Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEBT COLLECTION AND DEPOSIT CONTROLS IN THE DEPARTMENT OF DEFENSE

Report No. 96-038 December 11, 1995

Department of Defense

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Acronyms

DAO	Defense Accounting Office
DDMS	Defense Debt Management System
DFAS	Defense Finance and Accounting Service
FAR	Federal Acquisition Regulation
FMR	Financial Management Regulation
IRS	Internal Revenue Service
USACE	U.S. Army Corps of Engineers

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December 11, 1995

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

SUBJECT: Audit Report on Debt Collection and Deposit Controls in the Department of Defense (Report No. 96-038)

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

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. Because management comments on the draft of this report were not fully responsive, we request that the Defense Finance and Accounting Service provide comments on Recommendations B.1.b.(1)., B.2.a., and D.2.a. by February 12, 1996.

We appreciate the courtesies extended to the audit staff. Questions about the audit should be directed to Mr. Raymond D. Kidd, Audit Program Director, at (703) 604-9110 (DSN 664-9110), or Mrs. Saundra G. Elion, Audit Project Manager, at (703) 604-9113 (DSN 604-9113). Appendix H lists the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 96-038 (Project No. 4FH-0054) **December 11, 1995**

Debt Collection and Deposit Controls in the Department of Defense

Executive Summary

Introduction. Collecting debts from the public has been a continuing concern for DoD financial managers. In FY 1991, DoD consolidated debt management within the Defense Finance and Accounting Service (DFAS). Our audit evaluated the collection process for debts owed by contractors and former DoD employees and Service members. Two offices at the DFAS Columbus Center manage contractor debts. The Debt Management Division manages debts over 45 days delinquent and debts paid in installments, and the Accounts Receivable Branch manages all new debts. Other DFAS centers manage debts owed by individuals. DFAS reported that the public owed $5.04 billion to DoD as of September 30, 1994. During FY 1995, DoD expanded the Debt Avoidance Task Force to find ways to minimize debts owed to the agency.

Audit Objectives. Our objective was to evaluate the DoD debt collection process, including management controls over collections, deposits, and incentives to optimize collection rates. We also evaluated compliance with laws and regulations and the DoD management control program as it related to our audit objective. The audit also followed up on recommendations made in Inspector General, DoD, Audit Report No. 92-021, "Debt Collection and Deposit Controls," December 13, 1991.

Audit Results. Although DFAS implemented the recommendations in Audit Report No. 92-021 to consolidate debt management and issue uniform operating procedures (see Appendix C), DoD needs to further improve the collection and reporting process. Conditions that need further action are as follows.

o The DFAS Columbus Center did not reconcile its records with records at accountable stations. Consequently, DoD did not have an accurate account of amounts due, and accounting reports and financial statements were incomplete and understated by at least $1.43 billion in FY 1994 (see Finding A).

o The Debt Management Division, DFAS Columbus Center, did not always issue demand letters on time, transfer debts to collection agencies, or refer names of debtors to the "List of Contractors Indebted to the United States." As a result, DoD lost the collectible portion of about $203.5 million in debts because the statute of limitations expired on 577 debts during FY 1994 (see Finding B).

o The Accounts Receivable Branch, DFAS Columbus Center, did not always apply amounts collected to interest, correctly assess interest, or adequately pursue and monitor contractor debt. DFAS misapplied an estimated $561,000 to DoD appropriations and did not effectively pursue collection action on debts (see Finding C).

o DFAS centers did not effectively collect debts owed by individuals. Specifically, they did not validate debts and did not always return collections to the originating appropriations. The DFAS Indianapolis Center had a $14.1 million backlog of debts and did not promptly post collections to appropriations. In addition, the

DFAS centers did not assess interest when they referred debts to collection agencies or to the Internal Revenue Service. Consequently, DoD lost the use of about $24.1 million. DFAS also understated interest and did not collect interest of about $23.8 million (see Finding D).

Except for Finding A, the management control program at the DFAS centers did not identify these material weaknesses because self-assessments were too general (see Appendix A).

If implemented, recommendations in this report will improve the accuracy of receivables reported to the U.S. Treasury, and will increase collections. The report identifies an estimated $561,000 of monetary benefits. Additional monetary benefits could not be projected because of the variables involved. Appendix F summarizes the potential benefits of the audit.

Summary of Recommendations. For contractor debts, we recommend that DFAS establish guidelines for reconciling debts to accounting records, incorporate guidance on the statute of limitations into regulations, update the Defense Debt Management System, and identify and correct accounting systems that do not properly report receivables. We recommend that the DFAS Columbus Center establish and monitor performance standards for pursuing contractor debts, monitor data entry, and identify debts nearing the statute of limitations. We also recommend that the DFAS Columbus Center properly apply collections, pursue improperly closed debts, charge interest through the date of the administrative offset, issue timely demand letters when contractors remit credit memorandums, and develop a system for monitoring debts.

For individual debts, we recommend that DFAS improve methods for validating debts and assessing interest and penalties, and automate the posting of collections.

Management Comments. DFAS generally concurred with the recommendations. See Part I for a summary of management comments and Part III for the complete text of management comments.

