

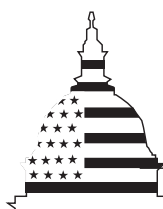
GAO

Report to the Honorable
Tom Harkin, U.S. Senate

February 2001

CONTRACT MANAGEMENT

Excess Payments and Underpayments Continue to Be a Problem at DOD



G A O

Accountability * Integrity * Reliability

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Abbreviations

DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense



United States General Accounting Office
Washington, D.C. 20548

February 22, 2001

The Honorable Tom Harkin
United States Senate

Dear Senator Harkin:

We have reported over the last several years that the Department of Defense (DOD) annually overpaid its contractors by hundreds of millions of dollars and that in some cases these excess payments were not being promptly returned. In response, you requested that we look at the scope of excess payments and underpayments. Specifically, this report examines, for DOD contract payments, the following issues:

- What is the amount of excess payments and what are the reasons they occur?
- What is the amount of underpayments and what are the reasons they occur?
- How quickly are excess payments repaid and underpayments resolved?

We examined the amount of excess payments and underpayments by looking at the amount of excess payments repaid during fiscal year 1999 and the amount of underpayments resolved during fiscal year 1999. We also collected data on the amount of excess payments and underpayments outstanding as of the time data was collected from contractors (May 2000).

Our review focused on large contractor business segments, that is, business entities receiving \$125 million or more in contract payments in fiscal year 1999 from the Defense Finance and Accounting Service (DFAS)—Columbus Center.¹ We collected information from 39 contractors, including in our sample all 11 contractors receiving in excess of \$1 billion in payments in fiscal year 1999 and a random selection of the remaining large contractors.² The 39 contractors in our sample received \$30 billion in

¹ Business segments were defined using DOD “cage codes.” These cage codes are used by DOD to track the business entities receiving payments under DOD contracts.

² Because we were assisted in the data collection by the Defense Contract Audit Agency, the sample was stratified by region in order to distribute the workload. We excluded a classified entity and a Canadian entity from the population of large contractors we sampled.

contract payments in fiscal year 1999, 42 percent of the \$71 billion in total contract payments reported for that year. The results cannot be projected to the population of large contractors because the workload required to gather the data limited the number of contractors that could be examined. Appendix I identifies the 39 contractors covered by our sample.

In addition to the data on large contractors, we also examined DFAS-Columbus data on the amount of contract payments returned by contractors (including both large and small contractors) in fiscal years 1999 and 2000. We did not independently verify the data reported by DFAS. Because of problems with the reliability of DOD's contract payment data, it is not possible to determine whether the amounts of excess payments reported by DFAS were complete and accurate.

We were assisted in this review by the Defense Contract Audit Agency (DCAA). DCAA collected data from the 39 contractors and selectively tested this data against contractor records. We performed follow-up visits at 11 contractor locations. We were solely responsible for the analysis of the data and development of this report.

Except as noted above, we performed our work in accordance with generally accepted government auditing standards.

Results in Brief

DFAS-Columbus reports that contractors repaid \$670 million in fiscal year 1999 and closer to a billion dollars—\$901 million—in fiscal year 2000. The higher amount for fiscal year 2000 reflects the inclusion of repayments made through offsets of other payments (\$269 million) in addition to the amount repaid by check (\$632 million).³ Although small in relation to total contract payments, these amounts represent a sizable amount of cash in the hands of contractors beyond what is intended to finance and pay for the goods and services DOD is purchasing.

The 39 large contractors covered by our review returned excess payments totaling \$351 million in fiscal year 1999. Seventy-seven percent of these excess payments stemmed from contract administration actions (such as finalizing the amount provided to cover overhead costs) and 18 percent stemmed from billing or payment errors. Most of the contract

³ Data on payments returned through offsets was not available for fiscal year 1999 or earlier years.

administration actions were associated with financing payments (progress payments) provided to support contract implementation. Repayments became necessary when, for example, physical progress did not keep pace with progress payments or when there was a decrease in the number of items purchased.

Reported underpayments were less common than excess payments. Large contractors we reviewed reported resolving \$41 million in underpayments during fiscal year 1999.⁴ Contractors attributed most underpayments to payment errors made by DFAS-Columbus. DFAS errors frequently came about in calculating how much had been paid through progress payments and how much was due when the item was delivered.

Finally, in looking at how quickly payment issues were resolved, we found that a substantial portion of excess payments—at least 39 percent of the dollars owed—were not repaid within 30 days. In addition, about 72 percent of underpayments took more than 30 days to resolve. It may be reasonable to expect underpayments to take a longer time to resolve since they were attributed to DFAS errors that still require reconciliation by the contractor and the government.⁵ Most excess payments, by contrast, were attributed to contract adjustments that have usually been agreed to by both the contractor and the government.

Our recommendations focus on reducing excess payments by periodically assessing the reasons excess payments occur and encouraging contractors to refund excess payments promptly. DOD generally agreed with our recommendations, saying that the amount of excess payments caused by contract administration actions should be reduced but that these payments were proper at the time of disbursement and the product of routine contract administration.

⁴ As discussed below, underpayments may not have been fully identified.

⁵ For billing and payment errors, we measured the 30 days from the date that the payment was received by the contractor. For contract administration actions, we measured the 30 days from the date of the contract adjustment that implemented the contract administration action.

Background

DFAS-Columbus pays contracts administered by the Defense Contract Management Agency (DCMA).⁶ This includes most contracts for development and production of weapon systems (except shipbuilding contracts). DFAS-Columbus paid \$71 billion to contractors in fiscal year 1999 and \$72 billion in fiscal year 2000.

