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BY THE COMPTROLLER GENERAL

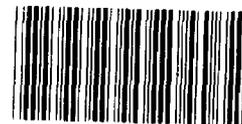
Report To The Congress

OF THE UNITED STATES

Defense's Accounting For Its Contracts Has Too Many Errors--Standardized Accounting Procedures Are Needed

For 9 years, the military services and Defense Contract Administration Services regions failed to implement effective and efficient standard procedures in contract accounting systems. Consequently, errors totaling millions of dollars were reported and recorded for contracts, and millions of dollars in unnecessary personnel and other costs were incurred due to duplication of accounting functions. The errors affected Defense's administrative control over funds and created problems in managing and accounting for foreign military sales.

GAO recommends ways to make Defense's contract accounting procedures more accurate.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report describes how the Defense Department's contract accounting is neither effective nor efficient.

We are sending copies of this report to the Director of the Office of Management and Budget and to the Secretaries of Defense, the Army, the Navy, and the Air Force.

Thomas A. Starks
Comptroller General
of the United States

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Contract administration

Cost overruns

Cost accounting standards compliance

Standards evaluation

Accounting in financial reporting

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Information system*

Federal agency contracting procedures

Department of Defense financial records contracts payment

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

DEFENSE'S ACCOUNTING FOR
ITS CONTRACTS HAS TOO MANY
ERRORS--STANDARDIZED
ACCOUNTING PROCEDURES ARE
NEEDED

D I G E S T

Nonstandard contract accounting procedures used by Defense components cause substantial errors in reporting, recording, and controlling contract financial data, and spending millions of dollars in unnecessary personnel and other costs due to duplication of accounting functions.

Because more than one Defense organization is usually involved in contract transactions, there is a need for standard accounting forms and codes so that (1) contract financial data can be communicated easily among the organizations and (2) each financial transaction can be manually put in mechanized form once, thus eliminating duplication of clerical effort at other organizations. (See pp. 1-2.)

The Military Standard Contract Administration Procedures for the financial control of contracts were to be implemented 9 years ago, but still have not been fully implemented by the military services and the Defense Contract Administration Services regions. Without these standard procedures, numerous errors are made by clerks in interpreting a variety of nonstandard forms, codes and financial transactions. (See pp. 5-8.)

The Defense Contract Administration Services regions were established in 1965 to administer most of Defense's contracts and to ensure that the unnecessary duplication of contract management functions was eliminated. As of March 30, 1979, the Contract Administration Services regions were administering about 250,000 contracts valued at \$73 billion and acting as the middle manager between the Government buyer and Defense contractor. About 45,000 of these contracts are financed by more than one appropriation. The military services, however, retained the responsibility for

procurement and management of congressional appropriations and foreign military sales.

FAILURE TO IMPLEMENT
STANDARD PROCEDURES

The Defense Department devised the Military Standard Contract Administration Procedures in 1966 to exchange contract administration data in automated form among the military services and Defense Contract Administration Services regions. GAO focused its review on the standard procedures which required uniform coding and processing of financial data, including

- abstracting key data from the contract in a standard automated format at the time the contract is initiated and
- reporting contract payment information in machine processible form to accounting organizations.

By 1970, all standard procedures were required to be operating in all pertinent Defense systems. However, Defense officials stated that the military services generally have not implemented the standard procedures because the military services could not see any direct benefits or savings for their operations. In 1977, apparently because the military services resisted implementing the standard procedures, Defense policymakers made implementation optional.

GAO believes that by implementing the standard procedures, the military services could obtain more accurate financial information for managing Defense procurement programs, and the Defense Department could reduce unnecessary duplication of some contract accounting operations.

INACCURATE FINANCIAL TRANSACTIONS
BEING PROCESSED

Too many errors are made in accounting for Defense contracts. From Defense contracts valued at over \$100,000 and financed by more than one appropriation, GAO randomly selected 26 contracts totaling about \$196 million. The

review was limited to these multifunded contracts to determine if accounting deficiencies cited by five Defense audits and studies of multifunded contracts had been corrected. (See p. 11.) Although the number of contracts selected was small, it entailed 856 financial transactions. GAO identified accounting errors of over \$90 million on 286 of the 856 transactions. (See pp. 6-8.) The high error rate GAO found together with deficiencies reported by Defense internal audit agencies indicate that the total dollar value of contract accounting errors is substantial.

