

Inspector General

United States
Department of Defense



Defense Finance and Accounting Service
Compliance with the Debt Collection and
Improvement Act of 1996 for the
Department of the Navy

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Acronyms

CDS	Contractor Debt System
DCPS	Defense Civilian Pay System
DCIA	Debt Collection Improvement Act of 1996
DCM	Debt & Claims Management
DDMS	Defense Debt Management System
DFAS	Defense Finance and Accounting Service
DMO	Debt Management Office
DoD FMR	Department of Defense Financial Management Regulation
DoN	Department of the Navy
IOOS	Individual Out-of-Service
MOCAS	Mechanization of Contract Administration System
RAO	Referring Accounting Office
TIN	Taxpayer Identification Number
TROR	Treasury Report on Receivables Due from the Public



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

February 6, 2008

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
NAVAL INSPECTOR GENERAL

SUBJECT: Report on Defense Finance and Accounting Service Compliance with the
Debt Collection and Improvement Act of 1996 for the Department of the
Navy (Report No. D-2008-046)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Comments received from the Columbus and Denver Defense Finance and Accounting Service offices were partially responsive. We request additional comments on Recommendations A.1.b, B.1 and B.2 by March 6, 2008. Recommendation A.1.c. was deleted. See the Finding section for the deleted recommendation.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audclev@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).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Edward A. Blair at (216) 706-0074, ext. 226 or Ms. Laura J.S. Croniger at (216) 706-0074, ext. 227. 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:

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Department of Defense Office of Inspector General

Report No. D-2008-046

February 6, 2008

(Project No. D2006-D000FC-0186.000)

Defense Finance and Accounting Service Compliance With the Debt Collection and Improvement Act of 1996 for the Department of the Navy

Executive Summary

Who Should Read This Report and Why? Defense Finance and Accounting Service (DFAS) and Department of the Navy personnel responsible for processing public debt and reporting Accounts Receivable balances should read this report. It discusses the processes used to collect public debt and Accounts Receivable reporting requirements, which are subject to the "Debt Collection and Improvement Act of 1996" (DCIA) and other pertinent regulations.

Background. Quarterly, DFAS Cleveland Departmental Reporting Office gathers and reports Department of the Navy public debts to the Department of the Treasury in the "Treasury Report on Receivables Due from the Public." DFAS Cleveland relies on other DFAS sites to obtain outstanding public debt information. The Department of the Treasury uses the "Treasury Report on Receivables Due from the Public" as a way to determine the status and condition of the Federal Government's debt portfolio, as required by the DCIA. The DCIA and other pertinent regulations provide requirements and guidance on how to manage and report public debt.

Results. DFAS is not complying with established regulations when processing Department of the Navy public debts. Below are the audit results from various DFAS sites contacted or visited during our audit.

DFAS Columbus Debt Management Office reports and manages contractor debts in the Contractor Debt System. The Debt Management Office didn't have adequate controls to ensure debt files were processed in accordance with the DCIA and other pertinent guidance. Specifically, it didn't require taxpayer identification numbers, didn't appropriately transfer debt files to Department of the Treasury and didn't adequately safeguard debt file records. As a result, the Debt Management Office is not fully compliant with the DCIA, Federal Acquisition Regulation, and DoD Financial Management Regulation. This hinders the Debt Management Office's ability to collect Department of the Navy public debt and properly report Accounts Receivable balances (finding A).

DFAS Denver Debt and Claims Management Office manages “Individual Out-of-Service Debts” in the Defense Debt Management System. Individual Out-of-Service Debts are amounts due to DoD by individuals without an active payroll account. The Debt and Claims Management Office improperly suspended debt accounts and didn’t maintain substantiating records necessary to support debt files classified as either financial hardship or bankruptcy. Also, the Debt and Claims Management Office didn’t limit the time allowed for validation and examination of the debt files and didn’t safeguard debt file records. As a result, the Debt and Claims Management Office took an average of 67 days to validate a debt file and debts classified as financial hardship or bankruptcy were suspended for up to 6 months. These delinquent debts are at a greater risk of being uncollectible (finding B).

DFAS payroll offices at Charleston, South Carolina and Pensacola, Florida manage “Individual In-Service Debts.” Individual In-Service Debts are amounts due from active civil service employees. The DFAS payroll offices use the DoD Civilian Pay System to manage debt files. The DFAS payroll offices did not adequately process public debt files or include sufficient substantiating supporting documentation for Individual In-Service Debts. DFAS misclassified debt files, didn’t fully support the status of debt files, and issued demand letters late. As a result, DFAS is not fully compliant with the DCIA, Office of Management and Budget Circular A-129, DoD Financial Management Regulation, and Defense Accounting Service Guide 7900.4G. Department of the Navy public debts are at risk of becoming uncollectible, which reduces the availability of Department of the Navy funds and overstates Accounts Receivable balances (finding C).

DFAS Cleveland Departmental Reporting Office inaccurately reported a negative amount of \$300,257 of accounts payable and employer contribution amounts as Accounts Receivable on the March 31, 2006 “Treasury Report on Receivables Due from the Public” and did not archive complete Individual In-Service Debt data. As a result, DFAS Cleveland overstated Department of the Navy public debt and was not fully compliant with the DCIA and DoD Financial Management Regulation. Also, the lack of proper record retention hinders DFAS Cleveland’s ability to support amounts reported on the “Treasury Report on Receivables Due from the Public” (finding D). See the Findings section of the report for detailed recommendations.

Management Comments and Audit Response. DFAS Indianapolis Director, Corporate Reporting, Standards and Compliance concurred with nine recommendations and nonconcurred with four recommendations. As a result of management comments, we deleted one draft recommendation. Management comments were responsive to eight recommendations, nonresponsive to three recommendations and partially responsive to one recommendation. DFAS Arlington Deputy Director, Compliance, Standards and Compliance concurred with four recommendations and provided updated management comments. We request that the Director, Defense Finance and Accounting Service provide additional comments on the final report by March 6, 2008. See the Findings 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.

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Background

Defense Finance and Accounting Service (DFAS) Cleveland provides finance and accounting services to the Department of the Navy (DoN). These include the consolidation and reporting of its outstanding public debt (Accounts Receivable), which is included in the “Treasury Report on Receivables Due from the Public” (TROR). Accounts Receivable arise from claims to cash or other assets. Accounts Receivable include, but are not limited to, monies due for indebtedness.

The March 31, 2006 TRORs prepared for the Navy General Fund and the Navy Working Capital Fund reported a total of \$3.7 billion in DoN public debt. The Debt Collection Improvement Act of 1996 and other pertinent regulations provide guidance on how to manage and report DoN public debt.

Debt Collection Improvement Act of 1996. A goal of the Debt Collection and Improvement Act of 1996 (DCIA) is to maximize collection of delinquent debt¹ owed to the Federal Government. Specifically, the DCIA ensures “quick action to enforce recovery of debts and the use of all appropriate collection tools.” Under this act, agencies are required to notify and transfer delinquent debts more than 180 days old to the Department of the Treasury in an effort to offset or reduce any future government payments made to the debtor. The DCIA also requires agencies to obtain a taxpayer identification number from entities doing business with that agency.

Treasury Report on Receivables Due from the Public. The TROR is a report on the status of the Federal Government’s public debt portfolio.² It is prepared in accordance with the requirements of the DCIA. As mentioned above, DFAS Cleveland prepares TRORs quarterly to report the status of outstanding DoN public debt associated with the General Fund and the Working Capital Fund accounts.

The Navy General Fund is made up of appropriated³ DoN funds that support overall Departmental operations. The second quarter FY 2006 Navy General Fund TROR reported \$3.6 billion for DoN public debt. The Navy Working Capital Fund is a revolving⁴ fund that supports the operating forces of the Navy and Marine Corps. The second quarter FY 2006 Navy Working Capital Fund TROR reported \$64.3 million for DoN public debt.

¹ Delinquent debt refers to a debt that has not been paid by the due date specified by the agency’s initial written demand for payment.

² The TROR only reports non-tax-related public debts.

³ Appropriated funds are directed from Congress and comprise the DoN General Fund account structure.

⁴ A revolving fund is an account or fund in which all income is derived from its operations and is available to finance the fund’s continuing operations without fiscal year limitations. The purpose of the revolving fund is to improve cost awareness and to promote cost consciousness.

DFAS Columbus Debt Management Office. The DFAS Columbus Debt Management Office (DMO) is responsible for managing and reporting DoD contractor debt. DMO uses the Contractor Debt System and the Mechanization of Contract Administration System to record and report public debt due from government contractors. DMO reports this information on the Monthly Debt Management Report.

