Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE FINANCE AND ACCOUNTING SERVICE BILLING RATES

Report No. 96-149 June 7, 1996

Department of Defense

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Acronyms

DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
USD(C)	Under Secretary of Defense (Comptroller)

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

June 7, 1996

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Defense Finance and Accounting Service Billing Rates (Report No. 96-149)

We are providing this report for review and comments. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Office of the Under Secretary of Defense (Comptroller) nonconcurred with the conclusions of the draft report and the recommendation. We request that the Under Secretary of Defense (Comptroller) reconsider his response to the recommendation. Final comments should be provided by August 7, 1996.

We appreciate the courtesies extended to the audit staff. Questions on this audit should be directed to Mr. James L. Kornides, Audit Program Director, or Mr. John K. Issel, Audit Project Manager, at (614) 751-1400. See Appendix E for the report distribution. Audit team members are listed inside the back cover.

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Assistant Inspector General
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Office of the Inspector General, DoD

Report No. 96-149 **June 7, 1996**
Project No. 5FJ-2010.01

Defense Finance and Accounting Service Billing Rates

Executive Summary

Introduction. This is the second in a series of reports we plan to issue as part of our Audit of the Defense Finance and Accounting Service Administration of Unit Cost Rates. As part of the Defense Business Operations Fund, the Defense Finance and Accounting Service (DFAS) is required to recover operating costs by charging fees or cost recovery rates to customers for goods and services. The Defense Business Operations Fund pricing policy requires that cost recovery rates, or billing rates, promote cost visibility and motivate cost effective behavior.

Audit Objective. The audit objective was to determine whether costs for services provided by the DFAS were accurately apportioned to customers through appropriate billing rates.

Audit Results. Because of DoD budget policy, costs of the nine DFAS outputs we reviewed were not accurately billed to customers. Specifically, customers were charged the same fee or rate (that is, a composite rate) for eight DFAS outputs even though the costs to provide the services varied significantly among the DFAS centers. For example, the billing rate for a travel voucher payment was $16.94, whereas the costs to process the voucher ranged from $7.41 to $34.12. For the ninth output, Monthly Trial Balances Maintained, a composite rate was not used. Yet, billing rates established in that case were not sufficient to cover the costs incurred at all DFAS centers to provide the service. As a result, some DFAS customers were under billed for services received, and some DFAS customers were subsidizing the costs incurred to provide services to other customers.

The recommendation in this report, if implemented, should result in billing rates that accurately reflect the costs of producing the outputs and provide more incentive for cost reduction to both the DFAS Centers and their customers. See Part I for a discussion of the audit results.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) establish rates for DFAS goods or services (outputs) that more accurately reflect the costs to provide the outputs to the customers of its operating centers.

Management Comments. We received comments on a draft of this report from the Office of the Director for Revolving Funds, Under Secretary of Defense (Comptroller). The Director for Revolving Funds nonconcurred with the recommendation and stated that while more unit costs could be developed, no significant benefit was identified that would compensate for the additional costs. We also received comments from the Assistant Secretary of the Navy (Financial Management and Comptroller). The Assistant Secretary disagreed with the conclusion of the report that composite rates are unfair to some DFAS customers. See Part I for a complete discussion of management comments and Part III for the complete text of those comments.

Audit Response. The major benefit derived from implementation of our recommendations is to accurately bill customers the costs of producing outputs. There may be some additional administrative costs incurred to produce appropriate billing rates and those costs must be passed on to the customer. However, we believe that the additional costs will be minimal because DFAS already has a system in place (the Resource Analysis Decision Support System) that can provide the cost information that is needed to accurately bill customers. To reaggregate the cost data being reported for individual centers in order to establish composite rates does not support the Defense Business Operations Fund philosophy of charging each customer only those costs incurred to provide the level of service requested.

We continue to believe that the current practice leaves DFAS and its customers without some of the basic cost reduction incentives that were supposed to accrue from including DFAS in the Defense Business Operations Fund.

We request that the Under Secretary of Defense (Comptroller) reconsider his position on the recommendation. Comments are requested by August 7, 1996.

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Part I - Audit Results

Audit Background

Reorganization of Finance and Accounting Organizations. In January 1991, most of the finance and accounting organizations of the Military Departments and Defense agencies were combined into the Defense Finance and Accounting Service (DFAS). The goals of that reorganization were to standardize, consolidate, and improve systems and operations, and to reduce the costs of providing finance and accounting support to the Military Departments and DoD organizations.

DFAS Organization and Customers. The DFAS consists of a headquarters in Washington, D.C., five major finance centers, and approximately 200 smaller organizations. The DFAS is planning to consolidate these 200 remaining smaller organizations into 21 Operating Locations that will be aligned under the centers. DFAS customers are primarily the Military Departments, the Marine Corps, the Defense Agencies, and other authorized organizations, such as the Coast Guard. The predominant customer and location of each Center follows.

