

# Inspector General

United States  
Department of Defense



Identification and Reporting of Improper  
Payments - Refunds from DoD Contractors

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### **Acronyms**

ACO	Administrative Contracting Officer
CLIN	Contract Line Item Number
DCAA	Defense Contract Auditing Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Service
FAR	Federal Acquisition Regulation
IPRA	Improper Payments and Recovery Auditing
KBR, Inc.	Kellogg Brown and Root, Incorporated
LOGCAP	Logistics Civilian Augmentation Program
MOCAS	Mechanization of Contract Administration Services
OMB	Office of Management and Budget
OUSD(C)/CFO	Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer
PBP	Performance-Based Payment



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
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January 31, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE  
(COMPTROLLER)/CHIEF FINANCIAL OFFICER  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING  
SERVICE

SUBJECT: Identification and Reporting of Improper Payments – Refunds from DoD  
Contractors (Report No. D-2008-043)

We are providing this report for information and use. We considered management comments on a draft report of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides at (614) 751-1400, ext. 211, or Mr. Curt W. Malthouse at (614) 751-1400, ext. 230. See Appendix B 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 cursive script, reading "Patricia A. Marsh", is positioned above the printed name.

Patricia A. Marsh, CPA  
Assistant Inspector General and Director  
Defense Financial Auditing Service



## **Department of Defense Office of Inspector General**

**Report No. D-2008-043**

**January 31, 2008**

(Project No. D2006-D000FJ-0156.000)

### **Identification and Reporting of Improper Payments – Refunds from DoD Contractors**

#### **Executive Summary**

**Who Should Read This Report and Why?** DoD financial managers and contracting officials responsible for identifying, researching, and reducing improper payments should read this report. It discusses ways in which DoD can more accurately identify, report, and reduce improper payments.

**Background.** This audit focused on whether refunds received by the Defense Finance and Accounting Service (DFAS) Columbus from contractors who were paid through its Mechanization of Contract Administration Services (MOCAS) system were researched and reported as improper payments when appropriate. The MOCAS system is used by DFAS Columbus and the Defense Contract Management Agency to administer complex contracts for the Military Departments and other DoD organizations. During FYs 2005 and 2006, contractors who were paid through MOCAS refunded \$1.6 billion to DFAS Columbus. DFAS Columbus reported to the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer that \$216.8 million of the MOCAS refunds were the result of improper payments. It did not report any of the remaining \$1.4 billion of refunds as having resulted from improper payments.

**Results.** DFAS Columbus did not perform adequate research to determine whether the MOCAS contractor refunds it received in FYs 2005 and 2006 were the result of improper payments. We reviewed a judgmental sample of \$239.7 million of the \$1.4 billion of refunds from contractors that DFAS Columbus did not include in its improper payment reporting and concluded that all \$239.7 million of refunds in our sample should have been more adequately researched. DFAS Columbus did not report at least \$24 million in improper payments associated with one of the most substantial refunds because the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer and DFAS Columbus did not have an adequate process in place to fully research the causes of the refunds DFAS Columbus received. Unless DoD improves its identification and research process, the Office of Under Secretary of Defense (Comptroller)/Chief Financial Office and DFAS Columbus will not be able to provide causes for improper payments to DoD entities so that they can take corrective actions to reduce overpayments. The Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer and DFAS needed to establish a process to coordinate with procurement contracting officers, the Defense Contract Audit Agency, the Defense Contract Management Agency, and other DoD Components to research contractor refunds in order to identify an accurate baseline of improper contractor payments. In addition, the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer internal controls were not adequate. We identified an internal control weakness in the identification of improper payments associated with contractor refunds. (See the Finding section of the report for the detailed recommendations.)

**Management Comments and Audit Response.** The Deputy Chief Financial Officer, Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer agreed with the intent of our recommendations to establish a process for DFAS to coordinate with procurement contracting officers, the Defense Contract Audit Agency, the Defense Contract Management Agency, and other DoD Components to research contractor refunds to identify reasons for refunds. He stated that DFAS already has a process in place and that the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer was working to improve the existing process and that the process would be monitored.

The Deputy Chief Financial Officer's plan to improve the existing process and improve oversight satisfies the intent of our recommendations. We strongly believe that fully investigating the causes of refunds and accurately reporting the amounts that are found to be caused by improper payments are imperative steps in monitoring and working to reduce the occurrence of improper payments in the Department. The Department needs to perform better research to identify the systemic problems that cause improper payments and identify and focus its attention on the weaknesses in its processes that are resulting in significant refunds. If the systemic problems are not identified, highlighted, and corrected, Defense contractors will continue to receive significant overpayments that could have been prevented.

See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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## Background

In FY 2002, the President sent Congress an agenda that was focused on improving the management and performance of the Federal Government. One component of the President's management agenda was an initiative to improve financial performance by reducing improper payments. On August 10, 2006, the Office of Management and Budget (OMB) issued OMB Circular A-123, Appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," that defines an improper payment as any payment that should not have been made or that was made in an incorrect amount under a statutory, contractual, administrative, or other legally applicable requirement. Incorrect amounts are overpayments and underpayments (including inappropriate denials of payment or service). An improper payment includes any payment that was made to an ineligible recipient or for an ineligible service, duplicate payments, payments for services not received, and payments that are for the incorrect amount. In addition, when an agency's review of a payment is unable to discern whether a payment was proper because of insufficient or lack of documentation, the payment must be considered an error. The Circular emphasizes the importance of establishing accurate baselines to show progress.

The Defense Finance and Accounting Service (DFAS) Columbus processes DoD contractor payments as part of its accounts payable functional area (formerly commercial pay). Contractor payment functions include paying contractors through written, long-term contract instruments that require contract administration. The contracts are for products and services for DoD Components (the Military Services and Defense agencies). The Defense Contract Management Agency (DCMA) typically administers the contracts. The contracts tend to be for complex, multi-year purchases with high dollar values, such as major weapons systems. During FYs 2005 and 2006, contractors who were paid through the payment module of DFAS Columbus Mechanization of Contract Administration Services (MOCAS) system refunded \$1.6 billion by check to DFAS Columbus. DFAS Columbus reported to the Office of Under Secretary of Defense (Comptroller)/Chief Financial Officer (OUSD[C]/CFO) that \$216.8 million of the refunds were the result of improper payments. It did not report any of the remaining \$1.4 billion of refunds as having resulted from improper payments.

Many of the contracts paid through MOCAS involved contract financing payments. Federal Acquisition Regulation (FAR), Part 32 "Contract Financing," September 17, 2007, defines a contract financing payment as "an authorized Government disbursement of monies to a contractor prior to acceptance of supplies or services by the Government." Contract financing payments include such payments as advance payments, performance-based payments (PBPs), progress payments, and interim payments. The FAR Part 32.008, "Notification of Overpayment," states:

If the contractor notifies the contracting officer of a duplicate contract financing or invoice payment or that the Government has otherwise overpaid on a contract financing or invoice payment, the contracting officer must promptly provide instructions to the contractor, in

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coordination with the cognizant payment office, regarding timely disposition of the overpayment.

