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Report to Congressional Requesters

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INTERNAL CONTROLS

Controls Over Expedited Payments to Defense Suppliers Need Improvement

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International Affairs Division

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The Honorable Pete Wilson
United States Senate

The Honorable John Glenn
Chairman, Committee
on Governmental Affairs
United States Senate

As requested in Senator Wilson's letter of April 15, 1987, we reviewed the Department of Defense's fast pay program. This is one in a series of reports related to the effectiveness of defense logistics.

As arranged with your Offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to interested committees and other Members of Congress; the Secretary of Defense; the Director, Defense Logistics Agency; and the Director, Office of Management and Budget. Copies will also be made available to other parties upon request.

for Bill W. Thurman

Frank C. Conahan
Assistant Comptroller General

government funds for a number of months before the overpayments were discovered and refunded.

Principal Findings

DLA Has Not Complied With OMB's Revised Fast Pay Procedures

DLA continues to authorize fast pay procedures for purchases of supplies sent to stateside depots, although such practices are not permitted by OMB Circular A-125. Also, one DLA purchasing activity was not complying with the OMB requirement that fast pay contracts in excess of $25,000 be reviewed and approved by the head of the agency. During the 8-month period ending January 31, 1987, this activity awarded 2,300 contracts in excess of $25,000. DLA believes that it will not be required to follow OMB's requirements until they are incorporated into the Federal Acquisition Regulations. GAO believes that DLA must comply with OMB's requirements irrespective of whether they are incorporated in the Federal Acquisition Regulations.

Internal Control Procedures Do Not Prevent Fast Pay Program Abuse

Some of the problems that prompted OMB to issue revised fast pay procedures continue to exist at DLA. GAO found:

- Internal controls at two DLA centers did not identify and resolve payments for items that were not received. For example, a shipment of sugar valued at $5,277 was rejected by the receiving depot in November 1985 and returned to the vendor because it did not meet contract specifications. The vendor was paid for the rejected sugar, but the DLA center did not detect the overpayment.
- At one purchasing office, action was not taken to collect $7 million from vendors for previously identified overpayments.
- Contractors with performance problems on previous contracts continued to receive fast pay contract awards. One of the two purchasing offices GAO visited developed a list of contractors who should have been denied future fast pay contracts. GAO found that the office awarded 519 fast pay purchase orders valued at $1.6 million to previously identified problem contractors because contracting officers either disregarded or did not check the sanction list before contracts were finalized.
- Controls have not been established to ensure receipt of material sent directly from contractors' plants to overseas locations.

cost-effectiveness of some of the actions. However, DLA has not provided data to support its estimates of added costs.

Abbreviations

AUTODIN	Automatic Digital Network
DESC	Defense Electronics Supply Center
DLA	Defense Logistics Agency
DLSSO	Defense Logistics Standard System Office
DOD	Department of Defense
DPSC	Defense Personnel Support Center
FAR	Federal Acquisition Regulations
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget

ensure that the government receives what it pays for. DLA centers established automatic receipt follow-up procedures to identify potential missing shipments.

- A June 1983 DOD Inspector General (IG) report disclosed that an estimated $24 million of material purchased by DOD in fiscal year 1980 under fast pay procedures was not received, and receipt of another $103 million of material was uncertain.[3] The IG recommended that DLA and the services establish an activity at each procurement office with a significant volume of fast pay awards to resolve nonreceipts. DLA centers established procedures to investigate and resolve potential nonreceipts.

Also, DLA's fiscal years 1985 and 1986 self-assessments of internal controls describe continuing problems in ensuring receipts of material under expedited payment methods.[4]

Revised Fast Pay Procedures Specified by Office of Management and Budget

The Office of Management and Budget (OMB) revised fast pay program guidance as a result of program abuses highlighted in the June 1983 DOD IG report. The 1985 revision was intended to limit the use of fast pay procedures rather than require its use to the maximum extent possible as prescribed by the existing Federal Acquisition Regulations (FAR).

OMB Circular A-125, titled "Prompt Pay" was initially published in August 1982 following enactment of the Prompt Payment Act (Public Law 97-177) and provided specific guidance to agencies concerning proper timing for payments to contractors. OMB's revised fast pay program revisions were published for comment in the December 7, 1984, Federal Register and issued as Attachment 2 to Circular A-125 in the April 12, 1985, Federal Register. Specifically, OMB's program revisions state fast pay procedures are appropriate in limited circumstances, but they should not be used for delivery of depot stocks and in other instances where timely payment can be made because receipt and acceptance is routinely communicated to the purchasing activity.

According to the revision, fast pay procedures may be used when all of the following conditions are present:

[3]Fast Pay Procurements (No. 83-142, June 9, 1983).

[4]The Federal Managers' Financial Integrity Act of 1982 requires heads of agencies to make an annual examination of their internal controls and issue annual reports on their systems and plans to correct identified weaknesses.

should only be used when the ultimate consignee is an afloat unit or the designated receiving activity is located in an overseas area. Also, the fast pay contractors were to have no prior history of fast pay performance problems. Finally, the notice required recipients of supplies to confirm receipts to purchasing offices by return mail of receipt acknowledgement cards or automated computer messages. Navy officials advised us that Navy inventory control points do not currently use fast pay for purchases of supplies sent to depots.

OMB Revisions Not Yet Included in Federal Acquisition Regulations

The FAR, which provides guidance to federal agencies in acquiring supplies, has not been changed to reflect the revised fast pay procedures published by OMB in April 1985. In a July 26, 1985 letter, the Deputy Under Secretary of Defense (Acquisition Management) directed the Defense Acquisition Regulatory Council to incorporate the revised fast pay procedures into the FAR. The Council approved fast pay revisions to the FAR in August 1986. The draft changes to the FAR were published for comment in the December 9, 1986, Federal Register. As of January 21, 1988, the changes had not yet been incorporated into the FAR.