Cleveland, OH	Navy
Columbus, OH	Defense Agencies
Denver, CO	Air Force
Indianapolis, IN	Army
Kansas City, MO	Marine Corps

Defense Business Operations Fund. On October 1, 1991, the Defense Business Operations Fund (DBOF) was established, and the DFAS was one of several organizations that were consolidated into the DBOF. The Under Secretary of Defense (Comptroller) (USD[C]) is responsible for developing financial policy for the DBOF and approving budget submissions. The USD(C) policy requires the DBOF organizations to recover all operating costs, net of prior years' operating results, by charging fees to their customers for providing goods and services.

DBOF Billing Policy. As a DBOF organization, DFAS is subject to the objectives and principles of the DBOF. One of the primary objectives of the DBOF was to create a buyer-seller relationship between fund organizations and their customers, such as a private enterprise. Customers would be charged the full cost of services provided. The theory was that fully identifying costs would ultimately lead to lowering of costs. Fund organizations managers and customers were to have full visibility of costs and take actions to control costs. As a result, DoD components would benefit by receiving services at lower overall costs.

Audit Objective

The objective of this audit was to determine whether costs for goods and services provided by the DFAS were accurately apportioned to customers through appropriate billing rates.

See Part II, Appendix A, for a complete discussion of the scope, methodology, management controls, and prior audit coverage. See Appendix B for a listing and definitions of the nine output categories included in our review.

DFAS Customer Billing Rates

Costs of the nine DFAS accounting and finance services reviewed were not accurately billed to customers. Specifically:

- o Customers were charged the same fee or rate (that is, a composite rate) for eight DFAS outputs even though the costs to provide the services varied significantly among the DFAS centers. For example, the billing rate for a travel voucher payment was $16.94, whereas the costs to process the voucher ranged from $7.41 to $34.12.

- o For the Monthly Trial Balances Maintained output, a composite rate was not used. Yet, billing rates established were not sufficient to cover the costs incurred at all DFAS centers to provide the service to its customers.

These conditions occurred because of an Under Secretary of Defense (Comptroller) decision to use composite rates (that is, the same rate even though processing costs varied). As such, billing rates were not established based on the costs of providing the service at each DFAS center or for each customer even though that information was collected and available for use. As a result, some DFAS customers were being insufficiently billed for services received while other customers were subsidizing the costs incurred to provide services.

DFAS Implementation of DBOF Pricing Policy

DBOF pricing policy is contained in Comptroller of DoD (now Under Secretary of Defense [Comptroller]) Memorandum, "Defense Business Operations Fund Pricing Policy," January 4, 1993, and in the Financial Management Regulation, DoD 7000.14-R, volume 11B, chapter 50, December 1994. The policy directs that billing rates (that is, prices for services received) are to recover the real cost to provide a service to each customer according to the customer's desired level of service. Consequently, costs would be equitably apportioned to the customers. Although DFAS primary functions are the disbursement, collection, and accounting for funds; DFAS identified and divided the primary functions into 16 output categories. Also, to comply with DBOF pricing policy, DFAS implemented the Resource Analysis Decision Support System. This system was designed to more accurately trace the costs incurred to provide the 16 output products to DFAS customers.

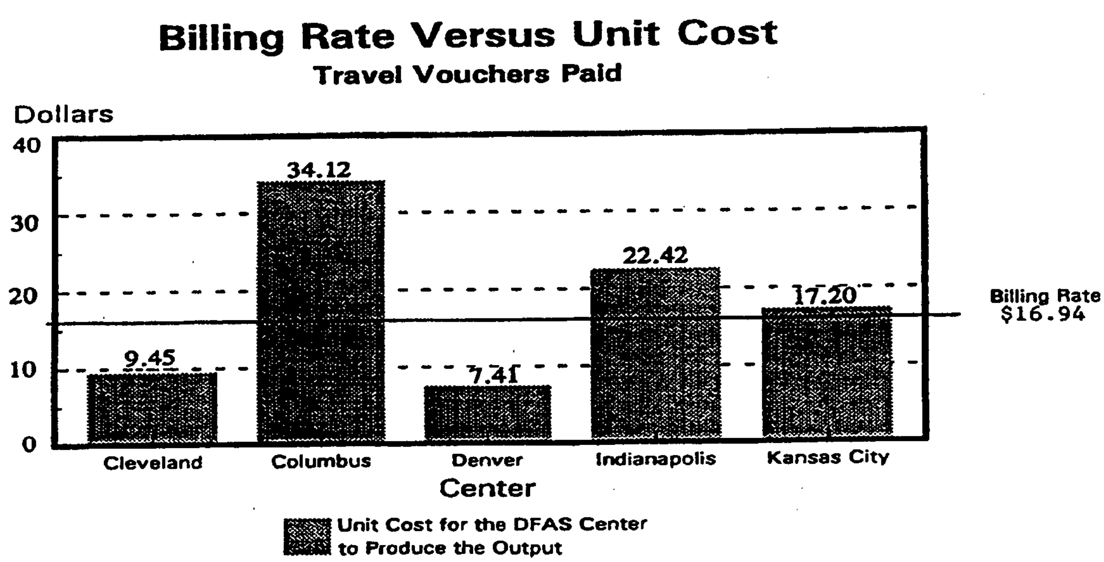
Use of Composite Billing Rates

Although DFAS implemented a Resource Analysis Decision Support System to identify the costs incurred to provide its services, DFAS customers were charged the same fee or rate (that is, a composite rate), for eight of nine DFAS outputs we reviewed. For example, during FY 1995, DFAS customers were charged $16.94 for each travel voucher processed and $29.53 for each commercial invoice paid, regardless of which DFAS center provided the service.