## **Objectives**

The audit objective was to determine whether DoD adequately reviewed all the programs and activities it administered, and identified and reported those that may be susceptible to making significant improper payments. We determined whether DoD established adequate processes to identify the amount of improper payments that caused refunds from DoD contractors paid through the MOCAS system.

## **Review of Internal Controls**

We identified an internal control weakness for the OUSD(C)/CFO as defined by DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," January 4, 2006. OUSD(C)/CFO did not have adequate internal controls in the identification of improper payments associated with contractor refunds. Specifically, OUSD(C)/CFO and DFAS did not have a process:

- for DFAS to coordinate with procurement contracting officers, the Defense Contract Auditing Agency (DCAA), DCMA, and other DoD Components to research contractor refunds to identify reasons for refunds;
- to determine whether the refunds resulted from improper payments based on reasons identified through coordination with DoD Components;
- to monitor DoD Components' actions to ensure that the cause for each refund is determined; and
- to develop solutions and trend information for use in demonstrating progress in reducing improper payments associated with refunds.

Recommendations in this report, if implemented, will improve OUSD(C)/CFO procedures for identifying and reporting improper payments associated with refunds from contractors. A copy of the report will be provided to the senior official responsible for internal controls in the OUSD(C)/CFO.

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## **Improper Payments Associated with Refunds from Contractors**

DFAS Columbus did not perform adequate research to determine whether the MOCAS contractor refunds it received in FYs 2005 and 2006 were the result of improper payments. We reviewed a judgmental sample of \$239.7 million of the \$1.4 billion of refunds from contractors that DFAS Columbus did not include in its improper payment reporting and concluded that all \$239.7 million of refunds in our sample should have been more adequately researched. DFAS Columbus did not report at least \$24 million in improper payments associated with one of the most substantial refunds because the OUSD(C)/CFO and DFAS Columbus did not have an adequate process in place to fully research the causes of the refunds that DFAS Columbus received. Unless DoD improves its identification and research process, Defense contractors will continue to receive significant overpayments that could have been prevented.

### **Refunds Reported as Resulting from Improper Payments**

DoD Financial Management Regulation volume 5, chapter 10, "Collections," February 2005, states that there are three types of collections: refunds, receipts, and reimbursements. A refund is defined as a payment made in error and collected by a disbursing officer. A refund occurs either because DoD issued a demand letter to an individual or contractor, or an individual or contractor became aware of the error and returned the funds to DoD.

The DFAS Columbus Debt Management Division processed the MOCAS refunds it received from contractors totaling \$1.6 billion for FYs 2005 and 2006. DFAS Columbus classified \$216.8 million of the \$1.6 billion as improper payments. We selected five of the refunds included in the \$216.8 million that DFAS Columbus reported to confirm that the DFAS Columbus review was complete and that the refunds had resulted from improper payments. The five refunds represented 67 percent (\$146.0 million) of the \$216.8 million DFAS Columbus reported.

We examined MOCAS check collections that contained a reason code for the return that stated "funds returned due to contractor or contracting identified payment errors." We verified that these collections were the result of an improper payment caused by an error in contract administration and agreed with the DFAS Columbus decision to report them as improper payments. Table 1 shows the details of the five MOCAS check collections.

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<b>Table 1. Sample of Refunded Checks Reported as Improper Payments</b>			
<b>Vendor</b>	<b>Amount Refunded to DoD and Reported as Improper Payment by DFAS Columbus</b>	<b>Reason for Refund Shown in the Documentation Provided</b>	<b>Amount of Refund Attributed to Improper Payment</b>
Lockheed Martin	\$ 86,541,307.35	Overpayment due to liquidation	\$ 86,541,307.35
United Defense Ground Systems Div	16,232,107.54	Invoices paid without recoupment	16,232,107.54
BAE Systems	24,315,356.57	Over and under liquidation of payments	24,315,356.57
BAE Systems	8,116,053.77	Over and under liquidation of payments	8,116,053.77
BAE Systems	10,806,825.02	Overpayment on shipment	10,806,825.02
<b>Totals</b>	<b>\$146,011,650.25</b>		<b>\$146,011,650.25</b>

## **Refunds Not Reported as Resulting from Improper Payments**

We judgmentally selected and reviewed 23 refunds, valued at \$239.7 million, from the universe of \$1.4 billion of refunds that DFAS Columbus did not report as having resulted from improper payments. The review showed that \$239.7 million of the refunds should have been more adequately researched for possible inclusion in the improper payment reporting information and that one refund for \$24 million (BAE Systems) should have been reported as an improper payment. DFAS Columbus confirmed an improper payment after they completed further research during the audit. After DFAS conducted further research, only two items in our sample (payments to the Boeing Company and Raytheon Company) contained evidence of adequate research to conclude that they were not improper payments. Table 2 shows the details of the 23 refunds.

<b>Table 2. Sample of Refunded Checks Reported as Proper Payments</b>			
<b>Vendor</b>	<b>Amount Refunded to DoD</b>	<b>Reason for Refund Shown in the Documentation Provided</b>	<b>Insufficient Initial Research Performed</b>
McDonnell Air & Missile Systems	\$ 34,105,000.00	Limitation of payments review discovered excess overbillings	\$ 34,105,000.00
The Boeing Company	29,110,378.00	Valid payment	29,110,378.00
KBR, Inc. <sup>1</sup>	27,908,679.48	Billed to incorrect task order	27,908,679.48
BAE Systems	23,983,614.79	Contract administrative error	23,983,614.79
Bell Helicopter	19,871,708.15	Refund of overpayment	19,871,708.15
KBR, Inc.	17,405,682.27	Billed to incorrect task order	17,405,682.27
Oshkosh Truck Corporation	14,401,210.30	Overpayment discovered during definitization	14,401,210.30
Lockheed Martin	13,438,145.92	Decrease in costs in current billing cycle	13,438,145.92
Raytheon Company	11,936,600.00	Tax settlement	11,936,600.00
Northrop Grumman	11,613,043.00	Litigation cost settlement	11,613,043.00
KBR, Inc.	6,465,319.00	Overpayment discovered during definitization	6,465,319.00
KBR, Inc.	5,945,748.08	Task order definitized funds de-obligated	5,945,748.08
KBR, Inc.	4,416,715.30	Task order definitized funds de-obligated	4,416,715.30
The Titan Corporation	3,236,683.17	Contractor timekeeping error	3,236,683.17
KBR, Inc.	2,755,290.21	Rate adjustment	2,755,290.21
KBR, Inc.	2,262,157.80	Refund of overpayment	2,262,157.80
KBR, Inc.	1,905,080.45	Partial costs	1,905,080.45
KBR, Inc.	1,876,759.40	Partial costs	1,876,759.40
KBR, Inc.	1,815,191.94	Overpayment discovered during definitization	1,815,191.94
KBR, Inc.	1,604,629.50	Overpayment discovered during definitization	1,604,629.50
KBR, Inc.	1,386,446.74	Adjustments to line items	1,386,446.74
KBR, Inc.	1,158,354.50	Rate adjustment	1,158,354.50
KBR, Inc.	1,075,080.97	Settlement for overbillings	1,075,080.97
<b>Totals</b>	<b>\$239,677,518.97</b>		<b>\$239,677,518.97</b>

When the audit began, DFAS Columbus did not provide adequate documentation to us to show why \$239.7 million of payments were refunded. DFAS Columbus initial research did not identify the original payments that were refunded. As a result, we could not review the payments to opine on the propriety of DoD actions taken during the approval of the original payments refunded by the contractors. In addition, DFAS had not conducted sufficient research or adequately coordinated with DoD Components that could have provided additional information to explain the cause of each refund. Except for two refunds from the Boeing Company and Raytheon Company, DFAS Columbus personnel reported the refunds shown in the table as not resulting from improper payments because its preliminary research indicated that the refunds were the result of the actions of

<sup>1</sup> Kellogg Brown and Root (KBR), Inc.

