsequently making an adjustment, because such practice violates United States Code, Title 31, Section 1301. We ask the Army to reconsider its position and provide additional comments to the final report by August 21, 1995.

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This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

Contracting for a foreign military sales (FMS) case is done by the Military Department that previously entered into the sales agreement with the foreign customer. Contractor invoices for large contracts are submitted to the Defense Finance and Accounting Service Columbus Center, Columbus, Ohio (DFAS Columbus Center), for payment. In previous years, payments were made by the Defense Contract Administration Services Regions (DCASRs). Between May 1989 and November 1992, individual DCASR paying offices were transferred to Columbus. The Columbus paying office was established under the Defense Logistics Agency in May 1989 and was transferred to DFAS in January 1991.

In many cases, contracts for goods and services purchased for foreign customers also include purchases for DoD customers. When those contracts are large in scope and span several years, the contractor may be entitled to progress payments as a form of contract financing for work performed to date. For service contracts, those payments are called interim, provisional, partial, or progress payments. In this report, we use the term "progress payments" to refer to both types of payments. When making payments, the paying office should charge foreign and DoD customers for their respective portions of the payment. Otherwise, DoD may pay for foreign purchases, and foreign customers may pay for DoD purchases. When progress payments are charged incorrectly, the errors may not be corrected until the contract is closed out. However, between the time of the erroneous charges and final payment on the contract, the customer may incur unnecessary interest. DFAS Columbus Center made 38,019 progress payments in FY 1994.

DoD contracts contain contract line item numbers (CLINs). Each CLIN represents a definable segment of contract work. Contracts are funded by obligating appropriated amounts on each CLIN. An accounting classification reference number (ACRN) is a code that references a specific appropriation and any related subdivision of the appropriation. Each CLIN is linked to one or more appropriations through the use of ACRNs.

The FMS Trust Fund is an account held by the U.S. Treasury to receive advance deposits of cash from foreign customers; these funds are later disbursed to contractors and Government suppliers. The advance deposits for a specific country are placed in that country's subaccount within the FMS Trust Fund.

Objective

Our overall audit objective was to determine whether progress payments, which the former DCASR Cleveland, the former DCASR Boston, and DFAS Columbus Center made to contractors for research, development, test, and

evaluation (RDT&E) of the M1A2 tank and production of the Patriot missile, were allocated accurately among DoD and FMS funds. We also reviewed implementation of the DoD management control program as applicable to the primary audit objective.

Scope and Methodology

The audit was performed at the DFAS Columbus Center, the U.S. Army Tank-automotive and Armaments Command (TACOM), and the U.S. Army Missile Command (MICOM) between January and December 1994. Using records at the DFAS Columbus Center, we examined all 117 progress payments totaling \$587.1 million, made on the M1A2 RDT&E contract (DAAE07-89-C-R045), during the period January 13, 1989, through December 16, 1993. We also examined all 30 progress payments, totaling \$394.1 million, made on the Patriot missile production contract (DAAH01-87-C-A025) between October 1, 1992, and May 5, 1994. Appendix B lists the organizations we visited or contacted.

Auditing Standards. The audit was performed in accordance with auditing standards established by the Comptroller General, as implemented by the Inspector General (IG), DoD, and Office of Management and Budget guidance, and accordingly included such tests of management controls and compliance with laws and regulations as we considered necessary. We did not assess the reliability of computer-processed data because such an assessment was outside the scope of this audit, and we did not place material reliance on such data.

Management Control Program

In our review of the implementation of the DoD management control program, we evaluated two areas: reviews of applicable management controls, and the specific management control techniques.

We examined the results of the DFAS Columbus Center's reviews of its management controls, including allocation of progress payments. We also examined the results of the TACOM review of its management controls over the allocation of payments to DoD and FMS customers. We reviewed the management controls that the DFAS Columbus Center used to make progress payments. Further, we assessed whether DFAS Columbus Center and TACOM complied with applicable DoD directives.

Adequacy of Self-Evaluation of Applicable Management Controls. Officials at DFAS Columbus Center and TACOM did not identify the allocation of progress payments as an assessable unit. Therefore, no applicable management control reviews were conducted. Neither DFAS Columbus Center nor TACOM identified the material management control weaknesses identified.

