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**DOD FINANCIAL
MANAGEMENT**

**Weaknesses in Controls
over the Use of Public
Funds and Related
Improper Payments**

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U.S. Government Accountability Office

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ACCOUNTABILITY ★ INTEGRITY ★ RELIABILITY



Highlights of [GAO-11-950T](#), testimony before the Panel on Defense Financial Management and Auditability Reform, Committee on Armed Services, House of Representatives

Why GAO Did This Study

The Department of Defense (DOD) is required to design and implement effective internal controls, including controls over its use of public funds (“funds controls”) and controls over its payment processes (“payment controls”). As a steward of the public’s resources, DOD is responsible and accountable for (1) using public funds efficiently and effectively and for the purposes and within the time frames and amounts prescribed by law, (2) making payments to the right parties in the correct amount within allowable time frames and recouping any improper payments, and (3) accurately recording and reporting on its transactions and use of public funds.

GAO’s testimony focuses on (1) challenges DOD faces in its funds control, and their effect on the reliability of DOD’s financial information, especially the budgetary information in DOD’s Statement of Budgetary Resources and (2) weaknesses in DOD’s payment controls that put the department at risk of making improper payments.

This statement is based on our prior work (see Related GAO Products) and reports issued by the department’s Inspector General (DOD IG). The panel requested that GAO provide its perspective on the status of DOD’s process for identifying and reporting on improper payments, examples of Antideficiency Act violations within DOD along with the causes of these violations, and the effect of problem disbursements on DOD’s ability to report reliable information on its financial statements.

View [GAO-11-950T](#). For more information, contact Asif Khan at (202) 512-9869 or khana@gao.gov.

September 22, 2011

DOD FINANCIAL MANAGEMENT

Weaknesses in Controls over the Use of Public Funds and Related Improper Payments

What GAO Found

For years, GAO and DOD IG have reported on DOD’s inability to provide effective funds control and report reliable financial information, including budgetary information. In 2008, GAO reported that DOD’s complex and inefficient payment processes, nonintegrated business systems, and weak internal controls impair its ability to maintain proper funds control, putting DOD at risk of overobligating or overspending its appropriations. Specifically, DOD’s weak internal control environment has hindered its ability to ensure that transactions are accurately recorded, sufficiently supported, and properly executed by trained personnel subject to effective supervision. Funds control weaknesses place DOD at risk of violating the Antideficiency Act (ADA), specifically through overobligations and overexpenditures. DOD reported ADA violations from fiscal year 2007 through September 15, 2011, with a total dollar amount of \$927.4 million.

DOD has identified payment transactions and related accounting steps as “problem disbursements.” Problem disbursements include unmatched disbursements (UMD) that represent disbursements that have been paid by an accounting office but that have not been matched to the correct obligation records. DOD reports that it has reduced overaged UMDs from \$666.5 million to \$109.6 million between second quarter of fiscal year 2009 to the same time in fiscal year 2011. These and other weaknesses have prevented DOD from reporting reliable financial information, including budgetary information in an auditable Statement of Budgetary Resources. Although DOD has dedicated significant resources to remediate its identified weaknesses, it faces significant challenges to address those persistent weaknesses.

DOD reported for fiscal year 2010 that it made an estimated \$1 billion in improper payments. However, this estimate is incomplete because DOD did not include estimates from its commercial payment programs, which account for approximately one-third of the value of DOD payments. Further, both GAO and the DOD IG have reported on weaknesses in DOD’s payment controls, including weaknesses in its process for assessing the risk of improper payments and reporting estimated amounts of them. DOD’s problem disbursements continue to be a concern and are a contributing factor to the department’s funds control issues. The department’s weak controls over payments increase the risk of inaccurate cost information and improper payments. Given DOD’s stated goal of achieving audit readiness on its consolidated financial statements by the end of fiscal year 2017, it will be critical that the department continue to ensure that steady progress is being made. Moreover, for DOD to move forward, it will be important that the department resolve its problems with multiple, disparate nonintegrated systems to ensure that whatever systems solutions are chosen will provide the underlying foundation for auditable financial statements.

Chairman Conaway, Ranking Member Andrews, and Members of the Panel:

It is a pleasure to be here today to discuss the Department of Defense's (DOD) controls over the use of public funds and their effect on the reliability of DOD's reported budgetary information and DOD's efforts to account for and control improper payments.

DOD is one of the largest and most complex organizations in the world. For fiscal year 2012, the budget requested for the department was approximately \$671 billion—\$553 billion in spending authority for its operations and an additional \$118 billion to support overseas contingency operations, such as those in Iraq and Afghanistan. DOD's fiscal year 2012 budget request also noted that it employed over 3 million military and civilian personnel—including active and reserve service members. DOD operations span a wide range of defense organizations, including the military services, large defense agencies and field activities, and various combatant and joint operational commands that are responsible for military operations for specific geographic regions or theaters of operation. To execute its operations, the department performs interrelated and interdependent business functions, including financial management, logistics management, health care management, and procurement. To support its business functions, DOD has reported that it relies on over 2,200 business systems,¹ including accounting, acquisition, logistics, and personnel systems.

Like all executive agencies of the federal government, DOD is required to design and implement effective internal controls,² including controls over

¹DOD excludes from its business systems those designated as national security systems under section 2222(j) of Title 10, United States Code. National security systems are information systems where the function, operation, or use of which involves intelligence activities, cryptologic activities related to national security, command and control of military forces, equipment that is an integral part of a weapon or weapon system or is critical to the direct fulfillment of military or intelligence missions (unless used for routine administrative and business applications), or is protected at all times by classification procedures in the interest of national defense or foreign relations, as authorized by law or executive order.

²Internal control represents an organization's plans, methods, and procedures used to meet its missions, goals, and objectives and serves as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, abuse, and mismanagement.

its use of public funds (“funds controls”) and controls over its payment processes (“payment controls”). As a steward of the public’s resources, DOD is responsible and accountable for (1) using public funds efficiently and effectively and for the purposes and within the time frames and amounts prescribed by law, (2) making payments to the right parties in the correct amount within allowable time frames and recouping any overpayments, and (3) accurately recording and reporting on its transactions and use of public funds.

Due to longstanding and pervasive weaknesses in DOD’s internal control, we have designated DOD’s financial management as one of DOD’s programs at high risk of waste, fraud, abuse, or mismanagement.³ DOD’s past initiatives to strengthen its internal control, become auditable, and improve its financial management have fallen short. While current efforts offer some encouragement, GAO and DOD auditors continue to find significant deficiencies in internal control that contribute to DOD’s inability to achieve effective financial management capabilities and prepare auditable financial statements. Under the DOD Financial Improvement and Audit Readiness (FIAR) Plan, first issued by the DOD Comptroller in 2005, DOD has begun to dedicate significant resources to remediate identified weaknesses.

