August 22, 2003

Financial Management

Certification of a DoD Payment for Telecommunications Services
(D-2003-124)

Office of the Inspector General of the Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DITCO	Defense Information Technology Contracting Organization
FAR	Federal Acquisition Regulation
FMR	Financial Management Regulation
FTS	Federal Technology Service
GSA	General Services Administration
SOCN	Service Order Completion Notice

INSPECTOR GENERAL
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August 22, 2003

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE
(COMPTROLLER)/DEPUTY CHIEF OFFICER
DIRECTOR, DEFENSE INFORMATION SYSTEMS
AGENCY
DIRECTOR, DEFENSE INFORMATION TECHNOLOGY
CONTRACTING ORGANIZATION

SUBJECT: Report on Certification of a DoD Payment for Telecommunications Services
(Report No. D-2003-124)

We are providing this report for your information and use. We performed this audit in response to a request by the Office of the Under Secretary of Defense (Comptroller)/Deputy Chief Financial Officer. We considered management comments on a draft of this report when preparing the final report.

The Defense Information Systems Agency comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides at (614) 751-1400 ext 211 or Mr. Stuart D. Dunnett at (614) 751-1400 ext. 214. See Appendix B for the report distribution. The team members are listed inside the back cover.

Paul J. Granetto
Defense Financial Auditing Service
Directorate

Office of the Inspector General of the Department of Defense

Report No. D-2003-124 **August 22, 2003**
(Project No D2002FJ-0202)

Certification of a DoD Payment for Telecommunications Services

Executive Summary

Who Should Read This Report and Why? Civil service and uniformed officers responsible for processing invoices and payments on the Federal Telecommunication Service 2001 contract should read this report. The report discusses the certification of payment for telecommunications services and associated internal control.

Background. This audit was performed in response to a request by the Office of the Under Secretary of Defense (Comptroller)/Deputy Chief Financial Officer. The Deputy Chief Financial Officer requested that we examine the certification of a $16.6 million lump sum payment for telecommunications services that DoD made in FY 2001, and the adequacy of internal control over the certification process. Defense Information Systems Agency (DISA) management stated that they consider the $16.6 million payment a settlement of a contractor dispute.

Results. The Defense Information Technology Contracting Organization's September 2001 certification of a disbursement of $16.6 million for telecommunications services, made as the result of a settlement agreement, had the effect of avoiding a number of Federal Acquisition Regulation and DoD Financial Management Regulation requirements. Specifically, at the direction of DISA management, the Defense Information Technology Contracting Organization (DITCO) certified the payment without researching and validating the 17,030 invoices that supported it. At the time of our audit, the research and validation remained uncompleted. Additionally, DITCO did not offset the disbursement with $12.8 million of credits the Government had earned. As a result, at least $6.3 million in overpayments were certified, and there is a risk that additional overpayments were made on the contract. To correct and improve its process, DITCO needs to apply year-end credits as they are identified and earned, to certify payments for charges according to established guidance, and to research the $2.2 million of invoices that were not researched. DITCO also needs to continue to work with the telecommunications contractor to obtain timely and accurate service completion notices. The $1.8 million of remaining disputed invoices past the contractual timeline for resolution should be taken by DITCO until MCIWorldCom can provide support that the disputed charges were valid. (See the Finding section of the report for the detailed recommendations.)

Management Comments and Audit Response. The DISA Acting Inspector General concurred with the report recommendations. He nonconcurred with the finding and stated that the report calls into question the authority of the General Services Administration contracting officer to interpret the contract at issue and to resolve contractual disputes. He also stated the report overlooks the authority of DISA to make a settlement payment. We do not question the authority of the GSA contracting officer to

interpret the contract or to resolve disputes. However, although the GSA contracting officer determined that the service order completion notices were not a prerequisite for payment, she did not direct DISA to make a lump sum settlement payment. We believe that DISA management made the settlement payment prematurely without properly verifying the supporting documentation and recovering approximately $10.1 million in credits still owed to DoD. We do not question the authority of DISA to enter into a legal settlement. However, a more favorable settlement payment could have been made had DISA management taken more time to verify the MCIWorldCom supporting records and to recover all of the credits owed to DoD. Because the DISA Acting Inspector General concurred with the recommendations, no further comments are required. See the Finding section for a summary of the management comments and the Management Comments section for the complete text of those comments.

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Background

This audit was performed in response to a request by the Office of the Under Secretary of Defense (Comptroller)/Deputy Chief Financial Officer. The Deputy Chief Financial Officer questioned the validity of a Defense Information and Technology Contracting Organization (DITCO) certification of a $16.6 million payment to MCIWorldCom and the adequacy of the internal control over the certification process.

DITCO Operations. DITCO is a field activity of Defense Information Systems Agency (DISA). DITCO provides solutions to information technology requirements by supplying networks, software, hardware, security, and maintenance. DITCO operates as a working capital fund with a budget of about $40 million obtained by charging customers a 2 percent surcharge on about $2 billion in contracting services paid for by DITCO customers.

Federal Telecommunication Service (FTS) 2001 Contract. In January 1999, the General Services Administration (GSA) awarded the Federal Telecommunication Service 2001 (FTS 2001) contract for use by all Federal agencies. The FTS 2001 contract was an 8 year, indefinite-delivery, indefinite-quantity contract that included voice, toll free, and video teleconferencing services. According to DITCO, DoD pays GSA a 7 percent service fee for use of the contract. The $16.6 million payment questioned by the Deputy Chief Financial Officer related to invoices on the FTS 2001 contract. According to DITCO, the vendors on the contract were MCIWorldCom and Sprint. All of the $16.6 million payment related to MCIWorldCom invoices. In April 2003 MCIWorldCom announced that it was changing its corporate name to MCI.

DoD Use of FTS 2001. The Assistant Secretary of Defense, Command, Control, Communications, and Intelligence* directed DoD to use the FTS 2001 contract and directed DISA to leverage the DoD sizable inventory and traffic volume to take maximum advantage of emerging technologies at the lowest possible cost. In addition, DoD Directive 4640.13, "Management of Base and Long-Haul Telecommunications Equipment and Services," assigned responsibility to DISA for the acquisition and management of the Department's long-haul telecommunications assets.

According to DITCO personnel, the DoD annual usage charges on the FTS 2001 contract totaled about $150 million. DITCO provided contracting services for about $100 million of the $150 million. The $50 million of non-DITCO administered service was directly billed and paid by the Military Departments.

FTS 2001 Contractual Requirements. To obtain the lowest rates possible, GSA wrote the FTS 2001 contract to allow the vendors to use industry billing practices and systems without significant modifications for Federal user requirements.

* In May 2003 the Office was restructured, and became the Office of the Assistant Secretary of Defense for Networks and Information Integration, DoD Chief Information Officer.

Because the contract allowed vendors to use their commercial billing systems, the contract included a provision allowing a customization charge for any additional information required by the Government.

After completing an order, FTS 2001 vendors are required to provide a Service Order Completion Notice (SOCN) to Federal customers within 24 hours. The SOCN should indicate that the service is complete and include billing information for connecting the service and recurring charges. The contract also requires the contractor to assign a unique service order number on the notification. The service order number should also be included either on the invoice or invoice supporting reports for invoice verification and tracking.

Payment Process. From the beginning of the FTS 2001 contract in 1999, DITCO requested hard copy invoices from MCIWorldCom because DITCO systems were not designed to accommodate and pay invoices received from MCIWorldCom's commercial billing platforms. As a result, DITCO personnel manually verified that every invoice matched a valid service order before sending it to the Defense Finance and Accounting Service (DFAS) for payment. According to DFAS records, from November 1999 until September 18, 2001, DITCO had received and paid approximately 149,000 MCIWorldCom invoices totaling $92.7 million through the normal DITCO process of matching the invoice with the service order. In October 2001, MCIWorldCom and DITCO began a process to submit and validate FTS 2001 invoices electronically.