Use of composite billing rates resulted in DFAS costs being inequitably apportioned to customers and caused some customers to subsidize the costs incurred by DFAS to provide services to other customers. The inequitable apportionment occurred because costs to produce outputs varied significantly among the centers. Yet, the DFAS centers' customers were charged the same rate regardless of the costs incurred by each center to provide the service.

To illustrate, the cost to pay a travel voucher by Denver Center was $7.41, and at the Columbus Center the cost was $34.12, but the billing rate, $16.94, was the same at each center. The result was a $24 million profit for Denver and a $4 million loss for Columbus. As shown in the following table, the other DFAS centers also had widely varying unit costs.

Table 1. Variation at DFAS Centers



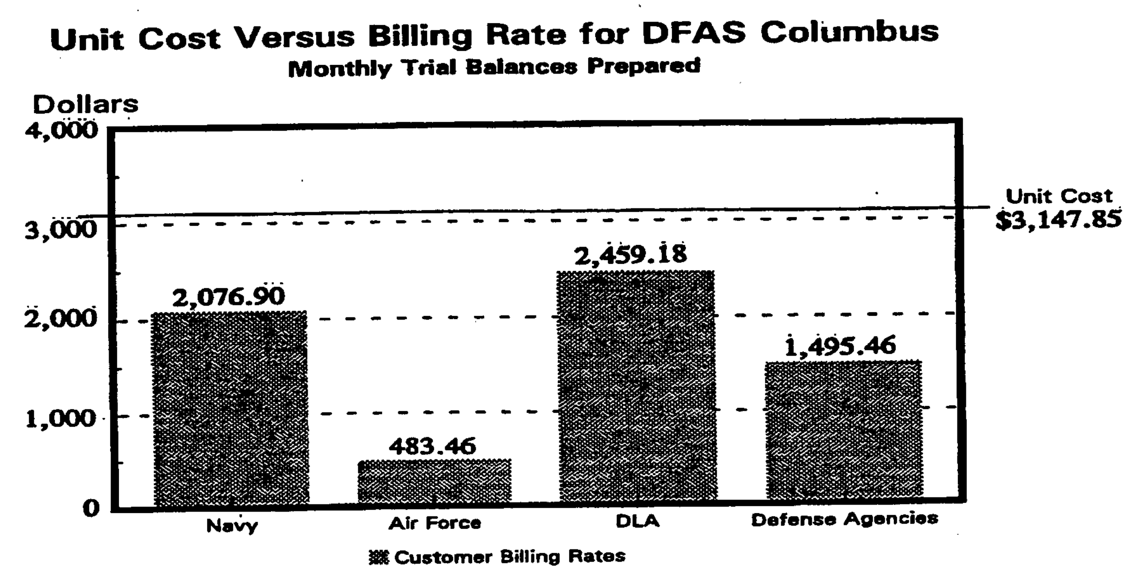
Because the costs were below the composite billing rate, profits generated through the Denver Center and Cleveland Center customers were used to compensate for losses incurred from the Indianapolis, Kansas City, and Columbus Center customers. The costs to pay travel vouchers at these three centers significantly exceeded revenues generated by the composite billing rate. These types of problems also occurred in the other output categories we reviewed. Details on the profits and losses achieved at each center for all outputs reviewed are listed in Appendix C.

Use of Service or Agency Unique Rates

For the other remaining output we reviewed, Monthly Trial Balances Maintained, a composite rate was not used. Instead, service or agency unique billing rates were established. However, the unique billing rates were not sufficient to cover the costs incurred (at certain DFAS centers) to provide the service to that center's customers. As a result, DFAS costs were again being inequitably apportioned to customers, and customers of one DFAS center were subsidizing the costs incurred at other DFAS centers to provide the service to their customers.

