Comptroller General
of the United States

Washington, D.C. 20548

B-279620

March 31, 1998

The Honorable Charles E. Grassley
United States Senate

Dear Senator Grassley:

This letter responds to your concern about a provision in the proposed Department of Defense (DOD) Reform Act that would permit DOD to use a combination of "fast pay" and statistical sampling procedures to verify receipt and acceptance of goods and services after payment. Your March 16, 1998, letter asked for our position on DOD's proposal.

Section 401 would provide DOD with independent authority to implement a vendor payment process commonly referred to as "fast pay." Using a fast pay process, DOD would pay vendors subject to post-payment verification of (1) receipt and acceptance of goods and services ordered and (2) the accuracy of invoices received. Section 401 directs DOD to perform its postpayment verification using statistical sampling procedures. DOD's proposal does not contain a dollar limitation for payments that would be subject to the fast pay procedures.

The Office of Management and Budget (OMB) Circular A-125, Prompt Payment, Part 13 of the Federal Acquisition Regulation (FAR), and Title 7 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies authorize agencies to implement fast pay processes using certain controls, which minimize the exposure of loss to the government. Separate legislative authority is not necessary for an agency that intends to follow these requirements.

DOD currently lacks adequate systems and controls over payments as evidenced by the $22.7 billion in DOD's reported problem disbursements. DOD should first demonstrate that it can meet the control requirements currently prescribed in OMB Circular A-125, Part 13 of the FAR, and Title 7 of GAO's Policy and Procedures Manual followed by other federal agencies, before it implements fast pay procedures.

A TYPICAL PAYMENT PROCESS

Federal agency payment processes typically follow certain procedures which are designed to provide adequate controls to ensure that payments are proper. For example, agencies initiate a purchase order to obtain goods or services for

authorized purposes and amounts and within certain time frames. The purchase order is approved and signed by an authorizing official and forwarded to the appropriate financial service center where an obligation is established in the accounting system and the purchase order is filed awaiting receipt of a receiving report and a vendor's invoice.[1] Vendors submit invoices to the cognizant service center, where manual or automated processes are used to provide obligation control and to establish the time limit[2] allowed for verifying receipt and acceptance of the goods or services ordered and making a payment pursuant to the Prompt Payment Act (31 U.S.C. 3901, et seq.).

Agency receiving officials are responsible for recording receipt and acceptance of items ordered and for comparing quantities and items received with lists of items ordered. If discrepancies exist, notations are required on the invoice and receiving report. For each invoice, the receiving official initials or signs indicating (1) approval for payment, (2) payment modification based on any adjustment made, or (3) disapproval of payment. The receiving official signs the receiving report to provide evidence that the above responsibilities have been properly discharged, and the receiving report is forwarded to the service center for certification and payment.

If the invoice amount exceeds the obligated amount, the finance officer (or other official with obligating authority) must either (1) use available unobligated funds to cover the difference or (2) not approve payment for the excess amount. Certifying officers verify initials or signatures on the invoice and receiving report; compare amounts (quantities and dollars) on the invoice and purchase order; and, if no discrepancies are found, schedule the invoice for payment. If discrepancies are found, the certifying officer contacts the receiving official and/or the vendor to resolve questions. In addition, 31 U.S.C. 3521(b) authorizes agency heads to establish statistical sampling programs for examination of vouchers in support of their certification and payment subject to Comptroller General limitations, which are currently set at $2,500.

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[1]DOD's contract payment process is more complex because payments are recorded by separate accounting and disbursing systems. Obligations must also be recorded in both systems.

[2]Unless a contract specified an earlier time limit for receiving a discount, the 30-day time limit in the Prompt Payment Act would apply.

CURRENT CONTROLS FOR FAST PAY

In contrast to the above procedures, fast pay procedures permit agencies, under certain circumstances, to verify receipt and acceptance of goods and services after payment has been made. Fast pay is not a new concept and has been used in certain circumstances in the federal government for over 3 decades.

Federal agencies have used fast pay procedures when certain controls are in place and operating effectively to minimize risk of loss to the government. OMB, the FAR, and GAO require the following controls for fast pay processes.

(1) Individual payments are subject to a general dollar limitation of $25,000.

(2) Participating vendors must agree to replace, repair, or correct supplies, and remedy services, not conforming to contract specifications.

It should be noted that Part 13 of the FAR states that payment for supplies can be based on the contractor's submission of an invoice that constitutes a "certification" that the contractor has delivered the supplies. However, the contractor's certification is not a substitute for an agency employee's postpayment verification of receipt and acceptance of goods or services as shown on a receiving report.

For items paid for under the fast pay process, OMB Circular A-125 requires agencies to (1) promptly inspect and accept goods, (2) ensure that receiving reports and payment documents are matched and steps are taken to correct discrepancies, and (3) ensure that specific internal controls are in place to assure that supplies paid for have been received.

Further, Title 7 of GAO's Policy and Procedures Manual requires that when an agency performs postpayment verification on a statistical sampling basis, the sampling plan must provide for examination of supporting documentation commensurate with the risk of loss to the government, yielding a probable net cost savings due to the use of sampling, and monitoring implementation of the plan to ensure that the risks to the government remain within tolerable limits. In order to achieve savings, the cost to the agency of examining the sample plus projected losses due to undetected errors on documentation not examined must be less than the cost to the agency of examining all documentation.

Title 7 and the FAR require agencies to have a system in place to identify vendors who abuse the fast pay process. In addition, we encourage agencies that use fast pay processes to periodically evaluate whether advances in communications technology as well as other electronic systems capabilities (in

particular, fully automated receipt and acceptance processes) allow the agency to conduct prepayment audits and assure timely payment economically.

The enclosure to this letter contains a list of selected GAO products related to fast pay procedures.

DOD LACKS ADEQUATE PAYMENT SYSTEMS AND CONTROLS

DOD presently lacks adequate systems and controls to ensure that payments are properly supported and that erroneous payments and overpayments do not occur, as evidenced by DOD's reported $22.7 billion in problem disbursements as of September 30, 1997. This represents payments and collections for which (1) DOD lacks documentation of an existing obligation (unmatched disbursement), (2) the payment exceeds the recorded obligation (resulting in a negative unliquidated obligation), or (3) DOD lacks supporting documentation needed to record the payment in its detailed accounting system records (in-transit and suspense transactions).

In our February 1997 high-risk series on defense contract management,[3] we reported that if DOD did not achieve effective control over its payment process, it would continue to risk overpaying contractors by millions of dollars and perpetuate other financial management and accounting control problems. The DOD Inspector General's recently issued disclaimer of opinion on DOD's fiscal year 1997 financial statements[4] demonstrates that DOD continues to have severe internal control weaknesses that make it unauditable. These control weaknesses include problems with DOD's payment processes. Our audit work continues to show that DOD has difficulty locating payment records, which include receiving reports, after a payment has been made.

In general, given DOD's current system and control weaknesses, there is no assurance that DOD would be able to verify receipt of goods or services after payments have been made. Therefore, statistical sampling procedures, which are not a control but are a tool for assessing the adequacy of controls, would only serve to confirm these weaknesses. DOD should first demonstrate that it can meet the control requirements currently prescribed in OMB Circular A-125,

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[3]High Risk Series: Defense Contract Management (GAO/HR-97-4, February 1997).

[4]Disclaimer of Opinion on the Department of Defense Consolidated Financial Statements for FY 1997 (Project No. 7FI-2030, February 27, 1998).

Part 13 of the FAR, and Title 7 of GAO's Policy and Procedures Manual followed by other federal agencies, before it implements fast pay procedures.

I hope this information is helpful to you in your evaluation of the provisions in section 401 of the proposed DOD Reform Act and DOD's current payment system and control environment. If you need further assistance on this issue, your staff may contact Lisa Jacobson, Director, Defense Audits, on (202) 512-9095.

Sincerely yours,

James F. Hinchman
Acting Comptroller General

Enclosure

GAO PRODUCTS RELATED TO FAST PAY PROCEDURES

REPORTS

Payment Processing (HUD) (GAO/AIMD-98-8R, October 21, 1997).

Payment Processing (Energy) (GAO/AIMD-97-77R, April 24, 1997).

Payment Processing (Coast Guard) (GAO/AIMD-97-35R, January 27, 1997).

Employee Travel Claims (DOI) (GAO/AIMD-97-25R, December 13, 1996).

Title 7 - Vendor's Invoice (GAO/AIMD-95-68R, January 23, 1995).

Electronic Imaging (GAO/AIMD-95-26R, November 10, 1994).

DECISION

68 Comp. Gen. 618 (1989).

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