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General Accounting Office  
Washington, D.C. 20548

Accounting and Information  
Management Division

B-275779

January 27, 1997

Captain Ronald D. Reck  
Commanding Officer  
U.S.C.G. Finance Center  
U.S. Coast Guard

Dear Captain Reck:

This letter responds to your September 10, 1996, request for an interpretation of the requirements of Title 7, "Fiscal Procedures," of GAO's Policy and Procedures Manual for Guidance of Federal Agencies. You specifically asked whether, for small purchases under \$2,500 made with a government credit card, it is permissible to (1) retain supporting receipts and documentation at the field office where purchases occur rather than forwarding them to the Coast Guard's certifying officer in Chesapeake, Virginia, and (2) eliminate the monthly 1-percent statistical sample performed after payment to verify that the internal controls in the payment process are working as intended.

As described in your letter, and explained by your staff during subsequent discussions, the Coast Guard is evaluating its existing voucher examination program with the intention of streamlining its operations and reducing the cost of government. We support initiatives to create a government that works better and costs less. At the same time, we believe that agencies have the responsibility to protect the government's interest.

To supplement the information in your letter, we contacted your staff to discuss your questions in more detail. Since we did not test your current system, our response only addresses your questions conceptually.

Based on our understanding of your proposal, we have no objection to your retaining supporting receipts and documents at the field offices provided that the employees responsible for maintaining the documents are familiar with required retention and storage procedures and are aware of the possibility that the documentation for some payments will need to be forwarded to the Coast Guard's Finance Center in Chesapeake, Virginia, for review or audit. However, statistical sampling procedures conducted after payment are necessary and

GAO/AIMD-97-35R Payment Processing (Coast Guard)

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should be continued since they provide a critical control in ensuring that the system is operating as intended, but the sample size and the frequency of the procedure can be modified based on the results of prior samples. These matters are discussed in detail in the following sections.

#### THE COAST GUARD'S CURRENT SYSTEM

Your staff provided the following information about the overall payment system practices, the volume of transactions occurring, the number of field offices affected, and the employees involved in the purchase process. The Coast Guard makes approximately 336,000 government credit card<sup>1</sup> purchases a year, totaling about \$100 million. About 7,800 Coast Guard employees are authorized to make purchases using their government-issued credit cards when conducting official business. These employees are assigned to approximately 1,300 field offices around the country, where 1,285 Coast Guard employees are designated as officials authorized to approve monthly credit card statements to be forwarded for payment. In a typical month, the Coast Guard's Finance Center in Chesapeake, Virginia, receives approximately 3,900 approved credit card statements that contain about 28,000 transactions to be certified for payment.

As your staff explained, each Coast Guard employee who makes credit card purchases receives a credit card statement listing data on each purchase during the month, including date of purchase, vendor, amount of purchase, vendor's transaction number for the item(s) purchased, and the outstanding total for the month. The employee must verify the accuracy of the statement, attach to the statement all receipts and related documentation that support each purchase, and provide a description of the items purchased. Then, the employee must sign the statement and forward it and the attached support to the approving official at the local unit for further processing.

The approving official reviews the statement and related attachments, signs the statement, and forwards it and the attachments to the Finance Center for payment certification. Your staff told us that the approving official's signature indicates that (1) budget authority was previously obligated and the items purchased were needed to achieve program objectives, (2) amounts on the statement are accurate, and (3) the items were received and accepted. If an unidentifiable purchase or improper amount has been charged by the vendor, the

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<sup>1</sup>Except for imprest fund purchases, all purchases are made with government-issued credit cards, and the cards are issued to authorized Coast Guard employees under an agreement with one bank.

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approving official's signature affirms that the credit card bank has been notified and the purchase or amount has not been approved for payment.

Each month, the Finance Center receives the approved statements with supporting documents from the field offices and an electronic file from the credit card bank containing the statements of all Coast Guard employees who made credit card purchases during the month. Finance Center employees verify that the approval signature is made by an authorized approving official and scan the statements looking for vendor names that may indicate questionable purchases. Any discrepancies or questionable items uncovered during the initial scan review are researched and resolved before Finance Center employees process the credit card statement in question. Then, the Finance Center employees enter two items into the automated consolidated billing system (CBS): the date the approved statements are received from the field offices and the total amount for each statement. Your staff advised us that the CBS then runs several electronic check and edit routines. One routine compares the total amount (the sum of all totals from all cardholders) with the related amount on the monthly invoice provided by the bank in order to help ensure completeness and accuracy. Any discrepancies are researched and adjusted prior to payment authorization.

