

May 1997

**FINANCIAL
MANAGEMENT**

**Improved Reporting
Needed for DOD
Problem
Disbursements**



**Accounting and Information
Management Division**

B-276402

May 1, 1997

The Honorable John Glenn
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable Stephen Horn
Chairman, Subcommittee on Government
Management, Information and Technology
Committee on Government Reform and Oversight
House of Representatives

The Honorable Charles Grassley
United States Senate

As you requested, we reviewed Department of Defense (DOD) reporting on the amount of its problem disbursements—an area that has been the source of much concern for many years. Problem disbursements are specific disbursements that have not been matched with corresponding obligations. Such disbursements can increase the risks of (1) fraudulent or erroneous payments being made without detection and (2) cumulative amounts of disbursements exceeding appropriated amounts and other legal spending limits. As discussed in more detail in the “Background” section of this report, problem disbursements consist of aged in-transits, unmatched disbursements, and negative unliquidated obligations.

DOD has many initiatives under way to reduce problem disbursements and, in March 1996, DOD stated in its annual report to the President and the Congress that eliminating problem disbursements was one of its key financial reform projects. DOD reported \$18 billion in problem disbursements as of May 31, 1996, a reduction of \$33 billion from the \$51 billion balance used as a baseline as of June 1993. For this report, we reviewed the accuracy of the problem disbursement report as of May 31, 1996, the most recent data available at the start of our review. The objective of our review was to determine whether DOD’s reporting is producing accurate and consistent data needed to effectively measure its progress and manage the reduction of its problem disbursements.

Results in Brief

To ensure that problem disbursement reports are an effective management tool, DOD’s reports, at a minimum, need to accurately identify the amount

of problem disbursements. However, the reports by Defense Finance and Accounting Service (DFAS), which is responsible for preparing DOD's reports on problem disbursements, do not provide this needed information. Our testing of problem disbursement amounts reported by DFAS as of May 31, 1996, shows that the \$18 billion total reported by DOD was understated by at least \$25 billion. Accordingly, neither the Congress nor DOD management can rely on DOD's reported amount to determine the extent of problem disbursements or to monitor progress made in resolving them.

Furthermore, the underlying data for DFAS' reports are not sufficient to ensure consistent reporting and do not provide basic information about the sources and causes of problem disbursements. Additional data are essential if DOD is to prioritize and focus reengineering efforts and other corrective actions on those organizations, activities, and actions that are the more significant contributors to disbursement problems and to measure its success in addressing specific problems. While summary data would be acceptable for some analyses, the ability to identify sources and causes of problem disbursements depends on the availability of detailed data about transactions that result in problem disbursements.

While DOD and DFAS have committed significant resources to reducing problem disbursements, they have not taken the steps needed to ensure (1) accurate and consistent reporting and (2) the availability of underlying data that are needed to quantitatively measure and manage reduction efforts. Although DFAS prepared its first comprehensive reporting guidance in May 1996, the understatement we identified resulted from the guidance (1) not being followed because DFAS did not establish adequate oversight and controls over the reporting process, (2) not offering detailed instructions for offsetting transactions, and (3) not appropriately identifying certain types of transactions as problems.

In written comments on a draft of this report, DOD disagreed with our findings and stated that it no longer characterizes one type of transaction, known as in-transits, as problem disbursements. We believe aged in-transits, which represent disbursements that have not been matched with related obligations within DOD's normal processing time of 60 or 120 days, are problem disbursements, and, until recently, they have been treated as such by DOD. DOD also stated that the Department officially reports in-transit disbursements on a net basis—that is, by offsetting collections, reimbursements, or adjustments against disbursement balances. This statement is inconsistent with the written policies of DOD

and DFAS, which require absolute amounts, and with numerous discussions we had with DOD and DFAS officials throughout the course of our work. To report these balances on a net basis grossly understates and masks the magnitude and seriousness of DOD's long-standing disbursing problems. For example, if DOD had an in-transit amount of \$10 related to a collection, DOD may not know the correct appropriation to credit. In addition, it may have a disbursement for \$8 for which the correct appropriation to charge is unknown. DOD has two problems totaling \$18 which must be resolved. To offset these amounts would show a total problem of \$2, severely understating the problem.

Background

Federal agencies, including DOD, are responsible for ensuring that appropriated funds are used only for the purposes, and within the amounts and time frames, authorized by the Congress. To comply with legal and regulatory requirements, DOD organizations' accounting and fund control systems must be able to accurately record disbursements as expenditures of appropriations and as reductions of previously recorded obligations. Proper matching of disbursements with related obligations ensures that the agency has reliable information on the amount of funds available for obligation and expenditure. Because problem disbursements are not properly accounted for, DOD is unable to ensure that it has complied with the Anti-Deficiency Act, which requires that disbursements not exceed available funds.

Problem disbursements not only affect reports prepared to monitor the obligation and expenditure of budgetary resources but also DOD's financial position and results of operations. In enacting the Chief Financial Officers Act, as expanded by the Government Management Reform Act, the Congress called for annual audited financial statements that provide the needed information for both monitoring the effective allocation of budgetary resources as well as for assessing management performance and stewardship. The extent of problem disbursements currently results in inaccuracies in DOD's financial statements and will also impact financial statements prepared pursuant to new reporting requirements that will be implemented in fiscal year 1998, including the program costs reported in the statement of net costs and the status of budgetary resources in the statement of budgetary resources.¹

¹DOD is required to prepare audited financial statements for fiscal years 1996 and beyond in the format prescribed by the Office of Management and Budget. Beginning in fiscal year 1998, the information required will be much more extensive than now and will include the statements noted above.

DFAS is responsible for reporting the status of problem disbursements each month to the DOD Comptroller. These reports are used to determine the amount of problem disbursements and, by comparison with prior months, to determine the effectiveness of DOD reduction efforts. In addition, DOD uses the reported amounts in its annual reports to the President and the Congress to report on progress in financial management reform. The reporting process begins when DFAS centers collect and compile problem disbursement balances for the military services for which they are responsible. Subsequently, these centers submit compiled problem disbursement balances to DFAS headquarters for consolidation.

Both DOD and DFAS guidance provide the framework for reporting the status of problem disbursements. The most comprehensive DOD guidance, which was issued in June 1995, establishes policies and procedures for researching and resolving problem disbursements. The most comprehensive DFAS guidance, issued in May 1996, updated previously issued guidance and provided instructions for reporting. Although not involving major changes to previous guidance, the May 1996 guidance was intended to improve the consistency of problem disbursement information by formalizing the format for reporting problem disbursements. Under this guidance, DFAS headquarters required its centers to report on the following categories of problem disbursements.

In-transit—Refers to disbursements and collections that have been reported to Treasury but have either not been received by the accounting station or have been received but not processed or posted by the accounting station.² In-transit disbursements can be made by an accounting station for its own transactions and for other accounting stations that are responsible for recording these disbursements into their accounting records. These disbursements can be for activities within the same military service or for different military services. Accounting stations that make disbursements for others are required to forward supporting documentation to the appropriate station to be matched to corresponding obligations. For the in-transit category, DFAS reports as problem disbursements transactions it considers over-aged—specifically, those (1) over 60 days old if the disbursing and accounting stations are assigned to the same DFAS center or (2) over 120 days old if the disbursing station is assigned to one DFAS center and the accounting station is assigned to another DFAS center, DOD component, or federal agency.

²An activity responsible for maintaining accounting records of assigned fundholders, i.e., accounting station.

Unmatched Disbursements—Refers to disbursements and collections that have been received by the accounting station, attempted to be matched to an obligation in the accounting system, but were not matched because an obligation was not identified in the accounting system. For example, if one or more of the accounting line elements for each transaction, such as appropriation, fiscal year, and program code, do not match the information in the accounting records, then the transaction is considered unmatched.

