Evaluation Report

DOD CONTRACT SHIP FUELS (BUNKER FUELS) ACQUISITION PROCESS

Report Number 98-141

May 29, 1998

Office of the Inspector General
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Acronyms

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MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
COMMANDER, DEFENSE ENERGY SUPPORT CENTER


We are providing this evaluation report for review and comment. This is the second of two reports on bunker fuels. We conducted the evaluation in response to a complaint made to the Defense Hotline. Management comments were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Energy Support Center comments were partially responsive. As a result of management comments, we revised the finding and redirected and renumbered draft report Recommendation 1. to the Director, Defense Finance and Accounting Service, as Recommendations 1.c. and 1.d.; added Recommendations 1.a. and 1.b.; deleted Recommendation 3.; and revised and renumbered Recommendation 4. as 2.a. and 2.b. We request that the Director, Defense Finance and Accounting Service, provide comments on the material control weakness discussed in Appendix A and on Recommendations 1.a., 1.b., 1.c., and 1.d. by July 30, 1998. We also request that the Commander, Defense Energy Support Center, provide additional comments on Recommendation 2.b. by July 30, 1998.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Mr. John A. Gannon at (703) 604-9176 (DSN 664-9176), email <jgannon@dodig.osd.mil>, or Lieutenant Colonel Thomas P. Toole, U.S. Air Force, at (703) 604-9177 (DSN 664-9177), email <ttoole@dodig.osd.mil>. See Appendix K for report distribution. The evaluation team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General for Auditing
Executive Summary

Introduction. This evaluation was performed in response to a complaint to the Defense Hotline. This report is the second of two reports on ships’ fuels, commonly known as bunker fuels. The Defense Energy Support Center (formerly the Defense Fuel Supply Center), which manages the bunker fuels program, funded purchases of more than $59 million in the 12-month period ending April 30, 1997. The complainant alleged that U.S. Government ships’ officers did not correctly complete standard material ordering and receiving forms when purchasing bunker fuel from DoD contract vendors and that the Defense Finance and Accounting Service was paying bunker fuel vendor bills late. Additionally, the complainant alleged that Government ships’ officers were wasting DoD funds by not purchasing bunker fuel from DoD contract vendors at those locations where contract fuel was available. This report addresses the first two allegations; a separate report addresses the third.

Evaluation Objectives. The evaluation objectives were to determine whether fuel billing and payment processes were effectively and efficiently managed. In addition, we evaluated the adequacy of the Defense Finance and Accounting Service and the Defense Energy Support Center management control programs as they applied to the evaluation objective. We also evaluated the Defense Hotline allegations to determine whether they were substantiated and, if substantiated, whether they were materially significant.

Evaluation Results. The Defense Finance and Accounting Service management controls over the bunker fuels bill disbursement process needed improvement. The Defense Finance and Accounting Service disbursing officers were paying bunker fuel invoices worth more than $25,000 without using Government-certified and -controlled receipt data to verify that quantities of fuel billed matched quantities of fuel received. Additionally, one of four bunker fuel customer organizations was not reconciling its bunker fuel transactions using Government-certified sales receipt data, and two organizations were reconciling only a portion of their transactions using Government-controlled sales receipt data. Also, the Defense Energy Support Center had implemented a bunker fuel electronic sales data collection system, known as “Magstrip,” that does not comply with the Comptroller General’s requirement that electronic financial management systems include data authentication and electronic certification capabilities. As a result, bunker fuel bills worth more than $29 million, or approximately 50 percent of total annual disbursements, were paid without quantities billed being matched to quantities received. For details on the evaluation results, see Part I. See Appendix A for details on the management control program. We partially substantiated the Defense Hotline allegations, but we did not consider them materially significant. The detailed results of our evaluation of the allegations are discussed in Appendix D.
Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service, work with the Director, Defense Energy Support Center and bunker fuel customers to ensure that disbursing officers at the Defense Finance and Accounting Service are provided proper bunker fuel receipt data for use in prepayment validation of invoices over $25,000. We also recommend that the Director, Defense Finance and Accounting Service discontinue the use of statistical sampling as a pre- or postpayment disbursement control for invoices exceeding $2,500 and to develop guidance to assist DoD customer organizations in the collection and transmission of bunker fuel receipt data to support the Defense Finance and Accounting Service disbursement and reconciliation internal control process. Additionally, we recommend that the Director, Defense Energy Support Center establish a memorandum of understanding with the Army Corps of Engineers and the U.S. Coast Guard that clarify bunker fuel bill reconciliation management control responsibilities. We also recommend that the Director, Defense Energy Support Center continue to explore electronic data collection technology alternatives to identify and implement an appropriate electronic receipt data collection system.

Management Comments. The Commander, Defense Energy Support Center, comments were generally responsive but stated that the Defense Finance and Accounting Service, rather than the Defense Energy Support Center, should be the primary organization held responsible for ensuring that disbursement internal controls are effective. The commander further stated that the Defense Energy Support Center had previously evaluated alternative electronic commerce techniques and found them to be cost-prohibitive.

The Director, Defense Finance and Accounting Service, concurred with the draft report. However, additional evaluation work and interim coordination of Defense Energy Support Center comments resulted in the Director, Defense Finance and Accounting Service, submitting additional comments (Appendix I). Those comments requested that the Office of the Inspector General obtain a written opinion from the General Accounting Office on whether existing bunker fuel disbursement internal control procedures were consistent with the Comptroller General’s guidance.

Although not required, we received comments from the Commander, Military Sealift Command, who agreed to develop appropriate procedures for collecting and transmitting bunker fuel receipt data and quickly took steps to implement the procedures.

See Part I for a summary of management comments and Part III for the complete text of management comments.

Evaluation Response. Management comments were generally responsive to the finding. We agree with the Defense Energy Support Center comments that the Defense Finance and Accounting Service has primary responsibility for establishing effective bunker fuel bill disbursement internal controls. We have therefore revised and expanded the finding and redirected the first recommendation to the Director, Defense Finance and Accounting Service. We requested a General Accounting Office opinion in a March 17, 1998, memorandum, but had not yet received a reply. The Defense Finance and Accounting Service is requested to provide comments on the revised recommendations and the Defense Energy Support Center is requested to provide additional comments by July 30, 1998.
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Part I - Evaluation Results
Evaluation Background

This evaluation was initiated as a result of a complaint made to the Defense Hotline on November 18, 1996. The complainant alleged that Government organizations purchasing bunker fuel from fuel sources contracted by the Defense Fuel Supply Center (now the Defense Energy Support Center [DESC]) were not completing bunker fuel ordering and receiving forms correctly. The complainant further alleged that because ordering procedures were not completed correctly, the Defense Finance and Accounting Service (DFAS) was unable to pay contract fuel vendors in a timely manner. Additionally, the complainant alleged that officers on Government ships were wasting DoD funds by not always purchasing bunker fuel from less expensive DESC contract vendors at locations where contract fuel was available. This report addresses the first two allegations; a separate report addresses the third.

Bunker Fuel Program. A “bunker” is an onboard storage compartment used as the direct source of fuel for ship’s propulsion system. DoD Manual 4140.25-M, “DoD Management of Bulk Petroleum Products, Natural Gas and Coal,” June 22, 1994, defines bunker fuel as fuel loaded into a ship for its own use rather than as cargo. The Commander, DESC, at Fort Belvoir, Virginia, is the DoD bunker fuel acquisition program manager. The contract bunker fuel program includes 72 contracts that offer DoD and other authorized customers fuel priced at pre-negotiated rates in 155 ports worldwide. DESC contract bunker fuel sales to DoD vessels and to some non-DoD vessels operated by the Army Corps of Engineers, Military Sealift Command (MSC) contract charters, and the U.S. Coast Guard total more than $59 million annually. MSC is a Command under the Chief of Naval Operations and also reports to the Commander in Chief, U.S. Transportation Command.

DESC Bunker Fuel Marketing Strategy. A DESC management objective is to make less expensive contract bunker fuel available to as many Government customers as possible. In April 1996, to identify ports where new or increased bunker fuel contract coverage may be cost-effective, DFAS Columbus Center centrally began paying some bills for open market transactions and providing bunker fuel demand data to DESC. Open market transactions are acquisitions made from bunker fuel vendors not under contract with DESC at the location where the fuel was purchased.

The DoD Disbursement Management Control Process. The DoD disbursement management control system consists of a system of pre- and postpayment reviews of Government-certified and -controlled receipt data.