Objective, Scope, and Methodology

In May 1986 we reported to Senator Pete Wilson, then Chairman of the Armed Services Committee's Task Force on DOD Inventory Management, on a wide range of inventory management problems.[5] As a result, Senator Wilson and Senator John Glenn, Chairman of the Senate Governmental Affairs Committee, asked us to review several of these problems in more detail. Our overall objective was to evaluate the effectiveness of control procedures used to ensure that DOD receives what it pays for when fast pay procedures are used. Specifically, we (1) determined whether the services and DLA had taken action to implement OMB's fast pay program revisions and (2) evaluated the effectiveness of internal control procedures and practices established by selected DLA purchasing offices to ensure receipt of material purchased under fast pay contracts. Because the services had acted to restrict use of fast pay and DLA had not, we directed our review efforts at examining DLA's internal controls.

To determine whether the services and DLA had implemented OMB's revised policies, we interviewed service and DLA officials and reviewed pertinent documentation. To evaluate internal controls established by DLA, we interviewed officials and reviewed agency records at two of

[5]Inventory Management, Problems in Accountability and Security of DOD Supply Inventories (NSIAD-86-106BR, May 23, 1986)

Our review was conducted during the period April 1986 through July 1987 in accordance with generally accepted government auditing standards.

DLA Uses Fast Pay Procedures for Depot Shipments Where Receipt and Acceptance Is Routine

OMB Circular A-125 indicates that fast pay procedures are not to be used to pay invoices for supplies delivered to depots where receipt and acceptance are routine. It specifies that fast pay procedures can only be used where there is both a geographical separation and a lack of adequate communications facilities between government receiving and disbursing activities.

DLA supply centers use fast pay procedures to pay vendors for supplies delivered to wholesale storage depots in the continental United States. The two DLA depots we visited had automated computer networks to communicate receipt confirmation reports to supply centers so that they could update inventory records daily. Usually, these reports were posted to the center's files before vendors were paid. Therefore, continued use of the fast pay procedure for purchases of supplies sent to stateside depots for receipt and acceptance is not justified under the OMB criteria.

Electronics Items

DESC officials told us they routinely use fast pay contracting and payment procedures for replenishment of depot stocks. In fiscal years 1985 and 1986, DESC awarded about 296,000 fast pay contracts for a total dollar value of about $598 million. DESC officials estimate that about 75 percent of the fast pay contracts were made for purchase of supplies sent to depots for stock replenishment.

We found that there are adequate communication facilities in place between the DESC disbursing office and the receiving depots to preclude the need for fast pay. The DESC uses the Standard Automated Material Management System to record and process all orders, shipments, and receiving reports. At the same time, depots routinely use the Defense Warehousing Automated Shipment Planning System to communicate receipt information back to the purchasing and disbursing offices.

Prompt payment procedures require that, unless a contract states otherwise, vendors will be paid 30 days after receipt of a properly prepared invoice or acceptance of the material, whichever is later. In contrast, fast pay procedures provide that vendors will generally be paid within 30 days after the agency receives an invoice. Proof of receipt and acceptance of the material at the destination is not required. We examined a selection of 25 fast pay invoices for supplies that were shipped to the Ogden and Mechanicsburg depots and found that in all cases, receipt confirmation reports were in the files before the invoices were paid. DESC

We found that DPSC awards fast pay contracts for brand name subsistence items without regard to dollar value limitation or shipping destination. Individual contract folders did not contain specific approval by the agency head or justification for use of fast pay procedures. During an 8-month period ending January 31, 1987, DPSC awarded more than 2,300 brand name subsistence contracts in excess of the $25,000 limitation. The total value of these contracts exceeded $300 million. DPSC officials estimate that 60 percent of the brand name items purchased are sent to stateside depots where receipt and acceptance is routine. Fast pay is not authorized for depot shipments under OMB Circular A-125. Table 2.1 shows some examples of higher dollar value contracts for subsistence items delivered to the Mechanicsburg depot.

Table 2.1: Examples of Subsistence Contracts Over $25,000

		Dollar value	
Contract number	Examples of items ordered	Total contract	Portion to be delivered to the Mechanicsburg depot
DLA-13H-86P-8611	Sugar	$199,265	$136,591
DLA-13H-86P-4988	Soap, Canned Goods	149,254	134,733
DLA-13H-86P-0790	Peanut Butter, Mayonnaise	261,208	222,726
DLA-13H-85P-7887	Soups, Canned Goods	289,078	243,263

The current FAR, which encourages maximum use of fast pay procedures, only authorizes fast pay purchases without dollar limits for brand name subsistence items ordered for direct shipment overseas. DPSC officials provided us with correspondence dated January 1972, which indicated that DLA headquarters (then the Defense Supply Agency) had requested a change to procurement regulations to authorize fast pay procedures for the purchase of brand name subsistence items without dollar limitation regardless of whether the items were to be delivered and accepted at stateside or overseas depots. According to the DPSC officials, this correspondence provided a basis for their practice of awarding fast pay contracts without regard to dollar value limitation or shipping destination. However, this change was not approved, as existing FAR language still contains the dollar value and destination limitations.

eliminated, contracting officers will have to choose an alternate payment method—source inspection and acceptance (a government representative accepts material at the vendors plant) or destination acceptance (material is accepted at a DOD storage activity). DLA stated that the average cost of each shipment would be $150 and contractors would incur additional costs of $18 million for paperwork, filing, and storage under the source inspection and acceptance method. DLA also stated that under destination acceptance, the 30-day contractor payment period would be extended by about 2 weeks.

We have repeatedly asked DLA to provide supporting data for its estimates of added costs and times resulting from implementation of Attachment 2. DLA has not provided such data. Currently, under fast pay procedures, material is inspected and accepted at the destination. If DLA chooses destination acceptance as the alternative payment method and the improvements in receipt confirmation that DLA informed us of are made, there may be no additional burden on depot personnel. DLA stated that its computer-to-computer communications between the depots and payment offices assures that most material receipt information is available to payment offices prior to release of the payment. Therefore, destination acceptance appears to be a reasonable alternative to fast pay.