Lump sum Payment. A disagreement between DITCO and MCIWorldCom over the contractual requirement to provide SOCNs resulted in thousands of unpaid invoices over the first two years of the contract. Specifically, DITCO believed that they were not being provided the SOCNs as timely or as accurately as the contract required and, therefore, could not match the invoice to a service order for payment purposes. DITCO raised this contract issue shortly after receiving FTS 2001 billings and worked with MCIWorldCom to correct the situation. However, an acceptable solution was not reached. In June 2001, GSA determined that although the lack of accurate and timely SOCNs was a contractual issue, MCIWorldCom's non-performance was not significant enough to withhold payment. After the GSA decision, DISA headquarters entered into discussions with MCIWorldCom to resolve the disagreement about the backlog of unpaid invoices. The discussions culminated in an agreement for DISA to pay a $16.6 million lump sum payment for the backlog of unpaid invoices.

DISA management considered the $16.6 million lump sum payment to be a settlement of a dispute with MCIWorldCom. As part of the settlement agreement, DISA management agreed to pay MCIWorldCom $16.6 million to settle charges on about 17,030 FTS 2001 paper invoices that MCIWorldCom contended were unpaid and past due. In return for the $16.6 million payment, MCIWorldCom agreed not to file a formal claim against DISA for the unpaid invoices and not to pursue prompt payment interest penalties that might be due from DISA. At the time the payment was made, DISA legal counsel considered it unclear whether prompt payment interest was payable to MCIWorldCom. Given, however, the GSA contracting officer's position that payments were being improperly delayed, DISA felt Prompt Payment Act penalties were an issue. MCIWorldCom provided a spreadsheet that listed the invoices that they considered to be unpaid and past

due. As part of the settlement agreement, DISA and MCIWorldCom agreed that the 17,030 paper invoices would be subsequently researched to establish the validity of the charges on the spreadsheet. DISA also retained the right to request adjustments to the payment if overpayments were identified as a result of the research.

Objectives

Our overall audit objective was to determine whether DITCO and related DFAS operations are in compliance with the Federal Acquisition Regulation. For this part of the audit, we determined whether the DITCO certification of the $16.6 million payment to MCIWorldCom was valid and proper under relevant guidance. See Appendix A for a discussion of the scope and methodology and for prior coverage related to the objectives.

Lump Sum Payment for FTS 2001 Invoices

In accordance with an agreement between DISA headquarters and MCI WorldCom, signed by a DISA contracting officer, DITCO authorized a disbursement of $16.6 million for telecommunications services on September 18, 2001. That agreement avoided a number of normal Federal Acquisition Regulation and DoD Financial Management Regulation prerequisites for payments. Specifically, DITCO did not research and validate 17,030 invoices prior to release of funds. At the time of our audit the research and validation remained uncompleted. Additionally, DITCO did not offset the disbursement amount by $12.8 million of credits it had earned in FYs 2000 and 2001. These events occurred because DITCO did not:

- recoup credits when they were identified and earned,
- sufficiently review the supporting documentation for the disbursement,
- assign adequate resources for processing FTS 2001 invoices, and
- believe the research was incomplete.

Also, MCIWorldCom did not comply with the provisions of the FTS 2001 contract as they related to disputes and providing service completion information. As a result, DITCO certified $6.3 million in payments that it subsequently determined to be overpayments, and additional overpayments may have been made on the contract.

Payment Requirements

Federal Acquisition Regulation and DoD Financial Management Regulation Requirements. The Federal Acquisition Regulation (FAR) 32.905, "Payment Documentation and Process," requires that invoice payments be based on receipt of a proper invoice accompanied by satisfactory contract performance, and that invoice payments be supported by an authorization document or receiving report. DoD Regulation 7000.14-R, DoD Financial Management Regulation (FMR), volume 10, chapter 7, "Prompt Payment Act," February 1996, requires similar documentation prior to disbursement. The FMR requires that, prior to disbursement, the payment office should verify that a proper obligation or contract exists, that an invoice has been received, and services have been provided.

Validity of $16.6 Million Lump Sum Payment

In accordance with an agreement between DISA headquarters and MCI WorldCom, signed by a DISA contracting officer, DITCO authorized a disbursement of $16.6 million for telecommunications services on September 18, 2001. That agreement avoided a number of normal FAR and DoD FMR prerequisites for payments. Specifically, DITCO did not research and validate 17,030 invoices prior to release of funds and as of July 21, 2003, the research and validation remained uncompleted. Additionally, DITCO did not offset the disbursement amount by all of the $12.8 million of credits it had earned.

DISA management directed the $16.6 million payment to MCIWorldCom after discussions with DITCO, DFAS, and GSA personnel in September 2001. DISA management considered the payment a settlement of a dispute, and based it on information contained in a spreadsheet of FTS 2001 invoices that MCIWorldCom provided to DITCO. The spreadsheet contained a list of 17,030 invoices totaling $19.3 million that MCIWorldCom asserted had not been paid by DITCO. The spreadsheet also contained 11,424 FTS 2001 credit memos totaling about $2.7 million. At that time, MCIWorldCom was requesting a net payment of $16.6 million for unpaid invoices that were purportedly past due.

Payment in Accordance With Regulations. Prior to the disbursement, DITCO did not verify that the MCIWorldCom charges represented services that were actually performed, or that the billing data was accurate as required by FAR Section 32.905 and the FMR. Specifically, DITCO did not determine that the $16.6 million payment was based on receipt of proper invoices, that there was satisfactory contract performance, and that the payment was supported by an authorization document or receiving report. In addition, DITCO did not ensure that proper documentation was provided to DFAS prior to disbursement. The FMR states that prior to disbursement, the payment office should verify that a proper obligation or contract exists, that an invoice has been received, and services have been provided.

DITCO and DISA management were aware of the FAR and FMR requirements. However, DISA management advised DITCO that the payment should be made prior to validating that the invoices were authorized and accurate. MCIWorldCom and DITCO management agreed that the invoices could be researched later and the charges verified. Additionally, DISA management informed DFAS that the invoices would be researched by DITCO later to verify that services were provided and the charges were valid.

To facilitate the payment to MCIWorldCom, DISA management overrode the DITCO internal control that would have normally prevented the invalid or duplicate payment of invoices. DISA management believed the payment should be made quickly, and supported a plan to pay MCIWorldCom without fully reviewing the supporting documentation prior to payment.

DITCO Research of Invoices. Subsequent research and validation efforts related to the payment, were not completed at the time of our audit. Specifically, as of July 21, 2003, $9.0 million of the charges were valid, $6.3 million were

overpayments, $1.8 million are disputed, and the remaining $2.2 million had not been researched.

In January 2003, based on detailed information obtained from DITCO research personnel and DFAS Pensacola, we estimated that invoices totaling $16.3 million had been researched. Of the $16.3 million, $6.6 million were valid charges, $6.0 million were overpayments, and $3.7 million was still in dispute. At that time, DITCO considered the research of the payment supporting records complete except for continuing to track disputed invoices with MCIWorldCom that remained unresolved. The DITCO comptroller directed that research stop when the invoices reviewed totaled $16.6 million instead of the $19.3 million of invoices paid from the MCI spreadsheet (before net revenue credits).

We questioned the DITCO decision to stop researching before all of the $19.3 million in paid charges were validated or disputed. As a result of this questioning and subsequent to the issuance of a draft of this report, DITCO stated that they had made progress in resolving disputed charges and that they had also researched a portion of the $3.0 million in invoices that remained unresearched as of January 2003.

We requested that DITCO provide supporting records for the additional invoices that they had researched since January 2003. We also requested updated information from DFAS Pensacola on credits that had been obtained by DITCO since January 2003. As a result of our request, DITCO provided updated detailed and summary research data.