Prepayment Reviews. Whenever and wherever a product or service is purchased, a Government official certifies, by signature, on an appropriate sales receipt or receiving report that a specific quantity of an item has been received, inspected (if appropriate), and accepted. DoD Regulation 7000.14-R, “Financial Management Regulation,” February 1996, assigns responsibility for the accuracy of receiving report data to the individual whose signature appears on the sales receipt or receiving report. The Government certifying official forwards the original receipt document or Government-controlled electronic receipt data stream to DFAS disbursing officers to establish an “obligation” ledger for the transaction. Title 7, Chapter 7, of the General Accounting Office
(GAO) "Policy and Procedures Manual," May 1993 (the GAO Manual), assigns disbursing officers the responsibility and liability for matching vendor invoices with Government-certified and -controlled receipt data prior to making any payments. However, under a procedure known as “fast pay,” the GAO Manual does permit Government agencies to pay vendor invoices that do not exceed $25,000 and that meet certain other restrictions without reviewing Government-certified and -controlled evidence of receipt prior to paying. Appendix C has additional details on policies and regulations.

Postpayment Reviews. On a monthly basis, the DFAS centers prepare “interfund” billing summaries in accordance with DoD Manual 4000.25-7-M, "Military Standard Billing System," January 1995 (the DoD Manual), and forward them to their customers. The DoD Manual requires customer organizations to reconcile interfund billing summaries by matching original receipts or Government-certified and -controlled receipt data to each of the transactions summarized on the interfund bill. If no mismatches are found, customer officials certify that billing data is correct as stated and forward the certification to the DFAS center. If mismatches are found, customers request that the DFAS disbursing officer reconcile the mismatches. The customers then certify the accuracy of the remaining transactions and forward the certification to the DFAS disbursing officer.

Electronic Commerce in the Bunker Fuel Financial Management System. The GAO Manual encourages Government agencies to integrate electronic commerce techniques into agency financial systems wherever it is appropriate and cost-effective to do so.

Prepayment. When electronic technologies are used to transmit transaction data to disbursing officers for use in verifying vendor invoices for payment, data systems must meet the Comptroller General's criteria provided in the GAO Manual. The criteria include the general requirement that disbursing officers have reasonable assurance that electronic messages are complete and correct before using the electronic data to verify invoices. Additionally, although the systems and processes for transmitting data for use in certifying vouchers for disbursement may vary, the disbursing officer is ultimately responsible and liable for the accuracy of payments. Therefore, disbursing officers must have reasonable assurance that the electronic systems, processes, and controls used to forward financial data to disbursing offices are working and reliable. Electronic financial systems must also be designed to have the controls to protect data from unauthorized access, whether inadvertent or deliberate. The GAO Manual states that electronic financial system procedures that strengthen controls are preferred over those that involve relaxing management controls.

Postpayment. The GAO Manual permits Government agencies to implement statistical sampling programs to select, after payment, vendor vouchers for examination in support of the certification and disbursement processes. The GAO Manual authorizes the use of statistical sampling for vouchers not exceeding $2,500. When using an appropriate statistical sampling technique, disbursing officers are permitted to certify vouchers for payment without reviewing point of sale receipt data for those vouchers.
Evaluation Objectives

The evaluation objectives were to determine whether fuel billing and payment processes were effectively and efficiently managed. In addition, we evaluated the adequacy of the DFAS and the DESC management control programs as they applied to the evaluation objective. We also evaluated the Defense Hotline allegations to determine whether they were substantiated and, if substantiated, whether they were materially significant. Appendix A discusses the scope and methodology and the management control program, Appendix B summarizes prior coverage, and Appendix D discusses the specific results of our evaluation of the allegations made to the Defense Hotline.
Bunker Fuel Bill Disbursement Process
Management Controls

The DFAS management controls over the bunker fuel bill disbursement process needed improvement. The DFAS disbursing officers were paying bunker fuel invoices worth more than $25,000 without using Government-certified and -controlled receipt data to verify that quantities of fuel billed matched quantities of fuel received prior to making disbursements. The condition existed because DESC and DFAS had implemented a bunker fuel electronic sales data collection system that did not comply with the Comptroller General’s requirement for electronic data collection systems to include data authentication and electronic certification capabilities. Furthermore, customer organizations had not implemented consistent receipt data collection procedures to effectively fulfill their bunker fuel bill reconciliation responsibilities. One bunker fuel customer organization was not using Government-certified and -controlled receipt data to reconcile vendor invoices that DFAS paid on the customer organization’s behalf. Two other organizations were using Government-certified and -controlled sales receipt data to reconcile only a portion of their vendor invoices. The condition was caused by a lack of clear DFAS guidance defining customer receipt data collection and transmission responsibilities. As a result, bunker fuel bill payments worth more than $29 million, or approximately 50 percent of total annual disbursements, were made with neither DFAS disbursing officers nor bunker fuel customers verifying that fuel quantities received matched quantities billed.

Bunker Fuel Billing and Disbursing Process

Bunker Fuel Billing and Disbursing Process. A Government purchase order initiates each transaction of a bunker fuel contract. After fuel loading is complete, the responsible ship official certifies the quantity of fuel purchased by signing the appropriate sales receipt. Each vendor and responsible officer retains a copy of the sales receipt. The vendor then uses one of two processing systems to submit the invoice to DFAS Columbus Center for payment. A manual invoice processing system requires the vendor to mail or transmit a facsimile of the invoice and sales receipt to DFAS Columbus Center for its use in prepayment verification. The sales data was Government-certified, but not Government-controlled. An electronic invoice processing system, known as “Magstrip,” was implemented by DESC in early 1997. Magstrip requires the vendor to use Government-furnished hardware and software to electronically transmit invoice and receipt data to DFAS Columbus Center for its use in prepayment verification. The electronically transmitted receipt data is not the Government-certified sales receipt, nor is it Government-controlled. In both the manual and electronic systems, if the vendor-provided receipt data matches the vendor’s invoice data, DFAS disbursing officers pay the vendor from the DESC bunker fuel revolving fund account.
Each month, the DFAS Columbus Center sent bills to customer organizations for bunker fuel transactions paid from the DESC revolving fund account. Customer organizations are required to reconcile DFAS billing data with Government-controlled and -certified sales receipts retained from the point of sale, providing management controls over both the vendor billing process and DFAS disbursing process. If Government-controlled and -certified receipt data are not used to reconcile DFAS bills, erroneous or fraudulent vendor bills or DFAS processing errors may not be detected. DoD customer organizations reimburse the revolving fund through electronic fund transfer, generally known as the interfund system. Figure 1 illustrates the bunker fuel payment and reconciliation processes.

![Diagram of bunker fuel payment and reconciliation processes]

Figure 1. Manual DoD Bunker Fuel Prepayment Invoice Validation and Post-payment Reconciliation Processes

Only the Navy was generally following the postpayment reconciliation process illustrated above. MSC (which is part of the Navy but also reports to the U.S. Transportation Command) was not following the process, and the Army Corps of Engineers and the Coast Guard were following the process for only a portion of their transactions.

Prepayment Controls

The DFAS disbursing officers were paying bunker fuel invoices worth more than $25,000 without using Government-certified and -controlled receipt data to verify that quantities of fuel billed matched quantities of fuel received prior to making disbursements. The condition existed because Magstrip, used by DESC and DFAS, does not include data authentication and electronic certification.
capabilities. Although the draft of this report focused primarily on the postpayment portion of the bunker fuel disbursement process, management comments and information provided by the GAO led us to conduct additional evaluation work. As a result, we revised the finding to include the prepayment disbursement process.

**Use of Government-Controlled Receipt Data.** DFAS Columbus Center disbursing officers were using receipt data provided by vendors as a primary internal control over the bunker fuel disbursement process. The GAO Manual and Office of Management and Budget (OMB) Circulars A-127, “Financial Management Systems,” July 23, 1993, and A-123, “Management Accountability and Control,” June 21, 1995, require Government agencies to establish financial systems and controls, whether manual or electronic, that provide disbursing officers reasonable assurance that vouchers are accurate prior to payment. When sales receipts or receiving reports are in the possession of vendors prior to being forwarded to DFAS disbursing officers, the risk that data contained in the reports could be altered is increased. Because DFAS did not require ship officials to forward receipt data directly to DFAS, disbursing officers were unable to verify the accuracy of vendor data prior to making payments.

**Use of Government-Certified Receipt Data.** DFAS disbursing officers were validating bunker fuel invoices in excess of $25,000 from vendors using Magstrip without first reviewing Government-certified receipt data to verify invoice accuracy. For vendors using Magstrip, DFAS had discontinued the requirement for them to forward copies of Government-certified receipt data to disbursing officers. DFAS disbursing officers were validating vendor invoices of all amounts using vendor-created electronic receiving reports that had been neither reviewed nor certified by an authorized Government official. Although the GAO Manual and OMB Circular A-125, “Prompt Payment,” December 12, 1989, permit agencies to pay vendor invoices worth less than $25,000 without first reviewing appropriately certified receipt data, that practice is expressly prohibited when invoices are in excess of $25,000.

**Postpayment Controls**

Customer organizations had not implemented consistent receipt data collection procedures to effectively fulfill their bunker fuel bill reconciliation responsibilities.

