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United States General Accounting Office
Washington, DC 20548

May 30, 2001

Brigadier General Edward M. Harrington, Director
Defense Contract Management Agency

Col. Ted F. Bowlds, Program Director
C-17 System Program Office (ASC/YC)

Thomas R. Bloom, Director
Defense Finance and Accounting Service

Subject: Internal Controls: C-17 Payment Procedures Can Be Improved

We are currently reviewing the business processes associated with the Air Force's C-17 aircraft production program focusing on acquisition, asset management, and accounting.¹ Our underlying objective was to conduct a case study to examine the business processes used to make investment expenditures during the production phase of a major weapons system. We selected the C-17 program because (1) it is currently a mature, stable program, (2) we have prior experience in reviewing the program, and (3) its current contract is performance-based rather than cost-based. We will be issuing a separate report on the end-to-end procurement business process, which includes acquisition, asset management, and accounting.

The purpose of this letter is to report certain internal control weaknesses specific to the C-17 program. These internal control weaknesses concern compliance with regulations, policies, and procedures over (1) establishing withhold amounts by the Air Force contracting officer for conditionally accepted items, (2) processing by the Administrative Contracting Officer (ACO) of performance-based payment requests, (3) processing by the ACO of invoices for delivered aircraft, and (4) processing of a delivery payment by the paying office at the Defense Finance and Accounting Service (DFAS) Columbus Center on a contract containing performance-based payment provisions.

The current C-17 production contract is performance-based—i.e., it ties payments to the accomplishment of specific milestones. This type of contract has not been frequently used by the Department of Defense (DOD) in the past, but will be the preferred type of financing used by DOD for fixed-price contracts in the future.

¹ The specific C-17 production contract we reviewed is F33657-96-C-2059 dated June 1, 1996. This contract is for the multiyear production of 80 aircraft, P-41 through P-120.

Results in Brief

We identified weaknesses in the internal controls over the approval and processing of payments for the C-17 contract we reviewed. Specifically, we found that

- the contracting officer did not estimate sufficient amounts to be withheld from payments for conditionally accepted aircraft,
- the ACO allowed the contractor to transmit approved performance-based payment (PBP) requests to the paying office rather than transmitting them directly,
- the ACO did not review invoices for delivered aircraft in a thorough and timely manner, and
- the paying office used incorrect payment criteria for one aircraft delivery, which resulted in an overpayment.

We are making a number of recommendations regarding the need to improve payment processing controls by following the applicable regulations, policies, and procedures. DOD agreed or partially agreed with 5 of our 6 recommendations. In general, DOD expressed the view that there were no control weaknesses in the payment procedures for the C-17. In particular, DOD did not seem to fully appreciate our concern that the ACO needed to play a more prevalent role in ensuring the accuracy and propriety of payments as contemplated by current government requirements. We continue to believe that following existing requirements and our related recommendations is important and that the ACO is the government official in the best position to carry out these responsibilities. Regarding our recommendation dealing with inadequate amounts withheld for incomplete, but conditionally accepted aircraft, we believe that withholding anything less than an amount based on the rate of profit cited in the C-17 production contract is not in the best interest of the government.

Background

The Federal Acquisition Streamlining Act of 1994 contained a new provision for the use of PBPs as an alternative to other forms of contract financing. According to DOD, in fiscal year 1999, the paying office processed approximately 1 million invoices for 363,000 major contracts. Of these, 195 contracts, or less than 1 percent of all contracts, contained performance-based provisions. These contracts are so few in number because they are a relatively new form of contracting within DOD. However, on November 13, 2000, the Under Secretary of Defense (Acquisition, Technology, and Logistics) directed that performance-based financing will be the preferred contract financing method for future fixed-price contracts in DOD.

Payments under this new type of contract financing method are contingent upon meeting certain performance criteria. The current C-17 production contract—under which the Air Force will pay \$14.5 billion for 80 aircraft—contains provisions that tie payments to accomplishing 7 production milestones. For example, milestone 5 requires the contractor to complete the forward, center, aft, and wing sections prior to payment for that milestone. Interim payments are based on fixed amounts

specified in the contract (e.g., the contractor received a payment of \$31,944,374 for completion of milestone 5 for aircraft P-69). These payments are referred to in the Federal Acquisition Regulation (FAR) Part 32.102 (f) as PBPs.