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other DoD Components or errors made by contractors after payments were made. DFAS Columbus did not have a process in place to coordinate with other DoD Components to confirm that the amounts may have resulted from improper payments.

## **Properly Categorized Refunds**

DFAS Columbus properly categorized two of the refunds in our sample as a valid payment and a tax settlement.

**Boeing Company Proper Payment.** A \$29.1 million refund from The Boeing Company was the result of a conversion of a contract from progress payments to PBPs. DCMA personnel stated that progress payments and PBPs cannot exist on the same contract. They stated that by using a modification, the procurement contracting officer incorporated the PBPs into the contract and made a one-time conversion from progress payments to PBPs. DCMA personnel indicated that all progress payments made as of a given date were refunded at the time the conversion was made to PBPs. We did not consider this collection to be the result of an improper payment because the amount paid was proper and remained unchanged despite the refund shown in the records.

**Raytheon Company Property Tax Settlement.** DFAS Columbus received a refund of \$11.9 million from Raytheon Company in December 2004. The research collection voucher provided by DFAS Columbus contained conflicting information about the refund. One section showed the amount was a “refund on income tax accruing on multi-government contracts,” while another section showed that it was a “property tax settlement.” DFAS Columbus did not provide additional documentation on this collection. On August 9, 2007, OUSD(C)/CFO personnel provided additional documentation on the refund showing that the refund was the result of a property tax settlement. We did not consider this collection to be the result of an improper payment because the amount paid was proper and remained unchanged despite the refund shown in the records.

## **Improperly Categorized Refunds**

OUSD(C)/CFO and DFAS Columbus personnel agreed that DFAS Columbus probably should have categorized one refund as an improper payment. The agreement came after DFAS Columbus completed additional research at our request during the audit. The additional research clearly showed that administrative error caused the refund. The refund was on the same contract as three refunds categorized as improper payments by DFAS in Table 1.

**BAE Systems Contract Administrative Error.** DFAS Columbus made a payment to BAE Systems based on the initial PBP schedule that referenced four contract line item numbers (CLINs). DFAS Columbus personnel stated that the overpayment occurred because the administrative contracting officer (ACO) processed a contract modification that referenced eight CLINs for the PBP schedule, but the ACO did not notify the DFAS Columbus payment office of the

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change in CLINs. As the contractor submitted invoices for deliveries on the eight CLINs, DFAS Columbus made payments on only four CLINs, causing an overpayment of \$24 million on the four original CLINs. The amount refunded was the result of the improper payment caused by a contract administrative error.

DFAS Columbus requested that DCMA personnel provide the DCMA guidance on when the ACO should notify the payment office of PBP schedule changes. DCMA personnel indicated that guidance on this topic did not exist in the DCMA PBP Guidebook. DFAS Columbus personnel stated that they will work with DCMA to see if this situation can be prevented by adding procedures to the DCMA PBP Guidebook.

DFAS Columbus personnel stated that problems with PBPs occur when the procurement contracting officer makes changes to the contract but does not notify DFAS Columbus. Problems with PBP contracts can be corrected if the contracting officer notifies DFAS Columbus of changes to line items being charged. DFAS needed to coordinate with procurement contracting officers, DCAA, and DCMA to prevent these types of improper payments.

DFAS Columbus identified three additional improper payments on the BAE contract as being improper payments (see Table 1) and should have completed research on the entire contract to identify the amount of improper payments.

### **Insufficient Research Performed to Identify the Cause for Refund**

DFAS Columbus did not perform enough initial research to determine the cause of the refunds and prove that the remaining refunds in our sample were not the result of improper payments.

**Multiple Kellogg Brown and Root, Inc. Refunds.** DFAS Columbus did not report improper payments on multiple refunds received from KBR, Inc., a contractor performing work for the Army. In December 2001, the Army awarded a contract to KBR, Inc. to support operations in Southwest Asia (DoD Contract DAAA09-02-D-0007, December 14, 2001). The Logistics Civilian Augmentation Program contract (LOGCAP III) had an estimated contract value of \$22.7 billion. DFAS Columbus received \$86.3 million in refunds on the contract from KBR, Inc. during FYs 2005 and 2006.

DFAS Columbus did not report any of the \$86.3 million as being improper payments. We examined documentation related to 14 refunds on the LOGCAP III contract, totaling \$78.0 million. Documentation showed that two refunds for \$45.3 million were the result of overbillings by the contractor because the contractor billed to the incorrect task order. We obtained documents that showed that DFAS Columbus did not perform adequate research or coordinate with DCAA and DCMA to verify the cause as overbilling to support its not reporting this as an improper payment.

Documentation from DCMA personnel showed that another five refunds for \$20.2 million were the result of overpayments made prior to the definitization of the contract. The Defense Federal Acquisition Regulation Supplement (DFARS)

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Subpart 217.74, “Undefinitized Contract Actions,” May 12, 2006, defines definitization as “the agreement on, or determination of, contract terms, specifications, and price.” The agreement or determination converts the undefinitized contract action to a definitive contract. DFARS defines an undefinitized contract action as “any contract action for which the contract terms, specifications, or price are not agreed upon before performance is begun under the action.” DCMA personnel stated that for three of the refunds, DCMA issued a demand letter to collect an overpayment. DCMA personnel provided documentation showing that the overpayment was the result of invoices that were paid prior to definitization of the task order that was then definitized for an amount less than what had already been paid. For the remaining two refunds, DCMA personnel stated that the task order was definitized, and funds were de-obligated.

The reasons for the remaining KBR, Inc. refunds are listed in Table 2 and include overpayments, rate adjustments, partial costs, adjustments to line items, and settlement for overbillings. We met with senior DCAA officials in March 2007 to discuss overpayments on the KBR, Inc. contract, and the officials stated that the KBR, Inc. financial system was at high risk for billing errors. An Army Audit Agency report<sup>2</sup> states “the process of submitting cost proposals to the Definitization Office wasn’t done in a timely manner. The current LOGCAP contract, DAAA09-02-D-0007, sets a target date for the submission of the contractor’s proposal of 45 days after award of the task order.” For the task orders in our sample of refunds, KBR, Inc. submitted cost proposals on task orders that ranged from 104 to 297 days after the notice to proceed. DCAA was still in the process of reviewing many of the LOGCAP contract charges. DFAS needed to coordinate with DCAA and DCMA to determine an amount, if any, to report as improper payments on the contract.