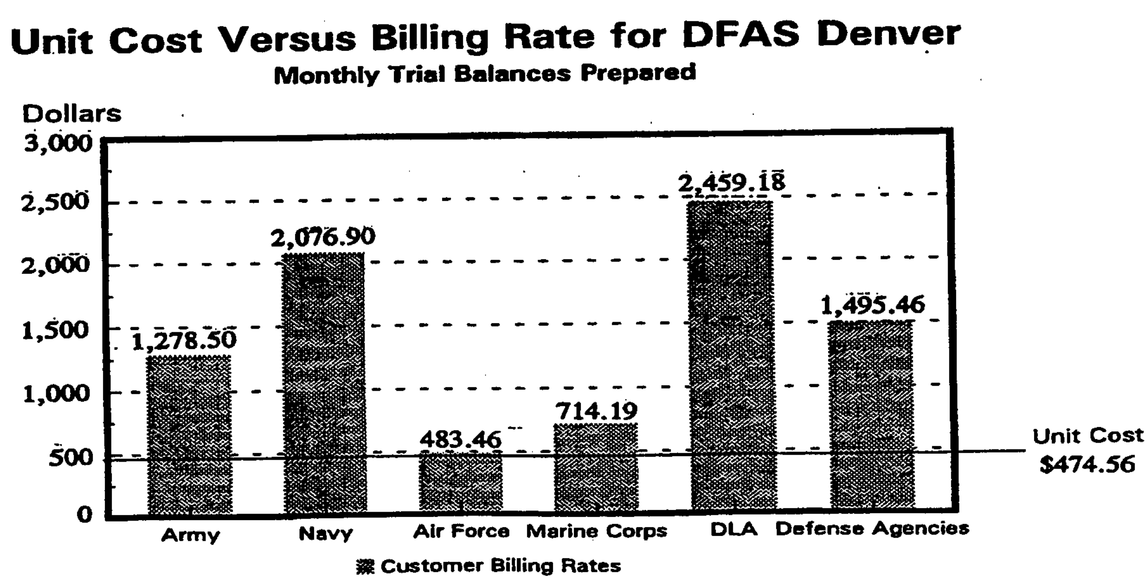
Six different billing rates were established for Monthly Trial Balances Maintained. Specifically, a unique billing rate was established for each Military Department (Army, Navy, and Air Force), the Marine Corps, the Defense Logistics Agency, and all other DoD agencies. While the billing rate established may have been sufficient to cover the costs for Monthly Trial Balances Maintained at the customers' primary servicing center, such as the Air Force at the Denver Center, it was not sufficient to cover costs for producing that customers' output at all centers. For example, as shown in the following table, the Monthly Trial Balances Maintained billing rates did not cover the costs incurred at the Columbus Center to provide the output to its customers.

Table 2. Cost Versus Rate - Columbus (DLA)



Conversely, the following table shows that the Monthly Trial Balances Maintained billing rates exceeded the costs to produce the outputs at the Denver Center.

Table 3. Cost Versus Rate - Denver (Air Force)



Consequently, revenues generated through customers of the Denver Center were covering losses in Monthly Trial Balances Maintained at the Columbus Center.

Establishment of DFAS Billing Rates

DFAS recommends billing rates to be charged for its services as part of the DBOF budgetary process. The billing rate that is ultimately used has to be justified to and approved by the USD(C).

Composite Rates. During FY 1994, DFAS had established and used differing rates for each of its output categories. However, in 1995, DFAS converted to composite rates for all outputs except Monthly Trial Balances Maintained. When we asked DFAS management why they converted to the use of composite rates in FY 1995, we were told that the use of composite rates was directed by the USD(C). In discussions with USD(C) budget officials, we were advised that the use of composite rates was directed because it simplified the budgetary process. Billing rates budgeted for fiscal years up to FY 1997 indicate that USD(C) budget officials intend to continue composite rates. While a simplified budgetary process may be desirable, the equitable apportionment of DFAS costs to its customers is more important to achieving the goals and principles upon which DBOF was established.

Monthly Trial Balances Maintained Rates. When we asked USD(C) management why they had established service or agency unique rates for the monthly trial balances maintained output, we were advised that the significant variances in costs to produce trial balances did not allow the use of a composite rate. Therefore, the rate established for each service or agency was based on the cost to produce the output for each service or agency at its primary servicing DFAS center. However, a billing rate based on the cost data from the primary servicing center was not sufficient to cover the costs to provide the customer the same output at another center. For example, the cost for a trial balance maintained output for the Air Force at the Columbus Center was $3,147.85 (Table 2); whereas, the cost for the same product for the Air Force at the Denver Center (the Air Force primary servicing center) was $474.56 (Table 3) The USD(C) management perceived the difference in costs for monthly trial balances maintained as customer related, rather than center related.

Billing Rate Effects on DFAS Customers

Decisions to simplify the rate structure did not reflect the realities of the differences in DFAS center costs. Costs to provide services to customers varied significantly among the DFAS centers. Because billing rates were uniform but costs were not, cost differences were not apparent to DFAS customers; some customers subsidized losses of other customers; and some customers provided disproportionate contributions to DFAS operating results. For example, the

Army, which accounted for only 39 percent of DFAS workload, contributed $129 million or 50 percent of DFAS total net operating results of $261 million for the nine outputs included in our review. In contrast, the DFAS incurred losses of $6 million to provide its service to the Defense Logistics Agency because billing rates were not sufficient to recoup its costs.