Under contracts containing PBP provisions such as the C-17 multiyear contract, DOD follows two different processes to ensure payments are properly authorized: (1) one process for interim payments, such as completion of milestones 1 through 6 based on PBP requests and (2) another process for delivery payments based on an invoice. Under the process for a PBP request, the contractor generates a completion report and submits it to a Defense Contract Management Agency (DCMA) quality assurance (QA) official for certification that the milestone requirements have been met. After receiving this certification, the contractor submits a PBP request package to the DCMA ACO. The ACO is required to review and approve the payment request before transmitting it to the paying office. This procedure is extremely important because PBP requests do not require a receiving and inspection report that is independent of the PBP request.

In contrast to the interim payment process, delivery payments require other procedures. Just prior to delivery of the aircraft, the Air Force C-17 contracting officer and the contractor negotiate the amount to be withheld from the delivery payment for conditionally accepted² items. Upon delivery of the C-17 aircraft, the contractor generates the receiving report containing the unit price and negotiated amount to be withheld and submits it to the DCMA QA representative for acceptance. After the DCMA QA representative accepts the receiving report and returns it to the contractor, the contractor modifies the report by adding information on the previous payments and the net amount due, and marking it as the invoice. The contractor then submits (1) the original invoice to the paying office for payment and (2) copies of the invoice to the ACO. The ACO gives one copy to his representative, who enters the receiving report information into the paying office system. Upon receipt of the invoice, the paying office determines whether the contractor is entitled to payment by matching payment data on the invoice to its records (purchase order and receiving report). The ACO is responsible for resolving any disputes that arise between the contractor and the government over the payment amount or timing of the payment.

Objective, Scope, and Methodology

The objective of this part of our work on the C-17 was to evaluate controls over the payment process for both interim and delivery payments on a performance-based contract. To evaluate the payment procedures for the C-17, we walked through the procedures for both PBPs and delivery payments with officials from the contractor as well as DCMA, DFAS, and the Air Force. We compared these procedures with the FAR and with DOD and Air Force policies and procedures. We also reviewed

² Conditional acceptance means that a contracting officer has determined that it is in the government's best interest to accept an item that does not conform to contract specifications or is otherwise incomplete, with the expectation that the contractor will later correct nonconformances or complete other work.

documentation for selected recent transactions to gain further evidence about what procedures were followed. We conducted this analysis of the payment process in accordance with generally accepted government auditing standards and in conjunction with our evaluation of the Air Force's procurement business process from July 2000 through March 2001.

Contracting Officer Not Estimating Sufficient Withholds for Conditionally Accepted Items

The Air Force generally accepts C-17 aircraft that are incomplete or do not fully conform to contract specifications with the understanding that the contractor will complete the work after delivery. To ensure that this work is eventually completed and that the government does not pay for incomplete work, a portion of the final payment for the aircraft is withheld until the work is finished. During prior work on the C-17, we noted that the amounts withheld were less than the estimated cost and profit to complete this work.³ During our current review, we found that this situation continues to exist.

The FAR Part 46.407(f) states that amounts withheld from payments generally should be at least sufficient to cover the estimated cost and related profit to correct deficiencies and complete unfinished work. The estimated cost to complete unfinished work should reflect a combination of material and labor plus a rate for overhead and profit. However, the contracting officer stated that in calculating withhold amounts for this contract, he used a rate of profit that was between 5 and 7 percent lower than the estimated rate of profit included in the production contract.

We reviewed the amounts withheld on all 30 aircraft delivered from August 1998 through December 2000. The amount initially withheld from the delivery payments on these 30 aircraft ranged from \$715,000 to \$4.6 million, or \$72.2 million in total. Based on the contracting officer's statement that an additional 5 to 7 percent should have been withheld, we used the lower estimate of 5 percent to calculate the additional amount that should have been withheld. As of January 29, 2001, the 30 aircraft had withheld amounts still outstanding totaling \$38.2 million. We calculated the amount of additional profit that should have also been withheld on this \$38.2 million to be over \$1.7 million.