**Use of Statistical Sampling Techniques.** DFAS disbursing officers were relying on postpayment statistical sampling techniques and customer reconciliation processes to identify inaccurate disbursements for invoices in excess of $2,500. In January 1997, in lieu of conducting 100 percent prepayment validation of Government-certified receipt data, DFAS authorized DESC to implement a statistical technique to identify a sample of bunker fuel vouchers for postpayment validation. DFAS officials stated that once vouchers were selected, the procedures required DESC, or a DESC contractor, to match original Government-certified receipts to DFAS disbursement records to assist DFAS in identifying and recovering overpayments that may have been made.
The GAO Manual states that sampling techniques may be used for quality control purposes to assess the effectiveness of disbursement internal controls. However, it also states that postpayment sampling techniques may not be used in lieu of a 100 percent review of appropriate receipt data for any invoices that exceed $2,500. Because most bunker fuel invoices exceed the $2,500 threshold, we do not believe that the DESC-implemented sampling technique is an appropriate internal control for the bunker fuel bill disbursement process.

Reliance on the Customer Postpayment Bill Reconciliation Process. The DFAS decision to eliminate prepayment review of Government-certified sales receipts was made, at least partially, because of an assumption that customer organizations were exercising effective management controls over the postpayment reconciliation process. However, customer interfund bill reconciliation processes were not adequate. Although the Navy was effectively reconciling 100 percent of its bills, Navy standards for resolving mismatches between sales receipts and the DFAS interfund bills were questionable. MSC was not reconciling DFAS interfund bills against appropriate receipt data. The Army Corps of Engineers and the Coast Guard were effectively reconciling only a portion of their bunker fuel transactions. Our April 28, 1997, memorandum to the Commander, DESC (Appendix E), notified the commander of the inconsistencies in customer postpayment reconciliation processes. The following are the details of customer interfund bill reconciliation programs.

Navy Reconciliation Procedures. Ship officers were collecting and retaining Government-certified bunker fuel sales receipts and using the Navy Energy Utilization Reporting System to electronically transmit data to the Navy Standard Accounting and Reporting System, which automatically compares the receipt data with the DFAS monthly interfund bills and produces an error listing when differences are identified. From May 1996 through April 1997, the DFAS payment office processed invoices valued at nearly $16 million for Navy bunker fuel purchases.

In our opinion, the Navy’s automated reconciliation system, implemented in October 1996, is an excellent bunker fuel management control tool. However, when the Navy’s automated reconciliation system identified differences between DFAS interfund bills and receipt data, Atlantic and Pacific Fleet financial managers applied arbitrary standards in deciding whether to notify DFAS Columbus Center of mismatches. As a result, the Navy did not always request that DFAS research mismatches between Navy sales receipts and DFAS interfund bills to determine which information was correct.

The Atlantic Fleet reconciliation standard allowed amounts from Navy sales receipts and DFAS interfund bills to differ by up to 5 percent before requesting that DFAS Columbus Center confirm which was correct. If the Atlantic Fleet sales receipt and interfund bill amounts differed by less than 5 percent and fleet managers could not resolve the mismatch using fleet resources, fleet financial managers accepted the DFAS interfund bill amounts as correct and adjusted Navy ledgers. Therefore, because some Atlantic Fleet bunker fuel amounts exceeded $200,000, differences of $10,000 or more may not have been accurately reconciled.
The Pacific Fleet used unwritten qualitative criteria in deciding whether to request that DFAS Columbus Center review mismatches between Navy sales receipts and DFAS interfund bills. If Pacific Fleet managers felt that the difference was small enough not to warrant a review effort, they did not request DFAS assistance in reconciling the amount. In those cases, fleet managers accepted the DFAS interfund bill amounts as correct and adjusted Navy ledgers. As a result, the Pacific Fleet routinely accepted an unknown number of interfund bill amounts that Navy sales receipts might have indicated were inaccurate.

The criteria used by the Navy could allow errors and fraud to occur undetected and weaken internal management controls. A dollar threshold would be a more effective method for determining which bunker fuel transaction mismatches the Navy should refer to DFAS for resolution. The specific dollar amount of the threshold should be commensurate with the Navy assessment of risk and the costs associated with processing referrals to DFAS.

**MSC Reconciliation Procedures.** MSC was not using Government-certified and -controlled sales receipts to reconcile bunker fuel interfund bills. The condition occurred because MSC ships did not forward sales receipts or the data from those receipts to the MSC comptroller office for use in reconciling monthly DFAS interfund bills. Instead, MSC was using historical fuel consumption data to estimate how much fuel ships might consume in covering known distances and then comparing those estimates to the monthly DFAS interfund bill. As a result, MSC was unable to accurately reconcile its annual fuel purchases, valued at more than $29 million. Figure 2 illustrates the MSC bill reconciliation process. For those vendors using Magstrip, there was no DFAS prepayment review of Government-certified sales receipts.

![Figure 2. MSC Bunker Fuel Postpayment Reconciliation Process](image)

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Bunker Fuel Disbursement Process Management Controls

Our April 4, 1997, memorandum to the Commander, MSC (Appendix F), highlighted the absence of Government-certified and -controlled sales receipts, or the data from those sales receipts, in the MSC reconciliation process and requested that MSC promptly implement procedures to collect and use Government-certified and -controlled receipt data to reconcile monthly DFAS interfund bills. In its June 10, 1997, response memorandum (see Part III), MSC agreed to develop and implement a method to collect and retain receipt data from the point of sale for use in verifying the accuracy of its interfund bills.

Army Corps of Engineers. We interviewed disbursing officials at six Army Corps of Engineers Districts. Five disbursing officials stated that they compared the sales receipts for the Corps of Engineers ships to monthly DFAS bills. The remaining district disbursing official stated that his district did not use sales receipts or similar source data to reconcile DFAS bills. The official further stated that his district simply accepts the DFAS bills as correct. During the 12-month period of May 1996 through April 1997, DFAS Columbus Center processed invoices valued at $6.1 million resulting from Army Corps of Engineers bunker fuel purchases.

Coast Guard Reconciliation Procedures. The Coast Guard disbursing office in Chesapeake, Virginia, was using Government-certified and -controlled sales receipts to reconcile DFAS bills if the receipt data were readily available at the time the DFAS bills were received. However, when Government-certified and -controlled sales receipts were not available for use in reconciling a particular bill, the Coast Guard disbursing office requested copies of vendor-provided sales receipts from DFAS to use in reconciling DFAS bills. Coast Guard financial managers estimated that approximately 50 percent of sales receipts were not available for reconciliation with monthly DFAS bills. Therefore, about half of the Coast Guard bunker fuel transactions were paid without comparing Government-certified and -controlled receipt data against the DFAS bill amounts. As a result, billing errors or intentional overcharges could have occurred without being detected. From May 1996 through April 1997, the DFAS payment office processed invoices valued at about $7 million for Coast Guard bunker fuel purchases.

DFAS Guidance to DoD Customers

The Director, DFAS, had not issued clear guidance to DoD customer organizations explaining their responsibilities for collecting and maintaining appropriate bunker fuel receipt data in support of the DFAS internal control process for disbursements. Specifically, customers were confused regarding the division of management control responsibilities as they related to the DFAS prepayment validation and customer postpayment reconciliation processes. Some DoD customers were not aware that DFAS paid invoices without reviewing Government-certified receipt data when vendors used Magstrip to submit invoices to DFAS, or that the customer postpayment reconciliation process was the sole DoD internal control over the accuracy of some disbursement data.
The MSC Deputy Comptroller and some Navy comptroller personnel stated that they believed DFAS disbursing officers were responsible for matching vendor invoices against Government-controlled and -certified receipt data prior to payment. Consequently, MSC and Navy managers saw their role in the bunker fuel acquisition program as being a "secondary management control," with the responsibility to ensure that DFAS interfund bills did not contain significant errors. Given that customers saw themselves as backup to DFAS, they did not consider it to be cost-effective to conduct 100 percent postpayment reconciliation of interfund bills. We brought this issue to the attention of the Director, DFAS, in an April 29, 1997, memorandum (Appendix G) and suggested that DFAS develop guidance on the DoD interfund billing reconciliation process. Our December 4, 1997, memorandum to the Director, DFAS (Appendix H), noted that the implementation of Magstrip created a management control weakness in the DFAS prepayment validation process that was exacerbated by the management control weakness in the postpayment reconciliation process.

DFAS Guidance to Non-DoD Customers

Although the DoD Manual provides receipt data collection guidance to DoD customers, it does not apply to the non-DoD organizations. Without memoranda of understanding (MOUs) that define responsibilities of non-DoD organizations for bunker fuel receipt data collection, non-DoD customers are not likely to forward Government-controlled and -certified receipt data to the DFAS disbursing officer for use in conducting prepayment validations of vendor invoices. DFAS had not established MOUs to ensure that those non-DoD customer organizations billed directly by DFAS Columbus Center fully understood their roles and responsibilities for collecting and transmitting bunker fuel receipt data to support the DFAS disbursement internal control process. The GAO Manual assigns disbursing officers the responsibility for gaining reasonable assurance that financial data collection systems and controls used to support the disbursement process are accurate and reliable. Therefore, it is essential that DFAS establish MOUs with non-DoD customers to document agreement on data collection and management control responsibilities.