Introduction

Adequacy of Management Controls. We identified material management control weaknesses for DFAS Columbus Center and TACOM, as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. The DFAS Columbus Center's procedures did not ensure that progress payments for research and development contracts were correctly allocated. TACOM did not have adequate controls to provide paying offices with the information they needed to accurately allocate progress payments between DoD and FMS funds when DoD and foreign customers' requirements were included on the same CLIN.

If management implements Recommendations 1. and 2., the management control weaknesses can be corrected and potential monetary benefits can be realized. We did not determine the amount of those benefits. The correct allocation of progress payments will result in reduced interest costs from proper use of FMS and DoD funds. See Appendix A for a summary of all potential benefits resulting from audit.

Prior Audits and Other Reviews

No previous audits have specifically addressed the separation of DoD and FMS charges for progress payments. The IG, DoD, has issued two audit reports on the citing of correct appropriations for progress payments.

- o IG, DoD, Report No. 92-064, "Titan IV Program," March 31, 1992, stated that progress payments for the Titan IV contract were not made from appropriations that corresponded to the type of work done. The contract was funded by four appropriations. Some of the CLINs were funded by more than one appropriation. The contract, however, did not require the contractor to allocate appropriations when requesting progress payments. The paying office used a predetermined method of allocation that did not relate the work accomplished to the appropriation that benefited from the work. The report recommended that the DoD policy be changed to segregate payment requests by appropriation, and that progress payments be made only after contractors stated how appropriations should be allocated. On March 31, 1993, a mediation agreement was reached between the Director, Defense Procurement, and the Assistant Inspector General for Auditing. The agreement provided for implementing improved procedures for most DoD contracts, but exempted incrementally funded RDT&E contracts from the new procedures. For incrementally funded RDT&E contracts, paying offices would continue to follow the existing policy of charging the oldest available appropriations, in the absence of other information to the contrary, which was viewed as consistent with how the work was executed. However, this policy does not address the commingling of DoD and FMS requirements on single CLINs as discussed in this report.

o IG, DoD, Report No. 94-054, "Fund Control Over Contract Payments at the Defense Finance and Accounting Service Columbus Center," March 15, 1994, stated that DFAS had problems with citing the correct appropriations because of data errors in the Mechanization of Contract Administration Services (MOCAS) system. The DoD generally concurred with the report.

Part II - Finding and Recommendations

Allocation of Progress Payments for M1A2 Contract

Progress payments made by the former Defense Contract Administration Services Region Cleveland, Cleveland, Ohio (DCASR Cleveland), and the DFAS Columbus Center on the research, development, test, and evaluation (RDT&E) contract for the M1A2 tank (contract DAAE07-89-C-R045) were not always charged to the correct funds. Specifically, 60 of 69 progress payments contained 98 erroneous charges. The 60 payments, amounting to \$344.6 million, contained the following errors.

- o Thirty-nine progress payments contained FMS requirements of \$49.5 million that were paid with DoD appropriations.

- o Ten payments contained DoD requirements of \$4.9 million that were paid with FMS funds.

- o Forty-nine payments contained \$82 million of joint requirements that were not correctly allocated to either customer. Of those 49 payments for joint work, 30 payments were charged entirely to DoD funds, 16 payments were charged entirely to FMS funds, and 3 payments were inaccurately charged to both DoD and FMS funds.

When making payments, the DFAS Columbus Center did not always charge the funds indicated on contractor-submitted invoices. The DFAS Columbus Center took action during our audit to correct the misallocations we identified, but did not completely reconcile the M1A2 contract payments. In addition, the U.S. Army Tank-automotive and Armaments Command (TACOM) did not give DFAS Columbus Center the information needed to accurately allocate payments on joint CLINs. The incorrectly charged payments caused each affected fund to be charged earlier than it should have been. Although misallocations should be corrected by the time the contract is closed out, the U.S. Treasury or FMS customers could incur unnecessary interest expense.

