

August 17, 2005



Financial Management

DoD Recovery Audit Program (D-2005-101)

Department of Defense
Office of the Inspector General

Constitution of
the United States

A Regular Statement of Account of the Receipts and Expenditures of all public Money shall be published from time to time.

Article I, Section 9

Additional Copies

To obtain additional copies of this report, visit the Web site of the Department of Defense Office of Inspector General at <http://www.dodig.osd.mil/audit/reports> or contact the Secondary Reports Distribution Unit, Audit Followup and Technical Support at (703) 604-8937 (DSN 664-8937) or fax (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact Audit Followup and Technical Support at (703) 604-8940 (DSN 664-8940) or fax (703) 604-8932. Ideas and requests can also be mailed to:

ODIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General of the Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-4704

DEPARTMENT OF DEFENSE

hotline

To report fraud, waste, mismanagement, and abuse of authority.

Send written complaints to: Defense Hotline, The Pentagon, Washington, DC 20301-1900
Phone: 800.424.9098 e-mail: hotline@dodig.osd.mil www.dodig.osd.mil/hotline

Acronyms

BIC	Business Initiative Council
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DWCF	Defense Working Capital Fund
FMR	Financial Management Regulation
GAO	Government Accountability Office
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
TMA	Tricare Management Activity
USD(C)/CFO	Under Secretary of Defense(Comptroller)/Chief Financial Officer



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

August 17, 2005


MEMORANDUM FOR UNDER SECRETARY OF DEFENSE
(COMPTROLLER)/CHIEF FINANCIAL OFFICER

SUBJECT: Report on DoD Recovery Audit Program (Report No. D-2005-101)

We are providing this report for information and use. We considered management comments on a draft of this report in preparing the final report. The Deputy Chief Financial Officer comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides or Mr. Curt W. Malthouse at (614) 751-1400. See Appendix C for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:


Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing
Service

Department of Defense Office of Inspector General

Report No. D-2005-101

August 17, 2005

(Project No. D2004-D000FJ-0150.000)

DoD Recovery Audit Program

Executive Summary

Who Should Read This Report and Why? DoD financial managers and contracting officials responsible for identifying and reducing erroneous payments should read this report. It discusses efforts and methods for using recovery audits to identify and collect overpayments.

Background. Recovery auditing is a function of management, and the Office of Management and Budget (OMB) does not consider it auditing in the traditional sense. Recovery auditors generally use proprietary software to review and analyze a company's books, supporting documents, and other available information to identify duplicate or erroneous payments to vendors. Recovery auditing has become standard practice in the private sector over the last 20 years.

Section 831 of the FY 2002 National Defense Authorization Act (Public Law 107-107) requires all Federal agencies with annual payments to contractors exceeding \$500 million to implement a cost-effective recovery audit program. Congress delegated implementation of this law to OMB. OMB requires Federal agencies to report results of their recovery audit programs in annual Performance and Accountability Reports.

Results. DoD implemented cost-effective recovery audit programs in two of its Defense Working Capital Fund Business areas and in one Defense General Fund Business area. DoD used contract firms in those areas over an 8-year period to perform audits that recovered approximately \$34 million. Additionally, DoD used its internal review staff to perform recovery audits and DoD successfully recovered \$48.2 million. Although the program has been successful, DoD did not expand its recovery audit program to other business areas, citing their lack of suitability. We concluded that further study of other areas in DoD is needed. Activities that appear to be good candidates, including activities funded with General Fund Appropriations, were never studied, and the use of recovery audits in the area of contract administration was not adequately explored. Additionally, DoD needed to fully report the success of its internal recovery audit efforts in its FY 2004 Performance and Accountability Report. We concluded that the FY 2004 Performance and Accountability Report understated the recovery audit results by at least \$27.1 million in FY 2004. (See the Finding section for the detailed recommendations.)