DBOF policy requires that billing rates be based on the costs incurred to provide goods or services and that the rates be sufficient to recover those costs. Neither composite rates nor the service or agency unique rates for monthly trial balances maintained used by DFAS satisfied this requirement. DFAS implemented the Resource Analysis Decision Support System to accurately trace the costs incurred by the DFAS centers to provide the 16 output products to its customers. Therefore, the Resource Analysis Decision Support System should also be used to establish billing rates that are sufficient to recover the costs incurred by each center to provide services to its customers.

Other DBOF Entity Billing Rates

The condition described in this report may also exist at other DBOF entities. However, our recommendation to eliminate the inequities may be premature for those other entities. USD(C) budget officials stated that DFAS has (in the Resource Analysis Decision Support System) the best unit costing system among DBOF participants. The system provides full visibility of unit costs at the various operating entity levels. This degree of capability may not be available at other DBOF organizations. Therefore the following recommendations are tendered for DFAS and may not be currently applicable throughout DBOF.

Recommendation, Management Comments, and Audit Response

Recommendation. We recommend that the Under Secretary of Defense (Comptroller) establish billing rates for DFAS outputs that more closely reflect the cost to provide the services to the customers of DFAS operating centers, that is, rates based upon the center producing the outputs. Specifically:

1. Discontinue the use of composite rates for outputs performed at multiple centers.

2. Establish rates for each output at each producing center that recover the cost to produce the outputs at the centers.

Management Comments. The Director of Revolving Funds, Office of the Under Secretary of Defense (Comptroller), nonconcurred with the recommendations. He stated that while more unit costs could be developed, no significant benefit was identified that would compensate for the additional costs. He also stated that the use of additional outputs for each accounting center would be difficult to manage effectively, and if the audit rationale were applied to each of the DFAS Operating Locations, it would result in the creation of hundreds of unit cost rates that would greatly increase the administrative burden and cost. The Director also questioned the validity and assumptions used to support the audit conclusion that some of DFAS customers provided a disproportionate contribution to DFAS operating results.

We also received comments from the Assistant Secretary of the Navy (Financial Management and Comptroller). The Assistant Secretary disagreed with the conclusion of the report that composite rates are unfair to DFAS customers. She believed that since customers cannot choose where their work will be done, composite rates were the only way to avoid preferential treatment of customers. She stated that differences in costs among sites should diminish as procedures are standardized and systems are upgraded. She expressed an interest in the causes for wide differences in costs among locations.

Part III contains the complete text of the comments.

Audit Response. We stand by our conclusion. Although we recognize that the development of additional rates will require more management effort, we continue to believe the rates are necessary for the Defense Business Operations Fund to operate as intended, like a business. If the Defense Business Operations Fund is to reflect business practices, charges to DFAS customers must closely align with the costs of providing goods or services.

We do not agree that the DFAS use of billing rates that more closely reflect the cost to provide services would not result in any cost savings. If that were the case, there would be no point in trying to capture the full costs of providing support services. The DFAS accounting centers and operating locations are already set up to service specific customers and already have the cost identification system in place (the Resource Analysis Decision Support System) that can produce more accurate billing rates. The number of cost centers used can be adjusted based on management judgment; and the options are far more diverse than a single composite rate per product versus many hundred cost centers, as posited in the Comptroller Office comments.

We request that the Under Secretary of Defense (Comptroller) reconsider his position and provide additional comments in response to the final report.

Regarding the comments from the Assistant Secretary of the Navy (Financial Management and Comptroller), we believe that a customer should pay the full cost of a product or service. Efforts by DFAS to make operations more efficient and effective will require the support and cooperation of its customers. We believe that if customers pay the full share of the cost of the products and services they receive, they will be more motivated to seek improvements to Defense Business Operations Fund management and efforts to achieve more efficient common systems. Likewise, they will have additional incentive to eliminate unnecessary purchases from Defense Business Operations Fund suppliers and to seek alternative sources. We agree that the current constraints on seeking out alternative suppliers is an impediment to driving down DoD support costs for products and services supplied by Defense Business Operations Fund activities. To achieve the full benefit of our recommendation, the DoD would have to strive toward providing more customer choice.

We assume that DFAS shares the Assistant Secretary's interest in the cost differences between DFAS centers. However, the interest of most DFAS customers and the significance of those differences are both limited so long as the composite rate approach is used.

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Part II - Additional Information

Appendix A. Scope and Methodology

Scope and Methodology

Our audit was limited to the effect of the USD(C) composite and customer rates for DFAS services performed at multiple sites as compared to the unit cost to provide those services.

We limited our scope to 9 of 16 outputs. We did not evaluate the other seven output categories because six of the outputs were performed at only one DFAS center, and, as such, all customers were charged the same amount based on that center's cost to provide the service. The remaining, or seventh, output was not reviewed because it was a cost reimbursement category; that is, the customer simply paid the cost incurred by the DFAS organization to provide the agreed-to unique or out-of-the ordinary type service.