DFAS Denver Debt and Claims Management Office. DFAS Denver Debt and Claims Management Office maintains Individual Out-of-Service public debt records in the Defense Debt Management System. These records serve as the subsidiary ledgers for Accounts Receivable balances provided to the DFAS Cleveland departmental-level accounting office for preparation of the TROR. The Debt and Claims Management Office is responsible for managing and reporting DoD out-of-service military and civilian debt.

DFAS Charleston and DFAS Pensacola. DFAS Charleston and DFAS Pensacola record and report current and former DoD civilian employee public debt in the Defense Civilian Pay System (DCPS). These DFAS centers are responsible for managing and reporting Individual In-Service Accounts Receivable records contained in DCPS. DCPS records should provide the current status of DoD public debt due from current and former DoD civilian employees.

DFAS Cleveland Departmental Reporting Office. DFAS Cleveland Departmental Reporting Office gathers DoN public debt from the sites mentioned above. DFAS Cleveland then prepares the DoN TROR and provides it to the Department of Treasury. Table 1 shows the DFAS sites with corresponding findings and systems used to manage debt files.

Table 1. DFAS Sites and the Corresponding Systems		
Finding	DFAS Site	System
A	Columbus	Contractor Debt System and Mechanization of Contract Administration System
B	Denver	Defense Debt Management System
C	Charleston & Pensacola	Defense Civilian Pay System
D	Cleveland	Reports DoN public debt data received from the various sites mentioned above

Objectives

Our overall audit objective was to determine whether DFAS was effectively complying with DCIA as it related to Department of Navy accounts. Specifically, we attempted to determine whether DFAS was managing DoN public debts properly and reporting them in compliance with established guidance. We also

evaluated the managers' internal control program as it related to the overall audit objectives at DFAS and Navy organizations. See Appendix A for a discussion of the scope and methodology related to the objectives.

Review of Internal Controls

Material internal control weaknesses were identified for DFAS sites as defined by DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," January 4, 2006. DFAS did not have adequate internal controls to comply with the laws and regulations related to reporting public Accounts Receivable (debt) for both Navy General Fund and Navy Working Capital Fund. Specifically, controls are needed to:

- ensure that all DoN debt files in the Contractor Debt System have a taxpayer identification number, are transferred to the Department of the Treasury as appropriate, and are adequately safeguarded;
- ensure that all DoN debt files in the Defense Debt Management System are validated in a reasonable time period and include all substantiating records for "financial hardship" and "bankruptcy" status debts;
- ensure that all DoN debt files in the Defense Civilian Pay System include all substantiating records, are researched effectively to ensure proper classification, and have demand letters sent in a timely manner; and
- ensure that Accounts Receivable are accurately recorded on the TROR and that Individual In-Service Debt data are accurately archived.

Implementing Recommendations A.1, A.2, B, C, and D will improve DFAS controls over the recording, reporting, and collection of DoN public Accounts Receivable. A copy of the final report will be provided to the DFAS senior officials responsible for the managers' internal control program.

A. Contractor Debt at DFAS Columbus Debt Management Office

DFAS Columbus Debt Management Office (DMO) did not have adequate controls to ensure that debt files were processed in accordance with the DCIA and other pertinent guidance. DMO processes were ineffective because they did not:

- require taxpayer identification numbers (TIN),
- transfer debt files to Department of the Treasury as appropriate, and
- adequately safeguard debt file records.

As a result, DMO is not fully compliant with the DCIA, the Federal Acquisition Regulation, and DoD Financial Management Regulation (DoD FMR). This hinders DMO's ability to collect DoN public debts and properly report account receivable balances.

DFAS Columbus Debt Management Office

DMO uses the Contractor Debt System (CDS) to perform a variety of debt management functions associated with delinquent contractor debts exceeding \$600.⁵ DMO receives delinquent debt information from a referring accounting office (RAO) and prepares a monthly report for the RAO that should allow for reconciliation to its general ledger. The RAO is responsible for initiating debt collection and issuing a demand letter within 90 days of when a debt is categorized as delinquent. After 90 days, the RAO transfers the debt information and collection actions to the DMO; however, the RAO retains responsibility for recording and reporting the contractor debts as Accounts Receivable. We selected a sample of debts that were in CDS as of March 31, 2006. See Appendix B for a discussion of our sample methodology.

⁵ Per DoD FMR Volume 10, Chapter 18, the minimum amount of debt that may be referred to the DFAS Columbus is \$600.

We selected a sample of 134 contractor debt files processed by DMO and tested them for compliance with the DCIA, the Federal Acquisition Regulation, and the DoD FMR. Table 2 shows the results of the 134 contractor debt files tested.

Table 2. Summary of all 134 Contractor Debt Files Tested	
Noncompliant Debt Files	58
Missing Debt Files	3
Compliant Debt Files	73
Total Debt Files Tested	134

Table 3 summarizes the 58 contractor debt files we identified as noncompliant. The “Issues by Category” column assigns a letter to each noncompliance issue identified. These letters are used again in Table 4.

Table 3. Summary of the 63 Noncompliant Contractor Debt Files Identified		
Issues by Category	Noncompliance Issue Identified	Total Debt Files
A	Missing Taxpayer Identification Number	33
B	Missing Taxpayer Identification Number and Sent to Department of the Treasury Late	6
C	Sent to Department of the Treasury Late	19
	Total Noncompliant Debt Files	58

Some of the 58 contractor debt files failed on one or more of the attributes tested. Table 4 summarizes the number of individual attribute compliance issues identified in each noncompliant debt file.

Table 4. Summary of Compliance Issues Identified by Attribute			
Issues by Category	Debt Files Missing TINs	Debt Files Sent Late to Treasury	Total
A	33		
B	6	6	
C		19	
Total	39	25	64

Debt File Information and Processing

Taxpayer Identification Numbers. Thirty-nine debt files tested did not include the required Taxpayer Identification Number (TIN).⁶ The DCIA, DoD FMR, and “Money and Finance,” section 7701, title 31, United States Code all require Federal agencies to obtain a TIN for contractors doing business with the agency, and the TIN must be included in the supporting documentation (excluding foreign debts). DMO accepted 39 files without TINs, rather than returning them to the RAO. DMO must require TINs for all debt files to verify contractor validity. Also, TINs are necessary for the issuance of an “IRS Cancellation of Debt Form 1099-C,” if a debt is determined to be uncollectible and therefore should be written off by the agency. Form 1099-C is filed with the Internal Revenue Service when an indebtedness of at least \$600 is canceled. This canceled debt must be reported as income by the debtor. The form must include the name, address, and TIN of the debtor. DMO must ensure that TINs are included in all debt files. If TINs are not included, the file should be returned to the RAO, or other research should be conducted to ensure compliance with the TIN requirements. As a result of our audit work, DMO did conduct research and found TINs for 26 additional debt files. We did not attempt to verify the additional TIN information.

Managing and Transferring Debt Files. For 25 debt files, DMO did not immediately transfer debts to the Department of the Treasury for collection after 90 days. The DoD FMR, volume 10, “Contract Payment Policy and Procedures,” chapter 18, “Contractor Debt Collection,” requires DMO to transfer public debts to Department of the Treasury for collection after 180 days of being delinquent. Procedures should be in place to require the transfer of debts from DMO to Department of the Treasury within the established timeframe. If debts are not eligible for transfer to Department of the Treasury, DMO must maintain adequate

⁶ A Taxpayer Identification Number is a nine-digit number which is either an Employer Identification number or a Social Security number

support for this classification. Debts that are not eligible for transfer to Department of the Treasury include debts that:

- are in litigation or foreclosure,
- will be disposed of under an approved asset sale program,
- have been referred to a private collection contractor for a period of time acceptable to Department of the Treasury,
- are at a debt collection center for a period of time acceptable by Department of the Treasury,
- will be collected under internal offset procedures within 3 years of when the debt first became delinquent, or
- are exempt by Department of the Treasury based on a determination that the exemption is in the best interest of the United States.

DMO did not adequately track debts eligible for referral to Department of the Treasury. DMO needs to improve its debt-tracking procedures to help improve the collection and reporting of debts.

As a result of our audit work, DMO produced additional documentation not previously provided to support some of the cited files. After reviewing this additional support, we were able to verify that out of the original 25 debt files sent late to the Department of the Treasury, 6 of the files were actually transferred within the required timeline. DMO should ensure that all debt file documentation supports the current status.

Availability of Records. DMO did not provide any supporting documentation for three contractor debt files tested. The debt associated with the missing files totals \$2.4 million. The inability to locate these debt files impedes substantiating and collecting valid debts.

The DoD FMR requires organizations to retain supporting documents or images for 6 years and 3 months. DMO stated that it was aware of the missing supporting documentation. However, it did not take effective actions to validate and collect these debts. DMO was responsible for these debt files for more than a year, but it took no action to gather more information in order to start the collection process. Procedures should be in place that require the periodic review of debt files to ensure that collections are being aggressively pursued. As a result of our audit work, DMO found supporting documentation for one debt file valued at \$1,136.