Negative Unliquidated Obligations (NULO)—Refers to disbursements that have been received and posted to specific obligations by the accounting station, but recorded disbursements exceed recorded obligations (i.e., more funds have been paid out than were obligated).

For illustrative purposes, one can draw analogies between these three types of problem disbursements and three situations which could arise with personal financial transactions. For example, in-transits can be likened, in a general sense, to a situation in which a couple shares one checkbook and one check register. If the wife has the checkbook and is out of town on a business trip and the husband is at home with the check register, the husband will not be able to record any checks in the register until he receives documentation from his wife as to the amount and nature of her expenditures. The time lag in recording the transactions could be several days, depending on whether the wife phones, faxes, or mails the needed information to her husband. Because the wife does not have the check register and is unaware of transactions that have been created by her husband, the couple may be faced with an overdrawn account when all expenditures are known. This problem is compounded for DOD because it allows a time lag (in-transit period), of up to 120 days as explained previously.

Unmatched disbursements can be compared to a situation in which a person receives the bank statement for a checking account, which lists all the checks that have cleared that month, including the date of the check, the amount, and the recipient. However, in attempting to reconcile the bank statement with the check register, the person finds several discrepancies. These discrepancies could be due to errors in entering checks in the register, including failure to enter transactions at all, or bank errors. The process of identifying and correcting errors becomes even more complicated if we assume the person has two checking accounts and sometimes records expenditures in the wrong check register. DOD's

situation is far more complicated because about 80 stations³ post and match millions of disbursements with obligations.

Finally, negative unliquidated obligations can be likened to an overdrawn checking account register. The causes can include problems in accurately recording checks and deposits in the correct account register. Similarly, at DOD, expenditures might exceed recorded obligated amounts, as explained above.

In a December 6, 1996, memorandum, the DOD Comptroller directed DFAS to stop the reporting of in-transits with the unmatched disbursements and negative unliquidated obligations and to develop a new methodology for reporting in-transits. The Director, DFAS, implemented the Comptroller's change and segregated in-transit problem disbursements beginning with the report for November 30, 1996 that was issued in January 1997.

In a February 1997 letter,⁴ we expressed our concerns about excluding aged in-transits from problem disbursement reports, which serve as the basis for communicating progress in reducing problem disbursements to the President and the Congress. In response, DOD agreed to continue reporting in-transits with unmatched disbursements and negative unliquidated obligations in external communications but indicated that the three types of problems would not be aggregated into one problem disbursement report.

Scope and Methodology

To assess whether DFAS compiled and reported problem disbursement balances in accordance with established guidance, and whether quality controls for such reporting existed, we reviewed Comptroller and DFAS guidance for problem disbursement reporting dated June 30, 1995, and May 15, 1996, respectively. We also reviewed the quality controls in place to ensure accurate and consistent reporting and the problem disbursement data used for the compilation of the reports. We did not audit the validity of the underlying data. Instead, we reviewed the compilation of reported amounts at DFAS centers. The testing of detailed transactional disbursement data, which should be done as a part of the audit of DOD's consolidated financial statements, could reveal further inaccuracies in reported problem disbursement balances.

³DFAS is in the process of consolidating its accounting stations from over 300 stations to not more than 21 stations. As of March 1997, about 80 accounting stations were operational.

⁴DOD Problem Disbursements (GAO/AIMD-97-36R, February 20, 1997).

Specifically, we reviewed how DFAS summarized and reported DOD's problem disbursements as of May 31, 1996, and compared this reporting to established guidance. DFAS' May 15, 1996, guidance was in effect for about 2 months before the May 1996 problem disbursement report was issued in July 1996. In addition, this guidance, which was to help consolidate and clarify problem disbursement reporting requirements, was essentially an update of guidance previously issued in September 1995 and earlier.

We performed our work at three DFAS centers—Cleveland, Denver, and Indianapolis—that accounted for 95 percent of the reported problems; the headquarters office in Washington, D.C., that consolidated the data and finalized the monthly report; and selected accounting stations. We obtained the databases used to quantify problem disbursement amounts and compared the amounts in these databases to center reports and consolidated totals. Where database totals did not agree with the reported amounts, we discussed the nature and causes of differences with center and headquarters officials. In addition, we assessed the controls in place at these locations to ensure compliance with guidance and accurate reporting. We also compared DOD's May 31, 1996, report with prior and subsequent months' reports to determine if significant changes or fluctuations had occurred.

We performed our work from May 1996 through December 1996 in accordance with generally accepted government auditing standards. We requested written comments on a draft of this report from the Secretary of Defense or his designee. The Under Secretary of Defense (Comptroller) provided written comments. These comments are discussed in the "Agency Comments and Our Evaluation" section and throughout the report where appropriate. DOD's comments are reprinted in appendix II.

Accurate and Complete Problem Disbursement Data Not Ensured by Guidance and Oversight

DOD's problem disbursement reports did not show the full extent of problem disbursements and, accordingly, did not provide a meaningful indicator for monitoring DOD's reduction efforts. Our testing of the May 31, 1996, reported amounts showed that the balance was inaccurate and that basic data needed to manage efforts to reduce problem disbursements were not collected. In addition, DFAS did not establish adequate guidance and effective controls to ensure accurate and consistent reporting of needed data.

Problem Disbursement Balance Is Inaccurate

DFAS' May 31, 1996, report significantly understated DOD's problem disbursement balance. Our analysis of the reported amount showed that,

in some instances, DFAS centers (1) excluded amounts from reported balances, (2) misclassified amounts within reporting categories, and (3) incorrectly aged transactions. We estimated that the DFAS reported total of \$18 billion was understated by at least \$25 billion based on using available data, existing guidance, and our adjustments for areas that the guidance did not address but we felt were appropriate. Appendix I summarizes these reporting problems, which are also discussed in more detail in the following paragraphs.

Excluded Amounts

As we and the DOD Inspector General (IG) previously reported in 1994,⁵ activities can significantly understate problem disbursement balances when problem disbursement amounts are excluded from reporting. We found that DFAS continues to exclude large problem disbursement amounts when it (1) offsets positive and negative amounts that result from disbursements, collections, reimbursements, or adjustments or (2) omits amounts from problem disbursement totals. In responding to our previous report, DOD and DFAS agreed that problem transactions that involve disbursements, collections, reimbursements, or adjustments should not be offset. In written comments on a draft of this report, DOD stated that the Department officially reports in-transit disbursements on a net basis—that is, by offsetting collections, reimbursements, or adjustments against disbursement balances. This statement is inconsistent with the written policies of DOD and DFAS, which require absolute amounts, and with the numerous discussions we had with DOD and DFAS officials throughout the course of our work. Absolute or total reporting of problem disbursement balances is necessary to present the full magnitude or impact of the problems and ensure that all problem disbursements are reported.

In the May 31, 1996, balance, about \$12.9 billion of the quantifiable understatements represented instances where DFAS centers continued to offset positive and negative amounts. Specifically, DFAS Cleveland offset amounts for all in-transit categories while DFAS Indianapolis and Denver offset amounts for certain in-transit categories. For example, DFAS Cleveland reported a problem disbursement amount of \$409 million for transactions in a suspense account where the correct appropriation to be charged or credited had not been identified. This balance represented disbursements, generally positive amounts, of \$1.04 billion and collection and reimbursements, generally negative amounts, of \$631 million. Because the two amounts represent different types of transactions, they should not

⁵Financial Management: Status of Defense Efforts to Correct Disbursement Problems (GAO/AIMD-95-7, October 5, 1994) and Uncleared Transactions By and For Others (DOD OIG 94-048, March 2, 1994).

have been used to offset one another. If DFAS guidance had been properly followed, a problem disbursement amount of \$1.7 billion, an over threefold increase, would have been reported. Thus, offsetting these two amounts resulted in an understatement of \$1.3 billion.