Management Comments. The Deputy Chief Financial Officer concurred and stated that policy to implement a cost-effective recovery audit program that expands DoD recovery audit efforts would be issued by August 31, 2005. She also agreed to establish a program manager for the DoD recovery audit program by September 30, 2005. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

Table of Contents

Executive Summary	i
Background	1
Objective	1
Finding	
Expanding the Recovery Audit Program	2
Appendixes	
A. Scope and Methodology	10
B. Prior Coverage	11
C. Report Distribution	12
Management Comments	
Office of the Under Secretary of Defense Comments	15

Background

Some Federal agencies, including DoD (the Department), have tested the use of recovery auditing and had success. As a result of the successes of those agencies' tests, Congress enacted a requirement to implement recovery auditing programs throughout the Government. Section 831 of the FY 2002 National Defense Authorization Act (Public Law 107-107) requires all Federal agencies with annual payments to contractors exceeding \$500 million to implement a cost-effective recovery audit program. Congress delegated implementation of this law to the Office of Management and Budget (OMB).

OMB provided implementing guidance to all Federal agencies in Memorandum M-03-07, "Programs to Identify and Recover Erroneous Payments to Contractors," (OMB Memorandum M-03-07) on January 16, 2003. OMB Memorandum M-03-07 defines a recovery audit as a review of an agency's books, supporting documents, and other information that is specifically designed to identify overpayments to contractors. The memorandum states that "It [a recovery audit] is not an audit in the traditional sense. Rather it is a control activity designed to assure the integrity of contract payments, and as such, it is a management function and responsibility."

The OMB memorandum also states that either employees of the executive agency or contractors (performing recovery audit services under contracts awarded by the executive agency) may perform recovery audits. In addition, OMB requires agencies to identify classes of contracts suitable for review by recovery auditors. Agencies are also required to report on recovery audit programs in the annual Performance and Accountability Report (PAR).

In the past, recovery auditors were retained on a contingency fee basis and the amount paid to them was a percentage of the amount that was collected. Recovery auditors hired by DoD were typically paid between 20 and 25 percent of the amounts that were actually collected. According to industry experts in the private sector, a good recovery auditor will usually recoup 0.1 percent for every dollar spent by the company.

The Defense Finance and Accounting Service (DFAS) reported that it paid DoD contractors and vendors approximately \$205 billion during FY 2004. Using industry standards, a successful DoD-wide program could expect to identify \$205 million in recoveries.

Objective

Our audit objective was to determine whether DoD implemented a cost-effective program to recover amounts erroneously paid to contractors. See Appendix A for a discussion of the scope and methodology and see Appendix B for prior coverage related to the objective.

Expanding the Recovery Audit Program

DoD implemented successful recovery audit programs using contract firms in two Defense Working Capital Fund (DWCF) areas and one Defense General Fund business area. Approximately \$34 million has been recovered in those business areas from FY 1997 through FY 2004. DoD did not expand the program to other business areas, citing lack of suitability. We concluded that further study of those areas is needed because activities funded with general fund appropriations were excluded from study, and application in the area of contract administration had not been explored. DoD has also used internal staff to perform recovery audits and successfully recovered \$48.2 million. DoD needed to fully report the success of those efforts in its FY 2004 Performance and Accountability Report (PAR). We determined that the PAR understated the recovery audit results by at least \$27.1 million in FY 2004.

DoD Implementation of a Recovery Audit Program

DoD began a recovery audit pilot program in 1996 at the Defense Logistics Agency (DLA) Defense Supply Center in Philadelphia. This pilot program was initiated in response to section 354 of the FY 1996 National Defense Authorization Act that required DoD to evaluate the feasibility of using private contractors to identify overpayments made to DoD vendors.

In a response to Government Accountability Office (GAO) report, Report No. GAO/NSIAD-00-134, "Contract Management: DoD's Use of Recovery Auditing," June 2000, the Under Secretary of Defense Deputy Comptroller (Program/Budget) stated that recovery auditing was a valuable management tool and that the Department would expand its use of recovery auditing as part of ongoing efforts to improve business practices.