Other Matters of Interest – Demand Letters

DFAS Columbus uses Mechanization of Contract Administration Services (MOCAS) to process amounts due to DoD from vendors. These usually result from overpayments to vendors. We tested a sample of 52 MOCAS transactions reported on the March 31, 2006 TROR. The DoD FMR, volume 10, “Contract Payment Policy and Procedures,” chapter 18, “Contractor Debt Collection” states, “Any available documentation that substantiates the indebtedness should be included with the demand letter.” DFAS Columbus did not follow the requirements of this regulation in 32 out of 52 of the transactions tested (62 percent). DFAS Columbus issued demand letters to contractors stating that documents were available for review upon request, rather than attaching the documents that supported the debt amounts, as required by the regulation. While there were no instances of noncompliance with the DCIA, the DoD FMR requires that indebtedness be substantiated to the contractor. Compliance with this regulation should improve the likelihood of collection. We suggest that DFAS Columbus consider revising its demand letter process to be in full compliance with the DoD FMR. See Appendix B for a discussion of our sample methodology.

Recommendations, Management Comments, and Audit Response

Deleted Recommendation. As a result of management comments, we deleted draft Recommendation A.1.c.

A.1. We recommend that the Director, Defense Finance and Accounting Service Columbus review Debt Management Office debt files to ensure that:

a. All non-foreign debt files include a taxpayer identification number.

Management Comments. The Director, Corporate Reporting, Standards and Compliance concurred. The Debt Management Office will require technicians to validate the existence of taxpayer identification numbers on debt referrals or take steps to obtain one if it is not included. DFAS will include obtaining non-foreign taxpayer identification numbers in its published desk procedures. DFAS identified an estimated completion date of May 1, 2008.

b. Eligible debt files more than 90 days old are referred to Department of the Treasury for further collection action.

Management Comments. The Director, Corporate Reporting, Standards and Compliance nonconcurred. He cited 31 Code of Federal Regulation Part 901.1, “Agencies shall transfer to the Secretary any debt that has been delinquent for a period of 180 days or more so that the Secretary may take appropriate action to collect the debt or terminate collection action.” He stated that the requirement does not apply to debts that will be collected under internal offset procedures within three years. DFAS considers this recommendation closed.

Audit Response. The Director, Corporate Reporting, Standards and Compliance comments are nonresponsive. The period of 180 days begins when a debt first becomes delinquent at the referring accounting office. If the debt is not collected within 90 days, the referring accounting office transfers the debt to DFAS Columbus Debt Management Office. From that point, DFAS has only 90 days left to refer the debt to the Department of Treasury. We identified debts that were more than 180 days old. We request that DFAS reconsider its position and provide comments on the final report. Specifically, DFAS should reconsider what procedures it has in place to ensure that eligible debts more than 180 days old are sent to the Department of Treasury for further collection action. We agree that referral procedures do not apply to debts being collected under internal offset procedures.

A.2. We recommend that the Director, Defense Finance and Accounting Service Columbus establish procedures requiring Debt Management Office to ensure that:

a. All debt files have complete supporting documentation and that the documentation is appropriately safeguarded for the required retention period of 6 years and 3 months.

Management Comments. The Director, Corporate Reporting, Standards and Compliance concurred. The Debt Management Office has asked its Training and Procedures Office to implement a requirement to conduct an annual inventory for closed receivables and validate that the files have complete supporting documentation. The new requirement will also include a retention period of six years and three months. DFAS identified an estimated completion date of May 1, 2008.

b. Debt file reviews are completed periodically to verify that the current status of every debt file is appropriate and that collection actions are being aggressively pursued.

Management Comments. The Director, Corporate Reporting, Standards and Compliance concurred. He stated that the Debt Management Office will update the Internal Controls Review Matrix to include a goal of monthly reviews of debts. This monthly review will validate the existence of sufficient supporting documentation for the current debt status and the appropriateness of actions taken to date. DFAS identified an estimated completion date of April 1, 2008.

B. Individual Out-of-Service Debt at DFAS Denver

DFAS Denver Debt and Claims Management Office (DCM) did not adequately process debts due from former DoD employees, also known as “Individual Out-of-Service (IOOS) Debts”. Specifically, we tested 130 IOOS debt transactions and determined that:

- 45 debt files were suspended more than 90 days for validation, and
- 13 debt files did not contain substantiating records to support their classification as either “financial hardship” or “bankruptcy.”

Debt files were not adequately processed because DCM did not establish a reasonable time limit for validating them. As a result, it took an average of 67 days to validate a debt file. Also, DCM did not have supporting documentation for debts classified as financial hardship or bankruptcy because standard operating procedures were not available. Debts classified as financial hardship or bankruptcy were suspended up to 6 months without justification and were therefore at greater risk of being uncollectible.

DFAS Denver Debt and Claims Management Office

DCM is responsible for managing IOOS debt amounts that are not associated with an active payroll account in any DoD system. Debts in this category must be at least \$225 and are transferred by another DoD agency to DCM, usually via the Defense Debt Management System (DDMS). We selected a sample of records that were in DDMS as of March 31, 2006. See Appendix B for a discussion of our sample methodology.

Processing and Validating of Individual Out-of Service Debt

We tested a sample of 130 DDMS transactions and found that DCM was not fully compliant with the DCIA and other established guidance for the IOOS debts. Specifically, DCM did not take quick action to facilitate recovery of debts.

DCM receives IOOS debts either manually or through a system interface. Manually transferred debts are validated by the DFAS sites and are sent to DCM for further collection action. Interface debts are not validated and come directly

into DDMS. DCM receives approximately 95 percent of the potential debts via interface and immediately suspends collection action in order to validate the debt.

It took an average of 67 days for DCM to validate a debt. To compute the 67-day average, we took the difference between the debt-establishment date and demand-letter-sent date and divided the total number of days by the number of our sample items. We reviewed the DCM's "Debt Establishment Procedure," and there is no stated guidance specifying the length of time for the validation process.

However, the DCIA requires agencies to ensure quick collection action to facilitate the recovery of debts. By suspending these debts without a deadline, DCM is not meeting the intent of the DCIA "quick collection" requirement. For example, 45 debt files were suspended for more than 90 days. DCM's process of suspending debt files without a deadline impedes compliance with the DCIA. DCM should re-examine its validation procedures to better comply with the "quick collection" requirement of the DCIA. Validation procedures should be completed within a reasonable amount of time. For example, several debt files were validated within 10 days. Establishing a deadline for when debt validation should be completed—for example, within 10 working days—would ensure a more aggressive collection process.

Supporting Hardship Files and Bankruptcy Debts

Financial Hardship. DCM did not substantiate files classified as financial hardship. In some files, DCM classified debts as financial hardship based on phone calls with the debtors and did not require further supporting evidence. DCM may classify debts as a financial hardship case by coding the debt as "FH" within DDMS. Once coded as "FH," all collection actions are suspended for up to 6 months under DCM procedures. Although the DoD FMR allows DCM to suspend the account if the debtor's financial condition is expected to improve, without verification of this condition the suspension is not warranted.

The DoD FMR, volume 5, "Disbursing Policy and Procedures," chapter 31, "Debt Compromise: Suspending and Terminating Collection Activity; Debt Write-Off and Retention," states that if a debtor is unable to pay the full amount due in a reasonable time using enforced collection, the following factors should be considered in determining the debtor's ability to pay:

- current financial statement from the debtor, or
- credit reports and other financial information.

This provides examples of source documentation that DCM should obtain when establishing that a debt file qualifies as a financial hardship case. The DCIA requires quick action to enforce the recovery of debts. The practice of suspending debts without sufficient supporting documentation brings into question the validity of the hardship and does not ensure quick action. Without sufficient

evidence, DCM personnel cannot determine whether the classification for financial hardship is accurate and the subsequent suspension is necessary. DCM should obtain other independent supporting documentation and should not allow debts to be suspended for up to 6 months based solely on phone conversations.

Bankruptcy Files. DCM did not provide court-ordered bankruptcy records to support the bankruptcy classification. DCM relied on system coding as support for debt suspension instead of obtaining external support. All files coded as bankruptcy and financial hardship in DDMS should have independent supporting documents.

As a result of our audit work, DCM provided additional documentation not available during the audit to support the cited files. After reviewing the documents, we verified that only 5 of the original 13 debt files supported their financial hardship or bankruptcy classifications.