For contractor debts, DFAS has issued or plans to issue guidance on reconciling debts, collecting debts through administrative offset, assessing interest through the offset date, and issuing demand letters on credit memorandums. DFAS will improve the debt management system so that it records complete and accurate debt information by accountable stations, produces billing statements and exception reports, and tracks debts and collection actions. DFAS has also created a report to notify accountable stations of the status of debts. DFAS also identified accounting systems that do not properly report receivables and plans to improve those systems that will be retained. DFAS also plans to pursue improperly closed contractor debts.

For individual debts, DFAS agreed to improve debt validation, post collections automatically, and assess interest and penalties through the date of collection for active debts.

Audit Response. Management comments were responsive except for three recommendations. Management should reconsider its comments regarding standard demand letters, since standard letters are currently generated for individual debt; existing performance standards for each critical collection technique, since none had been established; and updating accrued interest each year that debts are referred to the Internal Revenue Service. We request that the Director, DFAS, respond to the unresolved issues in this report by February 12, 1996.

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Part I - Audit Results

Audit Background

Debt Collection. The Debt Collection Act of 1982, Public Law 97-365, improved the Federal Government's means of collecting debts by giving Federal agencies the authority to make salary offsets; assess interest, penalties, and administrative fees; refer debts to collection agencies; and report overdue debts to consumer credit reporting agencies. Appendix E lists all laws and regulations applicable to debt collection through FY 1994.

Debts owed to DoD may be from Federal agencies and the public. Debts owed by Federal agencies are normally liquidated by interagency transfers of funds and cause few problems. Collecting debts from the public, however, has been a continuing concern to financial managers and audit organizations. As shown in Appendix B, the General Accounting Office, the Inspector General, DoD, and Service audit agencies continue to review debt management practices within DoD and have issued 15 reports recommending changes to improve DoD debt collection efforts.

In the DoD, debts owed by the public consist primarily of amounts owed by either contractors or individuals. Contractor debts result from damages or excess costs related to defaults in performance; expenses incurred to correct defects; and overpayments caused by errors in quantity, deficiencies in quality, errors in billing, and erroneous payments. Individual debts include overpayments, unearned portions of enlistment bonuses, medical care, and various other benefits that are incurred by current and former Service members and DoD civilian employees and private citizens. DoD reported to the U.S. Treasury that it collected $3.97 billion during FY 1994, and had a total of $5.04 billion of outstanding debts as of September 30, 1994 (see Table 1 on the following page).

As described in Appendix C, DoD consolidated debt management within the Defense Finance and Accounting Service (DFAS) and issued additional guidance to streamline and standardize the collection process.

Debt Avoidance. DFAS recognized that avoiding unnecessary debts is critical; therefore, in July 1994, the Director, DFAS, established a task force to address ways to avoid debts. The objective of the Debt Avoidance Task Force was to identify the causes of debts and recommend ways to reduce individual debts. The task force reviewed the types and causes of debts at each DFAS center and presented the results to the Senior Financial Management Oversight Council in April 1995. The Deputy Secretary of Defense expanded the task force and selected the Under Secretary of Defense for Personnel and Readiness to lead it. The expanded task force will focus on the business practices that cause debts and will develop goals, solutions, and procedures for minimizing debts owed to DoD.

Table 1. FY 1994 Accounts Receivable Activity for the Department of Defense
($ in millions)

	New Receivables	Collections	Outstanding Balance	Number of Outstanding Debts
Army	$ 650	$ 474	$ 397	153,189
Navy	1,099	968	294	33,761
Air Force	437	438	768	173,794
U.S. Army Corps of Engineers	391	210	1,025	3,056
Defense Agencies[1]	2,194	1,883	2,558	----[2]
Total	**$4,771**	**$3,973**	**$5,042**	**363,800**

[1]Includes the Defense Business Operations Fund.
[2]----means information was not available to management.

Audit Objectives

The audit objectives were to:

o evaluate the effectiveness of the DoD debt collection process and management controls over collections and deposits;

o evaluate the effectiveness of incentives used to optimize collection rates;

o assess compliance with applicable laws and regulations;

o evaluate compliance with the DoD management control program as it related to our audit objective; and

o follow up on recommendations made in Inspector General, DoD, Audit Report No. 92-021, "Debt Collection and Deposit Controls," December 13, 1991.

Finding A. Reporting Receivables on Contract Debts

None of the 10 DFAS offices we reviewed properly reported receivables on contract debts. This occurred because DFAS Headquarters had not issued guidance on who is responsible for reporting and reconciling receivables, and because of accounting systems' limitations. As a result, DoD did not have proper control over the amounts due, and reports and financial statements were incomplete and understated by at least $1.43 billion.

Debt Collection and Reporting Responsibilities

Two offices at the DFAS Columbus Center, Columbus, Ohio, the Accounts Receivable Branch (the Branch) and the Debt Management Division (the Division), had primary responsibility for collecting contractor debts. The Branch managed newly identified contractor debts (see Finding C) while the Division managed older debts (see Finding B). However, neither office accounted for or reported on contractor debts. Instead, accountable stations were responsible for accounting and reporting on debts owed by contractors. Accountable stations are Defense Accounting Offices (DAOs) and small field offices, primarily at Navy and Marine Corps installations.

The accountable stations should report accounting information to their designated DFAS centers. The DFAS centers consolidate the receivable data and report this information to the U.S. Treasury quarterly and annually.