These types of contracts often involve financing payments. Financing payments cover the costs incurred, for example, in manufacturing an aircraft or missile. These costs take the form of equipment, material, and labor needed for production. Financing payments may be provided through progress payments⁷ that reimburse contractors for most—75 percent for large contractors—of the costs they incur. As items covered by the contract are delivered, DFAS pays the remaining amount owed, deducting the progress payments from the price of delivered items. The rate used to determine the amount owed at delivery, known as the liquidation rate,⁸ may be adjusted when costs are higher or lower than projected. Under a fixed-price contract, this adjustment permits the contractor to receive the full amount due or, in the case of cost overruns, ensures that the government does not pay more than the agreed price.

When the contractor submits a bill for delivery of some or all of the items covered by a contract, DFAS recalculates the amount owed based on its records of whether progress payments have been made against the delivered items and what liquidation rate should be applied.

The Prompt Payment Act and the federal acquisition regulation require agencies to pay invoices for delivered items within 30 days. If not paid in 30 days, interest charges accrue. Requests for progress payments are not

⁶ DFAS-Columbus pays other contracts beyond those administered by DCMA. This report only covers payments made for DCMA-administered contracts and all references to DFAS-Columbus in this report are specific to these payments.

⁷ Financing payments may also be performance-based with payments based on the accomplishment of particular events or milestones. Financing payments, including both progress payments and milestone-based payments, typically apply to production contracts.

⁸ If the progress payment rate is 75 percent, the usual liquidation rate (the rate at which progress payments are liquidated) would also be 75 percent. The contractor would receive the remaining 25 percent on delivery of an item. However, an alternate rate of say 85 percent could be approved if costs were higher than expected. In this case, the contractor would receive a payment of 15 percent of the price rather than 25 percent of the price on delivery.

subject to interest charges. However, DOD regulations set a target of 7 days for paying progress payment requests.

DFAS-Columbus relies on the contracting officer for contract information necessary to make accurate and timely payments. Contract provisions specify key information such as the authorized progress payment rate, liquidation rate, and price. The DCMA contracting officer also monitors contract performance to ensure that amounts provided are commensurate with progress on the system. Contract provisions also define the ceiling price that is used to calculate payments when the price has not been negotiated (known as an undefinitized contract). Contracting officials also determine the indirect cost rate that is applied against direct costs, such as labor, to cover overhead costs.

Excess Payments Result From Contract Administration Actions

DFAS-Columbus reports that contractors repaid \$670 million in fiscal year 1999. This amount considers only repayments made through checks, not those made through offsets of other contract payments. (Data on payments returned through offsets was not available for fiscal year 1999.) DFAS-Columbus data for fiscal year 2000 indicates that contractors repaid closer to a billion dollars—\$632 million by check and \$269 million through offsets of other payments, for a total of \$901 million.

While these amounts represent a small portion of the total amount paid to contractors, they represent a substantial amount of cash in the hands of contractors beyond what is intended to finance and pay for the goods and services bought by DOD. Moreover, these funds are sometimes in the hands of contractors for several years before it is recognized that excess payments have occurred.

The 39 contractors we reviewed reported that they repaid \$351 million in fiscal year 1999, but many stated that they could not easily identify amounts repaid through offsets of other payments. These contractors also identified \$40 million in excess payments that, at the time of the contractor review, had not yet been repaid. However, the reported amount of outstanding payments does not fully capture the amounts already paid that may be recognized as excess payments in the future. For example, the indirect rate used to cover overhead costs may be estimated at the outset of the contract but may turn out to be higher than the actual rate determined

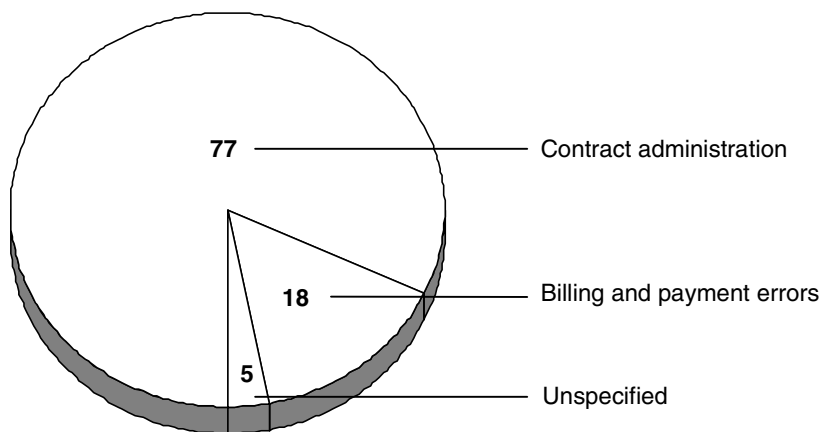
later on.⁹ When this occurs, the government will have paid the contractor too much for indirect (overhead) costs and will be due a refund. At the time of our review, neither the contractor nor DOD personnel would have recognized the payments as excessive and reported these excess payments as outstanding.

Reasons for Excess Payments

The large contractors we reviewed reported that 77 percent of the \$351 million in excess payments were principally related to contract administration actions. These actions include, for example, adjustments in the amounts provided through progress payments to finance the production of a system. A smaller portion of excess payments was related to contractor billing errors and DFAS-Columbus payment errors. Figure 1 further illustrates the sources of excess payments.

