

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

PROCESSING PROGRESS PAYMENTS IN
TEL AVIV, ISRAEL AND IN HEIDELBERG, GERMANY

Report Number 91-113

August 7, 1991

Department of Defense

The following acronyms are used in this report.

ACO.....	Administrative Contracting Officer
CAPS.....	Computerized Accounts Payable System
CAS.....	Contract Administration Services
DCAA.....	Defense Contract Audit Agency
DCMAO.....	Defense Contract Management Area Office
DFARS.....	Defense Federal Acquisition Regulation Supplement
DLAM.....	Defense Logistics Agency Manual
FAR.....	Federal Acquisition Regulation
TFC.....	Theater Finance Command
USACIDC.....	U.S. Army Criminal Investigation Command



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

August 7, 1991

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL
MANAGEMENT)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Processing Progress Payments in
Tel Aviv, Israel and in Heidelberg, Germany
(Report No. 91-113)

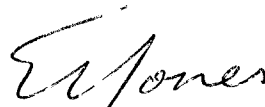
This is our final report on the Audit of Progress Payments in Tel Aviv, Israel and in Heidelberg, Germany, for your information. The audit resulted from an inquiry from Congressman Nicholas Mavroules concerning procedures and activities at the U.S. Army Mid-East Contract Administration Services (CAS) Branch Office, which was consolidated into the Defense Contract Management Area Office (DCMAO), Tel Aviv, Israel. Based on the review at the Mid-East CAS Branch, we expanded our review to include progress payment liquidation procedures by the 266th Theater Finance Command (TFC), Heidelberg, Germany.

The audit showed a lack of internal controls applicable to the approval of progress payments by the administrative contracting officer at the Mid-East CAS Branch. On 17 contracts reviewed, \$11.5 million in progress payments were authorized contrary to the Federal Acquisition Regulation and contractual requirements resulting in a loss of about \$548,000 in interest by the U.S. Treasury. At the TFC, internal controls were missing or circumvented in the processing of contract payments. Eleven contracts contained \$2.0 million in duplicate payments, \$4.4 million in progress payments that were not properly liquidated, and \$431,000 in lost interest to the Government.

On April 26, 1991, a draft of this report was provided to the Assistant Secretary of the Army (Financial Management) and the Director, Defense Logistics Agency, to whom the report recommendations were addressed. We received comments from the Defense Logistics Agency on June 20, 1991, and from the Army on June 26, 1991. The Defense Logistics Agency concurred with Finding A. and stated that an internal control review will be scheduled during fiscal year 1992. The Army concurred with Finding B. and stated that new procedures have been established to correct the internal control problems identified and that the duplicate payments made on both an Army and an Air Force contract have been corrected. These actions fully comply with the recommendations of the report. Complete texts of managements' comments are included in Part IV.

The management responses to a draft of this report conformed to the provisions of DoD Directive 7650.3. No unresolved issues exist on the audit recommendations and there are no potential monetary benefits. Accordingly, additional comments on this final report are not required.

The courtesies and assistance extended to the audit staff are appreciated. If you have any questions on this final report, please contact Mr. James J. McHale, Program Director, at (703) 614-6257 (DSN 224-6257), or Mr. Wayne K. Million, Project Manager, at (703) 693-0593 (DSN 223-0593). The audit team members are listed inside the back cover. Copies of the final report will be distributed as shown in Appendix F.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc:

Secretary of the Army
Assistant Secretary of the Army (Procurement)
Director, Defense Contract Management Command

Office of the Inspector General, DoD

AUDIT REPORT NO. 91-113
(Project No. OCD-0067.02)

August 7, 1991

PROCESSING PROGRESS PAYMENTS IN
TEL AVIV, ISRAEL AND IN HEIDELBERG, GERMANY

EXECUTIVE SUMMARY

Introduction. The audit was initiated as part of a congressional inquiry concerning procedures and activities at the U.S. Army Mid-East Contract Administration Services (CAS) Branch Office, which was consolidated into the Defense Contract Management Area Office (DCMAO), Tel Aviv, Israel. There were 10 allegations in the congressional inquiry and this report addresses the allegation concerning approval of progress payments by the Mid-East CAS Branch Office. Based on data in the records at Tel Aviv, the audit was expanded to include the payment of progress payments by the 266th Theater Finance Command (TFC), Heidelberg, Germany. The remaining allegations will be addressed in a future report.

Objectives. The audit objectives were to evaluate procedures and practices applicable to the approval, payment, and liquidation of progress payments. The audit also reviewed the adequacy of internal controls applicable to the audit objectives.

Audit Results. At the Mid-East CAS Branch, the Administrative Contracting Officer improperly approved progress payments that were prohibited by the Federal Acquisition Regulation (FAR) and contract provisions. For the 17 contracts in our sample, there were 53 improper progress payment authorizations totaling \$11.5 million. As a result of these premature payments, the U.S. Government lost about \$548,000 in interest.

TFC payment personnel did not liquidate \$4.4 million in progress payments as required on 11 contracts in our sample. Additionally, payments of \$2.0 million were paid in duplicate to contractors. Because of these improper liquidations and overpayments, the U.S. Government lost about \$431,000 in interest.

Internal Controls. Basic internal controls such as supervision and documentation were ignored and internal procedures were inadequate to prevent the improper use of the Government's funds. See Findings A and B for details of these weaknesses and Part I for details of our review of internal controls.

Potential Benefits of Audit. The audit identified internal control weaknesses which, when corrected, will result in improved operations. No monetary benefits were identified (Appendix D).

Summary of Recommendations and Management Comments. We recommended that the Commander, Defense Contract Management Command schedule an internal control review of DCMAO, Tel Aviv, within fiscal year 1992. The Defense Logistics Agency concurred with Finding A. and stated that an internal control review will be scheduled during fiscal year 1992. We also recommend that the U.S. Army Europe, Deputy Commander in Chief, Resource Management establish various internal procedures to correct the internal control weaknesses. The Army concurred with Finding B. and stated that all actions recommended were implemented. Management comments to the draft are summarized in Part II of this report, and the complete texts of the responses are in Part IV.