In 2001 the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD[C]/CFO) deemed the pilot program successful and ready for expansion to other DWCF activities. The USD(C)/CFO stated that several DLA activities and the Navy Fleet Industrial Supply Center had recovered a total of \$7.2 million since 1999. The USD(C)/CFO also stated that, subsequent to the successful pilot program results, he endorsed the use and expansion of recovery audits to the other DWCF activities.

In December 2001, the USD(C)/CFO updated chapter 18 of the DoD Financial Management Regulation (FMR), volume 10, "Contract Payment Policy and Procedures," to provide the following guidance regarding the use of recovery auditing.

Recovery Auditing. The use of contingency fee auditing services contracts to identify and recover contractor overpayments is encouraged within the Department, on a case-by-case basis, particularly for debts arising from overpayments of the Working Capital funds.

In July 2001 the Under Secretary of Defense for Acquisition, Technology, and Logistics announced the establishment of the Business Initiative Council (BIC) to improve the business operations of DoD through an array of short- and long-term initiatives. One of the first initiatives approved by the BIC was the full implementation of recovery auditing for all DWCF activities. A BIC recovery audit initiative was established, and a program champion was assigned. The program champion was picked from the Department of the Navy.

Despite the success of the program in some areas, the BIC suspended the recovery audit initiative in September 2003. According to the official minutes of the BIC meeting, the Navy representative on the Executive Steering Committee of the BIC stated that the recovery audit initiative was not cost-effective. The BIC then agreed to suspend the program. The conclusion was contrary to successful recovery audit efforts at DLA and subsequent successful efforts at the Tricare Management Activity (TMA). In addition, the conclusion was not supported by a cost-benefit analysis.

According to contract documents, the DLA recovery audit programs recovered about \$17.3 million from inception through FY 2004. The recoveries in FY 2004 were primarily related to contract management issues such as the untimely entry of contract modifications and other contract administration errors. Although the DLA recovery audit contract expired on August 31, 2004, DLA officials told us that they were drafting a new contract and have designated a program management office and a program manager to oversee the process. In addition, DLA told us that the new contract will cover payments it made since the previous contract expired in August.

The TMA recovery audit recouped \$16.6 million during FY 2004, the first year of its program. TMA had no plans to discontinue the efforts in the future.

DWCF Recovery Audit Contract Results

Although DoD suspended the business initiative it was using to expand and fully pursue a recovery auditing program throughout the Department, DoD needed to continue to consider expanding its use of recovery audits. Expansion should be considered in 14 major business areas of the DWCF in accordance with the DoD FMR, volume 10, "Contract Payment Policy and Procedures," December 2001.

The table shows the DWCF activities that we estimate exceeded the \$500 million threshold established by Public Law 107-107, the dollar amounts recovered in FY 2004, and the status of their respective recovery audit programs.

**DWCF Recovery Audit Program
(\$ in millions)**

<u>DWCF Activity Group</u>	<u>Estimated FY04 Contract Payments*</u>	<u>FY04 Recoveries</u>	<u>Recovery Audit Contract</u>
Army Supply Management	6,166.8	0	No
Army Depot Maintenance	2,294.6	0	No
Navy Supply Management	5,246.3	0.21	Yes
Navy Depot Maintenance	2,322.3	0	No
Navy Research and Development	5,395.9	0	No
Navy Base Support	1,072.2	0	No
Navy Transportation	1,228.9	0	No
Air Force Supply Management	9,903.5	0	No
Air Force Depot Maintenance	4,950.4	0	No
Air Force Information Services	527.1	0	No
Defense Finance and Accounting Service	719.5	0	No
Defense Information Systems Agency	3,127.3	0	Pending
DLA Supply Management	22,993.4	5.64	Pending**
DLA Distribution Depots	1,691.7	0	No
Defense Commissary Agency	5,565.0	0	Expired
U.S. Transportation Command	<u>7,192.7</u>	<u>0</u>	Expired
Total	80,397.6	5.85	