As part of its responsibility for collecting contractor debts, the Branch should send copies of demand letters to the accountable stations so that the stations can establish receivables in their accounting records. When the Branch or the Division collects the debts, they notify the accountable stations through automated interfaces and reports, such as the "Daily Transactions for Others" and the "Monthly Statement of Transactions Listing." For debts less than $100,000, if the Branch or the Division determines that a debt is uncollectible, it should prepare a memorandum informing the accountable station that the Division will no longer pursue collection and recommending that the accountable station write off the debt. Before preparing a memorandum on debts over $100,000, the Division is required to obtain authorization from the Department of Justice.

Reporting and Reconciliation Requirements for Debts

To provide reliable information on all debts, DoD Manual 7220.9-M, the "DoD Accounting Manual" (DoD Accounting Manual), chapter 33, as amended March 18, 1987, requires DoD offices to record accounts receivable accurately and promptly. The manual says that receivables are timely only if recorded in the same month that management discovered them. For contractor debts, the accountable station should record the receivable when a copy of the demand letter is received.

Further, the DoD Accounting Manual requires DoD offices to reconcile subsidiary records to account balances each month. Since the records at the DFAS Columbus Center support account balances, the reconciliation process should compare the DFAS Columbus Center's records with the appropriate accountable station's records. These requirements were incorporated into DoD Regulation 7000.14-R, the "DoD Financial Management Regulation" (FMR), volume 4, chapter 3, January 11, 1995.

Accountable Stations Report Debts

Nine of the 10 accountable stations we judgmentally selected for review did not report at least $1.43 billion of receivables, which the DFAS Columbus Center showed as open debts, to the U.S. Treasury. Although we did not statistically select the accountable stations reviewed, the problems could be more widespread within DoD, since reporting differences occurred at all but one[1] of the accountable stations we contacted. Table 2 summarizes differences between the DFAS Columbus Center's records and the accountable stations' records.

[1]The DFAS Columbus Center-Stock Fund's open debt amounts agreed with the Division's amount because the Division provided total balances to Stock Fund accounting each month. Although the monthly totals allowed the Stock Fund to maintain an accurate balance, the monthly totals did not provide sufficient information, such as the amount of current and noncurrent receivables, delinquent debts, and interest, on which to accurately report receivables to the U.S. Treasury.

Table 2. Comparison of Open Debts Recorded by the DFAS Columbus Center With Receivables Reported by Accountable Stations as of September 30, 1994
($ in thousands)

Accountable Station	DFAS Columbus Center	Accountable Station	Difference
DFAS Cleveland Center-DAO Arlington	$1,416,730.4*	$ 0.0	$1,416,730.4
DFAS Cleveland Center-DAO Philadelphia	1,295.2	0.0	1,295.2
DFAS Columbus Center-Stock Fund	1,570.2	1,570.2	0.0
U.S. Army Armament, Munitions, and Chemical Command	3,969.4	80.2	3,889.2
U.S. Army Missile Command	276.1	66.6	209.5
Naval Shipyard Philadelphia	3,863.6	0.0	3,863.6
Naval Shipyard Norfolk	161.1	0.0	161.1
Colorado Air National Guard-Buckley Field	399.6	0.0	399.6
Kelly Air Force Base	1,466.4	280.8	1,185.6
Kirkland Air Force Base	977.0	0.0	977.0
Total	**$1,430,709.0**	**$1,997.8**	**$1,428,711.2**

*Includes a single debt of $1,352,459 that is in litigation.

Except for the Stock Fund, the accountable stations either did not have information about the DFAS Columbus Center's recorded debts, or incorrectly reported the debts as negative unliquidated obligations. In addition, the accountable stations reported some amounts that were based on out-of-date information. That is, some debts liquidated during FY 1994 remained open on an accountable station's accounting records for several months in FY 1995.

Reconciling Debt Records With Accounting Records

Accountable stations did not correctly report receivables because DFAS Headquarters had not established a requirement for the DFAS Columbus Center to reconcile debt records with accountable stations' records. Further, the DFAS Columbus Center had not established procedures for reconciling its records to those maintained by the accountable stations.

DFAS Columbus Center Assumed Limited Responsibilities for Reconciling Debts. The Chief, Debt Management Division, indicated that office did not reconcile its records with accountable stations because no requirement existed to report this information and the Defense Debt Management System (DDMS) had limitations. Specifically, since the DDMS did not include a field for the accountable station's identification number, reconciling records with accountable stations would be time-consuming because the staff would have to manually summarize debts.

Although the Branch did not reconcile its records with accountable stations' records, it would periodically contact various accountable stations to determine whether those stations had received copies of specific demand letters. This procedure was not comprehensive and was not designed to determine whether accountable stations' balances agreed with the Branch's records.

For reconciliations to be effective, accountable stations need additional information that is not being provided. They need the debt's principal balance, collections, write-offs, accrued interest, and the age of the debt. They also need an assessment of the collectibility of the debt, and they need to know whether the debt is being paid through installments and whether those installment payments are current. Such information will allow accountable stations to properly report the status of receivables to their designated DFAS centers.