The fiscal year 1986 Financial Integrity Act report stated that proper procedures were explained to field activities in December 1986 to ensure prompt collection of previously identified overpayments. However, improvements in the timely identification and resolution of such improper payments were dependent upon implementation of revised computer programs scheduled to be completed in 1988 or 1989. Our review showed that DLA purchasing offices continued to experience problems in this area. The fiscal year 1987 report cited other plans to correct the problems, but these actions are not scheduled for completion until 1988 or 1989.

Ineffective Controls Over Payments for Deliveries From Fast Pay Contractors to DLA Depots

Effective internal controls must be established by all purchasing offices that use the fast pay procedure to ensure that items paid for are received. At the two supply centers we reviewed, vendors were paid for items purchased under the fast pay procedure that were not received at destination, and follow-up action either was not taken or was not initiated in a timely manner.

Defense Electronics Supply Center

DESC staff actively pursue and investigate potential lost shipments highlighted by monthly material in-transit reports. DESC has implemented automated control procedures that identify potential missing receipts 55 days after the reported shipment date. Generally, it sends necessary follow-up messages to vendors and depots to resolve the in-transit item cases; however, their follow-up efforts are not always effective or timely.

Although DESC personnel routinely investigate and follow up potential missing shipments, our sample results indicate that they do not always notify the contractors about missing shipments within the required time frame. The FAR specifies that vendors are responsible for replacement, repair, or correction of items if they are notified of the loss within 90 days of the reported shipping date (180 days for overseas shipments). In our sample of 52 fast pay in-transit shipments, valued at $71,267, neither the supply center nor depot could provide evidence to document receipt of material for 16 shipments valued at $18,618. DESC failed to notify vendors of the missing shipments within the 90-day time frame on 8 of these 16 fast pay procurements. As a result, DESC has paid for some material that apparently was not received, and vendors may not be responsible for providing replacement items.

Table 3.1: Examples of Subsistence Items Paid for and Not Received or Accepted

Contract number	Item description	Quantity paid for	Quantity not received or accepted	Unit of issues	Dollar value	Reason	Date center notified of problem	Date vendor paid
86P-1184	Cola	2,400	1,680	Cans	$294	Short shipped	12-16-85	1-25-86
86P-8420	Brown Sugar	11,568	11,568	Boxes	5,277	Items rejected/ no date of pack	11-15-85	3-11-86
86P-0859	Cookies	2,388	708	Bags	927	Short shipped	11-21-85	3-19-86
86P-4438	Coffee	1,416	1,416	Cans	2,903	Items rejected/ insufficient shelf life	03-28-86	5-05-86

DPSC's internal control procedures did not provide for prompt identification and request for repayment for a significant portion of these overpayments. DPSC officials advised us that missing shipments are generally not identified until contract files are closed, several months after vendors are paid. To close out the contract, the contracting officer prepares a contract modification reducing the total contract value by the amount of the overpayment. Although such contract modifications establish potential claims, we found that as of September 1987, DPSC had not taken action to collect refunds from the vendors even though from 3 to 21 months had elapsed since contract modifications were prepared.

Ineffective Collection of Refunds for Items Paid for but Not Received and Accepted

Fast pay provisions in the FAR make contracting officers responsible for initiating collections of debts resulting from failure of vendors to properly replace supplies lost, damaged, or not conforming to purchase requirements. The total value of outstanding claims owed to DPSC by fast pay contractors due to nonreceipt of material is not known because overpayments are not identified until contract files are closed. However, a computer-generated listing of pending claims identified during the contract closure process for all destinations indicated their value exceeded $7 million as of May 1987.

Our statistical sample of 70 of 1,719 in-transit purchases scheduled for delivery to DLA's Mechanicsburg depot showed that 35 of the 70 sampled purchases had not been received by the depot even though vendors had been paid. DPSC accounting records showed that vendors repaid 3 of the whether the debts had been repaid. Twelve contractors responded to our letter—nine of them acknowledged being overpaid; the other three replies were not responsive to our inquiry.

Two of the contractors which acknowledged prior overpayment told us they had previously attempted to initiate corrective action. For example, in November 1985 DPSC awarded a fast pay contract for $225,000. One of the items ordered—11,568 cartons of brown sugar—was delivered to the Mechanicsburg depot but rejected because the containers did not include a packing date or national stock number and, therefore, did not meet contract specifications. The material was returned to the contractor on November 15, 1985. On March 11, 1986, because fast pay disbursements are based only on a vendor's invoice and not receipt confirmation, the contractor was paid a total of $5,277 even though the shipment was refused 118 days earlier. The center had not detected the overpayment before our review. On July 28, 1987, company officials acknowledged the $5,277 overpayment and informed us that they had previously offered to settle the claim through offset of other invoices; however, according to them, supplemental invoices were paid in full. At our suggestion, company officials sent a refund check to the disbursing office to cover the amount of the overpayment.

In another case, a contractor provided copies of three letters previously sent to DPSC asking for guidance on how to repay the government for items paid for and not delivered to the depot. The contractor claimed that he never received responses to these letters. At our suggestion, the contractor sent a refund check to DPSC in the amount of $2,255 to satisfy the overpayment.

Duplicate Payments Possible for Subsistence Fast Pay Contracts

Some vendor invoices were paid twice. Of the 70 sample purchases we reviewed, we found that vendors received duplicate payments for three invoices valued at $7,254. DPSC comptroller personnel told us that duplicate payments occur when invoices are mistakenly processed through both the manual and automated system. Voucher examiners rely on the manual system whenever the computer is not available for timely processing. Although the overpayment occurred in early 1986, a DPSC official informed us that as of June 1987, the center had not initiated action to collect refunds from the vendors because contract files had not yet been closed.

were awarded to 15 companies which were listed on the Problem Contractors Award Checklist. The awards were made between the time they were first included on the checklist and February 6, 1987. The awards occurred because contracting officers either disregarded or did not check the sanction list before fast pay contracts were finalized.