Unit cost and workcount data for FY 1995 was taken from the DFAS Resource Analysis Decision Support System. Based on this data, we calculated each center's unit cost for the nine outputs, including the DFAS headquarters and overhead costs. We then compared the unit costs among centers for the nine outputs to the FY 1995 billing rates. Using the billing rates for FY 1995, we compared potential revenues to costs by major customer and calculated the relative contribution to the DFAS operating results for major customers.

We performed a limited review of the quality of computer-processed data from the Record Analysis Decision Support System. We did not identify any errors that would preclude the data from being used in our analysis.

This financial-related audit was conducted from March 1995 through February 1996 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. We did not use statistical sampling procedures. Organizations visited or contacted during the audit are in Appendix D.

Management Controls

A review of management controls was not applicable to the issue addressed in this report because the audit entailed an evaluation of a DBOF pricing policy.

Prior Audits

Since establishment of the DFAS, there have been no previous audits relating to the objective of our audit of DFAS unit costs. However, the General Accounting Office (GAO) has issued several reports and provided testimony to Congress addressing DBOF pricing policy as related to the recovery of operating losses in future year prices. The reports and testimony basically expressed the same opinion each time. The principal report and opinion is summarized in General Accounting Office Report No. GAO/AIMD-94-132, (OSD Case No. 9339-F), "Defense Business Operations Fund: Improved Pricing Practices and Financial Reports Are Needed to Set Accurate Prices," June 1994. The report stated that the DBOF policy of recovering past operating losses by increasing future year prices distorts the actual results of DBOF operations in a given year, diminishes the incentive for the DBOF to operate efficiently, and makes evaluation and monitoring of the DBOF difficult. This report contained no recommendations, but the GAO reiterated its opinion that the DBOF be required to justify recovering prior-year losses as part of the appropriation process rather than by increasing future prices.

In General Accounting Office Report No. GAO/NSIAD-95-127, (OSD Case No. 9921), "DoD Infrastructure: DoD's Planned Finance and Accounting Structure Is Not Well Justified," September 1995, the GAO discussed two areas affecting DFAS operating costs. These areas were the size and location of the DoD finance and accounting network and the reengineering of DFAS finance and accounting functions. The GAO stated that the planned DFAS infrastructure may be larger than necessary. The report also stated that the DFAS consolidation precedes most reengineering efforts. The GAO recommended that DoD reevaluate its consolidation and site-selection decisions concurrently with its ongoing consolidation efforts. The DoD concurred and committed to reevaluate the number of locations and personnel required to perform finance and accounting functions by November 30, 1995. Also, DoD agreed to annually reassess its site-selection decisions and report its findings to the Secretary of Defense.

Inspector General, DoD, Report No. 96-040, "Congressionally Directed Rebates in Defense Finance and Accounting Service Cost Recovery Rates," December 11, 1995, disclosed that DFAS complied with the direction of Congress and did not charge customers in FYs 1994 and 1995 for $135.2 million in services. However, in FY 1995, DFAS recouped the $85.2 million of rebates directed by Congress in FY 1994 through increased cost recovery rates. As a result, the intent of the FY 1994 congressional rebate, to reduce DFAS overhead costs passed along to customers, was partially thwarted. The report recommended that the Under Secretary of Defense (Comptroller) revise the "DoD Financial Management Regulation," volume 11B, to prohibit DBOF organizations from increasing rates to recover losses that are attributed to Congressional rebates. The Under Secretary of Defense (Comptroller) agreed to revise volume 11B, "Reimbursable Operations, Policy and Procedures'" to indicate that, on a case-by-case basis, determinations will be made to whether a DoD Component failed to comply with the intent of a congressionally directed rebate by not achieving associated projected savings, whether such actions resulted in a DBOF loss (and the amount of such loss), and whether such amounts are to be recovered in future DBOF rates.

Appendix B. DFAS Output Definitions, Management Centers, and FY 1995 Billing Rates

1. Civilian Pay Accounts Maintained: The number of civilian employees in an active pay status paid and serviced by DFAS. Managed by Cleveland, Columbus, Denver, and Indianapolis Centers.

Army: $14.64

All other customers: $12.52

2. Military Active Pay Accounts Maintained: The number of active military pay accounts maintained and paid within the active pay systems. Managed by Cleveland, Denver, Indianapolis, and Kansas City Centers.

$12.44

3. Military Retired Pay Accounts Maintained: All accounts maintained and paid on the retired pay systems for retired, annuitant, and former spouse accounts. Retired pay is performed by Cleveland Center and annuitant pay is performed by Denver Center.

$3.72

4. Military Reserve Pay Accounts Maintained: The number of reserve pay accounts maintained and paid on the reserve component pay systems. Managed by Cleveland, Denver, Indianapolis, and Kansas City Centers.

$3.99

5. Travel Vouchers Paid: All payments to an individual for actual or anticipated expenses while on approved local or temporary duty travel or for permanent change of station entitlements. Managed by all five centers.

$16.94

6. Transportation Bills Paid: Paying all bills for transportation requests, government bills of lading, and meal tickets. Managed by Cleveland, Indianapolis, and Kansas City Centers.