Background

Contract DAAE07-89-C-R045 is an RDT&E contract to improve the performance and combat capability of the M1 Abrams tank. The contract was awarded on December 14, 1988, by TACOM. Before May 1991, the former DCASR Cleveland made disbursements on the contract, and the DFAS Columbus Center made disbursements after May 1991. Hereafter, we will refer to these two activities as the paying offices. The contract included both DoD and FMS requirements and 23 CLINs identifying separate work segments of the contract. Thirteen of the CLINs contained DoD requirements, 5 contained FMS requirements, and 5 contained both DoD and FMS requirements.

Allocation of Progress Payments for M1A2 Tank Contract

Funds were obligated by CLIN through the use of ACRNs. Each ACRN referenced a specific appropriation and any related subdivision of that appropriation, and was assigned to one or more CLINs.

The contract gave instructions to the contractor on how to bill the Government for work performed. Contractor invoices identified amounts by CLIN. Disbursing officials at the paying offices were responsible for allocating correct amounts to the different ACRNs when making progress payments. Both paying offices used the Mechanization of Contract Administration Services (MOCAS) system to process payment requests. For progress payments on production contracts, MOCAS determined the allocation automatically. However, for the RDT&E contract on the M1A2 tank, MOCAS referred progress payments to DFAS for manual processing.

Payment Selection. For the RDT&E contract on the M1A2, we used records at the DFAS Columbus Center to examine all 117 progress payments made as of December 16, 1993, and documentation related to these payments. The 117 payments totaled \$587.1 million.

Validating Disbursements. To determine whether DoD and FMS funds were charged correctly, we examined obligations by CLIN and ACRN, as well as disbursement documents, for January 1989 through December 1993. Forty-eight disbursements were made before any FMS requirements were placed on the contract. As a result, these disbursements were not subject to a potential mischarge under our criteria of separation of DoD and FMS funds. Our universe comprised 69 disbursements, totaling \$378.4 million, that were subject to this type of error. The first of those 69 payments was disbursed on January 24, 1991.

Citing Funds

Personnel at the paying offices did not always correctly cite DoD or FMS ACRNs, which reflect specific funds, when making progress payments to the contractor. Although the contractor billed by CLIN, the paying offices disregarded the CLIN amounts. In 49 instances of erroneous charges, the paying offices could have charged funds correctly by charging ACRNs related to the CLINs correctly cited by the contractor. However, the paying offices charged a single ACRN for the 49 payments that pertained to more than 1 CLIN (and more than 1 related ACRN). As a result, \$54.4 million was charged erroneously (\$49.5 million to DoD and \$4.9 million to FMS) when the paying offices had the information they needed to correctly allocate funds between DoD and FMS. However, for the 49 invoices that billed \$82 million for the 5 joint CLINs, the paying offices had no information to use in correctly allocating the costs.

Contractor's Responsibility

The M1A2 contract required the contractor to separate DoD and FMS funds in requests for progress payments. The contractor billed by CLIN, which fully separated the costs related to the customer-unique CLINs. However, the contractor did not separate funds when billing the joint CLINs, and the contracting officer at TACOM did not enforce the requirement for these funds to be separated. The contracting officer concluded the requirement should not have been included in the contract and amended the contract to delete the requirement to separate DoD and FMS funds. We disagree with the action to delete this requirement in that failure to properly segregate the costs for payment from the proper funds can lead to potential violations of fiscal statutes. This is a DoD procurement problem that needs to be resolved by ensuring that each CLIN is associated with a single ACRN where possible and that the contract clearly identifies billing instructions.

Timing Errors

As a result of the payment misallocations discussed above, the affected DoD and FMS funds may have been charged from 1 month to several years earlier than they should have been. At the time the contract is closed out, all allocation errors should be identified and corrected. The U.S. Treasury incurs interest from the time the charge was made until the time it should have been made. FMS customers may also incur interest because of premature charges. From April 1991 through December 1993, the following occurred.

- o Thirty-nine payments, which amounted to \$49.5 million and cited FMS CLINs, were paid from ACRNs funded by DoD appropriations.

- o Ten payments, amounting to \$4.9 million and citing DoD CLINs, were paid from ACRNs funded by FMS.

- o Forty-nine payments, amounting to \$82 million, were partially misallocated.