The errors not only affected contract administration by the Contract Administration Services regions but also adversely affected the military services' administrative control over appropriated funds and created problems such as billing errors in managing and accounting for the foreign military sales program. (See pp. 6-8.)

DUPLICATION OF CONTRACT ACCOUNTING FUNCTIONS

By not using the Military Standard Contract Administration Procedures to process and exchange information in mechanized form (e.g., magnetic tape), some costly contract accounting functions were unnecessarily duplicated by the regions and the military services.

GAO visited 8 of the 48 Defense organizations that were heavily involved with contract management. GAO estimated that implementing standard procedures and eliminating duplicate operations at the 8 locations alone could reduce Defense costs by up to \$2.7 million annually. (See pp. 8-9.) For example, at two Contract Administration Services regions, 47 clerks (estimated salary of \$549,000), manually abstracted data from contracts. The contract data was also manually abstracted by each military service's purchasing office. If the standard procedures were implemented, the contract abstracting would be done only once manually, at the military service's purchasing office.

In addition to personnel costs, other substantial savings, such as those resulting from eliminating data recording equipment, would be available by implementing the standard procedures.

GAO recommends that the Secretary of Defense:

--Require the Defense Contract Administration Services regions to assure the accuracy of the financial transactions processed and sent to the military services.

--Require the implementation of the Military Standard Contract Administration Procedures in all Defense systems involved with contract accounting and management, and direct the Assistant Secretary of Defense (Comptroller) to require specific timetables from the military services on implementation dates for the Military Standard Contract Administration Procedures. The Comptroller also should actively monitor the implementation and require corrective action, when necessary, to ensure timely, effective implementation. (See p. 12.)

Defense concurred with GAO's recommendations. However, Defense questioned whether the financial transactions reviewed by GAO were representative of the numerous financial transactions in Defense contracts. GAO randomly selected a small number of Defense's most complex contracts because such contracts have the greatest potential for adverse impact due to errors. The number and dollar value of errors found should cause concern within Defense and should prompt it to take corrective action. (See pp. 12-14.)

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CHAPTER 1

INTRODUCTION

In 1965, The Secretary of Defense established the Defense Contract Administration Services to provide uniform field contract administration services for Department of Defense organizations. The Contract Administration Services was to eliminate duplication and overlap in contract management and provide a single face to industry for administration of defense contracts.

The Contract Administration Services consists of 9 regions with headquarters in Atlanta, Boston, Chicago, Cleveland, Dallas, Los Angeles, New York, Philadelphia, and St. Louis. These regions administer about 250,000 Defense contracts worth about \$73 billion as of March 31, 1979. About 45,000 of these contracts were financed by more than one appropriation. Each region is a middle manager between the military services and other buyers and the Defense contractor. Generally, the regions assist the military services in obtaining products of the right quality from industry at the contract price. These products range from torpedos, machine gun components, trucks, and jet engines to clothing and medicine.

DEVELOPMENT OF THE MILITARY STANDARD CONTRACT ADMINISTRATION PROCEDURES

In 1966, Defense designed the Military Standard Contract Administration Procedures to facilitate uniform contract administration throughout the Department. The procedures were to be implemented by the Contract Administration Services regions and the military services in all systems which manage and account for contracts. These procedures were established to simplify, standardize, and automate the processing of procurement, contract administration, and related logistics and financial data.

This standardization was to provide the basis for Defense organizations to design and implement compatible internal procedures for coding, transmitting, decoding, and using automated logistics information. The procedures were to reduce the flow of hard copy documents between contract administration organizations and other Defense organizations; permit uniform systems; ensure that the system of the contract administration offices provided the data needed by purchasing offices, inventory managers, program managers, and financial organizations; and assure a uniform data system which used resources most economically. Descriptions of two of the basic standard procedures follow.

Contract abstracting

The standard procedures require that contract data (quantities, prices, payment terms, and delivery dates) be abstracted from each contract when it is awarded. This data should be transmitted in machine processible form to the appropriate Contract Administration Services region to form the record from which the contract is administered. Thus, abstracting could eliminate recording contract data manually more than once--and, by automating the source data, reduce human error.

During the administration of the contracts, the Contract Administration Services region's data base should be electronically updated to reflect such things as contract modifications, shipments, and payments. Also, the data base should be used by the regions to prepare various status reports and other reports.