Today, I will discuss the challenges DOD faces in its funds control and their effect on the reliability of DOD’s financial information, especially the budgetary information in DOD’s Statement of Budgetary Resources (SBR), which the department has identified as its highest priority in achieving auditability, as well as its ability to reduce the risk of overobligating or overexpending resources. I will also discuss the weaknesses in DOD’s payment controls that put the department at risk of making improper payments. My statement today is based primarily on our prior work and includes DOD-reported information that we monitor as part of our annual audit of the Consolidated Financial Statements of the U.S. Government.⁴ In addition, my statement includes information from reports issued by the department’s Inspector General (DOD IG) that I present because, while we did not independently validate the IG’s methodology, the findings are similar to ours on relevant aspects of DOD’s funds and payment controls. Our work, on which this statement is based, was

³GAO *High-Risk Series: An Update*, [GAO-11-278](#) (Washington, D.C.: February 2011).

⁴See a list of Related GAO Products at the end of this statement.

conducted in accordance with generally accepted government auditing standards. Our previously published reports contain additional details on the scope and methodology for those reviews. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Budget and Accounting Procedures Act of 1950 and the law commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA)⁵ placed primary responsibility for establishing and maintaining internal control on the head of the agency. Internal control is an integral component of an organization's management that when properly implemented and operating effectively provides reasonable assurance⁶ that the following objectives are being achieved: (1) effectiveness and efficiency of operations; (2) reliability of financial reporting; and (3) compliance with laws and regulations.

Within this broad framework of internal control, DOD must design and implement effective funds control, payment controls, and internal control over financial reporting.⁷ Auditors of DOD's financial statements are to assess the effectiveness of these controls as part of the financial statement audit. However, DOD has acknowledged that long-standing weaknesses in its internal controls, its business systems, and its processes have prevented auditors from determining the reliability of DOD's financial statement information, including the budgetary information included in DOD's SBR. Moreover, we have previously reported that a weak overall control environment and poor internal controls limit DOD's ability to prevent and detect fraud, waste, abuse, and improper payments.

⁵31 U.S.C. § 3512(c), (d).

⁶The concept of reasonable assurance recognizes that no matter how well designed and operated, internal control cannot provide absolute assurance that an entity's objectives will be met. Management should design and implement internal control based on the related costs and benefits.

⁷Additional information about requirements and standards for funds and payment controls, and internal control over financial reporting is provided in app. I.

Because budgetary information is widely and regularly used for management, the DOD Comptroller designated as one of DOD's highest priorities the improvement of its budgetary information and processes underlying the SBR. The financial information in the SBR is predominantly derived from an entity's budgetary accounts, which are used by agencies to account for and track the use of public funds, in accordance with budgetary accounting rules.⁸ The SBR is designed to provide information on authorized budgeted spending authority and links to the Budget of the United States Government (President's Budget), including the source and availability of budgetary resources, and how obligated resources have been used.⁹ According to the Office of Management and Budget, the SBR was added as a basic federal financial statement so that the underlying budgetary accounting information is audited and is, therefore, more reliable for routine management use and budgetary reporting, such as the President's Budget.

In the FIAR Plan, DOD states that it expects to obtain five benefits from its planned efforts to achieve an auditable SBR. According to DOD, its efforts will

- improve the visibility of budgetary transactions, ensuring a more effective use of resources;
- provide operational efficiencies through more readily available and accurate cost and financial information;
- improve financial stewardship through reduced improper payments;
- improve budget processes and controls, thus reducing violations of funds control laws; and
- link execution to the President's Budget, thus providing more consistency with the financial environment.¹⁰

⁸Budgetary accounting rules are incorporated into generally accepted accounting principles (GAAP) for the federal government. For additional information on the two methods of tracking the use of public funds, see app. III to GAO, *A Glossary of Terms Used in the Federal Budget Process*, [GAO-05-734SP](#) (Washington, D.C.: September 2005).

⁹Budgetary resources include the amount available to enter into new obligations and to liquidate them. Budgetary resources are made up of new budget authority (including direct spending authority provided in existing statute and obligation limitations) and unobligated balances of budget authority provided in previous years.

¹⁰DOD, Office of the Under Secretary of Defense (Comptroller)/CFO, *Financial Improvement and Audit Readiness (FIAR) Plan Status Report* (May 2011).

Serious DOD Funds Control Challenges

For years, GAO and DOD IG have reported on DOD's inability to provide effective funds control and report reliable financial information, including budgetary information. In 2008, we reported that DOD's complex and inefficient payment processes, nonintegrated business systems, and weak internal controls impair its ability to maintain proper funds control, putting DOD at risk of overobligating or overspending its appropriations.¹¹ Specifically, DOD's weak internal control environment has hindered its ability to ensure that transactions are accurately recorded, sufficiently supported, and properly executed by trained personnel subject to effective supervision. Further, these weaknesses impair DOD's ability to ensure that amounts recorded as disbursements¹² are matched to the corresponding recorded obligations,¹³ resulting in "unmatched disbursements."¹⁴ These and other weaknesses have prevented DOD from reporting reliable financial information, including budgetary information in an auditable SBR, which DOD's FIAR Plan seeks to address through a multiyear effort across the military services and defense agencies. For example, we recently reported that inadequate processes, systems controls, and controls for accounting and reporting prevented the Marine Corps from passing an audit of its fiscal year 2010 SBR, the first SBR of a military service that DOD is attempting to successfully audit since the SBR was first required in 1998.¹⁵ Although DOD has dedicated significant resources to improving its financial

¹¹GAO, *DOD Financial Management: Improvements Are Needed in Antideficiency Act Controls and Investigations*, [GAO-08-1063](#) (Washington, D.C.: Sept. 26, 2008).

¹²A disbursement is an amount paid by a federal agency, by cash or cash equivalent, to liquidate obligations, such as payment for goods received under a contract. Disbursements often are referred to as "expenditures" or "outlays."

¹³An obligation is a definite commitment that creates a legal liability of the government for the payment of appropriated funds for goods and services ordered and received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Obligations include, for example, the awarding of contracts and grants.

¹⁴Unmatched disbursements refer 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.

¹⁵GAO, *DOD Financial Management: Marine Corps Statement of Budgetary Resources Audit Results and Lessons Learned*, [GAO-11-830](#) (Washington, D.C. Sept. 15, 2011.), *Department of Defense: Status of Financial Management Weaknesses and Actions Needed to Correct Continuing Challenges*, [GAO/T-AIMD/NSIAD-99-171](#) (Washington, D.C.: May 4, 1999).

management, including addressing known weaknesses in its funds control, neither the department nor its auditors have been able to verify that weaknesses have been sufficiently corrected in order to pass an audit. These weaknesses present challenges for DOD in: (1) reducing its risk of overobligating and overexpending¹⁶ its appropriations in violation of the law and making effective use of budgetary resources; (2) improving its ability to eliminate unmatched disbursements and other significant problem disbursements; and (3) producing reliable budgetary information.