Proper accounting for payments should ensure that the U.S. Treasury and FMS customers incur interest costs associated only with payments applicable to their respective requirements. Because the misallocations were prematurely charged and failed to charge the correct funds, an offset occurred that precluded us from determining whether any one party was harmed by the charging practices in use. Additionally, these charging practices were being used for other contract payments that would have to be considered in such an assessment. However, the potential clearly exists for one party to bear a disproportionate amount of interest expense if misallocations are not corrected and avoided in the future.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Finance and Accounting Service Columbus Center:

a. Establish procedures to ensure that progress payments are charged to the fund indicated by the contractor's invoice, when the invoice identifies the fund by means of a contract line item number or accounting classification reference number; and

b. Perform a reconciliation of payment allocations on the M1A2 development contract.

Management Comments. The DFAS concurred with the finding and Recommendations 1.a. and 1.b. DFAS will issue guidance for making payments on the basis of CLINs or ACRNs when the contractor's request for payment cites these numbers, and when payment on that basis meets the terms of the contract. The contract was reconciled on June 27, 1994.

Audit Response. The actions planned and taken by the Defense Finance and Accounting Service meet the intent of the recommendation.

2. We recommend that the Commander, U.S. Army Tank-automotive and Armaments Command, develop procedures for future contracts to have separate contract line item numbers for DoD and foreign military sales. When compelling reasons exist to commingle DoD and foreign military sales requirements on the same contract line item number, the Commander, U.S. Army Tank-automotive and Armaments Command, should provide criteria allowing the Defense Finance and Accounting Service Columbus Center to correctly allocate the amount of each progress payment to DoD and foreign military sales funds.

Management Comments. The Army nonconcurred with the finding and Recommendation 2. The Army stated that, when both DoD and FMS customers benefit from work on a single contract, any separation of that work will result in unnecessary administrative costs to both DoD and FMS customers and will require contractors to make arbitrary decisions in accumulating and recording costs. Separating DoD and FMS work into two CLINs would require additional administrative costs, since contractors would be required to establish accounts, accumulate costs, and prepare and submit multiple reports. On January 21, 1994, the contract was modified to provide payment criteria to the paying office. TACOM will continue to provide appropriate payment instructions, either in the contract or by issuing memorandums to DFAS.

The Army also disagreed with two statements in the report. The Army challenged our statement that the contract required the contractor to separate DoD and FMS work. The contract required the contractor to identify each affected contract line item number, sub-contract line item number, or work directive, along with the related dollar amounts. However, since DoD and

Allocation of Progress Payments for M1A2 Tank Contract

foreign funds were associated with sub-contract line item numbers, this requirement had the effect of separating DoD and foreign military sales charges. The response also stated that TACOM recognized the need to provide paying criteria to the DFAS Columbus Center prior to the auditors' arrival on March 1, 1994.

Audit Response. The Army's comments were partially responsive to the recommendation. We agree that the Army should provide payment instructions to the paying office when DoD and foreign country funds are placed on the same contract line item number. However, we do not agree that the Army should place DoD and foreign country requirements on the same contract line item number in the absence of compelling reasons, even if separating the requirements would result in additional administrative costs. Failure to adequately separate requirements may lead to violations of Title 31, United States Code, Section 1301, and other fiscal statutes. We previously addressed this matter in our Report No. 92-064, as discussed in the "Prior Audits and Other Reviews," section of this report. The legal opinion supporting that report cited a 1938 Comptroller General decision that stated:

An administrative officer may not, for the sake of administrative expediency, deliberately charge the wrong appropriation with the expectation of obtaining subsequently an adjustment thereof...-- such practice resulting in the rendition of false accounts and being violative of the provision of [31 U.S.C. 1301]. (17 Comp. Gen. 748.)

We consider the Comptroller General's decision applicable to the Army concern about unnecessary administrative costs and ask the Army to reconsider its position and provide additional comments to the final report.

The Army incorrectly implied that prior to our audit, TACOM recognized and corrected the problem of providing adequate payment criteria to the paying office. On two occasions prior to TACOM providing DFAS with paying instructions, we discussed the need for this information to be provided with the procuring contracting officer for the M1A2 RDT&E contract. We also discussed the matter with DFAS Columbus personnel.

