

May 15, 2006



# Financial Management

Vendor Pay Disbursement Cycle, Air  
Force General Fund:  
Funds Control  
(D-2006-085)

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### **Acronyms**

ACRN	Accounting Classification Reference Number
ACO	Administrative Contracting Officer
ANG	Air National Guard
CLIN	Contract Line Item Number
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Service
FAR	Federal Acquisition Regulation
FMR	Financial Management Regulation
GAO	Government Accountability Office
JFMIP	Joint Financial Management Improvement Program
O&M	Operations and Maintenance
PCIE	President's Council on Integrity and Efficiency
PGI	Procedures, Guidance, and Information



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May 15, 2006

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on Vendor Pay Disbursement Cycle, Air Force General Fund:  
Funds Control (Report No. D-2006-085)

We are providing this report for review and comment. This report discusses internal control weaknesses in the processing of vendor payments.

Management did not provide comments to the draft report. DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request comments by July 14, 2006.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Aud-DFS@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

Management comments should indicate concurrence or nonconcurrence with each applicable finding and recommendation. Comments should describe actions taken or planned in response to agreed-upon recommendations and provide the completion dates of the actions. State specific reasons for any nonconcurrence and propose alternative actions, if appropriate.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Marvin L. Peek at (703) 325-5777 (DSN 221-5777) or Mr. John W. Barklage at (303) 676-3298 (DSN 676-3298). 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:

A handwritten signature in black ink, appearing to read "Paul J. Granetto", is positioned above the typed name.

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

## Department of Defense Office of Inspector General

Report No. D-2006-085

May 15, 2006

(Project No. D2004-D000FD-0040.001)

### Vendor Pay Disbursement Cycle, Air Force General Fund: Funds Control

#### Executive Summary

**Who Should Read This Report and Why?** Air Force contracting officers, resource managers, fund holders, and officials who accept performance on contracts should read this report. This report discusses the need to improve internal control over the obligation and use of funds in accordance with laws and regulations.

**Background.** Management is responsible for establishing and maintaining internal control to ensure effective and efficient operations, reliable financial reporting, and compliance with laws and regulations. The Inspector General Act of 1978, as amended, provides for the independent review of agency programs and operations in accordance with generally accepted government auditing standards which require audit to report on internal controls and compliance with laws and regulations. Such a review of the vendor pay disbursement cycle spans the acquisition; funding; delivery, receipt, and acceptance; payment; and recording of the financial transactions in the official accounting records. This is the second in a series of five reports on internal control of the Air Force General Fund vendor pay disbursement cycle. This report identifies the weaknesses in internal control for maintaining effective fund control over the appropriations used in the purchase of goods and services in compliance with laws and regulations.

**Results.** Internal control was not effective to ensure monitoring and corrective actions were taken when funds were improperly used.

Air Force personnel did not effectively monitor and take corrective action when Defense Finance and Accounting Service personnel used incorrect funds to pay for goods and services delivered against 7 of the 45 contracting actions examined. The use of incorrect lines of accounting resulted in improper payments. Consequently, the risk is high that Air Force contract payments are charged to incorrect appropriations, unliquidated balances are not returned to the rightful fund holders, and cost overruns may go undetected (finding A).

Air Force personnel did not effectively monitor and follow up on unliquidated obligations. Fund holders did not take appropriate action to follow up on the status of unliquidated obligations for 11 of the 45 contracting actions examined. Funds either were not available to pay for goods when delivered and for services when performed, or were in excess of the contract requirements. As a result, the risk is high that a significant amount of invalid obligations is present in the Air Force accounting records (finding B).

**Management Comments.** Management comments were not received in response to the draft report issued February 2, 2006. We request that the Assistant Secretary of the Air Force (Financial Management and Comptroller) and Assistant Secretary of the Air Force (Acquisition) comment on this report by July 14, 2006.

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## Background

Management is responsible for establishing and maintaining internal control to ensure effective and efficient operations, reliable financial reporting, and compliance with laws and regulations. The Inspector General Act of 1978, as amended, provides for the independent review of agency programs and operations in accordance with generally accepted government auditing standards which require audit to report on internal controls and compliance with laws and regulations. Such a review of the vendor pay disbursement cycle spans the acquisition; funding; delivery, receipt, and acceptance; payment, and recording of the financial transactions in the official accounting records.

Three types of internal controls exist: compliance, operations, and financial reporting. In this audit, we conducted a series of control sample tests related to the three types of internal controls as presented in the Government Accountability Office (GAO) and President's Council on Integrity and Efficiency (PCIE) Financial Audit Manual. In accordance with the GAO/PCIE guidelines,<sup>1</sup> we randomly selected 45 contracting actions (which included funding modifications) for a comprehensive examination of:

- the nature and funding of the contracts;
- delivery, receipt and acceptance;
- payment; and
- financial recording of the related budgetary and proprietary transactions in the official accounting records.

In a sample of 45 items, one defect indicates that the risk is high that the relevant internal control is not effective. Depending on the type and nature of the internal control deviation, the internal control defect might be significant as a separate finding or treated as one of a homogeneous group of like errors and related causes.

Contracts for goods and services often include line items that are funded by different appropriations. Each line item has its own line of accounting to document the specific appropriation obligated to pay for the goods and services.

This is the second in a series of five audit reports on the effectiveness of internal control related to the Air Force General Fund vendor pay disbursement cycle. This report examines the effectiveness of the compliance controls that ensure that the correct lines of accounting are used in paying contracts.