- DPSC had developed a problem vendors list for subsistence contractors. Vendors were added to the problem list for various reasons, including bankruptcy, historical record of late deliveries, and nonconformance with purchase requirements. DPSC officials advised us that their problem vendor list is only intended to provide management visibility and to alert contracting officers that current contracts with these vendors require intensive monitoring. However, unlike DFSC, contracting officers were not required to exclude these vendors from future fast pay purchases. DPSC's computer records indicate that 6 of the 11 contractors included on the problem vendor list as of June 1986 received a total of 181 fast pay awards valued at about $29.7 million during the period June 1986 to January 1987.

Receiving and Payment Documents Not Matched for Direct Vendor Deliveries of Supplies Purchased Under Fast Pay Procedures

Supplies are sometimes purchased for delivery directly from contractors' plants to end users. The DOD inventory management system does not provide positive controls to assure that material shipped from vendors is received by end use customers. DOD recognized this weakness, and initiated a program in 1983 to establish reporting procedures through which recipients of direct vendor deliveries would notify purchasing offices of all receipts. Actual implementation of automated receipt confirmation procedures for direct vendor deliveries will not occur until 1989 or 1990. Until such procedures are established, purchasing offices should take some alternative steps to periodically match payment and receiving records to ensure that items paid for on the basis of a contractor's invoice alone are received at destination. Attachment 2 to OMB Circular A-125 specifies that agencies using fast pay procedures must ensure that receiving reports and payment documents are matched after the vendor is paid and that discrepancies are corrected. DPSC has not established interim procedures for matching payment and receiving documents for direct vendor deliveries of subsistence items received and accepted at overseas locations.

DOD Efforts to Establish Standard Reporting Procedures

In May 1983 the Deputy Assistant Secretary of Defense (Logistics and Material Management) asked the Defense Logistics Standard Systems Office (DLSSO) to review material receipt reporting procedures and recommend corrective actions. The study was initiated to resolve internal

Conclusions and Recommendations

Internal controls established by DLA purchasing offices do not prevent possible fast pay program abuse. Potential missing depot shipments are not always detected for timely follow-up and resolution. Also, one purchasing office did not ensure that contractors reimburse the government for the value of improper payments. In addition, contractors having previously identified performance problems continue to receive fast pay contract awards. Contracting officers should be directed not to award fast pay contracts to current problem vendors, and the heads of DLA purchasing offices should establish control procedures to ensure that contracting officers comply. Finally, controls have not been established to ensure receipt of material sent directly to overseas bases because payment and receiving reports are not matched. Because of the problems found in our review, we believe the Director should continue to address this issue as a material weakness in the 1988 self-assessment.

We recommend that the Director, DLA, improve controls over fast pay procurements by

- establishing interim measures to match receiving reports to payment records for direct vendor deliveries to overseas customers until the automated receipt confirmation process is established so that vendors can be notified of nonreceipt within prescribed time frames and
- ensuring that current problem vendors do not receive fast pay contract awards.

We also recommend that the Director, DLA, require the Commander, DPSC, to collect outstanding claims against contractors for materials previously paid for and not received.

In addition, we recommend that the Director again identify this area as a material weakness in the fiscal year 1988 internal controls annual assessment and discuss corrective actions planned.

Agency Comments and Our Evaluation

In their oral comments on a draft of this report, DOD concurred with the findings and recommendations. DOD informed us that all DLA purchasing activities will be given guidance on dealing with contractors who do not satisfy contractual obligations. DPSC has formed a working group to collect outstanding claims against contractors and expects to complete this effort by June 30, 1988. Finally, the Director, DLA, will identify the fast pay program as a material weakness in its fiscal year 1988 internal controls assessment.

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DOD concurred with the intent of our recommendation requiring interim controls for matching receiving reports to payment records for direct vendor deliveries to overseas customers. However, DOD believes the development and use of interim procedures prior to the introduction of the DOD-wide automated closed loop receipt confirmation system may not be cost-effective. DLA believes that the existing report of discrepancy system provides a cost-effective tool for assuring that inadequate performance by fast pay contractors is brought to the attention of purchasing offices. In our 1986 report on DOD inventory management, we reported that customers did not always submit discrepancy reports, and DLA did not use these reports to identify problem vendors. Therefore, we still believe that DLA should evaluate alternatives for providing the controls required by Attachment 2. DLA supply centers could, as the Navy does, require recipients of direct vendor deliveries to confirm receipts to purchasing offices by return mail of material acknowledgement cards or automated computer messages which can then be matched to completed payment records.

control weaknesses identified in previous DOD IG and GAO audit reports. On two separate occasions, DLSSO proposed changes to standard DOD reporting procedures that would establish positive controls for direct vendor deliveries. The Army and Navy rejected the proposals because they were deemed to be too costly and complex. DLA, however, concurred with DLSSO's plan and indicated that development of automated receipt confirmation procedures for direct vendor deliveries would effectively strengthen internal controls.

In September 1986 the Assistant Secretary of Defense (Logistics) decided that the necessary changes should be implemented in two separate improvement projects. The first project, for which DLSSO was expected to release instructions for comments by the end of December 1986, would establish positive receipt acknowledgement reporting requirements to supply sources (purchasing offices) for all recipients of direct vendor deliveries. As of June 30, 1987, the implementing instructions had not been finalized. A DLSSO official informed us that actual implementation of the material receipt acknowledgement process would probably not occur until 1989 or 1990 because substantial changes must be made to existing automated computer systems. The second project would provide procedures for development of an automated supply discrepancy reporting system.