Interim Coordination on the Finding

DESC Comments. DESC partially concurred with the finding. It acknowledged that DESC, DFAS, and the bunker fuel customers share responsibility for capturing, validating, and entering bunker fuel transaction data in the appropriate financial systems. However, DESC stated that it will formally request that DFAS take the lead in clarifying disbursement internal control guidance and developing effective internal control procedures. Additionally, DESC stated that it depends on customer postpayment reconciliation to ensure that the quantities of fuel billed by vendors and paid by DFAS were correct. DESC further stated that it had implemented a 100 percent postpayment review to ensure that payments were only made against valid invoices.
Evaluation Response. We agree with DESC that DFAS should take the lead in clarifying bunker fuel disbursement internal control guidance and developing effective internal control procedures. Therefore, we revised the finding to include prepayment controls and redirected recommendations to the Director, DFAS, as appropriate. We recognize that the customer postpayment reconciliation process is an important part of the bunker fuel disbursement internal control process. However, postpayment reconciliation alone does not provide effective internal control over the disbursement process. The GAO Manual requires that disbursing officers review Government-certified and -controlled receipt data prior to paying all vouchers more than $25,000. Additionally, the GAO Manual prohibits the use of statistical sampling techniques as a disbursement internal control for invoices in excess of $2,500. Therefore, the bunker fuel acquisition financial system is not compliant with the Comptroller General's guidance and should be modified accordingly. As the bunker fuel contract administrator, DESC has the primary responsibility for ensuring that the bunker fuel acquisition financial system is effective and compliant with Comptroller General guidance. However, we also recognize that DESC must depend on the expertise and advice of DFAS to carry out its contract administration responsibilities. We concluded that DFAS misinterpreted Comptroller General guidance and, therefore, provided unsound advice.

DFAS Comments. In its February 27, 1998, memorandum (Appendix I), DFAS did not concur with our interpretation of the GAO Manual in relation to Recommendations 1.a. and 1.b. DFAS officers asserted that, because bunker fuel customers certify receiving reports at the point of sale and give copies of those receiving reports to the vendors, disbursing officers should consider subsequent vendor-generated and -transmitted receipt data to be treated as Government-controlled and -certified.

Evaluation Response. On March 17, 1998, we submitted a request for a formal GAO interpretation (Appendix J) of the GAO Manual as it applies to Recommendations 1.a., 1.b., 1.c., and 2.b. An interpretation had not yet been received from GAO.

Summary

The DFAS management controls over the bunker fuel bill disbursement process needed improvement. DFAS prepayment controls permitted disbursing officers to pay bunker fuel invoices worth more than $25,000 without using Government-controlled and -certified receipt data to verify that quantities of fuel billed matched quantities of fuel received prior to making disbursements. Furthermore, DFAS guidance did not ensure that consistent receipt data collection and retention procedures were developed to support an effective postpayment reconciliation process. As a result, bunker fuel bill payments worth more than $29 million, or approximately 50 percent of total annual bunker fuel bill disbursements, were made with neither the DFAS disbursing officer nor the customer verifying that fuel quantities received matched quantities billed. Because of the significance of the management control
weakness, prompt corrective action is required to improve both the prepayment invoice validation process and the postpayment reconciliation management control process.

Recommendations, Management Comments, and Evaluation Response

Revised, Renumbered, Redirected, Added, and Deleted Recommendations. As a result of management comments, we revised, renumbered, and redirected draft report Recommendation 1. to the Director, Defense Finance and Accounting Service, as Recommendations 1.c. and 1.d. We added Recommendations 1.a. and 1.b. We deleted Recommendation 3. We revised and renumbered Recommendations 2. and 4. as 2.a. and 2.b., respectively. We request that the Director, Defense Finance and Accounting Service, provide comments on Recommendations 1.a., 1.b., 1.c., and 1.d. by July 15, 1998. We also request that the Commander, Defense Energy Support Center, provide additional comments on Recommendation 2.b.

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

   a. Work with the Defense Energy Support Center and bunker fuel customers to ensure that Defense Finance and Accounting Service disbursing officers are provided Government-controlled and -certified bunker fuel receipt data for use in prepayment validation of invoices exceeding $25,000.

   b. Discontinue the use of statistical sampling techniques as a pre- or postpayment disbursement control for invoices exceeding $2,500.

   c. Develop guidance, in conjunction with the Defense Energy Support Center, to assist DoD customer organizations in the collection and transmission of bunker fuel receipt data in support of the Defense Finance and Accounting Service Columbus Center disbursement and reconciliation internal control processes.

   d. Request the Defense Energy Support Center to establish memoranda of understanding with non-DoD bunker fuel customers to document agreements to follow DoD guidance for collection and transmission of bunker fuel receipt data in support of the Defense Finance and Accounting Service Columbus Center disbursement and reconciliation internal control processes.

2. We recommend that the Commander, Defense Energy Support Center:

   a. Work with the Army Corps of Engineers and the U.S. Coast Guard to establish memoranda of understanding that clarify bunker fuel bill reconciliation management control responsibilities.
b. Continue to explore electronic data collection technology alternatives to identify and implement a receipt data collection and transmission system that includes authentication and electronic certification capabilities.

DESC Comments. DESC comments were partially responsive. DESC concurred in part with draft Recommendation 2. and Recommendation 4., renumbered as Recommendations 2.a. and 2.b., respectively. On Recommendation 2.a., DESC stated that it would enter into memoranda of understanding with the Army Corps of Engineers and the Coast Guard should DFAS recommend it. If DFAS requests, DESC agreed to establish memoranda of understanding with the non-DoD bunker fuel customers. On Recommendation 2.b., DESC stated that it thoroughly investigated the available electronic data transfer technologies used for ground fuel transactions and that adapting those technologies would be cost-prohibitive.

Evaluation Response. We agree that prior to DESC entering into memoranda of understanding with the Army Corps of Engineers and the Coast Guard, the Director, DFAS, needs to identify the specific receipt data collection and retention responsibilities necessary to support the DFAS disbursement internal control process for disbursements. However, because the Magstrip electronic data system is not compliant with Comptroller General guidance for implementing electronic technology in financial management systems, this necessitates a reevaluation of available technology. DESC needs to conduct a quantitative cost and benefit analysis to identify the most cost-effective technology available to comply with Comptroller General guidance. Therefore, we request that DESC reconsider its position on the use of Magstrip and provide additional comments in response to Recommendation 2.b.

MSC Comments. Although not required to respond to the draft report, MSC provided comments. It agreed to develop procedures to collect bunker fuel receipt data from the points of sale to conduct postpayment reconciliation of DFAS interfund bills.

Evaluation Response. We commend MSC comptroller personnel for providing an unsolicited response and for taking action to eliminate bunker fuel bill postpayment reconciliation deficiencies by working to develop procedures to capture and retain receipt data from the points of sale.
Part II - Additional Information
Appendix A. Evaluation Process

Scope and Methodology

**Work Performed.** We reviewed DoD procedures related to the bunker fuel acquisition process, payment of purchased fuel, and reconciliation of vendor invoices. We evaluated the DFAS bunker fuel payment system and related internal controls, including certifying vendor invoices for payment, recording payments, and submitting interfund bills to bunker fuel customers for the payment period May 1996 through April 1997. In addition, we interviewed personnel associated with the bunker fuel payment and reconciliation processes in the Office of the Assistant Deputy Under Secretary of Defense for Materiel and Distribution Management, DFAS, DESC, Army Corps of Engineers, Army Petroleum Office, Military Sealift Command, Navy Atlantic Fleet, Navy Pacific Fleet, Navy Petroleum Office, and the U.S. Coast Guard. Furthermore, we evaluated the specific allegations made by the complainant to determine whether they were substantiated and, if so, their materiality.

**DFAS Payment Workload Data.** We reviewed DFAS payment workload data during the period May 1996 through April 1997. Over the 12-month period, the DFAS Columbus Center processed 2,900 vendor invoices for payment. During the same period, invoices received were valued at about $59 million. Specifically, we reviewed Orders for Supplies and Services (DD Form 1155), Defense Fuels Accounting Management System sales reports, and selected data from the Fuels Division Monthly Production Report issued by DFAS Columbus Center. To evaluate the specific allegations made to the Defense Hotline, we reviewed workload data for 1,257 bunker fuel payments, worth $29 million, which were disbursed from September 1, 1996, through January 31, 1997.

**Use of Computer-Processed Data.** To evaluate the number of late payments made to bunker fuel vendors, we relied on computer-processed data from the DFAS “Interest and Production Reporting System” and the DESC “Defense Fuel Automated Management System.” We did not perform tests of the systems’ general and application controls to confirm the reliability of the data. However, we did review some source documents to determine the accuracy of late payment data. We found no inaccuracies. The reliability of the data did not materially affect the results of our evaluation.