DFAS Reported Similar Problems. In its Annual Statement of Assurance for FY 1994, DFAS reported a discrepancy of $180 million between accounts receivable reported in the Air Force "Status of Funds Data Base Transfer Report" and installation-level public accounts receivable reported to the U.S. Treasury. Although the statement was based on data from the DFAS Denver Center, Denver, Colorado, DFAS stated that the problem probably affected all DFAS centers. Because accountable stations need feedback from the DFAS Columbus Center to accurately report contractor debts, DFAS Headquarters had planned to require the DFAS Columbus Center to begin distributing information on collections of contractor debts in March 1995.

In May 1995, DFAS Headquarters directed that the DFAS Columbus Center provide a list of outstanding contractor debts to the DFAS centers each month. However, that requirement does not adequately address the reconciliation deficiency because it does not require the DFAS centers to distribute the lists to accountable stations. Without the lists, accountable stations cannot verify that they are reporting all debts managed by the DFAS Columbus Center.

Adequacy of Navy Accounting Systems

The DAO Arlington and DAO Philadelphia did not have the capability to record contractor debts in their accounting systems. Therefore, the accountable stations took no action when they received copies of demand letters from the DFAS Columbus Center to ensure that debts they were accountable for were properly recorded and reported. Failure to either reprogram accounting stations or implement alternative management controls is unacceptable.

The Standard Accounting and Reporting System used at DAO Arlington reported accounting transactions for major Navy commands and tracked significant Navy accounts. Although that system has been selected as the accounting system for the Operating Locations that report to the DFAS Cleveland Center, Cleveland, Ohio, it does not record receivables. As a result, we were unable to trace to the accountable station's records $1.42 billion of the $1.43 billion that DAO Arlington should have reported on 15 debts included in our contract samples (see Table 2).

Similarly, the accounting system that DAO Philadelphia used for the Naval Aviation Supply Office did not report any contractor debts as receivables. Officials at that DAO stated that if a contract were overpaid, the system would not report the overpayment, but would identify the overpayment on an error report. Even when the DFAS Columbus Center verified that the reported error was a contractor debt, the DAO Philadelphia took no action to report overpayments to its designated DFAS center.

Although the accounting systems used by some DAOs are not adequate, those DAOs are still responsible for accounting for receivables. Therefore, until those systems are improved, the affected DAOs should develop alternative procedures to track and report receivables.

Conclusion

Until the accountable stations accurately report contractor receivables to the DFAS centers, DoD managers will not know the magnitude or status of receivables and interest owed to the Government. Managers will not know the age of the debt and will not be able to assess the collectibility of the debts. Furthermore, DFAS centers will not be able to produce accurate financial statements and U.S. Treasury reports for DoD Components. To accomplish this, the DFAS Columbus Center needs to periodically provide complete contractor debt information to the accountable stations for reconciliation. Also, accountable stations that do not have systems to account for receivables need to establish alternative means for reporting all receivables due to them.

Recommendations and Management Comments

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

1. Establish specific policy on reconciling contractor debts managed by the Accounts Receivable Branch and the Debt Management Division at the Defense Finance and Accounting Service Columbus Center with accountable stations' records.

Management Comments. DFAS concurred with Recommendation A.1. Specific policy on reconciling debts was provided to the DFAS Columbus Center on September 26, 1995. Also, beginning on October 31, 1995, the DFAS Columbus Center will provide a Debt Portfolio Reconciliation Worksheet to accountable stations each quarter.

2. Include in the Defense Debt Management System all essential fields (such as the accountable station identification number) that are needed for reconciling contractor debt information.

Management Comments. DFAS concurred with Recommendation A.2. By December 31, 1996, the DFAS Columbus Center will be able to retrieve debt information from the Defense Debt Management System by accountable station.

3. Modify the Standard Accounting and Reporting System, in conjunction with the Assistant Secretary of the Navy (Financial Management and Comptroller), to properly report receivables.

Management Comments. DFAS concurred with Recommendation A.3. An accounts receivable module is being developed to bring the accounting system into compliance with the Federal Managers' Financial Integrity Act and the Chief Financial Officers Act. DFAS estimated completion of this action by August 1997.

4. Identify all systems that do not account for receivables due from contractors and instruct the affected accountable stations to develop alternative methods of reporting receivables.

Management Comments. DFAS concurred with Recommendation A.4. DFAS centers have identified systems where reporting deficiencies exist. For accounting systems that are capable, DFAS has taken action to include all contractor debts in the systems. For locations not capable of accounting for contractor debts, DFAS centers will use alternative accounting records to report receivables.

Finding B. Collecting Older Contractor Debts

The DFAS Columbus Center did not effectively pursue older debts incurred by contractors. Specifically, the Debt Management Division did not issue demand letters promptly, did not transfer debts to collection agencies, and did not include debtors' names in the "List of Contractors Indebted to the United States" (the Contractors' List).[2] Debt collection efforts were hampered because performance standards had not been developed for employees, the Debt Management Division inherited many older debts that did not have sufficient documentation, and the DDMS was not adequate for tracking delinquent contractor debts. As a result, DoD did not collect most delinquent contractor debts, and 577 debts, valued at $203.5 million, were allowed to expire during FY 1994 because of the statute of limitations. Unless this problem is corrected, the Federal Government could experience additional losses.

Responsibilities for Managing Older Contractor Debts

The Debt Management Division (the Division), DFAS Columbus Center, manages debt collection of unresponsive contractors who have debts in excess of $600 and contractors who agree to repay their debts in installments. The FY 1994 inventory consisted of 2,887 debts with an original debt balance of $3.4 billion.