DITCO Summary Research Records. The summary records DITCO provided as of July 21, 2003, indicated $18.0 million had been researched and $1.3 million had not been researched. However, we consider the summary records to be less reliable than the detailed supporting records because of the methodology used by DITCO personnel to accumulate the summary amounts. Specifically, DITCO personnel stated that the summary researched amounts are higher than the detailed supporting records because the summary amounts sometimes include higher invoice amounts than those provided by MCIWorldCom on the summary spreadsheet used in support of the settlement payment. DITCO included higher invoice amounts if research personnel actually researched more charges from the hardcopy invoices than the corresponding charges on the MCIWorldCom provided spreadsheet. We believe that DITCO personnel were correct in researching the entire hardcopy invoice amount to determine valid and invalid charges, however, only the amount originally charged by MCIWorldCom should have been included in the research summary data.

DITCO Detailed Research Results as of July 2003. To determine the amount of the invoices paid as part of the $16.6 million payment that had been researched, we used the detailed records provided by DITCO and DFAS on July 21, 2003, because of the associated detail and the methodology used by DITCO to compile the summary research records. Based on updated detailed information provided by DITCO and DFAS, we calculated that DITCO had researched an additional $0.8 million in invoices and resolved $2.0 million of the open disputes since January 2003. Therefore, as of July 16, 2003, we estimate that DITCO has researched $17.1 million in paid charges and $2.2 million in paid

charges have not been researched. Therefore, as of July 21, 2003, $9.0 million of the charges were valid, $6.3 million were overpayments, $1.8 million are disputed, and $2.2 million remain unresearched.

Year-End Credits. DITCO did not offset the disbursement amount by all of the $12.8 million of credits it had earned. Federal agencies using the FTS 2001 contract receive year-end credits from MCIWorldCom in years 2 through 6 of the contract ranging from 15 to 25 percent. The contract requires MCIWorldCom to authorize year-end credits based on a percentage of net revenue. MCIWorldCom was to begin providing information on credits in July, August, and September each fiscal year and then October of the following fiscal year. Although the FY 2000 and part of the FY 2001 usage credit amounts were known, DITCO was behind in getting the year-end credits due from MCIWorldCom. Prior to negotiating and paying MCIWorldCom the $16.6 million lump sum payment, DITCO had not taken any of the FY 2000 credit amount of $5.5 million or the $7.3 million for FY 2001 credit. DITCO recouped $2.7 million of the $12.8 million in net revenue credits at the time it certified the $16.6 million payment to MCIWorldCom.

Justification and Research of Lump sum Payment

We believe that the $16.6 million lump sum payment was negotiated prematurely and, had additional work been done, a more favorable result could have been obtained. For example, DITCO did not recoup year-end credits when they were identified and earned, DITCO did not sufficiently review the supporting documentation for the disbursement, and DITCO did not assign adequate resources to processing FTS 2001 invoices. Additionally, DITCO believed that the research was complete, and researching all 17,030 invoices was not cost-effective. Also, MCIWorldCom did not comply with the provisions of the FTS 2001 contract related to disputes and completion of services.

Recouping Year-end Credits. Before September 18, 2001, DITCO had not recouped all of the $12.8 million in year-end credits earned from MCIWorldCom. The credits were based on annual net revenue of FTS 2001 services and were provided by MCIWorldCom in accordance with the contract before the $16.6 million payment.

DISA headquarters stated that DITCO delayed taking the credits because of the delays in paying FTS 2001 invoices and DISA headquarters did not believe it was appropriate to recoup the credits until DITCO began paying invoices faster.

However, by September 2001, DITCO had made progress paying FTS 2001 invoices, and was developing an automated means to reduce the amount of paper invoices submitted by MCIWorldCom. Additionally, DITCO had made payments of at least $92.7 million for FYs 2000 and 2001 FTS 2001 services in which no year-end credits had been applied. Therefore, it would have been appropriate for DITCO to request that MCI WorldCom offset the $19.3 million in invoices by the $12.8 million in credits earned.

During FY 2002, DITCO continued to lag behind in taking year-end credits for FTS 2001 usage. For example, December 2002 was the first month in which DITCO directed DFAS to begin to apply FY 2002 net revenue credits.

Support for the lump sum payment. DITCO did not sufficiently review the MCIWorldCom supporting documentation before making the payment. MCIWorldCom provided a list of invoices to DITCO that included the customer number, invoice number, and invoice date. MCIWorldCom asserted that this spreadsheet of invoices included only valid charges that had never been fully or partially paid and included only DITCO customers.

The spreadsheet included 17,030 invoices totaling $19.3 million. Based on the agreement signed by DISA and MCIWorldCom in September 2001, DITCO had five working days to review the MCIWorldCom supporting data. However, five working days was not enough time to analyze the spreadsheet and identify the inaccuracies that were later found after DITCO began intensively researching the individual invoices. DITCO found inaccuracies including invoice amounts that had been paid and inaccurate and invalid charges.

Paid Invoices. DITCO research personnel determined that the MCIWorldCom spreadsheet included invoices that had already had been paid. DFAS reconciliation data showed that approximately 182 invoices with charges of $4.4 million had already been paid before the September 18, 2001, lump sum payment was made. These duplicate payments were subsequently credited back to DITCO after DITCO disputed them.

Inaccurate Invoice Amounts. DITCO reconciliation information showed that many of the invoice amounts listed on the MCIWorldCom spreadsheet were inaccurate. Specifically, 467 invoices on the MCIWorldCom spreadsheet differed from the hard copy invoices by $2.1 million. For 329 of the 467 invoices, the dollar value of the hardcopy invoice amount was greater than the amount listed on the MCIWorldCom spreadsheet by $2.2 million. According to the DITCO reconciliation team, the amounts shown on the hard copy invoices were sometimes greater than the MCIWorldCom spreadsheet because MCIWorldCom included only the amount owed after accounting for partial payments on the spreadsheet. For 138 of the 467 invoices, the MCIWorldCom spreadsheet amounts were more than the corresponding hardcopy invoice amount by $151,000.

Invalid Charges. DITCO reconciliation efforts show that the invoice amounts provided on the MCIWorldCom spreadsheet included invalid charges totaling more than $1.1 million. These invalid invoices included charges that applied to non-DITCO customers, inaccurate billing rates, and service not provided.

Resources for Processing FTS 2001 Invoices. The $16.6 million lump sum payment was certified for payment prematurely because DITCO did not establish adequate resources to pay invoices on the FTS 2001 contract upon receipt. DITCO did not assign sufficient resources to manually process, research, and pay the volume of invoices delivered.

At the end of May 2001, DITCO was behind in processing FTS 2001 invoices. This occurred, in part, because prior to May 2001 only one accountant had been assigned to process FTS 2001 invoices for payment.

In June 2001, DITCO assigned a Tiger Team to assist in processing the invoices and authorized overtime. The Tiger Team was responsible for opening FTS 2001 invoices, entering accounting information into a spreadsheet, and sorting the invoices in preparation for submission to DFAS for payment.

From June through September 2001, 22 DITCO personnel worked 5,059 hours processing approximately 76,000 invoices for payment. DFAS records show that FTS 2001 payments to MCIWorldCom during this time were about $38.0 million. This amount was significantly more than the $35.4 million paid in the first eight months of FY 2001.

As of October 2001, DITCO and MCIWorldCom began to implement a project to terminate the manual submission of invoices. By November 2001, MCIWorldCom no longer sent hard copy invoices for the majority of FTS 2001 contract work. Electronic invoicing has removed the need for DITCO to open hardcopy invoices and enter the billing information into a spreadsheet for further processing.

Completing Research Efforts. Subsequent research efforts related to the $16.6 million payment were not completed at the time of audit. Specifically, disputes were not resolved in a timely manner and DITCO had not researched all of the $19.3 million in invoices.

Resolving Disputes. The FTS 2001 contract provided procedures for resolving disputes. MCIWorldCom was required to research and answer disputes within 30 days when the value of the invoice in dispute was under $10,000. Disputed invoices valued at greater than $10,000 should be resolved within 60 days. According to DITCO, $1.8 million in disputed charges are past the resolution date and awaiting action by MCIWorldCom. In addition to contractual requirements, the agreement signed by DITCO and MCIWorldCom prior to the $16.6 million payment established that disputes related to the payment would be resolved in a timely manner.

