



# *Testimony*



STATEMENT OF  
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BEFORE THE  
SUBCOMMITTEE ON NATIONAL SECURITY  
VETERANS AFFAIRS, AND INTERNATIONAL RELATIONS  
COMMITTEE ON GOVERNMENT REFORM  
UNITED STATES HOUSE OF REPRESENTATIVES  
ON  
FINANCIAL MANAGEMENT:  
THE PROMPT PAYMENT ACT AND DOD PAYMENT PROCESSES

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Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss the Prompt Payment Act and the Department of Defense (DoD) payment processes. As you know from the Inspector General's testimony to this Subcommittee last February 25 and from the Inspector General's semiannual reports to the Congress, we fully agree with the General Accounting Office's assessment of DoD financial management as a high risk area. It should be noted that the Department itself has candidly acknowledged numerous material financial management control weaknesses in its annual Federal Managers Financial Integrity Act assessments to the President and the Congress over the past several years. Although most Congressional interest and media attention have been directed toward the Department's financial reporting problems--specifically, the continued inability to produce auditable financial statements--problems affecting the efficiency with which the Department makes an average of \$22 billion in payments each month also merit close oversight.

## Background

The Defense Finance and Accounting Service (DFAS) is responsible for making most DoD disbursements. DFAS was activated on January 15, 1991 with the mission of reducing the cost and improving the overall quality of Department of Defense financial management through consolidation of 332 finance and accounting offices, as well as standardization and integration of previously decentralized and diverse finance and accounting operations, procedures and systems. DFAS has a key role in the Department's processes for purchasing an enormous range of goods and services. Its disbursing operations cover civilian and military pay, retiree and annuitant pay, progress payments to contractors, other contract payments for goods and services, travel reimbursements and transportation fees.

Typically, DFAS processes a monthly average of 9.8 million payments to DoD personnel; 1.2 million commercial invoices; 450,000 travel vouchers/settlements; 500,000 savings bonds; and 120,000 transportation bills of lading. Because of the volume of transactions, the disbursement processes depend heavily on computer systems.

The 1990's have been a decade of enormous change in the DoD financial management community. Besides the physical consolidation of finance and accounting operations into 5 centers and just 18 operating locations, several thousand personnel positions were eliminated. DFAS has drastically reduced the number of separate automated systems, with the intention of moving from 69 to 9 finance systems between FY 1996 and FY 2002 and from 150 to 23 accounting systems over the same period. The extensive DFAS systems development program is intended to field modern, fully integrated systems that will considerably improve operational efficiencies in both accounting and finance. Meanwhile, two successive administrations and Congress have instituted major acquisition, logistics and other process changes that profoundly impact the financial community. In addition, DoD financial managers are operating in public and private sector environments where previously radical innovations like electronic funds transfer and electronic commerce are now considered routine.

#### The Prompt Payment Act

Among various statutes and regulations governing DoD disbursing operations, the Prompt Payment Act, Chapter 39

of Title 31, United States Code, is probably the best known.

The Act requires Federal agencies to pay interest penalties on late payments and, at the same time, adhere to sound cash management principles by not paying bills prematurely. Bills are to be paid within 30 days after an invoice date, but not more than 7 days prior to the due date. The Act also specifies that, if the Government and contractors agree to payment terms differing from the Act, the contract terms take precedence. Implementation of the Act was expected to result in timely payments, better business relationships with suppliers, improved competition for Government business, and reduced costs through better cash management.

The last audit that we conducted on DoD compliance with the Prompt Pay Act was in 1993; resource constraints and heavy workload associated mostly with the Chief Financial Officers Act have caused us to defer further coverage recently.

The 1993 audit, which was a joint effort by my office and the Army, Navy and Air Force audit services, indicated that

both the timelines of payments and internal controls in the vendor payment process needed improvement. The interest penalties on late payments, forfeited discounts, and interest paid by the DoD on funds borrowed to make inappropriately early payments totaled an estimated \$36 million for the 6-month period covered by the audit.