Figure 1: Sources of Excess Payments

Percent of dollar value for excess payments repaid in FY 1999



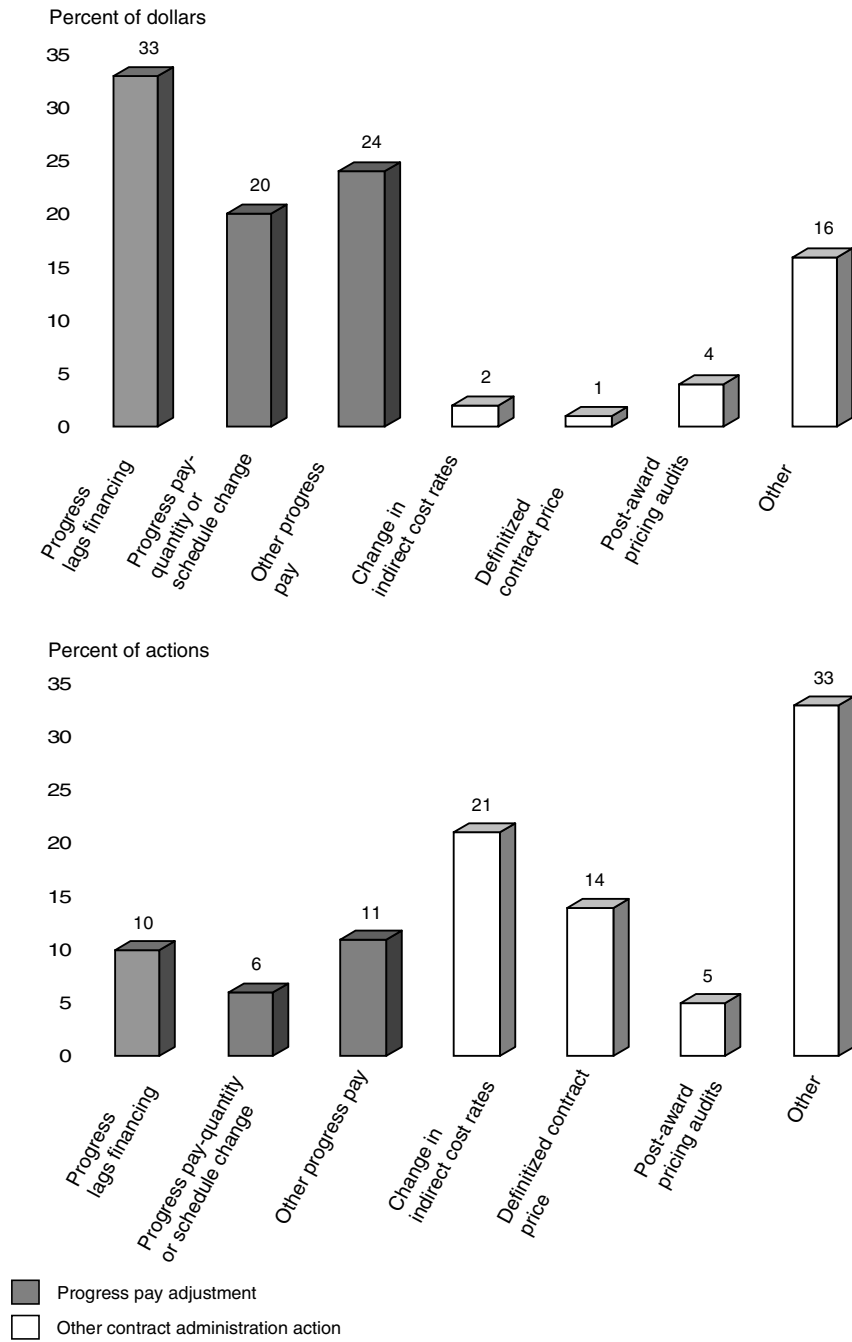
⁹ Changes in the indirect cost rate would affect payments for contracts where the contractor is reimbursed for costs or part of the price is based on actual costs.

Billing and payment errors accounted for a larger share of repayment actions. For the 1,153 repayment actions that make up the \$351 million of excess payments identified by contractors, 59 percent were attributed to contract administration actions and 26 percent to billing and payment errors. No reason was specified for 15 percent of the repayment actions.

Contract Administration Actions

As shown in figure 2, reimbursements of progress payments were the source of more than three-fourths of the dollar value of repayments attributed to contract administration actions. Reimbursements of progress payments occurred when physical progress was not commensurate with the amount of financing payments or when there was a change in the schedule or quantity of items to be delivered. The contracting officer is required to monitor program progress and take prompt action when progress lags financing payments. In these instances, costs may be higher than expected and the contractor will receive less profit or even incur losses on the contract. When the contracting officer adjusts the liquidation rate to recognize a lag in progress, the new rate is applied to previous payments, resulting in a refund due to the government.

Figure 2: Causes of Excess Payments Resulting From Contract Administration Actions



As shown in figure 2, some types of contract administration actions accounted for a substantial portion of the repayment actions but a small share of the excess payment dollars. For example, changes in indirect cost (overhead) rates accounted for 21 percent of actions but only 2 percent of excess payment dollars. Similarly, actions definitizing contract prices accounted for 14 percent of actions and 1 percent of excess payment dollars.

The examples below illustrate the types of contract administration issues that result in excess payments.

- At one location, the DCMA contracting officer recognized that payments needed to be adjusted because the contractor was incurring higher costs than expected. However, prompt action was not taken and additional progress payments were allowed before changing the liquidation rate 4 months later. When the rate was changed and applied to prior payments, the contractor reimbursed the government for \$13 million. About 3 months later, the DCMA contracting officer again identified a problem with the liquidation rate but allowed progress payments to continue before getting a refund of over \$25 million.
- In another case, the contractor relied on a time-phased plan for allocating material costs to contracts. Based on a 1998 delivery schedule, amounts were allocated to the contract and progress payments were made beginning in February 1998. In September 1998, the delivery schedule was extended to 1999. The contractor reallocated material to other contracts and, in November 1998, refunded \$10 million of prior payments.
- In another case, progress payments were made to finance the production of items used in satellite launches. However, the Air Force decided to defer delivery of these items and allowed the contractor to transfer them to commercial customers. The contractor repaid \$34 million in financing costs for these items. When production resumes, the contractor will again be eligible for progress payments.
- The Army expanded an existing contract for production of helicopters to include helicopters being purchased by the State Department. However, in modifying the contract, the contracting officer did not identify the payment office as the State Department. As a result, DFAS paid the contractor \$21 million in progress payments. Shortly afterward, the problem was identified and the contractor quickly reimbursed DFAS for these payments.