Funds Control Weaknesses Can Place DOD at Risk of Overobligation and Overexpenditure and Violations of the Law

We have reported that the department is at risk of overobligating and overexpending its appropriations because of its weaknesses in identifying and training its personnel who are responsible for funds control and carrying out supervisory duties, its challenges in properly supporting and accounting for its transactions, and its poor financial systems. These weaknesses have contributed to 64 DOD-reported instances of overobligation or overexpenditure of funds in violation of the law totaling \$927.4 million from fiscal year 2007 through September 15, 2011. However, there may be other violations that may not be detected, investigated, and reported because of the weaknesses in DOD's funds control and financial management overall. According to DOD, the most frequent causes of DOD's overobligations and overexpenditures include inadequate internal controls and standard operating procedures, not following prescribed internal controls and standard operating procedures, lack of appropriate training, and inadequate supervisory involvement or oversight.¹⁷ Examples of reported weaknesses in DOD's funds control include:

- Inadequately trained funds control personnel. In 2008, we reported that DOD had not effectively identified and established training programs for departmental personnel who carry out DOD's funds

¹⁶Overobligation or overexpenditure of an appropriation or fund occurs when an officer or employee of the United States has made or authorized an obligation, such as a contract, or an expenditure, respectively, in excess of the amount available in the applicable appropriation account or fund.

¹⁷DOD Financial Management Regulation 7000.14-R (DOD FMR), Vol. 14, Ch. 2, Antideficiency Act Violations, Para. 020301 (November 2010). DOD's FMR also describes common types of overobligations and overexpenditures, such as the improper use of operations and maintenance funds by program and contracting officials for military construction or procurement activities. *Id.* at para. 020402.B.

control.¹⁸ According to DOD, its funds control system relies extensively on the department's ability to (1) identify individuals who are performing key funds control roles, such as certifying officers,¹⁹ contracting officers, program managers, funds certifying officials, and other departmental accountable officials,²⁰ who incur obligations and make disbursements and perform related duties, and (2) ensure that those individuals have received the training necessary to fulfill their responsibilities in compliance with the DOD Financial Management Regulation (FMR). We made recommendations to DOD in our report to improve its process and system of identifying and training its key funds control personnel, which DOD agreed to implement, and last year DOD revised the policies in its FMR on this aspect of its funds control. We have not assessed the effectiveness of DOD's actions. However, as I testified before this Panel in July 2011, DOD has not completed a competency analysis of its financial management personnel and still has significant work to do to address this challenge to achieving its financial improvement goals.²¹

- Unsupported transactions. We have reported that DOD components have significant weaknesses in their ability to properly support transactions in order to reliably determine whether their obligations and disbursements are being used for authorized purposes and within the amounts and time frames established by law. For example, we recently reported that the auditors who attempted to audit the Marine Corps fiscal year 2010 SBR were unable to conduct the audit

¹⁸[GAO-08-1063](#).

¹⁹Disbursements may be made only on vouchers certified by the head of an agency or a certifying officer designated by the head of the agency. 31 U.S.C. § 3325(a). By law, certifying officers are responsible for, among other things, (1) the correctness of the facts in the certificate, voucher, and supporting documentation; (2) the correctness of computations on the voucher; and (3) the legality of a proposed payment under the appropriation or fund involved. 31 U.S.C. § 3528.

²⁰A departmental accountable official is an individual who is responsible in the performance of his/her duties for providing a certifying officer with information, data, or services that the certifying officer relies upon in the certification of vouchers for payment. Departmental accountable officials may include resource managers, fund holders, and funds certifying officials, who are responsible for the proper assignment of funding on an obligation document before the obligation is incurred and for maintaining a system of positive funds control. Departmental accountable officers also may include officers and employees who enter into obligations, such as contracting officers, and who make payment eligibility determinations.

²¹GAO, *DOD Financial Management: Numerous Challenges Must Be Addressed to Achieve Auditability*, [GAO-11-864T](#) (Washington, D.C.: July 28, 2011).

because, among other internal control deficiencies, the Marine Corps lacked documentation to support its transactions, which put the Marine Corps at risk of not being able to verify whether payments were made in the appropriate amount for authorized purposes, and to the appropriate parties.²² In its Agency Financial Report for Fiscal Year 2010,²³ DOD officials stated that one of 13 material weaknesses that prevent an audit of its financial statements will be resolved by 2017 by implementing processes and systems that can provide necessary transaction-level supporting documentation for its disbursements and collections.

- Inadequate recording of transactions. DOD faces challenges in properly recording its obligations and disbursements in its accounting and other business systems that impair its ability to track and control the use of public funds. According to DOD's FMR, obligations and expenditures are required to be recorded accurately and promptly, even if the recording results in a negative amount in the appropriation, fund, or other accounting level.²⁴ Last week, we reported that the auditors of the Marine Corps' fiscal year 2010 SBR found that the Marine Corps inappropriately used "bulk obligations" to record estimated liabilities that the Marine Corps did not match to actual payments due to weak internal controls.²⁵ As discussed below, a similar practice by the military departments led to overobligations in violation of the law. Further, DOD reported in its Agency Financial Report for Fiscal Year 2010 that another of 13 material weaknesses that prevented an audit of its financial statements relates, in part, to the department's inability to properly record payments due from other agencies and the public.²⁶
- Ineffective business systems. In our 2008 report on DOD's funds control, we found that DOD's nonintegrated and outdated business systems, including its financial systems and other systems that provide most of DOD's financial data to the financial systems, were a key impediment to effective funds control, and we noted that DOD had long-term plans to implement modernized, fully integrated, and

²²[GAO-11-830](#).

²³DOD, *Agency Financial Report for FY 2010, addendum A, table 2a-1* (Nov. 15, 2010).

²⁴DOD FMR, Vol. 14, Ch. 2, Para. 0203 (November 2010).

²⁵[GAO-11-830](#).

²⁶DOD, *Agency Financial Report for FY 2010, addendum A, table 2a-1*.

reliable business systems.²⁷ However, as I stated before this panel in July, DOD faces significant challenges in its effort to implement these new systems over the next several years.²⁸ In its Agency Financial Report for Fiscal Year 2010 and its FIAR Plan, DOD acknowledges the challenges related to weaknesses in DOD's financial management systems. For example, in DOD's annual statement on the status of its internal controls included in its Agency Financial Report, DOD reported that the department is not in conformance with internal control requirements because of a material weakness in its financial management systems. DOD's FIAR Plan states that implementing modernized, effective, and integrated business systems that reliably support financial needs of the department are critical to achieving the department's financial improvement and audit readiness efforts.

DOD's ineffective funds control has resulted in overobligations and overexpenditures in violation of the Antideficiency Act (ADA).²⁹ As we reported in 2008, weaknesses in DOD's funds control impaired its ability to accurately detect, investigate, and report such violations.³⁰ Under the ADA, agencies are prohibited from, among other things, incurring obligations or making expenditures in excess or in advance of appropriations or in excess of apportionments or formal subdivisions of those apportionments.³¹ When DOD determines that a violation of the ADA has occurred, the department is to immediately report to the President and Congress all relevant facts and a statement of actions

²⁷ [GAO-08-1063](#). The DOD FMR describes requirements and assigns responsibilities for implementing financial management systems as part of DOD's funds control. DOD FMR, Vol. 14, Ch. 1, Administrative Control of Funds, Para. 010210 (Jan. 2009).