In response to the audit findings, the Department took various corrective actions. We understand that there was temporary improvement, but recently interest penalty payments climbed as follows:

FY 1995	\$25 million
FY 1996	\$28 million
FY 1997	\$27 million
FY 1998	\$37 million

With the continuous introduction of new technologies, processes and systems over the next several years, DoD should find compliance with the Prompt Payment Act increasingly less difficult. Therefore it is reasonable to anticipate the number of untimely payments and related interest penalties dropping in the future.

We consider it important for the Government to be a reliable business partner when dealing with the private sector. This is especially true in light of the current DoD emphasis on changing or avoiding practices that may inhibit some firms with high technology commercial products from doing business with the Government. Unreliable bill paying processes could be such an inhibitor, especially for small businesses. We consider the Prompt Payment Act timeframes for determining late payments to be both reasonable and generally achievable. We also agree with GAO that there is no clear linkage between Prompt Payment Act requirements and DFAS disbursing problems. Even if it were demonstrated that hasty decision making is necessary to pay invoices within 30 days, the lesson to be drawn is that the disbursement processing procedures are cumbersome and need reengineering, not that the standard is too tough.

Likewise, we counsel caution in considering changes to the law or related policies with the intention of mandating earlier payments and imposing very broad use of anticipatory discounts. Considerably complicating the disbursement process by mandating earlier payments in a process that already is troubled by inaccurate payments and accounting errors could retard expected DFAS performance



improvements. Also, we have not seen indications that firms from across the full spectrum of DoD suppliers, from major contractors to small businesses, would support a mandated shift toward anticipatory discount pricing. The Prompt Payment Act already authorizes payments on negotiated schedules and related discounts. We have not seen any data on the extent to which contracts with such provisions are already in use or to what types of commodities they apply.

In summary, with regard to the Prompt Payment Act, our work has not resulted in any indication that the law is not working reasonably well. This is not to say that some fine tuning, such as revisiting the requirements to pay interest penalties as little as \$1, would not be useful. Again, I must caveat these opinions by noting that there has not been recent DoD audit coverage of Prompt Payment Act issues.

### Recovery Audits

Although wider application of post-payment "recovery auditing" could enhance the controls for some DoD disbursement processes, we think such a tool should be

applied selectively. Primary emphasis should be placed on making the payments correctly in the first place. Problems such as overpayments take money out of the DoD acquisition, logistics, and operational programs during the actual execution of contracts and projects. It does those programs little good to have funds returned to the Department years after they were needed and almost certainly not to the same specific programs. The DoD needs to accelerate implementation of the expanded recovery audit demonstration program mandated last year by the Congress. Until the results of those pilot efforts are known, we believe it would be premature to legislate further expansion of recovery audit requirements.

#### Other DFAS Pay Issues

Over the last five years, we have reported on a variety of DFAS pay issues including inadequate computer security, lack of verification of transportation bills and inaccurate disbursement accounting. The Defense Criminal Investigative Service (DCIS), the investigative arm of the Inspector General, DoD, has also been active in a number of initiatives to deter, detect and bring to justice any perpetrators of fraud against DFAS operations.

## Problem Disbursements

To maintain proper fiscal control and have reliable information on amounts available for obligation and expenditure, DoD needs to be able to match disbursements reported to the U.S. Treasury with obligations shown in DoD accounting records. Unfortunately, the disbursing and accounting functions are performed by separate activities, which are not yet linked in fully integrated systems and often are not collocated. Disbursement data therefore must "transit" to the accounting stations. Excessive delays and errors can occur in recording the disbursements in the accounting systems. DFAS uses the term "aged intransit disbursements" to denote excessive delays. If attempts to match disbursement and obligation data fail, the term "problem disbursements" is used. This overall problem is often compared to inability to balance a checkbook, but on a massive scale.