Recommendation

We recommend that the contracting officer follow the requirements of FAR Part 46.407(f) by negotiating a withhold amount that represents the full value of the unfinished work and thereby better protects the government's interests.

³ *Defense Acquisition: Guidance Is Needed on Payments for Conditionally Accepted Items* (GAO/NSIAD-98-20, Dec. 12, 1997).

Required Payment Procedures Are Not Followed by the ACO for Performance-Based Payment Requests

The DCMA QA representative properly certifies that a milestone has been completed by physically inspecting the aircraft and reviewing the contractor's milestone completion report. After DCMA QA's certification, the contractor prepares the PBP request and sends it to the DCMA ACO for his review and approval. We found that the DCMA ACO does not properly transmit PBP requests to the paying office as required by the FAR. As a result, there is the potential that unauthorized and inaccurate payments can go undetected.

According to FAR Part 32.1007, the contracting officer responsible for administration of the contract is responsible for receiving, approving, and transmitting all performance-based payment requests to the appropriate payment office. However, the ACO for the C-17 does not fully comply with this procedure. Instead, after approving and signing the PBP request, the ACO returns one copy to the contractor and relies on the contractor to send it to the paying office for payment. According to the ACO, this practice relieves the ACO of the administrative duties associated with mailing and tracking the PBP requests. The contractor's officials recognize that this reflects an internal control weakness. However, contractor officials stated that they have been processing the approved PBP requests in this manner because it allows them to ensure that the PBP requests are transmitted to the paying office on a timely basis.

An internal control weakness exists when the ACO allows the contractor to send PBP requests to the paying office. Although the ACO signs the request, he has no assurance that the contractor will not alter the request after it is approved. The ACO can only ensure the request's accuracy by independently transmitting it to the paying office. Without this independent verification and transmission of the request to the paying office, unauthorized and improper payments can go undetected.

Recommendation

We recommend that the ACO transmit all PBP requests to the paying office as required by FAR Part 32.1007.

Specified Payment Procedures Are Not Followed by the ACO for Delivered Aircraft

When an aircraft is delivered to the Air Force, the ACO is responsible for verifying the delivery of the aircraft and the accuracy of the payment invoiced amount. The Air Force Materiel Command (AFMC) Financial Management Handbook states that the ACO is responsible for (1) verifying delivery of the aircraft and (2) calculating the amount of payment. To help prevent erroneous payments from being made, we believe the ACO should carry out these responsibilities prior to submitting receiving report information to the paying office. The ACO stated that, for verifying delivery of the aircraft, he relies on DCMA QA's approval of the receiving report, which is done before the ACO's representative submits the independent receiving report to the

paying office. However, he indicated that he does not usually recalculate the amount of the payment until after the receiving report is sent to the paying office. Moreover, the recalculation does not include a verification of previous payments made. The ACO stated that he was not aware of the provisions in the AFMC Financial Management Handbook stating that he is to validate not only the delivery of the aircraft but also the payment amount. Without the ACO's independent verification of the payment amount, including withholds, the paying office may make an inaccurate payment based on the invoice amount.

When an aircraft is delivered, the contractor submits a DD Form 250 (Material Inspection and Receiving Report) to the DCMA QA representative showing the unit price of the aircraft being delivered and the negotiated withholds, if any. The QA representative signs the DD Form 250 receiving report to indicate that he has inspected and accepted delivery of the aircraft. After signing it, the QA representative returns the DD Form 250 receiving report to the contractor. The contractor then modifies the DD Form 250 receiving report by adding payment information and marking it as the invoice copy.⁴ The invoice copy shows the unit price of the aircraft, less the negotiated withhold amounts and the total previous PBPs made for the aircraft, and a calculation of the net balance due. The contractor sends the invoice to the paying office for payment and, at about the same time, provides copies to the ACO office.