²⁸ [GAO-11-864T](#).

²⁹ 31 U.S.C. §§ 1341-42, 1349-51, 1511-19.

³⁰ [GAO-08-1063](#).

³¹ Under law, an apportionment is the action by which the Office of Management and Budget (OMB) distributes amounts available for obligation, including budgetary reserves established pursuant to law, in an appropriation or fund account. An apportionment divides amounts available for obligation by specific time periods (usually quarters), activities, projects, objects, or a combination thereof. The amounts so apportioned limit the amount of obligations that may be incurred. An apportionment may be further subdivided by an agency into allotments, suballotments, and allocations. In apportioning any account, some funds may be reserved to provide for contingencies or to effect savings made possible pursuant to the Antideficiency Act. Funds apportioned to establish a reserve must be proposed for deferral or rescission pursuant to the Impoundment Control Act of 1974 (2 U.S.C. §§ 681-688).

taken and submit a copy to the Comptroller General at the same time. According to copies of ADA violation reports received by the Comptroller General, and as shown in table 1, DOD reported 64 ADA violations from fiscal year 2007 through September 15, 2011, with a total dollar amount of \$927.4 million. However, due to DOD's weaknesses in its funds control process, including the weaknesses described above related to DOD's challenges in controlling and recording obligations and disbursements and detecting violations, this listing may not be complete because all ADA violations may not have been identified or reported. For example, GAO identified a violation in June 2010 involving the Army's overobligation of its fiscal year 2008 Military Personnel—Army (MPA) appropriation, as evidenced by a \$200 million transfer DOD made to the MPA account from DOD's working capital fund, which has not yet been reported by DOD.³² Mr. Chairman, Ranking Member Andrews, I know that you and other members of Congress recently sent a letter to the DOD Comptroller asking for an explanation of why DOD has not reported this and other potential ADA violations. Such an explanation could provide greater transparency over the accuracy of reported numbers and amounts of violations.

³²GAO, *Department of the Army—The Fiscal Year 2008 Military Personnel, Army Appropriation and the Antideficiency Act*, B-318724 (Washington, D.C.: June 22, 2010). OMB policy requires DOD to report violations found by GAO. OMB Cir. No. A-11, section 145.8. Further, on March 30, 2011, we issued a legal opinion in which we concluded that an Enhanced Use Lease entered into by the U.S. Army violated the ADA by including a clause in the escrow agreement whereby the government indemnified an escrow agent against all liabilities arising under the escrow agreement. [GAO- B-321387](#), *Department of the Army—Escrow Accounts and the Miscellaneous Receipts Statute* (Mar. 30, 2011). DOD has not yet reported this violation to GAO. For additional information on this lease and the related ADA violation, see GAO, *Defense Infrastructure: The Enhanced Use Lease Program Requires Management Attention*, [GAO-11-574](#) (Washington, D.C.: June 30, 2011). For additional information on this lease and the related ADA violation, see also GAO, *Defense Infrastructure: The Enhanced Use Lease Program Requires Management Attention*, [GAO-11-574](#) (Washington, D.C.: June 30, 2011).

Table 1: Anti-deficiency Act Violations Reported by the Department of Defense (Fiscal Year 2007 through September 15, 2011)

Military service	Reported violations	
	Number	Amount (dollars in millions)
Army	31	\$548.0
Navy	15	237.6
Marine Corps	3	5.1
Air Force	12	129.5
Defense agencies	3	7.2
Total	64	\$ 927.4

Source: DOD.

Note: The data are unaudited information GAO extracted from Antideficiency Act reports received by GAO from DOD as of September 15, 2011. Because of the time required to investigate potential violations, the violations generally occurred 2 or more years prior to the dates of the reports.

Because the ADA prohibits, and effective funds control should prevent, overobligations and overexpenditures of public funds, the number and dollar amount of ADA violations are an indicator of the status of DOD's funds control. However, the nature of reported violations can also indicate systemic weaknesses in DOD's funds control. The following ADA violations involved systemic breakdowns in the controls necessary to track actual amounts of obligations incurred against amounts of available funding:

- As noted above, we found in June 2010 that the Army Budget Office lacked an adequate funds control process to provide it with ongoing assurance that obligations and expenditures do not exceed funds available in the fiscal year 2008 Military Personnel–Army (MPA) appropriation.³³ We found that the Army's total obligations against the fiscal year 2008 MPA appropriation exceeded the amount available in the account, as evidenced by the Army's need to transfer \$200 million from the Defense Working Capital Fund, Army appropriation to cover the shortfall. The overobligation likely stemmed, in part, from lack of communication between the Army budget office and program managers so that the Army budget office's accounting records reflected estimates instead of actual amounts until it was too late to control the incurrence of excessive obligations in violation of the act.

³³B-318724.

Thus, at any given time in the fiscal year, the Army budget office did not know the actual obligation and expenditure levels of the account. The Army budget office explained that it relies on estimated obligations—despite the availability of actual data from program managers—because of inadequate financial management systems.

- Similarly, in 2008, Navy officials reported an ADA violation in the Military Personnel–Navy (MPN) appropriation in the amount of \$183 million. The violation occurred when the Bureau of Naval Personnel (BUPERS) overobligated the fiscal year 2008 MPN appropriation due to its inability to accurately track the status of obligations and identify the need for additional funding.

To its credit, the department has issued and periodically updated policies that address responsibilities for preventing and identifying ADA violations.³⁴ DOD’s guidance also describes frequent causes of violations within the department and explains the actions necessary to avoid them, including emphasizing management and supervisory duties, training of key funds control personnel, and effective systems and procedures.

Efforts to Address DOD’s “Problem” Disbursements

Basic controls to match payments with the obligation records and account for and reconcile payments are not effective within the department. DOD has identified payment transactions and related accounting steps as “problem disbursements” and monitors them through management tracking reports as it attempts to correct them. Problem disbursements include unmatched disbursements (UMD) that represent disbursements that have been paid by an accounting office but that have not been matched to the correct obligation records. 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. For a description of two examples of DOD’s problem disbursements, see appendix II.

Problem disbursements increase the risk of making fraudulent or erroneous payments without detection. In addition, problem

³⁴DOD FMR, Vol. 14, Ch. 2 (November 2010). The guidance also describes common types of violations, including the use of appropriations for improper purposes, such as the use of operations and maintenance funds for military construction and procurement activities, which cannot be corrected by adjusting DOD’s accounts to charge the correct appropriation.

disbursements impair the reliability of DOD financial statements and DOD's ability to control its disbursements, a key aspect of funds control. According to DOD's tracking reports, the department has made progress in addressing problem disbursements, but the department has not achieved its goals in this area.