**Evaluation Type, Dates, and Standards.** This economy and efficiency evaluation was performed from January 1997 through August 1997 and January 1998 through March 1998, in accordance with standards implemented by the Inspector General, DoD. Accordingly, we included tests of the management controls considered necessary.

**Contacts During the Evaluation.** We visited or contacted individuals and organizations within the DoD and the Coast Guard. Further details are available upon request.
Appendix A. Evaluation Process

Management Control Program

DoD Directive 5010.38, "Management Control Program," August 26, 1996, 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 the Management Control Program. We reviewed DFAS Columbus Center and DESC management control guidance on customer procedures for ordering, purchasing, and reconciling of commercial bunker fuel transactions. We also reviewed DFAS and DESC procedures as implemented by the Army Corps of Engineers, the Coast Guard, the Military Sealift Command, and the Navy.

Adequacy of Management Controls. The DESC management control program was adequate as it applied to our evaluation objectives. We identified a material management control weakness for DFAS as defined by DoD Directive 5010.38. DFAS had established neither effective nor compliant bunker fuel bill disbursement internal controls. The report recommendations, if implemented, should improve management controls over the commercial bunker fuel payment and reconciliation processes. A copy of the report will be provided to the senior official responsible for management controls in the Defense Finance and Accounting Service.

Adequacy of Management's Self-Evaluation. DFAS officials did not identify the bunker fuel disbursement process as an assessable unit and, therefore, did not identify or report the material management control weakness identified by the evaluation.
Appendix B. Summary of Prior Coverage

During the last 5 years, the Office of the Inspector General, DoD, issued three reports that discussed bunker fuel operations and associated accounting systems.

Inspector General, DoD, Evaluation Report No. 98-140, “Defense Hotline Allegation on Bunker Fuel Purchases at Naples, Italy,” May 28, 1998. The report states that Navy ships purchased bunker fuel at Naples, Italy, from non-contract sources rather than from the available DESC contract source. As a result, the Navy paid at least $66,242 more than it would have if Navy ships had purchased the fuel from contract sources. The report disclosed a management control weakness relating to the Navy’s procedures in disseminating bunker fuel contract data, but it was not considered to be a material management control weakness. The report recommended that the Navy establish effective communications that promptly distribute bunker fuel contract data to officials and organizations responsible for ordering bunker fuel for Navy ships. The Navy concurred with the recommendation and has established procedures to effectively communicate bunker fuel contract data within the Navy.

Inspector General, DoD, Memorandum Report No. 95-262, “Bunker Fuel Operations,” June 29, 1995. The report states that MSC was collecting and providing fuel consumption data to DESC in support of the continuation and establishment of bunker fuel contracts and the contracts were effectively used by DoD-controlled vessels. Further, the report disclosed there were no material management control weaknesses. The report did not contain any recommendations.

Inspector General, DoD, Report No. 95-216, “Bunker Fuel Payments,” June 2, 1995. The report states that DFAS overpayments to bunker fuel contractors were occurring because of management control weaknesses. As a result, DFAS overpaid contractors about $3.2 million in FY 1993. The report recommended that DFAS strengthen management controls over the payment process, consolidate payment offices, and collect the overpayments from contractors. Management concurred with the recommendations and, in October 1995, consolidated 19 DFAS payment offices to a single office in Columbus, Ohio.
Appendix C. Policy Requirements

United States Code. Title 31, United States Code, Section 3521(b), establishes, subject to Comptroller General prescribed limitations, the authority for Government agency heads to implement statistical random sampling programs for the examination of vouchers in support of their certification and payment.

OMB Policies. OMB Circular A-123, "Management Accountability and Control," June 21, 1995, states that each agency head must establish controls that reasonably assure that assets are safeguarded against waste, loss, and abuse and that all revenues and expenditures are properly recorded and accounted for. The circular further states that Government management control standards shall include ensuring that appropriate authority, responsibility, and accountability are defined and delegated.

OMB Circular A-127, "Financial Management Systems," July 23, 1993, states that each Government agency shall establish and maintain a single, integrated financial system that complies with applicable accounting principles, standards, and related requirements to provide complete, reliable, and consistent financial management information and deter fraud, waste, and abuse of resources.

OMB Circular A-125, "Prompt Payment," December 12, 1989, authorizes Government disbursing officers to make payments without evidence that supplies have been received only when the individual orders do not exceed $25,000.

GAO Policies. GAO "Policy and Procedures Manual," May 1993, Title 7, Chapter 6, Section 6.2, states that disbursements shall be supported by basic payment documents either in hard copy or machine readable source records which shall include purchase orders and receiving reports. It also states that appropriate preparation of disbursement vouchers includes assuring, apart from subsequent audit, that goods were ordered by authorized officials, that the goods have been delivered and accepted, and that the invoiced amounts are evidenced by receiving reports. The chapter further states that effective control over disbursements ordinarily requires the prepayment examination and approval of vouchers before they are validated for payment.

DoD Policies. DoD Regulation 7000.14-R, "Financial Management Regulation," February 1996, Volume 6, Chapter 2, defines the roles and responsibilities of DFAS and its customers on the preparation of financial reports and treatment of transactions associated with such financial reports. The Regulation states that customer organizations are responsible for ensuring the accuracy, completeness, timeliness, and documentary support for all data generated for input into the finance and accounting systems and financial reports. It emphasizes that customer organizations are responsible for ensuring that DFAS financial report amounts are consistent and reconcilable with management reports prepared by the customer organizations. The Regulation requires customer organizations to validate source data associated with their financial transactions.
Appendix D. Evaluation of Allegations

This appendix provides the results of our evaluation of the allegations made in a complaint to the Defense Hotline.

Allegation 1. Government ships’ officers did not complete standard Government material ordering and receiving forms correctly when purchasing bunker fuel from DoD contract vendors.

Evaluation Response. This allegation was partially substantiated. Ships’ officers were not always completing ordering and receiving forms consistent with the DESC bunker fuel contract terms and conditions. We obtained the payment records for 1,257 bunker fuel bills representing payments made from September 1996 through January 1997. Of those records, 131 (10 percent) of the ordering and receiving forms were not completed correctly, resulting in late payments to vendors. The table below summarizes our analysis of late bunker fuel payments made to vendors from September 1996 through January 1997.

Late Bunker Fuel Payments Arising From Incomplete Ordering and Receiving Forms as of January 31, 1997

<table>
<thead>
<tr>
<th>Month</th>
<th>Number of Payments</th>
<th>Late Payments From Incomplete Forms</th>
<th>Error Rate on Late (Percent)</th>
<th>Interest Paid on Late Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep. 1996</td>
<td>157</td>
<td>26</td>
<td>17</td>
<td>$ 174</td>
</tr>
<tr>
<td>Oct.</td>
<td>260</td>
<td>27</td>
<td>10</td>
<td>1,059</td>
</tr>
<tr>
<td>Nov.</td>
<td>283</td>
<td>61</td>
<td>22</td>
<td>5,683</td>
</tr>
<tr>
<td>Dec.</td>
<td>304</td>
<td>7</td>
<td>2</td>
<td>657</td>
</tr>
<tr>
<td>Jan. 1997</td>
<td>253</td>
<td>10</td>
<td>4</td>
<td>988</td>
</tr>
<tr>
<td>Total</td>
<td>1,257</td>
<td>131</td>
<td>$8,561</td>
<td></td>
</tr>
</tbody>
</table>

Of those records, 131 (10 percent) of the ordering and receiving forms were not completed correctly. The forms contained missing or inaccurate data including: no authorizing signature by a government representative, fuel quantity missing or inaccurate, incorrect contract number, or incorrect fuel purchase date. Insufficient data were available to establish the precise cause of errors on each of the 131 bills. We did establish that purchasing organization guidance to ships’ officers was not always consistent with DESC bunker fuel contract clauses. For instance, a Navy instruction had not been updated to designate DFAS Columbus Center as the bunker fuel payment office, even though that change occurred in October 1995. Similarly, although DESC contracts state that Navy ships will usually issue written bunker fuel ordering forms to vendors within 24 hours of issuing verbal orders, the ships often do not provide written order forms until several days after verbal orders are issued. However, since 90 percent of the ordering and receiving forms were properly prepared, we believe that confusion caused by inconsistencies in procedural guidance was not widespread. Also, the 10 percent error rate for the 5-month period reviewed
resulted in total interest payments to vendors of only $8,561. Therefore, we concluded that, although the allegation had merit, it was not materially significant.

During the evaluation, DESC officials began working with DFAS and bunker fuel purchasing organizations to reduce or eliminate confusion among ships' officers in order to increase compliance with contract ordering and receiving procedures.

**Allegation 2.** The failure of ships' officers to correctly fill out standard material ordering and receiving forms caused DFAS to pay bunker fuel vendor bills late.

