

GAO

Report to the Chairman, Committee on  
Governmental Affairs, U.S. Senate

August 1994

# DOD PROCUREMENT

## Overpayments and Underpayments at Selected Contractors Show Major Problem



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United States  
General Accounting Office  
Washington, D.C. 20548

National Security and  
International Affairs Division

B-256249

August 5, 1994

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

Dear Mr. Chairman:

In April 1994, we testified before your Committee that defense contractors are returning millions in contract overpayments to the Defense Finance and Accounting Service (DFAS) within the Department of Defense (DOD).<sup>1</sup> Our testimony was based on an earlier report concerning \$751 million in returns by contractors during a 6-month period ending in April 1993.<sup>2</sup> Virtually all returned overpayments were detected and returned by the contractors without a government demand letter. However, because of concerns as to whether contractors are returning all overpayments, you asked us to determine whether defense contractors were retaining overpayments.

We initiated our work at nine major contractor locations. The magnitude and extent of overpayments not being returned, as well as underpayments not being corrected, show a major problem requiring immediate DOD attention. Accordingly, as agreed, we are providing this interim report and continuing to examine this issue.

## Results in Brief

The nine contractor locations we visited had unresolved payment discrepancies totaling about \$118 million—\$30.3 million in overpayments and \$87.7 million in underpayments. These overpayments and underpayments result in significant unnecessary costs to the government. At current interest rates, these identified overpayments could cost the government about \$5,800 per day. Because the Prompt Payment Act requires DOD to pay interest on valid invoices that are paid late, the underpayments we identified could cost DOD about \$16,800 per day.

Each contractor had returned some overpayments, but the nine contractors were retaining some overpayments. Contractor officials gave

<sup>1</sup>Financial Management: Financial Control and System Weaknesses Continue to Waste DOD Resources and Undermine Operations (GAO/T-AIMD/NSIAD-94-154, Apr. 12, 1994).

<sup>2</sup>DOD Procurement: Millions in Overpayments Returned by DOD Contractors (GAO/NSIAD-94-106, Mar. 14, 1994).

several reasons for not returning overpayments; however, none of the reasons appeared to justify not returning overpayments or delaying the resolution of discrepancies. The payments were made by several different DFAS offices, and some discrepancies have been outstanding for several years. DOD officials had been notified of some discrepancies but had not taken corrective action. Neither DOD nor the contractors appeared to be aggressively pursuing resolution of payment discrepancies.

DOD has not identified any comprehensive plans to mobilize resources to identify and correct current payment discrepancies. We believe such action is necessary to reduce (1) the cost to the government, (2) future payment discrepancies, and (3) the incidence of uncollectable overpayments.

## Discrepancies Include Both Overpayments and Underpayments

Our initial work, involving a review of payment records at nine contractor locations, identified significant payment discrepancies on DOD contracts. We found that contractor records identified over \$30 million in overpayments from DOD and over \$87 million in underpayments. Table 1 lists the overpayment and underpayment totals that we identified in each of the nine contractors' records during our visits in February and March 1994.

**Table 1: Overpayments and Underpayments by Contractor Location**

Contractor locations visited	Overpayments	Underpayments <sup>a</sup>
AT&T Technologies, Greensboro, North Carolina	\$476,786	\$24,101,282
Bell Helicopter Textron, Incorporated, Fort Worth, Texas	181,127	1,285,712
Harris Corporation, Government Electronics Systems Division, Melbourne, Florida	1,407,275	3,604,929
Hercules Aerospace Company, Missiles, Ordnance & Space Group, McGregor, Texas	159,820	1,017
Martin Marietta, Electronics, Information & Missiles Group, Orlando, Florida	19,820,679	417,994
Rockwell International Corporation, Missile Systems Division, Duluth, Georgia	250,661	682,477
Rockwell International Corporation, Collins Systems International, Richardson, Texas	1,381,643	7,596,595
Texas Instruments, Incorporated, Dallas, Texas	6,254,756	47,766,941
Tracor, Incorporated, Austin, Texas	339,312	2,210,530
<b>Total</b>	<b>\$30,272,059</b>	<b>\$87,667,477</b>

<sup>a</sup>Underpayments exclude current billings less than 30 days old.

Both overpayments and underpayments result in unnecessary costs to the government. Overpayments increase the government's interest costs because funds are needlessly disbursed. Contractors are not assessed interest on overpayments until 30 days after a demand for repayment is made. At current interest rates, these identified overpayments could cost the government about \$5,800 per day, or about \$2 million per year. Overpayments also expose the government to a greater risk of loss because some overpayments become uncollectable. In our March 1994 report, we noted that DFAS' reconciliation of 4,300 contracts had identified about \$17 million that was owed the government but could be uncollectable.