The first report in this series, "Report on Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding" (D-2006-056),

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<sup>1</sup> GAO/PCIE Financial Audit Manual, section 400, figure 450.1, "Sample Sizes and Acceptable Numbers of Deviations," July 2001.

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March 6, 2006, covered the internal control related to contract formation and followup, with the focus on the contracting officer's role and responsibility. The third and fourth reports in this series will cover the system of internal control related to vendor pay and core financial system reporting. A fifth report, which we will issue to summarize the internal control weaknesses, will assist the reader to understand how all personnel have a role in strengthening the financial management and reporting process.

## **Objectives**

Our overall audit objective was to assess internal controls and compliance with laws and regulations pertaining to the vendor pay disbursement cycle in the Air Force General Fund and supported activities. See Appendix A for a discussion on the scope and methodology and Appendix B for a complete list of the 45 contracting actions randomly selected for examination.

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## A. Charging Appropriations

Air Force internal control was not effective to ensure that personnel effectively monitored and took corrective action when Defense Finance and Accounting Service (DFAS) personnel used incorrect funds to pay for goods and services in 7 of the 45 contracting actions examined. DFAS personnel did not always use the correct line of accounting because of improper payment instructions in contracts, unclear vendor billing practices, and inadequate followup to identify lines of accounting that remained in undelivered status after goods or services were received. In addition, contracting officers sometimes wrote contracts with multiple accounting lines that were not traceable to a specific deliverable. Consequently, the risk is high that Air Force contract payments are charged to incorrect lines of accounting, unliquidated balances are not returned to the rightful fund holders, and that line item cost overruns may go undetected.

### Background and Critical Guidance

In a system of internal control, contracting officers and specialists, Air Force customers, resource managers, fund holders, and other officials have distinct responsibilities. According to section 2773a, title 10, United States Code, “Departmental Accountable Officials,” and DoD Directive 7000.15, “DoD Departmental Accountable Officials and Certifying Officers,” March 19, 2005, personnel<sup>2</sup> appointed as accountable officials may be held pecuniary liable for any illegal, improper, or erroneous payments made when DFAS personnel relied on the data, information, or services of the accountable officials to certify vouchers for payment.

When contracting officers write contracts with multiple accounting lines that personnel cannot trace through the official accounting records to the delivery and receipt of the specific deliverable, potential cost overruns at the line item level may go undetected. Personnel would not detect the overrun until later when the funding shortfall is exposed through the inadequate funding of the other line items delivered later in the performance or delivery period.

Finally, operating personnel may violate appropriation law in the use of their funds. Appropriation law statutes potentially violated include 31 U.S.C. 1502 (bona fide need) and 10 U.S.C. 2410a (severable services).

**Federal Acquisition Regulation.** The Federal Acquisition Regulation (FAR), Subpart 4.10 and 4.1001 provides the following description of the contract line item number (CLIN):

Contracts may identify the items or services to be acquired as separately identified line items. Contract line items should provide unit

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<sup>2</sup> Disbursing officers and certifying officials.



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prices or lump sum prices for separately identifiable contract deliverables, and associated delivery schedules or performance periods. Line items may be further subdivided or stratified for administrative purposes (e.g., to provide for traceable accounting classification citations).

**Defense Federal Acquisition Regulation Supplement.** The Defense Federal Acquisition Regulation Supplement (DFARS), Procedures, Guidance, and Information (PGI) states an accounting classification reference number (ACRN) related to payment instructions must provide adequate instructions to charge the ACRNs assigned to the contract line item in a manner that reflects the performance of work on the contract.

The DFARS PGI also states that payment instructions must provide a methodology for the paying office to assign payments to the appropriate accounting classification citation(s), based on anticipated contract work performance. The method established should be consistent with the reasons for the establishment of the line items. The payment method may be based upon a unique distribution profile devised to reflect how the funds represented by each of the accounting classification citations support contract performance. Payment methods that direct that payments be made from the earliest available fiscal year funding sources or that prorate across accounting classification citations assigned to the line item, or a combination of the two, may be used if that methodology reasonably reflects how each of the accounting classification citations supports contract performance.

**Departmental Accountable Officials.** According to 10 U.S.C. 2773a, accountable officials are those who are responsible for providing DoD certifying officials information, data, or services that are directly relied upon to certify a voucher for payment. Personnel who are designated by certifying officers as accountable officials<sup>3</sup> in accordance with DoD Directive 7000.15 may be held pecuniarily liable for any improper, illegal, or erroneous payments that results from a certifying officer who relied on provided data, information, or service.

**DoD Financial Management Regulation (FMR).** DoD FMR, volume 10, chapter 1 provides the following procedures related to the payment:

No payment is made without evidence of a liability and a determination of entitlement. The nature and extent of procedures vary for financing and invoice payments. Entitlement to financing payments shall be determined by contract terms and conditions, including any required approvals by contracting officers, contract administrators, or contract auditors. Entitlement to invoice payments shall include, as applicable, additional determinations such as proof of receipt and acceptance, receipt of a proper invoice, and verification of all computations.

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<sup>3</sup> In April of 2005, volume 5, chapter 33, of the FMR changed so that Agency Heads (or their designees) must designate accountable officials.

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In addition, DoD FMR, volume 5, chapter 33, acknowledges that contracting officers, receiving officials, and fund holders are accountable officials. Contracting officers are responsible for providing timely and accurate contract data, for example, payee's name, line of accounting, any assignment of claims actions and remittance address. Receiving officials (those who are the recipients of the goods and services) are responsible for providing timely and accurate receipt data, such as quantity and receipt date. Resource managers and fund holders are responsible for the proper assignment of funding on an obligation document before the obligation is incurred and for maintaining a system of positive funds control.