Part III - Additional Information

Appendix A. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.	Management controls. Accurately allocating progress payments will potentially reduce interest costs to the U.S. Treasury and foreign customers.	Monetary benefits not quantifiable.
2.	Management controls. Establishing only one ACRN for each CLIN will allow paying offices to allocate progress payments accurately. When multiple ACRNs exist on a single CLIN, criteria provided by contracting offices will allow paying offices to adequately allocate the related payments.	Monetary benefits not quantifiable.

Appendix B. Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Under Secretary of Defense (Comptroller), Washington, DC

Department of the Army

U.S. Army Materiel Command, Alexandria, VA

U.S. Army Missile Command, Huntsville, AL

U.S. Army Tank-automotive and Armaments Command, Warren, MI

Defense Agencies

Defense Finance and Accounting Service, Arlington, VA

Defense Finance and Accounting Service Columbus Center, Columbus, OH

Defense Finance and Accounting Service Denver Center, Denver, CO

Defense Security Assistance Agency, Alexandria, VA

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller) and Chief Financial Officer of the
Department of Defense
Under Secretary of Defense for Acquisition and Technology
Director, Defense Procurement
Deputy Under Secretary of Defense (Acquisition Reform)
Defense Logistics Studies Information Exchange

Department of the Army

Commander, U.S. Army Materiel Command
Commander, U.S. Army Missile Command
Commander, U.S. Army Tank-automotive and Armaments Command
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Security Assistance Agency

Non-Defense Federal Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
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 Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
 House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
 House Subcommittee on National Security, International Affairs, and Criminal
 Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part IV - Management Comments

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

APR 18 1995

DFAS-HQ/GB

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

SUBJECT: Audit Report on "Progress Payments for the M1 Tank and
Patriot Missile Programs," February 10, 1995 (Project
No. 4FD-5014)

In accordance with your memorandum of February 10, 1995, the
Defense Finance and Accounting Service response to the subject
report is attached.

A handwritten signature in cursive script, appearing to read "T. McCarty".

Thomas McCarty
Deputy Director for General
Accounting

Attachment

INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
AUDIT REPORT ON PROGRESS PAYMENTS FOR THE M1 TANK
AND PATRIOT MISSILE PROGRAMS, FEBRUARY 10, 1995
(PROJECT NO. 4FD-5014)

RESPONSE TO THE FINDING AND RECOMMENDATIONS

FINDING. Allocation of Progress Payments for M1A2 Tank Contract.

Progress payments made by the former Defense Contract Administration Service Region Cleveland (DCASR Cleveland) and the Defense Finance and Accounting Service Columbus Center (DFAS Columbus Center) on the research, development, test and evaluation (RDT&E) contract for the M1A2 tank (contract DAAE07-89-C-R045), were not always charged to the correct funds. Specifically, 60 of 69 progress payments contained 98 erroneous charges. The 60 payments, amounting to \$344.6 million, contained the following errors.

- o Thirty-nine progress payments contained foreign military sales (FMS) requirements of \$49.5 million that were paid with DoD appropriations.

- o Ten payments contained DoD requirements of \$4.9 million that were paid with FMS funds.

- o Forty-nine payments contained \$82 million of joint requirements that were not correctly allocated to either customer. Of those 49 payments for joint work, 30 payments were charged entirely to DoD funds, 16 payments were charged entirely to FMS funds, and 3 payments were charged to both DoD and FMS funds in an inaccurate manner.

When making payments, the DFAS Columbus Center did not always charge the funds indicated on contractor-submitted invoices. The DFAS Columbus Center took action during our audit to correct the misallocations we identified, but did not completely reconcile the M1A2 contract payments. In addition, the U.S. Army tank-automotive and Armaments Command (TACOM) did not give DFAS Columbus Center the criteria needed to accurately allocate payments on joint CLINs. The incorrectly charged payments caused each affected fund to be charged earlier than it should have been. Although misallocations should be corrected by the time the contract is closed out, the U.S. Treasury and FMS customers could incur unnecessary interest.

DFAS RESPONSE. Concur.

INTERNAL CONTROL WEAKNESS. The DFAS Columbus Center's procedures did not ensure that progress payments for research and development contracts were correctly allocated to the applicable funds.

