Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE FINANCE AND ACCOUNTING SERVICE ADMINISTRATION OF UNIT COSTS

Report No. 97-035 November 29, 1996

Department of Defense

Additional Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

DAO	Defense Accounting Office
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
OPLOC	Operating Location

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

November 29, 1996

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Defense Finance and Accounting Service Administration of Unit Costs (Report No. 97-035)

We are providing this final report for your information and use. This is the fourth and final report in a series of audit reports resulting from our "Audit of Defense Finance and Accounting Service Administration of Unit Cost Rates." We considered management comments on the draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3. Therefore, no additional response is necessary.

We appreciate the courtesies extended to the audit staff. Questions on this audit should be directed to Mr. James L. Kornides, Audit Program Director, or Mr. John K. Issel, Audit Project Manager, at (614) 751-1400. See Appendix E for the report distribution. Audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-035 **November 29, 1996**
(Project No. 5FJ-2010.03)

Audit of Defense Finance and Accounting Service Administration of Unit Costs

Executive Summary

Introduction. This is the fourth in a series of reports resulting from our "Audit of the Defense Finance and Accounting Service Administration of Unit Cost Rates." As part of the Defense Business Operations Fund, the Defense Finance and Accounting Service (DFAS) must recover all operating costs by charging fees or cost recovery rates to its customers for providing goods and services. DFAS charges operating costs to its customers based on counts (that is, work load counts) of products or outputs produced.

Audit Objectives. We conducted this part of our audit to find out whether unit costs for goods and services provided by DFAS were determined in accordance with DoD policies and based on actual costs incurred. In addition, we evaluated management controls over the accumulation of costs and work load data. To accomplish our objective, we reviewed selected aspects of unit cost administration at DFAS Headquarters and at each of the five major DFAS centers. We also judgmentally selected nine DFAS subordinate organizations (including Operating Locations and Defense Accounting Offices) for review. We selected 2 of the 16 DFAS outputs for the review, Commercial Invoices Paid (Output 9) and Monthly Trial Balances Maintained (Output 11). We examined those outputs because they made up $814 million, or 49 percent, of the $1.7 billion operating costs that were passed on to DFAS customers during FY 1995. In addition, because of concerns about billing for precertified travel vouchers at the DFAS Indianapolis Center, we performed a limited review of the precertified travel and precertified commercial invoice billing process at the DFAS Denver and Indianapolis Centers only. During FY 1995, the Travel Vouchers Paid output (Output 7) operating costs were $88 million, or another 5 percent of DFAS total costs.

Audit Results. DFAS made significant progress toward ensuring that unit costs for goods and services were determined in accordance with DoD policies. DFAS established 16 output products defining its major services and implemented a Resource Analysis Decision Support System to trace the costs of providing its products to customers. However, at the 15 DFAS organizations we reviewed, selected aspects of unit cost administration needed improvement. The organizations we reviewed did not accumulate accurate work load counts, charge appropriate outputs for personnel costs, and price output products based on the level of work or costs required to provide the output.

As a result, in the sampled areas at 15 DFAS organizations, customers were underbilled by $2.5 million and overbilled by $6 million for work performed, and personnel costs of $3.8 million were charged to incorrect outputs.

The deficiencies we identified could be expected during the extensive reorganization and consolidation of DoD accounting offices under the DFAS. Also, the problems may not appear overly significant in light of DFAS total operating costs of $1.7 billion. However, we believe that additional emphasis in these areas is warranted.

The DFAS Management Control Program needs improvement because of the weaknesses we identified relating to controls over the accuracy of costs billed to customers at the organizations included in our review. We believe that the errors disclosed at the 15 organizations may indicate systemic problems in the administration of unit costs at other DFAS organizations.

Recommendations in this report, if implemented, should result in charges for services that more accurately reflect the costs incurred by DFAS to produce an output. See Part I for a discussion of the audit results and Appendix C for a summary of the problems identified at each organization included in our review.

Summary of Recommendations. We recommend that DFAS require its centers to certify completion of required personnel cost account code reviews and establish separate outputs for precertified travel voucher and commercial invoice work loads.

Management Comments. The Director of Revolving Funds, Office of the Under Secretary of Defense (Comptroller), and the Deputy Director for Resource Management, Defense Finance and Accounting Service, generally concurred with the finding and each of the recommendations. The Deputy Director for Resource Management, Defense Finance and Accounting Service, stated that he had begun corrective action to obtain quarterly validation of cost account codes, conduct quarterly personnel mapping reviews, perform quarterly queries of the personnel data base to ensure personnel data are not duplicated, and collect work counts (including counts of precertified invoices and precertified travel vouchers) for use in the possible establishment of separate billing rates in FY 1998. See Part I for a summary of management comments and Part III for the complete text.