**Joint Financial Management Improvement Program (JFMIP).** According to JFMIP guidance,<sup>4</sup> an agency's single integrated financial management system must support pre-audit verification of invoices prior to payment. Pre-audit verification includes providing evidence of the receipt, acceptance, and payment matched to funding source(s) in accordance with the contract. The JFMIP document also requires that the system provide process controls that match the "description of items and services, quantity, and price on the invoice" with "the same elements in the contract to ensure that the correct contract/order number has been cited by the vendor, the correct obligation charged, and only contracted items/services and quantities are paid for."

## Mismatched Lines of Accounting

For 7<sup>5</sup> of the 45 contracting actions examined, DFAS personnel paid invoices from an incorrect line of accounting for the items ordered on the contracts. The following five contracting actions are provided as examples.

- An Air Force contracting officer executed a delivery order for research, development, test, and evaluation services that did not properly assign the lines of accounting in a manner that reflected the performance of work on the contract.<sup>6</sup> Initially, the vendor's performance was assigned by project. However, funding modifications to the order resulted in a loss of identity to the initial projects and to the periods of performance that applied to severable services<sup>7</sup> in the order. In response to our questions, the contracting officer stated:

We recognize that the nature of this contract did not provide for tracking of costs directly related to subCLIN line items (tasks). Because DFAS made payments by ACRN, as specified in the contract, DFAS payments were not aligned directly with contractor

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<sup>4</sup> Federal Financial Management Systems Requirements, "Acquisition/Financial Systems Interface Requirements," June 2002.

<sup>5</sup> Sample numbers 4, 12, 17, 25, 26, 31, and 50.

<sup>6</sup> Sample 4; contract F41624-97-D-6004, delivery order 0032.

<sup>7</sup> Section 2410a, title 10, United States Code. Also see the first report in this series, "Contract Formation and Funding," finding A and Appendix C.

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work supporting each modification. Since the contract did not provide for tracking the cost of individual tasks and DFAS paid invoices from funds in the order they were listed in Section G of the delivery order, payments were made without regard to what actual work was done during the invoice period.

The contracting officer and receiving officials did not provide adequate information to support vendor payments to ensure the payments were charged to the correct line of accounting. For example, we could not determine the actual cost, when the work was completed, or when the vendor was paid, for the five projects established and funded by the September 26, 2001, delivery order. Although those projects were referenced by job order number in the contract, they could not be traced to either the vendor pay or official accounting records.

- An Air Force project officer and fund holder did not effectively follow up with Comptroller or DFAS personnel after the vendor was paid from lines of accounting not established to pay for the services.<sup>8</sup> Followup was warranted because the project was completed and invoiced in full as of October 24, 2003, and the line of accounting should have been expended as of that date. However, DFAS personnel used the unliquidated balance of pre-existing lines of accounting to pay the vendor for other services, and later used the unliquidated balance of the line of accounting under review to pay the vendor for services rendered through April 23, 2004. In this case, the project officer was responsible for performing inspections and accepting services and delivered items. The fund holder was responsible for maintaining a system of positive fund control. Neither the project officer nor the fund holder appeared to have followed up on these responsibilities when we concluded our tests.<sup>9</sup>
- Neither the Administrative Contracting Officer (ACO) nor Air Force Air National Guard (ANG) personnel provided timely followup after DFAS personnel used an accounting line other than the Air Force ANG line of accounting to pay a vendor for services.<sup>10</sup> In this case, the ACO approved a vendor billing for \$71,108.54 in cost incurred against the Air Force ANG contract line item. However, on July 7, 2003, DFAS personnel used only \$54,817.58 of the Air Force ANG accounting line to pay the vendor, paying the remaining \$16,290.96 from other lines. As of June 30, 2004, the end of our field work, DFAS had adjusted only \$11.69 to the ANG funds. On September 22, 2004, the ACO requested another adjustment of \$15,672.43 to the ANG funds. As a result, \$606.84 remains charged against another line of accounting. We were unable to determine why the full amount was not charged against the Air Force ANG contract line item.
- An Air Force maintenance engineer and fund holder did not effectively follow up with the funding of a services contract to ensure sufficient funds

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<sup>8</sup> Sample number 12, F29601-97-C-0115, P00065, job order number 3151LR03 and task order 12.

<sup>9</sup> June 30, 2004.

<sup>10</sup> Sample number 25, F34601-97-C-0032, P00126, payment voucher BVN0091.

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were obligated to pay for the services rendered.<sup>11</sup> In an option contract, each option may be separately identified by a series of line items and lines of accounting. However, neither the engineer nor the fund holder followed up on what was billed year-to-date to ensure that adequate funds were obligated to cover the cost of services during the first and second option years. Consequently, when funds for option year-1 were not sufficient to cover the final option year-1 invoice, DFAS personnel erroneously paid the vendor using the funds obligated to pay for option year-2 services. DFAS personnel then used the remaining option year-1 funds to partially pay for the first month of the option year-2 services.

- An Air Force resource manager and fund holder did not effectively follow up after an acquisition manager approved an invoice for payment that spanned the initial and extended period of performance.<sup>12</sup> While each year's contract was separately funded, DFAS personnel used the unliquidated balance of the prior year FY 2002 operations and maintenance (O&M) funds to pay the invoice in full. DFAS personnel's use of the FY 2002 O&M line of accounting violated the bona fide need rule since the services rendered in the subsequent period were not a bona fide need of the FY 2002 appropriation. The vendor period of performance that related to the extended period should have been prorated and paid from the FY 2003 O&M funds that were obligated to pay for the services. Base personnel acknowledged the violation after we questioned the payment.