**Northrop Grumman Litigation Settlement.** DFAS Columbus collected a refund of \$11.6 million from Northrop Grumman that was related to unallowable legal costs incurred on contracts. The supporting documentation for the collection stated “final payment for all Qui Tam<sup>3</sup> litigation cost plus interest pursuant to the memorandum of agreement between DCMA Chicago and Northrop Grumman.” On August 9, 2007, OUSD(C)/CFO personnel provided additional documentation on the refund showing that \$2.1 million of the refund was interest on the Qui Tam settlement. The documentation did not identify the original payments made for the unallowable costs. Therefore, DFAS did not conduct sufficient research to show that the \$9.5 million in unallowable litigation costs refunded on the contracts were the result of proper payments.

**Titan Corporation Timekeeping Error.** One example of a contractor error that caused a refund was a \$3.2 million overpayment to the Titan Corporation. The refund occurred when the ACO at DCMA issued a demand for payment that

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<sup>2</sup> Army Audit Agency Report No. A-2004-0438-AML, “Definitization of Task Orders – Audit of Logistics Civil Augmentation Program,” August 12, 2004.

<sup>3</sup> Qui Tam is defined as a lawsuit brought by a private citizen (popularly called a “whistle blower”) against a person or company who is believed to have violated the law in the performance of a contract with the Government or in violation of a Government regulation.



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stated that the contractor's labor accounting system was inadequate and contained a number of significant deficiencies. Other deficiencies cited were that the contractor did not comply with timekeeping policy and did not document in the timecards the actual time worked. This resulted in an overbilling. When we met with DFAS Columbus and DCAA personnel to discuss the refund, they stated that because the error was a contractor billing error, the actual payment was proper when the payment was made. Senior DCAA personnel also stated that the demand for payment and ultimate collection was part of the normal audit oversight process of contracts and that the contractor might recover the refund later. However, DFAS Columbus could not provide documentation on the original payment that resulted in a refund or subsequent payments that reversed the demand letter.

Public Law 107-300, "Improper Payments Information Act of 2002," November 26, 2002 and OMB Circular A-123 do not include reporting exceptions for errors identified by oversight Components such as DCAA or DCMA. Identifying and researching these actions would highlight the problems and focus additional management attention on determining causes for overpayments. If DFAS Columbus provides the cause to its customers, including procurement contracting officers, the customers can take action to correct internal control weaknesses and prevent similar situations that result in overpayments.

The Titan Corporation refund illustrates that DFAS Columbus did not have adequate supporting documentation available to identify the cause of the collection when DFAS Columbus reported the refund as proper. We reviewed the documentation used by DFAS Columbus to determine whether the payment was reasonable and proper. We determined that the documentation was incomplete. Based on our request for additional information, DFAS Columbus contacted DCAA to obtain supporting documentation for the cause of the collection.

DCAA was able to provide the DCMA contracting officer's demand for payment that showed the cause of the error to be the contractor's labor accounting system. The labor accounting system was inadequate, and the contractor did not document the actual time worked. This example demonstrates the need for DFAS personnel to coordinate with DCAA and DCMA personnel to identify similar types of payments with the goal of preventing them by identifying contractor accounting problems prior to payment.

## **Additional Research**

In response to the draft report, the OUSD(C)/CFO performed its own research and provided information that the Deputy Chief Financial Officer stated showed that 20 refunds were the result of the normal contract administration process, and therefore, the refunds should not be categorized as improper payments. We reviewed the information and it did not show conclusively that the refunds were not improper payments. The documents provided to us did not match the refunds to the original payments. For the more substantial refunds, OUSD(C)/CFO and DFAS Columbus should trace the refund to the payment.

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In November 2006, the OUSD(C)/CFO Acting Deputy Chief Financial Officer established a DoD Project Officer for Improper Payments and Recovery Auditing (IPRA) and IPRA working group to improve the methodologies for identifying and reporting improper payments. The goals of the DoD Project Officer is to review the DoD statistical methodologies and processes for capturing and reporting IPRA information to verify that DoD reporting is accurate, complete, and meets or exceeds the minimum OMB reporting requirements. Another goal of the DoD Project Officer is to establish and coordinate an ongoing IPRA working group, consisting of representatives from DoD Components, to assist in the review of the IPRA of their Components and help modify methodologies and processes as needed. OUSD(C)/CFO needs to coordinate with the working group and the DoD Project Officer to improve researching the cause of refunds and reducing problems that cause them.

## **Identifying an Accurate Baseline**

In August 2006, OMB added additional documentation requirements related to the identification of improper payments. Specifically, OMB requires that when an agency's review of a payment is unable to discern whether a payment was proper because of insufficient or lack of documentation, the payment must be considered an error. Unless DoD improves its process of evaluating refunds from contractors, it should report them as improper payments. Because DFAS Columbus receives the refunds, it is in the best position to coordinate with other DoD activities to quickly determine the cause of the refunds and determine whether they are associated with improper payments. Unless the OUSD(C)/CFO and DFAS improve the DFAS evaluation and coordination process, DFAS Columbus will not be able to provide the causes for improper payments to its customers so that they can take corrective actions. DFAS needed to coordinate with procurement contracting officers, the DCAA, the DCMA, and other DoD Components to research contractor refunds to identify an accurate baseline of improper MOCAS payments.

## **Conclusion**

OUSD(C)/CFO and DFAS Columbus should consider reporting all refunds on MOCAS contracts as errors until definitive research shows that the refunds were the result of collections that did not involve contractor or administrative error. DFAS Columbus did not report at least one substantial improper payment because of insufficient research. OUSD(C)/CFO and DFAS Columbus personnel needed to improve review processes on contractor refunds and should use the IPRA working group to improve the existing process. The OUSD(C)/CFO also needs to monitor DoD Components actions to ensure that they determine a cause for each refund, develop solutions, and establish trend information to demonstrate progress in reducing improper payments associated with refunds.

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## Management Comments on the Finding and Audit Response

**Management Comments.** The Deputy Chief Financial Officer, OUSD(C)/CFO provided comments based on a draft of the Finding (see the Management Comments section for the text). In the draft, we stated that \$189.6 million of the \$239.7 million of refunds should have been reported as resulting from improper payments. We modified the final report to state that none of the refunds we examined (valued at \$239.7 million) were initially researched adequately, including two refunds that we subsequently determined were not the result of improper payments.

In response to the draft, the Deputy CFO stated that \$165.6 million out of the \$189.6 million in payments that we identified in the draft report as improper payments were the result of adjustments on interim contract financing payments. He added that the payments were designed to provide contractors with payments in advance of contract deliveries, and these payments typically include some degree of estimation. He also stated that depending on the type of authorizing contract, the payments may be (1) made provisionally and subject to final contract audit and closeout, (2) based on payment schedules included in the contract, or (3) limited to an amount less than the final negotiated contract price until final deliveries are made and accepted by DoD. He stated that refunds of interim financing payments resulting from the administration and settlement of contracts and occurring subsequent to the DFAS entitlement and payment processes demonstrate that appropriate internal controls are functioning effectively.

The Deputy Chief Financial Officer stated that he did not believe payments are improper when, at the time of the payment, they are correctly entitled and disbursed based on the contract terms, the applicable FAR, and the DFARS requirements. He stated that any interpretation to the contrary places DoD in the impossible position of determining whether to make an improper payment in accordance with the Improper Payments Information Act or not make a payment and violate the FAR and the terms of the underlying contract.

The Deputy agreed with the intent of three recommendations that would require DFAS to coordinate with procurement contracting officers, DCAA, DCMA, and other DoD Components to research contractor refunds to identify reasons for refunds. He also stated that the OUSD(C)/CFO was working to improve the existing process and that the improved process would be monitored.

**Audit Response.** We agree that routine contract adjustments on interim contract financing payments should not be reported as improper payments. However, the value of our sample items (\$1 million to \$34 million) was too substantial to be dismissed as routine contract adjustments when the limited supporting documentation showed that the refunds were the result of contractor overbillings, contractor errors, or contract administration problems.

The Deputy Chief Financial Officer stated that refunds may result from improper payments, but they may also be caused by other factors. We agree that refunds are not always the result of improper payments and should be reviewed on a case-by-case basis. However, sufficient documentation needs to accompany refunds to permit tracing the refunds to a payment. DFAS personnel were unable to identify the particular payments that caused the refunds and, as a result, we

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could not review the payments to opine on the propriety of DoD actions at the time DoD made the payments.

The Deputy Chief Financial Officer's plan to improve the existing process and improve oversight satisfies the intent of our recommendations. We strongly believe that fully investigating the causes of refunds and accurately reporting the amounts that are caused by improper payments are imperative steps in monitoring and working to reduce the occurrence of improper payments in the Department. The Department needs to perform better research to identify the systemic problems that cause improper payments and identify and focus its attention on the weaknesses in its processes that are resulting in significant refunds. If the systemic problems are not identified, highlighted, and corrected, Defense contractors will continue to receive significant overpayments that could have been prevented.

## **Recommendations, Management Comments, and Audit Response**

**Deleted and Renumbered Recommendations.** As a result of management comments, we deleted the first two recommendations and renumbered the final three recommendations. We also deleted recommendations on reporting material internal control weaknesses and the high-risk categorization of the accounts payable functional area because the recommendations were reported in a prior audit report,<sup>4</sup> and management actions on those recommendations were ongoing.

**We recommend that the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the DoD Improper Payments and Recovery Auditing Project Officer, and the Improper Payments and Recovery Auditing working group in coordination with Defense Finance and Accounting Service:**

**1. Establish a process for Defense Finance and Accounting Service to coordinate with procurement contracting officers, the Defense Contract Audit Agency, the Defense Contract Management Agency, and other DoD Components to research contractor refunds to identify reasons for refunds.**

**Management Comments.** The Deputy Chief Financial Officer, OUSD(C)/CFO agreed with the intent of the recommendation. He stated that DFAS already has a process in place to identify the reasons for refunds and DFAS reported \$216.8 million of improper payments identified through refunds for FYs 2005 and 2006. OUSD(C)/CFO personnel are working with DCMA and DCAA to improve the quality of the refund data. Better data will assist DoD Components in assessing and improving payment controls. The Deputy Chief Financial Officer stated that because DCMA administers most cost-type contracts, contracting officers will be involved on a case-by-case basis.

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<sup>4</sup> Report No. D-2005-100, "Identification and Reporting of DoD Erroneous Payments," August 17, 2005.

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**Audit Response.** The Deputy Chief Financial Officer's comments were responsive to the intent of the recommendation.

**2. Determine whether the refunds were the result of improper payments based on reasons identified through coordination with DoD Components.**

**Management Comments.** The Deputy Chief Financial Officer, OUSD(C)/CFO agreed with the intent of the recommendation. As stated in the response to Recommendation 1., he stated that DFAS currently has a process to identify the reasons for the refunds. However, OUSD(C)/CFO is working with DCAA and DCMA to enhance the process.

**Audit Response.** The Deputy Chief Financial Officer's comments were responsive to the intent of the recommendation.

**3. Monitor DoD Components actions to ensure that they determine a cause for each refund, develop solutions, and establish trend information to demonstrate progress in reducing improper payments associated with refunds.**

**Management Comments.** The Deputy Chief Financial Officer, OUSD(C)/CFO partially concurred and stated that, in accordance with the Improper Payments Information Act requirements, DoD will continue to focus on reducing improper payments; but this is not limited to payments associated with refunds. The Deputy Chief Financial Officer stated that in FY 2008, OUSD(C)/CFO will be implementing a monthly financial performance metric for tracking and reducing improper payments by program, which will include commercial (contract and vendor) payments. This metric will demonstrate progress in reducing improper payments Department-wide and allow management to closely monitor progress and take prompt corrective actions as needed. He also stated that making maximum use of the data gathered to determine improper payment causes, developing appropriate solutions, and implementing improvements in controls and procedures is inherent to achieving reductions in the improper payment measurements.

**Audit Response.** The Deputy Chief Financial Officer's comments were responsive to the intent of the recommendation.

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## Appendix A. Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We assessed whether DoD complied with the requirements of the Public Law 107-300, “Improper Payments Information Act of 2002,” November 26, 2002 as further defined by the OMB Circular A-123, Appendix C, “Requirements for Effective Measurement and Remediation of Improper Payments,” August 10, 2006. Specifically, we reviewed a judgmental sample of five FY 2005 and 2006 contractor check refunds for \$146.0 million reported as improper payments. The contractor check refunds we reviewed were originally paid through the DFAS Columbus MOCAS system.

We also reviewed a judgmental sample of 23 contractor check refunds for \$239.7 million not reported as improper payments. Furthermore, we judgmentally sampled refunds on the KBR, Inc. LOGCAP III contract of more than \$1 million. We reviewed the contractor check refunds to determine whether they were improper payments and the cause of the improper payment. We worked with DFAS Columbus, DCAA, DCMA, and other DoD Components to identify the cause of the refund. We reviewed the contractor check refunds to determine whether DFAS Columbus reported the refund that was the result of an improper payment.

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

**Use of Computer-Processed Data.** We did not use computer-processed data to perform this audit. Instead, we relied on information gathered by DFAS Columbus management on improper payments and FYs 2005 and 2006 contractor check refunds originally paid through MOCAS. We did not perform a formal reliability assessment on the management information.

**Government Accountability Office High-Risk Area.** The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the DoD Financial Management and DoD Contract Management high-risk areas.

### Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) and the Department of Defense Inspector General (DoD IG) issued four reports on the

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identification and reporting of improper payments. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

## **GAO**

Report No. GAO-07-92, “Agencies’ Fiscal Year 2005 Reporting under the Improper Payments Information Act Remains Incomplete,” November 2006.

Report No. GAO-02-749, “Coordinated Approach Needed to Address the Government’s Improper Payments Problems,” August 2002

## **DoD IG**

Report No. D-2006-094, “Improper Payments for Defense Fuels,” June 29, 2006

Report No. D-2005-100, “Identification and Reporting of DoD Erroneous Payments,” August 17, 2005

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## **Appendix B. 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 Army**

Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

Auditor General, Department of the Air Force

### **Combatant Commands**

Inspector General, U.S. Joint Forces Command

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Contract Management Agency  
Director, Defense Finance and Accounting Service

### **Non-Defense Federal Organization**

Office of Management and Budget



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## **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



# Office of the Under Secretary of Defense/Chief Financial Officer Comments



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1100

OCT 9 2007

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL AND DIRECTOR,  
DEFENSE FINANCIAL AUDITING SERVICE,  
OFFICE OF THE INSPECTOR GENERAL,  
DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on the "Identification and Reporting of Improper Payments – Refunds from DoD Contractors," (Project Number D2006-D000FJ-0156.000)

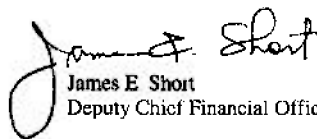
This memorandum is in response to your request for comments on the audit recommendations contained in the subject draft audit report. Upon review of the draft report, we partially concur with three recommendations and nonconcur with the remaining two recommendations. Our detailed response to the report is outlined in Attachment 1.

To address some fundamental assumptions in the report, we disagree with the DoD OIG on applying the definition of an improper payment, as set forth in Appendix C of the Office of Management and Budget (OMB) Circular A-123, "Management's Responsibility for Internal Control," to refunds. Refunds may result from improper payments, but they may also be caused by other factors. Determining whether a payment was improper must be based on a case-by-case review of the original payments, rather than the refund. We acknowledge that tracing refunds to original payments may aid in identifying improper payments, and we will continue to report improper payments identified in this manner. However, insufficient documentation accompanying refunds, which precludes tracing the refunds to payments, does not deem the payments improper. The definition of an improper payment provided in statute and in OMB guidance specifically addresses payments and does not include refunds.

Furthermore, recent OMB guidance indicated that agencies historically have not included payments related to contract adjustments in improper payment reporting. The fact that the identified refunds relate to interim contract financing payments is a key omission in the draft audit report. Interim contract financing payments are designed to provide contractors with payments in advance of contract deliveries, and these payments typically include some degree of estimation. Depending on the type of authorizing contract, the payments may be (1) made provisionally and subject to final contract audit and closeout, (2) based on payment schedules included in the contract, or (3) limited to an amount less than the final negotiated contract price until final deliveries are made and accepted by the Department. Refunds of interim financing payments, resulting from the administration and settlement of contracts and occurring subsequent to the Defense

Finance and Accounting Service entitlement and payment processes, demonstrate that appropriate internal controls are functioning effectively. We do not believe payments are improper when, at the time of the payment, they are correctly entitled and disbursed based upon the contract payment terms, the applicable Federal Acquisition Regulations (FAR), and the Defense Federal Acquisition Regulations Supplement (DFARS) requirements. Any interpretation to the contrary places the Department in the impossible position of determining whether to make an improper payment in accordance with the Improper Payments Information Act or not make the payment and violate the FAR, DFARS, and the underlying contract. Accordingly, our review determined only one refund, for \$24 million, was likely the result of improper payments.

We appreciate the opportunity to respond to your request for comments on the audit recommendations. My point of contact is Mr. Mike Weber. He may be reached by telephone at 703-697-6149 or by email at michael.weber@osd.mil.

  
James E. Short  
Deputy Chief Financial Officer

Attachments:

1. Response to Audit Recommendations
2. Analysis of Refunds and the Related Payments

**Department of Defense, Office of the Inspector General (DoD OIG)  
Draft Report on the "Identification and Reporting of Improper Payments –  
Refunds from DoD Contractors" dated August 10, 2007  
Project No. D2006-D000JF-0156.000**

The DoD OIG recommends that the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer and the DoD Improper Payments and Recovery Auditing Project Officer and Improper Payments and Recovery Auditing working group in coordination with Defense Finance and Accounting Service:

**Recommendation 1:** Report the accounts payable functional area as a high-risk area until the improper payments associated with refunds are fully identified and minimized.

**OUSD(C) Comments:** Nonconcur. The DoD OIG did not identify and provide specific individual payments which the DoD OIG considered improperly entitled and paid. Instead, the report identified refunds which represented many payments over a period of time. Determining whether a payment was improper must be based on a case-by-case review of the original payments, rather than the refund.

We do not believe payments are improper when, at the time of the payment, they are correctly entitled and disbursed based upon the contract payment terms, the applicable Federal Acquisition Regulations (FAR), and the Defense FAR Supplement (DFARS) requirements. Any interpretation to the contrary, places the Department in the impossible position of determining whether to make an improper payment in accordance with the Improper Payments Information Act or not make the payment and violate the FAR, DFARS, and the underlying contract. Furthermore, statements by the Government Accountability Office (GAO) support our opinion:

- In a 1999 report, AIMD-00-10, entitled "Financial Management – Increased Attention Needed to Prevent Billions in Improper Payments," the GAO states, "...some overpayments, by their nature, are not considered improper payments, such as routine contract price adjustments."
- In a 2006 report, GAO-07-92, entitled "Improper Payments – Agencies' Fiscal Year 2005 Reporting under the Improper Payments Information Act Remains Incomplete," the GAO states, "we agree with OMB that a payment that was made because of a legal requirement to make the payment subject to subsequent determinations that the payment is not due should not be included in an agency's estimate of its improper payments...because it does not meet the definition of an improper payment under the act."

We reviewed the refunds the DoD OIG identified and determined that all but one related to payments which were correct and in accordance with contract terms at the time they

Attachment 1: Page 1 of 3

Deleted

Final Report  
References

were paid. These could be classified in one or more of the following four contract-related categories: (1) costs paid provisionally and subsequently identified by others as unallowable, (2) contract financing payments, (3) price definitization or price adjustments, and (4) payments made due to a legal requirement to make the payment, subject to subsequent determinations that the payment was not due. The Office of Management and Budget's position is that Federal agencies historically have not included such contract adjustments as improper payments. Therefore, we do not agree with the DoD OIG determination that 21 (\$189.6 million) of 23 (\$239.7 million) judgmentally sampled refunds were the result of improper payments. Our analysis (at Attachment 2) identified only 1 refund, for \$24 million, was likely the result of improper payments.

**Recommendation 2:** Report a material internal control weakness in the identification of improper payments for the accounts payable functional area as a result of the significant amount of funds refunded by Defense contractors.