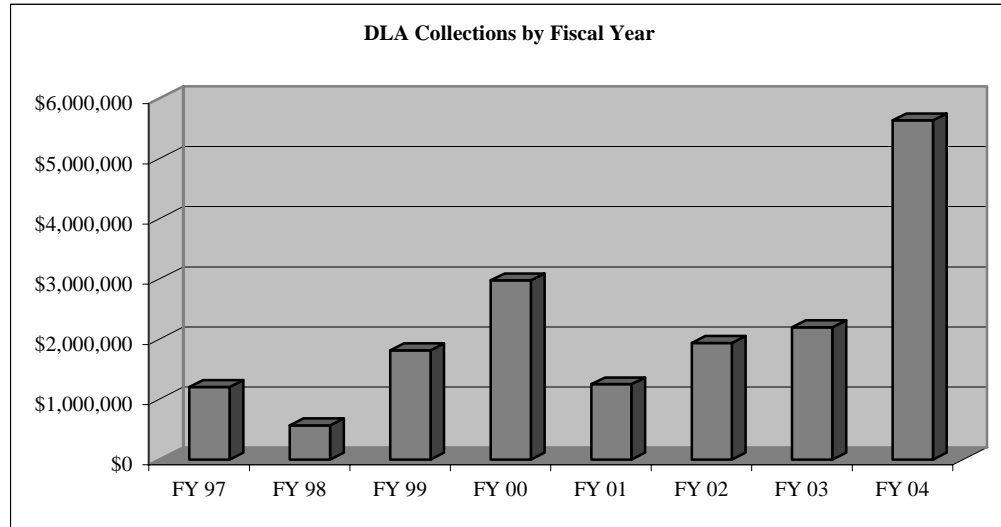
* We used DoD budget reports to estimate the annual contract payments. Actual payment data aggregated by DWCF activity groups were not available.

** The DLA Supply Management recovery audit program was active during FY 2004. Issuance of a new contract for recovery auditing services was pending at the time of the audit.

The table shows that 14 of the 16 DWCF activities did not have an active recovery audit program in place during FY 2004. Recovery audits were not applied to approximately \$52.2 billion in FY 2004 payments made by the remaining 14 Defense business areas. Only the Navy and DLA supply management business areas implemented programs. Those activities had some success.

Navy Results. Navy invoices show that recovery audit efforts were limited, and only \$350,000 has been recovered since it began using recovery auditors. In FY 2004 the Navy recovered \$211,185. Navy personnel indicated that their contracts are complex and many need to be sanitized prior to scrutiny by the contractor to protect classified and proprietary information that is resident in the contract files. This limited the success of the program in the past. Despite the limited success, the Navy maintained an active recovery audit contract in order to comply with the program requirements of Public Law 107-107.

DLA Results. DLA is another working capital fund activity that used recovery auditors to review payments made by its supply management business area. DLA used a pilot program that began in 1996 and recoveries on the first of two contracts occurred in FY 1997. Contract invoices submitted by the recovery auditor are shown in the following graph that depicts DLA recovery efforts.



The graph shows that overpayments were collected in each fiscal year since FY 1997 as a result of the DLA recovery audit program. The contract invoice data indicate that DLA recovered about \$17.3 million since FY 1997. Cognizant officials told us that the FY 2004 recoveries were primarily associated with contract modification and administration issues.

Expanding and Managing Use of Recovery Audit Contracts

DoD needed to consider expanding use of the recovery audit program, especially in the area of contracting. Previous recovery audit efforts were limited and mainly focused on payments made by DoD.

The first step in managing an expansion of the recovery audit program is establishment of an overall recovery audit program manager in DoD. DoD officials, former members of the BIC, and recovery auditors told us that the DoD recovery audit program cannot be expanded beyond its current state unless DoD establishes a program manager to oversee implementation of the program.