The Division's responsibilities include issuing the third and final demand letter, processing installment payments, and collecting debts by administrative offsets. The Division uses more aggressive debt collection methods than the Accounts Receivable Branch of the DFAS Columbus Center (see Finding C). Those methods include transferring debts to collection agencies, referring debts to the Department of Justice for litigation, and reporting debtors' names to the Contractors' List. When the Division determines that a debt is not collectible or that the estimated cost of pursuing the debt exceeds the recoverable amount, it recommends the debt be written off.

The Division tracked unpaid debts for up to 10 years, which is the length of time DoD is allowed by statute to collect debts. However, the statute of

[2]This Government-wide list, referred to as the "holdup list," is published bimonthly by the DFAS Indianapolis Center and should be used to collect delinquent debts by offsetting the debts against payments due on debtors' contracts with other Federal agencies.

limitations for taking legal action against debtors is 6 years. The statute of limitation can be extended if a contractor makes a voluntary payment or acknowledges its indebtedness to DoD.

The Division collects debts, but accountable stations maintain the accounting records and report on contractor debts. The Division notifies the accountable stations of all debt collections, write-offs, and closures, and sends related documents to those stations.

Collection Techniques for Older Debts

The Division did not pursue an estimated 50.9 percent of the debts in the FY 1994 inventory (see Appendix D, Sampling Plan A). In particular, the Division did not perform some of the more critical techniques, such as issuing demand letters, transferring debts to collection agencies, or adding the debtors' names to the Contractors' List.

Demand Letters. A third demand letter must be issued to give the contractor a final opportunity to settle the debt and inform the contractor of the repercussions of failure to pay. In accordance with the Division's policy, we considered the demand letters late when they were issued more than 14 days after the debts were established in DDMS. We determined that of the 115 debts in our sample for which demand letters should have been sent, only 44 letters were timely; 20 letters were not sent to the contractor, and 51 were sent late.

Collection Agencies. Transferring debts to collection agencies can be effective in obtaining payments. Those agencies can increase the pressure to pay a debt and can influence a contractor's credit rating. Since DFAS had not issued regulations for contractor debts, we used the criterion for individual debts (45 or more days after issuance of the third demand letter) to determine the timeliness of transfers to collection agencies. Using that criterion, 15 of the 65 debts in our sample were transferred to collection agencies in a timely manner.

Contractors' List. Adding a contractor's name and amount owed to the Contractors' List notifies other Federal agencies that contractors have delinquent debts. Those agencies can then withhold payments due to the contractor and send the amount to DoD. Neither DFAS nor the Division had developed a standard for adding contractors to this list. Therefore, we used 45 days as the standard for adding names to the Contractors' List and determined that 48 of the 88 debts in our sample that should have been added to the Contractors' List were added.

Other collection techniques could also have been used to expedite collections, but generally were not. Those techniques include obtaining the correct contractor address when mail is returned, maintaining the status of disputed debts or debts referred to the Department of Justice, and periodically following up on these debts.

Performance Standards for Collecting Contractor Debts

Some collection techniques were not performed because the Division had not established performance standards or methods of monitoring performance, or did not have exception reporting to ensure that action was taken. For instance, standards or monitoring procedures were not established for adding debtors' names to the Contractors' List or for sending debts to collection agencies; these techniques were inconsistently applied. In addition, although the Division chief required employees to issue demand letters within 14 days after receiving the debt, methods for monitoring how often this requirement was met had not been established. Without standards and exception reporting, the Division could not effectively evaluate performance or hold employees accountable for not taking specific actions.

Moreover, since the DDMS was not programmed to perform certain collection functions, employees had to manually perform those additional functions. For example, staff members manually calculated interest charges when they issued demand letters, and prepared statements of account to debtors with installment agreements. The Division chief also required employees to draft demand letters because the DDMS did not print letters on letterhead stationery. Such requirements prevented employees from more efficiently pursuing collections. Also, DDMS did not generate exception reports requiring supervisory reviews and more aggressive actions.

Researching and Pursuing Older Debts

When DoD consolidated the management of delinquent debts in FY 1991, the Division inherited a significant number of contractor debts that are now at least 6 years old. Since the status of those debts was not clear, the Division needed to manually research the locations of debtors and evaluate the prospects of collecting the debts before it could pursue collections. Division employees, therefore, concentrated their efforts on collecting newer debts and allowed the statute of limitations for legal action to expire on the older debts.

Title 28, United States Code, section 2415, "Time for Commencing Action," and title 31, United States Code, section 3716, "Administrative Offset," state that agencies are barred from pursuing collection actions after 6 years, other than through administrative offset. Administrative offset can be made for up to 10 years. Therefore, after the 6-year statute of limitations expires, DoD can collect debts only by administrative offset and should therefore write off such uncollectible debts.

Nearly 35 percent (843) of the 2,430 debts in the FY 1994 ending inventory were 5 or more years old. Many of the debts remained open, and case files did not show that employees attempted to collect the debts by administrative offsets.

Because the statute of limitations expired on debts 6 years old and older, DoD lost as much as $203.5 million on 577 debts in the FY 1994 inventory and may lose another $29.8 million on 266 debts in FY 1995 (see Figure 1).