Management Comments on the Finding and Audit Response

Management Comments. The Director, Corporate Reporting, Standards and Compliance nonconcurred with the identified findings and stated that the debts established in DDMS are suspended for a reasonable time period. The auditors were provided bankruptcy information and informed that additional bankruptcy files were held at the DFAS Denver General Counsel office. Concerning financial hardship cases, DDMS fully documented all the actions taken, and credit reports were pulled where appropriate. The Denver Debt and Claim Management Office is in compliance with the DCIA. In reference to the length of time it took to validate debts, the Director said that the 67-day average is a manpower issue but is not a problem. He said that the extra time allows all documents to post so that the office does not collect invalid debts. He added that “A 2-month delay does not impede collection when the law allows 10 years to collect the debt.”

Audit Response. The DFAS Denver Debt and Claims Management Office did not provide credit reports or court-ordered bankruptcy documents to support all cases. Without sufficient evidence, we could not determine whether the classification for financial hardship or bankruptcy was warranted. We were not informed that the DFAS Denver General Counsel office also maintains files on bankruptcy cases. If bankruptcy claim documents are stored at the DFAS General Counsel office, these documents should be available to auditors. Concerning the suspension of debt files for validation purposes, there are no regulations in place that state how much time DCM has to validate a debt. In 45 cases, it took DCM more than 90 days to validate a debt. In other cases, it took DCM only 10 days to validate a debt. We agree that it is important to validate a debt before it is sent to the debtor. However, establishing a deadline for when debt validation should be completed—for example, within 10 working days—would ensure a more aggressive collection process. We believe it is important to have a specific timeframe for DCM to validate debts. If DCM establishes a reasonable standard

processing time within its operating procedures, it would be considered responsive to the intent of our recommendation. Debts would be collected faster with an established timeframe for validation.

Recommendations, Management Comments, and Audit Response

B. We recommend that the Director, Defense Finance and Accounting Service Denver, require the Debt and Claims Management Office establish procedures to:

1. Ensure that all debt files accepted into the Defense Debt Management System are validated within a specific and reasonable timeframe that also meets the “quick collection” requirement of the Debt Collection and Improvement Act of 1996.

Management Comments. The Director, Corporate Reporting, Standards and Compliance nonconcurred and stated, “We surpass all required timelines within the DCIA 1996. . . . The primary timeline within the DCIA 96 requires that all debts be valid and legally enforceable in the amount stated and are referred to Treasury for additional collection action when the debt becomes 180 days delinquent.” He emphasized that DFAS is focused on “collecting valid debts amounts, not burdening our former military members with erroneous bills.” DFAS considers this recommendation closed.

Audit Response. The Director, Corporate Reporting, Standards and Compliance comments are nonresponsive. We request that DFAS designate a timeframe for the debt validation process. DFAS Denver has validated debts as quickly as 10 days from acceptance and in some cases debt validation has taken longer than 90 days. Defining a timeframe for debt validation would ensure a more aggressive collection process. Requiring a timeframe for the debt validation process would not burden former military members with erroneous bills as stated by DFAS. It would only require DFAS to speed up the validation process to ensure a more timely collection process. We request that DFAS reconsider its position and provide comments to the final report.

2. Ensure that independent supporting documentation is obtained to substantiate the financial hardship or bankruptcy classification of debt files and that all source documentation is adequately maintained within the debt file.

Management Comments. The Director, Corporate Reporting, Standards and Compliance nonconcurred and stated that suspension of an account is allowed for Financial Hardship. He said that credit reports are pulled and that the decision to suspend an account is documented in DDMS. He added that there is no

regulatory requirement to keep files containing old credit reports. Regarding bankruptcy files, he stated that “all documents required to substantiate the bankruptcy claim on our debts are also kept within the DFAS General Counsel office.” DFAS considers this recommendation to be closed.

Audit Response. The Director, Corporate Reporting, Standards and Compliance comments are nonresponsive. DFAS should substantiate all financial hardship cases with appropriate documentation. Placing a debt file in a financial hardship status based on a phone conversation is not appropriate. For cases where debt files are not supported, DFAS should have procedures to substantiate the financial hardship by maintaining adequate documentation, including, but not limited to, credit reports. DFAS stated it also obtains bankruptcy claim documents to verify bankruptcy status. During our audit, the majority of the files had either credit reports or bankruptcy claim documents to substantiate the status. However, some files did not contain credit reports or court-ordered bankruptcy documents. DFAS management comments stated that “all documents required to substantiate the bankruptcy claim on our debtors are also kept within the DFAS General Counsel office.” This information was not provided to us. If bankruptcy claim documents are kept in the DFAS General Counsel office, these documents should be available to auditors and would support the bankruptcy status. We request that DFAS reconsider its position and provide comments to the final report for establishing procedures to maintain documents to support debt files in a financial hardship or bankruptcy status.

C. Individual In-Service Debts Processed at DFAS Payroll Offices

DFAS payroll offices did not properly process the debt files or include sufficient supporting documentation for debts owed by civilian employees, also known as “Individual In-Service Debt.” Specifically, DFAS payroll offices:

- misclassified 14 debt files that were actually paid, waived, or determined to be invalid;
- did not resume collection action on 7 suspended debt files;
- could not adequately support debt amounts reported in 7 debt files; and
- did not properly issue demand letters for 2 debt files.

Debt files were not properly managed because DFAS payroll offices did not implement procedures necessary to ensure compliance with applicable guidance. As a result, DoN Individual In-Service Debts are at risk of becoming uncollectible and overstating Accounts Receivable.

Defense Civilian Pay System

DFAS payroll offices at Charleston, South Carolina and Pensacola, Florida process DoN debts owed by civilian employees. These debts are referred to as Individual In-Service Debts. The payroll offices use the Defense Civilian Pay System (DCPS), the standard DoD civilian pay system. DCPS maintains time and attendance data, pay and leave entitlement records, deductions and withholdings, and any related debts owed. Individual In-Service Debts are amounts due to DoD from active civil service employees or separated civilian employees who make installment payments. Individual In-Service Debts occur for several reasons, including overpayments and overdue overseas travel advances. We selected a sample of debts that were in DCPS as of July 31, 2006. See Appendix B for a discussion of our sample methodology.

Criteria for Managing Debt Files

Delinquent Debt. The DoD FMR volume 4, “Accounting Policy and Procedures,” chapter 3, “Receivables,” defines a delinquent account receivable as a receivable that has not been paid by the date specified in the initial written demand for payment or applicable agreement without other satisfactory payment arrangements having been made. Office of Management and Budget Circular

A-129, “Delinquent Debt Collection,” states that as soon as an account becomes delinquent, agencies should send demand letters to the debtor.

Audit Trails. According to the DoD FMR, volume 1, “General Financial Management Information, Systems and Requirements,” chapter 3, “Accounting Systems Conformance, Evaluation, and Reporting,” a key test of an audit trail is whether tracing the transaction forward from the source or back from the result will permit verification of the amount recorded or reported.

Defense Accounting Service Guide 7900.4G, “Audit Trail and System Control,” November 2004, requires all transactions, including computer-generated computations, be traceable to individual source records.

Individual In-Service Debt File Information and Processing

We analyzed 280 Individual In-Service Debt files for compliance with the DCIA and various regulations. We identified a total of 30 debt files that did not comply with established guidance because DFAS payroll offices misclassified debts, left debts in suspense, could not support debt amounts, and did not issue demand letters in a timely manner.

Misclassified Debts. DFAS payroll offices misclassified 14 debt files totaling \$39,966 as Accounts Receivable, even though the debts had been paid, waived, or determined to be invalid. These 14 debt files had the following problems:

- five debt files were waived⁷ or canceled;
- two debt files represented Individual Out-of-Service⁸ Debts and should have been transferred to DFAS Denver;
- two debt files represented the same employee debt, and one should have been removed from DCPS;
- two debt files were identified as invalid, but no further explanation was provided;
- one debt file was identified as invalid because DFAS payroll offices had incorrectly classified an employee as separated;

⁷ DoD FMR, Volume 8, “Civilian Pay Policy and Procedures,” defines a waiver as the “cancellation, forgiveness, or non-recovery of a debt owed by an employee to an agency as permitted or required by law.” Therefore, once a debt is waived, it must be reduced to zero and no longer reported as an accounts receivable.

⁸ Out-of-Service Debts are amounts due to the DoD by individuals who do not have an active payroll account in any DoD system.

-
- one debt file was fully paid but remained as an active debt in DCPS; and
 - one debt file included two separate debts for the same employee. The first was less than \$6, and therefore no collection action was pursued. The second debt should have been transferred to DFAS Denver because the employee was no longer a civilian employee.

DFAS payroll offices reduced the three invalid debt file balances to zero after the audit team brought the individual debts to their attention. DFAS payroll offices determined that the debts were inaccurately established and should have been removed from DCPS. DFAS payroll offices do not have procedures in place to ensure the proper classification of debts. This prevents them from effectively collecting debts and properly recording the debts as Accounts Receivable.