Audit Response. The actions taken by the Defense Finance and Accounting Service satisfy the intent of the recommendations. We have also modified the report where appropriate based on general comments provided by the Defense Finance and Accounting Service. Additional comments are not required.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objectives 2
Administration of Unit Costs 3

Part II - Additional Information

Appendix A. Scope and Methodology
Scope and Methodology 12
Management Control Program 13
Prior Audits and Other Reviews 13
Appendix B. DFAS Work Outputs 15
Appendix C. Results at Organizations Reviewed 17
Appendix D. Organizations Visited or Contacted 18
Appendix E. Report Distribution 19

Part III - Management Comments

Under Secretary of Defense (Comptroller) Comments 22
Defense Finance and Accounting Service Comments 23

Part I - Audit Results

Audit Background

Since assuming responsibility for DoD finance and accounting organizations and the existing accounting offices, the Defense Finance and Accounting Service (DFAS) has been in the process of reorganizing. DFAS organizational plans consist of a Headquarters element in Washington, D.C.; 5 major Centers (located in Cleveland and Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri); and 21 Operating Locations (OPLOCs) that will be aligned under the Centers. The reorganization is not yet complete; therefore, DFAS still operates about 200 of the smaller accounting offices, called Defense Accounting Offices (DAOs). Each of the DAOs report to and is under the responsibility of one of the DFAS Centers. DFAS total operating costs during FY 1995 were $1.7 billion. As part of the Defense Business Operations Fund (DBOF), the DFAS must recover all operating costs by charging fees or cost recovery rates to its customers for providing goods and services. DFAS charges operating costs to its customers based on counts (that is, work load counts) of products or outputs produced.

Audit Objectives

For this part of the audit, we determined whether unit costs for goods and services provided by DFAS were:

- determined in accordance with DoD policies, and
- based on actual costs incurred.

In addition, we evaluated the management controls over the accumulation of unit cost data and work load counting.

See Part II, Appendix A, for a complete discussion of audit scope and methodology, management control program, and prior audit coverage.

Administration of Unit Costs

DFAS made significant progress in ensuring that unit costs for goods and services were determined in accordance with DoD policies. However, the DFAS organizations we reviewed could improve certain aspects of their administration of unit costs. These DFAS organizations did not accumulate accurate work load count data, charge appropriate outputs for the costs of their personnel, and price output products based on the level of work or costs required to provide the output. The deficiencies identified at the limited number of DFAS organizations that we reviewed resulted in DFAS both undercharging ($2.5 million) and overcharging ($6 million) customers for work performed. These organizations also charged $3.8 million of personnel costs to incorrect output products. Because of the limited scope of our review, these results are not projectable to other DFAS organizations or outputs, and consequently, may not appear overly significant in comparison to DFAS total operating costs of $1.7 billion. In addition, the problems we identified could be expected to occur during the type of accounting office consolidation that DFAS was managing. However, these problems still warrant DFAS attention as it continues its reorganization.

DFAS Progress and the Unit Cost Process

DFAS made significant progress toward ensuring that unit costs for goods and services were determined in accordance with DoD policies through the measures discussed below.

Unit Cost Policy. DFAS established policy and procedures for unit costing in DFAS Regulation 7045.17-R, "The Defense Finance and Accounting Service (DFAS) Administration of Unit Cost," April 1993. DFAS policy requires that all costs incurred by an organization be related to an output (that is, a product) of that organization. Each output should sustain the most accurate cost possible.

Cost Tracking System. To aid its finance and accounting organizations in tracking costs, DFAS implemented the Resource Analysis Decision Support System. This system was designed to accurately trace the cost (such as personnel cost) incurred to provide output products to DFAS customers.

Cost Account Codes. DFAS also instituted the use of cost account codes. Cost account codes are used to identify, assign, and accumulate all costs to appropriate outputs. In addition to identifying the total costs incurred to produce specific outputs, having accurate counts of the number (work load counts) of outputs to customers is essential for determining unit costs. Total work load counts divided into total costs determines the unit costs.

Output Products. In accordance with DoD policies, DFAS established 16 output categories defining the major services provided to customers. During

the audit, we reviewed the accuracy of unit costs and work load counts for 3 of the 16 outputs: Commercial Invoices Paid, Travel Vouchers Paid, and Monthly Trial Balances Maintained. Those outputs accounted for more than 50 percent of the operating costs passed on to DFAS customers. A list of the 16 outputs and a description of the 3 outputs that we reviewed are in Appendix B.

Accuracy of Work Load Count Data

The DFAS organizations that we reviewed could improve certain aspects of their administration of unit cost. The DFAS organizations did not accumulate accurate unit cost data. Three of the 15 DFAS organizations that we reviewed were not accumulating accurate work load count data. Those organizations understated work load count data and did not bill customers for $2.1 million of work performed. (Another $0.4 million of undercharges for precertified work load is discussed later in this report.) Additionally, one organization was overstating its work load count by including incorrect items.

Understated Work Load Count Data. Errors in work load count data for commercial invoices paid and trial balances maintained outputs existed at the three organizations. Specifically:

o The DFAS Cleveland Center reported that a total of 2,446,238 commercial invoices were processed by the Center and its subordinate organizations during FY 1995. We noted that the DFAS Cleveland Center work load count data was understated by 18,465 commercial invoices. This occurred because the Norfolk OPLOC reported its work load count to the DFAS Cleveland Center in its monthly report, but the DFAS Cleveland Center did not bill customers for the $545,000 in "commercial invoices paid" work load. To determine the count, the DFAS Cleveland Center used an automated system that did not contain information from all activities of the OPLOC. The automated system used did not include three of the operating sections of the Norfolk OPLOC. The three sections were not connected to the automated system. Therefore, the DFAS Cleveland Center did not include the work load of these three activities in customer billings. As a result, customers were not billed the $545,000 in "commercial invoices paid" work load performed by three operating sections (detachments) at the Norfolk OPLOC in June 1995. DFAS Cleveland Center adjusted the work count bill in August as a result of the audit.