In another instance, two of the three centers we reviewed inappropriately offset problem disbursement transactions with collections and reimbursement transactions. At one center, transactions were offset if they pertained to the same accounting station. At the other center, transactions were offset if they related to the same fiscal station and activity total. Therefore, the reported balance was not based on individual transaction data. For example, DFAS Denver, for May 1996, offset disbursements, collections, and reimbursements by accounting station and then reported \$1 billion as problem disbursements for one of its in-transit categories. DFAS Denver would have reported \$1.2 billion had it obtained a total for each problem disbursement transaction, resulting in an understatement of about \$200 million.

As illustrated above, reporting problem disbursement amounts based on detailed transaction data is generally preferable. However, reporting the total of all transactions as problem disbursements is not appropriate in all cases. For example, if a problem disbursement was initially recorded at \$100 and \$55 had been entered as an adjusting amount, representing a negative number, and both transactions remain in the data file, the total problem disbursements based on transactional detail would be \$155, not the remaining problem disbursement balance of \$45. We examined DFAS Cleveland's files to identify relationships such as voucher number, accounting line, or reversal indicator to determine which transactions had a logical relationship and should offset one another. Those problem disbursements without these relationships should be reported in total in accordance with DFAS guidance. By using this process, we determined that a more accurate problem disbursement amount for one problem disbursement data file would be \$3.6 billion, about \$2.6 billion more than the \$1 billion reported by DFAS Cleveland.

In addition to offsetting unrelated transactions, DFAS centers omitted about \$9.5 billion from their May 31, 1996, problem disbursement reports. The identified understatement primarily resulted from DFAS Indianapolis omitting problem disbursement amounts for accounts not considered its responsibility and DFAS Cleveland omitting transactions that we believe represent problem disbursements although they were not specifically defined as problems by DFAS policy.

We noted two instances where DFAS Indianapolis omitted problem disbursement amounts. In the first instance, DFAS Indianapolis, although responsible for reporting Army problem disbursements, omitted \$3.8 billion of such disbursements relating to charges made by other military services against Army funds. Specifically, DFAS Indianapolis posted these charges in a suspense account because supporting documentation, which would have allowed it to recognize these charges as Army expenditures, remained outstanding for over a year. However, DFAS Indianapolis deleted the suspense amount from its problem disbursement total.

In the second instance, DFAS Indianapolis did not ensure that all problem disbursements relating to the Office of the Secretary of Defense (OSD) were reported. We noted several instances where OSD funds were not visible in any of DFAS' problem disbursement reports. According to DFAS Indianapolis officials, the Indianapolis center responsibilities for OSD funds included reconciling related disbursements to Treasury balances, reporting problem disbursements for Army-managed OSD funds, and consolidating OSD problem disbursements reported by Defense agencies. The completeness and accuracy of OSD problem disbursement reports were the responsibility of submitting stations. However, we found instances where problem disbursements were omitted from DFAS reports for a number of OSD accounts, such as OSD's budget clearing accounts.⁶ DFAS guidance identifies budget clearing accounts as a category of problem disbursement. DFAS Indianapolis did not include these accounts because each DFAS center was concerned with reporting only the portion of OSD funds for which it was responsible, and DFAS Indianapolis did not have a means to ensure that problem disbursements for all OSD funds were identified. Although we did not quantify the amount of problem disbursement understatements associated with OSD funds for the May 1996 report, DFAS Indianapolis identified about \$400 million in December 1996 that it previously omitted in its problem disbursement reports.

In commenting on a draft of this report, DOD mistakenly combined information from the two examples presented above. As stated above, the first example related to \$3.8 billion in an Army suspense account at DFAS Indianapolis. In September 1996, after we pointed out this problem, DFAS Indianapolis began to include the amounts in the Army suspense account in its monthly problem disbursement report. However, DFAS Indianapolis reported an adjusted net amount of about \$214 million rather than the

⁶Budget clearing accounts are Treasury accounts in which transactions are to be temporarily recorded until sufficient data are available to permit recording in the appropriate account.

total (absolute) amount of \$5 billion. Our second example related to OSD funds for which we were not able to quantify the understatement. DOD's representation of the \$3.8 billion of transactions in the Army suspense account as managerial information related to OSD funds (Department code 97) is inconsistent with our analysis and DFAS Indianapolis' subsequent characterization of these transactions as problem disbursements.

DFAS Cleveland also omitted problem disbursement amounts because certain transactions were considered recurring and routine, and reporting guidance specifically required the omission of these transactions from problem disbursement reports. Routine and recurring transactions, such as payroll disbursements made through automated teller machines (ATMs), are recorded in temporary holding suspense accounts by DFAS Cleveland and facilitate payroll disbursements aboard Navy ships. We agree that recurring and routine transactions held in suspense accounts should not be reported as problem disbursements. However, when transactions held in such accounts are neither routine nor temporary, the transactions should be included as problem disbursements. For example, after accounting for appropriate offsetting transactions, we noted that about \$4.5 billion of \$17 billion in these accounts were related to closed or invalid⁷ offices and decommissioned ships. In some cases, balances remained outstanding for several years after offices were closed and ships were decommissioned. Over 60 percent of the dollar amount and 65 percent of the number of transactions were at least 2 years old, with some balances originating as far back as January 1988. According to DOD disbursement regulations, such balances represent irregularities which must be promptly investigated. While the \$4.5 billion representing closed or invalid offices and decommissioned ships appear to be problems, a detailed analysis of transactions and supporting documentation would be required to determine whether other transactions in these accounts are problem disbursements.

In commenting on a draft of this report, DOD stated that the net outstanding balance for the ATM transactions in the suspense accounts is about \$10 million and only this amount would require corrective action. We disagree. These accounts relate to hundreds of disbursing offices and thousands of individual transactions. To simply offset all those ATM accounts with positive outstanding balances against all those with negative outstanding balances seriously understates the magnitude of this problem and the amount of research needed to resolve these irregularities, as required by DOD disbursement regulations.

⁷Offices that were not coded as being open or closed.

Misclassification of Problem Disbursements in the In-transit Category

As discussed previously, problem disbursements were reported in three categories—NULOS, unmatched disbursements, and in-transit disbursements. NULOS and unmatched disbursements are considered further along in the accounting cycle because an attempt has been made to match disbursements to corresponding obligations. Although in-transit disbursements have yet to be matched against corresponding obligations, they are viewed as an issue when an attempt to match has not been made for an extended time period. According to its May 1996 guidance, DFAS headquarters, when compiling data from the centers for problem disbursement reporting, excludes amounts for in-transit categories that are not more than 60 or 120 days old depending on the type of disbursement. As previously discussed, in-transit transactions are transactions that have either not been received by the accounting station or have been received but not processed or posted by the accounting station. DOD has determined that transactions within this “normal” in-transit time are not considered problem disbursements and therefore excludes these amounts from the problem disbursement reports.⁸

Although it could be argued that 60 or 120 days may be too long for a transaction to remain unrecorded in the accounting systems, we are not taking exception to this processing time in this report. However, we believe that certain transactions that are included in the in-transit category are known problems and should not be granted this “normal” processing time before being reported as problems. For example, DFAS Cleveland, in following DFAS headquarters guidance, excluded from its report \$2.2 billion for transactions that failed edit checks but were less than 60 days old. Edit checks are performed by DFAS centers prior to sending transactions to accounting stations for posting to accounting records and include checks to verify that cited appropriations are valid. Transactions that fail edit checks because of invalid appropriations, program limits, or other vital accounting data, are known problem disbursements. Like unmatched problem disbursements, they should be reported as problems regardless of age. While DFAS’ May 1996 guidance allows edit failures to be reported as in-transits, such reporting does not appear to be in agreement with the DOD Comptroller guidance. The DOD Comptroller guidance defines disbursements in suspense accounts, which contain these edit failures, separately from in-transit disbursements. Accordingly, the \$2.2 billion for suspense transactions less than 60 days old, including edit failures, should have been reported as problem disbursements.