An important aspect for ensuring that the payment is authorized is the independent review by the ACO that the amount is correct and the item has been accepted prior to his submitting the receiving report to the paying office. We found that the ACO typically reviews the invoices after (1) they have been sent to the paying office and (2) the ACO's representative has entered the receiving report information into the paying office system. The ACO stated that he processes invoices in this manner because he was not aware of the AFMC Handbook provisions stating that he is to validate not only the delivery of the aircraft but also the payment amount. As a result, for the C-17 contract, the paying office has no way to independently verify that the contractor has accurately calculated the net balance due and correctly reflected the negotiated amount of withholds, or to know if anyone else has verified their accuracy.

Recommendation

To ensure that the paying office does not process delivery payments based on inaccurate information on the invoice, we recommend that the ACO, in accordance with the guidelines contained in the AFMC handbook, verify delivery of the aircraft and calculate the amount of payment. We also recommend that these verifications occur before the ACO representative enters the receiving report information into the paying office system. We further recommend that, to reduce the likelihood of the need for corrections at the paying office, the ACO should review the payment information as soon as possible after receiving invoices from the contractor.

⁴ The DD Form 250, Material Inspection and Receiving Report, can serve multiple functions in the payment process. The form can serve as the shipment document and as the material inspection and acceptance document. In addition, the DD Form 250 can serve as the contractor invoice when the contractor submits it for payment to the paying office clearly marking the DD Form 250 as the "ORIGINAL INVOICE".

Paying Office Lacks Experience with Performance-Based Financing

During the course of our review, we identified an overpayment totaling \$30,655 for the delivery of a C-17 aircraft. While the contractor provided accurate payment information on the invoice, the paying office did not follow contract terms in processing the delivery payment on the PBP contract. As previously mentioned, PBP contracts are relatively new at DOD and few in number.

When the contractor discovered the overpayment, the contractor contacted the paying office to resolve the problem. The contractor's invoice clearly identified the actual PBPs made and showed the correct final amount (\$12,685,386) to be paid for delivery of the aircraft. The overpayment occurred because a voucher examiner at the paying office did not deduct from the unit price of the aircraft the actual amount previously paid to the contractor. Instead, the voucher examiner incorrectly deducted 90 percent of the unit price since most payments containing contract financing provisions processed at the paying office use the percentage method. As shown in the table below, deducting 90 percent of the unit price rather than the actual amount previously paid resulted in a \$30,655 overpayment.

Table 1: Comparison of Correct Payment Calculation Based on Amounts Previously Paid and Paying Office's Calculation Based on Percentage of Unit Price

	<u>Payment amount based on amounts previously paid</u>	<u>Payment amount based on percentage of unit price</u>
Unit price of aircraft	\$171,528,554	\$171,528,554
Less: Actual prior payments	- 154,406,354	--
Percentage of unit price (90 percent)	--	- 154,375,699
Withholds	- 4,436,814	- 4,436,814
Balance due	<u>\$ 12,685,386</u>	<u>\$ 12,716,041</u>
Difference (amount overpaid)		\$30,655

Source: GAO, based on information provided by contractor.

The contractor and the paying office resolved the overpayment quickly and the contractor refunded the \$30,655 less than a week after the original payment was made.

Recommendation

We recommend that the paying office management provide instructions to staff who process delivery payments for PBP contracts to help ensure that they recognize these types of payments and process them in accordance with the terms specified in the contract.

Agency Comments and Our Evaluation

DOD concurred with one of our recommendations, partially concurred with four others, and did not concur with one. In general, DOD did not perceive risks with its current payment procedures for the C-17 because it believes that the contracting officer withholds amounts sufficient to protect the government's interests and that the contractor properly processes requests for payment. However, regulations and other guidance indicate that the government has more responsibility for these actions. Our recommendations pertain to controls that are intended to minimize the risk of making payments either for the incorrect amount or for services that were not rendered.

First, DOD did not concur with our recommendation that the contracting officer negotiate a withhold amount that represents the full value of the unfinished work and thereby adequately protects the government's interests. DOD stated that it believed the contracting officer withheld an amount "sufficient to cover the estimated cost and related profit to correct deficiencies and complete unfinished work" in accordance with the FAR. However, as we stated in the report, the amounts withheld were based on a profit rate that was less than the profit rate cited in the production contract. If the full amount of profit for unfinished work is not withheld, the contractor has in effect received a portion of its profit prior to completing the associated work. Withholding anything less than the full contract profit rate is not in the best interest of the government.