**Evaluation Response.** This allegation was partially substantiated. The Prompt Payment Act requires that DoD pay vendors no later than 30 days after receipt of a properly completed invoice. Otherwise, interest on late payments will accrue. Our review of the payment records for 1,257 bunker fuel bills paid from September 1996 through January 1997 showed that only 131 (10 percent) were paid late because ordering and receiving forms were not correctly completed. As discussed in allegation 1 above, the 131 late payments resulted in subsequent interest payments of $8,561 for the 5-month period. However, an exceptional effort by DFAS Columbus Center officials quickly rectified the majority of ordering and receiving form errors that result in late interest charges. During that period, DFAS disbursed more than $29 million to bunker fuel vendors. Therefore, we concluded that, although the allegation had merit, it was not materially significant.

**Allegation 3.** Government ships' officers were wasting DoD funds by failing to purchase bunker fuel from DoD contract vendors at those locations where contract fuel was available.

MEMORANDUM FOR COMMANDER, DEFENSE FUEL SUPPLY CENTER

SUBJECT: Evaluation of the Bunker Fuels Acquisition Process (Project No. 7LB-8006)

We are conducting the subject evaluation to determine whether DoD organizations are processing bills for bunker fuels in a timely manner and effectively controlling bunker fuel, contract fund disbursements. As part of the evaluation, we reviewed the Defense Fuel Supply Center (DFSC) procedures for providing oversight of the bunker fuel acquisition process. We are providing this memorandum on existing DFSC acquisition processes and on the implementation of the electronic data interchange (EDI) vendor billing initiative known as MAGSTRIP for your information and use.

This memorandum is not subject to the provisions of DoD Directive 7650.3, but is intended to provide management an opportunity to reevaluate its policies and procedures for acquiring bunker fuels.

Our evaluation has identified considerable bunker fuel customer agency confusion as to the requirement to use government controlled sales receipts to verify the accuracy of Defense Finance and Accounting Service (DFAS) interfund bills. Although the DFAS Center Columbus is prevalidating bunker fuel vendor invoices prior to paying each bill, the DFAS process does not include comparing vendor invoices against government controlled sales receipts. Therefore, customer agency reconciliation of DFAS interfund bunker fuel bills serves as the sole internal control essential to ensuring that disbursements made against DFSC accounts are accurate and not duplicated. Each customer agency should develop procedures for collecting sales receipt data at the point of sale and using the receipt data to reconcile DFAS monthly interfund bills. To safeguard DoD managed funds, we suggest DFSC work with customer agencies to ensure that they all implement sound reconciliation procedures. We further suggest DFSC use the random sample audit program presently being developed to provide continuing visibility over the effectiveness and accuracy of the bunker fuel payment and billing processes.

Our evaluation disclosed that the Military Sealift Command (MSC) is not collecting bunker fuel sales receipts from the point of sale, and therefore, is not capable of accurately reconciling DFAS interfund bills. We discussed this matter with MSC management and they agreed to develop procedures for collecting sales receipts and using them for reconciliation. However, until MSC procedures are in place, we request DFSC pursue interim
measures to preserve the financial integrity of the newly
designed MAGSTRIP system. MAGSTRIP billing eliminates the DFSC
contract requirement for vendors to forward a government
certified copy of fuel receiving documents to DFAS for their use
in either pre- or post-payment validation procedures. Instead,
MAGSTRIP contract procedures allow the vendor to prepare and send
bunker fuel invoices electronically to DFAS for payment without a
government certifying official reviewing the documents for
accuracy prior to transmission. Consequently, DFAS is paying
bunker fuel bills that often exceed $100,000 without a government
official certifying the transmitted data as accurate.

Until MSC begins collecting copies of sales receipts from
the point of sale and providing post-payment certifications as to
the accuracy of DFAS interfund bills, DFSC funds are being spent
without pre-payment or post-payment certification. This
condition represents an unacceptable level of risk that bunker
fuel billing errors or fraud will occur and go undetected.
Because MSC is the largest DFSC bunker fuel customer with total
bunker fuel purchases in excess of $40 million annually, we
suggest that DFSC/MSC work with DFAS and take immediate action to
ensure that MSC-certified receiving documents are collected and
reconciled with interfund bills.

Shelton R. Young
Director
Logistics Support Directorate

cc: Deputy Director for Finance, DFAS-HQ
    Comptroller, Military Sealift Command
Appendix F. Memorandum for Commander, Military Sealift Command

MEMORANDUM FOR COMMANDER, MILITARY SEALIFT COMMAND

SUBJECT: Evaluation of Bunker Fuels Acquisition Process
(Project No. 7LB-8006)

We are conducting the subject evaluation to determine whether DoD organizations are processing bunker fuel bills in a timely manner and effectively controlling bunker fuel contract fund disbursements. As part of the evaluation, we reviewed the Military Sealift Command (MSC) and Defense Finance and Accounting Service (DFAS) procedures for reconciling DFAS monthly transaction reports (known as interfund bills) against government source documents to ensure that interfund bills are accurate. We had some concerns with the MSC reconciliation procedures for bunker fuel purchases. Managers have agreed to implement corrective action.

This memorandum is not subject to the provisions of DoD-Directive 7650.3, but, is intended to provide management information on the need for timely implementation of corrective action regarding its reconciliation procedures for bunker fuel bills.

In October 1995, the DFAS Columbus Center (DFAS-Columbus) became the DoD central paying office for bunker fuels purchased from Defense Fuel Supply Center contract vendors. Due to the lack of a DoD-wide accounting system that would allow DFAS-Columbus to automatically and quickly match vendor bunker fuel invoices with MSC sales source data, a two-phase reconciliation process became necessary. In the first phase, vendors send a copy of a government certified receiving document along with their invoice directly to DFAS-Columbus. Upon receipt, DFAS-Columbus verifies that contract information and unit prices are correct and pays the vendor. In the second phase, DFAS-Columbus sends an interfund bill to purchasing agencies notifying them of the details of each payment made on their behalf. The purchasing agencies are then, in accordance with accepted accounting standards, responsible to match the monthly interfund billing data against their own receiving records to ensure there are no errors; there are no duplicate bills for the same transaction; and that certified receiving documents sent to DFAS-Columbus were not altered. Conceptually, this two-phase system is sound and satisfies internal management control principles.
Appendix F. Memorandum for Commander, Military Sealift Command

The MSC is not currently collecting certified receiving documents on bunker fuel purchases from the point of sale to use in reconciling the monthly DFAS-Columbus interfund bill. As a result, MSC is unable to verify that the fuel quantity billed in a particular transaction is accurate. In lieu of sales receipts MSC is using historical fuel consumption averages to predict how much fuel might be consumed for a given distance and comparing that estimate against the actual quantity billed. Existing MSC procedures do not provide for adequate analysis of the interfund billing process or adequate controls over bunker fuel contract purchases.

In response to our concerns, MSC comptroller managers have agreed to establish procedures to collect point of sale receipt data that confirms the exact quantity of fuel acquired, use that confirmation data to reconcile the monthly interfund bills, and notify DFAS-Columbus of differences in quantities billed and amounts paid. To reduce the risk of funds being incorrectly disbursed, MSC data collection procedures and policies currently being developed should be completed and implemented as soon as possible.

We will continue to monitor the MSC corrective actions on these issues during our subject evaluation. If you have any questions or comments regarding this memorandum, please contact Mr. John A. Gannon, Evaluation Program Director, at (703) 604-9427 or Lieutenant Colonel Thomas P. Toole, Evaluation Project Manager, at (703) 604-9426.

Shelton R. Young
Director
Logistics Support Directorate

cc: Comptroller, Military Sealift Command
Director, Defense Finance and Accounting
Service-Columbus Center
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Appendix G. Memorandum for Director, Defense Finance and Accounting Service

ships' bills in their entirety directly from an MSC account. MSC later submits batches of Transaction By Others (TBO) reports to DFAS-Columbus. In turn, DFAS-Columbus uses TBO report information to debit the DFSC bunker fuels revolving fund account for the amount of bunker fuel purchased and to credit the MSC account for the same amount. To us, this is an unnecessary accounting procedure. Sending MSC charter ship fuel bills directly to DFAS-Columbus for payment will eliminate the need for the MSC and DFAS to process TBO transactions for bunker fuel. We propose that MSC charter ships send their invoices directly to DFAS-Columbus for payment. If charter ship invoices include non-fuel charges that the customer agency must pay, DFAS should subsequently forward a copy of the billing information to the appropriate MSC office for payment of non-fuel charges.

Our evaluation has identified considerable confusion in the customer agencies as to the responsibility to reconcile DFAS interfund bills. As a result, a material MSC management control weakness exists in this area. We suggest that Headquarters, DFAS develop specific guidance for customer agency reconciliation of interfund bills. A common perception is that an accurate and consistent match between agency sales receipts and DFAS interfund bills is not required. Some Navy finance offices allow a 5 percent variance between invoices and interfund bills without declaring a mismatch. Others use an informal estimate as criteria for identifying mismatches. MSC offices generally do not collect receipt data and are, therefore, unable to identify mismatches. Our position is that customer agencies should collect sales receipt data from the point of sale and use that data (or automated products developed from that data) to reconcile DFAS interfund bills. Because bunker fuels transactions can exceed $400,000 each, even a 5 percent variance would allow a $20,000 mistake or fraudulent claim to go undetected. A change initiated by Headquarters, DFAS to the PPR that clarifies customer roles and responsibilities and emphasizes the importance of a thorough account reconciliation process would significantly reduce confusion and eliminate a management control weakness.