DITCO Research of $16.6 million. DITCO made a decision to research $16.6 million of invoices instead of all of the invoices actually paid that totaled $19.3 million. DITCO's research-team personnel stated that the majority of the invoices not researched were low dollar invoices and it would not be cost-efficient to spend resources to research the remaining invoices. DITCO summary research records indicate that the amount that has not been researched is about $1.3 million. However, based on detailed data provided by DITCO and DFAS, there are about $2.2 million of invoices not yet researched. Of the $2.2 million of invoices that have not been researched, DITCO records indicate that there are at least 692 invoices valued at more than $1,000, totaling more than$1.6 million.

Service Completion Information. We believe that DITCO was correct initially in withholding payment, because MCI WorldCom was not providing SOCN

information within the time period required by the contract. The GSA contracting officer came to a different conclusion and DISA management indicated it felt bound by that decision.

In the months prior to September 2001, DITCO and MCIWorldCom had several discussions regarding the contractual requirement that MCIWorldCom provide accurate SOCNs for telecommunications services. DITCO records indicate that MCIWorldCom was experiencing problems in providing the contractually required SOCNs that DITCO needed to establish an expected billing amount and verify that telecommunications services had been provided. Without a SOCN, DITCO could not readily verify that charges applied to ordered services and that the invoice amounts were accurate. During the same time period, MCIWorldCom provided DITCO a letter claiming that accurate and timely SOCN information was being provided as required.

We performed an analysis of 43 invoices included in the $16.6 million lump sum payment to determine whether accurate and timely SOCNs were provided. We also contacted GSA regarding the issue.

Review of Invoices for SOCN Information. We reviewed 43 invoices that included valid charges that were part of the $16.6 million payment. MCIWorldCom had not provided accurate or timely SOCN information for the billed services on all the invoices. Specifically, twenty service orders did not have the accurate SOCNs provided to DITCO until after the September 18, 2001, payment. One out of the 43 service orders invoiced, had an accurate SOCN provided on time. MCIWorldCom had not provided an accurate or complete SOCN for 6 of the 43 invoices we reviewed. For the remaining 36 sample invoices, MCIWorldCom provided accurate SOCNs but the SOCNs were late on average by 300 days.

GSA Position. We contacted GSA regarding the DITCO claim that MCIWorldCom was providing inaccurate and late SOCNs. A GSA representative stated that he had done some research on SOCNs provided to the Air Force during April, June, and August of 2002. He selected all Air Force service orders completed for these months from MCIWorldCom's database and compared the dates the SOCNs were provided to the date the service was completed. He did not test the accuracy of the SOCN information. He determined that the SOCNs were late 27 percent of the time. The data provided by GSA supported both DITCO claims that MCIWorldCom was not providing accurate and timely SOCNs and our analysis of invoices included in the $16.6 million payment Despite this data, GSA FTS 2001 personnel have concluded that lack of timely or accurate SOCN information is not a valid reason for late payment of invoices.

We disagree that the lack of timely and accurate SOCN information is not a valid reason for late payment of invoices. Service order completion information, such as date of service and estimated charges, is required by the FTS 2001 contract as a prerequisite to submitting invoices, and specifically notifies DITCO that services have been provided. The MCIWorldCom submission of invoices without first providing accurate and timely SOCN information raises questions about whether these invoices are proper. It was

reasonable for DITCO to expect MCIWorldCom to provide service order completion information prior to disbursing funds for FTS 2001 services.

Overpayments Identified and Potential Overpayments

The agreement between DISA and MCI anticipated that some of the unresearched invoices could be invalid, for one reason or another, and preserved the Government's right to research those invoices and make payment adjustments based upon the result. DITCO subsequently determined that it overpaid at least $6.3 million to MCIWorldCom and there is a risk of additional overpayments related to about $1.8 million of disputed invoices that were paid and about $2.2 million in paid invoices that have not been researched. Based on the DITCO research results to date, the amount of overpayments still outstanding could be substantial.

Overpayments Identified. DITCO has identified at least $6.3 million in overpayments to MCIWorldCom for FTS 2001 invoices. The overpayments included duplicate charges on invoices that were already paid, invalid charges (such as charges for disconnected services), charges for service prior to the effective billing date, and charges for non-DITCO customers (such as the U.S. Army Corps of Engineers). Of the $6.3 million in overpayments identified, at least $4.9 million (78 percent) duplicated payments made on invoices before the September 18, 2001, lump sum payment.

Potential Overpayments. There is a risk of additional overpayments related to $1.8 million of unresolved disputed paid invoices and about $2.2 million in paid invoices that have not been researched by DITCO.

Disputed invoices. Based on the research results to date, DITCO has received approximately 37 percent of the researched amount back as credits. A significant portion of the $1.8 million of unresolved disputed invoices may also represent overpayments to MCIWorldCom. DITCO has grouped the disputed charges into categories such as duplicate payment, billing prior to effective service date, cancelled order prior to completion, and no match in the system found.

Non-researched invoices. DITCO has not researched about $2.2 million of the $19.3 million in paid invoices (before credits) and there is a risk that additional overpayments to MCIWorldCom related to these invoices occurred and will not be recovered. Based on the $8.1 million ($6.3 million in overpayments and $1.8 million in unresolved disputes) out of $17.1 million that was either overpaid or disputed, it is reasonable to expect that additional overpayments occurred related to the invoices that have not been researched. In addition, because DITCO is a reimbursable operation, the proper DITCO customer will not be billed accurately for valid charges and the Defense-wide Working Capital Fund will not be reimbursed for these charges. Based on the DITCO research results to date, the percentage of credits received has been 37 percent.

We believe that it is reasonable to expect that a significant amount of the unresearched invoices represent overpayments. Additionally, the approximate $2.2 million of invoices not yet researched include high dollar amounts that could be researched relatively quickly. For example, of the $2.2 million of invoices not yet researched, there are 692 invoices for more than $1,000 that total $1.6 million. Based on the time incurred on researching the $17.1 million of invoices, DITCO personnel could research these higher dollar invoices in a few months.

Management Comments on the Finding and Audit Response

DISA took issue with some parts of this report although they concurred with the recommendations. Specifically:

Management Comments on General Issues Regarding the Finding. DISA believes that the report calls into question the authority of the GSA contracting officer to interpret the FTS 2001 contract and to decide disputes, and discounts DISA authority to make a payment as a settlement of a dispute. For these reasons DISA recommended that the report not be issued.

Audit Response. The finding does not call into question the authority of the GSA contracting officer to interpret the contract or to decide disputes, although we disagree with the GSA preliminary decision that inaccurate and untimely SOCNs are not a significant reason to withhold payment until proper invoices are submitted by the contractor. While the GSA contracting officer determined that the SOCNs were not a prerequisite for payment, she did not direct DISA to make a lump sum settlement payment. We agree that DISA is liable for unpaid FTS 2001 charges that are determined to be valid. However, the settlement payment was made prematurely without properly verifying the supporting documentation and recovering credits owed to DoD. In addition, the finding does not question the authority of DISA to enter into a legal settlement. We specifically discuss the events that resulted in the legal settlement in the background of the report. The audit report addresses corrective actions related to unresolved issues from a settlement payment that occurred almost two years ago. Assistance was needed because at the time of the audit, $1.8 million in paid charges were still being disputed with MCIWorldCom and about $2.2 million in paid charges had not been researched and validated. The recommendations in the report will urge DISA management to resolve these long-standing issues and encourage DISA to identify and recover additional overpayments.

Management Comments on Finding Background. DISA management stated that the report failed to provide enough background information to introduce the dilemma leading up to the settlement payment. DISA stated that the settlement resulted after more than a year and a half of negotiations and was concerned that a reader of the report could obtain the impression that DISA actions were capricious and cavalier.