DLA Purchasing Office Does Not Match Payment and Receiving Reports for Subsistence Items Sent to Overseas Locations

DPSC has not established interim procedures for matching payments and receiving documents for direct vendor deliveries of subsistence items received and accepted at overseas locations. About 40 percent of the brand name subsistence items purchased by DPSC under the fast pay procedure specify direct delivery to overseas commissaries. DPSC has not developed a control procedure to verify receipt of these items at overseas bases. The DPSC purchasing office does not match payment records to receiving reports for direct vendor deliveries as required by OMB Circular A-125. A February 1985 memorandum from the Deputy Secretary of Defense to the Director, DLA, stated that there was insufficient follow-up to ensure that items purchased under the fast pay procedure were received. Matching of receiving reports with payment documentation is appropriate whenever fast pay procedures are approved. DPSC officials told us that they rely on overseas recipients to report nonreceipts through the report of discrepancy procedure. Currently, there is no automated system whereby the overseas commissaries provide routine receipt confirmation data to purchasing activities, and DPSC has not implemented an alternative approach because it would require extensive manual effort and increased staffing.

Fast Pay Awards Given to Contractors With Prior Performance Problems

Some vendors have received fast pay contracts even though supply centers had previously identified them as not adequately meeting government contract performance requirements. According to DOD, local procurement offices should deny fast pay privileges to contractors with prior records of performance problems. Purchasing offices we visited have established various problem vendor lists; however, inclusion of a specific contractor on the lists did not always preclude future fast pay awards. The Comptroller General approved DOD's use of fast pay procedures, provided specific controls were established, such as restricting fast pay contract awards only to vendors who consistently satisfied previous contractual obligations.

The June 1983 audit report by the DOD IG concluded that fast pay contracts were routinely awarded to vendors regardless of performance on prior contracts. The IG recommended that purchasing offices with significant volumes of fast pay contracts should periodically assess suppliers conformance with fast pay provisions. The Deputy Under Secretary of Defense (Acquisition Management) disagreed with the recommendation, indicating that Defense regulations already specified that contracts will only be awarded after a determination is made that vendors are capable of performing in a responsible fashion and that irresponsible contractors should be denied awards of new fast pay contracts.

The Deputy Assistant Secretary of Defense (Management Systems) stated in a letter dated August 1985 that DOD policy requires local management to deny fast pay privileges to contractors with prior records of performance problems. Procurement officials are supposed to check proposed contract awards against problem vendor lists before fast pay contracts are awarded. Proposed changes to the FAR fast pay procedures, as approved by the Defense Acquisition Regulation Council in August 1986, would require purchasing offices to identify suppliers having current performance problems. These problem vendors would be denied future fast pay privileges.

The two DLA purchasing offices that we visited had established locally controlled problem vendor lists; however, inclusion of a specific contractor on the lists did not always prevent future fast pay awards. For example:

- DESC had developed a monthly contractor sanction list which specifically denies future fast pay privileges to identified vendors. DESC's computer records showed that 519 fast pay purchase orders totaling $1,618,075, 35 overpayments. On April 21, 1987, we sent a letter to the DPSC Commander advising him of the overpayments and the lack of evidence that DPSC had taken action to collect refunds from the remaining contractors.

On May 28, 1987, the DPSC Commander acknowledged problems in their collection of refunds from brand name subsistence vendors. He attributed this problem to a lack of coordination between the contracting and bill payment offices and lack of an automated procedure to generate claim letters to vendors. The Commander confirmed that overpayments were made for 25 items, and he provided us with documentation that contractors had repaid claims for 7 more of the overpayments. He also said that all of the items will be retained on a controlled transaction listing of potential collections pending completion and implementation of a new automated claim processing procedure. For these 25 items, DPSC officials said that although they were previously unaware of seven overpayments, they would have been identified eventually during the routine contract closure process. Based on our sample, we estimate that as of May 1987, DPSC had not collected refunds of overpayments to vendors for 614 purchases valued at about $784,000.[6]

The automated claim processing procedure will automatically generate claim letters to contractors requesting repayment, then offsets against future invoices will follow if claims are not satisfied within 30 days. The new procedures will automatically initiate offsets regardless of whether vendors were notified of the discrepancy shipments within the 90-day notification period.

The automated claims system was implemented on July 15, 1987. Although it should provide controls necessary for more effective claim collection performance, settlement of claims identified prior to July 15, 1987, will require manual review and verification before claim letters are sent to vendors. DLA informed us that collection or other resolution of all claims for subsistence procurements prior to July 1987 is expected to be completed by June 30, 1988.

Debts Confirmed by Contractors

On June 30, 1987, we sent confirmation letters to the 25 overpaid contractors asking them to verify specific information concerning quantities DLA had ordered, accepted, and paid for. We also asked the contractors

[6]We are 90-percent confident that between 439 and 789 of the 1,719 purchases represent items paid for and not received and that the dollar value of unpaid claims would range between $404,663 and $1,115,257

In discussing these cases with DESC officials, we were informed that the failure to notify vendors within the prescribed time frames has rarely hindered DESC from subsequently getting the contractors to replace missing items. Although contractors may rarely refuse to replace items after the 90-day notification period has expired, DESC is still required by regulation to notify vendors within the prescribed time frame to protect the government's rights in all cases. DLA officials informed us that DLA recognized the problem and that as of January 1988, it had implemented a substantial portion of a new automated tracking system, referred to as Project Action, which among other things will ensure timely notification of vendors regarding missing shipments. Full implementation should occur in 1989.

Defense Personnel Support Center

DPSC has not established visibility and control over in-transit subsistence shipments—items paid for under the fast pay procedure but not confirmed as received. Although DPSC maintains an automated system which provides the current status of subsistence contracts, the system does not generate routine listings of in-transit purchases (potential missing or rejected shipments) for follow-up investigation. Consequently, systematic comparison of receiving reports and payment records is not accomplished. Such comparisons are of utmost importance since vendors are paid without any evidence of receipt at destination. Failure to effectively monitor and control subsistence items paid for and not confirmed as received could result in undetected losses or theft.