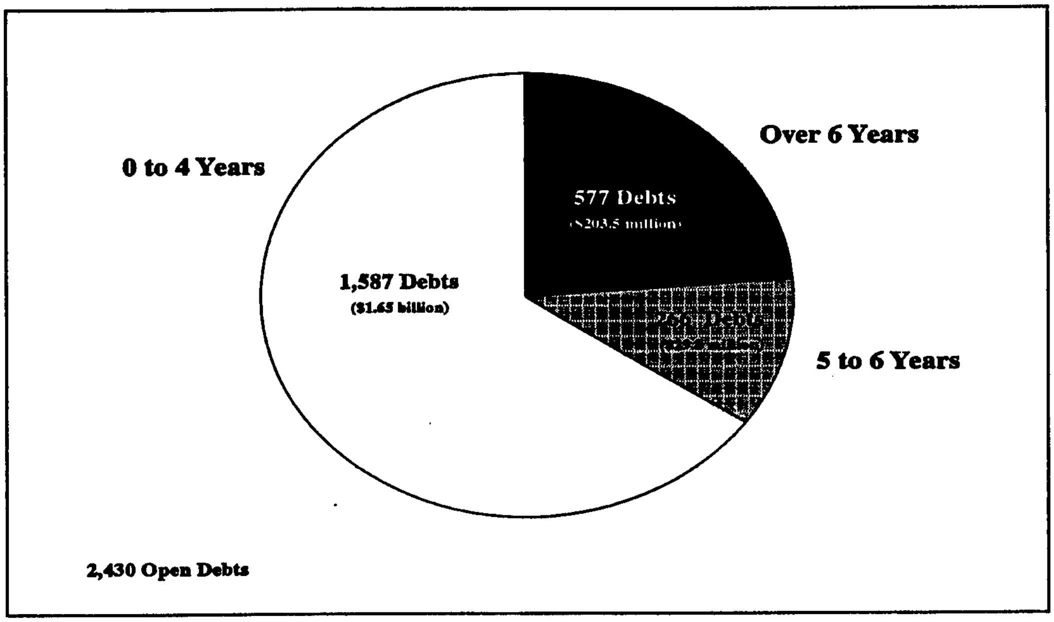

Figure 1. Age of Open Debts in the DDMS FY 1994 Ending Inventory

The files for many debts that were 6 years old or older indicated that action had not been taken for several years. Division employees had neither conducted needed followup nor notified the accountable stations to write off those debts. Action was not taken on many debts because the Division could not locate the debtors or did not provide sufficient information about the debtors to the Department of Justice. Although the Division had unlimited authority to recommend that debts over 6 years old be written off, it did not do so. To ensure that all possible administrative offsets are taken on contractor debts for up to 10 years, the Division should identify, in DDMS, debts that are over 6 years old, and should periodically determine whether the contractors have ongoing contracts. Such procedures are used to monitor debts owed by individuals.

We recognize that not all of the $203.5 million of the debts that expired in FY 1994 could have been collected; however, a portion of those debts could have been collected through more aggressive collection efforts. The balance includes uncollectible debts that have not been written off because the Division had not established effective procedures. Aggressive efforts, including more active use of the DDMS to identify debts nearing the statute of limitations, could minimize similar losses during the 6-Year Future Years Defense Program.

Contractor Debt Information in DDMS

Transaction and status information in the DDMS was inaccurate or inconsistent with documentation in the Division's debt case file for an estimated 34.8 percent of the debts in the FY 1994 inventory. Transaction errors included incorrect amounts of debt principal and collections, and incorrect adjustments and contract numbers. Status errors included incorrect activity dates, reasons for debts, debt origins, and suspense codes. In addition to being unreliable, the information was sometimes unverifiable. DDMS data could not be verified for 16 of the 460 debts in our sample because 11 case files did not have adequate documentation, and 5 case files could not be found.

Inaccuracies and inconsistencies in debt information occurred because DFAS Headquarters implemented the DDMS before ensuring that the system, which was initially designed to manage individuals' debts, could effectively manage contractor debts. Since Division employees could not use DDMS to calculate interest or generate acceptable demand letters and billing statements, they did not update collection actions and status changes in DDMS. Also, DDMS information could not be relied on to locate missing case files because the system did not contain the status of the debts. As a result, DDMS was not an effective management tool to determine the status of contractor debts, and the Division chief could not use the DDMS to effectively collect debt. Aggressive action is required to implement changes to DDMS in order to minimize manual input (such as the demand letters, statements of account, and interest calculations) and to provide management with the status of collection actions and amounts of debts.

Recommendations, Management Comments, and Audit Response

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

a. Incorporate guidance into the DoD Financial Management Regulation, volume 10, chapter 18, "Contractor Debt Collection," to require the Defense Finance and Accounting Service Columbus Center to pursue collections in accordance with time limitations specified in title 28 and title 31, United States Code.

Management Comments. DFAS concurred with Recommendation B.1.a. Guidance will be incorporated into the DoD Financial Management Regulation. DFAS estimated completion of this action by December 1995.

b. Update the Defense Debt Management System to:

(1) Produce standard demand letters and statements of account for all contractor debts.

(2) Produce exception reports on each problem category.

(3) Track debts that have exceeded the 6-year statute of limitations but are available for administrative offset for up to 10 years.

Management Comments. DFAS partially concurred with Recommendation B.1.b.(1). The Debt Management Division, DFAS Columbus Center, does not issue a standard demand letter for contractor debts because each circumstance is different; however, the Defense Debt Management System will generate standard billing statements by June 1996. The DFAS concurred with Recommendation B.1.b.(2). Exception reports will be produced by June 1996. DFAS also concurred with Recommendation B.1.b.(3). On July 27, 1995, the DFAS Columbus Center began using a new report to assist in tracking debts that exceed the statute of limitations.

Audit Response. The DFAS comments on standard demand letters for contractor debts were not fully responsive. Standard demand letters were currently generated by the Defense Debt Management System for individual debts, although the circumstance of each debt is different. Therefore, standard demand letters can also be generated for contractor debt. We request that DFAS reconsider its comments to Recommendation B.1.b.(1) and provide additional comments on the final report.

c. Notify accountable stations to write off debts that exceed the 6-year statute of limitations.

Management Comments. DFAS concurred with Recommendation B.1.c. Although the Debt Management Division, DFAS Columbus Center, has had procedures to notify accountable stations to write off contractor debts since 1993, a new report has been used since July 27, 1995, to enhance the process.

B.2. We recommend that the Chief, Debt Management Division, Defense Finance and Accounting Service Columbus Center:

a. Establish and monitor performance standards for each critical collection technique. Critical techniques should include transferring debts to collection agencies and to the Department of Justice, as well as adding contractors' names to the "List of Contractors Indebted to the United States."

Management Comments. DFAS concurred with Recommendation B.2.a. The Chief, Debt Management Division, DFAS Columbus Center, has used a monthly report since July 1994 to monitor staff work load and continually review performance standards for each critical collection technique. DFAS stated that this corrective action is complete.

Audit Response. The DFAS comments were partially responsive. Except for standards for issuing demand letters, the Debt Management Division, DFAS Columbus Center, had not established performance standards for critical collection techniques. We request that DFAS, in its response to the final report, provide additional comments on establishing performance standards for all critical collection techniques.

b. Develop procedures to identify debts approaching the 6-year statute of limitations and ensure that all appropriate collection techniques are used to collect those debts.

Management Comments. DFAS concurred with Recommendation B.2.b. On July 27, 1995, the Debt Management Division, DFAS Columbus Center, implemented new procedures and produced a new report for identifying debts approaching the statute of limitations and aggressively collecting contractor debts. The new report also tracks the collection processes used by each division employee.

c. Implement procedures to notify accountable stations to write off debts for which the 6-year statute of limitations has expired.

Management Comments. DFAS concurred with Recommendation B.2.c. The new procedures implemented on July 27, 1995, require the Debt Management Division, DFAS Columbus Center, to notify accountable stations to write off contractor debts when the 6-year statute of limitations expires.

d. Monitor inputs to the Defense Debt Management System to ensure that all contractor debt transactions and status changes are accurate and timely.

Management Comments. DFAS concurred with Recommendation B.2.d. Systems change requests are being developed to improve updates to collections and monitor changes in the status of debts in the Defense Debt Management System. DFAS estimated completion of this action by December 1995.

Management Comments Required

Management is requested to comment on the items indicated with an X in the following table.

Table 3. Management Comments Required on Finding B.

Recommendation	Organization	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issue
B.1.b.(1)	Headquarters, DFAS	X	X	X	Economy and efficiency
B.2.a.	DFAS Columbus Center	X	X	X	Management controls

Finding C. Managing Newly Identified Contractor Debts

The DFAS Columbus Center did not properly apply collections to interest, correctly assess interest on debts, or adequately pursue and monitor newly identified contractor debts. Collection efforts were ineffective because the Accounts Receivable Branch did not monitor the application of amounts collected and the collection and assessment of interest; management allowed contractors an additional 60 days to voluntarily remit payments; and controls over the Demand Letter Tracking System were not adequate. As a result, DFAS misapplied receipts totaling approximately $561,000 and did not pursue debts that remained collectible.

Responsibilities for Monitoring Newly Identified Debts

The Accounts Receivable Branch (the Branch) at the DFAS Columbus Center records, controls, and collects debts that contractors owe to DoD. Most of those debts are new debts on contracts paid by the DFAS Columbus Center. During FY 1994, the Branch employed 28 accounting technicians and managers to monitor about 3,560 debts totaling $387.5 million. Older debts (defined as debts over 45 days delinquent) are managed by the Debt Management Division (the Division) at the DFAS Columbus Center (see Finding B).

Sources Used to Identify Debts. Several sources notify the Branch that contractor debts exist. For example, the Reconciliation Branch at the DFAS Columbus Center transfers debts identified as a result of reconciling contract files and contract payment records; contracting officers transfer debts that they cannot collect; and contractors voluntarily send credit memorandums[3] acknowledging that they owe DoD a specific amount.

Contractor-Identified Debts. Some contractors used credit memorandums to notify DoD that they had been overpaid. When this happened, the Branch distributed the credit memorandums to one of its technicians. As instructed by DFAS Columbus Center management, the technicians did not send demand letters for at least 60 days after receiving the credit memorandums. If the Branch did not receive a response after the first demand letter, technicians could offset the amount owed against the contractor's existing contract with DoD. That is, they could take the amount owed from any outstanding invoice owed to the contractor.