As we reported in 2003, the Defense Finance and Accounting Service (DFAS) expanded its use of existing financial management performance metrics to include special measures for the recording of payments, including the amount of disbursements that are not matched to the corresponding obligations, or UMDs.³⁵ DOD, in its May 2011 FIAR Plan Status Report³⁶ on the implementation of its FIAR Plan, included a metric on UMDs. This metric tracks UMDs that are over 120 days old, which DOD refers to as "overaged UMDs."³⁷ As stated in that report, DOD's goal is to have no UMD amounts greater than 120 days old. According to the report, the benefit of reducing UMDs, especially overaged UMDs, is greater accuracy of DOD components' account balances on management reports and the SBR. Reduction of the amount of UMDs will allow DOD to have more accurate information about the obligations that have been liquidated, improving its budgetary accounting. The presence of UMDs prevents the department from having accurate information about the amount of funds available for obligation and expenditure to carry out its mission, thus increasing the risk of possible ADA violations. The following table appears in the May 2011 status report on the FIAR Plan for overaged UMDs and indicates that, from the second quarter of fiscal year

³⁵GAO, *Financial Management: DOD's Metrics Program Provides Focus for Improving Performance*, [GAO-03-457](#) (Washington, D.C.: Mar. 28, 2003). We monitor the DFAS tracking reports as part of our annual audit of the *Consolidated Financial Statements of the U.S. Government*.

³⁶ DOD FIAR Plan Status Update, app. I (May 2011).

³⁷For this metric, UMDs are defined as disbursements that cannot be matched to an obligation in the accounting system. According to DOD's Financial Management Regulation 7000.14-R, vol. 3, ch. 11, "collocated" offices have a total of 90 days to research and resolve a UMD and "noncollocated" offices have a total of 120 days to research and resolve a UMD.

2009 through the second quarter of fiscal year 2011, DOD is making progress at reducing overaged UMDs:³⁸

Table 2: DOD Reported Unmatched Disbursements over 120 Days as of May 2011 (dollars in millions)

DOD component	Fiscal year 2009		Fiscal year 2010		Fiscal year 2011
	Second quarter	Fourth quarter	Second quarter	Fourth quarter	Second quarter
Army	\$6.5	\$54.6	\$156.4	\$4.8	\$36.7
Navy	565.4	496.6	559.4	23.2	40.9
Air Force	94.6	68.5	3.4	0.5	2.8
Defense Logistics Agency	0.00	0.00	40.6	32.8	29.2
Total	\$666.5	\$619.7	\$759.8	\$61.3	\$109.6

Source: DOD.

Note: Unaudited data are from FIAR Plan Status Report as of May 2011.

In the results section accompanying this table, DOD officials noted Army's UMDs reportedly increased due to systems issues with recording obligations and lines of accounting in its Enterprise Resource Planning (ERP) systems.³⁹

DOD's Funds Control Weaknesses and Problem Disbursements Impair the Reliability of DOD's Financial Information

As we and DOD's auditors have reported, DOD's funds control and related internal control weaknesses and problem disbursements have impaired its ability to produce reliable financial information for reporting, especially the reliability of the department's SBR, as well as its other budgetary information. For example, we reported in 1999 that the reliability of DOD's budgetary information reported in its SBR was impaired.⁴⁰ In 2009, the DOD Comptroller directed that the department's

³⁸DOD's corrective actions have included the implementation of a process to match proposed disbursements with corresponding obligations before making payments, which Congress has required by law since 1995 for certain large disbursements. This process, known as prevalidation, checks whether DOD organizations have recorded obligations properly in an official accounting system as well as reserved sufficient funds in accounting records to cover the proposed disbursement before payments are made.

³⁹An Enterprise Resource Planning (ERP) solution is an automated system using commercial off-the-shelf (COTS) software consisting of multiple, integrated functional modules that perform a variety of business-related tasks such as general ledger accounting, payroll, and supply chain management. ERP systems represent a critical element of DOD's FIAR strategy.

⁴⁰[GAO/T-AIMD/NSIAD-99-171](#).

components focus their efforts on budgetary information and the ability to prepare an auditable SBR as one of two first priorities that are now being implemented through the DOD's FIAR Plan, its FIAR Guidance, and the components' individual financial improvement plans. As a pilot, DOD designated the Marine Corps SBR as the first military service SBR to undergo an audit. However, as we reported last week, the Marine Corps was unable to undergo an audit of its fiscal year 2010 SBR due to serious control weaknesses that prevented the auditors from performing the audit.⁴¹ Although we found that the Marine Corps was able to address some of these weaknesses, many remained unresolved. We found that the Marine Corps did not develop an effective overall corrective action plan to address the 70 audit findings and related 139 recommendations that identified risks, prioritized actions, and identified required resources needed to help ensure that actions adequately respond to recommendations. Instead, its approach to addressing auditor findings and recommendations for its prior and current audit efforts focuses on short-term corrective actions necessary to support heroic efforts to produce reliable financial reporting at year-end. Such approach may not result in sustained improvements over the long term that would help ensure that the Marine Corps could routinely produce sound data on a timely basis for decision making and reporting. We also reported key lessons learned from this pilot that, if effectively shared with the other military services, could help them to address similar known challenges in preparing reliable SBRs.

The SBR is designed to provide information on budgeted spending authority reported in the President's Budget, including budgetary resources, availability of budgetary resources, and how obligated resources have been used. Both Congress and the administration use this information to make decisions about the amounts of appropriations DOD needs to carry out its operations. However, as we stated in our February 2011 High-Risk Series: An Update, DOD's pervasive control weaknesses adversely affect DOD's ability to, among other things, anticipate future costs and claims on the budget.

⁴¹[GAO-11-830](#).

Risk of DOD Improper Payments

DOD, in its Agency Financial Report for Fiscal Year 2010, reported that it made an estimated \$1 billion in improper payments⁴² under five of its programs.⁴³ However, this estimate is incomplete because DOD did not include estimates from its commercial payment programs, which account for approximately one-third of the value of DOD payments. Further, both we and the DOD IG have reported on weaknesses in DOD's payment controls, including weaknesses in its process for assessing the risk of improper payments and reporting estimated amounts of them. DOD's payment controls are hindered by problems related to inadequate payment processing, poor financial systems, and inadequate supporting documentation.

Weaknesses in DOD's Payment Controls

In our February 2011 High-Risk Series: An Update, we identified various DOD high-risk areas, including contract management (designated in 1992) and financial management (designated in 1995), that we have previously reported make the department vulnerable to improper payments.⁴⁴ DOD's contract management weaknesses, such as ineffective oversight, increase the risk that DOD will pay more than the value of the goods delivered or services performed. Financial management deficiencies have adversely affected the department's ability to control costs, to ensure basic accountability, and to prevent and detect fraud, waste, and abuse, and represent a significant obstacle to achieving an unqualified opinion on DOD's and the U.S. government's consolidated financial statements. In addition, the DOD IG recently

⁴²An improper payment is defined as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payment for services not received, and any payment that does not account for credit for applicable discounts. OMB guidance also instructs agencies to report payments for which insufficient or no documentation was found as improper payments.

⁴³DOD, *Agency Financial Report for FY 2010, addendum A*. In its improper payment reporting, DOD identifies the primary causes of improper payments for each of the five programs. For example, DOD reports that underpayments accounted for \$338.8 million (67 percent) of the \$505.9 million in improper payments for the Military Pay program. According to the information provided by DOD, most of these underpayments (\$207 million) occurred within the Army Reserve and Army National Guard, most of which involved unpaid leave not used before members were discharged or deactivated back to Reserve from Active duty status.