In fiscal years 1985 and 1986, DPSC spent more than $990 million to purchase brand name subsistence items for which vendors received payment under the fast pay procedure. We reviewed a random sample of 70 potential missing fast pay shipments for subsistence items—shipments where receipt had not been confirmed—valued at about $113,000 from a universe of 1,719 shipments valued at $5.6 million. From this sample, we found that although vendors had been paid, 35 shipments valued at about $39,376 were either (1) received at the depot and rejected because they failed to meet contract specifications, or (2) the vendor failed to ship the quantity specified in the contract. Nevertheless, DPSC Comptroller records showed that the vendors still received payment for these items even after the depot had notified the center's purchasing office of the discrepant shipments. These overpayments occurred because the purchasing office had not notified the payment office of the receipt discrepancy. Some examples are listed in table 3.1.

Lack of Effective Internal Controls to Prevent Fast Pay Program Abuse

DLA had not implemented effective controls to ensure receipt of material at destination. Some of the problems that prompted OMB to issue revised fast payment procedures continued to exist at DLA more than two years after issuance of new criteria. DLA purchasing offices that we reviewed continued to be vulnerable to losses on their fast pay procurements.

In reviewing internal control procedures established by two of DLA's supply centers, we found that (1) they had not established effective controls to identify and resolve potential missing depot shipments, (2) one purchasing office had not established an effective procedure to collect a possible $7 million from vendors for items previously identified as having been paid for but not received or rejected and returned to the vendor, (3) fast pay contracts were awarded to vendors who have been previously identified as not adequately meeting government contract performance requirements, and (4) purchasing offices had no assurance that items purchased for direct delivery from vendors to overseas locations were received. While DLA's self-assessment of internal controls confirmed weaknesses in existing control procedures and identified some planned corrective actions, more needs to be done.

DLA Self-Assessment of Internal Controls

The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512(b)) requires executive agencies to establish and maintain effective systems of internal control. The internal control systems are to ensure that assets are safeguarded against waste, loss, or unauthorized use; that obligations and costs comply with applicable laws; and that revenues and expenditures are recorded and accounted for properly so that accountability of assets may be maintained.

The act requires heads of agencies to make an annual examination of their internal controls using guidelines established by OMB. Agencies report in an annual statement whether the established agency systems comply with the above stated objectives. Any identified internal control weaknesses and plans for corrective action must also be reported.

We reviewed internal control certification statements prepared by DLA for fiscal years 1985, 1986, and 1987. DLA reported material weaknesses which recognized that it did not have effective controls to ensure receipt of material when fast pay procedures were used. For example, DLA reported that it had paid for some items that were not received. Because the improper payments were not identified in a timely manner, the government lost interest on the funds and failed to collect the overpayments from the vendors.

Conclusions and Recommendations

DLA has not implemented revised fast pay program requirements specified by Attachment 2 to OMB Circular A-125 issued in April 1985 because the FAR has not yet been changed. OMB's Circular was issued pursuant to the Prompt Payment Act and, in our opinion, has the force and effect of law and should be complied with.

DLA should cease awarding fast pay contracts for supplies sent directly to DLA depots where receipt and acceptance is routine. With computer networks established between DLA depots and disbursing offices, DLA has the capability to make timely payments for depot shipments based on confirmed receipt and acceptance. Furthermore, individual awards to purchase brand name subsistence items ordered for direct overseas delivery should not exceed OMB's specified dollar value limitations without case-by-case approval by the head of the agency.

We recommend that the Director, DLA, conform to provisions of OMB Circular A-125 by

- discontinuing use of fast pay procedures for payment of supplies sent to depots and
- reviewing and approving fast pay contracts awarded in excess of the $25,000 limitation specified by OMB.

Agency Comments and Our Evaluations

In their oral comments on a draft of this report, DOD concurred in our findings and recommendations and provided information on actions taken or planned to correct problems and implement our recommendations. DOD provided other technical corrections and clarifications which have been incorporated in the report.

DOD will issue guidance requiring DLA to implement Attachment 2 to OMB Circular A-125, and DLA will take action to stop the use of fast pay procedures for supplies sent to depots. Additionally, the Commander, DPSC, will be instructed to review and approve all fast pay contracts in excess of $25,000.

Although DOD concurred in our recommendations and agreed to take the necessary actions to implement the provisions of Attachment 2 to OMB Circular A-125, DLA questioned the cost-effectiveness of some of the actions. According to DLA, stock fund prices could increase from 3 to 10 percent if fast pay is eliminated for depot shipments. When fast pay is could therefore have made timely payments to vendors based on verification of receipt at destination without use of fast pay procedures.

Subsistence Items

DPSC also uses fast pay procedures to pay vendors for brand name subsistence items delivered to depots where receipt and acceptance is routine. DPSC purchases common items generally found on grocery store shelves for resale in overseas commissaries, including items such as soap, sugar, soft drinks, snack foods, and canned goods. From May 1985 to August 1986, DPSC spent $178 million under the fast pay procedure to purchase brand name subsistence items for delivery to wholesale storage depots.

Three stateside depots (Tracy, California; Alameda, California; and Mechanicsburg, Pennsylvania) receive and accept brand name commissary supplies purchased by DPSC. As of January 1987, all new contracts for brand name subsistence items specify that vendors will be paid by the DPSC Comptroller Department. Although there is a geographical separation of the receiving activities and payment office, there is an automated network between the depots and DPSC. Receipt confirmation data is entered through computer terminals and transmitted over the Automatic Digital Network (AUTODIN). DPSC personnel use this confirmed receipt data as a basis for directing transfer of material from the depot to overseas commissaries; however, they do not use this receipt confirmation data as the basis for paying vendors. Circular A-125 indicates that facilities served by AUTODIN are generally deemed to have adequate communication facilities sufficient to overcome the geographic separation exception that would otherwise justify the use of fast pay contracts.

Subsistence Contracts Exceed $25,000 Value Limitation

Unlike DESC, DPSC routinely awards fast pay contracts in excess of $25,000 without specifically justifying their use on a case-by-case basis as OMB requires. OMB initially proposed that individual fast pay contracts should not exceed $25,000. However, the final issuance of Circular A-125, Attachment 2, provides an exception whereby heads of executive agencies may permit a higher limit on a case-by-case basis. An OMB official informed us that this means each contract awarded in excess of the $25,000 limitation would require approval by the head of the purchasing activity.