DISA also stated that anticipated FTS 2001 services were about $100 million per year, and therefore DISA calculated that monthly Accounts Payable should be about $8.3 million. In contrast, DISA calculated that the average monthly

payment was about $4.5 million. Therefore DISA management believed that they had a basis to conclude that an Accounts Payable problem existed. In addition, DISA stated that they were receiving virtually no calls from customers complaining about service interruption and therefore, the assumption could be made that FTS 2001 services were being provided and payment was due.

Audit Response. The background and body of the report addresses many of the DISA concerns and contains sufficient information so that an informed reader can make an objective conclusion about the appropriateness of the settlement payment.

We agree with DISA management that comparing monthly billing information with payments can be a valid tool for generally tracking Accounts Payable. However, we disagree that summary information should be used to support lump sum payments for telecommunications services. In addition to overdue payments, several other factors could account for the discrepancy between billings and disbursements for telecommunications services, such as billing inaccuracies with MCIWorldCom, service charges at start-up being lower than they had become by the time of the lump sum payment, delays in service being switched from the prior FTS contract, or lower rates and usage than expected.

For financial accounting purposes, Accounts Payable balances are derived from accounting transactions supported by vendor invoices, and not summary level estimates or unverified summary invoice lists from contractors. Based on the results of the DITCO research of the supporting records for the $16.6 million payment and other FTS 2001 billing issues, we consider DISA management's use of MCI billing records to support owed amounts without verification from DITCO records imprudent. Regarding the lack of customer calls concerning service interruption, this could indicate that FTS 2001 services had not been switched over before the lump sum payment was made.

Management Comments on the Applicable Regulations. DISA requested that the finding section be rewritten because it completely ignores the DISA assertion that the payment was a settlement agreement and the OIG DoD statement that the payment does not comply with the FAR, and the DoD FMR should not be cited because it ignores the DoD Disputes and Appeals policy.

Audit Response. The finding is specific regarding which sections of the FAR and DoD FMR DISA deviated from in directing the lump sum payment be made. Specifically, prior to the disbursement, DITCO should have verified that the MCIWorldCom services were actually performed or that the billing data was accurate as required by FAR Section 32.905, "Payment Documentation and Process," and the DoD FMR volume 10, chapter 7, "Prompt Payment Act."

The finding does not question the legality of the settlement agreement, but demonstrates that the payment deviated from certain FAR requirements and was premature. DISA should have conducted a proper review of the supporting documentation for the $19.3 million in past due charges and recovered all of the credits owed to DoD before making payment.

Management Comments on Validity of $16.6 million Lump Sum Payment.

DISA stated that the report ignores the fact that the MCIWorldCom spreadsheet was provided in accordance with the settlement agreement as a means of providing a reasonable assurance that the payment amount was not inflated and had a rational relationship to the amount due on the overdue invoices. In addition, DISA believes that there was a reasonable basis at the time, and probably a similar basis today, to conclude that the vendor has not been paid timely for their services.

Audit Response. There was very little basis for DISA management to conclude that the summary invoice list provided by MCIWorldCom provided reasonable support for the payment. DISA management was aware that MCIWorldCom was experiencing difficulty in producing accurate FTS 2001 billings, that MCIWorldCom had initially requested a larger payment for overdue invoices of $33 million. DISA management also had been repeatedly made aware of MCIWorldCom billing problems by DITCO personnel. Therefore, it was more reasonable to expect DISA management to perform a rigorous review of the supporting documentation before making such a large disbursement from the working capital fund. In addition, the exhaustive research efforts performed by DITCO subsequent to the payment show that valid charges amounted to only about $6.6 million of the $16.6 million payment. As discussed in the audit report, the research results clearly indicate that the summary invoice list provided by MCIWorldCom was inaccurate and was not a reasonable representation of overdue FTS 2001 charges.

Management Comments on Overpayments Identified. DISA requested that the section of the finding titled "Over Payments Identified and Potential Over Payments" be rewritten because the conclusion that the settlement was improper is not substantiated.

Audit Response. The finding supports a conclusion that DISA made overpayments on some of the invoices that were included as part of the settlement payment to MCIWorldCom. Specifically, at least $6.3 million was overpaid and additional overpayments related to $1.8 million of disputed invoices and $2.2 million in unresearched invoices may also have occurred. Existence of accounts payable to MCIWorldCom, not covered by the settlement agreement at the time of the $16.6 million payment, is a separate matter from the overpayments that did occur on the invoices that were included in the settlement agreement.

Recommendations, Management Comments, and Audit Response

We recommend that Director, Defense Information Technology Contracting Organization, Defense Information Systems Agency improve the FTS 2001 payment process. Specifically, we recommend that the Director:

1. Apply future Federal Technology Services 2001 contract year-end credits as they are identified and earned.

Management Comments. The Defense Information Systems Agency concurred with the recommendation, stating that Defense Information Technology

Contracting Office will work with Defense Finance and Accounting Service to apply credits as they are identified.

2. Pay only valid Federal Technology Services 2001 contract charges according to the requirements of The Federal Acquisition Regulation 32.905, "Payment Documentation and Process," and the DoD Regulation 7000.14-R, DoD Financial Management Regulation, volume 10, chapter 7, "Prompt Payment Act," and do not make any additional lump sum payments on Federal Technology Services 2001 charges.

Management Comments. The Defense Information Systems Agency concurred with the recommendation, stating that this payment was a unique one-time action and they are working to ensure this will not occur in the future. However, they requested a rewording of the recommendation to included the word "settlement."

Audit Response. The intent of this recommendation is not to prevent the Defense Information Systems Agency from entering into another legal settlement.

3. Continue to research the approximately $2.2 million of invoices (paid in the lump sum $16.6 million payment) that have not been researched to identify potential overpayments and require appropriate credit back to Defense Information Technology Contracting Organization.

Management Comments. The Defense Information Systems Agency concurred with the recommendation, stating that they have assembled a team of telecom account managers, contracting officers, finance management staff, and automation support to reconcile overall FTS 2001 issues.

4. Continue to work with MCIWorldCom to improve the timeliness and accuracy of service order completion notices and resolve disputed invoices related to the $16.6 million payment. Direct that the Defense Finance and Accounting Service withhold the $1.8 million disputed amount from current invoices until MCIWorldCom properly resolves the disputed invoices.

Management Comments. The Defense Information Systems Agency concurred with the recommendation, stating that Defense Information Technology Contracting Office has dedicated personnel to work outstanding MCI issues and to work with Defense Finance and Accounting Service to determine the proper methodology for withholding the disputed amounts from current invoices.

Appendix A. Scope and Methodology

We reviewed supporting documentation related to a DITCO certification of a $16.6 million lump sum payment made to MCIWorldCom on September 18, 2001. The supporting documentation included applicable FTS 2001 contract clauses, a summary invoice list received from MCIWorldCom, and correspondence between GSA, MCIWorldCom, DITCO, and DISA concerning possible solutions to FTS 2001 billing problems around the time of the payment. We also randomly selected and reviewed service order completion notices (SOCNs) related to valid charges included in the $16.6 million lump sum payment, obtained DITCO summary and detailed research information for the $16.6 million payment as of January 8, 2002, and obtained DFAS detailed support of the DITCO overpayments as of January 8, 2003, and July 21, 2003. Subsequent to the draft report, we obtained DITCO summary and detailed research information for the $16.6 million payment as of July 21, 2003.

We contacted GSA to discuss and clarify relevant FTS 2001 contract clauses and to obtain additional information regarding the circumstances leading up to the $16.6 million lump sum payment and whether MCIWorldCom was complying with contractual requirements to provide accurate and timely SOCNs. We contacted MCIWorldCom to discuss the supporting documentation provided in support of the $16.6 million lump sum payment.

We obtained an understanding of the DITCO FTS 2001 ordering, validation, invoice processing, disbursement, and customer billing process. We also obtained an understanding of the research methodology implemented by DITCO after making the $16.6 million payment.

We performed this audit from August 2002 through July 2003 in accordance with generally accepted government auditing standards.