TABLE OF CONTENTS

	<u>Page</u>
TRANSMITTAL MEMORANDUM	
EXECUTIVE SUMMARY	i
PART I - INTRODUCTION	1
Background	1
Objectives	2
Scope	2
Internal Controls	4
Prior Audits and Other Reviews	4
Other Matters of Interest	4
PART II - FINDINGS AND RECOMMENDATIONS	7
A. Approval of Progress Payments	7
B. Progress Payments and Invoices	13
PART III - ADDITIONAL INFORMATION	19
APPENDIX A - U.S. Army Criminal Investigation Command Case Numbers Related to Finding A.	21
APPENDIX B - Listing of Sample Contracts Reviewed at Tel Aviv, Israel	23
APPENDIX C - Listing of Sample Contracts Reviewed at 266th Theater Finance Command	25
APPENDIX D - Summary of Potential Monetary and Other Benefits Resulting from Audit	27
APPENDIX E - Activities Visited or Contacted	29
APPENDIX F - Report Distribution	31

PART IV - MANAGEMENT COMMENTS	33
Defense Logistics Agency Comments	35
Assistant Secretary of the Army (Financial Management) Comments	39

This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of this report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703) 693-0340 (DSN 223-0340).

PART I - INTRODUCTION

Background

The Federal Acquisition Regulation (FAR) establishes codification and publication of uniform policies and procedures for all acquisitions by executive agencies. FAR part 32 (as amended by Federal Acquisition Circular 84-30) sets forth the basic policies and procedures for Federal agencies to use for contract financing and other payment issues. Specifically, FAR section 32.102,(b) defines progress payments based on costs as payments "made on the basis of costs incurred by the contractor as work progresses under the contract." The Defense Federal Acquisition Regulation Supplement (DFARS) contains the guidance and direction that DoD contracting personnel should use when they administer and finance DoD contracts. The Military Departments and Defense agencies further supplement the FAR and DFARS with their own acquisition regulations.

FAR 32.502-1(a) states that the contracting officer may contractually provide for progress payments if the contractor:

(1) will not be able to bill for the first delivery of product, or other performance milestones, for a substantial time after work must begin (normally 4 months or more for small business concerns; 6 months or more for others), and (2) will make expenditures for contract performance during the predelivery period that have a significant impact on the contractor's working capital.

As the contractor incurs expenditures during the predelivery period, progress payments may be requested on Standard Form 1443, "Contractor's Request for Progress Payment," which replaces Department of Defense Form 1195, and submitted to the administrative contracting officer (ACO) for approval. Before approving progress payments, the ACO must be reasonably assured that the Government is adequately protected against any subsequent loss.

Two types of progress payments are allowed by FAR section 32.501: customary and unusual. Customary progress payments are made under the customary progress payment rate of 80 percent and use costs as the base. The frequency of payments is determined by the progress payment clause in the basic contract. All other progress payment methods are considered unusual and require special approval by the agency. Unusual progress payments may use various rates, ranging as low as 70 percent or as high as 90 percent. The progress payment rate indicates the percentage of incurred costs, as well as the percentage of the total contract price that may be paid through progress payments.

Objectives

Audit of DoD Contracting in Europe was initiated on April 24, 1990, to determine if contractor selection and award and contract administration procedures are in accordance with applicable laws, regulations, and host nation agreements. The audit also focused on the internal controls applicable to the audit objectives and the effectiveness and efficiency of the implementation of the management control program at the Defense Logistics Agency. On April 17, 1990, we received a congressional request from Representative Nicholas Mavroules, which included 10 allegations concerning procedures and activities at the U.S. Army Mid-East Contract Administration Services (CAS) Branch Office, which was subsequently consolidated into the Defense Contract Management Area Office (DCMAO), Tel Aviv, Israel. Since the audit of DoD Contracting in Europe included the Mid-East CAS Branch Office, Tel Aviv, the congressional request was incorporated into the ongoing audit. Additionally, we found liquidation problems at the Mid-East CAS Branch Office in progress payments made by the 266th Theater Finance Command (TFC), Heidelberg, Germany.

On reviewing the congressional request, we changed the objectives of the audit to evaluate the procedures, practices, and internal controls applicable to the approval, payment, and liquidation of progress payments to contractors. Since contracts were not awarded at either the Mid-East CAS Branch or TFC, we did not review award procedures at these locations. Separate reports will be issued, that will respond to the overall congressional complaint and cover the other portions of the announced objectives of the audit.

Scope

The U.S. Army Mid-East (CAS) Branch Office provides contract administration functions for Defense contractors located in Israel. In July 1990, the Mid-East CAS Branch Office administered 173 Israeli contracts, valued at about \$731 million. Since one of the allegations specifically charged that progress payments were approved contrary to contract provisions and without adequate review and scrutiny, we attempted to identify those contracts with progress payments and limited contractual provisions. Our review included 17 such contracts awarded during fiscal years 1986 through 1989 and valued at \$198.0 million. We did not attempt to identify or sample all such contracts because we believe that these 17 contracts are the majority of the contracts and dollar values involved. Therefore, projection of results would not be appropriate and would not yield any significant differences.

We analyzed the requests for progress payments to determine whether they were properly reviewed and approved at the Mid-East

CAS Branch Office. During this analysis, we observed indications that payment and liquidation of progress payments by the paying office may not have been in accordance with DoD requirements. Accordingly, we expanded our audit to include the paying office for these contracts.

The primary function of the Commercial Accounts Branch at the TFC is to process payments for supplies, equipment, and nonpersonal services to foreign contractors for the DoD. The TFC maintains a computerized accounts payable system (CAPS) database, which accumulates payment data on contracts assigned to the TFC for payment. As of August 27, 1990, there were approximately 9,800 contracts (excluding Blanket Purchase Agreements) in the CAPS database for payments totaling \$533 million. Of the 9,800 contracts, approximately 60 percent was to be paid in 12 foreign currencies. Our sample was based on large-dollar-value contracts because the TFC did not have a means of identifying those contracts with progress payment provisions. Using the CAPS database, we identified 60 contracts valued at over \$500,000 each. A physical review of the contract folders determined that no payments had been made for nine of these contracts at the time of our review. Of the remaining 51 contracts, TFC located only 46 contract folders for our review. Eleven of these contracts (valued at \$105.7 million) were determined to have progress payment provisions and therefore became the basis for our audit. Six of these contracts, valued at \$ 91.5 million, were also included in our review at DCMAO Tel Aviv. Because of the poor contract file storage procedures at the TFC, we believe that the five contract files not located were actually missing. During our review, TFC personnel implemented new contract file storage procedures and began to reconstruct these missing files.