⁸DOD officials stated that DOD has reluctantly accepted, for the present time, these time frames as the “normal” processing times due to the limitations of existing systems. They add that DFAS has been tasked to reengineer the disbursement and collection reporting processes.

In commenting on a draft of this report, DOD stated the Department does not intend to impose a special new requirement to identify and report all transactions that failed edit checks. However, DOD already has readily available information on these transactions. For example, DOD's May 1996 report included a footnote that stated that \$14 billion (which included the \$2.2 billion of edit failures) was not included in problem disbursement totals because of the 60- or 120-day exclusion criteria. As stated above, those transactions identified as edit failures should not be categorized as in-transits and therefore should be reported immediately rather than waiting until the 60- or 120-day "normal" processing period has elapsed.

Another instance of underreporting occurred because DFAS Indianapolis reported unmatched disbursements as in-transits. Because DFAS headquarters excludes certain in-transit balances less than 60 days old from problem disbursement amounts, but reports all unmatched transactions regardless of age, problem disbursements are understated when unmatched balances are misreported as in-transits. DFAS Indianapolis officials said that their accounting system did not distinguish between unmatched and in-transit problem disbursements when the accounting and disbursing stations are different. Accordingly, data were not readily available to determine what portion of the \$3.5 billion reported as in-transit disbursements less than 60 days old should have been reported as unmatched disbursements and as problem disbursements. Reporting of problem disbursements by correct category is not only necessary for compiling accurate problem disbursement reports but for also ensuring that management actions needed to address the problems are appropriately focused. Management actions to resolve these problems would normally be different for unmatched disbursements and for in-transit disbursements.

Incorrect Aging

As discussed earlier, the number of days that an in-transit transaction is in process can determine whether it is considered "normal" or is counted as a problem disbursement. For example, disbursements for which the disbursing station and the accounting station are different but both stations report to the same DFAS center are not considered problem disbursements unless the processing time exceeds 60 days. DOD considers up to 60 days as the normal time to process such transactions. Accordingly, aging of transactions (number of days since transaction originated) becomes critical in determining which in-transit items are classified as problem disbursements. DFAS guidance on problem disbursements does not clearly define what date should be used to age a

disbursement. However, the Comptroller's June 1995 guidance, with which we agree, clearly defines the date the disbursement was paid as the beginning date.

We found that certain DFAS centers inappropriately aged disbursements. DFAS Cleveland, for the most part, used the date paid for aging disbursements. However, Denver and Indianapolis used later dates—generally the date the transaction was sent to the accounting station or received by the DFAS center. As a result, when DFAS headquarters exclude from reporting in-transit amounts less than 60 or 120 days that are underaged by these centers, the problem disbursement balance is understated. Because these centers often did not collect data necessary to properly age disbursements, we were only able to determine and quantify the resulting understatements of problem disbursement amounts where data were available. As of May 31, 1996, we identified three instances of understatements related to improper aging that we could quantify. These three instances totaled about \$662 million and are discussed below.

We identified one DFAS Indianapolis problem disbursement database that required both disbursement and processed dates. However, about 14 percent of the 108,000 transactions in the database either did not contain the date paid or contained obviously invalid data. For the transactions where we could identify date paid in this file, problem disbursements were understated by at least \$258 million as of May 31, 1996, because transactions were incorrectly considered less than 60 days old and not reported as problem disbursements. In some cases, the transactions were incorrectly aged by at least 90 days. We did not perform similar analyses for DFAS Denver because problem disbursement data files did not include date paid information.

In addition, DFAS Indianapolis added an extra 30 days beyond the 60 days before certain in-transit transactions were reported as problems. DFAS Indianapolis misreported these in-transit transactions by showing that they were from 0 to 60 days old when they were actually up to 90 days old. According to Indianapolis officials, they added in this extra time to compensate for slow mail handling of voucher information. In this instance, if DFAS Indianapolis had reported all in-transits older than 60 days, DOD's May 31, 1996, balance would have been \$250 million more.

Likewise, in June 1, 1995, guidance to its fiscal stations, DFAS Indianapolis stated that NULOS discovered on October 1, 1994, or after were to be reported in the month after the month of discovery. Officials said that

fiscal stations were to use this period to resolve NULOS. Determining the precise amount of understatement because of this misreporting would be time-consuming because NULO balances existed at a multitude of fiscal stations and May 1996 data were no longer available. However, we reviewed DFAS Indianapolis' subsequent month NULO report and determined that, at a minimum, \$154 million of NULOS were excluded by fiscal stations following Indianapolis' instructions.

Basic Data About Sources and Causes Not Collected

In March 1996, DOD reported in its fiscal year 1996 report to the President and the Congress that one of its financial reform projects was to eliminate problem disbursements and that one critical component of its financial management reform efforts was to reengineer its business processes. DOD has numerous initiatives under way to make both short-term incremental improvements as well as to develop long-term initiatives described by DOD as reengineering entire processes. However, in reengineering business processes to eliminate problem disbursements, DOD needs additional basic data about the sources and causes of problem disbursements to determine the most efficient corrective actions. In addition, baseline data on the sources and causes of problem disbursements are necessary to establish performance measures to determine whether the reengineered processes are achieving desired results.

In assessing the business case for reengineering, performance measurements and benchmarking are key to making this determination because they help an agency understand the nature and size of the gap between current and desired performance levels. In addition, performance measures are to be used to (1) determine whether the new process is achieving the desired results and (2) provide feedback on problem areas that need further improvement. Performance measures can also be valuable in determining the cost/benefit of incremental short-term initiatives.

We noted during our review that DOD did not collect the basic data necessary to develop and select improvement initiatives nor to measure the success of its initiatives. For example, in its report, titled Eliminating Unmatched Disbursements, A Combined Approach, dated June 1995, DOD stated that the precise reasons causing contractor payments to become unmatched were difficult to pinpoint because quantitative data were unavailable. As a result, the determination of root causes was based on observations and experience. Accordingly, the amount of problem disbursements that related initiatives were to resolve was undeterminable.

In addition, although DOD is working toward matching every disbursement to an obligation prior to payment—referred to as prevalidation—as a key initiative to prevent future problem disbursements, it is unable to adequately measure whether the initiative is achieving desired results. For example, one of the indicators used to measure progress in reducing problem disbursements is the number of new problem disbursements. However, DFAS collects this performance measure inconsistently. Specifically,

- DFAS Cleveland reports the actual number of problem disbursement transactions;
- DFAS Denver estimates its volume of transactions based on the average number of transactions typically sent to accounting stations for a month; and
- DFAS Indianapolis understates its volume of transactions by summarizing and reporting as one transaction multiple individual transactions with the same appropriation and accounting station.

As a result of these inconsistent reporting methods, DOD cannot quantify new problem disbursements.

Compiling basic information necessary to perform a comprehensive analysis on the causes of problem disbursements requires detailed transactional data that underlie summary reporting. The actual number of problem disbursements, the total dollar amounts, type of disbursements, date paid, funding stations, and disbursing offices are examples of such data. While some of these data are available at some locations, they are not consistently collected, compiled, and used in analyzing disbursement problems and determining progress resulting from management initiatives. For example, DFAS Indianapolis was not able to determine the full scope of problem disbursements because only summary data were available for reporting problem disbursements. DFAS Indianapolis did not have readily available detailed transactional data. Until detailed transactional information is collected, consolidated, and analyzed, DFAS Indianapolis will not be able to adequately identify the nature and scope of problem disbursements and develop adequate performance measures for related initiatives. Collecting consistent data that identify and quantify the nature of these problems would allow DOD to better support management initiatives to reduce such problems.