Underpayments also increase costs because the Prompt Payment Act requires interest to be paid on overdue amounts.<sup>3</sup> The late payment penalty rate, which is set by the U.S. Treasury, is currently 7 percent. Late payment penalties on the underpayments at the nine contractors we visited could cost DOD about \$16,800 per day, and some underpayments have existed for extended periods. At one contractor, about \$5.4 million in underpayments had been outstanding for more than a year. Our review of the contractor's records showed that DOD was notified of most of these underpayments.

Contractor officials said that DFAS paying offices were not always notified of payment discrepancies. However, according to these officials, even when DFAS was notified, DOD did not always take action to collect the overpayments. Our test of payment discrepancies identified instances of the conditions described by contractor officials. In one instance, a contractor notified DFAS officials on December 10, 1992, that the company had received duplicate payments on four invoices totaling about \$360,000. When we reviewed the contractor's accounts receivable as of February 1994, over a year after DFAS was notified of the discrepancy, we found the contractor still had the duplicate payments. A contractor official said that DOD had not requested return of the duplicate payments.

In another instance, a contractor notified DFAS officials on December 15, 1992, that it had been underpaid and was owed about \$155,000 on two invoices. The contractor said DFAS had incorrectly deducted progress payments on one invoice and made an excessive price deduction on the other because DFAS had not updated its records. The underpayment was resolved after our visit. The final payment made in May 1994 was about

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<sup>3</sup>The Prompt Payment Act requires the payment of an interest penalty for payment made after the due date or 30 days after the presentation of a valid invoice. The act provides a 15-day grace period.

2 years after the original payments. In accordance with the Prompt Payment Act, DFAS paid a late payment penalty of about \$10,000.

In another case, a contractor returned three overpayments totaling about \$160,000 identified during our review. DOD had been formally notified about one of the three overpayments. DOD was notified in a January 1994 letter of a \$66,000 overpayment that occurred about 3 years earlier. The other two overpayments, \$28,000 and \$66,000, had been outstanding for 6 and 18 months, respectively. There was no record of DOD being notified of these two overpayments, but the contractor's accounting manager believes he discussed the larger overpayment with a DOD contracting official.

Another contractor's long-standing overpayment was also resolved during our visit. According to DOD's records, in September 1993, DFAS temporarily suspended payments on one contract because available contract funding was not sufficient to pay the contractor's progress payment billings. DOD calculated that the contractor had been overpaid by about \$28 million on the contract, mostly because progress payments on foreign military sales had been improperly billed. Our review of the contractor's accounts receivable records in February 1994 showed about \$15.7 million in overpayments on this contract.

During our visit, the contractor recalculated the payment status and returned \$5.4 million in overpayments and applied the balance, about \$10.3 million, against additional contract costs incurred between August 1993 and March 1994. The contractor's records showed that most of the overpayments on this contract had been outstanding over 200 days and one overpayment of \$670,000 had been outstanding 695 days. The contractor sent a check to DOD in October 1992 for the \$670,000 overpayment, but the DOD contracting official did not process the check and returned it because the contract was being reconciled. On another contract, this contractor had an overpayment of about \$5,000 that had been outstanding since February 1988, over 6 years.

The contractors we visited, although retaining some overpayments, returned a significant amount of overpayments between October 1, 1992, and March 14, 1994, to the DFAS Columbus Center, the primary contract payment center for DOD. (About 2,200 of the 26,000 contractors paid by the DFAS Columbus Center have returned overpayments.) The amounts returned, as shown in table 2, are the total for the contractor, not just the

locations we visited, because data on checks received by contractor location were not readily available.

**Table 2: Amounts Received by the DFAS Columbus Center From Selected Contractors From October 1, 1992, to March 14, 1994**

<b>Contractor</b>	<b>Number of checks</b>	<b>Amount</b>
AT&T	66	\$5,960,307
Bell Helicopter Textron, Incorporated	35	3,047,360
Harris Corporation	57	3,820,944
Hercules Aerospace Company	21	5,207,666
Martin Marietta	540	134,592,556
Rockwell International Corporation <sup>a</sup>	124	49,032,757
Texas Instruments, Incorporated	35	38,592,384
Tracor, Incorporated	39	1,147,458
<b>Total</b>	<b>917</b>	<b>\$241,401,432</b>

<sup>a</sup>We visited two locations of this contractor.