## **Funds Control – A System of Internal Control**

Air Force personnel, including contracting officers, receiving officials, resource managers, and fund holders, have roles and responsibilities in minimizing the opportunity for erroneous payments and to execute procedural safeguards affecting proposed payments. DFAS personnel, when certifying vendor payments and accounting for transactions, rely on the written contract, appropriate invoice approvals,<sup>13</sup> receipt and acceptance documents, and followup to ensure that vendor payments are properly and accurately paid and that related budgetary and proprietary transactions are accounted for in the official accounting records. In the previous section, we provided four examples where internal control was not effective. The following explains why they were not effective.

Contracting officers, through the improper formation and structuring of the contract line items and lines of accounting, risked violating appropriation laws when multiple lines of accounting with fixed year appropriations were cited on the contract and the contracting officer included payment instructions that DFAS personnel use the earliest funds to pay vendors. In response to our question about

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<sup>11</sup> Sample number 31, F42650-02-C-0024, P00013.

<sup>12</sup> Sample number 50, contract GS35F4415G, order number F41691-02-F-0653.

<sup>13</sup> If the contract designates a billing office other than the paying office, that activity or organization is first to receive the invoice for review prior to forwarding to the paying office.

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the structuring of a delivery order on sample number 4, a contracting officer acknowledged that payments were made without regard to what actual work was done during the invoice period. The contracting officer stated:

This could be corrected by issuing a delivery order for each of the discrete tasks and determining for each task severability or non-severability, bona fide need, and limit funding to one line of accounting per contract line item or subCLIN at the lowest level for each. Or, establishing subCLINs for each discrete task with the corresponding ACRN assigned and having one basic CLIN for general service support with funding instruction to DFAS to pay invoice presented for CLIN general service support only. The contractor must then be required to establish separate work orders for each task and submit monthly invoices with the costs incurred against each task listed separately and the corresponding ACRN cited. This tracking mechanism would ensure that contract structure establishes strong financial discipline and integrity of delivery line.

In addition, contracts should clearly state that invoices are prepared and billed by contract line item for accurate application against the line of accounting for the period of performance for which the goods or services were a bona fide need. In the case of sample number 4, the Senior Contract Administrator for the company stated, regarding the preparation of invoices, that “we had no contractual or customer requirements to track costs to the subCLIN or task level.”

We found no evidence that personnel who accepted the goods and services, such as the project officer (sample number 12) and maintenance engineer (sample number 31) and who approved the invoice for payment, such as the ACO (sample numbers 25, 50), coordinated with their contracting officers, resource managers, and fund holders to ensure the correct line of accounting was used to pay for goods or services. We also did not find any indication that resource managers or fund holders examined the status of funds on the contracts to effect corrective action.

## **Conclusion**

An effective system of internal control over payments to vendors requires coordination between Air Force contracting officers, receiving officials, resource managers, and fund holders. In our opinion, systems of internal control are effective when personnel are accountable in their roles and responsibilities. Contracting officers must form and structure contracts to provide maximum visibility and traceability between the contract line items, lines of accounting, and periods of performance. Receiving officials must coordinate the receipt and acceptance of goods and services with DFAS personnel, the contracting officer, resource managers and fund holders. Resource managers and the fund holders must follow up on recording transactions to ensure that their lines of accounting are correctly identified to appropriately pay for the items delivered. These controls, and the acknowledged accountability of personnel over those controls, are necessary to establish strong financial discipline and integrity of the delivery line. In the absence of such internal control, vendors may be improperly,

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illegally, or erroneously paid resulting in the pecuniary liability of personnel. In addition, cost overruns or funding shortfalls may go undetected and appropriation law may be violated where a bona fide need did not exist based upon the date the goods or services were ultimately delivered.

## Recommendations

A.1. We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller) revise existing Air Force regulations and procedures to strengthen the system of internal control related to the duties and responsibilities of receiving personnel, resource managers, and fund holders who oversee the status of funds. The strengthening of the internal control structure should include:

a. Clarifying DoD policies that describe the duties and responsibilities of Air Force personnel, including the contracting officer, receiving personnel, resource managers, and fund holders, in maintaining an effective system of internal control.

b. Reviewing and clarifying procedures for contracting officers, receiving personnel, resource managers, and fund holders as part of the FY 2006 implementation of the Office of Management and Budget, Circular A-123, "Management's Responsibility for Internal Control," December 21, 2004.

A.2. We recommend that the Assistant Secretary of the Air Force (Acquisition) direct applicable commands and installations to:

a. Require all contracting office personnel to receive training in the proper formation and structuring of contract line items, lines of accounting, and periods of performance to provide maximum visibility of the items ordered and the lines of accounting obligated to pay for the deliverables.

b. Require that contracting office personnel verify that the vendor payment instructions are followed, and that invoices clearly delineate the cost to the respective contract line items.

c. Establish effective controls to comply with the DoD policy and FAR and DFARS requirements discussed in the criteria section of this report in the formation, structuring and execution of contracts.

d. Establish guidelines that require financial managers, resource advisors, and fund holders to follow up on the deliveries and payments made where multiple contract lines, lines of accounting, and performance periods are on contract.

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## **Management Comments Required**

The Air Force did not comment on a draft of this report. We request that the Air Force provide comments on the final report.