DFAS RESPONSE. Concur. The procedural corrections included in the response to recommendation 1A will correct this internal control weakness.

RECOMMENDATION 1A. The IG, DoD, recommends that the Director, Defense Finance and Accounting Service Columbus Center establish procedures to ensure that progress payments are charged to the fund indicated by the contractor's invoice, when the invoice identifies the fund by means of a contract line item number or accounting reference number.

DFAS RESPONSE. Concur. For those contractor payment requests that cite a contract line item or reference an accounting classification reference number (ACRN), payment will be made on that basis by the Defense Finance and Accounting Service - Columbus Center when that is a proper basis in accordance with the contract. Guidance is being issued to all contract payment employees instructing them to validate a contractor's invoice submission citing appropriation(s) for the payment allocation to the official contract prior to payment allocation.

Completion: June 1995. (Issuance of payment guidance.)

MONETARY BENEFITS. Monetary benefits not quantifiable.

DFAS RESPONSE. Concur.

RECOMMENDATION 1B. The IG, DoD, recommends that the Director, Defense Finance and Accounting Service Columbus Center perform a reconciliation of payment allocations on the M1A2 development contract.

DFAS RESPONSE. Concur. The reconciliation was started in June 1993 and completed on June 27, 1994. Adjustment allocations applicable to the reconciliation were updated in the Mechanization of Contract Administration Services system on June 27, 1994, and the Contingent Liability Report was updated on June 28, 1994.

Completion: Completed.

MONETARY BENEFITS. Monetary benefits not quantifiable.

DFAS RESPONSE. Concur.

Department of the Army Comments



REPLY TO
ATTENTION OF

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH DEVELOPMENT AND ACQUISITION
103 ARMY PENTAGON
WASHINGTON DC 20310-0103

17 April 1995



SARD-SI

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, 400 ARMY
NAVY DRIVE, ARLINGTON, VIRGINIA 22202-2884

SUBJECT: Audit Report on Progress Payments for the M1 Tank and
Patriot Missile Programs (Project No., 4FD-5014)

Reference your memorandum, dated February 10, 1995, subject:
same as above.

The attached report is submitted to you in response to your
request.

Point of contact for this memorandum is Ms Betty LaFavers,
Room 3D478, commercial: (703)695-8471, DSN: 225-8471; facsimile
commercial: (703)695-8470, facsimile DSN: 225-8470.

John W. Holmes, Col, GS
for
BARBARA L. HOSKINS
GM-15
Acting Assistant Deputy
for Horizontal Technology
Integration



OFFICE
ATTENTION OF

DEPARTMENT OF THE ARMY
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND
8901 BISHOP AVENUE, ALEXANDRIA, VA 22304-6001



AMCIR-A (36-2b)

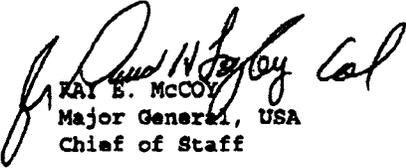
6 April 1995

MEMORANDUM FOR MR. JOHN BOURGALT, ASSOCIATE DIRECTOR, AUDIT
FOLLOWUP AND COMPLIANCE DIVISION, U.S. ARMY
AUDIT AGENCY, ALEXANDRIA, VA 22202-0000

SUBJECT: Department of Defense Inspector General Draft Report,
Progress Payments for the M1 Tank and Patriot Missile Programs,
Project 4FD-5014 (AMC No. D9423)

1. We are forwarding our position on subject report IAW AR 36-2.
2. Point of contact for this action is Mr. Robert Kurzer,
(703) 274-9025.
3. AMC -- America's Arsenal for the Brave.

Encl
as


KAI E. MCCOY
Major General, USA
Chief of Staff



DEPARTMENT OF THE ARMY
UNITED STATES ARMY TANK-AUTOMOTIVE AND ARMAMENTS COMMAND
WARREN, MICHIGAN 48397-5000



REPLY TO
ATTENTION OF:

AMSTA-CS-CJA (36-2b)

27 MAR 1995

MEMORANDUM FOR Commander, U.S. Army Materiel Command, ATTN:
ANCIR-A, 5001 Eisenhower Avenue, Alexandria, VA
22333-0001

SUBJECT: DODIG Draft Report, Progress Payments for the M1 Tank
and Patriot Missile Programs, Project 4FD-5014 (AMC No. D9423)

1. Reference memorandum, HQAMC, ANCIR-A, 23 February 1995, SAB.
2. This memorandum is to inform you of our nonconurrence with the reported finding and recommendation 2. The rationale for our position is presented in the attached reply.
3. The TACOM POC for this audit is Jerry Norris, DSN 786-7773.