Defense Logistics Agency Has Not Complied With Provisions of OMB Circular A-125

DLA has not implemented revised fast pay procedures specified by Circular A-125, Attachment 2, issued by OMB in April 1985. In fiscal years 1985, 1986, and 1987 (through August 1987), DLA officials estimate that their six supply centers spent about $4.7 billion for fast pay procurements, with DPSC and DESC expending about $1.8 billion. Contrary to OMB Circular A-125, we found that DPSC and DESC routinely authorized fast pay procedures for procurement of stocks sent directly to supply depots. Further, DPSC authorized fast pay procedures for depot shipments without regard to the $25,000 limit specified by OMB. For example, the center had established no dollar limitation on using fast pay procedures in contracts for brand name subsistence items which can exceed $1 million.

DLA Has Not Implemented Attachment 2 to OMB Circular A-125

Initially, DLA opposed OMB's proposed fast pay revisions because it was concerned over the possible increase in costs to verify receipts before vendors are paid. For example, in November 1985, DLA projected that if fast pay was eliminated it would experience a 170 staff year increase in personnel to verify receipt before vendors are paid. DLA suggested this increased staffing requirement could be significantly reduced if fast pay was eliminated for only those contracts awarded over $5,000, since approximately 80 percent of their fast pay contracts were valued below $5,000. DLA based its computation of added personnel requirements on the assumption that approximately 50 percent of all receipts handled by DLA depots would require manual follow-up before vendors could be paid. As of September 1987, automated computer networks have been established between DLA payment centers and depots, which provide receipt confirmation data for most transactions handled by DLA depots. Therefore, manual follow-up should not be necessary.

On December 9, 1986, a draft change to the FAR incorporating OMB Circular A-125 changes was published in the Federal Register. Comments were requested by February 9, 1987. DLA did not comment on the changes or their impact on DLA's operations; however, DLA maintains that it is not required to limit use of fast pay because OMB's revisions have not yet been made part of the FAR.

The Director, OMB, is directed by statute to prescribe regulations implementing the Prompt Payment Act and has issued Circular A-125 to carry out this requirement. Regulations promulgated pursuant to statutory authority have the force and effect of law. Therefore, DLA's position is not legally tenable, and it should implement OMB's directions regarding fast pay without waiting for the FAR to be revised.

DLA's six supply centers—Defense Electronics Supply Center (DESC) in Dayton, Ohio, and Defense Personnel Support Center (DPSC) in Philadelphia, Pennsylvania. At DPSC we concentrated our review efforts on the subsistence commodity. We selected the centers based on their volume of fast pay awards and the results of prior fast pay audits. The two centers accounted for approximately 40 percent of DLA's total fast pay program expenditures in fiscal years 1985 and 1986.

To test the effectiveness of the centers' internal controls to ensure receipt of material under the fast pay procedure and to find out whether they had paid for items that were not received, we analyzed statistical samples of in-transit items—items that were purchased where payment to the vendor was indicated but receipt of material had not been confirmed or posted to the contract files. We reviewed a sample of 70 purchases by DPSC for which supplies were scheduled for delivery to DLA's Mechanicsburg, Pennsylvania, depot. We also reviewed a sample of 52 purchases by DESC for delivery to either the Mechanicsburg or Ogden, Utah, depot. We selected the Ogden depot because it receives the greatest portion of DESC shipments and the Mechanicsburg depot because it receives the greatest portion of subsistence shipments.

Our sample of 70 in-transit purchases for subsistence items was drawn from a universe of 1,719 in-transit purchases each having a value greater than or equal to $250 and ordered during the 12-month period ending May 1986. The 1,719 in-transit purchases were valued at $5.6 million. Our sample of 52 electronics items was selected from a universe of 230 fast pay purchases valued at $250 or more in the in-transit files as of October 1986. The 230 in-transit purchases were valued at $398,604. For each sample item, we reviewed contract files and receiving records at both the purchasing office and the receiving depot to validate the accuracy of information reflected in the computerized file. For selected overpayments identified in our analysis of sample items, we evaluated agency actions to obtain replacement items or refunds for the value of the items paid for but not received. For 25 such overpayments, we sent confirmation letters to contractors asking them to verify specific information concerning quantities ordered, accepted, and paid for. We also asked the contractors to confirm whether they had repaid improper payments received from DLA.

We also reviewed and evaluated actions taken by DLA under its fiscal years 1985, 1986, and 1987 assessments of internal controls required to be reported under the Federal Managers' Financial Integrity Act of 1982.

- Individual fast pay orders do not exceed $25,000, except heads of executive agencies may permit a higher limit on a case-by-case basis.
- Supplies are to be delivered to locations where a geographical separation and lack of adequate communication facilities between government receiving and disbursing activities make it impractical to provide timely payments based on evidence of federal acceptance.
- Title to the supplies vests in the government (1) upon delivery to a post office or common carrier or (2) upon receipt by the government where the post office or common carrier is not used.
- The vendor agrees to replace, repair, or correct supplies not received at destination, damaged in transit, or not conforming to purchase requirements.

Agencies using fast pay procedures are also supposed to ensure that

- receiving reports and payment documents are matched and steps are taken to correct discrepancies and
- specific internal controls are in place to assure that supplies paid for are received.

Actions Taken by DLA and the Services to Implement OMB Provisions

DLA has not limited its use of fast pay in accordance with OMB Circular A-125, while the Army, Navy, and Air Force have taken various actions to limit the use of fast pay contracting.

The Air Force Logistics Command notified purchasing offices in a letter dated September 1985 that fast pay procedures were not appropriate for most Air Force procurements. The letter stated that fast pay contracts must include specific justification signed by the contracting officer. Command officials informed us that fast pay was not now routinely being used.