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## B. Unliquidated Obligations

Air Force personnel did not effectively monitor and follow up on unliquidated obligations. DoD policy requires fund holders to review unliquidated obligations at the end of January, May, and September of each year. While these triannual reviews are subject to a dollar threshold for each appropriation, an annual review of all unliquidated obligations is required, regardless of the dollar amount. Fund holders did not effectively review the unliquidated balances of 11 of the 45 contracting actions examined. These unliquidated obligations were invalid because goods and services had not been delivered, or the amounts obligated exceeded the period of performance and were no longer a bona fide need of that period. Unliquidated obligations were not effectively monitored because DoD policy did not clearly identify the actions fund holders should take to review and coordinate with contracting officers, comptroller or fiscal officers, and customers on the cause of the unliquidated balances. Fund holders need to monitor and follow up when deliveries are not made as scheduled, unliquidated balances remain after performance is complete, or the performance period in which the funds meet a bona fide need of the period is passed. On the 11 contracting actions, 13 lines of accounting had partial or no deliveries reported during the period the funds were available for obligation under the bona fide need rule. As a result, the risk is high that a significant amount of invalid unliquidated obligations is present in the Air Force accounting records. As long as the unliquidated obligations remain in the accounting records, fund holders lose the opportunity to use the funds to meet other requirements if the contract was completed. If not completed, DFAS personnel are apt to use those funds to pay vendors for performance in subsequent periods in violation of appropriation law.

### Critical Guidance

**DoD Financial Management Regulation (FMR).** DoD FMR, volume 3, chapter 8, requires fund holders to review obligations for timeliness, accuracy, and completeness during the periods ending January, May, and September. Fund holders are required to review all unliquidated balances at least once each fiscal year. Fund holders are DoD officials that receive a documented administrative subdivision of funds including apportionments, allocations, suballocations, allotments and suballotments through their funding channels or from other government departments, agencies and activities holding an administrative subdivision of funds. Consequently, fund holders are given the responsibility to conduct the triannual and annual reviews because they initiated the actions that resulted in the obligations, and, therefore, are in the best position to determine the accuracy and status of the transactions. When necessary, fund holders are required to request assistance from the accounting offices. Accounting personnel are required to provide listings or automated media to enable the fund holders to verify the balances shown in the proprietary and budgetary accounts, thus ensuring that the account balances are valid, accurate, and reconciled.



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## Unliquidated Obligations, Undelivered Orders

We identified 11<sup>14</sup> of 45 contracting actions where invalid unliquidated obligations existed because goods and services had not been delivered, or the amounts obligated exceeded the period of performance and were no longer a bona fide need of that period. The following four contracting actions are provided as examples.

- An Air Force military family housing O&M obligation for minor construction expired and was no longer a bona fide need of the period the funds were available for obligation. We believe the FY 2003 O&M funds were improperly used, and FY 2004 O&M funds should have been used after base personnel were unable to provide physical evidence that either work had started or costs were incurred to justify the construction as a bona fide need of FY 2003.<sup>15</sup> The fund holder, working in conjunction with the contracting officer, should have taken corrective action to either ensure that work started or, if termination for default was warranted, issued a replacement contract. As a result, \$117,991 was improperly expended because the project was not a bona fide need of the period. In addition, the unliquidated balance of \$24,167 (as of June 30, 2004) could not be used to complete the project.
- Air Force O&M funds, obligated for a services contract on five accounting lines, had unliquidated balances as of the end of the period of performance. However, instead of de-obligating the funds on these accounting lines, the contracting officer carried forward the unliquidated balances to pay for the next option year based on the belief the contract was for nonseverable services.<sup>16</sup> The contracting officer's action violated 10 U.S.C. 2410a, "Contracting for Severable Services." To effectively perform a triannual and annual review and identify possible violations of laws and regulations, fund holders must understand the terms of contracts on which their funds are obligated. The defined roles and responsibilities of the contracting officer, fund holder, and customer in the receipt and acceptance of the goods or services form a segregation of duties that extend from the initial execution of a contract to its administration. As a result, over \$2.8 million in FY 2003 O&M funds was reported as an unliquidated obligation at the end of the performance period and required A contracting officer, de-obligation.
- An Air Force O&M obligation for non-warranty support and repair expired on January 1, 2004, without any Air Force cost incurred for the support and repair action.<sup>17</sup> The contracting officer had set the periods of performance for the two contract line items through November 30, 2003, and December 31, 2003, respectively. In this case, the contracting officer

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<sup>14</sup> Sample numbers 2, 7, 11, 19, 20, 22, 33, 35, 36, 46, and 54.

<sup>15</sup> See Sample number 11; contract number F62321-00-D-0007, delivery order 5130.

<sup>16</sup> See Sample number 19; contract number F42600-01-D-0027, delivery order 0003.

<sup>17</sup> See Sample number 20; contract number F08635-03-D-0007, delivery order 0003.

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had to de-obligate \$184,000 of FY 2003 O&M funds that had expired after determining the Air Force installations that possessed the assets had not forwarded them to the vendor for the non-warranty support and repair action. The fund holder, working with the inventory management specialist who requested the funding, should have taken action to prompt the installations to send the assets to the vendor. Because the fund holder did not take this action, \$184,000 of FY 2003 funds that could have been used by the Air Force was allowed to expire.

- An Air Force O&M obligation for purchasing mobility equipment expired and had to be de-obligated when the vendor failed to deliver the equipment in accordance with the delivery schedule in the contract. Base personnel subsequently de-obligated the FY 2003 O&M funds because the funds were not proven to be a bona fide need of that year.<sup>18</sup> When following up with the contracting officer, customer, and program manager, the fund holder should have taken action to de-obligate the FY 2003 O&M funds and to modify the contract, using the FY 2004 O&M appropriation to fund the purchase. The fund holder's coordination with the contracting officer indicated that a binding agreement was not in place; therefore the use of the FY 2003 funds would have been in violation of law. As a result, the contracting officer had to de-obligate \$206,530 of FY 2003 O&M funds that had expired and were no longer available for other needs of the base.