Another automated routine, as your staff further explained, is one that reviews of each statement to identify purchases that may be unauthorized or require special approval. Using its Standard Industrial Codes (SIC)<sup>2</sup> file, which contains a universal data bank of "merchant types," the Center will judgmentally select a number of SICs (such as bars, cellular phone companies, auto rental and video rental merchants, and florists). The system can search all monthly statements and identify and report any statements that contain purchases from any of the chosen SICs. Based on vendor name and predefined dollar threshold amounts, the purchases identified through the SIC comparison would be researched and either require special approval by the field office approving official or be disallowed.

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<sup>2</sup>SICs are four-digit numbers assigned to types of private-sector merchants, such as restaurants, video rental stores, motor boat parts stores, and so on. The codes were developed by the credit card company (VISA) for the purpose of identifying the types of merchants. Each credit card purchase, whether for government business or the private sector, requires the seller to record its assigned number, which identifies, among other data, the merchant type and specific merchant.

Each month after payment is authorized and made, a 1-percent statistical sample is selected from the universe of all paid transactions for further examination to ensure that the payment processing controls are working as intended. Your staff explained that the sample selection and testing follow the requirements of Title 7. Each transaction selected for review, along with its attached supporting documentation, is examined thoroughly to determine, among other items, that the amount is accurate, the purchase is for authorized goods or services, and the cardholder is an authorized Coast Guard employee.

**THE COAST GUARD'S PROPOSED  
SYSTEM MODIFICATIONS**

You propose two changes to the current system. First, instead of requiring cardholders and their approving officials to forward all credit card statements and supporting documentation to the Finance Center each month, you would require them to use an alternative standardized, comprehensive Purchase Log.<sup>3</sup> Each month, the Purchase Log would be completed by the cardholder, listing for each purchase the date of purchase, vendor name and identification code, description of the goods or services purchased, amount of the purchase, and monthly totals. The cardholder would sign the log and the monthly credit card statement; ensure that the card statement and the log are reconciled; and forward them, along with all related receipts and supporting documentation, to the approving official. The approving official would review the log and statement, sign them, retain the receipts and supporting documentation on file, and forward the log and the statement to the Finance Center. The receipts and documentation would be retained at the field office for the required period and be available for review as needed.

When the log and the statement are received by the Finance Center, the Center's employees would perform the same tasks that are currently done, except that the log entries describing the item(s) purchased would be reviewed in place of the hard copy supporting documentation, as is currently done. The automated check and edit routines would remain the same.

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<sup>3</sup>Although the Coast Guard will require the use of the log in the foreseeable future, until the requirement is fully implemented, each field office would be given the option (to gain the support of the field office employees) of either forwarding the log without the supporting documents or forwarding the supporting documents, as is presently done.

According to your staff, the use of the log offers many benefits over the current system. The most compelling benefits are (1) eliminating photocopying and forwarding enormous volumes of receipts and supporting documents to the Finance Center and (2) relieving the Center's staff of having to scan, review, and analyze the documents, except when questions arise. All the needed information for authorizing and certifying payments would be contained in the log. You estimate that use of the log, when fully adopted, will result in approximately \$180,000 in annual savings/cost avoidance to the Coast Guard.

Second, you propose to eliminate the 1-percent statistical sample of transactions after payment, which is currently conducted to ensure that the controls are working as intended. Your staff explained that the vast majority of discrepancies or questionable purchases are uncovered not as a result of the 1-percent sampling procedures, but during the manual scan reviews, SIC routines, and automated check and edit routines. Your staff stated that the scan reviews and SIC routines would verify whether the payment processing controls are working as they should.

#### GAO'S ASSESSMENT OF THE PROPOSED SYSTEM MODIFICATIONS

Title 7 requires that payment be based on sufficient evidence to establish the validity of the claim prior to payment being made. To establish validity, the certifying officer must ensure the (1) propriety of the amounts claimed, (2) legality of disbursements, (3) correctness of the computations, and (4) accuracy of the facts stated on the claim voucher and supporting documents. However, GAO has long recognized that because of the high volume of transactions and the geographical dispersion of activities, the certifying officer must rely on the system of internal controls in the payment processing activities as the basis for assessing the validity of claims. The following sections discuss each of your two proposed modifications.