**OUSD(C) Comments:** Nonconcur. We do not concur based on the reasons stated in our response to Recommendation 1.

**Recommendation 3:** Establish a process for Defense Finance and Accounting Service (DFAS) to coordinate with procurement contracting officers, the Defense Contract Audit Agency (DCAA), the Defense Contract Management Agency (DCMA), and other DoD Components to research contractor refunds to identify reasons for refunds.

**OUSD(C) Comments:** Partially concur. We agree with the intent of the recommendation. However, DFAS already has a process in place to identify the reasons for refunds, through which DFAS identified and reported \$216.8 million of improper payments identified through refunds for fiscal years 2005 and 2006. We are working with DCMA and DCAA to improve the quality of the refund data to further its use in assessing and improving payment controls. Since DCMA administers most cost-type contracts, procuring contracting officers will be involved on a case-by-case basis.

**Recommendation 4:** Determine whether the refunds were the result of improper payments based on reasons identified through coordination with DoD Components.

**OUSD(C) Comments:** Partially concur. We agree with the intent of the recommendation. As stated in the response to Recommendation 3, DFAS currently has a process to identify the reasons for the refunds. However, enhancements can be made in that process, and we are currently working with both DCAA and DCMA to bring those about.

Attachment 1: Page 2 of 3

**Recommendation 5:** Monitor DoD Components' actions to ensure that they determine a cause for each refund, develop solutions, and establish trend information for use in demonstrating progress in reducing improper payments associated with refunds

**OUSD(C) Comments:** Partially concur. In accordance with the Improper Payments Information Act requirements, the Department will continue to focus on reducing improper payments; but this is not limited to payments associated with refunds. In fiscal year 2008, we are implementing a monthly financial performance metric for tracking and reducing improper payments by program, which will include commercial (contract and vendor) payments. This metric will demonstrate our progress in reducing improper payments Department-wide and allow management to closely monitor progress and take prompt corrective actions as needed. Making maximum use of the data gathered to determine improper payment causes, developing appropriate solutions, and implementing improvements in controls and procedures, is inherent in achieving reductions in the improper payment measurements.

Renumbered  
as Recommendation 3.

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## **ANALYSIS OF REFUNDS AND THE RELATED PAYMENTS**

### **IMPROPER PAYMENTS**

Payments associated with the following refund appear to have been improper payments:

#### **Table 2, Item 4: Contract Administrative Error**

BAE Systems	\$23,983,615
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Contract financing payments were made in the form of performance-based payments (PBPs) in accordance with the terms of contract DAAE07-01-C-M016. The PBPs were paid out of specific contract line item numbers (CLINs) and accounting classification reference numbers. The contracting officer issued a modification changing the deliverables from one CLIN to another. The CLINs of the delivered items no longer matched the CLINs of the previously paid PBPs, and thus the contractor was paid the full amount of the delivered items, without reduction of previously paid PBPs. The payments causing this refund were "probably" improper payments within the meaning of the Improper Payments Information Act of 2002 (IPIA).

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### **NOT IMPROPER PAYMENTS**

Payments associated with the following refunds were for (1) costs paid provisionally and subsequently identified as unallowable, (2) contract financing payments, (3) price definitization or price adjustments, or (4) payments made due to a legal requirement to make the payment, subject to subsequent determinations that the payment was not due. The payments were correct at time they were made in accordance with contract terms. Therefore, they are not considered improper payments.

#### **Table 2, Item 1: Quarterly Limitation on Payments**

McDonnell Air & Missile Systems	\$34,105,000
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The Defense Finance and Accounting Service (DFAS) made contract financing payments based upon the terms and conditions of contract N00019-99-C-1226. This refund of those financing payments occurred as the result of the contractor complying with the Incentive Price Revision-Firm Target clause (Federal Acquisition Regulation (FAR) 52.216-16) in that contract. This clause requires the contractor to prepare a quarterly limitation on payments statement as prescribed in FAR 52.216-16(g), and if on any quarterly statement the amount under subdivision (g)(1)(iv) of the clause exceeds the sum due the contractor as computed in accordance with subdivisions (g)(1)(i), (ii), and (iii) of the clause, the contractor is to refund or credit the Government the amount of the excess. The objective of the quarterly limitation on payments statement is to keep negotiated billing prices during contract performance in-line with expected final prices until they are negotiated and settled. This quarterly process allows for computed excess contract financing payments to be recouped and excessive billing prices to be adjusted on a timely

Attachment 2: Page 1 of 6



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### **ANALYSIS OF REFUNDS AND THE RELATED PAYMENTS**

basis, when necessary. This refund was the result of a normal and very common contract administration activity and was not issued in satisfaction of an improper payment in accordance with the IPIA.

#### **Table 2, Item 3: Task Order Billing**

Kellogg Brown and Root (KBR) Inc

\$27,908,679

DFAS made interim contract financing payments as required by the Allowable Cost and Payment clause (FAR 52.216-7) contained in the contract DAAA09-02-D-0007 (LOGCAP III), Task Order 59. The contractor's requests for interim contract financing payments were provisionally approved by the Defense Contract Audit Agency (DCAA) under Defense Federal Acquisition Regulation Supplement (DFARS) 242.803(b)(i)(B). At the time costs are provisionally approved for payment, subject to later audit, the financing payment is correct. By its very nature, however, provisional approval recognizes that some of the underlying costs may be later adjusted, allocable to another task order, or disallowed by the contracting officer. A payment of provisionally approved costs is not an improper payment under IPIA when costs are later discovered to be allocable to a different task order. In this instance, the refund represented accrued Defense Base Act insurance premiums that were initially billed on Task Order 59, but were allocable and billed to the follow-on Task Order 89. The interim contract financing payments made on both cost-type task orders (59 and 89) are subject to final audit and closeout.

#### **Table 2, Item 5: Contract Modification, Change in Line Item Billing**

Bell Helicopter

\$19,871,708

This is a refund of interim contract financing payments made in accordance with the terms of contract N00019-00-C-0183. The refund was the result of subsequently issued contract modifications requiring the contractor to effectively re-bill costs to Navy lines of accounting (LOA), instead of Air Force LOA. These transactions occurred on the same contract, and were accomplished by the use of two separate public vouchers (Voucher 094 and 095) dated the same day. One voucher credited the Air Force LOA and the other billed the Navy LOA. This unified transaction was not a flow of obligations between the contractor and the Government, but was a realignment of prior disbursements to a different LOA. This refund is related to contract administration activities, and is not related to a prior improper payment within the meaning of the IPIA.