We used the CAPS database for the initial identification of large-dollar-value contracts. According to TFC personnel, the data input to the database had not been verified, and accuracy was already questionable. In our opinion, the 11 contracts selected at the TFC represent the major portion of the dollar value of contracts with progress payments. Projection of results would not be appropriate and would not yield any significant differences. Accordingly, we did not attempt to evaluate the accuracy of this database.

This economy and efficiency audit was performed at the Mid-East CAS Branch Office, Tel Aviv, Israel, and TFC, Heidelberg, Germany, from July 1990 through December 1990 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly, included such tests of the internal controls as were considered necessary. Activities visited or contacted are listed in Appendix E.

Internal Controls

We evaluated internal controls applicable to the Mid-East CAS Branch Office's and TFC's processing of progress payments. Specifically, we reviewed the Mid-East CAS Branch office contract files; TFC contract files; CAPS data at the TFC; and FAR, DFARS, Defense Logistics Agency and Army regulatory requirements. In addition, we interviewed contract or payment personnel at both locations to further evaluate internal controls.

The audit identified material internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Existing internal controls were not followed, and additional internal controls needed to be implemented. The internal control weaknesses included inadequate supervision, insufficient documentation, and noncompliance with regulatory requirements for the approval, payment, and liquidation of progress payments. Changes implemented during our review and the recommendations in Findings A and B, if implemented, will correct these weaknesses. We did not identify measurable monetary benefits to be realized by implementing the recommendations. A copy of the final report will be provided to the senior officials responsible for internal controls within the Office of the Secretary of the Army and the Director, Defense Logistics Agency.

Prior Audits and Other Reviews

U.S. Army Audit Agency issued Report No. EU 90-9, "Pay and Commercial Accounts Operations," April 17, 1990, pertaining to TFC, Heidelberg, Germany. Finding E. of that report identified problems with internal controls that resulted in fraudulent duplicate payments of invoices. The U.S. Army Audit Agency recommended that the TFC request help from the Deputy Chief of Staff, Information Management, U.S. Army, Europe and Seventh Army to revise accounting system programs. The program that was intended to identify duplicate payments required modification to identify invoices submitted for payment twice in the same month. TFC initiated an in-house change to modify the criteria for possible duplicate payments to include two additional date fields. In addition, TFC agreed to accept assistance from the Deputy Chief of Staff as recommended and would submit a request no later than March 31, 1990. This action was considered responsive. Part II, Finding B., of this report also identified duplicate payments which were processed prior to the implementation of TFC's changes.

Other Matters of Interest

Effective October 1, 1990, the U.S. Army Mid-East CAS Branch Office merged with the U.S. Air Force, Detachment 32, Contract Management Command, Tel Aviv, to become the DCMAO, Tel Aviv.

Because our review was initiated before the reorganization and the congressional complaint was directed at the U.S. Army CAS Branch Office, we concentrated our review on U.S. Army administered contracts. Through discussions with Air Force personnel in Tel Aviv, we determined that very few of the Air Force administered contracts contained progress payments; therefore, we did not include them in our review.

During January 1990, a new Chief was appointed to the U.S. Army CAS Branch Office. The new Chief revised various procedures that he determined to be inadequate. Procedures for the approval of progress payments were totally revised, which now require a determination that the expenses were incurred and that the contractor's accounting system is adequate to support progress payments. All problems we identified were applicable to the conditions that existed before the change of command and the reorganization under the Defense Contract Management Command.

Because the congressional complaint contained allegations of possible criminal implications, the U.S. Army Criminal Investigation Command (USACIDC) sent special agents to review the allegations. USACIDC was reviewing much of the same data as our audit; therefore, it was agreed that the allegations would be resolved by a joint effort. As a result of this combined audit/investigation, USACIDC opened cases involving some of the same areas that we included in this report. USACIDC's results will be identified separately in reports of investigation documented under USACIDC case numbers. See Appendix A for related USACIDC case numbers.

PART II - FINDINGS AND RECOMMENDATIONS

A. APPROVAL OF PROGRESS PAYMENTS

The Administrative Contracting Officer at the Mid-East CAS Branch Office improperly approved progress payments that were prohibited by the contracts. The progress payments were approved because there were no internal controls and because local procedures circumvented regulatory requirements. These procedures were not in conformance with the FAR, the DFARS, the requirements of the Army and the Defense Logistics Agency. As a result, authorizations of progress payments were not in accordance with contract provisions, and 53 improper payments of \$11.5 million were made to Israeli contractors. These payments resulted in interest of \$547,831 lost to the U.S. Government.

DISCUSSION OF DETAILS

Supervision, Administration, and Approval of Progress Payments

FAR 32.503, "Postaward matters," establishes the Administrative Contracting Officer's (ACO) responsibility in the supervision, administration, and approval of progress payments after the contract is awarded. FAR 32.503-3 states:

(a) For contractors that the administrative contracting officer (ACO) has found by previous experience or recent audit review (within the last 12 months) to be (1) reliable, competent, and capable of satisfactory performance, (2) possessed of an adequate accounting system and controls, and (3) in sound financial condition, progress payments in amounts requested by the contractor should be approved as a matter of course.

(b) For all other contractors, the ACO shall not approve progress payments before determining (1) that (i) the contractor will be capable of liquidating any progress payments or (ii) the Government is otherwise protected against loss by additional protective provisions, and (2) that the contractor's accounting system and controls are adequate for proper administration of progress payments.

During the period covered by our audit, the Chief of the contract administration office issued local procedures for processing progress payments. These procedures covered internal processing requirements, which included time stamping and logging in the receipt of the progress payment request, ensuring that the form was properly executed and mathematically correct, and processing of a cover letter to the payment office. The most significant part of the procedures, identified in all capital letters, was the statement:

ALL INCOMING PROGRESS PAYMENTS WILL BE PROCESSED AND FORWARDED TO APPROPRIATE FINANCE CENTER WITHIN 24 HOURS OF RECEIPT. IF YOU ARE UNABLE TO ACCOMPLISH THIS WITHIN THE REQUIRED TIME FRAME ASK FOR HELP!

Although the local procedures included some internal controls, the local procedures ignored all requirements of the FAR pertaining to the evaluation and approval of progress payments and did not require a review of the contract to determine if progress payments were authorized. The major emphasis was placed not on the protection of the Government's interest, but rather on assisting the contractor in receiving a quick payment.