The DoD has been working to reduce aged intransit and problem disbursements for several years. DFAS reported a decrease in aged intransit disbursements from \$22.9 billion in June 1997 to \$9.6 billion in June 1998. DoD also has

indicated a reduction in problem disbursements from \$34.3 billion in June 1996 to \$10.9 billion in February 1999. Despite those significant decreases, unmatched disbursements will remain a major DoD financial management problem until fully integrated systems are fielded and the backlog of unmatched disbursements is eventually eliminated. Until then, the Department must make the best of a bad situation and try to minimize its exposure to Antideficiency Act violations and undetected improper payments.

Last year, we conducted an audit of the reporting for aged intransit disbursements and problem disbursements. The audit indicated that, while there continued to be overall progress, some DoD components were actually losing ground and the unmatched disbursements in their accounts were increasing.

To help avoid problem disbursements, Congress has directed the DoD to phase in efforts to match pending disbursements to corresponding obligations before making payments. This is referred to as "prevalidating disbursements." Thus far, full implementation has been hampered because significant payment delays were encountered when trying to prevalidate

all disbursements over \$2,500 at DFAS Columbus Center. The DoD is committed to implement prevalidation fully by July 2000, which could possibly cause a temporary spike in late payments and interest penalties. Eventually, however, we are confident that better systems will virtually eliminate problem disbursements, making prevalidation less necessary or at least easier.

#### Transportation Pay

In an ongoing audit, we have identified over \$1.7 million in overpayments to carriers/freight forwarders on a limited sample of DoD Government Bills of Lading (GBLs) for air freight shipments and \$12.4 million on motor freight shipments during FY 1997. Management controls and processes for the preparation, submission, acceptance, approval, and distribution of tenders; carrier selection; verification of delivery of freight; payment of GBLs; and monitoring of carrier performance were inadequate.

Additionally, transportation management functions and responsibilities are fragmented among DoD components that have different transportation priorities. The risk of fraud in this area is high and neither the DoD pre-payment screening nor GSA post-payment auditing is an effective

control. Implementation of the new Power Track freight payment system under DoD's Management Reform Memorandum No. 15 will improve the payment process and controls. However, we are concerned that the remaining weaknesses will continue to allow substantial overpayments. We will issue a report to the Department on this matter later this year.

Our DCIS and Audit offices are taking proactive efforts focusing on fraud affecting transportation pay. For example, a DCIS project at DFAS Center Indianapolis, Indiana targets transportation carriers who have received duplicate payments. The DCIS reviews found 1,083 duplicate payments for personal property shipments totaling approximately \$1.5 million and 590 duplicate payments for other freight shipments totaling \$160,055. The recoveries to date exceed \$1.4 million.

#### Other Contractor Pay Issues

During the past year, the Department has stepped up efforts to: ensure appropriation integrity when making progress payments to contractors; encourage managers not to add to the accounting burden by creating unnecessary extra

accounts; and introduce extensive use of credit cards for purchasing goods and services. We have not yet had an opportunity to provide an independent evaluation of these initiatives, although it is clear that the Department has made only limited progress. For example, there continues to be a lack of sound procedures for controlling credit card use. We continue to support all three concepts, however, and hope to provide at least some audit coverage later in FY 1999 or 2000.

#### Systems Security

Turning to other challenges confronting the DoD financial community, I would like to emphasize concern about information assurance. As numerous recent hacker and virus incidents demonstrated, any automated system may be attacked or misused. Motives can include vandalism, sabotage, thrill seeking, propaganda, pranks, invasion of privacy and fraud. DoD financial systems that process tens of millions of disbursements worth over \$250 billion annually are clearly at risk from individuals with any of those motives. For the computer criminal who intends to hack into systems controlling money, the DoD disbursement systems are prime targets.

We have been working closely with the Defense Information Systems Agency and the DFAS over the past several years to address this problem. Fortunately, one byproduct of DoD efforts to reduce the number of separate financial management systems will be somewhat reduced exposure from a security standpoint. To minimize risk, however, it is imperative that security awareness be stressed, adequate training be provided, periodic security audits be performed for every system and processing center, and prudent measures be taken to detect, react to and learn from unauthorized intrusions.