Finally, we suggest that Headquarters, DFAS work with DFSC to streamline the approval process for non-contract (open market) bunker fuel invoices. In April 1996, DFSC provided DFAS a database that edits and electronically validates information contained in vendor bills against pertinent contract data requirements. However, since the automated validation process is contingent on a contract number, DFAS is not able to use the automated system for open market transactions until a contract number is assigned. DFSC currently requires DFAS-Columbus to send a facsimile of a vendor's invoice to Headquarters, DFSC so that a contract number can be assigned and returned. Although the process has improved since the start of our evaluation,
further improvements are possible. We suggest that DFAS request DFSC to provide automated open market transaction approval so that processing and payments are not delayed.

In response to our concerns, Headquarters, DFAS managers have agreed to convene a working group to address these three process improvement opportunities. We will continue to monitor DFAS actions on these issues during our subject evaluation. If you have any questions or comments regarding this memorandum, please contact Mr. John A. Gannon, Evaluation Program Director, at (703) 604-9427, (DSN 664-9427), or e-mail address jgannon@dodg.osd.mil; or Lieutenant Colonel Thomas P. Toole, Evaluation Project Manager, at (703) 604-9426, (DSN 664-9426), or e-mail address ttoole@dodg.osd.mil.

Shelton R. Young
Director
Logistics Support Directorate

cc: Commander, Defense Fuel Supply Center
Commander, Military Sealift Command
MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Evaluation of Bunker Fuels Acquisition Process (Project No. 7LB-8006)

The objective of the evaluation was to determine whether DoD organizations are processing bunker fuel bills in a timely manner and effectively controlling bunker fuel contract fund disbursements. As part of the evaluation, we reviewed the Defense Finance and Accounting Service (DFAS) procedures for validating vendor billing data to ensure that disbursements were accurate and timely. A management control issue surfaced during our evaluation that warrants your attention. This memorandum is intended to provide management with information to facilitate DFAS implementation of process improvements.

Our evaluation showed that DFAS-Columbus Center was unable to confirm the quantity of bunker fuel received by Defense Fuel Supply Center (DFSC) customers prior to paying vendor fuel invoices, some of which exceeded $200,000. Also, bunker fuel customers were not using material receipt data to conduct precise post-payment reconciliations. As a consequence, DoD is paying bunker fuel invoices worth more than $50 million annually, without confirming that vendor invoices match receipts.

In February 1997, in accordance with DFSC contract requirements, contract bunker fuel vendors commenced electronic invoice transmissions to the DFAS-Columbus Center bunker fuels payment office. At that time, DFSC provided each vendor the electronic invoicing capability under a DFSC program known as Magstrip. The Magstrip program consists of DFSC-provided hardware and software that vendors use to electronically transmit invoices to DFAS for payment. As implemented, the Magstrip program does not permit government certification of the receipt data contained in vendor transmissions to DFAS. Concurrent with the implementation of Magstrip, DFSC eliminated the contract requirement for vendors to forward copies of certified material receiving reports to DFAS-Columbus Center.

The DFAS headquarters letter, "Termination of Tests of Paying Invoices under $2500 without Receiving Reports," October 9, 1997, terminated DFAS test initiatives associated with paying invoices without evidence of a receiving report in the payment office because the tests did not meet DoD General Counsel approval. Although the DFAS-Columbus Center bunker fuels payment office was not participating in the test initiative, they were paying bunker fuel invoices without evidence of a proper receiving report.
We consider the high dollar amount of the bunker fuel payments to be a high-risk area that should be subjected to a greater level of management control. We suggest that DFAS headquarters work with DFSC to develop a method to electronically transmit mutually agreed upon material receipt data from the points of sale to DFAS-Columbus Center. For example, the data need only include sufficient information for DFAS-Columbus Center to confirm the accuracy of vendor invoices and, as a minimum, include contract number, ship identification, date received, fuel grade, and quantity received. Receipt information may be transmitted by radio, telephone, fax, electronic mail, or various combinations of those methods as warranted by customer operating environments and existing data collection practices. For security reasons, the means to transfer material receipt data must remain under government control during transfer to DFAS.

We request you provide written comments to us on this memorandum and your plans for implementing the suggested corrective action by December 31, 1997. Our points of contact are Mr. John A. Gannon, Evaluation Program Director, at (703) 604-9176 (DSN 664-9176), email <jgannon@dodig.osd.mil>, or Lieutenant Colonel Thomas P. Toole, U.S. Air Force, Evaluation Project Manager, at (703) 604-9177 (DSN 664-9177), email <ttoole@dodig.osd.mil>.

Shelton R. Young
Director, Readiness and Logistics Support Directorate

cc: Commander, Defense Fuel Supply Center
MEMORANDUM FOR DIRECTOR, READINESS AND LOGISTICS SUPPORT
DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

SUBJECT: Evaluation of Bunker Fuels Acquisition Process (Project No. 71B-8006)

We share the DoDIG concern about the control of receipt information used to certify payments under the Bunker Fuels Magstrip process. The current Magstrip process allows certified receipt information to be transmitted by the fuel provider. The GAO Policy and Procedures Manual states in Title 7, Chapters 6 and 7 that the government is free to take advantage of electronic data systems to improve the financial accounting system as long as "appropriate auditing and accounting controls are maintained." The transmission of receipt information by the fuel provider requires review to determine consistency with GAO Policy and Procedures Manual Title 7, Chapters 6 and 7.

We also request the DoDIG assess the economic merits of the current Magstrip process.

Roger W. Searce
Brigadier General, USA
Director for Finance
March 17, 1998

Mr. Gene L. Dodaro
Assistant Comptroller General
Accounting and Information Management Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Dodaro:

The purpose of this letter is to request your assistance in the form of an interpretation of the required internal controls relating to payment processing contained in Title 7, "Fiscal Procedures," of the GAO Policy and Procedures Manual for Guidance of Federal Agencies (the Manual). Specifically, we have three questions: (1) Is it an acceptable procedure for disbursing officers to authorize payment of invoices without first reviewing a valid statement or report from an authorized employee attesting to the receipt and acceptance of goods or services? (2) Is it acceptable for disbursing officers to authorize payment of invoices using receipt and acceptance evidence maintained by the vendor in the form of a delivery verification signed by an Government official? and, (3) Is it acceptable to implement an alternative process of completing receipt verification and acceptance after payment based on audits of a statistically selected number of invoices in lieu of conducting prepayment verification?

An ongoing Inspector General (IG), DoD, evaluation indicates that in certain DoD organizations, there are two different interpretations of the Comptroller General's guidance as it relates to the three questions above. The pertinent reference for the first question is Title 7, Chapter 6, Paragraph 6.2b, of the Manual, which states that the preparation of disbursement documents must include the essential step of assuring that goods or services ordered have been delivered, accepted and evidenced by receiving reports. Defense Finance and Accounting Service (DFAS) interprets Paragraph 6.2b to mean that actual receiving statements or reports need not be sent to the disbursing office for disbursing officer review prior to authorizing payment. DFAS asserts that it is acceptable for the disbursing officer to complete the verification and acceptance process using facsimiles of receiving statements or reports or using other electronic messages containing receiving report information. We disagree. Our interpretation is that disbursing officers should be provided hard copies of the actual receiving statements or reports or provided access to certified, machine-readable, electronically transmitted receiving report data prior to authorizing payment.

Regarding our second question above, DFAS interprets Paragraph 6.2b of the Manual to mean that disbursing officers can accept vendor-provided, original receiving statements or reports to complete verification and acceptance. Our interpretation is that only authorized Government employees should transmit the receiving statements or reports directly to the DFAS disbursing officer. We disagree with the DFAS premise and foresee a loss of control.
over receiving documents that could preclude detection of errors or mischarges. We do not consider vendors, although on contract with the Government, to be authorized to act as Government employees for the purposes of transmitting receiving statements or reports.

The pertinent reference for our third question is Title 7, Chapter 7, Paragraph 7.4c, which states that "with the proper application of available technology, it is possible to perform required prepayment audits without assembling the source records from other locations." This paragraph further states that when agencies apply available technology to the prepayment audit process, they should "implement techniques that will provide reasonable assurance that data in electronic messages are complete, correct, and authorized." DFAS interprets paragraph 7.4c to mean that the disbursing officer need not assemble receiving statements or reports prior to authorizing payment as long as postpayment reconciliations and statistically selected postpayment invoice audits are conducted to provide reasonable assurance that previously paid invoices were accurate. DFAS asserts that strong postpayment controls that can be expected to identify and rectify errors or instances of fraud are reasonable assurance to the disbursing officer that data provided will be correct. We disagree with that interpretation. We interpret this paragraph to mean that agencies may implement electronic technologies that allow the electronic transmission of certified receiving statements or reports from the point of sale to the DFAS disbursing office. We further interpret the requirement for providing the disbursing officer reasonable assurance that data is correct to mean that reasonable assurance should be obtained from prepayment review of certified electronic receiving statements or reports and not from postpayment reconciliations and audits. In a related matter, the DoD has submitted proposed legislation which would permit the use of post-payment receipt sampling techniques in lieu of prepayment validation of receiving reports or statements.