⁴⁴[GAO-11-278](#).

reported their assessment that DOD's risk of making improper payments is high.⁴⁵ This assessment was based on control deficiencies identified by the Defense Finance and Accounting Service (DFAS) as well as prior assessments made by GAO and DOD IG.

Our prior work and reports issued by DOD IG have highlighted the department's long-standing and significant problems with estimating and preventing improper payments. Specific weaknesses in DOD's payment controls include inadequate payment processing, inadequate supporting documentation for expenditures, financial system deficiencies, and weak contract audit and payment controls. For example:

- Inadequate payment processing. The DOD IG reported that the U.S. Marine Corps Forces Special Operations Command did not have effective controls over the reporting and processing of baseline and contingency funds, resulting in improper payments.⁴⁶ Specifically, the DOD IG reported that the command did not have effective controls over the recording and processing of 35,699 transactions.⁴⁷ Of the 320 sample transactions,⁴⁸ 245 had one or more deficiencies. In addition, of the 29 travel vouchers with deficiencies or unsupported expenses, the payments made on 10 vouchers were improper payments. According to the DOD IG report, the improper payments occurred because the certifying officers and departmental accountable officials approved the travel vouchers with deficiencies and unsupported expenses without thoroughly reviewing them.
- Inadequate documentation. As we reported last week, we continue to find that the Navy and Marine Corps have issues with maintaining adequate documentation for their transactions.⁴⁹ On the basis of the

⁴⁵DOD, Inspector General, *DOD Needs to Improve High Dollar Overpayment Review and Reporting*, D-2011-050 (Arlington, Virginia: March 16, 2011).

⁴⁶DOD, Inspector General, *U.S. Marine Corps Forces Special Operations Command Needs to Improve Controls Over Financial Transactions*, D-2011-086 (Arlington, Virginia: July 20, 2011).

⁴⁷The 35,699 transactions were valued at \$131.8 million in obligations and \$54.1 million in expenditures from October 1, 2008 to October 16, 2009.

⁴⁸The 320 sample transactions included obligations valued at \$83.8 million and expenditures of \$20.6 million.

⁴⁹GAO, *DOD Financial Management: Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan*, [GAO-11-932T](#) (Washington, D.C.: Sept. 15, 2011).

sample of items we tested for an ongoing audit, the Navy did not maintain adequate documentation for us to independently validate its efforts to research and resolve differences between its Fund Balance with Treasury balances with the records of the Department of the Treasury, which is a process similar to reconciling a checkbook with a bank statement. Some payments are considered improper payments due to insufficient or missing documentation. In July 2011, the DOD IG reported that DFAS made potentially improper payments of \$4.2 million from January 2005 through December 2009 related to active duty military personnel.⁵⁰ According to the report, DOD did not ensure that the Defense Joint Military Pay System–Active Component contained only valid active-duty military accounts. For example, the DOD IG found that this system contained military personnel that received payments after their reported date of death.

- Financial system deficiencies. In 2009, we reported that DOD traced the root cause of many improper payments in its military and civilian pay to the inaccurate or untimely reporting of entitlement data to DOD’s automated systems on such areas as time and attendance, personnel actions, and pay allowances.⁵¹ We reported that DOD had described steps to monitor and track these improper payments; however, it was unclear whether these actions would address the root causes of these deficiencies. In August 2011, the DOD IG reported that the Army’s controls over its Deployable Disbursing System⁵² (DDS) payments were inadequate and resulted in, among other things, improper payments.⁵³ The DOD IG found that the Army was at risk of improper payments because its Financial Management Centers did not effectively review user access to DDS or oversee the payment process. The DOD IG reported that the Army’s disbursing personnel made nine duplicate payments to vendors and did not collect on these improper payments. Two of the duplicate payments were referred by

⁵⁰DOD, Inspector General, *Active Duty Military Personnel Accounts Were Generally Valid and Secure, but DOD May Have Made Improper Payments*, D-2011-093 (Arlington, Virginia: July 27, 2011).

⁵¹ GAO, *Improper Payments: Significant Improvements Needed in DOD’s Efforts to Address Improper Payment and Recovery Auditing Requirements*, [GAO-09-442](#) (Washington, D.C.: July 29, 2009).

⁵²DFAS developed the Deployable Disbursing System to fulfill a need for a tactical disbursing system and to maintain accountability of U.S. Treasury funds.

⁵³DOD, Inspector General, *Controls Over Army Deployable Disbursing System Payments Need Improvement*, D-2011-101 (Arlington, Virginia: Aug. 17, 2011).

the DOD IG to the Defense Criminal Investigative Service because of the suspicious and potentially fraudulent nature of the payments.

- Weak contract audit and payment controls. As we testified in February 2011, our 2009 audit work identified, among other weaknesses in DOD's contract payment controls, weaknesses in contract auditing, which increase the risk of improper payments.⁵⁴ In 2009, we reported on audit quality problems at Defense Contract Audit Agency (DCAA) offices nationwide, including compromise of auditor independence, insufficient audit testing, and inadequate planning and supervision.⁵⁵ In addition, DCAA's management environment and quality assurance structure were based on a production-oriented mission that put DCAA in the role of facilitating DOD contracting without also protecting the public interest. At that time, we found serious quality problems in the 69 audits and cost-related assignments we reviewed, resulting in DCAA rescinding over 80 audit reports and removing over 200 DOD contractors from direct billing privileges, which allow them to submit invoices for payment without review by the government.

Concerns over Incomplete DOD Reviews and Reporting on Improper Payments

The Improper Payments Information Act of 2002 (IPIA)⁵⁶ requires DOD to annually identify programs and activities susceptible to significant improper payments, estimate amounts improperly paid under those programs and activities, and report on these estimates and the actions to reduce improper payments. In July 2009, we reported that DOD did not conduct risk assessments on all of its payment activities, as \$322 billion in agency outlays were excluded from the amounts DOD assessed.⁵⁷ While DOD components conducted risk assessments for six payment activities totaling about \$493 billion in fiscal year 2007, we identified an additional \$322 billion in outlays reported in DOD's SBR⁵⁸ that had not been assessed. Also, the DOD IG recently reported that DOD's First

⁵⁴GAO, *Contract Audits: Role in Helping Ensure Effective Oversight and Reducing Improper Payments*, [GAO-11-331T](#) (Washington, D.C.: Feb. 1, 2011).

⁵⁵GAO, *DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform*, [GAO-09-468](#) (Washington, D.C.: Sept. 23, 2009).

⁵⁶Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002), as amended by the Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, 124 Stat. 2224 (July 22, 2010).

⁵⁷[GAO-09-442](#).

⁵⁸DOD's SBR for fiscal year 2007 reported gross outlays of about \$815 billion.

Quarter FY 2010 High Dollar Overpayments Report⁵⁹ (Overpayments Report) did not accurately portray the department's risk of high-dollar overpayments.⁶⁰ The DOD IG reported that the Overpayments Report was incomplete because not all DOD payments were examined. DFAS reviews for high dollar overpayments excluded approximately \$167.5 billion or 55 percent of DOD's total \$303.7 gross outlays.⁶¹ DOD's inability to identify and reconcile total payments to its SBR affected the reliability and completeness of its estimates for and reviews of improper payments.

In addition to not conducting risk assessments for all of its agency outlays, we reported that DOD had neither established a methodology to estimate nor had it estimated the amount of improper payments for commercial pay—its largest payment activity.^{62, 63} At the time of our report, DOD officials stated that reporting commercial improper payments under both IPIA and the Recovery Auditing Act⁶⁴ would create duplicative reporting. We disagreed with DOD officials stating that the department

⁵⁹Executive Order 13520, *Reducing Improper Payments* (Nov. 20, 2009), requires that the head of each agency report quarterly on high dollar overpayments identified and recovered. The report is also to include the actions taken to prevent high dollar overpayments.

⁶⁰A high-dollar improper payment is defined as any overpayment that is in excess of 50 percent of the correct amount of the intended payment where (1) the payment to an individual exceeds \$5,000 as a single payment or in cumulative payments for the quarter or (2) the payment to an entity exceeds \$25,000 as a single payment or in cumulative payments for the quarter.

⁶¹DOD's Comptroller reported gross outlays of \$303.7 billion for the first quarter of fiscal year 2010 in DOD's SBR.

⁶²[GAO-09-442](#).

⁶³DOD separates its payment of commercial invoices into two business lines—(1) contract pay—which pays invoices for larger, more complex contracts and (2) vendor pay—which processes payments for smaller, less complex contracts, purchase orders, and other miscellaneous payments.

⁶⁴At the time of our report, agencies were required to report on their efforts to recover overpayments made to contractors under section 831 of the National Defense Authorization Act for Fiscal Year 2002, formerly codified at 31 U.S.C. §§ 3561-67, commonly known as the Recovery Auditing Act. This provision was repealed and replaced by the Improper Payments Elimination and Recovery Act of 2010 with a more comprehensive recovery audit program requirement. Pub. L. No. 111-204, § 2(h), 124 Stat. 2224, 2228 (July 28, 2010). For more details on these requirements, see GAO, *Improper Payments: Recent Efforts to Address Improper Payments and Remaining Challenges*, [GAO-11-575T](#) (Washington, D.C.: Apr. 15, 2011).

could leverage the results from its existing Recovery Auditing Act processes identifying actual commercial under- and overpayments to develop its statistical sampling methodology and enhance the reported estimate.

The DOD Comptroller testified in May 2011 that DOD had not estimated the amount of improper payments for commercial pay because the department uses prepayment screening, both automated and manual, to prevent improper payments.⁶⁵ He added that one especially important tool to prevent commercial pay improper payments is the department's Business Activity Monitoring (BAM)⁶⁶ software program introduced in August 2008. However, the DOD IG reported, among other things, that the BAM tool had a false positive⁶⁷ rate of more than 95 percent and that the BAM review methodology was not standardized across payment systems or even within the same office. The large number of payments flagged for review (false positives) made it difficult to conduct the appropriate research in a timely manner without delaying payment. The IG reported that the lack of a standardized methodology could lead to DFAS not detecting and preventing improper payments due to poor quality review. The Comptroller stated, in his May 2011 testimony, that in view of legislative changes and more recent OMB guidance, DOD plans to do postpayment statistical sampling for commercial payments for those systems not currently covered by the BAM tool to supplement its prepayment measures.

Concluding Observations

Although DOD has dedicated significant resources under its FIAR Plan to remediate its identified financial management weaknesses, it faces significant challenges in addressing those persistent weaknesses. DOD's large number of nonintegrated business systems, complex and inefficient payment processes, and weak internal controls put the department at risk

⁶⁵DOD, *Statement of The Honorable Robert F. Hale, Under Secretary of Defense (Comptroller) before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate* (Washington, D.C.: May 25, 2011).

⁶⁶BAM is a tool that runs a discrete number of tests to identify potential improper payments before disbursement.

⁶⁷A false positive is a payment flagged as a potential improper payment that after review is determined to be proper.

of overobligating or overspending its appropriations. DOD has been addressing its problem disbursements, but they are a contributing factor to the department's funds control issues. The department's weak controls over payments increase the risk of inaccurate cost information and improper payments. Given DOD's stated goal of achieving audit readiness on its consolidated financial statements by the end of fiscal year 2017, it will be critical that the department continue to ensure that steady progress is being made. Moreover, for DOD to move forward, it will be important for the department to resolve its problems with multiple, disparate nonintegrated systems and to ensure that whatever systems solutions are chosen will provide the underlying foundation for auditable financial statements.

Mr. Chairman and members of the panel, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the panel may have at this time.

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Appendix I: Requirements and Standards for Federal Agencies' Internal Controls

Congress has long recognized the importance of internal control, beginning with the Budget and Accounting Procedures Act of 1950, over 60 years ago. The 1950 act placed primary responsibility for establishing and maintaining internal control squarely on the shoulders of agency management. In 1982, Congress enacted the law commonly known as the Federal Managers' Financial Integrity Act (FMFIA), and the Office of Management and Budget (OMB) issued Circular No. A-123 to require each agency to establish and maintain internal control systems that would enable obligations and costs to be recorded in compliance with applicable law; funds, property, and other assets to be safeguarded; and revenues and expenditures applicable to agency operations to be properly recorded and accounted for. Within this broad framework of internal control required by FMFIA, the Department of Defense, like other executive-branch agencies, must also design and implement effective systems of funds control, payment controls, and internal control over financial reporting. Auditors of DOD's financial statements assess the effectiveness of these four types of internal controls in varying degrees as part of the financial statement audit. Further, one financial statement, the Statement of Budgetary Resources, was designed for the purpose of reporting on agencies' use of federal funds and to subject agencies' funds control to audit. Listed below is a brief description of the four types of controls.

Internal Control

Internal control represents an organization's plans, methods, and procedures used to meet its missions, goals, and objectives and serves as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, abuse, and mismanagement. Internal control is to provide reasonable assurance that an organization's objectives are achieved through (1) effective and efficient operations, (2) reliable financial reporting, and (3) compliance with laws and regulations. Safeguarding of assets is a subset of all these objectives.