Second, DOD did not fully concur with our four recommendations pertaining to the ACO's role and responsibilities. Specifically, DOD made the following comments.

- DOD partially concurred with the recommendation that the ACO, rather than the contractor, transmit all performance-based payment requests to the paying office, as required by the FAR. However, DOD stated that it is acceptable to rely on the contractor to transmit the payment requests because the ACO monitors payments using the paying office's payment system. The ACO's monitoring of payments, however, occurs after the payments are made to the contractor. While monitoring serves as a compensating control, if the ACO found that a payment amount was incorrect, follow-up procedures would have to be carried out to correct the erroneous payment. Not only would this involve added administrative burden, but as we recently reported,⁵ DOD has difficulties resolving payment errors. Therefore, a preventive control, as we recommended, would be preferable.
- DOD partially concurred with our recommendation that the ACO verify delivery of the aircraft and calculate the amount of payment, in accordance with the AFMC Handbook. While DOD agrees that these procedures are necessary, it does not believe these are appropriate responsibilities of the ACO under the current process. We agree that the ACO can rely on the DCMA QA representative's signature on the receiving report as verification of delivery. However, the ACO's office was not reviewing that information until after invoices were sent to the paying office. Also, we do not agree that the ACO can rely on the paying office to

⁵ *Contract Management: Excess Payments and Underpayments Continue to Be a Problem at DOD* (GAO-01-309, Feb. 22, 2001).

calculate the payment because it does not have any independent information about the accuracy of withholds for incomplete work. The ACO obtains information on the agreed-upon withhold amounts from the program contracting officer. Therefore, only the ACO is in a position to verify the accuracy of the payment information.

- DOD also indicated that the AFMC Handbook is not applicable to ACOs who work for DCMA. Regardless of whether the AFMC Handbook is applicable to the DCMA ACO, calculating the payment is an important function that needs to be performed by the ACO, as explained above. In addition, during our review, the program contracting officer said that he believed this is an important responsibility. Moreover, this responsibility is important for major contracts for all of the military services. Therefore, the responsibility for calculating payments should be specified in whatever guidance the ACO follows, such as the DCMA One Book. The One Book does not currently require the ACO to calculate payments.
- DOD partially concurred with our recommendation that the verifications of delivery and payment accuracy occur before the ACO representative enters the receiving report information into the paying office system. We agree that DCMA QA verifies delivery prior to the acceptance data being entered in the system. However, as stated above, the ACO is in a unique position to verify the accuracy of the payment information on the invoice. Also, this verification should be done prior to the entry of acceptance information because doing so would ensure that the invoice is accurate before the paying office begins processing it for payment and avoids the need for burdensome corrective actions if the paying office were to process an inaccurate invoice.
- DOD partially concurred with the recommendation that the ACO review the payment information as soon as possible after receiving invoices from the contractor. DOD agreed that invoices should be reviewed by the government prior to payment, but not necessarily by the ACO. Again, as explained above, the ACO is the only person in a position to verify the accuracy of payment information prior to submission of invoices to the paying office because the paying office does not have information about withhold amounts.

Finally, DOD concurred with the recommendation that DFAS management provide instructions to staff who process delivery payments for performance-based contracts. It stated that while additional local operating procedures have already been issued by the paying office, DFAS will also reiterate the importance of properly determining entitlement for PBPs by disseminating interim guidance to staff no later than June 25, 2001.

We acknowledge and appreciate the cooperation and assistance provided by the Air Force, DCMA, and DFAS officials and staff during our audit of the C-17 business processes. We are sending copies of this letter to Senator John Warner, Chairman, and Senator Carl Levin, Ranking Member, Senate Committee on Armed Services; Senator George V. Voinovich, Chairman, and Senator Richard J. Durbin, Ranking

Member, Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, Senate Committee on Governmental Affairs; Representative Bob Stump, Chairman, and Representative Ike Shelton, Ranking Minority Member, House Committee on Armed Services; and Representative Steve Horn, Chairman, and Representative Jim Turner, Ranking Minority Member, Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform. We are also sending copies to the Honorable Donald H. Rumsfeld, Secretary of Defense and Dr. Lawrence J. Delaney, Acting Secretary of the Air Force. The letter will also be available on GAO's home page at <http://www.gao.gov>. If you have any questions or need assistance in addressing these matters, please contact me at (202) 512-9505. Key contributors to this assignment were Larry Bridges, Kristi Karls, and Keith McDaniel.