We request an interpretation of Title 7 and your review and opinion on the facts presented, so that we may complete our ongoing evaluation. If you have any questions regarding this memorandum, please contact Mr. John A. Gannon, Evaluation Program Director, at (703) 604-9176 (email jgannon@dodig.osd.mil) or Lieutenant Colonel Thomas P. Toole, U.S. Air Force, Evaluation Project Manager, at (703) 604-9177 (email ttoole@dodig.osd.mil).

Sincerely,

Robert J. Lieberman
Assistant Inspector General
for Auditing
Appendix K. Report Distribution

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Director, Defense Finance and Accounting Service
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   Commander, Defense Energy Support Center
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Appendix K. Report Distribution

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General Accounting Office
  National Security and International Affairs Division
  Technical Information Center
Director of Finance and Procurement, U.S. Coast Guard
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  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 Government Management, Information, and Technology,
    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
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Part III - Management Comments
Defense Fuel Supply Center (now Defense Energy Support Center) Comments

SUBJECT: DoD Contract Ship Fuels (Bunker Fuels) Acquisition Process, TLB-8006

FINDING: Fuels Bill Payment Reconciliation Process (See pg 6 of the Draft Rpt)

DFSC COMMENTS:

Partially Concur. We agree that material receipt acknowledgment and transaction data collection are vital parts of the material management, contract administration and financial management processes. DFSC shares a joint responsibility with DFAS to ensure that what is bought from vendors is what the vendors bill. DFSC also shares responsibility with DFAS and bunker fuel customers for capturing, validating, and entering bunker fuel transactions. Our financial systems are designed to accomplish these tasks.

In our move to an electronic commerce and commercial payment environment, we no longer required vendors to submit a hardcopy receipt. We rely on our customers, who receive the fuel, to ensure that receipts are properly certified and controlled. We also rely on the same receipt/sales data and reconciliation process to fulfill our contract administration and financial management responsibilities. We agreed that reconciliation of receipt data to our customers' interfund bills would involve our customers internal control procedures to ensure that items purchased by us and sold to our customers via direct vendor delivery were billed by our vendors. Since DFAS is DFSC's financial agent, and as DoD 4000.25-7-M prescribes, reconciliations by billed offices are to be accomplished in accordance with the interfund reporting and clearing procedures of the appropriate Service, we intend to formally request that DFAS take the lead in clarifying the guidance and ensuring the sales data collection process is adequate.

Additionally, to safeguard both our and our customers' funds, we agreed to initiate a postpayment sampling plan (100% of the universe initially) to ensure that payments were only made against valid invoices. By employing this additional procedure, we acknowledged that the material receipt certification and interfund bill reconciliation processes are two areas that have the potential for problems.

INTERNAL MANAGEMENT CONTROL WEAKNESSES: Nonconcur

Action Officer(s): Robert McCullin (Management Control)
MIL. Exrp (Technical Expert)
Reviewing Official: Robert Molina, MMP
Coordination: Elaine Parker, DDAI, 767-4264

DLA APPROVAL
Final Report Reference

Redirected, revised, and renumbered as 1.c. and 1.d. Added Recommendations 1.a. and 1.b.

Revised and renumbered as Recommendation 2.a.

Deleted

Revised and renumbered as Recommendation 2.b.

SUBJECT: DoD Contract Ship Fuels (Bunker Fuels) Acquisition Process, 7LB-9906

RECOMMENDATION:

1. Develop, in conjunction with the Defense Finance and Accounting and bunker fuel customers, clear and comprehensive bunker fuel interfund bill reconciliation procedures. When developed, these procedures should be disseminated to all bunker fuel customer organizations.

2. Establish memoranda of understanding with the Army Corps of Engineers and the Coast Guard to clarify organizational responsibilities and procedures for bunker fuel bill reconciliation.

3. Establish the commercial bunker fuel reconciliation process as an assessable unit within the management control program of the Defense Fuel Supply Center.

4. Evaluate the feasibility of using commercially available technology to electronically certify and record bunker fuel sales receipt data at the point of sale and electronically transmit the sales data directly to the Defense Finance and Accounting Service, Columbus, Ohio.

DFSC COMMENTS:

1. Partially concurs. We will assist DFAS and bunker fuel customers to clarify their interfund bill reconciliation procedures where required and formally request by December 31, 1997 that DFAS review current interfund billing procedures to determine their adequacy. We will also initiate corrective actions for capturing adequate sales data if the results of our sampling plan indicate unresolved material problems.

2. Partially concurs. Once a determination is made concerning the adequacy of existing interfund procedures and should DFAS recommend the need to enter into memoranda of understanding to clarify responsibility for implementing the procedures, we will assist them. Our goal is to have any necessary memoranda signed NLT March 31, 1998.

3. Partially concurs. We do not agree that DFSC should establish the interfund reconciliation process as an assessable unit within its management control program. The basic responsibility for the function lies outside DFSC. However, recognizing that the report raises legitimate concerns about the accuracy of sales data and with the total process, we will implement the post-payment sampling plan of bunker payments and by doing so cover this area under that financial management control technique. We feel these additional procedure will provide meaningful visibility of any potential reconciliation problems. Our goal is to complete these actions is March 31, 1998.
4. Partially concur. DFSC thoroughly investigated the feasibility of deploying reader technology to the point of sale and will continue to do so as a normal course of business. Available portable commercial technology does not pass minimum Class I, Division 1 safety requirements for use in the bunkering "area". Per the Underwriters Laboratory test commissioned by DFSC, the potential for explosion caused by a spark in the portable device exceeded its utilization at the point of sale. Since much of bunkering is subcontracted and frequently occurs at varying unspecified locations away from the contractors' facilities, the "gas station" commercial technology does not lend itself to the portability required. The technology developed by the Air Force is not feasible because of approximately $5000 per truck, with multiple trucks per contractor/subcontractor/location, it is cost prohibitive.

DISPOSITION:
(X) ECD for No. 1 is December 31, 1997. ECD for No. 2 and No. 3 is March 31, 1998.
(X) Action Item Number 4 is Considered Complete.

Action Officer(s): Robert McClellan (Management Control)
Mike Harp (Technical Expert)

Reviewing Official: Robert McAnious, MMP

Coordination: Elanor Parker, DDAL 767-4244

DLA APPROVAL: [Signature]
From: Comptroller, Military Sealift Command
To: Inspector General, Department of Defense
Subj: EVALUATION OF BUNKER FUELS ACQUISITION PROCESS (Project No. 7LB-8006)
Ref: (a) DODIG memo of 4 Apr 97

1. Reference (a) states that the Military Sealift Command is not currently collecting certified receiving documents on bunker fuel purchases from the point of sale to use in reconciling the monthly DFAS-Columbus interfund bill. Recognizing this deficiency, MSC established a working group in March 97 to determine the best method to reconcile the monthly interfund bills. The working group's proposed solution is to require all ships to include the amount of fuel bunkering on the departure reports. The departure report will be used to validate the quantity of bunker fuel billed to COMSC on the interfund bills. The reports will be submitted to a centralized location in the Accounting Division at COMSC Comptroller. COMSC will notify DFAS-Columbus of any differences in quantities received and billed. A Plan of Action and Milestone (POA&M) to refine the validation method is being developed and will be forwarded to your office no later than 30 September 1997.

2. While MSC agrees that the billings to MSC must be validated, COMSC believes the primary responsibility for the audit of invoices resides at DFAS-Columbus, the paying office, and should be made prior to actual payment. DFAS-Columbus should receive all support documentation. The current register (chargeable) is often inaccurate, incomplete and slow in processing, causing extensive follow-up and added labor costs to the process. These conditions makes it difficult for COMSC to perform post-audits of the invoices.

3. COMSC POC, Ms. Iris Y. Davis, 202 685-5978.

RICHARD S. HAYNES
Asst Dep Commander for Bus Ops
MEMORANDUM FOR DEPUTY DIRECTOR FOR AUDIT FOLLOWUP, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE


DFAS concurs with all recommendations.

My point of contact is Mr. Mickley, DFAS-HQ/FCC, 703 607-1198.

Roger W. Scearce
Brigadier General, USA
Deputy Director for Finance
Evaluation Team Members

This report was prepared by the Readiness and Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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John A. Gannon
Lieutenant Colonel Thomas P. Toole, U.S. Air Force
Jeffrey Lee
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