Contractor officials provided one or more of the following reasons that they did not always return overpayments: (1) DFAS was reconciling the contract; (2) the amounts were relatively small; (3) DFAS did not issue a demand letter; (4) the overpayments compensated for underpayments; and (5) when overpayments were returned, DFAS did not always correctly account for the returns causing fund shortages on later contract payments. Contractor officials said that each payment discrepancy had a distinct cause that required research to resolve. The officials said that DFAS does not accept contractor information by itself as evidence of a payment error; consequently, the contractors often wait for DFAS to reconcile contract payments.

None of the reasons provided appeared to justify not returning overpayments or delaying resolution of discrepancies. For example, the DFAS Columbus Center policy is to collect all overpayments offered without waiting for reconciliation to be completed, a process that can take several months. Additionally, the processing of demand letters can unnecessarily delay return of overpayments. Finally, overpayments should not be used to compensate for underpayments because the Prompt Payment Act provides contractors with interest on late payments.

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Management and Budget; and other interested congressional committees.  
Copies will also be available to others upon request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in cursive script that reads "David E. Cooper". The signature is written in black ink and is positioned centrally on the page.

David E. Cooper  
Director, Acquisition Policy, Technology,  
and Competitiveness Issues





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# Major Contributors to This Report

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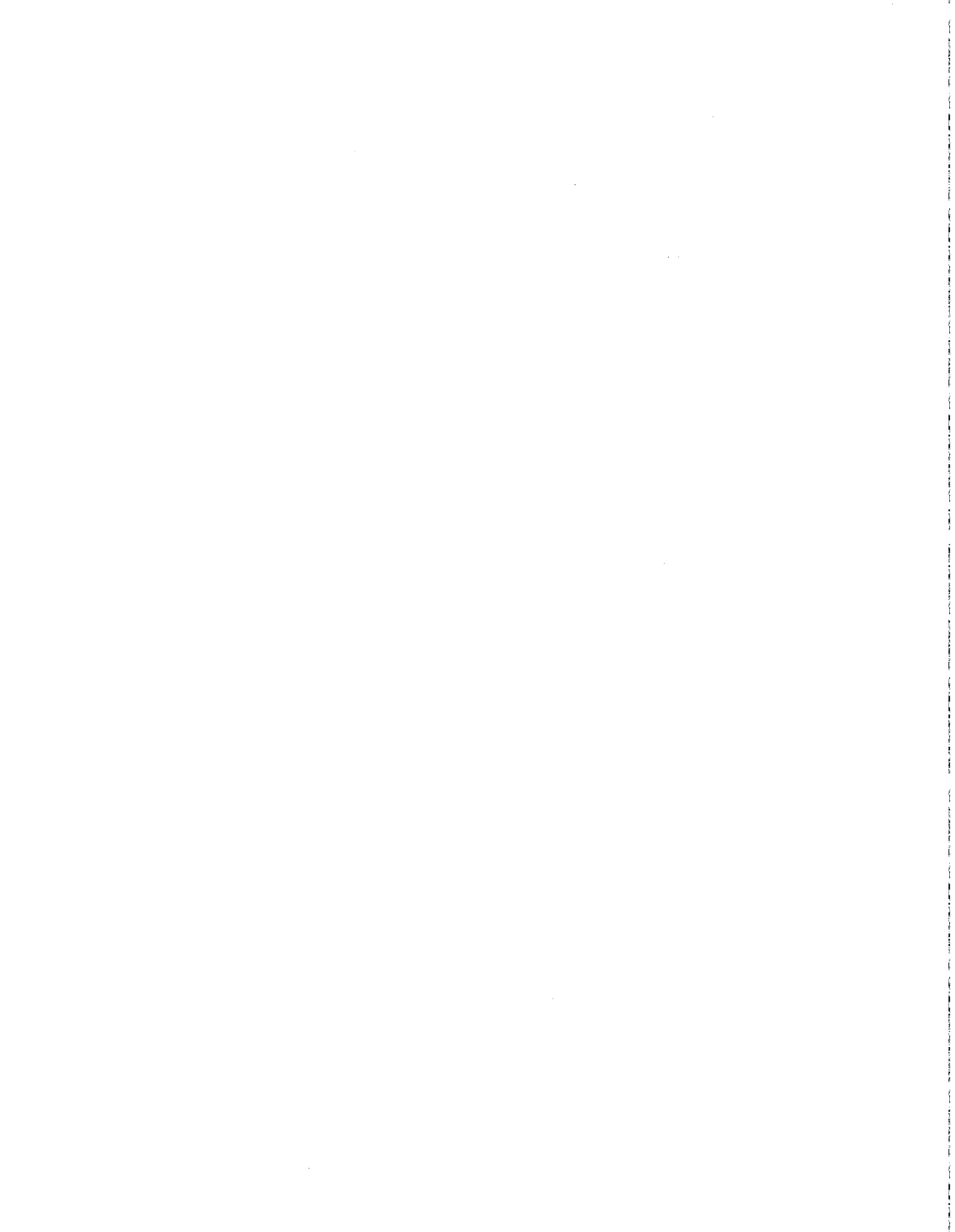
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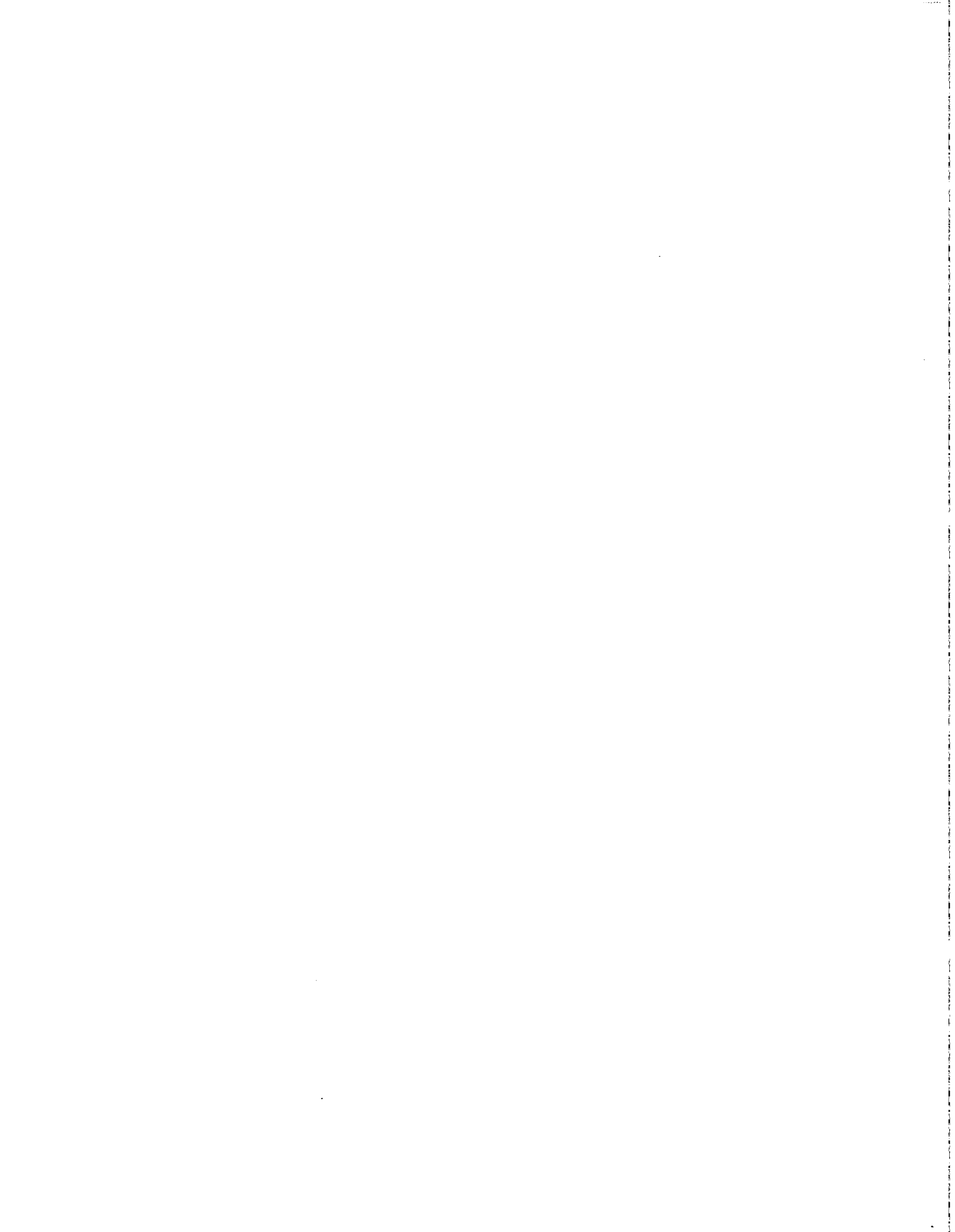
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