o For FY 1995, the Norfolk OPLOC reported 9,388 trial balances maintained and 305,536 commercial invoices processed. However, Norfolk OPLOC customers would not have been billed for $1.02 million (that is, $640,000 in monthly trial balances maintained and $380,000 in commercial invoices paid) had we not identified the unreported work load counts. The trial balances maintained work load count was understated by 501 trial balances and the commercial invoices paid count was understated by 12,814 invoices. This resulted from the consolidation of the Fort Eustis DAO with the Norfolk OPLOC in June 1995. The Fort Eustis DAO was previously assigned to the

DFAS Indianapolis Center and its work load count was reported for billing purposes by that Center. When the Fort Eustis DAO was consolidated into the Norfolk OPLOC, it became the DFAS Cleveland Center's responsibility to report the work load count for billing purposes. However, neither DFAS Center (that is, the Cleveland nor the Indianapolis Center) was going to bill for the work load count because each Center believed the other would. The understated work load counts represented all of Fort Eustis's trial balances maintained and commercial invoices paid work load for June 1995. The Norfolk OPLOC initiated corrective action immediately after we advised that office about the unreported work load counts.

o At the San Diego OPLOC, the total "monthly trial balances maintained" work load count for FY 1995 was not available. However, we noted that the total San Diego OPLOC work load counts, if available, would not have included 250 trial balances and that customers were not billed $519,000 for "monthly trial balances maintained." The San Diego OPLOC "monthly trial balances maintained" work load counts would have been understated because the OPLOC did not include the work load counts for the Great Lakes DAO. The Great Lakes DAO was consolidated into the San Diego OPLOC in July 1995. The Great Lakes DAO was reporting separately until the end of FY 1995.

Overstated Work Load Count Data. For FY 1995, Fort Eustis DAO reported a total of 54,150 commercial invoices processed of which 9,150 were "returned" commercial invoices. However, the Norfolk OPLOC and (before that OPLOC opened) the DFAS Indianapolis Center incorrectly included "returned" commercial invoices by the former Fort Eustis DAO in its work load counts. The Fort Eustis DAO was transferred from the DFAS Indianapolis Center to the Norfolk OPLOC in June 1995. Whenever an error in a commercial invoice occurs that prevents the processing of the invoice for payment, it must be returned for correction. DFAS policy specifies that "returned" commercial invoices are to be excluded from work load counts. However, the Norfolk OPLOC, and the DFAS Indianapolis Center as part of absorbing Fort Eustis work load, included 9,150 of Fort Eustis "returned" commercial invoices in its work load counts. As a result, DFAS customers were overcharged $270,000.

Actions Initiated by DFAS. After completion of our audit field work, DFAS Headquarters approved a plan to improve work load count accuracy. The DFAS Headquarters plan, dated June 7, 1996, requires continuing reviews of the accuracy of work load counting at all of the DFAS subordinate organizations. Also, a Systems Change Review Working Group at Headquarters, DFAS, is working to automate the work load data in many of the DFAS migratory and interim migratory financial systems to ensure the accuracy of the data. Implementation of these actions should correct the majority of the problems identified during our review. Therefore, we are not making additional recommendations on work load count accuracy.

Assignment of Personnel Costs

The DFAS organizations did not charge appropriate outputs for the cost of their personnel. At 6 of the 15 DFAS organizations reviewed, personnel costs were charged to the wrong outputs. Specifically:

o Five of the OPLOCs (the Charleston, Honolulu, Norfolk, Oakland, and San Diego) paid personnel costs of $23.8 million in 1995. We noted that those five OPLOCS charged $2 million of personnel costs to incorrect outputs including "civilian pay accounts maintained," "travel vouchers paid," and "Foreign Military Sales." The personnel costs should have been charged to the "monthly trial balances maintained" output. The same five OPLOCs also charged $1.1 million of personnel costs that supported the "commercial invoices paid" output to inappropriate outputs including "transportation bills paid" and "Foreign Military Sales."

o The DFAS Indianapolis Center, which had personnel costs of $336 million in FY 1995, charged $240,000 in personnel costs for nine accounting and finance interns to "trial balances maintained." DFAS Headquarters indicated the costs should be charged directly to the outputs each intern supported.

o In addition to charging personnel costs to the wrong outputs, the DFAS Headquarters personnel costing data bases contained 17 duplicate personnel assignments. These 17 individuals were simultaneously assigned to two different cost account codes. The salary of these duplicated personnel was $500,000. Once we identified the situation, DFAS Headquarters initiated corrective action. Total FY 1995 personnel costs included in the DFAS Headquarters personnel data bases was $750 million, as of June 1995. Even though the $500,000 in duplicate personnel costs was insignificant compared with total DFAS personnel costs for FY 1995, we are reporting this situation because the DFAS personnel costing systems allow duplicate costing of personnel to different outputs (the systems did ensure that personnel were not paid twice), and the potential exists for duplicate personnel costing to be substantially greater. Also, we believe that duplicate costing of personnel could be solved through periodic reviews of the personnel data bases for duplicate personnel costing assignments.