Excess Payments Also Result From Billing and Payment Errors

Contractors reported that \$64 million in contract repayments resulted from billing and payments errors,¹⁰ as shown in table 1. Contractor billing errors accounted for the larger dollar amount but a smaller number of repayment actions.

Table 1: Excess Payments Due to Billing and Payment Errors

Type of error	Excess payments resolved in FY 1999	
	Total (in millions of dollars)	Number of actions
Contractor billing	\$46.5	98
DFAS payment	17.1	198

Examples of contractor billing errors include the following cases.

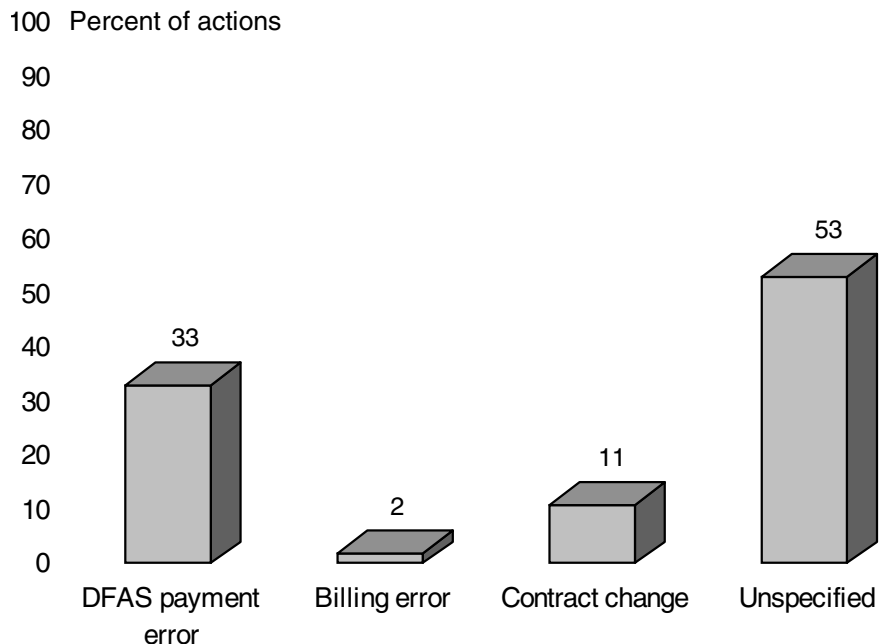
- A sizable repayment involved a contractor that billed twice for the same fees, resulting in excess payments of \$16 million between September 1997 and July 1999. This occurred when the contractor included award fees (profit) paid to a partnering company in its own costs and then separately billed for these same fees. The contractor did not detect the double billing until August 1999. The contractor refunded the excess payments 8 days later and took steps to prevent such billing errors in the future. In response, the DCMA office overseeing this contractor issued an alert to other offices about the potential for double billing under similar circumstances.
- A smaller error occurred in a case in which the contractor overpaid its supplier by \$1.3 million and charged that amount to the government. The contractor identified its error in October 1998 and repaid the government 42 days later—time needed, according to the contractor, for internal processing and approval.

¹⁰ We relied on the contractor's assessment of whether errors were due to DFAS-Columbus payment errors or billing errors. We did not independently verify each transaction. However, we did review a small number of transactions with DFAS-Columbus officials and they agreed with the contractor's classification for most of these transactions.

Pattern for Outstanding Excess Payments Differs

For most excess payments that were outstanding at the time of the contractor reviews, the causes of the excess payments were not specified.¹¹ For those payments where a cause was identified, contractors attributed most of the excess payments to DFAS errors, as shown in figure 3.

Figure 3: Reasons for Outstanding Excess Payments



Note: Numbers do not add to 100 percent due to rounding.

One very large payment for \$29 million was outstanding at the time of the contractor reviews.¹² The contractor attributed the problem to a DFAS error, but we questioned whether this is the appropriate classification of the payment. In this case, the contracting officer modified a contract for

¹¹ The contractor did not specify a reason the excess payments occurred in its response to DCAA.

¹² Because this one large payment greatly affects the proportion of dollars attributable to any reason category and because we did not agree with the contractor's identification of the reason as a DFAS error, we are not presenting reasons for excess payments by dollar amounts.

production of Air Force aircraft to add manufacturing support for the foreign military sale of aircraft. In modifying the contract, the contracting officer did not reference a DOD regulation requiring that, in the case of foreign military sales, requests for progress payments allocate the amount requested by purchasing country. Contracting officials stated that the clause was not referenced because they did not expect progress payments to be requested for the manufacturing support portion of the contract—manufacturing support was payable in increments of one-twelfth of the annual amount. (Contracting officials stated that progress payments will be expressly prohibited in a follow-on contract.) Although experienced in foreign military sales, the contractor did not identify its progress payment requests as related to foreign military sales. When no country is identified, DFAS-Columbus allocates progress payments to the U.S. portion of the contract. As a result, when the contractor submitted invoices for final payment against the foreign military sales portion of the contract, DFAS-Columbus did not deduct progress payments from the price; instead, it paid the full amount for manufacturing support. The contractor notified DFAS when the excess payments began, but payments had accumulated for 14 months at the time of our review. Two months later, payments were reconciled and the contractor repaid \$29 million.