Sincerely yours,

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is written in a cursive, flowing style.

Gregory D. Kutz
Director, Financial Management and
Assurance Issues



ACQUISITION AND
TECHNOLOGY

DP/CPF

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3 MAY 2001

Mr. Gregory D. Kutz
Director, Financial Management and Assurance
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Kutz:

This is the Department of Defense (DoD) response to the GAO draft report, Internal Controls: C-17 Payment Procedures Can Be Improved, April 6, 2001 (GAO Code 918993/OSD Case 3071).

The DoD nonconcurrs with GAO finding and recommendation 1, partially concurs with recommendations 2 through 5, and concurs with recommendation 6 of the draft report. Our detailed comments are provided in the enclosure.

Thank you for providing us the opportunity to comment on the draft report.

Sincerely,

for Deidre A. Lee
Director, Defense Procurement

Enclosure



GAO DRAFT REPORT DATED APRIL 6, 2001
GAO CODE 918993 / OSD CASE 3071

"INTERNAL CONTROLS: C-17 PAYMENT PROCEDURES CAN BE IMPROVED"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the contracting officer follow the requirements of FAR Part 46.407(f) by negotiating a withhold amount that represents the full value of the unfinished work and thereby better protect the government's interests. (p. 8/Draft Report)

DOD RESPONSE: Nonconcur with the GAO reported finding that the contracting officer did not estimate sufficient withholds for conditionally accepted items. We believe the contracting officer has withheld an amount "sufficient to cover the estimated cost and related profit to correct deficiencies and complete unfinished work" in accordance with FAR Part 46.407(f), and, thereby, has protected the government's interests.

The GAO report implies that FAR 46.407(f) requires the use of the production contract basic profit rate in computing the withhold amounts. FAR 46.407(f) does not state that the contracting officer must use a pre-established contract profit rate.

The FAR 46.407(f) statement, "related profit to correct deficiencies," guides the contracting officer to calculate a fair profit rate related to correcting the nonconforming work on delivered aircraft. In this situation, these corrections will be made in the field and not on the production line, and therefore the rate being utilized to calculate withhold amounts is appropriate.

The GAO reported that an additional profit amount of over \$1.7 million should have been withheld on the 30 unfinished aircraft delivered from August 1998 through December 2000. The GAO calculation of the additional withhold amount appears to be based primarily on a statement made by the contracting officer that "an additional 5 to 7 percent should have been withheld" for profit in computing the withhold amounts. The contracting officer does not recall making this statement.

RECOMMENDATION 2: The GAO recommended that the ACO transmit all performance based payment requests to DFAS Columbus as required by FAR Part 32.1007. (p. 9/Draft Report)

Enclosure

DOD RESPONSE: Partially concur. We believe that relying on the contractor's system to transmit the payment when there is reasonable assurance that it will do so in a timely and accurate fashion is an acceptable manner of forwarding the performance-based payment (PBP) request to the payment office. To ensure the accuracy of the PBP amount, the ACO monitors payments through the Mechanization of Contract Administration Services (MOCAS) system. Any altered PBP amount would be readily apparent and appropriate action would be taken. Currently, the Defense Contract Management Agency Directive 1, Contract Management "One Book", does not formally prescribe post-payment monitoring of PBPs by ACOs; however, it will be revised to specifically state this requirement.

RECOMMENDATION 3: The GAO recommended that the ACO, in accordance with the guidelines contained in the AFMC handbook, verify delivery of the aircraft and calculate the amount of payment. (p. 12/Draft Report)

DOD RESPONSE: Partially concur. We do not believe that the current procedure represents an internal control weakness. The existing processes for verification of delivery and calculation of the amount of payment are low risk and adequately protect the interests of the government, as described below. We do concur that proper verification of delivery and calculation of payment amount by the government are necessary, however, we do not agree that these are appropriate responsibilities for the ACO under the current process.