Suspended Debt Files. When a debt file is suspended, all collection actions are discontinued. DFAS payroll offices erroneously left seven debt files valued at \$4,511 in suspense for as long as 3 years. DFAS payroll offices did not know why five of these debt files were suspended and provided the following explanations for suspending the other two debt files:

- One debt was suspended when an individual entered a Leave-Without-Pay status. However, collection actions were not resumed when the individual returned to an Active Pay status.
- One debt was suspended when the individual's account was transferred from one data system to another. Debt collection actions were not resumed after the transfer was complete.

Collection actions resumed for all seven suspended, debt files after the audit team brought these problems to the DFAS payroll offices attention. DFAS payroll offices do not have procedures in place to track debts that are in suspense. This prevents DFAS payroll offices from adequately collecting debts.

Supporting Documentation. DFAS payroll offices could not provide support for three debt files and had only partial support for four debt files. DFAS Guide 7900.4G, "Audit Trail and System Control," specifies that supporting documentation must be traceable to the individual source records. Without supporting documentation, public debts have a greater chance of not being collected. Four debt files were incomplete because demand letters were not included. Demand letters are proof that the debtor received notification of an outstanding debt and begin the debt collection process. DFAS payroll offices' inability to provide complete supporting documentation for seven debt files indicates that employee debt files are not being monitored to determine debt validity and to ensure that collection actions have appropriately begun.

Timely Demand Letters. DFAS did not properly send demand letters for two debt files. The DoD FMR, volume 5, “Disbursing Policy and Procedures,” chapter 28 “General Provisions on Indebtedness,” states that a demand letter should be issued as soon as the status of the debt is confirmed. The issuance of a demand letter formally notifies the debtor and begins a 60-day repayment period. If the demand letter is not sent promptly, it delays the collection process. In one instance, DFAS never sent a demand letter for a \$1,195 debt that was originally recorded 3 years earlier. DFAS stated that the debt was placed in suspense and never restarted, but no reason was given to explain why the debt was left in suspense. After the audit team brought this to the DFAS payroll office’s attention, DFAS said that the debt file would be unsuspended and a demand letter sent, thereby starting collection actions. In another instance, a demand letter was sent 4 months after the debt was confirmed. The DFAS payroll office did not explain why the demand letter was sent 4 months late but agreed that it wasn’t timely. DFAS needs to review its processes for issuing demand letters and placing debt files in suspense.

The DCIA was passed to maximize the collection of delinquent debts owed to the government by ensuring quick action to enforce recovery of debts, using all available collection tools. DFAS payroll offices do not have adequate procedures in place to continuously ensure that debts are valid and actively being collected. Procedures and system controls were not in place to ensure that debts are current. Most Individual In-Service Debts are owed by individuals in a Pay status and should be easily collected. DFAS payroll offices should aggressively monitor all Individual In-Service Debt to ensure timely collection.

Recommendations and Management Comments

C. We recommend that the Director, Defense Finance and Accounting Service Charleston and Director, Defense Finance and Accounting Service Pensacola establish procedures to improve collection processes and reporting of Accounts Receivable balances. Specifically, Defense Finance and Accounting Service payroll offices should ensure that:

1. Debt files are routinely reviewed to determine whether the debt status indicated in the debt file is accurate and agrees with the debt status indicated in the Defense Civilian Pay System. Defense Finance and Accounting Service payroll offices should verify that all waived, paid, or invalid debts are appropriately recorded in the Defense Civilian Pay System.

DFAS Indianapolis Comments. The Director, Corporate Reporting, Standards and Compliance concurred. He stated, “Payroll management is revising our Federal Managers’ Financial Integrity Action (FMFIA) Assessable Unit – Debt Processing to include the following control point: quarterly review of debt status to ensure accuracy, i.e., status of any invalid, paid-in-full/partial, and any waivers received.” DFAS identified an estimated completion date of December 1, 2007.

DFAS Arlington Comments. The Deputy Director, Compliance, Standards and Compliance concurred. He stated, “Payroll management has revised the FMFIA Assessable Unit for Debt Processing to include controls to ensure quarterly reviews of debt status are accurate.” This was completed on November 26, 2007.

2. Debt files that have been suspended are reviewed on a regular basis to verify that the suspension is still warranted.

DFAS Indianapolis Comments. The Director, Corporate Reporting, Standards and Compliance concurred. He again stated that payroll management is revising the FMFIA Assessable Unit – Debt Processing to include a quarterly review of debt status to ensure any debt suspension or “on-hold” status is still valid.

DFAS Arlington Comments. The Deputy Director, Compliance, Standards and Compliance concurred. He stated that payroll management revised the FMFIA Assessable Unit – Debt Processing to include quarterly reviews of debt statuses for suspensions and “on-hold”. This was completed on November 26, 2007.

3. Debt files include the necessary supporting documentation to validate the debt and to verify that collection actions have begun, indicated by the issuance of a demand letter.

DFAS Indianapolis Comments. The Director, Corporate Reporting, Standards and Compliance concurred. He again referred to revising the FMFIA Assessable Unit – Debt Processing to include quarterly reviews of all supporting documentation to ensure collections have begun.

DFAS Arlington Comments. The Deputy Director, Compliance, Standards and Compliance concurred. He stated that payroll management revised the FMFIA Assessable Unit – Debt Processing to include quarterly reviews for supporting documentation to ensure collection. This was completed on November 26, 2007.

4. All demand letters are sent in a timely manner and in accordance with applicable regulations as soon as the status of the debt is confirmed. Defense Finance and Accounting Service payroll offices should regularly review the Defense Civilian Pay System to identify debts that have not been issued a demand letter.

DFAS Indianapolis Comments. The Director, Corporate Reporting, Standards and Compliance concurred, again referring to revising the FMFIA Assessable Unit – Debt Processing to include quarterly reviews of all debts to ensure demand letters are sent timely.

DFAS Arlington Comments. The Deputy Director, Compliance, Standards and Compliance concurred. He stated that payroll management revised the FMFIA Assessable Unit – Debt Processing to include quarterly reviews to ensure demand letters are sent on time. This was completed on November 26, 2007.

D. Reporting and Archiving Navy Public Debt at DFAS Cleveland

DFAS Cleveland Departmental Reporting Office inaccurately reported a negative amount of \$300,257 on the March 31, 2006 “Treasury Report on Receivables due from the Public” (TROR). This total is comprised of accounts payable totaling \$258,123 and employer contributions totaling \$42,134. Accounts payable and employer contributions were erroneously included because DFAS Cleveland did not have adequate controls over the reporting process. Also, DFAS Cleveland did not archive complete Individual In-Service Debt data, because procedures allow for DCPS data, including debt data, to be overwritten each pay period. As a result, DFAS Cleveland understated its public debt and was not fully compliant with the DCIA and the DoD FMR. Also, the lack of proper record retention hinders DFAS Cleveland’s ability to support amounts reported on the TROR.

Preparing the TROR at DFAS Cleveland

Accounts Payable Reported on the TROR. The DoD FMR, volume 4, “Accounting Policy and Procedures,” chapter 3, “Receivables,” defines account receivable as a debt owed to the DoD from a non-DoD entity. Receivables include monies due for indebtedness to the DoD. Examples of indebtedness to the DoD include overdue travel advances, dishonored checks, and overpayments.

DFAS Cleveland Departmental Reporting Office erroneously reported negative Accounts Receivable totaling \$258,123 in the March 31, 2006 universe of DCPS transactions. These transactions should have been reported as accounts payable. The DoD FMR, volume 4, “Accounting Policy and Procedures,” chapter 9, “Accounts Payable,” states that accounts payable are monies owed to other entities for receipt of goods and services, progress in contract performance, and rents from the DoD.

In accordance with these definitions, and based upon our review, the negative items identified are accounts payable, not Accounts Receivable, and should not be reported on the TROR, which is a Department of the Treasury report used to track only public Accounts Receivable. DFAS Cleveland should examine its reporting procedures to ensure that accounts payable are not reported on the TROR.

Employer Contributions Reported on the TROR. DFAS Cleveland Departmental Reporting Office erroneously included employer contribution amounts on the March 31, 2006 TROR. Employer contributions are the cost of employee benefits, such as portions of health insurance premiums paid by the agency. Employer contributions are strictly governmental transactions, not public transactions, and therefore not subject to reporting on the TROR. The Accounts

Receivable universe of transactions that was provided by DFAS Cleveland included Individual In-Service Debt amounts coded with a “U.” This “U” represents employer contributions. This code appears on the Accounts Receivable universe as either a negative or a positive amount. The negative “U” codes are monies owed by the government. The positive “U” codes are monies owed to the government. Negative employer contribution amounts totaling \$55,889 and positive employer contribution amounts totaling \$13,755 were in the Accounts Receivable universe for Individual In-Service Debt. Neither amount should have been reported on the March 31, 2006 TROR or captured in the Individual In-Service Debt as Accounts Receivable. DFAS Cleveland inaccurately reported DoN public debts. DFAS Cleveland should examine its reporting procedures to ensure that it is accurately reporting public Accounts Receivable on the TROR.