Contract payment notices

The contract payment notices should be the means by which the Contract Administration Services regions (acting as disbursing offices) report payment information in a machine processible form to the military services' accounting points.

CONTRACT ACCOUNTING RESPONSIBILITIES

The Contract Administration Services regions perform many functions. The regions' contract accounting responsibilities include insuring that appropriations cited as financing the contracts are not overdisbursed and that payments are made promptly. To preclude overdisbursements, the regions need accurate obligation data from the military services on each appropriation for each contract.

As payments are made, the regions report detailed payment accounting data to the military services' accounting points. The military services must match the payments with the obligations to effectively fulfill administrative control over appropriated funds as required by the Anti-Deficiency Act (31 U.S.C. 665). Matching payments with obligations provides the military services with the status of program expenditures to help program managers make decisions.

CHAPTER 2

DEFENSE FAILS TO IMPLEMENT EFFECTIVE

CONTRACT ACCOUNTING PROCEDURES

Defense failed to implement effective and efficient procedures in contract accounting systems used by the Contract Administration Services regions and the military services to process contract obligation and disbursement transactions. Since 1966, Defense has spent millions of dollars attempting to implement the Military Standard Contract Administration Procedures to exchange and process contract administration data among the systems that account for contracts. After 13 years, the standard procedures have not been fully implemented in the Contract Administration Services' system and the military services' systems.

Further, in 1977, Defense, apparently because of resistance by the military services, made implementation of the standard procedures optional. Since the standard procedures have not been implemented, financial transactions are manually processed and recorded by the regions and the military services. As a result, obligations and disbursements are, because of clerical errors, inaccurately processed among the systems that account for Defense's appropriations and the foreign military sales program.

Defense is making too many errors in accounting for contracts. We randomly selected and reviewed 26 contracts totaling \$196 million, each valued at over \$100,000 and financed by more than one appropriation, to determine if accounting deficiencies identified in five Defense audits and studies of multifunded contracts had been corrected. While the number of contracts selected was small, there were 856 financial transactions on these contracts and we identified accounting errors totaling over \$90 million on 286 of the 856 transactions. Considering the high error rate and the deficiencies reported by Defense internal audit agencies, we believe the total dollar value of errors in the system is substantial. These errors adversely affect administrative control over billions of dollars the military services are appropriated annually and create problems in accounting for foreign military sales. Also, the military services' internal audit agencies have identified several problems concerning Contract Administration Services regions' processing of financial data.

Not implementing the standard procedures also has caused unnecessary duplication in some accounting operations in the Contract Administration Services regions and in the military services. We estimated that up to \$2.7 million could be saved

annually by implementing the standard procedures and eliminating the unnecessary duplication of several accounting operations.

ACCOUNTING RESPONSIBILITIES
OF FEDERAL AGENCIES

The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 66, 66a), places responsibility for establishing and maintaining adequate systems of accounting and internal control upon the head of each executive agency. The systems must conform to the accounting principles, standards, and related requirements prescribed by the Comptroller General in our Policy and Procedures Manual for Guidance of Federal Agencies.

Effective accounting is an important part of any organization's internal management control system. Accounting records and reports must provide reliable financial information for managements' use. Since effective accounting contributes significantly to attaining internal control objectives, an agency's accounting system should be designed to cover a number of internal control requirements. These requirements include devising systems that will (1) comply with legal and other requirements, (2) properly account for all financial transactions, and (3) promptly provide accurate and reliable financial data to management.

One important legal provision is in the Anti-Deficiency Act (31 U.S.C. 665(g)) which requires that each agency have a control system to restrict obligations or expenditures to the amounts appropriated. To accomplish this, each accounting system should provide information and controls to ensure that (1) funds are used for only authorized purposes and (2) obligations and expenditures do not exceed the amounts authorized.

Another specific legal requirement is related to the Foreign Military Sales Act (22 U.S.C. 2762(a)). Accurate disbursement data is necessary for cash forecasts to fulfill the Act's requirements that foreign countries make payments in advance of when payments are due Defense contractors. To comply with this law, Defense requires cash deposits in the foreign military sales trust fund before delivery, performance, or progress payments to contractors. To ensure that enough money is on deposit in the foreign military sales purchasers' accounts for these advance payments, the military services must forecast cash expenditure requirements and continually update the forecasts when disbursements are made from the customers' funds. The forecasts are contingent on the military services receiving accurate disbursement data.