DCMA Does Not Analyze Reasons for Excess Payments

When a contractor submits a check to repay an excess payment, DFAS-Columbus classifies it as either a payment error or contract administration action. The results of DFAS's analysis is similar to our own—it reports that 82 percent of the dollar value of excess payments in fiscal year 1999 was due to contract administration actions. When an excess payment is due to a payment error, it identifies the source of the problem to prevent future recurrence. However, DFAS does not analyze the causes for excess payments resulting from contract administration actions because these excess payments involve actions outside its control, such as contract price adjustments.

DCMA does not analyze the data generated by DFAS to understand the nature of excess payments caused by contract administration actions. Such an analysis would be helpful in identifying systemic problems that result in excess payments or in identifying problems specific to a particular contractor or contracting organization. Without such information, substantial reductions in the amounts of excess payments are unlikely.

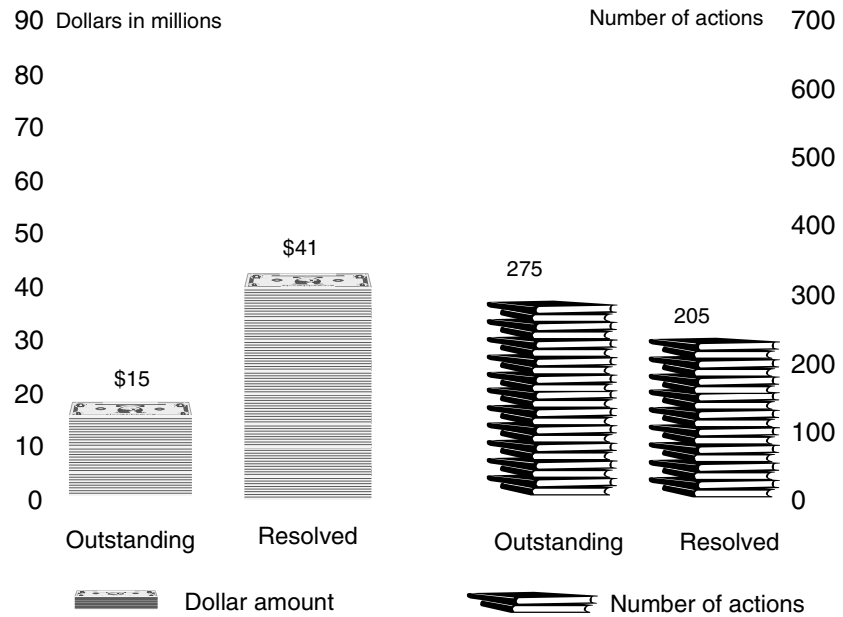
According to DCMA officials, they do not receive DFAS's data on excess payments even though DFAS's data is a central source of information on

excess payments resulting from contract administration actions. For each check DFAS receives, DFAS shows the refund amount, contractor's name, contract number, and the general nature of the contracting action. For example, a refund check may be associated with a change in the liquidation rate. Thus, the DFAS data would indicate the excess payment was associated with progress payments although the data would not indicate if the change is resulting from delays in delivery schedules or higher than expected costs. We believe that the DFAS data can be used as a tool for initially identifying the types and locations of contract administration actions that are generating excess payments and appropriately targeting efforts to reduce excess payments.

Underpayments Attributed to Payment Errors

Contractors identified a smaller amount of underpayments compared to excess payments. Contractors covered by our review reported that they had resolved underpayments totaling \$41 million in fiscal year 1999, as shown in figure 4. Contractors also reported that \$15 million in underpayments were outstanding at the time of the review. While the dollar impact of underpayments is smaller, compared to overpayments, the resolution of these problem payments creates an administrative burden on DFAS, contracting officers, and contractors. Furthermore, when the underpayment occurs on an invoice for delivery of an item, the underpayment may be subject to interest charges. DFAS-Columbus reports that it paid \$24 million in interest in fiscal year 1999 and \$16 million in fiscal year 2000.

Figure 4: Scope of Underpayments



DCMA and contractor officials stated contractors might not have fully reported underpayments. If a contract adjustment results in recognizing that the contractor is due additional monies (for example, a decrease in the liquidation rate due to lower-than-expected costs), the contractor will normally prepare an invoice for the amount owed. Officials said that because the amount owed is paid through a separate invoice, contractors might not have identified the payment as an underpayment. DCAA officials also stated that some contract actions—such as pricing audits—only result in identifying excess payments, not underpayments.

As a result, contractors attributed most underpayments to DFAS payment errors—93 percent of the dollar value of underpayments resolved in fiscal year 1999. Three percent of underpayments resolved in fiscal year 1999 were attributed to contractor billing errors. For underpayments outstanding at the time of our review, contractors did not specify a cause for 39 percent of the dollar value underpayments and attributed 61 percent to DFAS payment errors. None of the outstanding underpayments were attributed to contractor billing errors.

Many of the DFAS errors came about in determining how much was due when the item was delivered and how much had been paid through

progress payments. For example, one contractor reported that DFAS deducted progress payments for items in the contract that were not eligible for and had not received progress payments. The contractor reported that an underpayment for \$123,000 occurred in August 1998. Two months later, DFAS completed its review and paid the contractor \$123,000.

Discrepancies also occurred when DFAS and the contractor processed invoices in different sequences. In preparing its invoice, the contractor may apply outstanding progress payments to the first invoice and show the full amount, without a deduction for progress payments, on later invoices. However, DFAS may not process the invoices in the same sequence if, for example, multiple invoices are submitted on the same day or within a few days of each other. DFAS applies progress payments to invoices as they are paid, until no progress payments remain.

Some Excess Payments and Underpayments Are Not Resolved Promptly

A substantial portion of excess payments was not repaid promptly. As shown in table 2, for the 39 contractors we reviewed, 55 percent of the dollar value of excess payments was repaid in 30 days or less while 39 percent was not. (Data to determine the time taken to repay was not available for the remaining amount.) Unless a formal demand for payment is made, there is no penalty or interest charged to contractors for repayments taking more than 30 days.