Archiving DCPS Transactions at DFAS Cleveland

Archiving Transactions. DFAS Cleveland Departmental Reporting Office does not archive complete DCPS data. We requested the March 31, 2006 Accounts Receivable universe of transactions in DCPS but were told it was not available. The DFAS payroll offices at Pensacola, Florida and Charleston, South Carolina use DCPS to process Individual In-Service Debts. DFAS payroll offices send complete DCPS transaction data to DFAS Cleveland, which includes social security numbers. However, every two weeks, all transaction data in the DFAS Pensacola and DFAS Charleston DCPS databases is overwritten with data for only the current pay period.

DFAS Cleveland receives complete DCPS transaction data from the DFAS payroll offices, but it removes data considered to be unnecessary, including social security numbers. Although DFAS Cleveland does not use social security numbers for preparing the TROR, the social security number is necessary for an audit trail. Without a social security number, the audit trail is lost because there is no link to the supporting documentation. Because DFAS could not provide the March 31, 2006 DCPS universe, we arranged to perform audit testing on the July 31, 2006 DCPS universe.

The DoD FMR, volume 1, “General Financial Management Information, Systems and Requirements,” chapter 3, “Accounting Systems Conformance, Evaluation, and Reporting,” states that a key test of an audit trail is whether tracing the transaction forward from the source or back from the result will permit verification of the amount recorded or reported. In addition, Defense Accounting Service Guide 7900.4G, “Audit Trail and System Control,” requires that all transactions, included computer-generated computations, be traceable to individual source records. DFAS Cleveland did not maintain an adequate audit trail for testing. DFAS Cleveland did not archive complete DCPS data because procedures were not in place requiring this data to be archived. DFAS

Cleveland's lack of archiving makes it difficult to audit its outstanding debts. Without complete data, auditors cannot ensure that all amounts reported are accurate. DFAS Cleveland further maintains that DCPS users at the DFAS payroll offices are responsible for maintaining archived records. While archiving may be a function of the DFAS payroll offices, DFAS Cleveland should ensure that proper support for amounts it reports is coordinated and maintained in conjunction with its subordinate activities.

Recommendations, Management Comments, and Audit Response

D. We recommend that the Director, Defense Finance and Accounting Service Cleveland, in coordination with the Defense Finance and Accounting Service payroll offices in Charleston and Pensacola, ensure proper public debt and Accounts Receivable reporting on the Treasury Report on Receivables. Specifically, procedures must be established to ensure that:

1. Only public debt amounts are included on the Treasury Report on Receivables.

Management Comments. The Director, Corporate Reporting, Standards and Compliance concurred. He stated that DFAS Pensacola and DFAS Indianapolis, Standards and Compliance will coordinate the effort regarding how DCPS data affects the DFAS network. DFAS identified an estimated completion date of April 1, 2008.

Audit Response. Although the Director, Corporate Reporting, Standards and Compliance concurred with our recommendation, his comments were partially responsive. The coordinated effort between DFAS Pensacola and DFAS Indianapolis, Standards and Compliance should ensure that employer contribution amounts are excluded from amounts reported on the Treasury Report on Receivables. We request that the Director, Corporate Reporting, Standards and Compliance provide a proposed date as to when employer contributions will not be reported on the Treasury Report on Receivables.

2. All transactions from supporting systems are archived and traceable to the source documentation by specific record numbers, such as a social security number.

Management Comments. The Director, Corporate Reporting, Standards and Compliance concurred. He stated that DFAS Cleveland Accounting and Operations began archiving the DCPS report in March 2007. This action was completed on March 31, 2007.

Appendix A. Scope and Methodology

To analyze Defense Finance and Accounting Service (DFAS) compliance with the Debt Collection and Improvement Act of 1996 (DCIA) and other pertinent regulations for the Department of the Navy (DoN), we reviewed amounts reported by DFAS as DoN public debt on the second quarter FY 2006 Treasury Report on Receivables (TROR) totaling \$3.7 billion. DFAS uses the TROR to gather financial data to be reported as Navy's Public Receivables. Specifically, we reviewed contractor debts, Individual Out-of-Service Debts, and Individual In-Service Debts from the DFAS locations and systems described below, respectively. We reviewed systems that represented 84 percent of the reported amount in the second quarter FY 2006 TROR. Our work focused on debt and collection activities at:

- DFAS Columbus Debt Management Office for processing Contract Debt System (CDS) and Mechanization of Contract Administration System (MOCAS) data,
- DFAS Denver Debt & Claims Management for processing Defense Debt Management System (DDMS) data, and
- DFAS Charleston and DFAS Pensacola payroll offices for processing Defense Civilian Pay System (DCPS) data.

Our work also focused on how DFAS Cleveland Departmental Reporting Office reports public debt on the TROR.

Work Performed. To identify the legal requirements, policies, and procedures established for debt collection, we reviewed pertinent laws, related federal regulations, the DoD Financial Management Regulation, and DFAS procedures. To identify the activities undertaken by the DFAS Debt Management Office, payroll offices, and Debt and Claims Management, we reviewed debt files, demand letters, and related correspondence, and discussed debt collection activities with DFAS officials. We then reconciled all the reported amounts from these systems to the second quarter FY 2006 TROR for both the Navy General Fund and the Navy Working Capital Fund.

Sample Selections. In selecting debt files for further review, we coordinated with the Quantitative Methods Directorate, DoD OIG, in developing the statistical sample design. See Appendix B for a discussion of the statistical sampling methodology.

Sample reviews. In reviewing the selected samples, we (1) examined the files and the collection activities, (2) determined if the debts were valid, and (3) discussed issues and questions related to the debts with DFAS officials.

We performed this audit from April 2006 through May 2007 in accordance with general accepted government auditing standards.

Use of Computer-Processed Data. To achieve the audit objective, we relied on computer-processed data contained in the universe of data provided by DFAS from CDS, MOCAS, DDMS and DCPS. Nothing came to our attention as a result of specified procedures that caused us to doubt the reliability of the computer-processed data.

Testing the reliability of the CDS, MOCAS, DDMS and DCPS systems was not an announced audit objective, given the intended use of the data. Therefore, the reliability of data has not materially affected the results of the audit. Our audit included tests of the data contained in CDS, MOCAS, DDMS and DCPS that were compared to other independent data. No material discrepancies were detected that would negatively affect our audit results. The level of reliability of CDS, MOCAS, DDMS and DCPS data extracted from the database was sufficient to achieve specific audit objectives.

Use of Technical Assistance. Quantitative Methods Directorate provided technical assistance in developing the sample design and selecting samples of Accounts Receivable transactions. Specifically, Quantitative Methods Directorate provided statistical samples for CDS, MOCAS, DDMS, and DCPS. See Appendix B for a discussion of the statistical sampling methodology.

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

Prior Coverage

No prior coverage has been conducted on the subject during the last 5 years.

Appendix B. Statistical Sampling Methodology

Systems

We used statistical sampling to efficiently test compliance with the DCIA from four systems: Contract Debt System (CDS), Mechanization of Contract Administration System (MOCAS), Defense Debt Management System (DDMS), and Defense Civilian Pay System (DCPS). For all the systems, transactions reported on the TROR for the General Fund or Working Capital Fund were included in the sampling process.

CDS

As of March 31, 2006, CDS had a universe of 816 transactions representing six transaction types: Bankruptcy, Dispute, Litigation, Other, Closed and Treasury. We tested 134 transactions. Quantitative Methods Directorate considered the six types of transactions in the universe for representation in designing the sample. Quantitative Methods Directorate provided a statistical sample of 125 out of 397 non-zero transactions. In addition, the audit team judgmentally⁹ selected six zero-value transactions (one for each of the six transaction types), and three additional transactions that may have not been reported in the TROR for testing.

MOCAS

As of March 31, 2006, MOCAS had a universe of 221 transactions representing three transaction types: Closed, Other, and Dispute. We tested 52 sample items. Quantitative Methods Directorate considered the three types of transactions in the universe for representation in designing the sample and suggested auditing all 46 non-zero transactions for sampling (by excluding the 175 zero-value transactions out of the universe of 221 transactions). In addition, the audit team judgmentally selected five zero-value transactions and one additional transaction that may have not been reported in the TROR.