## Fund Holder Actions

The DoD FMR does not provide clear instructions on fund holder responsibilities for the review and followup of triannual and annual reviews of unliquidated obligations. We did not find evidence that fund holders initiated contact with contracting officers and customers to follow up when deliveries were past due or when unliquidated balances existed at the end of the contract periods of performance. On the 11 contracting actions, 13 lines of accounting had partial or no deliveries reported during the period the funds were available for obligation under the bona fide need rule. While the DoD FMR<sup>19</sup> requires fund holders to determine that the unliquidated balance is valid during the triannual and annual reviews performed each year, improvements could be made in the instructions for orders that are not delivered or for balances remaining at the end of the contract periods of performance.

## Conclusion

As part of a system of internal control, fund holder triannual and annual reviews are critical in reviewing and following up with contracting officers, comptroller or fiscal officers, and customers if the cause for an unliquidated balance is to be

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<sup>18</sup> See sample number 35, contract number GS06F0007J, order number F61521-03-F-A494.

<sup>19</sup> DoD FMR, volume 3, chapter 8, paragraph 080403.

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identified and corrective action is necessary. That followup could identify instances where: (1) timely corrective actions (for example, termination for default and issuance of a replacement contract) could preserve the original use of the funds (sample number 11); (2) appropriations originally cited were ultimately not valid as a bona fide need of the original orders (sample number 35); (3) unliquidated balances were excessive to the periods of performance, allowing for timely deobligation (sample number 19); and (4) Air Force personnel did not follow through to ensure they took the necessary action to have the work done (sample number 20). A high risk exists that a significant amount of invalid unliquidated obligations is present in the Air Force accounting records. If action is not taken to de-obligate those balances, DFAS personnel are apt to use the funds to pay the vendor in violation of appropriation law.

## **Recommendations**

B.1. We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller) review existing Air Force regulations and procedures, and strengthen the system of internal control related to conducting triannual and annual reviews. The duties and responsibilities of fund holders should include:

- a. Reviewing the contract or order so they will know the delivery terms and periods of performance that apply to the obligation of the funds.
- b. Reviewing any unliquidated balances related to the undelivered order.
- c. Reviewing unliquidated balances that are potentially excessive to the costs expected to be incurred during the period of performance.
- d. Requiring coordination between the comptroller or fiscal officer and DFAS personnel to determine whether the goods or services were received but were not recorded on the fund holders' line of accounting in the official accounting records.
- e. Requiring coordination between the contracting officer and customers to determine the status of the order, and if delivery or performance was not made.
- f. Reviewing and clarifying procedures for the triannual and annual reviews as part of the FY 2006 implementation of the Office of Management and Budget, Circular A-123, "Management's Responsibility for Internal Control," December 21, 2004.

B.2. We recommend that the Assistant Secretary of the Air Force (Acquisition) direct the applicable commands and installations to require all contracting office personnel and receiving personnel to coordinate with fund holders to determine the status of the delivery or performance.

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## **Management Comments Required**

The Air Force did not comment on a draft of this report. We request that the Air Force provide comments on the final report.

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## Appendix A. Scope and Methodology

This is the second in a series of reports examining internal control and compliance with laws and regulations of the Air Force General Fund vendor pay disbursement cycle. In this report, we discuss the outcome of our tests related to the Air Force personnel review and followup, and fund holders conduct of the triannual and annual reviews of unliquidated balances for the 45 contracting actions. We performed internal control tests to determine whether Air Force contracting officers, customers who received goods and services, and fund holders reviewed and followed up on the deliveries made against the contracts and on the lines of accounting that were used to pay for the goods and services. Our sample of 45 contracting actions was randomly selected from a universe of 15,096 items reported during the period July 1, 2003, through September 30, 2003. The audit test period extended from October 1, 2003, through June 30, 2004. In a control sample test of 45 items, one deviation represents a high risk that internal control is not effective.

In our examination of the 45 contracting actions (which included funding modifications), we examined the contract file documentation for each sample to determine the timing, nature, character, and terms and conditions related to the action. We also obtained copies of the funding documents for the contracting action. Based upon the contract data gathered, we traced the delivery of the goods and services through receipt and acceptance by the Government, invoice certification, payment, and recognition of the related transactions in the budgetary and proprietary general ledger accounts in the official accounting records.

We performed this audit from January 2004 through November 2005 in accordance with generally accepted government auditing standards. Our review of the transactions related to the deliveries and payments made against the contracting actions during the period October 2003 through June 2004, except for those actions that were funding modifications. We reconstructed the funding and payment histories on all funding modifications back to the inception of the basic order.

**Use of Computer-Processed Data.** We relied on data from the Integrated Accounts Payable System, Mechanization of Contract Administration Services, and Electronic Document Access systems. However, we did not perform a formal reliability assessment on these systems. Instead, we compared system data to the hardcopy contract and funding documents, invoices, and receiving documents to assess data reliability for the lines of accounting charged and payments made against the 45 contracting actions selected for audit.

**Use of Technical Assistance.** The Office of Legal Counsel, Office of the Inspector General, assisted in the review of the legality of the contracting actions and funds used to pay vendors identified in this report. In addition, personnel from the Quantitative Methods Division, Office of the Inspector General, assisted in the development of the statistical analysis presented in this report.