The DCMA Quality Assurance Representative (QAR), prior to preparation of the invoice by the contractor, verifies delivery of the aircraft on behalf of the government. There is no need for the ACO to repeat this function.

The payment entitlement process is performed by DFAS, not the ACO, for contracts administered by DCMA. During entitlement, DFAS determines the validity of the invoice by matching the invoice to the acceptance document and contract, applying any withholds, liquidating an appropriate amount of financing payments and finally calculating the resulting payments. Even if the ACO were to review the invoice, any adjustments made by the ACO would be reviewed and recalculated by DFAS. Therefore, no benefit would be derived from having the ACO perform this function.

The sub-heading on page 9 of the report, "Specified Payment Procedures are not followed by the ACO for Delivered Aircraft" is misleading, because it mistakenly conveys the impression that the information contained in the AFMC Financial Management Handbook is applicable to DCMA ACOs. Similarly, the first sentence under that heading incorrectly states that the ACO is responsible for

verifying the delivery of the aircraft and the accuracy of the payment invoiced amount. As explained above, for contracts administered by DCMA, verification of delivery is the responsibility of the DCMA QAR, and calculating the amount of payment is the responsibility of DFAS. The guidance in the AFMC handbook appears to be directed at Air Force Materiel Command ACOs. DCMA personnel apply policy and guidance issued through DCMA channels. No change in the existing process is planned.

RECOMMENDATION 4: The GAO recommended that the verifications referenced in Recommendation 3 occur prior to the ACO representative entering the receiving report information into the paying office system. (p. 12/Draft Report)

DOD RESPONSE: Partially concur. As noted above, the DCMA QAR performs the verification of delivery. As noted on page 10 of the report, the verification is performed prior to entering the acceptance data into the payment system. No change to the existing process is planned.

RECOMMENDATION 5: The GAO recommended that the ACO review the payment information as soon as possible after receiving invoices from the contractor. (p. 12/Draft Report)

DOD RESPONSE: Partially concur. This paragraph refers to delivery invoices, not PBP financing payments. We concur with the need for government review of invoices prior to payment; however, for DCMA-administered fixed-price contracts, the review of delivery invoices is normally performed by DFAS. As noted on pages 10 and 11 of the report, the C-17 ACO does review the contractor's delivery invoice for the C-17 aircraft. The purpose of this ACO review is to extract information from the invoice pertaining to waivers and deviations that are then entered into a database, and in fact this could be done after the payment is made.

Contractors are responsible for proper preparation of invoices, and the cost of this is built into the contract price. DFAS is responsible for the entitlement process, including invoice review and calculation of the proper amount to pay.

No change to the existing process is planned.

RECOMMENDATION 6: The GAO recommended that DFAS management provide instructions to staff who process delivery payments for performance-based contracts to help ensure that they recognize these types of payments and process them in accordance with the terms specified in the contract. (p. 14/Draft Report)

DOD RESPONSE: Concur. DFAS processes performance-based contracts as prescribed by FAR Clause 52.232-32, and the instructions as

outlined in FAR Subpart 32.10, PBPs. The FAR guidance is also implemented by local guidance contained in Desk Procedure 401, Contractor Entitlement, dated June 1996, pages 19-1 through 19-11. DFAS Columbus has also issued additional local operating procedures to facilitate processing procedures. The MOCAS Policy and Procedures Branch will reiterate the importance of properly determining entitlement on PBPs by disseminating interim guidance to entitlement associates no later than June 25, 2001.

GAO Comments

1. In its comments, DOD said that the contracting officer does not recall saying that “an additional 5 to 7 percent should have been withheld.” We have documentation of more than one conversation with the contracting officer during which he told us what the range of the profit margin was for the C-17 production contract and the profit rate that he used for determining withhold amounts. We then calculated that the difference between the two profit rates ranged from 5 to 7 percent.

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