We have issued 20 audit reports during the 1990's on security matters related to DFAS systems and about 185 of our 220 recommendations have been implemented. Most of the recommendations were made just recently and action on many of them is still ongoing. As demonstrated by those numbers, the Department has been quite responsive to audit advice. Currently there is a huge backlog of general and application control reviews and other computer security audits and the risks related to limited security oversight for DoD systems, including finance systems, are worrisome.



We hope to be able to apply more resources to this area in the future.

A positive move along those lines is that the Defense Criminal Investigative Service recently established an Information Infrastructure Team. This new unit works in partnership with other law enforcement organizations and DISA to react immediately to system penetration incidents. Additionally, we have a special agent assigned full time to the FBI National Infrastructure Protection Center.

#### Vulnerability to Fraud

Numerous factors have contributed to the vulnerability to fraud of DoD finance operations. Those factors have included a weak internal control environment, staff turbulence and lack of sufficient fraud awareness training for finance personnel. Congressional hearings in September 1998 before the Senate Committee on the Judiciary graphically identified control weaknesses and the damage done by a few unscrupulous individuals who exploited those weaknesses.

The DCIS has primary investigative jurisdiction concerning allegations of fraud that directly impact the DFAS, including fraudulent conduct by contractors and government employees. The Military Criminal Investigative Organizations have primary investigative jurisdiction concerning allegations of fraud pertaining to DFAS services provided at individual military installations, as well as pay, allowance and travel fraud committed by a civilian employee or Service member of a Military Department. DCIS currently has 84 open investigations involving DFAS, 25 of which are theft or embezzlement cases. DCIS efforts over the past 5 years have resulted in 73 convictions and recovery of \$4.9 million from cases related to DFAS operations.

At the February 25 hearing, the Inspector General described the rather notorious case of Staff Sergeant Robert H. Miller to this Subcommittee. Miller and an accomplice were convicted of stealing nearly a million dollars in Government checks. Miller was stationed at a DFAS disbursing office.

An example of a more recently closed case and conviction was that of Cabel Calloway, who defrauded DoD of about

\$78,000. This individual's three companies obtained approximately 200 contracts between 1991 and 1997 to provide goods from manufacturers directly to military bases and various other DoD facilities. Calloway was paid for numerous items which he never provided. He concealed his scheme and was able to obtain additional DoD contracts by using multiple company names and fictitious employee names. Calloway was sentenced to 4 months home detention, 5 months probation and restitution of the \$78,000. The DoD debarred his companies. Although the amounts involved in individual fraud cases like this are seldom huge, we are concerned that weak controls leave the Department vulnerable to numerous abuses of this type, which cumulatively could amount to very significant losses.

Since 1994, IG, DoD, auditors and investigators have supported Operation Mongoose, a Deputy Secretary of Defense initiative involving the use of computer matching techniques to detect fraud. Problems with data base accuracy have been an inhibiting factor; however, the project has been a useful laboratory for determining the viability of various matches as internal controls and fraud detection tools.

More recently, DCIS has conducted over 70 fraud awareness briefings for DFAS personnel, reaching an audience of about 6,600 employees and participated in a DFAS stand down day for such training last year. We are working with DFAS on new training initiatives specifically addressing vulnerability in the vendor pay area and on improving fraud referral procedures.

### Summary

The DoD faces continued challenges in providing proper stewardship of the resources provided to the Department by the taxpayers for national defense. Improving controls in the fund disbursement process is a vital aspect of that stewardship. The DoD needs to be able to control payments to prevent errors and fraud; however, at the same time it must be a reliable business partner and comply with the reasonable requirements of the Prompt Payment Act. We believe that advanced technology and application of sound management principles, including a good internal control plan and effective oversight, can enable the Department to meet these goals.