Recovery auditors (outside the Department) told us that results from the program would be more significant if DoD established a program manager to adjudicate cross cutting issues related to data access. They indicated that DWCF officials are reluctant to provide them access to contract files that typically constitute 80 percent of recovery audit findings. At least five other Government agencies (General Services Administration, Department of Justice, Department of Transportation, Department of Interior, and the Social Security Administration) allow recovery auditors to access their respective contract files. Additionally,

within DoD, TMA has demonstrated that complex contract files (overseen by the Defense Contract Auditing Agency) can successfully be reviewed by recovery auditors.

Cognizant officials and recovery auditors told us that problems obtaining useful and timely contract disbursement data precluded successful implementation of a program in the Defense Commissary Agency. The problems were not resolved, and the contract was discontinued after 1 year. If DoD established a process, overseen by a project manager, similar issues on future recovery audit contracts could be minimized.

OMB Memorandum M-03-07 provides that agency heads may exclude classes of contracts if the agency head determines that recovery audits are not a cost-effective method for identifying erroneous payments. Accordingly, DoD needs to perform a cost-benefit analysis and identify the classes of contracts most suitable for review by recovery auditors before expanding the program to other business areas and DoD activities. The USD(C)/CFO needs to designate a program manager to oversee the implementation of the recovery audit program and ensure that effective rules for access to records are established and that cost-benefit analyses are used to support decisions on where recovery audits are used.

Access to Contract Files and Expansion to General Fund Activities

DoD did not issue guidance that provided recovery auditors access to required contract files. When DoD establishes a program manager, one of the manager's first tasks should be to improve access to contract files.

Another key action DoD needs to do is to examine DoD general fund activities to fully explore the use of recovery audits in those activities. Despite the successes of a limited number of recovery audits, DoD has not studied expansion of the program into many of the general fund activities. DoD officials indicated that the general fund areas in the Department were not suitable candidates for recovery auditing. However, there was no study of the suitability performed.

Public Law 107-107 requires all Federal agencies with annual payments to contractors exceeding \$500 million to implement a cost-effective recovery audit program. According to DFAS, total FY 2004 payments to contractors and vendors exceeded \$205 billion. With the exception of the DWCF business areas noted in the table, the majority of these payments are attributable to programs funded with direct appropriations that have not been subject to review by recovery audit contracts.

Department of Treasury reports show that many DoD general fund appropriations had outlays exceeding \$500 million in FY 2004. According to the "Fiscal Year 2004 Detail of Appropriations, Outlays, and Balances," there were 41 separate DoD general fund appropriations with FY 2004 outlays exceeding \$500 million. In total, Treasury reported FY 2004 outlays of about \$317.1 billion from the 41 appropriations.

The DoD FMR, volume 10, chapter 18, "Contract Payment Policy and Procedures," December 2001, encourages the use of recovery auditing only for DWCF activities. The USD(C)/CFO needs to issue new DoD policy to ensure that the DoD recovery audit program is considered throughout DoD and implemented where appropriate in accordance with Public Law 107-107 and OMB Memorandum M-03-07.

DoD Internal Efforts to Recover Overpayments

DoD officials told us that the recovery audit efforts may have been limited because internal efforts were already being used by DoD to identify duplicate payments. DFAS and TMA used internal audits and payment system control techniques to identify and recover contract overpayments. The techniques used by DFAS and TMA are somewhat similar to techniques used by private industry.

DFAS Results. According to DFAS reports, edit routines that automatically detect duplicate payments and data mining software identified about \$65.4 million in duplicate payments in FY 2004. The edit routines prevented DFAS from making \$54.9 million in potential duplicate payments. DFAS referred the remaining \$10.5 million for recovery. In addition, 23 separate audits, conducted by the DFAS internal review staff, recovered \$37.7 million in overpayments since FY 2000.