Causes for Inaccurate Personnel Cost Account Coding. We attributed the inaccurate personnel cost account coding at the DFAS organizations we reviewed to the lack of required quarterly cost account code reviews by the DFAS Centers and subordinate organizations. DFAS Instruction 7045.17-R, "The Defense Finance and Accounting Service Administration of Unit Cost," April 1993, requires that the DFAS Centers review and validate the accuracy of cost account coding at least quarterly and as missions and responsibilities change, to ensure that costs are properly allocated to the appropriate outputs. However, the reviews were not being performed as required. For example, the Cleveland Center last reviewed its cost account code assignments in December 1994 and had yet to review its subordinate organizations.

We attributed the existence of duplicate personnel cost coding in the DFAS Headquarters personnel data bases to the two separately maintained data bases not being reconciled periodically. Periodic reconciliations would identify duplicate costing assignments so that corrective action could be taken.

Unit Costs for Precertified Output Products

The DFAS organizations did not price output products based on the level of work or costs to provide the output. At the two DFAS Centers (Denver and Indianapolis) included in our review of precertified output products, the pricing of output products was not adjusted for the level of work or costs required to provide the outputs. Consequently, customers were overcharged by $5.7 million and undercharged by $0.4 million. Details on inaccurate costing of precertified commercial invoices and travel vouchers follows.

Precertified Commercial Invoice. Precertified commercial invoices require less effort to process than standard commercial invoices. Precertified invoice processing is simpler because the invoices have already been audited by another organization and approved by an authorizing official for payment. DFAS organizations simply have to pay the approved invoice by disbursement of a check. However, some DFAS customers were billed the same for a precertified invoice as for a standard commercial invoice. Conversely, other DFAS customers were not charged at all for precertified commercial invoices. Examples follow:

o The DFAS Denver Center reported a total of 3,168,439 commercial invoices processed during FY 1995. We reviewed the Air National Guard as part of that work load and found that the DFAS Denver Center charged the Air National Guard for processing precertified invoices the same amount, $29.53 per invoice, as a standard commercial invoice. However, the cost and effort to process precertified invoices is substantially less. Because the DFAS Denver Center did not separately identify the number of precertified invoices processed, the amount of overcharge for processing precertified invoices received from the Air National Guard could not be determined.

o The DFAS Indianapolis Center processed 3,746,860 commercial invoices during FY 1995. Our review of Army National Guard work load showed that the DFAS Indianapolis Center did not charge the Army for National Guard precertified commercial invoice work load. As a result, we estimate that the Army was undercharged at least $449,000 (based on DFAS Indianapolis Center's estimated cost of $1.73 for each check issued in payment of a precertified commercial invoice) for 259,485 National Guard precertified invoices processed during FY 1995.

Precertified Travel Voucher. As with precertified commercial invoices, precertified travel vouchers require less effort to process than a standard travel voucher, yet DFAS customers were charged the standard travel voucher billing rate for precertified travel vouchers. Examples were:

o The DFAS Denver Center reported a total of 2,546,430 travel vouchers processed during FY 1995. Our review of charges to the Air National Guard indicated that the DFAS Denver Center charged the Air National Guard to process a precertified travel voucher the same amount, $16.94 per voucher, as for a standard travel voucher. The total amount the Air National Guard was overcharged was not available because the DFAS Denver Center did not separately accumulate work load counts of precertified travel vouchers.

o The DFAS Indianapolis Center processed a total of 2,425,568 travel vouchers in FY 1995. We reviewed the Army National Guard's part of that work load and found that at the DFAS Indianapolis Center, the Army National Guard was overcharged by $5.7 million for the processing of 373,338 precertified travel vouchers during FY 1995. The estimated $5.7 million overcharge was calculated by taking the difference between the amount the Army National Guard was charged at the standard rate ($16.94) times 373,338 vouchers processed, or $6.3 million, and the cost to disburse a check in payment of a precertified travel voucher ($1.73 times the 373,338 vouchers processed, or $645,874).

Cause for Inappropriate Charges. We attributed inappropriate charges to the absence of DFAS output products that accommodate the varying cost or work required to process precertified commercial invoices and precertified travel vouchers.

Significance in Comparison to DFAS Total Costs

We recognize that the mischarges we identified (that is, $2.5 million in undercharges, $6 million in overcharges, and $3.8 million in personnel costs charged to incorrect outputs) do not, on the surface, appear significant in relation to DFAS total costs of $1.7 billion. Additionally, we recognize that many of the problems encountered could be expected to occur as part of the DFAS organization's growing pains and that DFAS has made significant progress toward ensuring that the administration of its unit costs was conducted in accordance with DoD policies. However, because of the limited nature of our review (that is, only 15 of over 200 DFAS organizations and only 3 of 16 output products), and because of the lack of available work load data at subordinate DFAS organizational levels, our results are not projectable to all DFAS organizations and outputs. Also, the lack of data prevented comparison of identified deficiencies in work load count data with total work load for the respective output at each of the organizations included in the review. Nevertheless, the results of the audit demonstrate that the problems exist. We believe that the problems deserve additional DFAS attention as it continues to evolve and assume more of the total DoD finance and accounting responsibilities. The problems identified for each organization we reviewed are summarized in Appendix C.