FAILURE TO IMPLEMENT STANDARD
PROCEDURES FOR FINANCIAL
TRANSACTIONS ON CONTRACTS

For 13 years, Defense has attempted to implement the Military Standard Contract Administration Procedures in all systems which managed and accounted for contracts. However, after spending several million dollars, the standard procedures still have not been implemented fully. Consequently, the processing of contracts' financial data by the military services and Contract Administration Services regions is highly ineffective and inefficient.

While the standard procedures were procurement- and logistics-oriented, much of the data to be exchanged and processed was accounting information that affected the financial operations of the contracting organization. The standard procedures would have standardized the coding and processing of financial transactions to provide more timely and reliable accounting information for the military services' financial and program managers.

The standard procedures were established in December 1966 and were mandatory for use by Defense organizations for all contracts administered by the Contract Administration Services regions. Partial implementation began in September 1967 with full implementation initially set for July 1970. Defense officials stated that they did not know the cost of attempting to implement the standard procedures, but several officials said the cost exceeded several million dollars.

Some aspects of the standard procedures have been implemented by the military services. For instance, the Army's commodity commands and the Air Force Systems Command use the contract abstracting procedures and are preliminarily testing the use of contract payment notices through the standard procedures with Contract Administration Services regions.

Defense officials stated that the military services did not implement most of the procedures because the military services could not see any benefit or savings to their operations. The military services, however, could not show us any cost benefit studies on the desirability of implementing the procedures.

Subsequently, Defense Logistics Agency officials informed us that their centers (which are similar to military service operations) had been using the standard procedures about 3 years. They found that the procedures saved the centers and the Contract Administration Services regions considerable manual work. The regions could mechanically establish the

contract data base from the contract abstract while the centers could mechanically post disbursements to records from the contract payment notices.

Apparently, because the military services resisted implementing the standard procedures, Defense policymakers made implementation optional in December 1977.

INACCURATE TRANSACTIONS PROCESSED

The need to improve accounting for Defense contracts was apparent from our tests of 856 financial transactions. We selected 26 contracts totaling \$196 million, each valued at over \$100,000 and each financed by more than one appropriation. We identified 286 transactions with over \$90 million of accounting errors made by the Contract Administration Services regions. The errors consisted of

--\$8.8 million in obligations that were erroneously recorded or not recorded by the Contract Administration Services regions and

--\$82.8 million in disbursements for delivered items and progress payments charged to the wrong appropriations and wrong foreign customers by the Contract Administration Services regions.

These errors could have adversely affected the military services' administrative control over appropriated funds by precluding the services from accurately reporting the status of funds. The errors also created problems in accounting for foreign military sales by disbursing the wrong customers' funds.

Obligations recorded erroneously

The Contract Administration Services regions omitted or erroneously recorded obligations of \$8.8 million on nine contracts. It is important that the regions record accurate obligation data for each contract because a region's records are used to preclude overdisbursement.

The military services prepare the contracts including citing the appropriations financing the contracts and amounts obligated for each appropriation. Next, the military services record the obligation data in their accounting systems when abstracting it from the hard copy contract. Then, the services send the contracts to the Contract Administration Services regions to administer. The regions manually abstract

the data for administration including the appropriations cited and obligation data. This procedure at the regions results in inevitable clerical errors in transcribing data manually. In addition, the regional clerks err in recording the obligation data because the contract obligation documents were not prepared in a standard or consistent format by the military services.

For the Contract Administration Services regions to accurately determine the obligation data for their systems, clerks would have to do a detailed, time-consuming review and analysis. Even if sufficient clerks were available, they would need extensive knowledge of contractual documents and aspects of the military services' accounting systems to decipher what to record as an obligation. Under the standard procedures, the pertinent contract data, including obligation data, would be abstracted only once manually. The military services' purchasing offices would do this--and prepare the data for automatic recording in the regions' system--when the contract was initiated. This would preclude the regions' problems of recording obligations accurately by eliminating the manual abstracting and recording of contract data.

Disbursements charged erroneously

For the 26 contracts we reviewed at the Cleveland and Philadelphia regions, the regions charged \$82.8 million in disbursements for delivered items and progress payments to wrong appropriations and/or to wrong foreign customers. Charging disbursements to wrong appropriations could adversely affect administrative control over funds and charging wrong foreign customers could result in erroneous billings to foreign customers.