In a December 6, 1996, memorandum, the DOD Comptroller requested that a new methodology be developed for reporting on in-transit disbursements and that they be tracked by type of transaction and by origination. As discussed above, we agree that more detailed data are needed to determine the scope and sources of the problems and whether initiatives aimed at fixing the problems are effective.

Efforts Not Adequate to Ensure Accurate and Consistent Reporting of Needed Data

DFAS' efforts have not been adequate to ensure the accurate and consistent reporting of problem disbursements. Specifically, although DFAS prepared its first consolidated guidance in May 1996, our identified understatements resulted from the guidance (1) not being followed, (2) not offering detailed instructions for offsetting transactions, and (3) not appropriately identifying some transactions as problems. In addition, DFAS did not establish adequate oversight and controls over the reporting process.

As previously stated in this report, the DFAS centers we reviewed significantly understated problem disbursement balances. Although guidance was established by DFAS headquarters for reporting problem disbursements, DFAS headquarters did not establish enforcement mechanisms to ensure that its centers followed it. For example, the duties of two staff at DFAS headquarters assigned to problem disbursements primarily consisted of consolidating center balances into final reports. They did not view their responsibilities as ensuring that data submitted by center personnel were accurate or that DFAS and DOD guidance were followed. Moreover, one of the two staff positions is rotated annually, resulting in a loss of institutional knowledge and a "learning curve" situation every time a new person is assigned.

We also found that the DFAS guidance was not consistent with the DOD Comptroller guidance in reporting certain problem disbursements. DFAS guidance treated edit failures the same as in-transits—they were not reported as problems until the processing time exceeded 60 or 120 days. The DOD Comptroller guidance recognized edit failures as problems from the date they occurred. Further, we found instances where unrelated transactions were offset against one another and where dates used to age problem disbursements were later than the disbursement date. These instances occurred because DFAS guidance did not expand on certain requirements for reporting problem disbursements. For example, DFAS guidance required problem disbursement reports to be presented in total, without offsetting, by aging category but provided no other guidance. When adjustments or other offsetting transactions are included in problem disbursement data files, DFAS guidance did not specify how to treat them in

compiling problem disbursement reports. Likewise, DFAS guidance did not specify how to age problem disbursements when processing does not capture disbursement dates.

Lastly, we found that control procedures for ensuring accurate problem disbursement reporting were often not documented at DFAS centers and at headquarters. Although ad hoc procedures existed in some cases, the errors we identified indicate that this approach was not effective in ensuring that DOD's problem disbursement reports were as accurate as possible. For example, DFAS Cleveland maintained a checklist for ensuring the completeness of problem disbursement data files. However, it relied solely on the submitting accounting stations to provide reliable problem disbursement data. Although we did not test the validity of data file transactions, DFAS Cleveland noted two instances where data files did not agree with hard copy totals, and it used the hard copy totals without researching the reasons for the differences and reconciling the data. Because of the general lack of controls over reporting, DFAS cannot ensure the credibility of DOD's problem disbursement reports.

Conclusions

The reporting issues we identified raise doubt about whether DOD has the appropriate tools necessary to design and evaluate efforts to reduce problem disbursements. Because DOD has not successfully identified the scope of its problem disbursements, related reports do not provide a basis to measure reduction efforts. In addition, because the basic data underlying DOD's reports are often not sufficient to identify specific causes of problems, DOD does not have management information necessary to effectively manage the reduction of these problems. In order to effectively manage the reduction of its problem disbursements, DOD needs to be able to identify the root causes of its problems, prioritize them, perform corrective actions, and measure its success in resolving problem disbursements. Furthermore, until DOD reduces its problem disbursements to acceptable levels, DOD will not be able to accurately report on its operating costs and budget execution in required financial statements.

Recommendations

We recommend that the Secretary of Defense ensure that the Under Secretary of Defense (Comptroller) take the following steps to provide for accurate and consistent reporting of DOD's problem disbursements.

- (1) Revise DFAS reporting guidance to include:

-
- reporting problem disbursements from detailed transactional data at the DFAS center level, which would allow DOD to maintain a source of management data necessary to identify, quantify, and resolve its problems and would provide for more meaningful calculations of amounts;
 - detailed instructions addressing the offsetting of positive and negative transactions and the logical relationships, such as voucher number, accounting line, or reversal indicator, of these transactions;
 - reporting all transactions that are rejected by edit routines as problems regardless of age, consistent with current DOD Comptroller guidance; and
 - reporting additional problems such as recurring and routine suspense transactions citing closed or invalid disbursing offices and decommissioned ships.

(2) Establish adequate quality controls over the collection, compilation, and reporting of problem disbursements at DFAS to enhance the credibility of problem disbursement reports. Such measures, if properly developed and executed, should not be costly to implement and would establish reporting credibility. At a minimum, these controls should:

- include documentation of the process, procedures, and sources of data used for preparing problem disbursement reports at all reporting centers and headquarters; and
- establish an accountability process to include reviewing and approving the compilation of the reported amounts at all reporting levels, enforcing existing guidance for classifying and aging transactions, and reporting total problem disbursement amounts.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD did not concur with our findings, conclusions, and recommendations and stated that the report was totally misleading and, in part, incorrect. DOD based its position on two major assertions: (1) DOD no longer considers in-transits to be problem disbursements and the understatements we identified almost exclusively relate to in-transit transactions and (2) the underreporting we identified is really a definitional issue related to the use of absolute or net numbers for reporting purposes.

We disagree with DOD's position. First, DOD's comments ignore the fact that as of May 1996 (the date of the DOD problem disbursement report that we reviewed), DOD's policies and procedures clearly defined aged in-transits as problem disbursements, and they were included in DOD's problem disbursement reports. Our report defines the three types of problem

disbursements that were included in DOD's May 1996 comprehensive reporting guidance: in-transits, unmatched disbursements, and negative unliquidated obligations. DOD began including in-transits in its problem disbursement reports in response to our recommendation in an October 1994 report.⁹ DOD's official response to that report, a letter dated April 17, 1995, from the Deputy Chief Financial Officer, clearly states: "The Department agrees that in-transit transactions over 60 days old are disbursing problems."

As stated in the "Background" section of our report, it was not until December 1996, after we had completed our field work and briefed DOD officials on our findings, that the Under Secretary of Defense directed that in-transits be excluded from DOD's monthly reporting. We issued an interim report in February 1997¹⁰ to discuss our position that eliminating these transactions from the reports would adversely affect the reports' accuracy, completeness, and usefulness as an oversight tool. In that report, we stated that any transaction that has not been matched with an obligation within DOD's "normal" processing time of 60 or 120 days is clearly a problem disbursement that should be reported, researched, and resolved. Moreover, DOD's aging information on the \$7.7 billion of aged in-transits included in its problem disbursement total as of May 31, 1996, showed that over \$1.4 billion had been in the "in-transit" category for over 2 years. Clearly, such aged in-transits are problem transactions that should be identified and monitored just as unmatched disbursements and NULOS are. In his February 1997 comments on our interim report, the Under Secretary of Defense (Comptroller) stated that DOD would continue to report in-transits along with problem disbursements in external communications.

In our evaluation of DOD's comments on our interim report, we agreed that as long as DOD's monthly reporting mechanism provides accurate and consistent information on all types of problem disbursements, we would consider DOD's actions responsive to our recommendation that in-transits continue to be reported. At that time, we believed that DOD's intent was to report in-transits separately from unmatched disbursements and NULOS, but that they would, nonetheless, be reported and tracked. However, we are concerned about DOD's assertion in its comments that the Department no longer views in-transits as problem disbursements. We continue to believe that any discussion of problem disbursements is incomplete

⁹Financial Management: Status of Defense Efforts to Correct Disbursement Problems (GAO/AIMD-95-7, October 5, 1994).