In 1990, the new Chief at the Mid-East CAS Branch Office, Tel Aviv, recognized that these procedures were inappropriate. Subsequently, procedures established in Defense Logistics Agency Manual (DLAM) 8105.1 were implemented. Part 32.591-2 of DLAM 8105.1, "System Requirements Prior to Submission of First Progress Payment," requires that the ACO complete a series of actions before the first progress payment can be paid. Some of these actions include:

- If required, establishment of a first article dollar limitation.
- Determination of the adequacy of the contractor's accounting system for the use of progress payments.

First Article Limitations

Before full production, the Government may require that the contractor produce a preproduction, initial, test, or pilot sample. The samples are referred to as "First Article" items and are to be tested first (First Article Testing) to ensure that the subsequently delivered product conforms to all contract requirements. Contract clauses applicable to first article testing provide additional limitations on the use of progress payments.

Under the basic first article clauses (FAR 52.209-3 and 4), no progress payments are allowed until the First Article item is approved:

Before first article approval, the acquisition of material or components for, or the commencement of production of, the balance of the contract quantity is at the sole risk of the Contractor. Before first article approval, the cost thereof shall not be allocable to this contract for (1) progress payments, or (2) termination settlements . . .

If it is necessary for the contracting officer to authorize the contractor's purchase of material or commencement of production prior to First Article approval, an alternate clause may be used. This alternate clause provides that only specific, written authorized cost may be applicable to progress payments:

Before first article approval, the Contracting Officer may, by written authorization, authorize the Contractor to acquire specific materials or components or to commence production to the extent essential to meet the delivery schedules. Until first article approval is granted, only costs for the first article and costs incurred under this authorization are allocable to this contract for (1) progress payments, or (2) termination settlements . . .

For the 17 contracts in our sample, we found no evidence that the contracts' progress payment provisions had been reviewed to determine if any limitations existed. None of the contract folders contained instances of a progress payment being disapproved due to the requirement for First Article approval. For 6 of the contracts reviewed, 28 progress payments totaling \$2.5 million were authorized before the First Article approval, though prohibited by the contract clauses. For these contracts, we attempted to determine whether the Government was adversely affected. For four of the six contracts, the First Article was subsequently approved, and the contractor made deliveries as necessary. For one of the six contracts, the First Article tests were being performed. The ACO elected to wait for the results of the tests before taking further action. The contractor was still experiencing problems in producing an acceptable item for the sixth contract. Discussing this contract with the ACO resulted in the initiation of a repayment demand letter to the contractor. Accordingly, the contractor provided a check for \$91,048. This action represented three progress payments made between November 1988 and April 1989, to which the contractor was not entitled. Further, for three of the six contracts (all to one contractor), a Method "C" was processed for a period of time in which no product could be accepted and all payments were halted until the contractor could make necessary corrections to comply with contract requirements. During this time, however, the ACO approved a progress payment of \$47,730 for the contractor.

With the assistance of a financial expert from TFC and a special agent from USACIDC, the contractors were questioned as to why these requests were submitted. In all cases, it was determined that the contractors were not clear on the requirements of the First Article provisions in relation to progress payments. There were no indications that the contractors intentionally attempted to defraud the Government.

Review of Contractor's Financial Accounting System

FAR 32.503, further requires that the ACO be assured that the contractor has an adequate financial accounting system and controls to support progress payments before progress payments can be approved. If the contractor has not had an evaluation performed before the award, such as a pre-award survey, a cost study, a Defense Contract Audit Agency (DCAA) audit, or other evaluations within the most recent 12 months, the ACO must request financial services to obtain assistance. This assistance would normally be obtained from DCAA, in the form of a financial accounting system review of the contractor's records, procedures, and internal controls, to determine if they are adequate to support progress payments.

For 5 of the contracts in our sample, 14 progress payments totaling \$2.3 million were authorized without documentation to indicate that the ACO was assured that the contractor had an adequate financial accounting system and controls. Additionally, for three of these five contracts, which included six progress payments totaling \$1.0 million, First Article requirements were ignored along with the financial accounting system and controls requirement when progress payment request approval was granted.

For three additional contracts in our sample, the ACO had received the results of a DCAA audit. These three audits determined that the contractor did not have an adequate financial accounting system and controls to support progress payments. The audits recommended that no progress payments be approved until corrections were made. On these 3 contracts, the ACO approved 17 requests for progress payments totaling \$7.7 million contrary to DCAA's recommendations. Subsequently, DCAA determined that corrections were made and the financial accounting systems and controls were adequate.

Interest Lost to the U.S. Government

On 11 contracts, the ACO approved progress payment requests totaling \$11.5 million that were contrary to the requirements of the FAR and contract clauses. When we brought these conditions to the attention of the current ACO, various actions were taken. However, during the interim period of time, the contractors had use of \$11.5 million, which should not have been paid. Considering the rate of interest, as provided by the U.S. Treasury Department, we calculated that \$547,831 was lost to the U.S. Government as a result of the inappropriate actions by the ACO.

Actions Taken

Although we identified material internal control weaknesses, replacement of the ACO/Office Chief at the Tel Aviv office, brought about new internal procedures and practices, which should correct the problems and internal control weaknesses identified in the report. The reorganization under the Defense Contract Management Command has resulted in additional changes since our audit. Accordingly, we are not making specific recommendations applicable to the DCMAO, Tel Aviv. However, because our review was during the reorganization, we only reviewed internal controls related to progress payments. We believe that it would be prudent to have a general review of all internal controls by an outside organization.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Commander, Defense Contract Management Command, International, schedule an internal control review of the Defense Contract Management Area Office, Tel Aviv, within the next fiscal year.

MANAGEMENT COMMENTS

The Defense Logistics Agency concurred with the recommendation and provided comments stating that an internal control review will be scheduled for fiscal year 1992. A complete text of the comments is in Part IV.

B. PROGRESS PAYMENTS AND INVOICES

The Commercial Accounts Branch at the 266th Theater Finance Command improperly processed progress payments and incorrectly paid invoices because existing internal controls were either inadequate or circumvented. As a result, \$2.0 million in invoices and progress payments were paid in duplicate, \$4.4 million of progress payments were not properly liquidated, and \$289,687 was erroneously adjusted, causing the loss of \$430,780 in interest to the U.S. Government.

DISCUSSION OF DETAILS

Background

DoD Directive 5010.38, "Internal Management Control Program," identifies six specific standards that should be included in internal control programs. These standards include, but are not limited to, supervision and documentation.

Supervision. Internal controls generally require that adequate supervision, which includes qualified and continuous oversight, be provided to ensure that internal control objectives are achieved. Furthermore, operating level staff must be provided necessary guidance, training, and review. Duties, responsibilities, and accountabilities must be clearly delineated and communicated for each functional process. Work must be reviewed and approved to the extent necessary to ensure that critical objectives are accomplished and that errors, waste, and wrongful acts are minimized.

Supervisory review and approval are essential, since documents such as invoices, progress payments, and DD Forms 250, "Material Inspection and Receiving Report," are such vital tools in ensuring proper payments to contractors. The role of the supervisor is a control that helps eliminate errors, misunderstandings, and improper practices; and increases the chance that an illegal act will be detected.

During the audit, there were no indications that supervisors were actively involved in the payment process that included progress payments. However, during the audit, new supervisory procedures were being implemented, which should improve the accuracy and productivity at the TFC.

Documentation. Documentation requires that all transactions and significant events be complete and accurate to facilitate tracking the transaction or event from inception to completion. Further, the documentation must be available for examination. In our opinion, the internal control standard requires that documentation be purposeful and useful to managers to facilitate control of the operations. Additionally, the documentation must

be organized in a manner that allows operating personnel, supervisors, auditors, and others who review the file, to clearly reconstruct the complete series of events.

At TFC, we found that documentation was not maintained in a manner conducive to the reconstruction of prior transactions. We initially requested contract folders to identify those contracts containing progress payment provisions. After exhaustive searching, TFC personnel were unable to locate 5 of the 60 contract folders that we requested. The current (new) division manager explained that prior to her arrival, there was no system for storage and maintenance of active contracts. A contract folder file and checkout system had been recently installed and missing folders were still being identified.

Once TFC personnel provided us the contract folders, we determined that the documentation in the folders was not complete. Six of the eleven contracts we reviewed did not contain the basic contract or modification data. When the basic contract or any modifications are missing or never received, examiners are unable to determine or verify different contract provisions such as progress payment rates and liquidation rates. Additionally, only active invoice and payment data were available in the contract files. Older payment data, which is useful in determining and eliminating duplicate payments, were sent to a records holding area and were not immediately available.

Processing of Payment Request

TFC uses CAPS to assist in processing and monitoring obligations and expenditures. However, during the implementation of CAPS at TFC, existing obligation and expenditure data were entered into CAPS without being verified as accurate before the input. Additionally, the data input was not verified as accurate when entered. As a result, there are significant errors or missing data currently in the CAPS data base, which contributed to payment processing inaccuracies.

When contractors submit invoices for payment, personnel at TFC enter the amounts and due dates of the invoices in the computer. A batch printout of the invoices, with the same due date, is distributed to voucher examiners. The voucher examiners should review the invoices before the due date for accuracy and correctness, and should review the contract for any limiting provisions that may affect the payment process. Then, as invoices become due, payments can be correctly executed.

Payment transfers. For 5 of the 11 contracts in our sample, initial payments were made by a designated paying office other than TFC and then officially transferred to TFC for subsequent payments. When payment responsibility was transferred to TFC, a

summary of payments was received from the previous payment office; however, none of the details supporting the payments were ever requested or received by TFC. This process also contributed to incomplete and inaccurate data being entered into CAPS. Additionally, TFC personnel could not always determine which items had been paid or the amount of liquidation of progress payments.

Duplicate payments. Three of the eleven contracts reviewed contained duplicate payments totaling \$1,964,566. For example, contract DAAE07-87-CA077 included an invoice for \$237,600, which was paid on January 31, 1990. In addition, a progress payment request for \$1,346,416 was paid on February 26, 1990. Both of these items were paid again on March 26, 1990, resulting in an overpayment of \$1,584,016.

In one instance, a duplicate payment was processed under two different contracts. On November 27, 1989, TFC made an invoice payment on U.S. Army contract DAAA09-86-C0995 for \$360,297. This invoice was for items supplied to the U.S. Air Force, by the same contractor, under contract F09603-86-C2279. Contract payment data showed that a subsequent payment was correctly made against the Air Force contract on December 18, 1989. However, an adjustment was not processed against the Army contract reversing the erroneous payment.

In addition to CAPS, TFC also maintains a manual payment log in the contract file. The amount, date of payment, and invoice or progress payment number are recorded on these logs by accounting appropriation. However, even with both a mechanized support system and a manual support system, these four payments were still duplicated. The U.S. Army Audit Agency had also identified this problem of duplicate payments in Report No. EU 90-9, "Pay and Commercial Accounts Operations," dated April 17, 1990. TFC responded to that report and was in the process of implementing corrective action during our review.

Liquidation of Progress Payments

FAR section 32.503-8, states, "Progress payments are recouped by the Government through the deduction of liquidations from payments that would otherwise be due to the contractor for completed contract items." Progress payment rates, as well as the corresponding liquidation rates are set forth in the progress payment clauses of the contract. The liquidation rate is normally the same as the progress payment rate unless the contracting officer has specifically authorized the use of a different rate. Once a contractor requests and receives progress payments, subsequent invoice requests for payment must be reduced by the liquidation rate. When applied properly, this results in the Government recovering, from each invoice, that portion of the invoice previously paid by means of progress payments.

At TFC, we found no system, either mechanized or manual, which identified or tracked unliquidated progress payments. This allowed for invoice payments to be made without the required reduction to liquidate prior outstanding progress payments. For 8 of the 11 contracts in our sample, progress payments were not properly liquidated. For 47 invoices on these 8 contracts, operating personnel at TFC approved disbursements on which the payment was not properly reduced to liquidate outstanding progress payment amounts. As a result, \$4.4 million was improperly disbursed to contractors. Additionally, for 14 of these 47 invoices, the contractor identified the net amount due. The invoice showed the total amount delivered, less the amount applicable to liquidate progress payments, to arrive at a net amount due. However, TFC personnel still approved and paid the full amount of the invoice. Of the \$4.4 million overpayment, the contractors correctly identified the net amount due on \$1.2 million of this overpayment.

Additionally, there were no controls to identify when a progress payment had been fully liquidated. On contract N00600-86-C0341, progress payment liquidations were identified and processed against invoices as they were submitted. However, when the progress payments were fully liquidated, an additional invoice for \$164,195.10 was paid at the liquidation rate of 20 percent, or \$32,839.02; an underpayment of \$131,356.08.

Erroneous Adjustments

On contract DAAE07-87-CA077, the contractor notified both the ACO and the TFC concerning various overpayments that the contractor had received. The ACO also forwarded the overpayment information to the TFC. When TFC personnel reviewed the data, it was determined that on seven vouchers, overpayment had been made and an appropriate adjustment was made for \$524,240 on January 31, 1990. However, on February 26, 1990, TFC personnel processed a duplicate adjustment for four of the seven prior overpayments causing a net underpayment of \$289,687. TFC personnel could not explain the second adjustment.

Lost Interest

As a result of the deficiencies involving duplicate payments and improper liquidation of progress payments, the Government lost interest because funds were disbursed in excess of that authorized. Combining the various problems, about \$6.7 million was inappropriately disbursed by TFC personnel. Using the interest rates provided by the U.S. Treasury Department, we calculated that the U.S. Government lost \$430,780 in interest.

Recovery of Overpayments

Subsequent to our review at TFC, we returned to Israel to complete additional audit work related to the congressional complaint. As part of this continuing review, USACIDC Special Agents and financial experts from TFC accompanied us as contractor personnel were contacted. As a result of these visits to contractors that were overpaid, three contractors provided five refund checks for overpayments, totaling \$476,000. TFC personnel accepted and processed these checks on behalf of the U.S. Government. By the completion of our audit, all payment errors discussed in this finding were corrected or were in the process of being corrected, except the duplicate payment processed under two different contracts.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the U.S. Army Europe, Deputy Commander in Chief, Resource Management:

1. Establish procedures to maintain all contracts and payment data either within the contract folder or in a readily identifiable and recoverable storage location.
2. Validate all existing data in the Computerized Accounts Payable System and implement procedures so that all subsequent data are entered accurately.
3. Request supporting details when payment functions are transferred from other paying activities.
4. Process necessary correction to contract DAAA09-86-C0995 to correct erroneous payment of invoices from contract F09603-86-C2279.
5. Establish procedures to monitor the liquidation of progress payments which, as a minimum, identify the liquidation rate, progress payments paid to date, unliquidated progress payment amount, and establishes a control that progress payments are consistently liquidated and prevents overliquidation of progress payments.

MANAGEMENT COMMENTS

The Department of the Army concurred with the five recommendations and provided comments stating that actions and procedures have been implemented to comply with these recommendations. A complete text of the Army's comments is in Part IV.

PART III - ADDITIONAL INFORMATION

APPENDIX A - U.S. Army Criminal Investigation Command
Case Numbers Related to Finding A.

APPENDIX B - Listing of Sample Contracts Reviewed at
Tel Aviv, Israel

APPENDIX C - Listing of Sample Contracts Reviewed at
266th Theater Finance Command

APPENDIX D - Summary of Potential Monetary and Other
Benefits Resulting from Audit

APPENDIX E - Activities Visited or Contacted

APPENDIX F - Report Distribution

**APPENDIX A: U.S. ARMY CRIMINAL INVESTIGATION COMMAND CASE
NUMBERS RELATED TO FINDING A.**

0081-90-CID507-17022-5M3E/8G1

0082-90-CID507-17023-5M3E/8G1

0085-90-CID507-17024-5M3E/8G1

0087-90-CID507-17025-5M3E/8G1

0088-90-CID507-17026-5M3E/8G1

APPENDIX B: LISTING OF SAMPLE CONTRACTS REVIEWED AT TEL AVIV, ISRAEL

<u>Contract Number</u>	<u>Contractor</u>	<u>Dollar Amount</u>
DAAE07-87-CA077	Ashot Ashkelon Industries, Ltd	\$ 6,428,400
DAAA09-86-C0687	Reshef	\$ 1,622,237
DAAE07-87-CR113	IAI Ramata	\$28,799,049
DAAB07-86-CT004	Tadiran	\$ 7,325,099
DAAH01-87-C0868	IMCO	\$ 119,777
DAAB07-88-CG225	IMCO	\$ 140,300
N00024-87-C5402	IMI Haifa	\$65,894,295
F04606-88-C0887	Orbit	\$ 8,438,398
DAAE07-88-C0357	IMCO	\$ 325,053
DAAB07-89-CT061	Tadiran	\$18,006,753
DAAA09-86-C0995	IMI Bamifneh	\$ 2,646,191
N00019-88-C0054	IAI Tamam	\$40,461,984
N00600-86-C0341	IMI Ramat Hasharon	\$ 3,267,235
DAAJ09-89-C0159	IAI Ramata	\$ 478,667
DAAA09-87-C0821	Rabintex Industries, Ltd	\$10,547,368
DLA100-86-C4018	Hanany	\$ 787,644
F09603-86-C2279	IMI Ramat Hasharon	\$ 2,709,605

**APPENDIX C: LISTING OF SAMPLE CONTRACTS REVIEWED AT 266TH
THEATER FINANCE COMMAND**

<u>Contract Number</u>	<u>Contractor</u>	<u>Dollar Amount</u>
DAAE07-87-CA077	Ashot Ashkelon Industries, Ltd.	\$ 6,428,400
DAAA09-86-C0995	IMI Bamifneh	\$ 2,646,191
DAAA09-87-C0821	Rabintex Industries, Ltd.	\$10,547,368
N00600-87-C0725	IMI Ramat Hasharon	\$ 2,015,433
N00019-86-C0141	IMI Haifa	\$ 4,945,208
N00024-87-C5402	IMI Haifa	\$65,894,295
N00104-89-CM161	Safare-Crouzet	\$ 3,472,929
N00163-88-C0275	IMI Jerusalem	\$ 1,950,494
F09603-86-C2279	IMI Ramat Hasharon	\$ 2,709,605
DAAA15-87-C0087	IMCO Industries, Ltd.	\$ 1,789,866
N00600-86-C0341	IMI Ramat Hasharon	\$ 3,267,235

**APPENDIX D: SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS
RESULTING FROM AUDIT**

<u>Recommendation Reference</u>	<u>Description of Benefit</u>	<u>Amount and/or Type of Benefit</u>
A.	Internal control to improve payments on contracts	Nonmonetary
B.1. through B.5.	Internal control to improve payments on contracts	Nonmonetary

APPENDIX E: ACTIVITIES VISITED OR CONTACTED

Department of the Army

Assistant Secretary of the Army (Procurement), Washington, DC
U.S. Army Contracting Command, Europe, Heidelberg, Germany
U.S. Army Europe Contracting Center, Frankfurt, Germany
Mid-East CAS Branch, U.S. Army Contracting Command, Europe,
Tel Aviv, Israel
266th Theater Finance Command, Heidelberg, Germany
Headquarters, Second Region, U.S. Army Criminal Investigation
Command, Mannheim-Seckenheim, Germany
Europe Fraud Team, Second Region, U.S. Army Criminal
Investigation Command, Frankfurt, Germany

Department of the Air Force

Detachment 32, Air Force Contract Management Command, Tel Aviv,
Israel

Defense Agencies

Defense Logistics Agency, Alexandria, VA
Defense Contract Management Command, Alexandria, VA
Defense Contract Management Command International, Wright-
Patterson AFB, OH
Defense Contract Management Area Office, Tel Aviv, Israel

Non-DoD Activities

United States Embassy, Tel Aviv, Israel
Criminal Investigation Division, Israeli National Police, Jaffa,
Israel

Contractors

Ashot Ashkelon Industries, Ashkelon, Israel
Israel Military Industries, Haifa Division, Haifa, Israel
Israel Aircraft Industries, Ltd., Technologies Division/RAMTA
Structures & Systems, Beersheba Israel
IMCO Industries Ltd., Tel-Hanan, Israel
Reshef Systems Ltd., Haifa, Israel

APPENDIX F: REPORT DISTRIBUTION

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics)
Comptroller of the Department of Defense
Director of Defense Procurement

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Assistant Secretary of the Army (Research, Development, and Acquisition)
Commander in Chief, U.S. Army, Europe
U.S. Army Criminal Investigation Command
Commander, Second Region, U.S. Army Criminal Investigation Command

Other Defense Activities

U.S. Commander in Chief, Europe
Defense Logistics Agency
Defense Contract Management Command
DoD Inspector General Regional Office, Europe

Non-DoD Activities

Office of Management and Budget
U.S. General Accounting Office, NSIAD Technical Information Center
Congressional Committees:
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Subcommittee on Investigations, Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security,
Committee on Government Operations

Representative Nicholas Mavroules

PART IV - MANAGEMENT COMMENTS

Defense Logistics Agency Comments

Assistant Secretary of the Army (Financial Management)
Comments

DEFENSE LOGISTICS AGENCY COMMENTS



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100



IN REPLY
REFER TO

DLA-CI

20 JUN 1991

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Processing Progress Payments
in Tel Aviv, Israel and in Heidelberg, Germany
(Project No. OCD-0067.02)

The enclosed comments to the draft report are provided in
response to your memorandum dated 26 April 1991. The comments
have been approved by Ms. Helen T. McCoy, Deputy Comptroller,
Defense Logistics Agency.

2 Encl

JACQUELINE G. BRYANT
Acting Chief, Internal Review Div.
Office of Comptroller

DEFENSE LOGISTICS AGENCY COMMENTS (continued)

TYPE OF REPORT: AUDIT

DATE OF POSITION: 19 Jun 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Audit Report on Processing Progress
Payments in Tel Aviv, Israel, and Heidelberg,
Germany (Project No. OCD-0067.02)

FINDING A: The Administrative Contracting Officer at the DCMAO improperly approved progress payments that were prohibited by the contracts. The progress payments were approved because there were no internal controls and because local procedures circumvented regulatory requirements. These procedures were not in conformance with the FAR, the DFARS, the Army, and the Defense Logistics Agency requirements. As a result, authorizations of progress payments were not in accordance with contract provisions, and 53 improper payments of \$11.5 million were made to Israeli contractors. These payments resulted in interest lost to the U.S. Government of \$547,831.

DLA COMMENTS: Concur. The facts as presented in the subject report are correct. The problems occurred within the U.S. Army Contracting Center Europe (USACCE) Tel Aviv Office prior to its consolidation into DCMC. The Administrative Contracting Officer of the USACCE Office was replaced in January 1990 and management actions were taken to implement a system for proper processing of progress payments. The system assures active involvement of Defense Contract Audit Agency in reviewing contractor accounting systems and requires timely production progress reviews. Progress payment review procedures and documentation was made a special interest item on the DCMAO Tel Aviv Internal Self Inspection Program. Overpayments were recovered on two contracts. The remaining 36 contracts with a progress payments clause were reviewed to assure that the Government's interests were adequately protected. Deficiencies found during the audit were the result of the absence of an adequate progress payment process. The procedures and controls along with the ability and willingness to comply with these procedures are now in place.

MONETARY BENEFITS: None.

DLA COMMENTS:

ESTIMATED REALIZATION DATE:

AMOUNT REALIZED:

DATE BENEFITS REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:

- () Nonconcur. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
- (X) Concur; however, weakness is not considered material. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
- () Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Mr. William Hill, DLA-AC

REVIEW/APPROVAL: CAPT James R. McNabney, Acting Executive Director,
Directorate of Contract Management, 7 Jun 91

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

DEFENSE LOGISTICS AGENCY COMMENTS (continued)

TYPE OF REPORT: AUDIT

DATE OF POSITION: 19 Jun 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Audit Report on Processing Progress
Payments in Tel Aviv, Israel, and Heidelberg,
Germany (Project No. OCD-0067.02)

RECOMMENDATION A: We recommend that the Commander, Defense Contract Management Command International schedule an internal control review of the Defense Contract Management Office, Tel Aviv within the next fiscal year.

DLA COMMENTS: Concur. Defense Contract Management Command International (DCMCI) will perform a Staff Assistance Visit to DCMAO Tel Aviv during fourth quarter FY 1991 to assess the progress payment process. A management oversight position has been identified and approved for DCMCI. When the position is filled, an Internal Management Control Review will be conducted. The tentative schedule is March 1992.

DISPOSITION:

(X) Action is ongoing; Final Estimated Completion Date: 31 Mar 1992
() Action is considered complete.

MONETARY BENEFITS: None

DLA COMMENTS:

ESTIMATED REALIZATION DATE:

AMOUNT REALIZED:

DATE BENEFITS REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:

() Nonconcur. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
(X) Concur; however, weakness is not considered material. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
() Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Mr. William Hill, DLA-AC

REVIEW/APPROVAL: CAPT James R. McNabney, Acting Executive Director,
Directorate of Contract Management, 7 Jun 91

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
COMMENTS



DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
WASHINGTON, DC 20310-0103



26 JUN 1991

MEMORANDUM FOR THE INSPECTOR GENERAL, DOD (AUDITING)

SUBJECT: Draft Audit Report on Processing Progress Payments
in Tel Aviv, Israel, and in Heidelberg, Germany
(Project CD-0067.02)

Responses to the subject audit report are provided.

FINDING: The Commercial Accounts Branch at the 266th Theater Finance Command improperly processed progress payments. Invoices were incorrectly paid because existing internal controls were either inadequate or circumvented. As a result, \$2 million in invoices and progress payments were paid in duplicate, \$4.4 million of progress payments were not properly liquidated, and \$0.3 million was erroneously adjusted. The errors resulted in a loss of \$430,780 in interest to the U.S. Government.

COMMAND RESPONSE TO THE FINDING: Concur.

RECOMMENDATION B-1: Establish procedures to maintain all contract and payment data either within the contract folder or in a readily identifiable and recoverable storage location.

COMMAND RESPONSE TO RECOMMENDATION B-1: Concur. Procedures established and in place since October 1990, are in accordance with the guidelines from Department of the Army Circular 11-86-1, Army Programs Internal Control Review Checklist. All existing contracts and payment information relative to progress payments were removed from the central files room. The data was stored in a secured filing cabinet and clearly labeled "Israel Contract and Progress Payments." The only personnel authorized access to this documentation was the division chief and the director. All payments relating to contracts with progress payments are paid separately from other payments within Commercial Accounts Division to ensure identification of any related progress payment.

RECOMMENDATION B-2: Validate all existing data in the Computerized Accounts Payable System and implement procedures so that all subsequent data are entered accurately.

ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT) COMMENTS
(continued)

-2-

COMMAND RESPONSE TO RECOMMENDATION B-2: Concur. Effective October 1990, all existing contracts involving progress payments were inventoried using a locally developed checklist. Inventory included: basic contract and all modifications, invoices, progress payments DD Form 250 (Material Inspection Receiving Report), First Article approval or alternate clause addressing only specific cost applicable to progress payments, contracting office representative name, telephone and facsimile numbers, and contractor's office representative name, telephone and facsimile numbers.

Data developed also included payment and liquidation spread sheet plus diskette and a supervisor's evaluation sheet. The supervisor's evaluation sheet is used to ensure pay requirements are met and to satisfy the previous material weakness and practices identified in this report. Following completed inventory, each contract was reviewed to ensure Defense Contract Management Area Office (DCMAO), Tel Aviv, Israel, had equivalent information. Current procedures require all payment transactions to be placed on the left side of the contract folder. All prior payment transactions not in the file were secured from records holding area and validated with payment data at DCMAO, Tel Aviv, Israel and the contractors. Upon completion of our review, the contract payment information was reconciled with the Commercial Accounts Payment System (CAPS) database. Regulatory and procedural guidelines were obtained from the Federal Acquisition Regulation (FAR) subchapter E, part 32, subpart/subsections, 501 through 606, 614-1 and 900 through 907 and Department of the Army Regulation 37-107 Chapter 2 Section I, paragraphs 1 through 8; Section II, paragraphs 1 through 13; Section III, paragraphs 14 through 19 and Chapter 3, Section I, paragraphs 1 through 3; Section II, paragraphs 4 through 18; Section III, paragraphs 19 through 24. To further strengthen internal controls, as a secondary measure an audit spread sheet of contract and payment data is maintained by diskette in each contract file. The diskette is subsequently updated to reflect payments, contract modification and liquidation of progress payments. (Printouts are available upon request). Supervisory controls are such that at least quarterly, a review of each contract is conducted for compliance with established controls. As a result of our visit to DCMAO, and contractor's offices in Israel, we now use the facsimile communication as the primary source with the U.S. Mail system as a secondary source for distribution and receipt of information and or documentation. This avoids lengthy delays in obtaining current information.

ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
COMMENTS (continued)

-3-

RECOMMENDATION B-3: Request supporting details when payment functions are transferred from other paying activities.

COMMAND RESPONSE TO RECOMMENDATION B-3: Concur. Procedures outlined in Recommendation B-2 above will be used to ensure that any contracts transferred in the future contain all essential data.

RECOMMENDATION B-4: Process necessary correction to contract DAAA09-86-C0995 to correct erroneous payment of invoices from contract F09603-86-C2279.


COMMAND RESPONSE TO RECOMMENDATION B-4: Concur. Contractor was paid twice for the delivery of items common to both contracts. First payment was made in November 1989 for \$360,297 against U.S. Army contract DAAA09-86-C0995. A second payment was made in December 1989 against U.S. Air Force contract F09603-86-C2279. The erroneous payment was reversed in November 1990.

RECOMMENDATION B-5: Establish procedures to monitor the liquidation of progress payments which, as a minimum, identifies the liquidation rate, progress payments paid to date, unliquidated progress payment amount, and establishes a control that progress payments are consistently liquidated and prevents over-liquidation of progress payments.

COMMAND RESPONSE TO RECOMMENDATION B-5: Concur. Procedures outlined in Recommendation B-2 above will be used to monitor the liquidation of progress payments. The Commercial Accounts Division has been reorganized to facilitate the use of automation, and to strengthen internal controls throughout the entire life cycle of a contract. Every effort will be expended to prevent any erroneous payments in the future.

Key personnel from the 266th Theater Finance Command assisted the auditors and inspectors in resolution of the matters outlined in this report.

If I can be of further assistance in this matter, please feel free to contact me at your convenience.


Douglas A. Brook
Assistant Secretary of the Army
(Financial Management)

CF:
SAIG-PA

LIST OF AUDIT TEAM MEMBERS

David K. Steensma, Director, Contract Management Directorate
James J. McHale, Program Director
Wayne K. Million, Project Manager
Stephanie F. Mandel, Team Leader
Robert A. Harris, Auditor