When making a contract payment, a region cites the appropriation to charge. The military service then uses that data to liquidate the corresponding obligation. When only one appropriation finances a contract, this procedure is no problem. However, when more than one appropriation finances a contract, the regions frequently err by charging one appropriation for items which should be charged to other appropriations.

To insure that the proper appropriation and customer is charged, the regional clerks would have to manually perform detailed, time-consuming evaluations of the contracts to identify the correct appropriation to charge. These evaluations would require extensive knowledge of contracts and the military services' accounting systems, which the regional clerks generally did not have. Implementation of the standard procedures for payments would alleviate this problem.

Examples of disbursements being charged to wrong appropriations and to the wrong customers follow:

- On a \$50.6 million contract, 55 payments totaling \$32 million were charged to the wrong appropriations. Army appropriations were charged for 21 of these payments (\$8.1 million) which should have been billed to foreign customers. After a detailed reconciliation by the Army, \$8.1 million was identified as charges to foreign customers, and the errors were corrected.
- On a \$1.7 million contract, 30 disbursements totaling \$1.2 million were charged to the wrong appropriations and 8 payments totaling \$874,200 were charged to the wrong foreign customers. The 8 payments affected 14 foreign customers, with payments being made from one country's funds while deliveries were made to a different country.
- On a \$5.6 million contract, \$372,500 in items were delivered to a foreign customer, but a Contract Administration Services region cited Navy appropriations in making the payments.
- On an electronics contract, \$194,000 in progress payments were charged to an Army appropriation. When deliveries valued at \$158,000 were made from the contractor's plant to the Army and to a foreign country, only the Army was charged for the items. About 3 months later, the Army, which should only have been charged \$48,000, found the error and corrected it.

Under the standard procedures, the scheduled delivery dates for contract items would be included in the regions' system. The system would check the deliveries with the delivery schedule and provide the correct appropriation to charge for the payment. By correlating the payments and deliveries in the system, the regions would be able to more accurately charge the disbursements to the appropriations.

COSTLY DUPLICATION IN CONTRACT ACCOUNTING

Defense's current, nonstandard procedures for processing financial transactions among the military services and Contract Administration Services regions contract accounting system results in costly duplication. The Contract Administration Services regions were established in 1965 to eliminate the overlap of contract management functions. Using the standard procedures, Defense could meet this objective in processing contract accounting data.

At eight of the 48 Defense organizations heavily involved in contract management, we reviewed two standard procedures--contract abstracting and contract payment notices--and determined that implementation of these two mechanized processes could save Defense at least \$2.7 million in personnel costs annually. Substantial additional savings probably could be realized at the other Defense organizations involved in contract accounting.

Duplication of contract abstracting

Contract abstracting was being unnecessarily duplicated at two regions and at four military services' organizations at a cost of about \$1.3 million annually.

Under present, nonstandard procedures, a military service's purchasing office manually abstracts data from the contract when the contract is initiated. Copies of the contract are sent to the military service's accounting points and to the regions where data is manually abstracted for key punching and recording in their respective accounting systems.

If the standard procedures were employed, the manual abstracting effort at the regions and accounting points would be eliminated because the purchasing office would prepare and send these organizations contract abstracts in mechanized form suitable for input into their systems.

By implementing the standard procedures for contract abstracting at six organizations we visited, the following savings could be made:

	<u>Number of organizations</u>	<u>Clerical jobs that could be eliminated</u>	<u>Annual savings</u>
Contract Administration Services regions	2	47	\$ 549,000
Army	3	52	637,000
Air Force	<u>1</u>	<u>8</u>	<u>100,000</u>
	<u>6</u>	<u>107</u>	<u>\$1,286,000</u>

More could be saved by eliminating the equipment these clerks use to abstract the data from the contracts and record the data in the system. A recent cost study performed by Defense at the Los Angeles Defense Contract Administration Services

region identified reductions available by implementing standard procedures for contract abstracting of 16 clerks and 18 input machines. Eliminating the need for the 18 machines would save about \$510,000 annually.

Duplication of contract
payment procedures

By not using the standard procedures for contract payments, all six military service organizations reviewed duplicated the Contract Administration Services regions accounting for contract payments. The duplication primarily consisted of (1) military services reviewing each payment for the appropriations charged and (2) the data on contract payments being manually keypunched and recorded by the military services. We estimated annual personnel savings of \$1.4 million from implementing the standard procedures for contract payments at the six locations.