¹⁰DOD Problem Disbursements (GAO/AIMD-97-36R).

without a discussion of in-transits and that they should continue to be reported externally.

Regarding the second major issue—offsetting reimbursements, collections, or adjustments against disbursements (referred to as net) versus total (or absolute) reporting—DOD’s statement that it officially reports in-transits on a net basis is not consistent with the written policies of DOD and DFAS and with the numerous interviews and discussions we had with DOD and DFAS officials throughout the course of our work. As stated in the report, in response to DOD IG and GAO reports issued in 1994, DOD agreed that problem disbursement transactions should not be offset. Since that time, the Department’s official policy for reporting problem disbursements has been on a total or absolute basis, as stated in DFAS’ May 1996 guidance.

Reporting the total or absolute amount of problem disbursements helps ensure that accurate baseline data are available to focus attention on the resolution of problem disbursements and measure progress towards that goal. To illustrate, if DOD has an in-transit amount of \$10 related to a collection or reimbursement, DOD may not know the correct appropriation to which it should be credited nor whether it has the authority to spend it. Meanwhile, it may also have an in-transit disbursement amount of \$8 for which the correct appropriation to charge is not known. Thus, DOD has two problems that must be resolved—one for \$10 and one for \$8—for a total of \$18. To offset these amounts and indicate a total problem amount of \$2, as DOD advocates, would be inaccurate and misleading.

Our report explains that offsetting unrelated transactions is generally not appropriate. However, in cases where a proper relationship can be demonstrated, it may be appropriate. In arriving at the estimated \$25 billion understatement of problem disbursements, we offset transactions when we could identify a relationship between transactions. DOD’s apparent confusion over its own reporting policy is further support for our recommendation that its reporting guidance be revised to include detailed instructions addressing the offsetting of positive and negative transactions.

In addition to its two major points, DOD took issue with our report on a number of other factual and conceptual areas. We address these points in our detailed comments in appendix II. We continue to believe that DOD is significantly understating the magnitude of its disbursement problems. Without basic underlying problem disbursement data that are collected

consistently by a credible process, the Department cannot accurately measure the extent of its disbursement problems, much less progress made in reducing such balances. The \$25 billion understatement we were able to quantify demonstrates our point that DOD's reporting process over all its disbursing problems needs to be improved.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from the date of this letter. At that time, we will send copies to the Chairman of the Senate Committee on Governmental Affairs; the Chairmen and Ranking Minority Members of the Senate Committee on Armed Services, the House Committee on National Security, and the House Committee on Government Reform and Oversight; the Ranking Minority Member of the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform and Oversight; and the Director of the Office of Management and Budget. We will also send copies to the Secretary of Defense, the Under Secretary of Defense (Comptroller), and the Director of the Defense Finance and Accounting Service. Copies will be made available to others upon request.

Please contact me at (202) 512-9095 if you or your staffs have any questions on this report. Major contributors to this report are listed in appendix III.



Lisa G. Jacobson
Director, Defense Audits

Contents

Letter	1
Appendix I Total Quantifiable Understatements as of May 31, 1996	26
Appendix II Comments From the Department of Defense	29
Appendix III Major Contributors to This Report	36

Abbreviations

ATM	automated teller machine
CERPS	Centralized Expenditure and Reimbursement Processing System
CFO	Chief Financial Officer
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
FRS	Financial Reporting System
IG	inspector general
NULO	negative unliquidated obligations
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
SAMS	Suspense Aging Monitoring System
TBO	Transactions by Others

Total Quantifiable Understatements as of May 31, 1996

Dollars in millions

DFAS location	Category/ Sub-category	Reporting issue	DFAS amount reported	GAO minimum reportable amount	Understatement
Excluded amounts by offsetting of transactions					
Cleveland	In-transit/Interfund ^a	Offsetting positive and negative balances	\$1,846	\$4,315	\$2,469
Cleveland	In-transit/Cross disbursing ^b	Offsetting positive and negative balances	632	5,007	4,375
Cleveland	In-transit/CERPS ^d	Offsetting positive and negative balances	409	1,672	1,263
Cleveland	In-transit/SAMS ^d	Offsetting positive and negative balances without establishing relationships	968	3,572	2,604
Cleveland	In-transit/FRS ^d	Offsetting positive and negative balances	373	1,496	1,123
Denver	In-transit/Intra service ^c /Cross disbursing ^b	Offsetting positive and negative balances	1,024	1,225	201
Denver	In-transit/Suspense	Offsetting positive and negative balances	464	1,115	651
Indianapolis	In-transit/Unprocessed TBOs	Derived from summary data which "offsets" disbursement detail with collection detail when total amounts required	N/A	Unknown	Unknown
		Offsetting positive and negative balances	273	539	266
Subtotal			\$5,989	\$18,941	\$12,952
Excluded amounts by omission					
Indianapolis	In-transit/Unsupported cross disbursing ^b	Deletions relating to Army suspense accounts not reported	\$0	\$3,833	\$3,833
Indianapolis	In-transit/Unsupported cross disbursing ^b	OSD appropriations not fully visible in problem disbursement reports	0	0	Unknown
Cleveland	In-transit/SAMS hold ^d	Transactions held in suspense not reported as problems. Some transactions are old, cite closed and invalid offices	0	4,525	4,525
Denver	In-transit/Intra service ^c /Cross disbursing ^b	Normal processing time not applicable	0	1,155	1,155
Subtotal			\$0	\$9,513	\$9,513

(continued)

**Appendix I
Total Quantifiable Understatements as of
May 31, 1996**

Dollars in millions

DFAS location	Category/ Sub-category	Reporting issue	DFAS amount reported	GAO minimum reportable amount	Understatement
Misclassification of disbursements					
Cleveland	In-transit/CERPS ^d	First 60 days not reported for transactions rejected by edit routines	\$0	\$264	\$264
Cleveland	In-transit/SAMS ^d	First 60 days not reported for transactions rejected by edit routines	0	179	179
Cleveland	In-transit/FRS ^d	First 60 days not reported for transactions rejected by edit routines	0	1,746	1,746
Cleveland subtotal for misclassifications					\$2,189
Denver	In-transit/Suspense	First 60 days not reported by DFAS headquarters for transactions rejected by edit routines	\$0	\$103	\$103
		Out of balance conditions and disbursements not yet validated		Unknown	A portion of \$1.3 billion would be reportable
Indianapolis	In-transit/Unprocessed TBOs	Unmatched transactions included in this category when required to be reported separately by category	N/A	Unknown	A portion of \$3.5 billion would be reportable
Subtotal			\$0	\$2,292	\$2,292
Incorrect aging					
Indianapolis	In-transit/Unprocessed TBOs	Transaction aged based on date received rather than date paid	\$0	\$258	\$258
		30 days not reported	0	250	250
Indianapolis	NULO	First 30 days not counted when all NULOs should be reported	0	154	154

(continued)

**Appendix I
Total Quantifiable Understatements as of
May 31, 1996**

Dollars in millions

DFAS location	Category/ Sub-category	Reporting issue	DFAS amount reported	GAO minimum reportable amount	Understatement
Denver	All	Transactions aged based on date received by Denver rather than date paid as required by DOD guidance for obligating problem disbursement amounts	Unknown	Unknown	Unknown however a portion of \$5.3 billion would be reportable
Subtotal			\$0	\$662	\$662
Total (Minimum Understatement)			\$5,989	\$31,408	\$25,419

^aInterfund transactions are paid through a billing process used by DOD to purchase materials from within the Department or other government entities; generally reimbursement transactions.