Summary

The DFAS accounting and finance organizations that we reviewed were not consistently accumulating accurate work load counts, accurately charging personnel costs to the proper output, and pricing output products based on the level of work or costs required to provide the output. Because DFAS is still in the process of consolidating its smaller organizations into the Centers and OPLOCs, adequate controls and effective oversight of subordinate organizations are needed to ensure that work load count data are accurately maintained, personnel costs are accurately charged to outputs, and output products are priced based on the level of work or costs required to provide the output. The errors disclosed at the 15 DFAS organizations reviewed may be indicative of systemic problems in the administration of unit costs at DFAS. Furthermore, even though many of the problems we identified could be attributed to the operating deficiencies expected to occur during the ongoing DFAS reorganization effort, the problems warrant additional DFAS action.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service:

1. Require DFAS Centers and subordinate organizations to certify the completion of required cost account reviews.

2. Direct that periodic reconciliations of the personnel costing data bases be performed to ensure that duplicate personnel costing assignments do not occur.

3. Establish separate output categories and appropriate output pricing for precertified commercial invoices and travel vouchers.

Defense Finance and Accounting Service Comments. The Director of Revolving Funds, Office of the Under Secretary of Defense (Comptroller) and the Deputy Director for Resource Management, Defense Finance and Accounting Service Headquarters, concurred with each of the recommendations.

The Director of the Revolving Funds agreed with each recommendation and provided general comments. He indicated that, with the magnitude of the reorganization of the DFAS, it is conceivable that some work load may not be properly allocated to outputs. He also agreed that the DFAS should reconcile personnel cost data to greatly minimize duplicative recording of costs. Additionally, he indicated that the DFAS is formulating additional outputs that would reward customers for submitting precertified commercial invoices and precertified travel vouchers and using the innovative International Merchant

Purchase Authorization Card to reduce costs. The results of those changes will be examined in FYs 1998 and 1999.

The Deputy Director for Resource Management, Defense Finance and Accounting Service Headquarters, agreed with each recommendation and provided specific comments. In response to Recommendation 1., he indicated that in June 1996 the DFAS issued a memorandum requiring the quarterly validation of cost account codes. Also, DFAS began conducting quarterly personnel mapping reviews. He agreed with Recommendation 2. and stated that the DFAS will perform quarterly queries of the personnel data base to ensure that the only duplicate personnel in the data base are DFAS personnel transferring within the organization. He also agreed with Recommendation 3. and indicated that during FY 1997 the DFAS will collect work counts, including counts of precertified invoices and precertified travel vouchers, for use in the possible establishment of separate billing rates in FY 1998.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope and Methodology

We selected 2 of the 16 DFAS outputs for a detailed review of unit costs. Commercial Invoices Paid (Output 9) and Monthly Trial Balances Maintained (Output 11) were examined because they made up $814 million, or 49 percent, of the $1.7 billion operating costs that were passed on to DFAS customers during FY 1995. In addition, because of concerns over billing for precertified travel vouchers at the DFAS Indianapolis Center, we performed a limited review of the precertified travel and precertified commercial invoice billing process at the DFAS Denver and Indianapolis Centers only. The Travel Vouchers Paid output (Output 7) operating costs during FY 1995 were $88 million, or another 5 percent of DFAS total costs.

Audit work was performed at DFAS Headquarters and at each of the five major DFAS centers. In addition, we judgmentally selected nine DFAS subordinate organizations, including both OPLOCs and DAOs, for review. The audit included reviews of the accuracy of the work load count data reported for the Commercial Invoices Paid and Monthly Trial Balances Maintained outputs, as well as unit cost data. We also examined the effect of inaccurate and inconsistent costs accumulated for these two outputs. Moreover, data obtained from DFAS Headquarters on personnel costs that were being charged to DFAS outputs was reviewed for accuracy.

We relied on computer-processed data from the Defense Business Management System and the Resource Analysis Decision Support System to determine the accuracy of unit costs, work load counts, and personnel cost codes. Although we did not perform a formal reliability assessment of the computer-processed data, we determined that unit cost amounts, work load count numbers, and personnel assignments shown on manual records at the DFAS organizations audited generally agreed with the information in the computer-processed data. We did not find errors that would preclude use of the computer-processed data to satisfy the objectives of the audit or that would change the conclusions in this report.

This financial-related audit was conducted from March 1995 to March 1996, in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. We did not use statistical sampling procedures. Organizations visited or contacted during the audit are in Appendix D.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of DFAS management controls over unit costs, work load counts, and personnel cost account coding. Specifically, we reviewed the appropriateness of costs passed on to DFAS customers. This review entailed determining whether costs for goods or services provided by DFAS were based on actual costs incurred, were determined in accordance with DoD policies, were based on accurate counts of outputs provided to customers and also, whether personnel costs were accumulated to appropriate output categories.

Adequacy of Management Controls. At the organizations we reviewed, we identified material management control weaknesses as defined by DoD Directive 5010.38 relating to costs passed on to DFAS customers, accuracy of work load count data, and accumulation of personnel costs to appropriate outputs. DFAS lacked adequate controls and oversight over these processes. Recommendations 1. through 3., if implemented, will ensure that these problems do not reoccur. We do not have any additional recommendations addressing inaccurate work counts because of DFAS's Unit Cost Group initiatives. The overall amount of potential monetary benefits for the DFAS could not be quantified because we only reviewed 15 of the more that 200 DFAS organizations and only 3 of 16 output products. A copy of the report will be provided to the senior official in charge of management controls for the DFAS.