DFAS efforts to identify erroneous payments reduced the potential pool of overpayments that would be available for recovery audits to detect. As such, the DFAS efforts need to be considered in the cost-benefit analysis used to measure the success of the program and in any justification for expanding the recovery audit program to other business areas and other DoD activities. However, recovery auditing officials indicated that most savings relate to contract administration issues. DoD should not allow contractors to duplicate efforts already being performed internally.

TMA Results. In FY 2004, TMA demonstrated that a DoD program funded by direct appropriation can benefit from a successfully implemented recovery audit program. TMA recovered \$16.6 million in FY 2004 using recovery audit techniques.

TMA also used special software to detect fraudulent and duplicate billings. In FY 2003, TMA reported that its software stopped \$87.6 million in fraudulent or abusive billings. In addition TMA reported that from calendar years 1997 through 2003 special duplicate edit software identified and accounted for \$89.6 million in recoupments and offsets. Despite those efforts, a pool of recoverable overpayments remained and in FY 2004, TMA implemented a successful recovery audit contract that recovered the additional \$16.6 million.

Reporting Recovery Audit Results

The USD(C)/CFO gathered and presented the recovery audit information shown in the Department's FY 2004 PAR. Although it included recoveries identified by

contract auditors, the compilation process for FY 2004 omitted the internal efforts by DFAS and did not identify the TMA recovery audit contract. This resulted in understating recoveries by at least \$27.1 million.

FY 2004 was the first year that Public Law 107-107 required agencies to report on their recovery audit programs. OMB Memorandum M-04-20, "FY 2004 Performance and Accountability Reports and Reporting Requirements for the Financial Report of the United States Government," July 22, 2004, promulgated agency reporting requirements.

For FY 2004 the USD(C)/CFO included results for only the Navy and DLA recovery audit contracts in Appendix A of the PAR. DoD officials responsible for collecting the data for the PAR told us that they did not know about the TMA recovery audit contract and therefore did not report the results. According to documents provided by TMA, the recovery audit contract resulted in \$16.6 million in recoveries for FY 2004.

In addition, the PAR omitted \$10.5 million in duplicate payments identified for recovery by DFAS. We concluded that the techniques used by DFAS (edit routines and data mining) to identify duplicate payments are recovery audits and should be reported as such in the PAR.

The USD(C)/CFO needs to develop and implement an improved process for compiling a more complete and accurate compendium of information on the DoD recovery audit program to ensure full disclosure and compliance with OMB reporting requirements for the PAR.

Recommendations and Management Comments

We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer:

1. Issue policy to consistently implement a cost-effective recovery audit program as required by Public Law 107-107 and Office of Management and Budget Memorandum M-03-07. The policy should require DoD activities and programs to:

a. Perform cost-benefit analyses that consider Defense Finance and Accounting Service efforts to reduce the pool of overpayments.

b. Determine the classes of contracts to be included.

c. Expand the program to those business areas and general fund activities most likely to experience overpayments due to contract administration errors.

Management Comments. The Deputy Chief Financial Officer concurred and stated that policy to implement a cost-effective recovery audit program that expands DoD recovery audit efforts would be issued by August 31, 2005.

2. Establish and designate a program manager to:

a. Develop and implement a process for compiling complete and accurate information on the DoD recovery audit program to ensure full disclosure and compliance with Office of Management and Budget annual reporting requirements.

b. Oversee implementation of the DoD recovery audit program.

c. Establish cost-effective rules for access to contract data files.

d. Ensure that cost-benefit analyses are completed by management in a timely and consistent manner.

e. Ensure that contractors do not duplicate efforts performed internally.

Management Comments. The Deputy Chief Financial Officer concurred and agreed to establish a program manager for the DoD recovery audit program by September 30, 2005.

Appendix A. Scope and Methodology

We assessed whether DoD complied with the requirements of Public Law No. 107-107 (Section 831 of FY 2002 National Defense Authorization Act) as implemented by OMB Memorandum M-03-07, January 16, 2003. We obtained contractor invoices and contract payment data from DFAS Columbus, Navy Supply Systems Command, and TMA Aurora. We analyzed the invoices to determine the dollar amount of collections for fiscal years 1997 through 2004 but did not verify these amounts to the accounting records. Based on our analysis of the invoices, we estimated that about \$34 million was recovered from FY 1997 through FY 2004. We will complete additional work related to the processing and disposition of recoveries from recovery audit contracts during a subsequent audit. Specifically, we will assess the process of evaluating and processing claims, recovering funds, and the awarding of fees to recovery audit contractors.

We analyzed FY 2004 DoD budget documents—revenue and expense statements—to estimate the amount of annual payments to contractors by DWCF activities. For example, we identified the expenses, such as for depreciation and personnel costs, which are not likely to represent contract payments. We considered the remaining expenses to be a fair estimate of payments to contractors. In addition, we analyzed FY 2004 Department of Treasury reports to identify DoD appropriations with outlays exceeding \$500 million.

We utilized FY 2004 disbursement and payment data compiled by DFAS. DFAS provided spreadsheets showing that vendor and contract payments (called commercial payments) totaled \$205 billion in FY 2004. According to DFAS, the \$205 billion excludes progress payments and commercial payments made by other DoD activities. We did not verify the accuracy of the supporting data.

We also reviewed past GAO reports, Congressional requests, meeting minutes, and survey results, and interviewed DoD management to determine whether the Department implemented a cost-effective recovery audit program.

Review of the management control program was not an objective of the audit and we did not complete a review of the program.

We performed this audit from June 2004 through April 2004 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We analyzed FY 2004 DoD budget documents—revenue and expense statements—to estimate the amount of annual payments to contractors by DWCF activities. The data were compiled by DoD from Department budgetary records and were presented as part of the President's Budget. We did not verify the accuracy of the supporting data.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the contract payment and financial management high-risk areas.

Appendix B. Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) has issued seven reports discussing Recovery Auditing. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>.

GAO

GAO Report No. GAO-02-635, “DoD Contract Management: Overpayments Continue and Management and Accounting Issues Remain,” May 24, 2002

GAO Report No. GAO/NSIAD-00-134, “Contract Management: DOD’s Use of Recovery Auditing,” June 16, 2000

GAO Report No. GAO/NSAID-00-66R Recovery Auditing, “Contract Management: DoD Could Benefit From the Use of Internal Recovery Auditing,” March 10, 2000

GAO Report No. GAO/T-NSIAD-99-213, “Recovery Auditing: Reducing Overpayments, Achieving Accountability, and the Government Waste Corrections Act of 1999, Statement of David M. Walker, Comptroller General of the United States” June 29, 1999

GAO Report No. GAO/T-NSIAD-99-193, “Department of Defense: Improving the DoD Payment Process, Using Recovery Auditing and Changing the Prompt Payment Act, Statement of David Cooper, Associate Director, Defense Acquisition Issues,” June 16, 1999

GAO Report No. GAO/NSIAD-99-78, “Contract Management: DoD Is Examining Opportunities to Further Use Recovery Auditing,” March 17, 1999

GAO Report No. GAO/NSIAD-99-12, “Contract Management: Recovery Auditing Offers Potential to Identify Overpayments,” December 3, 1998

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Combatant Command

Commander, U.S. Transportation Command

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Information Systems Agency
Director, Defense Logistics Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Office of the Under Secretary of Defense Comments



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE

1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

JUN 27 2005

MEMORANDUM FOR PROGRAM DIRECTOR, DEFENSE FINANCIAL AUDITING
SERVICE, OFFICE OF INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

SUBJECT: Office of the Inspector General, Department of Defense (OIG, DoD) Draft
Report on DoD Recovery Audit Program (Project No. D2004FJ-0150)

This memorandum is in response to the subject April 27, 2005, draft report
provided to this office for review and comment. Our response to each of the audit report
recommendations directed to the Under Secretary of Defense (Comptroller)/Chief
Financial Officer is attached.