^bCross disbursing transactions are those transactions where the disbursement is being made on the behalf of one service for another service or the State Department.

^cIntra service transactions are where the disbursing station and the accounting station differ but both are operating on the behalf of the same service.

^dThe CERPS, SAMS, and FRS suspense files includes data from specific systems used to process disbursements. CERPS-Central Expenditure and Reimbursement Processing System, SAMS - Suspense Aged Monitoring System, and FRS-Financial Reporting System. SAMS transactions are classified as being either in a "process" (in-transit) or "hold" status.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMPTROLLER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



APR 9 1997

Mr. Gene L. Dodaro
Assistant Comptroller General
Accounting and Information
Management Division
U. S. General Accounting Office
441 G Street, NW, Room 6101
Washington, DC 20548

Dear Mr. Dodaro:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "FINANCIAL MANAGEMENT: Improved Reporting Needed for DoD Problem Disbursements," dated March 13, 1997 (GAO Code 919050/OSD Case 1316). The Department appreciates the opportunity to comment on this report.

See comment 1.

The Department does not concur with the GAO report on problem disbursements. In fact, the Department finds the report totally misleading and, in part, incorrect. The main thesis of the report is that DoD's problem disbursements are understated by at least \$25 billion. The report goes on to indicate that the Department does not have sufficient data to ensure consistent reporting or to provide information about the sources and causes of the problem disbursements. The second observation is based on the premise that the Department is understating the problem disbursements by \$25 billion; thus the Department's critique of the GAO findings relate principally to this dollar issue.

See comment 2.

The GAO makes no distinction among the categories of unmatched disbursements, negative unliquidated obligations (which the Department categorizes as problem disbursements), and in-transit disbursements. The Department no longer characterizes in-transits as problem disbursements. We keep them in a separate category because they are fundamentally different in character from problem disbursements since detailed transaction data usually are not available when in-transits are reported.

See comment 3.

See comment 4.

Also, the GAO report almost entirely ignores the extensive progress that has been made in reducing the magnitude of the problem disbursements. For example, unmatched disbursements and negative unliquidated obligations have been reduced by almost 80 percent between June 1993 and March 1997--from \$35 billion to \$8 billion. And in-transit disbursements have been reduced by 35 percent--from \$17 billion to \$11 billion. The GAO opts to give the impression that the efforts of the Defense Finance and Accounting Service managers are insufficient to identify and correct the causes of in-transit disbursements. The significant reductions made by the Department are factual documentation that our management approach works.

See comment 5.

Appendix II
Comments From the Department of Defense

See comment 6.

See comment 7.

See comment 8.

Instead, the report speaks to an alleged \$25 billion understatement of problem disbursements which are, in fact, almost exclusively in-transit disbursements. But, more importantly, the GAO report does not point out that the alleged underreporting is really a definitional issue and not one of substance or of a failure to disclose. Specifically, the Department officially reports in-transit disbursements on a net basis--the GAO thinks the data should be reported officially on an absolute basis and, thus, the significant difference revolves around this issue and not on the issue of a failure to report.

The reader would not discern this fine, but rather important point, about absolute versus net reporting, by simply reading the report. Instead, this point is obscured in the GAO report and the reader would conclude that the Department is misstating the magnitude of the problem, which is not true. Also, it should be noted that the Department does report in-transit transactions on both a net and an absolute basis, when appropriate, on internal monthly reports. However, for the reasons stated throughout this response, the Department only reports net numbers in published reports.

The distinction between absolute numbers and net numbers is at best arcane, but for purposes of a summary explanation, the following additional points are made as to why in-transits are best reported on a net basis and not on an absolute basis:

See comment 9.

First, one needs to understand the distinction between absolute and net. An absolute number is the sum of all transactions in the accounting records ignoring whether it represents an adjustment, a cash outflow, or a cash inflow (for example, the absolute value for revenue of \$10 and payments of \$8 would be \$18). A net number is the sum of all transactions recognizing positive or negative cash flows (for example, the net for revenue of \$10 and payments of \$8 would be \$2). Using absolute numbers is far less accurate. It is akin to having corporate stockholder statements reporting the absolute sum of all checking account deposits and withdrawals; it would present a very large value with zero utility to the investor and, in fact, would totally mislead the investor. Financial statements, either in the private or public sector, must be presented in net amounts, and the Department needs to be congruent with commonly understood requirements.

See comment 10.

See comment 11.

Second, only the net amount is required in the official accounting reports for appropriated funds, as well as in Chief Financial Officer (CFO) statements to the Office of Management and Budget (OMB), Department of Treasury, and the DoD Components. Furthermore, any appropriation account reconciliation between OMB/Treasury records and DoD records is done on a net basis, not absolute.

See comment 12.

See comment 9.

Third, the purpose of reporting in-transit transactions is fundamentally different than reporting unmatched and negative unliquidated obligations. Specifically, providing visibility of in-transit disbursements reminds the finance community of the existence of these amounts, and that, if such transactions are not posted correctly to the accounting records, they might turn into a problem disbursement. Equally important is the fact that, although dollar amounts and dates are difficult to obtain, the Department maintains transaction work flow data to identify ways to minimize the time between payment and posting to the accounting records. In this regard, the reporting of in-transits on a net basis is much more representative of the magnitude of the

Appendix II
Comments From the Department of Defense

potential problem than reporting on an absolute basis. If, for example, an agency ultimately must obligate dollars to cover an in-transit disbursement, it would be an amount that equates to the net number and not the absolute.

See comment 13.

As recognized by the GAO in the report, the use of absolute amounts can exaggerate the dollar amount of in-transits. The GAO attempted to deal with this issue in calculating its absolute amounts of in-transits by excluding transactions with an identified relationship such as voucher number, accounting line, or reversal indicator. However, the GAO's attempt to correct its calculations failed to address the extent to which an overstatement can occur from using absolute amounts. The difficulty encountered by the GAO in determining the full extent of the overstatement in calculating an absolute amount for in-transits is exactly the reason that the Department has concluded that an absolute amount for in-transits is not a meaningful measure for in-transit disbursements. For example, the GAO's absolute calculation would overstate the in-transits by \$800 million for the Indianapolis Center for February 1997. The overstatement would occur because the transmittal control total for the disbursement record (\$400 million) reported by the disbursing station did not match the amount posted to the accounting records, cleared by the accounting station, and reported to the Indianapolis Center (\$399.953 million). This is illustrated as follows:

	<u>Absolute</u>	<u>Net</u>
Disbursement Control Total	\$400,000,000	\$400,000,000
Clearance Control Total	<u>399,953,000</u>	<u>399,953,000</u>
Total	\$799,953,000	\$ 47,000

See comment 14.

This real example is not an isolated instance but is a systemic problem that could occur repeatedly, following the GAO approach, and permeate any calculation of in-transits on an absolute basis. Therefore, the Department has concluded that making such calculations on an absolute basis would result in gross distortions of the amounts on a month-to-month basis and would not be a consistent or meaningful measure of our in-transits.

See p. 11.

Another example is the \$4.5 billion amount in Appendix I termed "SAMS hold" and cited by the GAO as "Excluded amounts by omission" by the Cleveland Center. Of this amount, \$3.5 billion represents detailed history transactions for shipboard automated teller machines (ATM). The net outstanding balance (inflows minus outflows) for this ATM account is about \$10 million. Thus, the ATM account consists primarily of historical records for which corrective action is not required.

See p. 10.

Also, the alleged \$25 billion understatement cited by the GAO is in error because of a failure to understand fully the data contained in the Department's files. A major portion of the \$3.8 billion amount in Appendix I identified by the GAO as "Excluded amounts by omission" by the Indianapolis Center represents only management information required by that Center for oversight of department code 97 funds and not a valid Army suspense account balance as

Appendix II
Comments From the Department of Defense

See comment 15.

reported by the GAO. Also, the \$1.4 billion amount identified as “Misclassification of disbursements” by the Denver Center represents merely an amount due from other Centers rather than transactions “rejected by edit routines.”