Under the present, nonstandard system, when making contract payments, the regions charge the payments to appropriations cited on the contracts. The payment data is manually recorded in the regions' system and then sent to the pertinent military service organization, where the data is manually recorded in the organization's system. Under the standard system, the regions would record payments in mechanized form which could, then be used by the military services for their systems, thereby eliminating manual duplication of the regions' work.

In addition to manually recording the payment data, the Army was reviewing in detail, each payment made by the regions to insure that the appropriations were correctly charged and that the Army made adjustments based on the review. For example, at one commodity command, 11 clerks work full time reviewing contract payments made by the regions. However, this process also created some errors and did not catch all the errors made by the regions. The standard procedures would process the payments in a standard format and enable more accurate citations of appropriations by using delivery schedule data already in the regions' system.

Other savings also could be realized by implementing the standard procedures for contract payments. Under present procedures, the regions must prepare 17 different payment reports for the military services (the Army requires eight reports, the Navy three, and the Air Force six), which cannot be generated from the standard procedures. Under the standard procedures, the regions would prepare only the standard reports.

We were unable to estimate the cost of preparing the 17 reports, but with computer processing time involved in preparing each report, we believe significant savings would accrue to Defense through standardization.

RECOGNITION BY THE MILITARY
SERVICES OF CONTRACT
ACCOUNTING PROBLEMS

Over the past few years, the military services identified problems in contract accounting which implementation of the standard procedures would help rectify.

- In 1977, the Air Force Audit Agency reported that there were long delays at Air Force accounting stations in recording contract payments made by the regions. This distorted the status of appropriated funds and hindered monthly reconciliation of accounts.
- A 1978 Naval Audit Service report identified large discrepancies between obligations recorded by the regions and recorded in the Navy's procurement accounting and reporting system on contracts. These differences did not surface because the Navy failed to periodically reconcile the regions' data with its own records.
- A Navy comptroller memorandum of December 1976 discussed management problems with the foreign military sales program which resulted from progress payments being charged to the wrong contract fund citations.
- In 1975, the Army identified serious problems with the financial management of its procurement appropriations, which resulted in overobligations of \$225 million. A contributing factor was that disbursements made by the regions were charged to wrong accounts thus affecting the status of the procurement appropriations.
- The Defense Audit Service and Naval Audit Service collaborated on a review of Navy contracts financed by two fiscal 1976 appropriations and identified about \$4.6 million of obligation and disbursement discrepancies between Navy records and the regions' records.

The standard procedures would have alleviated these problems through the use of uniform coding and processing of the financial data.

CHAPTER 3

CONCLUSIONS, RECOMMENDATIONS, AGENCY COMMENTS AND OUR EVALUATION

CONCLUSIONS

Defense failed to implement effective and efficient procedures for processing contract accounting transactions. As a result, the inaccurate financial data processed by the various contract accounting systems may adversely affect administrative control over appropriated funds and management of the foreign military sales program. Also, contract accounting functions are unnecessarily duplicated at substantial costs to Defense.

RECOMMENDATIONS

GAO recommends that the Secretary of Defense:

- Require the Defense Contract Administration Services regions to assure the accuracy of the financial transactions processed and sent to the military services.
- Require the implementation of the Military Standard Contract Administration Procedures in all Defense systems involved with contract accounting and management; and, direct the Assistant Secretary of Defense (Comptroller) to require specific timetables from the military services on implementation dates for the Military Standard Contract Administration Procedures. The Comptroller also should actively monitor the implementation and require corrective action, when necessary, to ensure timely, effective implementation.

AGENCY COMMENTS AND OUR EVALUATION

In a November 15, 1979, letter (App. I), the Assistant Secretary of Defense (Comptroller) concurred with each of our recommendations, but added that:

"We find that the draft report does not support the conclusions highlighted by the title and the comments on page 5. While it is a matter of judgment as to what constitutes 'too many errors,' the GAO sample is not an adequate basis for projecting the amount of errors in accounting to all contracts. Further, you do not state the causes of the errors you did find, so it is not certain that standardized automated procedures would prevent recurrence."

"While standardization and automation should reduce errors, they cannot eliminate the clerical errors described in the report. You also overestimate the potential savings that may occur under full implementation of MILSCAP [Military Contract Administration Procedures]. The Defense Contract Administration Services Regions are expected to continue to have responsibilities for negotiating contract modifications. This means the Regions will need to continue the manual abstracting and inputting of contract data. Therefore, the estimated savings should not be based upon complete elimination of abstracting and inputting contract data at the Regions.

"The sample is biased. Your audit covered only 26 of the some 250,000 contracts administered by the Defense Contract Administration Services Regions (DCASRs). Further, the 26 audited were among the most complex, multi-appropriation funded contracts. Of the \$90 million cited as errors in accounting, \$32 million represents clerical errors on one contract. Additionally, as indicated on pages IV of summary [deleted from final report] and 8 of the report and, subsequently confirmed by GAO personnel, these clerical errors were discovered and reconciled by the Army prior to or during the GAO review, which indicates that the system does provide the capability to detect clerical errors. Finally, the errors occurred in 1976 and 1977 but no mention is made of improvements made to systems since then. Several such improvements are outlined in the enclosure to this letter."

The sample was randomly selected from among the most complex contracts because such contracts have the greatest potential for adverse impact due to errors. Even though we looked at a relatively small number of contracts, our sample was sufficient to test the effectiveness of contract administration procedures and processes which should be designed to adequately handle the most complex contracts. The large number and dollar value of the errors made in administering these contracts should cause concern within Defense and should prompt it to take corrective action.

Furthermore, while we recognize that the Army did catch some of the errors through extensive manual checking, most errors went undetected. Moreover, it should be noted that effective, efficient accounting systems should not need extensive manual efforts to identify and correct errors.

Finally, we believe our report does adequately set out the causes of the errors. (See pp. 6-8.)

Improvements made by Defense since the transactions mentioned in our report were processed have been commented on in the appropriate sections of the report.

CHAPTER 4

SCOPE OF REVIEW

We reviewed the procedures and systems for recording, reporting, and controlling financial transactions on Defense contracts. Our review included examining legislation, policies, procedures, documents, and transactions dealing with contract accounting. We interviewed responsible officials to discuss policies, operating procedures, and related matters. Also, we considered information from a number of our previous reviews on implementation of accounting policies and procedures.

We made our review at the following departments and organizations:

- Headquarters, Departments of Defense, the Army, the Navy, and the Air Force; Washington, D.C.
- Headquarters, Defense Logistics Agency; Washington, D.C.
- U.S. Army Tank-Automotive Readiness Command; Warren, Michigan.
- U.S. Army Missile Readiness Command; Huntsville, Alabama.
- U.S. Army Electronics Command; Ft. Monmouth, New Jersey.
- U.S. Navy International Logistics Command; Philadelphia, Pennsylvania.
- Aviation Supply Office; Philadelphia, Pennsylvania.
- Air Force Systems Division; Dayton, Ohio.
- Defense Contract Administration Services Region; Cleveland, Ohio.
- Defense Contract Administration Services Region; Philadelphia, Pennsylvania.



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

15 JUL 1979

COMPTROLLER

Mr. D. L. Scantlebury
Director, Division of Financial
and General Management Studies
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Scantlebury:

This is in reply to your letter to the Secretary of Defense dated July 26, 1979, regarding the GAO draft report, "Defense's Accounting for its Contracts has too many Errors—Standardized Accounting Procedures are Needed" (OSD Case #5238).

We find that the draft report does not support the conclusions highlighted by the title and the comments on page 5. While it is a matter of judgment as to what constitutes "too many errors," the GAO sample is not an adequate basis for projecting the amount of errors in accounting to all contracts. Further, you do not state the causes of the errors you did find, so it is not certain that standardized automated procedures would prevent recurrence. While standardization and automation should reduce errors, they cannot eliminate the clerical errors described in the report. You also overestimate the potential savings that may occur under full implementation of MILSCAP. The Defense Contract Administration Services Regions are expected to continue to have responsibilities for negotiating contract modifications. This means the Regions will need to continue the manual abstracting and inputting of contract data. Therefore, the estimated savings should not be based upon complete elimination of abstracting and inputting contract data at the Regions.

The sample is biased. Your audit covered only 26 of the some 250,000 contracts administered by the Defense Contract Administration Services Regions (DCASRs). Further, the 26 audited were among the most complex, multi-appropriation funded contracts. Of the \$90 million cited as errors in accounting, \$32 million represents clerical errors on one contract. Additionally, as indicated on pages IV of the summary and 8 of the report, and subsequently confirmed by GAO personnel, these clerical errors were discovered and reconciled by the Army prior to or during the GAO review, which indicates that the system does provide the capability to detect clerical errors. Finally, the errors occurred in 1976 and 1977 but no mention is made of improvements made to systems since then. Several such improvements are outlined in the enclosure to this letter.

In Chapter 3 the report is expanded from the subject of the audit to a general discussion which recounts once again previous GAO audit reports regarding

accounting systems for depot maintenance, Foreign Military Sales pricing and accounting policies, and the Army's procurement appropriation accounting system. Without any substantive review of the current situation, the report concludes that OSD has failed to assure that the DoD Components implement accounting policies. This is not only irrelevant to the subject audited, but a sweeping indictment which is not constructive. Either DoD actions on the cited reports should be recognized and included in the report, or Chapter 3 should be eliminated. (See GAO Note.)

The enclosure sets forth our specific response to each recommendation.

Sincerely,



Enclosure

Fred P. Wacker
Assistant Secretary of Defense

GAO Note: Discussion of implementation of Defense accounting policies, in general, has been deleted from this report along with the related recommendation for Defense to establish milestones for and actively monitor implementation of prescribed accounting policies and procedures. A comprehensive review is underway which will more fully evaluate the planning and implementation of Defense accounting systems.

GAO Recommendation

The Secretary of Defense should direct the Assistant Secretary of Defense (Comptroller) to require specific timetables from the Military Services on implementation dates for prescribed accounting policies and procedures. The Comptroller should also actively monitor the implementation of the policies and procedure and require corrective action when necessary to insure timely, effective implementation by the Military Services.

OSD Comment

The OASD(C) does actively monitor implementation of policies and procedures. Although the Military Services are required to implement accounting policies and procedures as prescribed in our directives, the time required to do so varies for each Military Service due to individual problems, circumstances, and resource constraints. Timetables are required.

GAO Recommendation

The Secretary of Defense should require the Defense Contract Administration Services Regions to assure the accuracy of financial transactions processed and sent to the Military Services.

OSD Comment

Concur. This appears to be inherent in the responsibilities assigned to the Regions. Continued attention is paid to this area and a quality assurance program is in place. The program is used to determine the causes of errors and to develop training courses to help eliminate the causes.

Some specific examples of actions taken follow. In 1978 the Defense Logistics Agency (DLA) and the Army established a Direct Procurement Request Order Number/Accounting Classification Reference Number/Contract Line Item Number relationship to assure correct disbursement and reporting of Army appropriations. Also, DLA implemented a quality assurance program to monitor the accuracy and timeliness of the contract administration system used by the DCASRs. This program is used to determine the causes of errors and the need for additional training to eliminate them. Further, a uniform contract format, standard contract forms and a uniform contract line item numbering system were prescribed, all of which aid in avoiding errors.

GAO Recommendation

The Secretary of Defense should require the implementation of the Military Standard Contract Administration Procedures (MILSCAP) in all Defense systems involved with contract accounting and management.

OSD Response

Concur. Implementation of the Military Standard Contract Administration Procedures (MILSCAP) is currently required whenever contract related data are to be exchanged on an automated basis. However, where automated capabilities

are not in place, manual procedures are still necessary. Action will be initiated to accelerate implementation, to require expanded reporting of implementation schedules and to improve monitoring of system performance. The Systems Administrator for MILSCAP has established a program for its phased implementation based on current capabilities and needs. In coordination with the Components, the Administrator will accelerate efforts to achieve the objectives of full MILSCAP implementation.

The status of MILSCAP implementation is:

MILSCAP has been implemented by the Defense Logistics Agency for about three years. The Army has implemented most of the segments and has a time-phased plan for implementing the remaining segments. The Air Force Systems Command (AFSC) has achieved substantial progress in terms of contract abstracting and automated transmission of abstract data. The Air Force Logistics Command (AFLC) has considered MILSCAP in its overall plan for the implementation of all its automatic data processing systems. The Navy implementation of MILSCAP has been minimal because, generally, its activities (including accounting and disbursing activities) involved in the acquisition process cannot, at present, use all the MILSCAP segments advantageously. However, the Naval Electronics Systems Command has been testing the contract abstract segment with DCASRs. A cost-benefit analysis for contract abstracts is being prepared and should be completed in six months. The results of this analysis will be used by the Navy in further implementation of MILSCAP, consistent with the resource availability. The Navy is developing the conceptual design for a major financial management improvement program. The design of the system will include MILSCAP requirements together with other improvements.

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