$14.58

7. Commercial Invoices Paid: Processing and paying documents which are a claim to the Government by a commercial entity for goods or services rendered. Managed by all five centers.

$29.53

8. Out-of-Service Debt Cases Closed: The number of debt cases to the Government closed as collected in full, referred for operational offset, formally compromised, and General Accounting Office approved waivers for personnel no longer employed by the DoD and past-due debts by commercial entities. Managed by all five centers; however, Columbus Center only collects commercial entity debts, while the other four centers collect debts from former members of the formerly aligned Service and past employees.

$605.69

9. Monthly Trial Balances Maintained: The performance of accounting services for an organization where the services result in a trial balance or other summary report at the end of the month. Managed by all five centers.

Army	$1,278.50
Navy	$2,076.90
Air Force	$ 483.76
Marine Corps	$ 714.19
Defense Logistics Agency	$2,459.18
Other Defense Agencies	$1,495.46

Appendix C. DFAS Billing Rates Versus Unit Cost by Center

Defense Business Operating Fund (DBOF) principles require its entities to operate at break-even. This means that the difference between the cost to provide services (the unit cost) and the fees charged (the billing rate) should be zero. With the DFAS cost and rate structure, DBOF was not achieving the goal of breaking even. Reflected below are the FY 1995 billing rates and unit costs for the nine DFAS outputs reviewed.

		FY 95		
Output	**Center**	**Billing Rate**	**Unit Cost***	**Difference**
Civilian Pay Accounts Maintained				
	Cleveland	$12.52	$9.16	$3.36
	Columbus	$12.52	$11.66	$0.86
	Denver	$12.52	$12.04	$0.48
	Indianapolis			
	Army	$14.64	$23.18	($8.54)
	Others	$12.52	$23.18	($10.66)
Military Active Pay Accounts Maintained				
	Cleveland	$12.44	$7.74	$4.70
	Denver	$12.44	$7.48	$4.96
	Indianapolis	$12.44	$7.65	$4.79
	Kansas City	$12.44	$9.06	$3.38
Military Retired Pay Accounts Maintained				
	Cleveland	$3.72	$2.94	$0.78
	Denver	$3.72	$6.76	($3.04)
	Indianapolis	$3.72	$2.53	$1.19

Output	Center	FY 95 Billing Rate	FY 95 Unit Cost*	Difference
Military Reserve Pay Accounts Maintained				
	Cleveland	$3.99	$2.33	$1.66
	Denver	$3.99	$3.66	$0.33
	Indianapolis	$3.99	$2.25	$1.74
	Kansas City	$3.99	$13.13	($9.14)
Travel Vouchers Paid				
	Cleveland	$16.94	$9.45	$7.49
	Columbus	$16.94	$34.12	($17.18)
	Denver	$16.94	$7.41	$9.53
	Indianapolis	$16.94	$22.42	($5.48)
	Kansas City	$16.94	$17.20	($0.26)
Transportation Bills Paid				
	Cleveland	$14.58	$8.49	$6.09
	Indianapolis	$14.58	$12.39	$2.19
	Kansas City	$14.58	$1.40	$13.18
Commercial Invoices Paid				
	Cleveland	$29.53	$26.00	$3.53
	Columbus	$29.53	$26.77	$2.76
	Denver	$29.53	$28.24	$1.29
	Indianapolis	$29.53	$14.30	$15.23
	Kansas City	$29.53	$14.96	$14.57
Out-of-Service Debt Cases Closed				
	Cleveland	$605.69	$384.69	$221.00
	Columbus	$605.69	$3,283.01	($2,677.32)
	Denver	$605.69	$379.77	$225.92
	Indianapolis	$605.69	$142.04	$463.65
	Kansas City	$605.69	$233.84	$371.85

Output	Center	FY 95 Billing Rate	FY 95 Unit Cost*	Difference
Monthly Trial Balances Prepared				
	Cleveland			
	Army	$1,278.50	$1,934.61	($656.11)
	Navy	$2,076.90	$1,934.61	$142.29
	Air Force	$483.46	$1,934.61	($1,451.15)
	Marine Corps	$714.19	$1,934.61	($1,220.42)
	Defense Agencies	$1,495.46	$1,934.61	($439.15)
	Columbus			
	Navy	$2,076.90	$3,147.85	($1,070.95)
	Air Force	$483.46	$3,147.85	($2,664.39)
	Defense Logistics Agency	$2,459.18	$3,147.85	($688.67)
	Defense Agencies	$1,495.46	$3,147.85	($1,652.39)
	Denver			
	Army	$1,278.50	$474.56	$803.94
	Navy	$2,076.90	$474.56	$1,602.34
	Air Force	$483.46	$474.56	$8.90
	Marine Corps	$714.19	$474.56	$239.63
	Defense Logistics Agency	$2,459.18	$474.56	$1,984.62
	Defense Agencies	$1,495.46	$474.56	$1,020.90
	Indianapolis			
	Army	$1,278.50	$1,263.57	$14.93
	Air Force	$483.46	$1,263.57	($780.11)
	Defense Agencies	$1,495.46	$1,263.57	$231.89
	Kansas City			
	Marine Corps	$714.19	$991.19	($277.00)

*Includes a proportional share of DFAS Headquarters cost and overhead.