DDMS

As of March 31, 2006, DDMS had a universe of 145,515 Individual Out-of-Service Debt transactions. We tested 130 of those transactions. Quantitative Methods Directorate designed a statistical sample of 400 transactions, considering the dollar amount for representation in designing the sample. The sample was selected by transaction line items, instead of by social security numbers. A social

⁹ The judgmental sample does not generalize to the universe.

security number (SSN) could have multiple debts associated with it. Although 400 transactions were selected for sampling, we only tested 130, due to limited resources. We tested all 124 transactions located at DFAS Denver and judgmentally selected six transactions from the remaining 276 inactive or off-site transactions.

DCPS

As of July 31, 2006, the DCPS universe consisted of 15,874 transactions traceable to 3,980 SSNs. We tested all transactions associated with 280 SSNs. Quantitative Methods Directorate designed a sample of 260 SSNs, which included 180 from the positive-value transactions, 70 from the negative-value transactions, and 10 from the zero-value transactions. Quantitative Methods Directorate considered the dollar amount for representation in designing the sample and whether to use SSNs versus line items. In addition, the audit team judgmentally selected 20 additional SSNs with negative transactions to verify that they were truly Accounts Receivable, not accounts payable or other transactions.

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)
Director, Program Analysis and Evaluation

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Combatant Command

Inspector General, U.S. Joint Forces Command

Other Defense Organizations

Director, Defense Finance and Accounting Service

Non-Defense Federal Organization

Office of Management and Budget
Government Accountability Office

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 Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement,
Committee on Oversight and Government Reform
House Subcommittee on National Security, and Foreign Affairs,
Committee on Oversight and Government Reform

Defense Finance and Accounting Service Indianapolis Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE
8899 EAST 56 TH STREET
INDIANAPOLIS, INDIANA 46249

OCT 26 2007

DFAS-JJR/IN

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE,
OFFICE OF THE INSPECTOR GENERAL, DoD

SUBJECT: DFAS response on DoDIG Discussion Draft "Defense Finance and
Accounting Service Compliance with the Debt Collections and
Improvement Act of 1996 for Department of the Navy,"
Project No. D2006-D000FC-0186.000, dated September 17, 2007

Attached are management comments to the subject recommendations in the DoDIG
Discussion Draft Report, "Defense Finance and Accounting Service Compliance with the Debt
Collection and Improvement Act of 1996 for the Department of the Navy", dated September 17,
2007.

Questions your staff may have concerning these matters may be directed to
Ms. Dru Burge at 317-510-4356.


William E. Bergmeyer
Director, Corporate Reporting
Standards & Compliance

Attachment:
As stated

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**DFAS response on DoDIG Discussion Draft "Defense Finance and Accounting
Service Compliance with the Debt Collections and
Improvement Act of 1996 for Department of the Navy,"
Project No. D2006-D000FC-0186.000,
dated September 17, 2007**

Recommendation A.1.: We recommend that the Director, Defense Finance and Accounting Service Columbus review Debt Management Office debt files to ensure that:

a.: All non-foreign debt files include a taxpayer identification number.

Management Comments: Concur. The Debt Management Office (DMO) will implement changes requiring technicians to validate the existence of Taxpayer Identification Numbers (TINs) on debt referral forms and to take steps to obtain a TIN if one is not included with the debt referral. These changes will be based on the DMO submission of requirements for obtaining TINs to be included in the updates to their desk procedure. The updated desk procedure will be officially published as DFAS 7800.3-I by February 29, 2008. To confirm the DMO is including the TIN in non-foreign debt files and the procedures have been implemented, the estimated completion date is May 1, 2008.

Estimated Completion Date: May 1, 2008

b.: Eligible debt files more than 90 days old are referred to Department of the Treasury for further collection action.

Management Comments: Non-concur. The 31 Code of Federal Regulation (CFR) Part 901.1 states "Agencies shall transfer to the Secretary any debt that has been delinquent for a period of 180 days or more so that the Secretary may take appropriate action to collect the debt or terminate collection action." Additionally, this requirement does not apply to any debt that will be collected under internal offset procedures within three years after the debt first became delinquent as required by 31 U.S. Code Section 3711 Paragraph (g)(2).

Estimated Completion Date: This recommendation is considered closed

c.: All debt files eligible for write-off are transferred back to their referring account office for such action.

Management Comments: Non-concur. The DMO is not required to transfer debts to the referring accounting office but is responsible for collection actions after the debt has

Deleted

been referred to them by an accounting office. The DoD FMR Volume 4 Chapter 3 section 030318 states "DoD Component fund holders, AROs, and DCOs will maintain documentation to support actions taken on each accounts receivable." The DMO provides the Monthly Debt Management Report (MDMR) through an ePortal project to assist the accounting offices in maintaining accounting records and taking write off action as required. The MDMR is made available to additional personnel in accounting offices as requested. The MDMR provides the collection status and age of debts referred to the DMO. A review of the MDMR showed 0.086 percent or \$1,920,244.59 of the total ending principle balance reported on the MDMR had a DMO status code of TM, indicating the debt needed to be written off as of the October 2007 release of the report. The 0.086 percent of the dollar amount represented 19 of the 23,578 records recorded on the MDMR. The small percentage of records needing to be written off indicates the MDMR is being used to assure timely write off of debts.

Estimated Completion Date: This recommendation is considered closed

Recommendation A.2.: We recommend that the Director, Defense Finance and Accounting Service Columbus establish procedures requiring Debt Management Office to ensure that:

a.: All debt files have complete supporting documentation and that the documentation is appropriately safeguarded for the required retention period of 6 years and 3 months.

Management Comments: Concur. The DMO currently maintains the documentation for the active files which is validated each month as part of the internal control matrix reviews. The DMO has drafted and submitted to the Training and Procedures Office, a requirement to conduct an annual inventory for closed receivables and validate the files have complete supporting documentation. The new requirement includes retaining documentation for six years and three months as designated by DFAS 5015.2-R and 5015.2-M Schedule 7330/12. Based on the drafted changes to the DFAS 7800.3-I the Debt Management Office will implement these new procedures by October 31, 2007. The changes to the DFAS 7800.3-I will be completed by February 29, 2008. To verify the implementation of the new procedures and the completion of the changes to DFAS 7800.3-I, the estimated completion date is May 1, 2008.

Estimated Completion Date: May 1, 2008

b.: Debt file reviews are completed periodically to verify that the current status of every debt file is appropriate and that collection actions are being aggressively pursued.

Management Comments: Concur. The Debt Management Office will update the Internal Controls Review Matrix (ICRM) to include a goal for monthly reviews of debts in the Debt Management Office. The monthly reviews will verify debts against the debt records in the Contractor Debt system (CDS) to ensure debts are coded correctly and collection actions are being aggressively pursued. The new internal control goal will include the validation of supporting documentation, validation of current status on debts, and a review of the appropriateness of actions taken to date. This new goal will be added to the ICRM by November 1, 2007. To confirm the implementation of the new internal control goal that verifies the current status of every debt file is appropriate, the estimated completion date is April 1, 2008.

Estimated Completion Date: April 1, 2008

Finding B: We non-concur with Finding B. Individual Out-of-Service Debt at DFAS Denver. When debts are established in DDMS they are suspended for a reasonable time limit. We also provided the auditors with the Bankruptcy information and identified to them that additional bankruptcy files were kept within DFAS-Denver General Counsel files. The DDMS system is fully documented on all actions taken by us regarding financial hardships and credit reports were pulled where appropriate. Allowing an ex-military member in financial constraints a 6 month delay in repaying the debt is within our authorization and is the right thing to do, and improves our chances of collection. We are fully compliant with all aspects of the DCIA and the Department of the Treasury has commended us for our participation. We have been on the leading edge in implementing all Treasury programs.

The average of 67 days to validate the debts was probably accurate (a manpower issue) but in reality is a plus in collecting debts received by us through the military pay systems, to allow all documents to post so we are not collecting invalid debts. A two month delay does not impede collection when the law allows 10 years to collect the debt.

Recommendation B.: We recommend that the Director, Defense Finance and Accounting Service Denver, require the Debt and Claims Management Office establish procedures to:

1.: Ensure that all debt files accepted into the Defense Debt Management System are validated within a specific and reasonable timeframe that also meets the "quick collection" requirement of the Debt Collection and Improvement Act of 1996.

Management Comments: Non-concur. POC is Bruce Hahn, Director for Debt and Claims Management, commercial (303) 676-2700. We surpass all required timelines within the DCIA 1996. The reference to "quick collection" requirement by the auditor is not a timeline defined within the DCIA 1996. The primary timeline within the DCIA 96

requires that all debts be valid and legally enforceable in the amount stated and are referred to Treasury for additional collection action when the debt becomes 180 days delinquent. We refer all debts long before the required timeline. Debt collection cannot begin until due process starts on a valid debt. Our concern is collecting valid debt amounts, not burdening our former military members with erroneous bills.