We appreciate the opportunity to respond to your draft audit report and look
forward to resolving the cited issues. My point of contact is Mr. Tom Summers. He can
be contacted by telephone at 703-697-3193 or e-mail at tom.summers@osd.mil.

A handwritten signature in cursive script, appearing to read "T. McKay".

Teresa McKay
Deputy Chief Financial Officer

Attachments:
As stated

cc:
ODGC(F)
DFAS

DRAFT REPORT DATED APRIL 27, 2005
PROJECT NO D2004FJ-0150

“Report on DoD Recovery Audit Program”

OIG AUDIT RECOMMENDATION 1

The Office of the Inspector General (OIG), Department of Defense (DoD), recommends that the Under Secretary of Defense(Comptroller)/Chief Financial Officer (CFO):

1. Issue policy to consistently implement a cost-effective recovery audit program as required by Public Law 107-107 and Office of Management and Budget Memorandum M-03-07. The policy should require DoD activities and programs to:
 - a. Perform cost-benefit analyses that consider Defense Finance and Accounting Service efforts to reduce the pool of overpayments.
 - b. Determine the classes of contracts to be included
 - c. Expand the program to those business areas and general fund activities most likely to experience overpayments due to contract administration errors.

USD(C) RESPONSE

The Department concurs that policy guidance is needed to consistently implement a cost-effective recovery auditing program. The guidance will be predicated in a cost-benefit analysis that considers Defense Finance and Accounting Service efforts and will identify the classes of contracts to be considered for review. While the guidance will expand recovery auditing into the general fund activities, the primary area for recovery will continue to focus on disbursement errors rather than contract administration errors. The DoD Components, however, will be encouraged to identify areas where the scope of the recovery auditing effort could be expanded to include access to contract files.

Estimated Completion Date: August 31, 2005.

Attachment
Page 1 of 2

OIG AUDIT RECOMMENDATION 2

The Office of the Inspector General (OIG), Department of Defense (DoD), recommends that the Under Secretary of Defense(Comptroller)/Chief Financial Officer (CFO):

2. Establish and designate a program manager to:
 - a. Develop and implement a process for compiling complete and accurate information on the recovery auditing program to ensure full disclosure and compliance with the Office of Management and Budget annual reporting requirements.
 - b. Oversee implementation of the DoD recovery audit program.
 - c. Establish cost-effective rules for access to contract data files.
 - d. Ensure that cost-benefit analyses are completed by management in a timely and consistent manner.
 - e. Ensure that contractors do not duplicate efforts performed internally.

USD(C) RESPONSE

The Department concurs with the recommendation to establish a program manager for recovery auditing. Prior to making such a designation, a review will be performed to determine the level of responsibility associated with the new position. To accommodate this review, a memorandum will be forwarded no later than July 31, 2005, from the Deputy Chief Financial Officer to the Director, Defense Finance and Accounting Service (DFAS), requesting a list of business areas and general fund activities by DoD Component where the contract payments exceed \$500 million annually. This information will be forwarded as part of the implementation guidance (see Recommendation 1) to the DoD Components requesting that candidates for recovery auditing be identified. The Components will rank these candidates according to potential for recovery. To ensure a cost-effective approach, the Components' input will be weighed against the level of DFAS resources needed to assist in the recovery auditing effort. An assessment will also be made as to the extent that recovery auditing efforts are currently being performed by DFAS Internal Review and recovery auditing vendors. Subsequent to completion of this review, a memorandum identifying a program manager and the responsibilities assigned to that position will be issued.

Estimated Completion Date: September 30, 2005.

Attachment
Page 2 of 2

Team Members

The Office of the Deputy Inspector General for Auditing of the Department of Defense, Defense Financial Auditing Service prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

Paul J. Granetto
James L. Kornides
Curt W. Malthouse
John R. Williams
Benjamin M. Howison
Ann Thompson
Meredith H. Johnson