Encl


EUGENE E. WILSON
Colonel, GS
Chief of Staff

COMMAND REPLY
DOD Inspector General Draft Report, Audit of
Progress Payments for the M1 Tank and
Patriot Missile Programs

CLINS, it would essentially accomplish the effect of the statement.

Contracting Officer Responsibilities: The following report statements do not properly describe the responsibilities of the contracting officer or the actions previously taken to amend the contract.

"However, the contractor did not separate funds when billing the joint CLINS, and the contracting officer at TACOM did not enforce the requirement for these funds to be separated. The contracting officer said the requirement should not have been included in the contract."

The original contract provision was ambiguous and questionable. It appeared to require the contractor to accumulate costs by sub-CLIN. This would have required the contractor to make arbitrary divisions where none existed, since the work was for both DOD and FMS. The contractor would also have incurred unnecessary administrative expense to establish and accumulate costs versus simply defining a payment mechanism to appropriately charge the respective accounts. Alternatively, the provision appeared to require the contractor to determine the appropriate respective billing amounts, something the contractor could not determine on its own. In either case, the contract provision, as originally written, was defective. Action (Modification P000204) to correct this defect was taken on 21 January 1994, as discussed below.

Contract Modifications: The sentence "During our audit, the contracting officer amended the contract to delete the requirement to separate DOD and FMS funds." is also a misstatement of the fact. Page 8 of the draft report shows the audit was performed at DFAS Columbus Center, MICOM, and TACOM between February and December 1994. The auditors arrived and began work in the TACOM/PEO-ASM community on 1 March 1994. As mentioned above, P000204, dated 21 January 1994, modified the defective provision to remove the requirement to identify affected sub-CLINS and/or work directives and their related dollar amounts. It retained the requirement at the CLIN level. Significantly, this modification also added provision G.4, Government Payment Instructions, which required the payment office to make payments for joint CLINS based on the respective proportions of DOD and FMS funds in each joint CLIN. This method was later changed (Modification P00212, dated 14 March 1994) from proportional to a first-in, first-out payment based on when the

COMMAND REPLY
DOD Inspector General Draft Report, Audit of
Progress Payments for the M1 Tank and
Patriot Missile Programs

funding was added to each joint CLIN. Both methods accomplish clear criteria to the payment office on how payments should be allocated between DOD and FMS and have already been implemented.

RECOMMENDATION 2: We recommend that the Commander, U.S. Army Tank-automotive and Armaments Command, require future contracts to have separate contract line item numbers for DOD and foreign military sales. When compelling reasons exist to commingle DOD and foreign military sales requirements on the same contract line item number, the Commander, U.S. Army Tank-automotive and Armaments Command, should provide criteria allowing the Defense Finance and Accounting Service Columbus Center to correctly allocate the amount of each progress payment to DOD and foreign military sales funds.

ACTION TAKEN: Nonconcur. When both DOD and FMS benefit from a single contractual work effort, any separation of that effort will result in unnecessary administrative costs to both DOD and FMS and require contractors to make arbitrary decisions in accumulating and recording costs. DOD cost reimbursement contracts properly require and contractor's accounting systems properly accumulate and report costs by separate work effort-not by source of funds. Separating DOD and FMS into two CLINs would require additional administrative costs since contractor's would be required to establish accounts, accumulate costs, prepare and submit multiple reports. Furthermore, these costs would be incurred even if the correct allocation was provided to the contractor. We also nonconcur with the the last part of the recommendation. As outlined above, we recognized the need to provide criteria to DFAS Columbus Center and did so by modifying the contract on 21 January 1994. This action was accomplished before the auditors arrived to begin their audit on 1 March 1994. We will continue to provide appropriate payment instructions, either in the contract or by issuing memorandums to DFAS.

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