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC
  Director of Revolving Funds, Office of the Deputy Comptroller (Program/Budget), Washington, DC

Defense Agencies

Defense Finance and Accounting Service, Washington, DC
  Defense Finance and Accounting Service Centers,
    Cleveland, OH
    Columbus, OH
    Denver, CO
    Indianapolis, IN
    Kansas City, MO

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense (Logistics)
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, Defense Information Systems Agency
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
U.S. General Accounting Office, National Security and International Affairs Division,
Technical Information Center
Defense and National Aeronautics and Space Administration Management Issues
Military Operations and Capabilities Issues

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House 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

Part III - Management Comments

Under Secretary of Defense (Comptroller) Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER
(Program/Budget)

May 7, 1996

MEMORANDUM FOR ACTING DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, DOD INSPECTOR GENERAL

SUBJECT: Draft Audit Report on Defense Finance and Accounting Service Billing Rates (Project No. 5FJ-2010.01)

The working draft of audit report, Project Number 5FJ-2010.01, dated April 26, 1996, titled Defense Finance and Accounting Service Billing Rates has been reviewed. The audit objective was to determine whether costs for services provided by the DFAS were equitably apportioned to customers through appropriate billing rates. The audit recommended that the Department discontinue the use of composite rates for outputs performed at multiple centers, and establish unit cost rates for each output at each producing accounting center. The audit author postulates that certain customers are being charged more for services due to the use of composite rates.

The DBOF uses unit cost outputs to focus management attention on the total cost to produce a product and to ensure full cost recovery. A unit cost output is simply the average total cost of producing one unit of output. A unit cost output is calculated by dividing the total cost of production by the total number of units produced. DoD unit cost methodology and policy results in using unit cost outputs that are aggregated. With regard to this audit, DFAS presently has 21 unit cost outputs. The Department believes that 21 outputs are sufficient to monitor cost and performance. While more unit costs could undoubtedly be developed, no significant benefit has been identified that would compensate for the additional cost.

The audit stated that, since the Resource Analysis Decision Support System can identify costs at a lower level, additional unit cost outputs for each accounting center should be implemented. This would produce approximately 80 unit cost outputs. This large number of unit cost rates would be difficult to manage effectively and produce very few if any significant benefits. The present unit cost reports do provide detail by center and by Operating Locations (OPLOCs). If the Department applied the audit rationale, which is to implement additional unit cost outputs because the information is available, the Department should provide unit cost rates by OPLOCs. This would produce hundreds of unit cost rates and greatly increase the administrative burden and cost. The existing process does provide this additional information to the managers, providing assistance when monitoring the unit cost outputs. In addition, the audit report failed to identify the costs to be associated with its new proposals when, from a Departmental perspective, there can be no savings.

The audit also states that some customers provide a disproportionate contribution to DFAS operating results, subsidizing other customers due to the present 21 unit cost outputs. We questioned the validity and assumptions used to derive this estimate during our previous discussions and continue to do so. The audit assumptions are highly suspect and are not substantiated by the available data.

This office does not concur with the ODoDIG recommendation. Request that you revise the draft, or more fully study the subject to identify total Departmental savings. Also please provide any rationale supporting any projected savings.

William C. Coonce
Director for Revolving Funds

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments

THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, D.C. 20350-1000

6 May 1996

MEMORANDUM FOR THE ACTING DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, DODIG

SUBJECT: DFAS BILLING RATES (PROJECT #5FJ-2010.01)

Although I was not asked to comment on the draft audit report, as a DFAS customer I have a vested interest in the issues you raise. I strongly disagree with the report's contention that use of composite rates is not fair to customers. Quite the contrary, since customers cannot choose where their work will be done, composite rates are the only way DFAS can avoid giving some customers preferential treatment.

I realize that the differences in costs reflect in part the structures that DFAS inherited from the individual services. DFAS has considerably altered what it inherited, however, and the services have had little voice in the pace and direction of change. As DFAS standardizes systems (e.g., DCPS) services are being consolidated into a few sites that are product vice service orientated. Finally, the differences in costs among sites should diminish as procedures are standardized and systems upgraded. Until all this change is completed, DFAS should be able to smooth out any inequities in the rate of change among customers by using composite rates.

I hope one of your other reports will investigate why there are such wide differences in costs among locations.

Deborah P. Christie

Deborah P. Christie
Assistant Secretary of the Navy
(Financial Management and Comptroller)

cc: USD(C)
Director, DFAS

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Defense Finance and Accounting Service Billing Rates

B. DATE Report Downloaded From the Internet: 12/01/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

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F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ **Preparation Date 12/01/99**

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