Adequacy of DFAS Self-Evaluation. DFAS officials identified the unit cost area as an assessable unit, but, in our opinion, incorrectly identified the risk associated with the unit as low. In discussions with DFAS management, we were told that the unit cost area risk was assessed as low because the DFAS had recently implemented an improved cost accumulation system, the Resource Analysis Decision Support System. DFAS management did acknowledge problems in the unit costing area caused by the ongoing consolidation of numerous organizations into the DFAS Centers and OPLOCs.

Prior Audits and Other Reviews

During the last 5 years, the General Accounting Office (GAO) has issued several reports and provided several testimonies to Congress addressing DBOF pricing policy as related to the recovery of operating losses in future year prices. In addition, the Office of the Inspector General, DoD, performed audits relating to the objectives of this audit.

General Accounting Office Report No. GAO/AIMD-94-132, (OSD Case No. 9339-F), "Defense Business Operations Fund: Improved Pricing Practices and Financial Reports Are Needed to Set Accurate Prices," June 1994. This report states that the DBOF policy of recovering past operating losses by increasing future year prices distorts the actual results of DBOF operations in a given year, diminishes the incentive for the DBOF to operate efficiently, and makes evaluation and monitoring of the DBOF difficult. This report contained no recommendations, but the GAO reiterated its opinion that the DBOF be required to justify recovering prior-year losses as part of the appropriation process rather than by increasing future prices.

Inspector General, DoD, Report No. 96-040, "Congressionally Directed Rebates in Defense Finance and Accounting Service Cost Recovery Rates," December 11, 1995. This report discloses that DFAS complied with the direction of Congress and did not charge customers in FYs 1994 and 1995 for $135.2 million in services. However, in FY 1995, DFAS recouped the $85.2 million of rebates directed by Congress in FY 1994 through increased cost recovery rates. As a result, the intent of the FY 1994 congressional rebate, to reduce DFAS overhead costs passed along to customers, was partially thwarted. The report recommended that the Under Secretary of Defense (Comptroller) revise DoD 7000.14-R, "Financial Management Regulation," volume 11-B, "Reimbursable Operations, Policy and Procedures--Defense Business Operations Fund," to prohibit DBOF organizations from increasing rates to recover losses that are attributed to Congressional rebates. The Under Secretary of Defense (Comptroller) agreed to revise DoD 7000.14-R, volume 11-B, to indicate that, on a case-by-case basis, determinations will be made to whether a DoD Component failed to comply with the intent of a congressionally directed rebate by not achieving associated projected savings, whether such actions resulted in a DBOF loss (and the amount of such loss), and whether such amounts are to be recovered in future DBOF rates.

Inspector General, DoD, Report No. 96-149, "Defense Finance and Accounting Service Billing Rates," June 7, 1996. This report states that costs for nine DFAS outputs were not accurately billed to customers. Specifically, customers were charged the same fee or rate (that is, a composite rate) for eight DFAS outputs even though the costs to provide the services varied significantly among the DFAS Services. The report recommends that the Under Secretary of Defense (Comptroller) establish rates for DFAS goods or services (outputs) that more closely reflect the costs to provide the outputs to the customers of its operating centers. The Under Secretary of Defense (Comptroller) nonconcurred with the recommendation and stated that while more unit costs could be developed, no significant benefit was identified that would compensate for the additional cost. The Office of the Inspector General stands by the audit results and the report is currently in mediation using DoD audit followup procedures.

Appendix B. DFAS Work Outputs

Output 1:	Civilian Pay Accounts Maintained
Output 2:	Civilian Pay - Partial DBMS (Columbus Only)
Output 3:	Military Active Pay Accounts Maintained
Output 4:	Military Retired Pay Accounts Maintained
Output 5:	Military Reserve Pay Accounts Maintained
Output 6:	Contract Invoices Paid - Mechanization of Contract Administration Services
Output 7:	Travel Vouchers Paid
Output 8:	Transportation Bills Paid
Output 9:	Commercial Invoices Paid
Output 10:	Out of Service Debt Cases Closed
Output 11:	Monthly Trial Balances Maintained
Output 12:	Finance and Accounting Support Per Commissary
Output 14:	Foreign Military Sales
Output 19:	Contract Invoices Paid - Standard Automated Materiel Management System
Output 23:	Military Pay - Incremental
Output 24:	Information Services Direct Billable Hours

Definitions for the three outputs we reviewed are:

Commercial Invoices Paid (Output 9). DFAS defines a commercial invoice as a document that results in a payment to a commercial entity for goods or services performed, including local payments for the transportation of things and persons and credit card purchases. The processing of commercial invoices entails reviewing accounting records to determine whether the purchase was authorized, determining whether the material or services ordered were received, determining whether there are sufficient funds available for payment, and then posting the accounting entries so that the disbursing system can issue a check to the vendor.