The Army notified accounting and finance centers on February 8, 1985, that they may continue to pay fast pay contracts before receipt confirmation reports are obtained; however, payment vouchers must be documented with a receiving report before the payment files are closed. Army headquarters officials advised us that Army inventory control points do not currently use fast pay procedures for purchases of supplies sent to depots.

In a notice dated June 30, 1983, the Naval Supply Systems Command notified field contracting offices that fast pay procedures were to be changed based on the DOD IG findings. The notice stated that fast pay

Introduction

Fast pay procedures allow federal agencies to pay commercial vendors based on submission of an invoice where they certify that the supplies have been shipped. Confirmation of receipt is not required by the paying office prior to payment; however, adequate follow-up steps must be taken to assure that goods are received and the government's interest is protected. Fast pay procedures were designed to speed payments to contractors for small dollar contracts and to enable agencies to make timely payment to vendors for items sent to geographically separated locations where it would be impracticable to base payment on evidence of receipt.

In 1968 the Comptroller General approved the use of the fast pay procedures in the Department of Defense (DOD) provided that contractors agreed to replace items paid for but not received and DOD maintained adequate controls to ensure detection and resolution of nonreceipts of fast pay shipments.[1] The Comptroller General also specified that agencies awarding fast pay contracts must

- establish a procedure to confirm that all items paid for are received,
- demonstrate a need for accelerated payments in order to pay bills on time,
- establish and adhere to upper limits on dollar value of fast pay transactions, and
- restrict fast pay awards only to vendors who have consistently satisfied previous contractual obligations.

Results of Prior Audits

Prior audits have disclosed internal control weaknesses in DOD's use of the fast pay procedure. For example:

- In June 1982 we reported that the Defense Logistics Agency (DLA) had paid for material valued at about $4 million under the fast pay procedure and receipt of the material was not confirmed by the depot.[2] We recommended that the Director, DLA, strengthen processing controls to

[1] Title 7 to General Accounting Office (GAO) "Policy and Procedure Manual for Guidance to Federal Agencies" requires agencies to preaudit payment vouchers to determine whether the goods were received in accordance with the contractual agreement. However, we will approve on an individual basis the use of fast pay procedures whereby payment is based on vendor assurance that goods have been shipped, rather than awaiting notification of receipt and acceptance. When fast pay is approved, adequate follow-up must be made to assure that goods are received and the government's interest is protected.

[2] Improvements Needed in Defense's System for Controlling Material Shipments to Defense Logistics Agency Depots and Customers (PLRD-82-81, June 10, 1982)

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GAO believes that because of the problems identified in its review, the Director of DLA should again identify this area as a material weakness in the fiscal year 1988 internal controls annual assessment conducted pursuant to the Federal Managers' Financial Integrity Act of 1982.

Recommendations

GAO recommends that the Director, DLA,

- conform to provisions of OMB Circular A-125 by discontinuing use of fast pay procedures for payment of supplies sent to depots, and reviewing and approving all fast pay contracts awarded in excess of the $25,000 limitation specified by OMB;
- establish internal controls to ensure that (1) until the DOD-wide automated receipt confirmation system is implemented, receiving reports are matched to payment records for direct vendor deliveries to overseas locations and (2) current problem vendors do not receive fast pay contract awards;
- require the Commander, Defense Personnel Support Center, to collect outstanding claims against contractors for materials previously paid for and not received; and
- again identify fast pay procedures as a material weakness in the fiscal year 1988 internal controls annual assessment and discuss corrective actions.

Agency Comments and GAO's Evaluation

DOD generally concurred with GAO's findings and recommendations and noted actions taken or planned to correct problems and implement the recommendations. While it concurred with the intent of GAO's recommendation requiring interim controls for matching receiving reports to payment records for direct vendor deliveries to overseas customers, DOD believes the existing report of discrepancy system provides a cost-effective tool for assuring that inadequate performance by fast pay contractors is brought to the attention of purchasing offices. In 1986 GAO reported that customers did not always submit discrepancy reports and DLA was not using these reports to identify problem vendors. GAO, therefore, still believes that DLA should evaluate alternatives for providing the needed controls and could require that receipts be confirmed by return mail of receipt acknowledgement cards, as the Navy has done.

Although DOD concurred with GAO's recommendations and stated actions would be taken to comply with OMB Circular A-125, DLA questioned the

Executive Summary

Purpose

Under fast pay procedures, agencies pay vendors based on a shipping invoice without verification of receipt and acceptance of the items ordered. The procedure was developed to expedite payments to contractors for small purchases. However, audits have disclosed serious internal control weaknesses in the use of fast pay procedures by the Defense Logistics Agency (DLA). In fiscal years 1985, 1986, and 1987, DLA spent an estimated total of about $4.7 billion under the fast pay procedure.

GAO reviewed

- actions taken by DLA and the military services to implement fast pay program revisions imposed by the Office of Management and Budget (OMB) and
- the effectiveness of internal controls used by selected DLA purchasing offices to ensure receipt of items purchased under the fast pay procedure.

Background

In 1968 the Comptroller General approved use of fast pay methods in the Department of Defense (DOD), provided that agencies maintained adequate controls to ensure receipt of items paid for, established and adhered to dollar limits on the value of fast pay transactions, and restricted the use of fast pay awards to vendors who have consistently satisfied previous contractual obligations.

In April 1985 OMB issued revised fast pay program requirements to limit the use of this expedited payment method. The revised procedures were intended to strengthen controls over program expenditures and avoid continuing payments to vendors for items that were not received. According to OMB's requirements, fast pay procedures are appropriate in limited circumstances, but they should not be used for delivery of depot stocks and in other instances where timely payment can be made because receipt and acceptance is routinely communicated to the purchasing activity

Results in Brief

DLA has not implemented OMB's revised fast pay requirements and, consequently, was continuing to routinely use rather than curtail fast pay procedures in inappropriate circumstances.

Internal controls established by the two DLA purchasing offices that GAO reviewed were not adequate. As a result, the government paid for some items it did not receive. In other cases, contractors received and used