We did not review the management control program as it related to processing FTS 2001 orders and payments because management controls over payment of invoices were circumvented to make the lump sum payment, and part of the process has changed since the invoices were received and the payment made. In addition, the research performed after the lump sum payment was made is not a normal DITCO business process. Not assessing the management control program over the current process to order, validate, and pay FTS 2001 invoices did not affect our results.

We did not perform detailed testing on the DITCO supporting invoices and other research documentation related to the $16.6 million lump sum payment. Specifically, we did not individually review FTS 2001 invoices that DITCO determined to include valid charges, disputed charges, or overpayments. To verify overpayments and credits received back from MCIWorldCom, we relied on detailed DFAS records.

Use of Computer-Processed Data. To achieve the audit objectives, we relied on computer-processed data, accumulated by DITCO research personnel, related to the $16.6 million lump sum payment to MCIWorldCom for FTS 2001 services.

Our comparison of summary and detailed DITCO information on overpayments and disputed charges and with DFAS credit amounts on applicable FTS 2001 invoices casts doubt on the data's validity. However, the differences are not significant enough that we believe the opinions, conclusions, and recommendations in this report are invalid.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the DoD Contract Management high-risk area.

Prior Coverage

During the last five years, the General Accounting Office (GAO) has issued one report related to the FTS2001 contract payment problems. Unrestricted GAO reports can be accessed over the Internet at http://www.gao.gov/.

GAO

GAO Report No. GAO-01-289, "FTS2001: Transition Challenges Jeopardize Program Goals," March 30, 2001

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
    Deputy Chief Financial Officer
    Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense for Networks and Information Integration, DoD Chief Information Officer

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
    Director, Defense Finance and Accounting Service – Pensacola
Director, Defense Information Systems Agency
    Comptroller, Defense Information Systems Agency
    Director, Defense Information and Technology Contracting Organization

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Defense Information Systems Agency Comments

DEFENSE INFORMATION SYSTEMS AGENCY
701 S. COURTHOUSE ROAD
ARLINGTON, VIRGINIA 22204-2199

IN REPLY REFER TO INSPECTOR GENERAL (IG)

13 June 2003

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Draft Report, Certification of a DOD Payment for Telecommunications Services, D2002FJ-0202

1. The enclosed document provides the Defense Information Systems Agency response on the Draft Report for the audit described above.

2. The DISA IG points of contact for this action are Liz Lippmann, 703.607-6306 and Teddie Steiner, 703.607-6316.

Enclosure a/s

FRANK S. CHASE
Acting Inspector General

Quality Information for a Strong Defense

DISA Comments – General

Position Summary: DISA has reviewed the recommendations in the subject draft DoD Inspector General (IG) Report and provides the below comments. In general, DISA concurs with the recommendations but does not agree that financial settlement was made in error. The Report fails to accept the authority of the GSA contracting officer to interpret the contract at issue, fails to recognize the GSA contracting officer's authority to decide disputes, fails to address the authority of the Agency to make a payment as a settlement of a dispute, and is not appropriate notwithstanding reported scope limitations. The scope limitations exclude these material facts and the legal consequences of these facts so as to make the report an academic exercise. In fact, the Government has a strong policy "to try to resolve all contractual issues in controversy by mutual agreement at the contracting officer's level." For these reasons, DISA recommends this Report not be issued and urges you to consider the detailed comments below to further appreciate the underlying process issues that made this settlement necessary.

1. The Draft IG report fails to provide the requisite background to introduce the dilemma leading to this settlement, fails to address the authority of the Agency to make a payment as a settlement of a dispute, and is, in our opinion, not appropriate notwithstanding reported scope limitations. DISA was not driven to pursue a settlement with WorldCom overnight. Rather, the settlement was the result of a long, arduous process that culminated after more than a year and a half of negotiations to resolve a dispute over what documentation the vendor was contractually required to provide to permit DISA to reconcile almost 150,000 paper invoices received in individually wrapped envelopes. Without that background, an independent reader of the report could obtain the impression that DISA's actions were capricious and cavalier. In fact, our actions were just the opposite.

2. The contracting officer was within their authority to settle the FTS 2001 dispute. The Government has a strong policy "to try to resolve all contractual issues in controversy by mutual agreement at the contracting officer's level." FAR 33.204. In fact, the Federal Acquisition Regulation (FAR) instructs, "reasonable efforts should be made to resolve controversies prior to the submission of a claim." Id. The FAR gives contracting officers broad authority "within any specific limitations of their warrants, to decide or resolve all claims arising under or relating to a contract subject to the Contract Disputes Act (CDA)." FAR 33.210. In addition to the regulatory guidance, the legislative history of the CDA contains the following statement at 124 Cong. Rec. H10,725 (1978):

> It is still the policy of Congress that contractor claims should be resolved by mutual agreement, in lieu of litigation, to the maximum extent possible.

Final Report Reference

Clearly, the contracting officer has authority to settle claims and the vast majority of contract issues are settled before the filing of a claim. Settlement of claims may be total or partial. If the parties settle only on some issues and leave others for resolution through the disputes process, the settlement agreement must state the issues or claims that are excluded. The September 18, 2001 settlement agreement was specifically not a "final agreement," requiring a complete accounting of the unpaid invoices, and adjustment of any discrepancies. It was not necessary for the invoices to be totally free from defects in order to be proper and create a valid demand on the government. FMR Volume 10, Chapter 7, Paragraph 0702.

3. We have attached a memorandum for the DoD Deputy General Counsel for Fiscal Law from the DISA General Counsel, prepared in September 2001, that describes DISA's decision to negotiate an agreement to pay a sum in settlement of all outstanding invoices over 30 days old in exchange for a waiver of Prompt Payment Act interest and subject to reconciliation of the invoices. His memorandum identifies the facts that DISA considered and the legal analysis that supported actions to resolve the outstanding invoices situation. Several factors were key to this decision: *

   a. The position taken by the GSA contracting officer was for DISA to pay invoices upon receipt and subsequently dispute them. Also the contracting officer was of the opinion that a Service Order Completion Notice was not a prerequisite to paying the invoices when received.
   b. The vendor desired to pursue a claim under the Contract Disputes Act and had estimated Prompt Payment Act penalties of $2 million.
   c. The settlement agreement would preserve the government's right to review all items on the Summary Invoice List and obtain refunds of any incorrect charges.

4. We have also included a list of specific comments for your consideration that are cross-referenced to your draft audit report. As noted in meetings with the audit staff, we believe that the actions taken by DISA at that time, and with the facts in hand were prudent and preserved our ability to ensure that payment was made only for services rendered. In particular, we also note that the auditors were correct in their observation that the original list of invoices was not completely researched and reconciled. DITCO continues to work the remaining reconciliation of the original $16M during day-to-day efforts. We have assembled a team of telecom account managers, contracting officers, finance management staff and automation support. DITCO's approach uses an integrated, multidisciplinary, cohesive team overseen by senior staff from contracting, financial, management, automation and Chief DITCO Scott Field Office. DISA had given DFAS its commitment to complete that reconciliation as a condition to their approval of the payment associated with this settlement. We will comply with the auditors' recommendation in that regard.

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* Memorandum is not re-printed because an official copy was not provided by DISA

Final Report Reference

Report-Specific Comments

(The following comments are cross-referenced to the draft report.)

Executive Summary, Para 2, Background:

The report should note that, at the time this settlement was made, the Deputy Chief Financial Officer was the Director of the DFAS-Columbus Center that authorized the $16.6M settlement. It should also note that the DFAS-Cleveland was the Disbursing Office for DISA at the time this settlement was made.

DITCO did offset the disbursement with $2.7M of credits earned.

Page 1, Background, Para 1:

See comment above under Executive Summary, Para 2, Background.

Page 1, Background, Para 3, Federal Telecommunications Service (FTS) 2001 Contract:

Revised

Prior to FY 2002 the GSA management fee was 8%. DoD currently pays GSA a 7% management fee.

Page 1, Background, Para 5, DoD Use of FTS2001:

DITCO provides both contracting and financial services for our customers who order FTS2001 services through DITCO.