Travel Vouchers Paid (Output 7). DFAS defines a travel voucher as a document that results in a payment to an individual for actual or anticipated expenses while on approved local or temporary duty travel or for permanent change of station entitlements, to include advances and settlements. Travel voucher work load counts include the number of payment vouchers disbursed by other-than-electronic-funds transfer. Processing travel vouchers entails reviewing travel orders to determine whether the trip was authorized, comparing claimed expenses on the voucher with receipts submitted, computing the traveler's entitlement, determining whether sufficient funds are available for payment, and entering the data into the travel system so that the disbursing system can issue a check to the traveler.

Monthly Trial Balances Maintained (Output 11). DFAS defines trial balances as a report containing a summarized classification of accounting transactions that show the economic resources belonging to a business entity and

the claims against those economic resources. Monthly Trial Balances Maintained output basically entails keeping the accounting records for organizations, processing accounting transactions, and producing various accounting reports for DFAS customers. Generally, any function performed by DFAS organizations that cannot be specifically traced to another of the output categories is included in this output. DFAS requires its organizations to count different departments, fiscal years, appropriations, subheads, allotments, and suballotments as separate trial balances.

Appendix C. Results at Organizations Reviewed

Organization	Area of Identified Problems (Values in thousands)					
	Work Count Errors	Value of Errors	Personnel Costing Errors	Value of Errors	Precerts Processed	Value of Error
DFAS Headquarters			X	500		
DFAS-Cleveland	X	545				
OPLOC Charleston, SC			X	509		
OPLOC Honolulu, HI			X	727		
OPLOC Norfolk, VA	X	1,290	X	394		
OPLOC Oakland, CA			X	440		
OPLOC San Diego, CA	X	519	X	1,087		
DFAS-Columbus, OH						
DFAS-Denver, CO					X	1/
OPLOC Dayton, OH					X	1/
DAO Scott AFB, IL					X	1/
DFAS-Indianapolis, IN			X	240	X	6,100
DASA, Indianapolis, IN					X	2/
DAO, Fort Wood, MO					X	2/
DFAS-Kansas City, MO						

Notes:
X - Errors identified

1/ Amount not quantifiable
2/ Value included in DFAS-IN total

AFB - Air Force Base
DASA - Defense Accounting Service Activity

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC
- Director for Revolving Funds, Office of the Deputy Comptroller (Program/Budget), Washington, DC

National Guard Bureau

Ohio Army National Guard U.S. Property and Fiscal Office, Worthington, OH
Ohio Air National Guard, Rickenbacker Air National Guard Base, OH

Defense Finance and Accounting Service

Defense Finance and Accounting Service Headquarters, Washington, DC
- Defense Finance and Accounting Service Center, Cleveland, OH
  - Operating Location, Charleston, SC
  - Operating Location, Honolulu, HI
  - Operating Location, Norfolk, VA
  - Operating Location, Oakland, CA
  - Operating Location, San Diego, CA
- Defense Finance and Accounting Service Center, Columbus, OH
- Defense Finance and Accounting Service Center, Denver, CO
  - Operating Location, Dayton, OH
  - Defense Accounting Office, Scott Air Force Base, IL
- Defense Finance and Accounting Service Center, Indianapolis, IN
  - Defense Accounting Office, Defense Accounting Service Activity, Indianapolis, IN
  - Defense Accounting Office, Fort Leonard Wood, MO
- Defense Finance and Accounting Service Center, Kansas City, MO

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
General Counsel of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
  Commander, Defense Contract Management Command
Director, Defense Information Systems Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Under Secretary of Defense (Comptroller) Comments

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

COMPTROLLER
(Program/Budget)

AUG 14 1996

MEMORANDUM FOR DEPUTY DIRECTOR FOR AUDIT FOLLOW-UP, DOD IG

SUBJECT: Draft OIG Audit Report, Project No. 5FJ-2010.03 "Defense Finance and Accounting Service Administration of Unit Costs"

The working draft of audit report, Project Number 5fj-2010.03, dated July 30, 1996, titled Audit of Defense Finance and Accounting Service Administration of Unit Costs has been reviewed. The audit objective was to determine whether unit costs for goods and services provided by DFAS were determined in accordance with DoD policies and whether they were based on actual costs incurred. The audit recommended that: the DFAS Centers and subordinate organizations accumulate accurate work load count data; reconcile personnel cost data to ensure that duplicate personnel costing assignments do not occur; and establish separate output categories and appropriate output pricing for precertified commercial invoices and travel vouchers.

DFAS is in the process of consolidating its departmental accounting offices (DAOs) into their Centers and Operating Locations (OPLOCs). This encompasses activities that affect thousands of DFAS employees. With the magnitude of this reorganization, it is conceivable that some work load may not be properly allocated to outputs.

In addition, we agree with your recommendation that DFAS should reconcile personnel cost data that would greatly minimize duplicative recording of such costs. DFAS has been asked by Comptroller staff to take measures to remedy these two potential problem areas.

As referenced in your audit report, DFAS has made significant progress toward ensuring that unit costs for goods and services are determined in accordance with DoD policies. In addition, DFAS is currently not only formulating additional outputs that would reward customers for submitting precertified commercial invoices and precertified travel vouchers but also using the innovative International Merchant Purchase Authorization Card (IMPAC). This purchase card program is estimated to save millions of dollars to DFAS customers who use this method of payment for small purchases. These changes will be examined in the FY 1998/1999 Defense Biennial Budget Review.