#### Retaining Documentation at the Field Offices

The certifying officer relies on two major controls within the payment processing system—administrative approval and the review of supporting documentation. The administrative approval is normally done by an official who works with or supervises the employee making the purchase, knows the circumstances surrounding the purchase and, therefore, can help assure the certifying officer that the purchase was valid. Review and examination of the supporting documentation—such as sales receipts, packing slips, common carrier statements,

and invoices--also provides assurance to the certifying officer that the purchase is adequately supported and accurate.

Under your proposed modifications, administrative approval will remain a critical control in establishing the validity of purchases. The approving official would continue to be familiar with the circumstances surrounding purchases and would review invoices (the monthly bank credit card statements) and supporting documentation to assess the accuracy, propriety, and correctness of the invoices. The log, containing all the detailed information about each purchase, would be sent to the certifying officer's location (the Finance Center); only the supporting documentation would remain at the field office.

As we have previously reported on systems for processing employee travel claims,<sup>4</sup> supporting documentation can be maintained at the official duty station where claims are initiated. Documentation supporting the validity of payments must be maintained for specified periods and under conditions that physically protect the documents. If the documents are needed for review by either the certifying officer (if questions arise or samples are selected for testing) or auditors (in the periodic examination of the system), they should be provided as requested. Also, we believe that the administrative approval process you propose should continue to provide the detailed information needed for payments to be certified. However, as a result of the changing procedures, the individual responsible for maintaining the supporting documents must be made fully aware (1) of the retention and storage requirements set forth in Title 8, "Records Retention," of GAO's Policy and Procedures Manual and (2) that he or she may be requested to forward the documents for review by the certifying officer or an auditor. Notifying the responsible person of these two requirements will help ensure that the quality of the documents is maintained and the documents are readily accessible and will be forwarded promptly when requested.

#### Eliminating Statistical Sampling

You propose to eliminate the statistical sampling procedures currently performed at your Finance Center because both the frequency and amount of errors uncovered have been minimal. However, we believe the sampling procedures are critical since they provide a mechanism for determining if the controls in the system are operating as intended and the document retention requirements are

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<sup>4</sup>See Employee Travel Claims (GAO/AIMD-95-71R, February 6, 1995); Air Force Automated Travel System (GAO/AIMD-95-74R, February 14, 1995); and Employee Travel Claims - DOD (GAO/AIMD-95-171R, June 26, 1995).

understood and being satisfied. Over time, processes may change and the effectiveness of controls may weaken; however, periodic sampling procedures should identify those controls that are not operating as intended and need corrective actions, thus ensuring over time that controls are effective. This sampling procedure helps the certifying officer effectively discharge his or her responsibilities, since staff independent of the field offices verify that (1) employees purchasing goods and services made proper, legal, and authorized purchases within the scope of their responsibilities and (2) the administrative officers' review and examination of the purchases were complete, accurate, and effectively carried out.

The depth and frequency of sampling procedures may vary depending upon the number and materiality of errors uncovered during the prior sampling processes. The objective is to use the sampling process to the extent necessary to ensure that the system is working as intended. If, as you stated, the current sampling process at the Finance Center uncovers minimal and immaterial errors, a smaller sample size could be selected and the procedure could be performed less frequently, such as once every quarter or longer. Conversely, if a sample uncovers higher error rates and/or greater materiality, the frequency and sample size would need to be increased accordingly.

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In conclusion, we believe it is necessary to periodically verify the adequacy of the system operation as is currently done by sampling procedures conducted after payment. Also, we believe it is necessary to ensure that field office employees are adequately discharging their responsibility to retain documentation. Therefore, the following procedures or steps should be maintained or implemented:

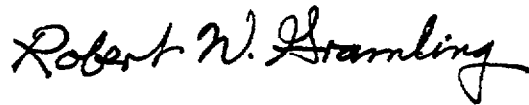
- Continue conducting some level of after-payment sampling to ensure that the system is operating as intended and that documents are being retained.
- Formally communicate with or conduct training sessions for employees and officials responsible for maintaining supporting documentation at the field offices regarding the retention and storage requirements set forth in Title 8.
- Formally communicate to field office personnel that some documentation supporting those purchases will be requested for review or detailed examination and would need to be forwarded to the Center.

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The contents of this letter were discussed with Mr. John Barcynski of your staff. We hope our comments are helpful. If you have any questions or would like to discuss these matters further, please contact me at (202) 512-9406 or Bruce Michelson, Assistant Director, at (202) 512-9366.

Sincerely yours,

A handwritten signature in cursive script that reads "Robert W. Gramling".

Robert W. Gramling  
Director, Corporate Audits and Standards

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