See p. 13.

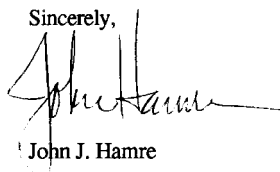
Furthermore, the Department disagrees that any of the \$3.6 billion amount identified in Appendix I by the GAO as “First 60 days not reported for transactions rejected by edit routines” should be added to the in-transit report. The Department’s reporting requirements specifically exclude in-transits during the first 60 days as normal processing time for these transactions. The Department does not intend to impose a special new reporting requirement to identify and report all transactions that may have failed any edit routine at any point in the process from the time of disbursement until recorded in the accounting system. Transactions are edited repeatedly at many points in the current process. Most such transactions that fail these edits are corrected routinely.

See comment 16.

The GAO report also indicates that in-transit and problem disbursements lead to undetected fraud. This type of allegation has been repeated now in several recent GAO reports without citing any factual instances. The Department has internal controls in place to reduce the risks associated with fraudulent payments. The DoD controls require the disbursing officer to ensure that each disbursement is proper and valid by ensuring a proper and valid invoice, contract, and receiving report. As demonstrated over the course of extensive GAO audits in this area, the risk is minimal at best. In addition, the Department has implemented a new and innovative fraud detection program (Project Mongoose) to perform post-analyses of a large number of transactions, including extensive computer matching of a number of our data bases.

For the reasons addressed above, the Department does not agree with the recommendations contained in the above referenced GAO report.

Sincerely,



John J. Hamre

The following are GAO's comments on the Department of Defense's letter dated April 9, 1997.

GAO Comments

1. We address DOD's characterization of our report in the "Agency Comments and Our Evaluation" section.
2. Our report clearly distinguishes between the categories of unmatched disbursements, negative unliquidated obligations, and in-transit disbursements. The "Background" section defines each and includes analogies that relate these types of problems to personal financial situations.
3. As discussed in the "Agency Comments and Our Evaluation" section, we disagree with DOD's decision to no longer characterize in-transits as problem disbursements. This matter is discussed in detail in our interim report, DOD Problem Disbursements (GAO/AIMD-97-36R, February 20, 1997).
4. Our report does not ignore the reduced amount of problem disbursements reported by DOD. Page 1 states that DOD reported a \$33 billion reduction in problem disbursements. However, the concerns discussed in this report about the basis for those amounts preclude us from relying on gross dollar changes in DOD's reported problem disbursements as a true indicator of progress in resolving disbursement issues.
5. Our report demonstrates that DFAS' efforts have not been sufficient to quantify and correct the causes of in-transit disbursements. Furthermore, in a December 6, 1996, memorandum to the DFAS Director, the DOD Comptroller stated that DOD had "failed to come to grips with the underlying causes and potential solutions to the in-transit problem."
6. In addition to the \$25 billion of understatements we identified that relate primarily to in-transits, we reported other issues that resulted in unquantifiable amounts of understatements pertaining to unmatched disbursements and NULOS. Moreover, the control weaknesses we identified relate to the compilation and reporting of all problem disbursement data.
7. We have modified the report to include DOD's comment that its official policy is to report problem disbursement data on a net basis. This matter is discussed in detail in the "Agency Comments and Our Evaluation" section.

8. Our report fully discusses the reporting of net (offset) amounts versus absolute (full or total) amounts and presents our position that when offset amounts are reported, problem disbursement totals, and hence the significance of the issues, are minimized. The report also recognizes the need for DOD to establish logical transactional relationships before absolute amounts are calculated.

9. DOD's example of using net amounts for revenue and payments is not analogous to offsetting in-transits that involve collections or reimbursements and disbursements because these transactions are not necessarily related. See the "Agency Comments and Our Evaluation" section for our overall discussion on the net versus absolute issue and an example that illustrates our position that the use of absolute amounts is generally the accurate and appropriate method for reporting problem disbursement data.

10. DOD's characterization of financial statement presentation is misleading. DOD's scenario would be analogous to a Statement of Operations presenting one bottom-line number for net income or net loss. In fact, financial statements show the details, such as specific kinds of revenues and expenses, that allow users to see how the bottom-line number was determined. These critical details allow users to assess the condition of an entity and determine whether any changes are needed to improve performance in specific areas.

11. Financial statements prepared pursuant to the CFO Act and submitted to the Office of Management and Budget are to be prepared in accordance with standard accounting and reporting conventions, such as accumulating and reporting the total of like transactions. DOD's netting of potentially unrelated transactions, such as collections and various types of disbursements, could result in information that is misleading or of marginal utility in managing operations.

12. We agree that in-transits, unmatched disbursements, and negative unliquidated obligations are different types of problems and that different management actions are needed to address each type of problem. Our point is that only by identifying, reporting, and tracking all disbursing problems can management determine appropriate corrective actions and ultimately resolve these problems.

13. Our report recognizes the complexity of determining an accurate measure of problem disbursements. Although absolute amounts will

generally provide the most accurate calculation, as explained in the “Agency Comments and Our Evaluation” section, we used net amounts where we could establish transactional relationships. Any difficulty we encountered in determining the full extent of DOD’s problem disbursements was the result of the lack of clear and consistent DOD reporting guidance that was adhered to by all locations.

14. The second paragraph of page 2 of DOD’s comments states that the Department does report in-transit transactions on both a net and an absolute basis, when appropriate, on internal monthly reports. This supports our position that in-transits reported in absolute terms on a month-to-month basis would result in a consistent and meaningful measure of these transactions.

15. After DFAS Denver provided us with additional information in April 1997, we determined that the \$1.4 billion included (1) edit failures which could be quantified and (2) out-of-balance conditions and disbursements awaiting supporting documentation/verification, both still problems that could not be readily separated and quantified. In addition, because disbursements awaiting documentation were redated and reclassified as another in-transit category, the 60- or 120-day processing time for these type of transactions does not apply. According to a DFAS Denver official, these disbursements could be posted to accounting records and matched to an obligation in no more than 30 days. Accordingly, we modified the report to recognize these changes in category, but they do not affect the \$25 billion in quantifiable understatements we reported.

16. Our audits, and those of the Inspector General and audit services, have identified material internal control weaknesses in areas such as general electronic data processing, basic reconciliations, and supervisory reviews. DOD’s inability to match over \$40 billion (the DFAS-reported amount and our quantified understatements) of disbursements with recorded obligations, including disbursements that cite closed bases and decommissioned ships, is also indicative of major control weaknesses. All of these weaknesses would contribute to making DOD’s payment processes vulnerable to fraudulent payments and diminish the Department’s ability to detect fraudulent and other improper payments that occur. Operation Mongoose, referred to in DOD’s response, was initiated as a post-payment audit process to counter the effects of the lack of internal controls. Also, it is focused on certain vendor and payroll payments and does not address contractor payments, which are generally the subject of this report.

Major Contributors to This Report

**Accounting and
Information
Management Division,
Washington, D.C.**

David Childress, Assistant Director
Miguel Castillo, Project Manager
Francine DelVecchio, Communications Analyst
James Loschiavo, Social Science Analyst
James Ungvarsky, Computer Specialist

**Kansas City Field
Office**

Cecelia Ball, Senior Evaluator
Edwin Boothe, Senior Evaluator
Shirley Klaudt, Staff Evaluator
Marshall Picow, Senior Evaluator

Atlanta Field Office

Pat Sevon, Computer Specialist

**Office of the General
Counsel**

Thomas Armstrong, Assistant General Counsel
Amy Shimamura, Senior Attorney

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested