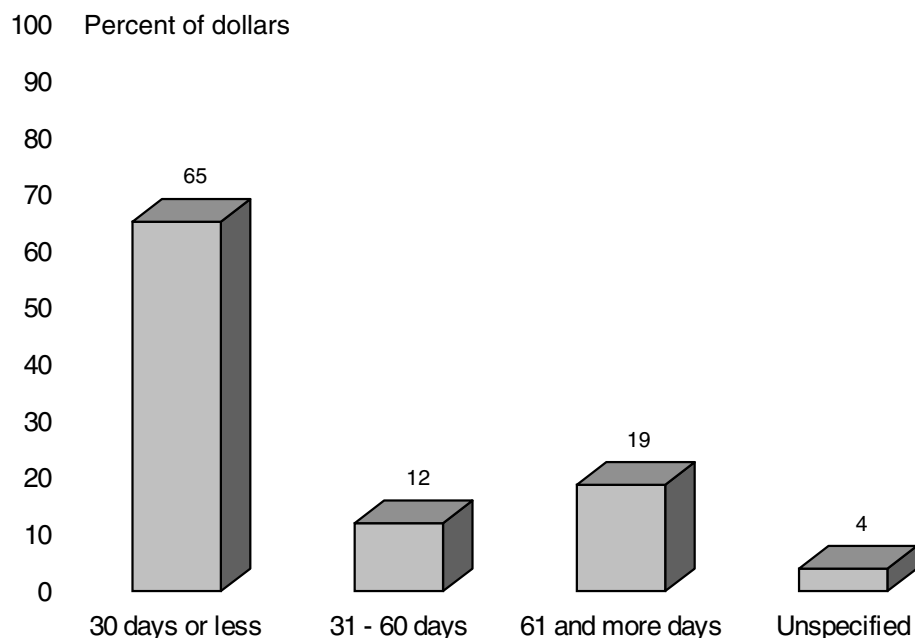
Table 2: Time Involved in Resolving Excess Payments and Underpayments

Number of days	Excess payments repaid in FY 1999		Underpayments resolved in FY 1999	
	Percent of dollars ^a	Percent of cases	Percent of dollars	Percent of cases ^a
30 days or less	55	30	26	42
31-60 days	13	12	44	15
61-90 days	9	7	22	15
91-180 days	12	7	5	17
181-365 days	1	8	0	6
Over 1 year	4	9	1	4
Unknown	5	27	2	2
Total	100	100	100	100

^aDoes not total 100 percent due to rounding.

Because most excess payment dollars—77 percent—stemmed from contract administration actions, it is reasonable to expect repayment within 30 days of the contract adjustment. These actions are normally implemented through modifications to the contract that are usually agreed to by both the contracting officer and the contractor. Thus, at the time the contract modification is signed, there is recognition that a repayment will result from the action and the amount owed is identified or can be readily calculated. Yet, as shown in figure 5, a substantial portion of excess payment dollars resulting from contract adjustments was not repaid in 30 days.¹³

Figure 5: Time Taken to Repay Excess Payments Resulting From Contract Administration Actions



¹³ By comparison, for excess payments resulting from billing and payment errors, 71 percent was not repaid in 30 days. At the end of 60 days, 58 percent had not been repaid. As discussed below, it is reasonable to expect that billing and payment errors would take somewhat longer, on average, to resolve.

Contractors had different policies for refunding excess payments. Some had policies and procedures for identifying and refunding excess payments promptly. Others waited for government action before refunding. Some contractors would not refund excess payments if they also had unresolved underpayments. And some contractors preferred to offset other payments rather than issuing a check, a process that would take longer and is less visible. In August 2000, in response to our recommendation, a revision to the federal acquisition regulation was proposed requiring contractors to notify the contracting officer if the contractor becomes aware of an overpayment.¹⁴ Our recommendation was intended to apply to excess payments caused by contract administration actions as well as billing and payment errors. However, the proposed regulation only applies to invoice payments and not contract financing payments (i.e., progress payments).

DOD has the ability to demand payment within 30 days and to impose interest charges if not repaid within this time. The federal acquisition regulation directs that the responsible official (usually the contracting officer) act promptly to determine the amount owed the government and DOD regulations require that a demand for payment be made as soon as this amount has been determined. Moreover, the federal acquisition regulation imposes interest charges for debts not paid in 30 days. Yet, contracting officers do not consistently issue demands for payment when contract changes are negotiated even though, in most instances, the amount owed is known or is calculable from the data used to determine the contract change. For example, in one case, the contracting officer negotiated a price reduction because certain engineering tasks were eliminated from the contract. After negotiating for nearly a year, agreement was reached and a contract modification signed reducing the contract price by \$6.9 million. However, the contracting officer did not issue a formal demand for payment. The contractor did not refund the \$6.9 million until January 1999, more than a year later and 2 years after the scope of engineering tasks was reduced.¹⁵

In the case of underpayments, we found that 72 percent of the dollar value of underpayments took more than 30 days to resolve. However, contractors attributed most underpayments—93 percent—to DFAS payment errors. In

¹⁴ *DOD Contract Management: Greater Attention Needed to Identify and Recover Overpayments* (GAO/NSIAD-99-131, July 19, 1999).

¹⁵ According to the contractor, it did not refund the money promptly because the contract modification was, inadvertently, not communicated to the accounting department.

these cases, a problem would be identified at the time the contractor received the payment and the process of reconciling identified discrepancies would begin at this point. It would therefore seem reasonable to expect resolution of payment errors to take longer than repayments arising from contract administration actions. Twenty-six percent of the dollar value of underpayments was resolved in 30 days and an additional 44 percent was resolved in 31 to 60 days. Twenty-eight percent took more than 60 days to resolve. Underpayments were therefore resolved more quickly than excess payments—58 percent of the dollar value of excess payments attributed to billing and payment errors took more than 60 days to resolve.

Payments Outstanding at the Time of Our Review Took Long Periods to Resolve

The time involved for resolving excess payments and underpayments that were outstanding at the time of our review differed substantially from the time involved for cases resolved in fiscal year 1999. As shown in table 3, most excess payments and underpayments that were unresolved at the time of our review had been unresolved for at least 6 months. Some had been unresolved for several years.

Table 3: Amount of Time Taken to Resolve Outstanding Excess Payments and Underpayments

Number of days	Outstanding excess payments		Outstanding underpayments	
	Percent of dollars	Percent of actions	Percent of dollars ^a	Percent of actions ^a
30 days or less	0	0	0	0
31-90 days	0	2	0	0
91-180 days	2	5	0	0
181-365 days	9	34	53	46
Over 1 year	83	54	39	53
Unknown	6	5	7	0
Total	100	100	100	100

^aDoes not add to 100 percent due to rounding.

Several reasons were given for the lengthy times involved in these cases. DFAS officials stated that the process for resolving payment discrepancies could be labor-intensive and time-consuming, particularly for large contracts covering several years with large numbers of payments. And

some contractors said they do not repay excess payments if underpayments had also occurred.

Conclusions

The amount of excess payments repaid in fiscal year 2000—\$901 million—is small compared to the total amount paid by DFAS-Columbus. Nonetheless, it represents a substantial amount of financial resources paid to contractors beyond what is intended to support the financing of programs. Most of these excess payments were due to contract administration actions, particularly adjustments in progress payments. These actions largely fall under the purview of DCMA. However, DCMA does not review the data generated by DFAS on reasons excess payments occurred. Such a review is necessary if excess payments are to be reduced.

While a sizable portion of excess payments is repaid within 30 days, a substantial portion is not. It is reasonable to expect that excess payments resulting from contract administration actions should be repaid in this time frame since the amount owed is identified in the contract change or can be calculated from the data used to develop the contract adjustment. More consistent application of requirements to issue demands for payment is needed.

Recommendations for Executive Action

We recommend that the Secretary of Defense

- Require that DCMA endeavor to minimize excess payments by (1) routinely analyzing DFAS data on the reasons for excess payments relating to contract administration, (2) further investigating problem areas identified by this data, and (3) identifying and implementing actions to reduce the amount of excess payments caused by contract administration actions.
- Require, when contract administration actions result in recognition of an excess payment, that contracting officers compute the amount owed and demand payment of this amount at the time the contract is modified.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD partially concurred with the first recommendation. Specifically, DOD stated that it partially concurred with the need to routinely analyze DFAS data and identify problem areas, stating that DCMA will conduct an initial review of excess

payment data generated by DFAS and determine whether routine receipt and analysis of this data would be meaningful. DOD agreed that the amount of excess payments caused by contract administration actions should be reduced, and it specifically concurred with the need to identify and implement actions to reduce these excess payments. DOD further commented that contract actions at times necessitate recoupment of funds from contractors in the normal course of contract performance and that these payments were proper at the time they were paid to contractors. DOD stated that it is misleading to call the funds recouped from contractors excess payments and that they only become excess payments if contractors delay in making repayment.

We believe that if DCMA concludes that the DFAS data does not give it sufficient information to justify routine receipt of this data, it is imperative that DCMA identify an alternate approach for identifying actions that will reduce the amount of excess payments caused by contract administration actions. We disagree with DOD's comments that only those amounts the contractor delays in repaying are really excess payments. DOD seems to be confusing the issue of whether a payment is proper (i.e., consistent with contract terms) with whether the payment is the right amount to accomplish its intended purpose (e.g., reimbursing the contractor for the actual amount of indirect costs being incurred). Some recoupment of payments will be necessary as a result of normal contract management, in part, because it is not practical to gain perfect knowledge of the exact amount needed to accomplish the intended purpose. We believe it is essential that controls are in place and timely management oversight is conducted so that the amount of payments recouped from contractors (i.e., excess payments) is kept to a minimum. The amount currently being recouped is too high. Further, we understand that DOD is considering plans to increase the progress payment rate from 75 percent to 80 percent (for large contractors). Such an action would increase the amount of progress payments going to contractors and would likely lead to an increase in excess payments if no actions are taken to manage progress payments more effectively.

With regard to the second recommendation on demanding payment of amounts owed, DOD agreed with the recommendation and stated that DCMA will improve its guidance to contracting officers to ensure they issue demands for payments with the execution of contract modifications.

DOD comments appear in appendix II. DOD also provided technical comments that we have incorporated as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute this report until 30 days from its date. At that time, we will send copies of this report to the appropriate congressional committees; Donald H. Rumsfeld, Secretary of Defense; and Mitchell E. Daniels Jr., Director, Office of Management and Budget.

GAO contacts and staff acknowledgments to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink that reads "David E. Cooper". The signature is written in a cursive style with a large, prominent initial "D".

David E. Cooper, Director
Acquisition and Sourcing Management

Contractors Reviewed

Lockheed Martin Corp., Marietta, Ga.
Primex Technologies Co., St. Petersburg, Fla..
United Technologies Corp., West Palm Beach, Fla.
Northrop Grumman Corp., Melbourne, Fla.
Lockheed Martin Corp., Orlando, Fla.
Allison Engine Co. Inc., Indianapolis, Ind.
Lockheed Martin Tactical, Akron, Ohio
Textron Systems Corp., Wilmington, Mass.
Hughes Arabia Limited, Malaz District, SAU
Lockheed Martin Corp., Syracuse, N.Y.
General Dynamics Defense, Pittsfield, Mass.
Sikorsky Aircraft Corp., Stratford, Conn.
Lockheed Martin Corp., Nashua, N.H.
Raytheon Co., Marlborough, Mass.
Lockheed Martin Commercial, Littleton, Colo.
Lockheed Martin Corp., Littleton, Colo.
Oshkosh Truck Corp., Oshkosh, Wis.
Raytheon Aircraft Co., Wichita, Kans.
McDonnell Douglas Corp., St. Louis, Mo.
DYN Corp/Aerospace Technology, Ft. Worth, Tex.
Stewart & Stevenson Services, Sealy, Tex.
Alliant Techsystems Inc., Hopkins, Minn.
Lockheed Martin Corp., Ft. Worth, Tex.
Raytheon Co., Tucson, Ariz.
Science Applications Intl., San Diego, Calif.
Litton Systems Inc., Woodland Hills, Calif.
Lockheed Martin Corp., Sunnyvale, Calif.
Boeing Co., Seattle, Wash.
McDonnell Douglas Corp., Huntington Beach, Calif.
McDonnell Douglas Corp., Long Beach, Calif.
Boeing North American Inc., Downey, Calif.
TRW Inc., Carson, Calif.
Lockheed Martin Corp., Baltimore, Md.
Lockheed Martin Corp., Manassas, Va.
Marconi Systems Technologies, Rockville, Md.
Boeing Sikorsky Comanche, Philadelphia, Pa.
Boeing Helicopters, Ridley Park, Pa.
United Defense LP, York, Pa.

Comments From the Department of Defense



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

FEB 20 2001

Mr. David E. Cooper
Director
Acquisition and Sourcing Management
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "CONTRACT MANAGEMENT: Excess Payments and Underpayments Continue To Be A Problem," dated January 19, 2001 (GAO Code 707411/OSD Case 3029).

GAO examined excess payments and underpayments by looking at the amount of excess payments repaid and underpayments resolved during fiscal year 1999. The review focused on large contractor business segments that received at least \$125 million in contract payments from the Defense Finance and Accounting Service (DFAS) - Columbus Center. Data was also collected on the amount of overpayments and underpayments outstanding as of the time data was collected from contractors (May 2000).

Many of the examples characterized in the draft report as excess payments are in fact the expected product of routine contract administration actions. Such actions include adjustments to progress payment liquidation rates, approval of material transfers, calculation of loss ratio factors, and negotiation of overhead rate settlements. These actions at times necessitate recoupment of funds from contractors in the normal course of contract performance and are based on applicable regulations and contract terms; at other times, these actions necessitate payment of additional funds to contractors. It is therefore misleading to characterize these amounts as excess payments. These amounts were, in general, proper at the time they were paid to contractors. They become "excess payments" only if the contractor delays in making repayment after the adjustment process is completed.

The DoD partially concurs with recommendation 1 and concurs with recommendation 2 (Enclosure). The Defense Contract Management Agency (DCMA) will conduct an initial review of data



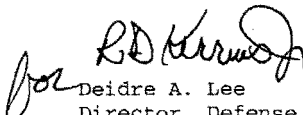
Appendix II
Comments From the Department of Defense

generated by DFAS regarding excess payments resulting from contract administration, to determine if the DFAS data would be meaningful for routine receipt and analysis by DCMA. The DCMA will also improve its guidance to contracting officers to ensure they issue demands for payment of amounts due the government concurrent with the execution of contract administration modifications that create a need to recoup payments.

Technical and clarification comments were provided directly to the GAO staff for their consideration.

Thank you for the opportunity to comment on the subject draft report.

Sincerely,


Deidre A. Lee
Director, Defense Procurement

Enclosure:
As stated

Appendix II
Comments From the Department of Defense

GAO Draft Report
January 19, 2001

"CONTRACT MANAGEMENT: EXCESS PAYMENTS AND
UNDERPAYMENTS CONTINUE TO BE A PROBLEM"

(GAO CODE 707411) OSD CASE 3029

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense require that DCMA (1) routinely analyze DFAS data on the reasons for excess payments relating to contract administration, (2) further investigate problem areas identified by this data, and (3) identify and implement actions to reduce the amount of excess payments caused by contract administration actions. (p. 21/GAO Draft Report)

Now on p. 21.

DOD RESPONSE:

(1) Partially concur. DCMA will work with DFAS to review current DFAS procedures and reports in order to identify information that would be meaningful for receipt and analysis by DCMA, and to develop procedures, if needed, for receipt and analysis of data on contractor repayments.

(2) Partially concur. If meaningful data are available, or if procedures can be revised to provide meaningful data, DCMA will pursue correction/improvement of problem areas identified.

(3) Concur. We agree that the amount of excess payments caused by contract administration actions should be reduced. DCMA will revise its policy to emphasize the need for prompt repayment of any amounts that become due during the course of contract administration actions.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense, when contract administration actions result in recognition of an excess payment, require that contracting officers compute the amount owed and demand payment of this amount at the time the contract is modified. (p. 21/Draft Report)

Now on p. 21.

DOD RESPONSE: Concur.

ENCLOSURE

GAO Contacts and Staff Acknowledgments

GAO Contacts

Dave Cooper (202) 512-4841
Karen Zuckerstein (202) 512-6785

Acknowledgments

In addition to those named above, Odilon Cuero, Jack Edwards, Carlos Garcia, Paul Greeley, Noel Lance, Martin Lobo, Kenneth Roberts, and Raffaele Roffo made key contributions to this report.

We would also like to acknowledge the contributions of Barry Turner, Defense Contract Audit Agency, to this report.

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