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## **ANALYSIS OF REFUNDS AND THE RELATED PAYMENTS**

### **Table 2, Item 6: Task Order Billing**

KBR Inc. \$17,494,180

DFAS made interim contract financing payments as required by the Allowable Cost and Payment clause (FAR 52.216-7) contained in the contract DAAA09-02-D-0007 (LOGCAP III), Task Order 36. The contractor's requests for interim contract financing payments were provisionally approved by DCAA under DFARS 242.803(b)(i)(B). At the time the costs are provisionally approved for payment, subject to later audit, the financing payment is correct, although by its very nature, provisional approval recognizes that some of the underlying costs may be later adjusted, allocable to another task order, or disallowed by the contracting officer. The refund resulted from a reconciliation performed by the contractor on billed amounts (based on in-country accounting records) to the contractor's official books of record for Task Order 36. The contractor claims it under-billed these costs on another task order, Task Order 27. An interim contract financing payment of provisionally approved costs is not an improper payment under IPIA when costs are later discovered to be allocable to a different task order. The interim contract financing payments on both cost-type task orders (36 and 27) are subject to final audit and closeout.

### **Table 2, Item 7: Contract Definitization**

Oshkosh Truck Corporation \$2,494,302

This refund of contract financing (performance-based) payments previously paid in accordance with the terms in contract M67854-04-D-5016, Delivery Order 0005, resulted from definitization of the contract. A definitization action is an agreement which converts an undefinitized contract action to a definitive contract. An undefinitized contract action is any contract action for which contract terms, specifications, or price is not agreed to prior to commencement of performance. During the period prior to definitization the contractor is entitled to interim payments as specified in the contract. If the definitive price is less than the tentative agreement while the contract is undefinitized, a refund may be due from the contractor to the Government. The original financing payments, made in accordance with contract terms, are not improper payments under the IPIA.

### **Table 2, Item 8: Contractor Cost Transfers**

Lockheed Martin \$18,383,853

Based upon a review of the underlying documentation associated with the refund, we believe the refund amount is overstated by approximately \$3 million. This amount is associated with the inclusion of contractor performed work during the billing period on the same voucher as the refund. This work is not associated with events causing the

Attachment 2: Page 3 of 6

### ANALYSIS OF REFUNDS AND THE RELATED PAYMENTS

refund, so we do not believe the \$3 million should have been included in the cited refund amount.

DFAS made interim contract financing payments as required by the Allowable Cost and Payment clause (FAR 52.216-7) contained in contract F33657-01-C-2095. The contractor's request for interim contract financing payments was provisionally approved by DCAA under DFARS 242.803(b)(i)(C). At the time the costs are provisionally approved for payment, subject to later audit, the financing payment is correct, although by its very nature, provisional approval recognizes that some of the underlying costs may be later adjusted.

The refund occurred as a result of two cost transfers made by Lockheed Martin within their accounting system, which adjusted the amount of interim financing payments previously billed as compared to the amounts provisionally paid. The cost transfers occurred subsequent to the proper payment of interim contract financing payments. An interim contract financing payment of provisionally approved costs is not an improper payment under IPIA when costs are later adjusted by the contractor.

#### Table 2, Item 10: Advance Agreement on Qui Tam Litigation Costs

Northrop Grumman

\$9,469,181

This refund resulted from the execution of a memorandum of agreement (MOA), dated September 19, 2005, between the Government and the contractor regarding costs incurred in defending a Qui Tam action. The associated payment closed out the litigation cost issue that remained following the resolution of the Qui Tam complaint on March 1, 2005, for litigation costs incurred between 1992 and the date of the MOA. FAR 31.205-47 states that the costs are unallowable if, as a result of the action, there is a finding of liability. At the time the costs were provisionally paid, there was no finding of liability. Thus, the payment was proper, or provisionally allowed, under DFARS 242.803(b)(i)(C) or the interim approval by DCAA under DFARS 242.803(b)(i)(B). Since the payments were proper when made, they were not improper payments in accordance with IPIA.

#### Table 2, Items 11, 12, 13, 19, and 20: Contract Definitization

KBR, Inc

Item 11	\$6,465,319
Item 12	\$5,945,718
Item 13	\$4,416,715
Item 19	\$1,815,192
Item 20	\$1,604,629

These refunds of interim contract financing payments, previously paid in accordance with the terms of contract DAAA09-02-D-0007, resulted from the definitization of various

Attachment 2: Page 4 of 6

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### **ANALYSIS OF REFUNDS AND THE RELATED PAYMENTS**

undefinitized task orders issued under the contract. A definitization action is an agreement which converts an undefinitized contract action to a definitive contract or order. An undefinitized contract action is any contract action for which contract terms, specifications, or price is not agreed to prior to commencement of performance. During the period prior to definitization, the contractor is entitled to reimbursement of costs as specified in the contract. If the definitive price is less than the tentative agreement while the contract is undefinitized, a refund may be due from the contractor to the Government. The original interim contract financing payments were made in accordance with contract terms and are not improper payments under the IPIA. The interim contract financing payments on these task orders are subject to final audit and closeout.

#### **Table 2, Item 14: Withhold of Payments Due to Timekeeping System Deficiencies**

The Titan Corporation	\$3,236,683
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This refund is for interim contract financing interim payments paid to the contractor in accordance with the Allowable Cost and Payment Clause (FAR 52.216-7) contained in contract DASDC01-99-D-0001. The refund resulted from a demand for payment issued by the Administrative Contracting Officer (ACO) as a payment withhold to protect the Government's interest until an internal control deficiency was satisfactorily corrected. After the contractor implemented corrective actions the ACO allowed the contractor to re-bill for the costs, and the contractor was paid back in January 2005.

The original contract financing interim payments made under this contract were provisionally approved by DCAA under DFARS 242.803. At the time the costs are provisionally approved for payment, subject to later audit, the financing payment is correct, although by its very nature, provisional approval recognizes that some of the underlying costs may be later adjusted or disallowed by the contracting officer. In this case, the interim contract financing payments previously made were retrieved by the Government and temporarily held until the contractor satisfied the ACO that deficiencies were corrected. An interim contract financing payment of provisionally approved costs is not an improper payment under IPIA, when costs are later held back to protect the Government's interest and then subsequently returned to the contractor. These interim financing payments are subject to a final audit and closeout.

### ANALYSIS OF REFUNDS AND THE RELATED PAYMENTS

**Table 2, Items 15, 16, 17, 18, 21, 22, and 23: Cost Adjustments**

KBR Inc	Item 15	\$2,755,290
	Item 16	\$2,262,158
	Item 17	\$1,905,081
	Item 18	\$1,876,759
	Item 21	\$1,386,447
	Item 22	\$1,158,354
	Item 23	\$1,075,081

These amounts are refunds of interim contract financing payments previously paid in accordance with the terms of contract DAAA09-02-D-0007. DFAS made the interim contract financing payments as required by the Allowable Cost and Payment clause (FAR 52.216-7) contained in the contract. The contractor's request for interim contract financing payments were provisionally approved by DCAA under DFARS 242.803(b)(1)(B). At the time the costs are provisionally approved for payment, subject to later audit, the financing payment is correct. By its very nature, however, provisional approval recognizes that some of the underlying costs may be later adjusted, allocable to other task orders, or disallowed by the contracting officer. These interim contract financing payments, based on provisionally approved costs in accordance with contract terms, are not improper payments under IPFA. The interim contract financing payments on these task orders are subject to final audit and closeout.



## **Team Members**

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# Inspector General Department of Defense