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**Government Accountability Office High-Risk Area.** The Government Accountability Office has identified several high-risk areas in DoD. This report addresses issues related to the Defense Financial Management high-risk areas.

## **Prior Coverage**

No prior coverage has been conducted on the Air Force General Fund vendor pay disbursement cycle during the last 5 years.

## Appendix B. Contracting Actions Selected for Review

Sample Number	CONTRACTING OFFICE	CONTRACTING ACTION	CONTRACT VALUE	DESCRIPTION GOODS/SERVICES
1	WR-ALC / LRK 750 3rd Street Robins AFB, GA 31098-2122	F34601-00-G-0006 RU32	319,431	Miscellaneous Engine Accessories, Aircraft
2	Air Force Material Command Aeronautical System Center 2640 Loop Road West, Building 557 Wright-Patterson AFB, OH 45433-7106	F33657-00-G-4029	645,500	Airframe structural components
3	OO-ALC / LGJ 6050 Gum Lane, Building 1215 Hill AFB, UT 84056-5825	GS-07F-7465C F42630-03-F-0059	677,385	Converters, Electrical, Nonrotating
4	Air Force Material Command Human System Center / PKR 7909 Lindbergh Drive Brooks AFB, TX 78235-5352	F41624-97-D-6004	112,000	RDT&E Other Research and Development-Eng. / Manuf. Development
5	Air Force Material Command Air Force Research Laboratory 2310 8th Street, Building 167 Wright-Patterson AFB, OH 45433-7801	F33615-03-M-2385	99,661	RDT&E / Aircraft-Applied Research
6	55 Contracting Squadron 101 Washington Square, Building 40 Offutt AFB, NE 68113-2107	F25600-02-D-0008	319,972	Automated Information System Design and Integration Services
7	OC-ALC/PSK B-52 3001 Staff Drive, Building 3001, Suite 2AG87A Tinker AFB, OK 73145-3020	F34601-99-C-0006 P00130	75,000	Systems Engineering Services
10	ASC/PKW Area C Building 1 1940 Allbrook Drive, Suite 3, Wright-Patterson AFB, OH 45433-5309	NIH--26303D0541 F33600-03-F-3217	68,570	ADP Support Equip
11	18 CONS / Infrastructure Acquisition Unit 5199, Building 95 Kadena AB--Japan APO, AP 96368	F62321-00-D-0007	142,185	Maintenance / Other Miscellaneous Buildings
12	Department 8, AF Research Laboratory, Directorate of Contracting / PK 2251 Maxwell Avenue SE Kirtland AFB, NM 87117-5773	F29601-97-C-0115 P00065	106,600	RDT&E / Weapons-Adv Tech Development
14	39 CONS / LGC FA5685 39 Uncu Kontrat Subayligi Bina Number 488, 10 Uncu Tanker US Komutanligi Incirlik/Adana, Turkey	F61358-03-P-0104	128,750	Aircraft Ground Servicing Equipment
17	R325 CONS / LGCB / STOP 28, 501 Illinois Avenue, Suite 5 Tyndall AFB, FL 32403-5526	F08637-02-D-6999	680,028	Facilities Operations Support Services
18	OC-ALC / PKOAA 7858 5th Street, Suite 1 Tinker AFB, OK 73145	NAS501142 F34650-03-F-A384	148,127	ADPE System Configuration
19	Directorate of Contracting Building 1206, OO-ALC / LHKC 6039 Wardleigh Road Hill AFB, UT 84056-5838	F42600-01-D-0027	3,688,503	Systems Engineering Services
20	AAC / YUB Building 11, 102 W. D Avenue, Ste 300 Eglin AFB, FL 32542-6808	F08635-03-D-0007	195,626	Bombs

Note: Sample Numbers are not in consecutive order. Contracting actions resulting in deliveries and payment prior to September 30, 2003 were replaced.

Sample Number	CONTRACTING OFFICE	CONTRACTING ACTION	CONTRACT VALUE	DESCRIPTION GOODS/SERVICES
21	Air Force Material Command 311th Human Systems Wing / PKV 3300 Sidney Brooks Brooks City Base, TX 78235-5112	F41624-01-D-8552	99,461	Other Industrial Buildings
22	OO-ALC / YWK Directorate of Contracting Building 1215, 6050 Gum Lane Hill AFB, UT 84056-5825	F42630-99-C-0170 P00085	56,862	Maintenance and Repair of Equipment / Training Aids and Devices
23	Contracting Squadron IT 14040 Building 17000 Andersen AFB, GU 96543-4040	F64133-03-P-0242	89,708	Miscellaneous Items
24	CONS / Infrastructure Acquisition Unit15199, Building 95 Kadena AB--Japan APO, AP 96368	F62321-03-D-0010	83,345	Maintenance / Other Miscellaneous Buildings
25	OC-ALC Directorate of Contracting / Aircraft 3001 Staff Dr, Suite 1AE1 107B Tinker AFB, OK 73145-3020	F34601-97-C-0032 P00126	587,000	Aircraft Fixed Wing
26	ESC / SRK Electronic Systems Center Air Force Material Command Hanscom AFB, MA 01731-3010	GS-35F-4668G F19628-02-F-8197 P00010	1,508,316	Other Professional Services
27	374 Contracting Squadron Unit 5228, Building 620 Yokota AB--Japan Fussa-Shi, Tokyo 197-0001	F62562-03-C-0049	620,200	Maintenance / Religious Facilities
28	AAC / PKO-FA2823 205 West D Avenue Building 350, Suite 541 Eglin AFB, FL 32542-6862	GS-07F-0397K F08651-03-F-A294	68,995	Recreational and Gymnastic Equipment
30	Air Force Material Command HQ Aeronautical Systems Center 2300 D Street Wright-Patterson AFB, OH 45433-7249	F33657-98-D-0021	876,488	Data Analyses (Other Than Scientific)
31	OO-ALC / PKOS 6038 Aspen Ave, B1289 NE Hill AFB, UT 84056-5805	F42650-02-C-0024 P00013	250,000	Custodial-Janitorial Services
32	82 CONS / LGC 136 Avenue, Ste 1, Building 1664 Sheppard AFB, TX 76311-2746	F41612-01-D-0006	573,366	Maintenance / Maintenance Building
33	374 Contracting Squadron Unit 5228, Building 620 Yokota AB--Japan Fussa-Shi, Tokyo 197-0001	F62562-03-P-0648	42,085	Maintenance / Family Housing Facilities
34	88 ABW / PKS 1940 Allbrook Drive, Suite 3 Wright-Patterson AFB, OH 45433-5309	GS-28F-8021H F33601-03-F-0228	67,770	Office Furniture
35	USAFE Contracting Squadron Unit 3115 APO, AE 09094	GS-06F-0007J F61521-03-F-A494	206,530	Miscellaneous Items
Note: Sample Numbers are not in consecutive order. Contracting actions resulting in deliveries and payment prior to September 30, 2003 were replaced.				