Funds Control

The purpose of funds control is to implement controls that restrict both obligations¹ and disbursements² from exceeding appropriations and

¹An obligation is a definite commitment that creates a legal liability of the government for the payment of appropriated funds for goods and services ordered and received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Obligations include, for example, the awarding of contracts and grants.

supporting the proper preparation and execution of the budget. Funds control systems must be able to accurately record obligations, collections, and disbursements against appropriations and the accounts established to track the status of appropriations. An agency's fund control system is the primary tool for ensuring that the agency complies with congressional spending mandates, and is, therefore, central to Congress's ability to exercise its constitutional power of the public purse. In the executive branch of the federal government, funds control requirements are implemented by executive agencies consistent with policies and guidance issued by OMB, the Department of the Treasury (Treasury), and the head of each executive agency. According to OMB Circular No. A-11, proper funds control should include the following elements:

- agency regulations that are required by, and designed to ensure compliance with the prohibitions contained in, the Antideficiency Act (ADA), which are described below;³
- the purpose of funds control is to implement controls that restrict both obligations and expenditures from exceeding appropriations and related administrative accounts, as well as hold officers and employees accountable when they violate the restrictions; and
- the funds control systems must operate within the internal control systems, including the objective of complying with laws and regulations.

²A disbursement is an amount paid by a federal agency, by cash or cash equivalent, during the fiscal year to liquidate obligations, such as payment for goods received under a contract. Disbursements often are referred to as "expenditures" or "outlays."

³The ADA is one of the major laws in the statutory scheme by which the Congress exercises its constitutional control of the public purse. Despite the name, it is not a single act, but rather a series of related provisions that evolved over a period of time in response to various abuses. As late as the post-Civil War period, it was not uncommon for agencies to incur obligations in excess, or in advance, of appropriations. Perhaps most egregious of all, some agencies would spend their entire appropriations during the first few months of the fiscal year, continue to incur obligations, and then return to the Congress for appropriations to fund these "coercive deficiencies." These were obligations to others who had fulfilled their part of the bargain with the United States and who now had at least a moral—and in some cases also a legal—right to be paid. The Congress felt it had no choice but to fulfill these commitments, but the frequency of deficiency appropriations played havoc with the United States' budget. The Congress expanded the ADA several times throughout the 20th century to require and enforce apportionments and agency subdivisions of apportionments to achieve more effective control and conservation of funds. The ADA contains both affirmative requirements and specific prohibitions. For a more detailed description of the requirements for funds control systems under the Antideficiency Act and other fiscal statutes, see GAO, *DOD Financial Management: Improvements Are Needed in Antideficiency Act Controls and Investigations*, [GAO-08-1063](#) (Washington, D.C.: Sept. 28, 2008).

The ADA prohibits federal officers and employees from

- making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law, 31 U.S.C. § 1341(a)(1)(A);
- involving the government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law, 31 U.S.C. § 1341(a)(1)(B);
- accepting voluntary services for the United States, or employing personal services not authorized by law, except in cases of emergency involving the safety of human life or the protection of property, 31 U.S.C. § 1342; and
- making obligations or expenditures in excess of an apportionment or reapportionment, or in excess of the amount permitted by agency regulations, 31 U.S.C. § 1517(a).

Once it is determined that there has been a violation, the agency head “shall report immediately to the President and Congress all relevant facts and a statement of actions taken,” and they shall transmit a copy to the Comptroller General at the same time. OMB has issued further instructions on preparing the reports, which may be found in OMB Circular No. A-11, Preparation, Submission, and Execution of the Budget, § 145.

Internal Control over Financial Reporting

Internal control over financial reporting should assure the safeguarding of assets from waste, loss, unauthorized use, or misappropriation as well as assure compliance with laws and regulations pertaining to financial reporting. Financial reporting includes annual financial statements of an agency as well as other significant internal or external financial reports. Other significant financial reports are defined as any financial reports that could have a material effect on a significant spending, budgetary, or other financial decision of the agency or that is used to determine compliance with laws and regulations on the part of the agency. An agency needs to determine the scope of financial reports that are significant, that is, which reports are included in the assessment of internal control over financial reporting. In addition to the annual financial statements, significant reports might include: quarterly financial statements; financial statements at the operating division or program level; budget execution reports; reports used to monitor specific activities such as specific revenues, receivables, or liabilities; reports used to monitor compliance with laws and regulations such as the Anti-Deficiency Act.

Payment Controls

Payment controls, as a discrete subset of internal controls and funds control, establish an effective system of internal controls needed to maintain accountability over resources, including identifying, reporting, and reducing improper payments and problem disbursements, and recouping improper payments when they are made. Controls should ensure payments and collections are timely and accurate and that public funds are used properly for the payments. Managers are responsible for ensuring that internal controls are established and functioning properly. Managers with responsibilities for determining entitlement, authorizing and executing payments and collections shall

- create, document, and maintain an organizational structure and business processes that appropriately segregates assigned duties, emphasizes adherence to policies and procedures, and employs sound internal accounting and system access controls;
- implement finance and accounting systems that comply with the federal financial management systems requirements, keep disbursement (entitlement), and accounting records accurate and in balance from contract execution through closeout, and monitor the causes of late payments and interest penalties incurred;
- establish systematic controls that capture adequate audit trails to allow the tracing from source documents of financial events to general ledger account balances through successive levels of summarization and financial reports/statements;
- ensure data is processed using accurate coding and errors are researched and corrected;
- employ systems that ensure the authenticity of data that are electronically transmitted, including the electronic signature and ensure controls provide reasonable assurance that deliberate or inadvertent manipulation, modification, or loss of data during transmission is detected; and
- validate cash management and payment performance quality and effectiveness on an annual basis; and periodically test effectiveness of internal controls, document results of testing, and take necessary corrective actions.

Appendix II: DOD “Problem Disbursements”

The Department of Defense’s (DOD) disbursement posting policy is in Chapter 11 of Volume 3 of its Financial Management Regulation (FMR).¹ According to Chapter 11, DOD’s policy is that a disbursement be matched to its corresponding, detail-level obligation and be recorded as promptly as current systems and business practices reasonably permit. DOD recognizes that while most obligations and disbursements are matched automatically, some obligations and disbursements are required to be manually matched, mainly due to nonautomated processes or the rejection of transactions by automated systems.

As defined by DOD, problem disbursements include unmatched disbursements and negative unliquidated obligations. The definitions for these terms are also in Volume 3, Chapter 11 of the DOD FMR.

Unmatched Disbursement (UMD)

- An unmatched disbursement is defined as a disbursement transaction that has been received and accepted by an accounting office, but has not been matched to the correct detail obligation. This includes transactions that have been rejected back to the paying office or central disbursement clearing organization by an accounting office.

Negative Unliquidated Obligation (NULO)

- A negative unliquidated obligation is a disbursement transaction that has been matched to a cited detail obligation (unlike unmatched disbursements), but the total recorded disbursement(s) exceed the recorded obligation.

Chapter 11 also prescribes the requirements for researching UMDs and NULOs. For example, prevalidation is defined as a procedure that requires a proposed payment be identified/matched to its applicable proper supporting obligation that has been recorded in the official accounting system and that the line(s) of accounting cited on the payment match the data recorded in the accounting system. As stated in Chapter 11, prevalidation procedures help better ensure that contracts are not overpaid.

¹DOD Financial Management Regulation 7000.14R, Vol. 3, Ch. 11, Unmatched Disbursements, Negative Unliquidated Obligations, and In-Transit Disbursements (November 2010).

Related GAO Products

DOD Financial Management: Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan. [GAO-11-932T](#). Washington D.C.: September 15, 2011.

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