Estimated Completion Date: This recommendation is considered closed

2.: Ensure that independent supporting documentation is obtained to substantiate the financial hardship or bankruptcy classification of debt files and that all source documentation is adequately maintained within the debt file.

Management Comments: Non-concur. POC is Bruce Hahn, Director for Debt and Claims Management, commercial (303) 676-2700. Per DoDFMR, Volume 5, Chapter 31, Section 310301, 310302, suspension of an account is allowed for Financial Hardship. Before we make that decision, we pull credit reports on the individual and fully document our decision on the DDMS which is our official record. There is no regulatory requirement to keep files containing old credit reports. Supporting documentation is obtained where required and kept in files. All decisions are also documented on the DDMS system. In addition to our files, bankruptcy files containing all documents required to substantiate the bankruptcy claim on our debtors are also kept within the DFAS General Counsel office.

Estimated Completion Date: This recommendation is considered closed

Recommendation C.: We recommend that the Director, Defense Finance and Accounting Service Pensacola establish procedures to improve collection processes and reporting of accounts receivable balances. Specifically, Defense Finance and Accounting Service payroll offices should ensure that:

1.: Debt files are routinely reviewed to determine whether the debt status indicated in the debt file is accurate and agrees with the debt status indicted in the Defense Civilian Pay System. Defense Finance and Accounting Service payroll offices should verify that all waived, paid, or invalid debts are appropriately recorded in the Defense Civilian Pay System.

Management Comments: Concur. Payroll management is revising our Federal Managers' Financial Integrity Action (FMFIA) Assessable Unit –Debt Processing to include the following control point: Quarterly review of debt status to ensure accuracy, i.e., status of any invalid, paid in full/partial, and any waivers received.

Estimated Completion Date: December 1, 2007

2.: Debt files that have been suspended are reviewed on a regular basis to verify that the suspension is still warranted.

Management Comments: Concur. Payroll management is revising our FMFIA Assessable Unit –Debt Processing to include the following control point: Quarterly review of debt status to ensure any debt suspension or ‘on-hold’ status is still valid.

Estimated Completion Date: December 1, 2007

3.: Debt files include the necessary supporting documentation to validate the debt and to verify that collection actions have begun, indicated by the issuance of a demand letter.

Management Comments: Concur. Payroll management is revising our FMFIA Assessable Unit –Debt Processing to include the following control point: Quarterly review of all supporting documentation to ensure collections have begun.

Estimated Completion Date: December 1, 2007

4.: All demand letters are sent in a timely manner and in accordance with applicable regulations as soon as the status of the debt is confirmed. Defense Finance and Accounting Service payroll offices should regularly review the Defense Civilian Pay System to identify debts that have not been issued a demand letter.

Management Comments: Concur. Payroll management is revising our FMFIA Assessable Unit –Debt Processing to include the following control point: Quarterly review of all debts to ensure demand letters are sent timely.

Estimated Completion Date: December 1, 2007

Recommendation D.: We recommend that the Director, Defense Finance and Accounting Service Cleveland, in coordination with the Defense Finance and Accounting Service payroll offices in Charleston and Pensacola, ensure proper public debt and accounts receivable reporting on the Treasury Report on Receivables. Specifically, procedures must be established to ensure that:

1.: Only public debt amounts are included on the Treasury Report on Receivables.

Management Comments: Concur. DFAS Pensacola and DFAS Indianapolis, Standards and Compliance will coordinate the effort as the Defense Civilian Pay System (DCPS) data affects the DFAS Network.

Estimated Completion Date: April 1, 2008

2.: All transactions from supporting systems are archived and traceable to the source documentation by specific record numbers, such as a social security number.

Management Comments: Concur. Since March 2007, DFAS Cleveland Accounting Operations has archived the DCPS report in our shared drive, which is backed up on a daily basis via the Altiris Recovery Agent. The DCPS report supports the Treasury Report on Receivables and provides an audit trail. We have concerns regarding social security numbers included in the file as the audit trail to the source. Since a minimum number of DFAS Cleveland personnel have authorized access to the shared drive, the risk for unauthorized use is somewhat mitigated. We recommend that the DCPS report format be revised to include a unique identifier to identify the data to the source. This recommendation is considered closed.

Completion Date: March 31, 2007

Defense Finance and Accounting Service Arlington Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE
ARLINGTON
1851 SOUTH BELL STREET
ARLINGTON, VA 22240-5291

DEC 20 2007

DFAS-JJ/AR

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE,
OFFICE OF THE INSPECTOR GENERAL, DoD

SUBJECT: DFAS comments on DoDIG Draft Report, "Defense Finance and Accounting Service Compliance with the Debt Collection and Improvement Act of 1996 for the Department of the Navy", Project No. D2006-D000FC-0186.000, dated September 17, 2007

Attached are current management comments to the subject recommendations in the DoDIG Draft Report, "Defense Finance and Accounting Service Compliance with the Debt Collection and Improvement Act of 1996 for the Department of the Navy", dated September 17, 2007.

Questions your staff may have concerning these matters may be directed to Ms. Sandra Barrineau at 850-453-4141, extension 1562.

A handwritten signature in black ink, appearing to read "David E. McDermott".

David E. McDermott
Deputy Director, Compliance
Standards & Compliance

Attachment:
As stated

www.dod.mil/dfas
Your Financial Partner @ Work

DFAS comments on DoDIG Draft Report, "Defense Finance and Accounting Service Compliance with the Debt Collection and Improvement Act of 1996 for the Department of the Navy," Project No. D2006-D000FC-0186.000, dated September 17, 2007

Recommendation C: We recommend that the Director, Defense Finance and Accounting Service Charleston and Director, Defense Finance and Accounting Service Pensacola establish procedures to improve collection processes and reporting of accounts receivable balances. Specifically, Defense Finance and Accounting Service payroll offices should ensure that:

1. Debt Files are routinely reviewed to determine whether the debt status indicated in the debt file is accurate and agrees with the debt status indicated in the Defense Civilian Pay system. Defense Finance and Accounting Service payroll offices should verify that all waived, paid, or invalid debts are appropriately recorded in the Defense Civilian Pay System.

Previous Management Comments: Payroll management is revising our Federal Managers' Financial Integrity Action (FMFIA) Assessable Unit – Debt Processing to include the following control point: Quarterly review of debt status to ensure accuracy, i.e., status of any invalid, paid in full/partial, and any waivers received.

Previous Estimated Completion Date: December 1, 2007

Current Management Comments: Payroll management has revised the FMFIA Assessable Unit for Debt Processing to include controls to ensure quarterly reviews of debt statuses are accurate. First quarterly review will be for quarter ending December 31, 2007.

Completion Date: November 26, 2007

2. Debt files that have been suspended are reviewed on a regular basis to verify that the suspension is still warranted.

Previous Management Comments: Payroll management is revising our FMFIA Assessable Unit – Debt Processing to include the following control point: Quarterly review of debt status to ensure any debt suspension or "on-hold" status is still valid.

Previous Estimated Completion Date: December 1, 2007

Current Management Comments: Payroll management has revised the FMFIA Assessable Unit for Debt Processing to include controls to ensure quarterly reviews of

debt statuses for suspensions and “on-hold” are accurate. First quarterly review will be for quarter ending December 31, 2007.

Completion Date: November 26, 2007

3. Debt files include the necessary supporting documentation to validate the debt and to verify that collection actions have begun, indicated by the issuance of a demand letter.

Previous Management Comments: Payroll management is revising our FMFIA Assessable Unit – Debt Processing to include the following control point: Quarterly review of all supporting documentation to ensure collections have begun.

Previous Estimated Completion Date: December 1, 2007

Current Management Comments: Payroll management has revised the FMFIA Assessable Unit for Debt Processing to include controls to ensure quarterly reviews of supporting documentation to ensure collection have begun. First quarterly review will be for quarter ending December 31, 2007.

Completion Date: November 26, 2007

4. All demand letters are sent in a timely manner and in accordance with applicable regulations as soon as the status of the debt is confirmed. Defense Finance and Accounting Service payroll offices should regularly review the Defense Civilian Pay system to identify debts that have not been issued a demand letter.

Previous Management Comments: Payroll management is revising our FMFIA Assessable Unit – Debt Processing to include the following control point: Quarterly review of all debts to ensure demand letters are sent timely.

Previous Estimated Completion Date: December 1, 2007

Current Management Comments: Payroll management has revised the FMFIA Assessable Unit for Debt Processing to include controls to ensure quarterly reviews of debts to ensure demand letters are sent on time. First quarterly review will be for quarter ending December 31, 2007.

Completion Date: November 26, 2007

Team Members

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Inspector General Department of Defense