William C. Coonce
Director for Revolving Funds

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

OCT 2 1996

DFAS-HQ/CA

MEMORANDUM TO ACTING DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: DRAFT Audit Report on Defense Finance and Accounting Service Administration of Unit Cost (Project No. 5FJ-2010.03)

We have reviewed the subject draft audit report and we generally concur with the recommendations. Prior to and during this audit, we began several unit cost initiatives which we believe will enhance our overall administration of unit cost within DFAS. Our initiatives and comments to the audit findings are attached.

Bruce M. Carnes
Deputy Director for
Resource Management

Attachment
As stated

Defense Finance and Accounting Service

Comments on

Draft Audit Report on Defense Finance and Accounting Service Administration of Unit Cost (Project No. 5FJ-2010.03

OVERVIEW

We agree that we have made significant progress towards ensuring that unit cost for goods and services are being determined in accordance with DoD policies. We are also taking additional steps to assure our customers that our work counts are accurate and that our products and services are fairly priced. Some of these steps are:

- Headquarters Unit Cost Working Group was formed in July 1995 to address unit cost issues agency-wide.
- Work count review teams are visiting Centers and Operating Locations (OPLOCS) to review work count collection procedures and enforce work count guidance. This will be an ongoing effort.
- A team has been formed to provide the functional analysis required to automate work counts in our financial systems.
- We have established quarterly unit cost conferences with our Center and OPLOC unit cost representatives for the purpose of disseminating unit cost information. Our last conference was held August 27-28, 1996.
- We issued our first quarterly "Unit Cost Gazette" in April 1996. The "Gazette" was issued to distribute unit cost information to all Center and OPLOC unit cost POCs.
- We expect to transition from Trial Balances Maintained to Direct Billable Hours. We believe this will provide our customers a better cost visibility of the accounting services we provide.

We are aggressively pursuing meaningful and cost effective avenues to improve our unit cost processing and our service to our customers.

1

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. Require DFAS Centers and subordinate organizations to certify the completion of required cost account reviews.

COMMENT

We concur with this finding and have issued a memorandum dated June 12, 1996, subject: Validation of Cost Account Code Accuracy, which requires each Center to provide a quarterly written validation of its cost account code (CAC) mapping and personnel CAC assignments. This memorandum requires continuous monitoring of CAC assignments by the Centers and their subordinate activities. We continuously stress the importance of properly assigning CACs.

We are also conducting CAC mapping reviews at our quarterly unit cost conferences to ensure that CACs are mapped consistently across Centers.

2. Direct that periodic reconciliation of the personnel costing databases be performed to ensure that duplicate personnel costing assignments do not occur.

COMMENT

We concur with this recommendation. As stated above, we have tasked the Centers to review personnel CAC assignments and validate their accuracy quarterly. In addition, we at Headquarters have developed a database query to pull all duplicate social security numbers, activity codes, CACs, and entered on duty dates. We will run this query quarterly and review the results to ensure that the duplicate personnel in the database are DFAS personnel transferring within the organization.

3. Establish separate output categories and appropriate output pricing for precertified commercial invoices and travel vouchers.

COMMENT

We concur with this recommendation. We are implementing Dr. Hamre's policies on the use of the Rocky Mountain National Bank's International Merchants Purchase Card (I.M.P.A.C.) which would result in a lower billing rate to our customers. We are exploring ways to give our customers alternative methods for invoice submissions. One such method is by providing reduced billing rates as incentives for using I.M.P.A.C. and disincentives such as increased billing rates, for not using I.M.P.A.C. for purchases under $2,500. We have requested work count estimates in the FY 1998/99 budget submissions for I.M.P.A.C. invoices, precertified invoices, precertified travel, and multi-line item invoices for possible use in FY 1998.

Final Report Reference

GENERAL COMMENTS

Revised p. 4

Reference "Accuracy of Work Load Count Data," page 4: The work count shortfall of 18,465 commercial invoices was inadvertently not reported in June. However, an adjustment was made in August. All work counts were billed for FY 1995.

Revised p. 5

Reference "Accuracy of Work Load Count Data," page 5: The DAO Great Lakes trial balance work load count referred to in the subject report as understated was actually reported separately from OPLOC San Diego until the end of FY 1995.

Revised p. 6

Reference "Assignment of Personnel Costs," page 6: We do not agree that accounting and finance interns should be chargeable to general and administrative expense. Personnel costs for these interns are properly chargeable to the outputs they support.

Revised p. 7

Reference "Precertified Travel Voucher," page 8: The Last paragraph implies that the Army National Guard was billed; the Army National Guard bill is a part of the overall Army bill, as such the Department of Army was billed appropriately.

Revised p. 8

Reference "Precertified Travel Voucher," page 9: The first paragraph suggest that our charges for precertified transactions were "erroneous." We suggest the word "erroneous" be removed from the paragraph. The charges (billings) addressed were not erroneous; rather, the auditor has an opinion that we should set a lower-value rate for work we receive as "precertified."

3

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
James L. Kornides
John K. Issel
Terry D. Holdren
Walter J. Carney
Ted R. Paulson
Melisa A. Sikora
Melanie S. Steel
Eric T. Thacker
Deborah Curry