Sample Number	CONTRACTING OFFICE	CONTRACTING ACTION	CONTRACT VALUE	DESCRIPTION GOODS/SERVICES
36	OC-ALC / PKOE 7858 5th Street, Suite 1 Tinker AFB, OK 73145	F34650-98-D-0033	124,359	Architect - Engineering Services
37	99 CONS / LGCB 5865 SWAAB Boulevard, Building 588 Nellis AFB, NV 89191-7063	GS-35F-4076D F26600-03-F-8613	486,000	ADP Input / Output and Storage Devices
38	35 CONS / LGC Unit 5201, Building 302 (Japan) APO, AP 96319-5201	GS-07F-8756D F62509-03-F-0067	77,173	Tractor, Wheeled
40	38 Contracting Squadron Unit 14040, Building 17000 Andersen AFB, GU 96543-4040	F64133-98-D-0009	128,590	Maintenance / Other Miscellaneous Building
41	Air Force Material Command Aeronautical Systems Center 2640-Loop Road West, Room 213 Wright-Patterson AFB, OH 45433-7106	F33657-03-C-3003 P00016	3,232,511	Drones
42	15th Contracting Squadron 90G Street, Building 1201 Hickam AFB, HI 96853-5230	F64605-03-C-0020	1,499,980	Maintenance / All Other Non-Building Facilities
44	Special Operations Forces Contracting Division WR-ALC / IUK 228 Cochran Street Robins AFB, GA 31098-2200	F09603-02-C-0286 P0007	442,297	Modification of Equipment / Aircraft Components & Accessories
46	Air Force Material Command Aeronautical Systems Center 2640 Loop Rd West, Room 203 Wright-Patterson AFB, OH 45433-7106	F33657-00-G-4042	85,371	Systems Engineering Services
47	ASC / PKW Area C, Building 1 1940 Allbrook Drive, Suite 3 Wright-Patterson AFB, OH 45433-5309	F42620-00-D-0039 RZ16	71,092	Engineering Technical Services
48	OC/ALC / LGKIB (CFT) 3001 Staff Drive, Suite 1AC197E Tinker AFB, OK 73145-3028	F34601-97-D-0423	1,130,678	Maintenance and Repair of Equipment / Aircraft Structural Comps
50	12 CONS / LGCB-FA1691 395 B Street West, Suite 2 Randolph AFB, TX 78150-4525	GS-35F-4415G F41691-02-F-0653 P00001	74,630	Other ADP & Telecommunication Services
51	OO-ALC / LHKS Directorate of Contracting Building 1239, 6012 Fir Avenue Hill AFB, UT 84056-5820	F04606-97-D-0059 QPSB	317,027	Telephone & Telegraph Equipment
53	42nd Contracting Squadron 50 Lemay Plaza South Maxwell AFB, AL 36112-6334	F01600-03-F-A306	149,160	Office Furniture
54	22nd Contracting Squadron, FA4621 53147 Kansas Street, Suite 102 McConnell AFB, KS 67221-3606	DAHA14-02-D-5222 X406	168,272	Maintenance Religious Facilities
56	Air Force Material Command Air Armament Center Building 349, 207 West D Avenue, Suite 622 Eglin AFB, FL 32542-6844	F08635-03-C-0098	2,500,000	Guided Missiles
57	50th Contracting Squadron, GWE 21D Falcon Parkway Schriever AFB, CO 80912-2118	GS-07F-6337A FA2550-03-F-A122	199,943	Miscellaneous Furniture and Fixtures
Note: Sample Numbers are not in consecutive order. Contracting actions resulting in deliveries and payment prior to September 30, 2003 were replaced.				

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
Director, Acquisition Resources and Analysis  
Under Secretary of Defense (Comptroller)/Chief Financial Officer  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Director, Program Analysis and Evaluation  
Director, Defense Procurement and Acquisition Policy

### **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)  
Assistant Secretary of the Air Force (Acquisition)  
Auditor General, Department of the Air Force

### **Other Defense Organizations**

Director, Defense Finance and Accounting Service  
Director, Defense Contract Audit Agency  
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Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform

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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

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