As noted in discussion with the audit staff, the anticipated services of $100 million per year equals about $8.3 million per month in Accounts Payable. The audit disclosed that DISA was averaging payments of about $4.5 million per month to the vendor over a 22-month period. It would appear that there was a basis for DISA senior management to conclude that an Accounts Payable problem existed and was growing at about $4 million per month.

Page 1, Background, Para 7, FTS2001 Contractual Requirements:

For the most part, the customers who were on the existing FTS2000 contract were simply transitioned to the new contract and features. Thus, DISA received virtually no calls about service interruption or other complaints, aside from the desire to be billed more timely. While we needed the SOCN documentation to establish Communications Service Agreements at DITCO, that did not preclude GSA from asserting that invoices should be paid when received and disputes filed later.

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Page 2, Background (cont.), Para 2, Payment Process:

It would be useful to the requestor and readers of this report to have more background on the payment process situation that confronted DISA including: (1) mounds of individually wrapped paper invoices (about 12,000 documents per month), (2) GSA management demands to make payments, (3) the failure of WorldCom to consistently use the appropriate CSA number on the invoices and SOCN's severely hampering DISA's ability to track circuit usage and permit the recovery of FTS2001 costs from our customers, and (4) the failure of WorldCom even to provide SOCN's in many instances. Also worth noting is the fact that, while WorldCom's billing platforms were not designed to accommodate the DISA process, continuous efforts were maintained by the government (DITCO and GSA) with the vendor for more than a year to achieve the level of automation noted during the audit. The culmination of those efforts resulted in the implementation of electronic invoicing in October 2001.

Page 2, Background (cont.), Para 3, Lump Sum Settlement:

This was a settlement, not a "lump sum payment for FTS2001 invoices" and the distinction is not trivial. While the DISA General Counsel's memorandum details the basis and propriety of a settlement, DISA had an obvious dilemma that should be noted in this section. The SOCNs were necessary for us to validate invoices, yet the GSA officials made a determination that vendor invoices should be paid notwithstanding. Every attempt was made to work with the vendor and perform due diligence on the thousands of paper transactions, which DITCO received monthly and was not staffed to process. And, in many cases, the SOCNs were not just untimely, but failed to provide the CSA number to match to the orders or were non-existent. An extraordinary effort, to include assigning an additional 29 people to the process, took place over many months to bring some semblance of order to the situation. Still, both the vendor and GSA complained about the growing Accounts Payable problem while refusing to fix the SOCN process. DISA headquarters involvement only became necessary when it was apparent that: (i) there would be no timely resolution to the paper invoice verification process, (ii) all parties began to stiffen their positions, making cooperative solutions unlikely, (iii) the vendor was postured to file a contract dispute with estimated interest penalties estimated at $2 million, and (iv) GSA management and the contracting officer sided with the vendor on all points (and, to date, have not enforced the SOCN provision of their contract). Also of significance was the fact that there were no complaints from DISA customers with respect to the quality or availability of FTS2001 service; thus, it was fairly evident that the vendor was providing service. A settlement was pursued after consultation with GSA, DFAS, and Office of the Under Secretary of Defense (Comptroller) senior personnel. There were no efforts to preclude full disclosure of the situation or to hide facts from DFAS or OSD officials, and every effort was taken to protect the government's interests.

Final Report Reference

Revised

Page 4, Lump Sum Payment for FTS2001 Invoices:

The word "headquarters" should be inserted after DISA, as DITCO is part of DISA. As stated above and in the DISA General Counsel's memorandum, this was a settlement that permitted a post-payment review of the invoices. As noted by the auditors, the validation was not completed, and actions will be taken to ensure that it is. Having stated that, the DITCO staff did act to reduce the initial dispute amount from about $33 million to the $16.6 million number. The entire discussion of credits is indicative of the need for a process review, which DISA will investigate. However, it is not germane in the context of DISA's attempt to settle the vendor's dispute and should be decoupled from the settlement issue.

WorldCom believed that it was contractually compliant and had the support of GSA. As the validation of the Summary Invoice List is completed, DISA will ensure that any overpayments are recovered. At 31 December 2002, DISA had Accounts Payable to the vendor totaling about $28 million; not including all the amounts owed for usage of the FTS2001 circuits. Of that amount, we showed about $13 million of payables that were under-billed by WorldCom. While we will attempt to provide more insights into this data, it is clear that by any reasonable measure, we have significant payables that are more than 30 days old. Additional actions will be directed by DISA headquarters to improve this situation or to find alternatives to this contract.

* Page 4, Payment Requirements, Federal Acquisition Regulation and DoD Financial Management Regulation Requirements:

See DISA General Counsel's memorandum on the permissibility of a settlement under federal regulations. DISA's action in settling a dispute is a critical fact that the report fails to analyze. There are laws and regulations governing settlement of disputes that must be addressed before a conclusion on the propriety of the payment can be reached.

Page 5, Validity of $16.6 Million Lump Sum Settlement, Para 1:

In general, this section must be rewritten to take into account the foregoing comments. As written it completely ignores the fact of the settlement agreement and the legal effect arising from it. The statement that the payment does not comply with the FAR ignores the provisions on Disputes and Appeals. FAR Part 33.204 "Policy. The Government's policy is to try to resolve all contractual issues in controversy by mutual agreement at the contracting officer's level. Reasonable efforts should be made to resolve controversies prior to the submission of a claim." Similarly, the statement that the payment does not comply with the DOD FMR ignores Vol 10 Chapter 3, Claims, Paragraph 030202 Responsibility of Contracting Officer, Disbursing Office, and DFAS Columbus;

The Contract Disputes Act of 1978 provides a fair, balanced, and comprehensive statutory system of legal and administrative remedies in resolving government

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* Memorandum is not re-printed because an official copy was not provided by DISA

contract claims. The Act's provisions help to induce resolution of more contract disputes by negotiation prior to litigation; to equalize the bargaining power of the parties when a dispute exists; to provide alternate forums suitable to handle the different types of disputes; and to ensure fair and equitable treatment to contractors and Federal agencies.

Both of these regulations speak approvingly of settling disputes without resort to formal claims processes, which is precisely what DISA did in negotiating the settlement. DOD FMR Vol 10, Chapter 12, paragraph 120106 "Payment to Contractor When Contracting Officer Approves Claim Under the Contract Disputes Act of 1978 (41 U.S.C. 601-613 and FAR 33.0 and 52.233-1)" describes the process for making payments in settlement of a claim, a process that would apply equally to settling a dispute before it becomes a formal claim. The IG's report cannot narrow the scope of inquiry to eliminate these critical factual and legal issues.

Page 5, Validity of $16.6 Million Lump Sum Settlement, Para 2:

This paragraph ignores the fact that the spreadsheet was provided pursuant to the settlement agreement as a means of providing a reasonable assurance that the sum agreed to in the settlement agreement was not inflated and had a rational relationship to the amount due on the overdue invoices. Again, there was a reasonable basis at that time, and probably a similar basis today, to conclude that the vendor has not been paid timely for their services. All parties have continued to work this problem cooperatively, which was embodied in the intent to negotiate a settlement.

Page 5, Validity of $16.6 Million Lump Sum Settlement, Para 3, Payment in Accordance with Regulations:

The FAR section cited does not apply to payments in settlement of a dispute. This is made clear in FAR Part 32.907(d) Disagreements. The propriety of the payment must be examined in the context of the settlement of a dispute. There was considerable effort on the part of DITCO to avoid duplicate payments. As noted previously, the original estimates of the amount to be paid were reduced, as payments in transit were identified. That effort continued to up to the time settlement was made.

Page 5, Validity of $16.6 Million Lump Sum Settlement, Para 5, Payment in Accordance with Regulations:

DISA strongly objects to this paragraph. It is a mischaracterization of the facts, totally ignoring the fact that there was a settlement agreement and the payment was made pursuant to that agreement in settlement of a dispute. The record is clear that every attempt was made to protect the government's interests and avoid a formal contract dispute that would have incurred costs for litigation and interest penalties. The settlement removed these additional costs. DISA headquarters deemed this preferable to engaging in litigation with a vendor that had another Federal agency (GSA) and the contracting officer supporting their position. After no substantive progress in reducing WorldCom's FTS2001 Accounts Payable balance in spite of numerous meetings between DITCO and WorldCom for about 18 months , it was appropriate for DISA management to devise a solution because the problem had escalated to GSA and WorldCom senior management levels. There is also the implication in this section of the report that the vendor was overpaid. While not disclosed in the audit, on 31 December 2002, DISA had Accounts Payable to WorldCom totaling about $28 million, not including all the amounts for usage of the FTS2001 circuits. Of that amount, we showed about $13 million of payables that were under-billed by WorldCom. Absent some better data, it is wrong to presume that WorldCom benefited, or that the government lost in this transaction. It would be inappropriate to describe this transaction in such a way.

Page 5, Validity of $16.6 Million Lump Sum Settlement, Para 6, DITCO Research of Invoices:

DISA will adhere to its commitment and reconcile all invoices. A major effort is in progress involving DITCO and WorldCom resources to resolve all outstanding FTS2001 invoicing issues. DITCO has assembled a team of 391 telecom account managers, 1102 contracting officers, an array of 500 series staff and automation support. DITCO's approach uses an integrated, multidisciplinary, cohesive team overseen by senior staff from contracting, financial, automation and the DITCO Scott Chief. Part of this process involves checking the reconciliation database prior to closing out each issue, so eventually all items, that have not been reconciled, will be resolved.

Page 6, Validity of $16.6 Million Lump Sum Settlement (cont.), Para 3, Year-End Credits:

Credits, while a valid issue we pursued, were separate from the settlement. DISA has always intended to obtain credits we are due.

Page 6, Justification and Research of Lump Sum Settlement:

Comments above pertain. The reconciliation has not stopped, this section repeats statements refuted above.

Final Report Reference

Page 7, Justification and Research of Lump Sum Settlement (cont.), Recouping Year-end Credits, Para 2 and 3:

Revised

Recommend deleting the reference to "DITCO Comptroller". The position or policy to delay taking the credits was in fact a DISA HQ policy not a local DITCO Field Office policy. Furthermore, it is difficult to demand credits from a vendor who has taken the position that DISA was substantially behind in paying their invoices. To suggest that such a dialogue would have been fruitful is just not reasonable. Yes, DITCO had made some progress, but how much? With average payments of about $4.2 million per month against an expected cost of about $8.3 million per month, it is not illogical to roughly gauge the magnitude of the problem and appropriateness of the settlement approach.

Page 7, Justification and Research of Lump Sum Settlement (cont.), Support for the lump sum settlement, Para 5:

Page 8

This paragraph and subsequent sections should be revised to reflect that this was a settlement and recognize the methodology used by DISA, in consultation with DFAS, to protect the government's interests. In addition to the DFAS consultation, we discussed our approach with OUSD(Comptroller) personnel, particularly with respect to the impact this transaction would have on the DWCF cash position.

Page 9, Justification and Research of Lump Sum Settlement (cont.), Service Completion Information, Para 3 and GSA Position, Para 7:

Page 10

GSA has not enforced the need to provide DITCO with the SOCNs on a timely basis. In fact, despite the report's constant references to receipt of "contractually required SOCNs" as a prerequisite to payment under the contract, the Contracting Officer, who has the authority to interpret the contract, had ruled that receipt of SOCNs were not required by the contract before payment could be made. The report must be changed to eliminate any implication that receipt of SOCNs were a prerequisite to payment under the contract in view of the Contracting Officer's decision. It should not be overlooked that DISA did not have a similar problem with the prior contract, FTS2000. DITCO's processes operated successfully when the requisite data was provided timely.

Page 10, Overpayments Identified and Potential Overpayments:

Page 11

This section must be rewritten because the statement that the settlement was improper is not substantiated. This is due to the failure of the report to analyze the payment as settlement of a dispute. However, we agree that we must complete the research of the line items on the Summary Invoice List and reconcile them with the invoices as provided in the settlement agreement.

Final Report Reference

Page 13

Page 11, Recommendations:

DISA concurs with the recommendations, but suggest recommendation #2 be reworded. We entered into a settlement (vice lump-sum settlement of FTS2001 invoices) and do not plan another one. Contract disputes are settled as a course of business and have legal and regulatory support that the report must acknowledge.

Page 11, Recommendation #1: Apply future Federal Technology Services 2001 contract year-end credits as they are identified and earned.

DISA Comment: Concur. The Defense Information Technology Contracting Office (DITCO) will work with DFAS Pensacola to apply FTS 2001 credits to payment vouchers as they are identified by MCI. In the past, MCI began issuing credit memos as early as June of the fiscal year of service, but thereafter these amounts were frequently and repeatedly adjusted throughout the period June through December based on actual revenue data. MCI provides a final, definitized listing of credits approximately December of the fiscal year following the fiscal year of service. DITCO has deferred applying the credits until the final definitized credits are received; this avoids repetitive processing of accounts payable and reduces the workload of DITCO and DFAS Pensacola. In order to concur with the DoD IG recommendation, DITCO and DFAS Pensacola will work together to establish a process that allows for a bottom-line adjustment to the payment vouchers for credit memoranda received and a procedure for subsequent adjustments to the credit memo amounts.

Page 11, Recommendation #2: Pay only valid Federal Technology Services 2001 contract charges according to the requirements of the Federal Acquisition Regulation 32.905, "Payment Documentation and Process," and the DoD Regulation 7000.14-R, DoD Financial Management Regulation, volume 10, chapter 7, "Prompt Payment Act," and do not make any additional lump sum settlements on Federal Technology Services 2001 charges.

DISA Comment: Concur. The settlement in question here was a unique one-time action to preclude a formal claim being submitted by the vendor pursuant to the disputes clause of the contract. Since that time, DITCO has worked with MCI (via a GSA contract modification) to implement an electronic invoice submission and validation process that will help preclude a recurrence of the problems that led to the need for this one-time settlement. DITCO also is participating in biweekly meetings with MCI to proactively work Accounts Payable issues. Finally, DITCO is working closely with DFAS to continuously improve vendor invoice certification and payment processes and procedures.

Page 11, Recommendation #3: Continue to research the approximately $3.0 million of invoices (Paid in the lump sum $16.6 million settlement) that have not been researched to identify potential overpayments and require appropriate credit back to DITCO.

Final Report Reference

DISA Comment: Concur. DITCO continues to work the remaining reconciliation of the original $16.6M settlement during day-to-day efforts. We have assembled a team of telecom account managers, contracting officers, finance management staff and automation support to reconcile overall FTS2001 A/P A/R issues. DITCO's approach uses an integrated, multidisciplinary, cohesive team overseen by senior staff from contracting, financial management, automation and the Chief of DITCO Scott's Field Office. To date, DITCO has reconciled $17.2M of the $19M in debit invoices. This leaves a balance of less than $2M and 11,000 associated invoices yet to reconcile. DISA remains committed to completing the reconciliation as a condition to their approval of the payment associated with this settlement. We will comply with the auditors' recommendation in that regard

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Page 11, Recommendation #4: Continue to work with MCIWorldCom to improve the timeliness and accuracy of service order completion notices and resolve disputed invoices related to the $16.6 million settlement. Direct that the Defense Finance and Accounting Service withhold the $3.6 million disputed amount from current invoices until MCIWorldCom properly resolves the disputed invoices.

DISA Comment: Concur. DITCO has instituted ongoing information exchanges with MCI personnel to improve all aspects of their relationship. This includes dedicating personnel to work outstanding MCI issues. Further, DITCO will work with DFAS to determine the proper methodology for withholding of the $3.6 million disputed amount from current invoices. This action needs to be fully researched and the agreement between DFAS and DITCO will be well documented to preclude any future questions raised as to the appropriateness of this action as well as to the parties that provided concurrence.

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