Procedures Used to Collect Debts. When a DoD office notified the Branch of a debt, the Branch generally allowed a maximum of 5 days for a technician to

[3]A credit memorandum is a request by the contractor that the Government collect the debt by offset against unpaid bills due the contractor.

send a demand letter to the contractor. The demand letter specified the amount of the debt, the payment due date, and the interest rate that would be assessed if the payment was made after the due date. If payment was not received within 30 days of the first demand letter, the technician should send a second demand letter. If the contractor still failed to send payment within 45 days after the initial request for payment, the Branch transferred debts of $600 or more to the Debt Management Division for further action. For debts of less than $600, Branch personnel notified the accountable station that the Branch was no longer pursuing collection of the debt.

System for Tracking Contractor Debts. Upon determining that a debt was greater than $50, an accounting technician established an accounts receivable case file. The case file, in accordance with Federal Acquisition Regulation (FAR) subpart 32.606, "Debt Determination and Collection," February 25, 1992, included specific information on each debt. The technicians maintained the case files and input data into the Demand Letter Tracking System, an automated data base containing detailed information on each debt. Although each technician input data into the Demand Letter Tracking System, that system was only used to produce the "Bill of Collection List," a list of all debts that were open during the quarter. Management used this list to select debts for detailed review each quarter. Quarterly reviews are positive management controls and sound business practices that DFAS should continue to use.

Contractor Debt Management Regulations

Since DFAS Headquarters had not issued consolidated guidance for contractor debt, the DFAS Columbus Center personnel relied on the FAR; the Defense Logistics Agency Manual 7000.1, "Accounting and Finance Manual," August 18, 1980; and DFAS Columbus Center "Desk Procedures 901 for Accounts Receivable" to provide guidance for collecting debts from contractors.

Determination and Collection of Debts. FAR subpart 32.610, "Demand for Payment of Contract Debt," July 25, 1991, states that a demand for payment should be made when the responsible official has computed the amount of refund due. FAR subpart 32.606 (d) requires that a contractor liquidate a debt by cash payment in a lump sum or by credit against unpaid bills due the contractor. Additional guidance from the Director, Defense Procurement, states that "upon receipt of a credit memorandum, the payment office will offset the debt against current invoices due and payable. If the debt is not immediately and fully collected by that offset, the contractor is still in debt for the remainder, and interest still accrues."

According to the DoD Accounting Manual, chapter 33, and DFAS desk procedures, a collection shall be applied first toward administrative and penalty charges; second, toward accrued interest; and third, toward the remaining balance due. This requirement was subsequently incorporated into chapter 3, volume 4, of the FMR.

Interest Charges. FAR subparts 32.614-1, "Interest Charges," July 25, 1991, and 52.232-17, "Interest," January 22, 1991, give the periods for accruing interest. Specifically, interest charges are to be computed for the actual number of calendar days involved, beginning on the due date and ending on the date on which:

o the designated office received payment from the contractor;

o the Government issued a check to the contractor and an amount otherwise payable was withheld from such a check as a credit against the contractor debt; or

o an amount withheld and applied to a contract debt would otherwise have become payable to the contractor.

Debts bear simple interest from the date of the first written demand for payment, at the rate applicable for each 6-month period as fixed by the Secretary of the Treasury, until paid, unless paid within 30 days of becoming due.

Application of Amounts Collected

Applying Amounts Collected to Principal Before Interest. Often, when a payment was received from debtors, the Branch applied it to the principal debt amount without regard to the accrued interest. This did not comply with the DFAS desk procedures or the DoD Accounting Manual, which require DFAS to subtract accrued interest from the amount collected and apply the remainder to the debt's principal. Although the Branch conducted quality reviews, those reviews did not determine whether the staff applied amounts collected to the proper account.

The Branch should have collected at least $1.04 million in interest payments during FY 1994, but only $483,000 was recorded. Based on our statistical sample, more than $561,000[4] in debts would have been outstanding and collectible if the Branch had applied amounts collected to the accrued interest before the principal debt amount. Therefore, the Branch incorrectly closed debts that should have remained open. In effect, the Branch forgave the contractors for the interest that was due.

[4]The projected $561,000 was based on amounts over $50 that remained outstanding after the collections were made (see Appendix D, Sampling Plan B). DFAS established $50 as the minimum threshold for pursuing debts.

Collecting Interest on Administrative Offsets. The Branch did not always collect interest on debts collected by administrative offset. Specifically, of the 105 debts in our sample that were collected by offset, the total interest due was not collected on 100 debts. Either the technician did not consistently calculate the amount of interest due, or the paying office did not collect the interest due because the offset calculation did not include interest. As a result, the Government lost at least $41,400 from debts that were collected by offset. See Table 4 for examples of debts on which interest could have been but was not collected.

Table 4. Examples of Uncollected Interest on Contractor Debts Collected by Administrative Offsets During FY 1994

Sample Number	Debt Principal	Accrued Interest	Contract Offset	Interest Not Collected
29	$2,566,880	$18,480	$2,566,880	$18,480
307	8,388,149	8,128	8,388,149	8,128
389	32,752	1,391	32,752	1,391
442	442,642	3,110	442,642	3,110
491	28,528	3,101	28,528	3,101

Source: Debt Case Files

Assessing Interest on Accounts Receivable

The Branch did not consistently assess interest up to the date of collection. For example, the Branch did not always assess the correct amount of interest on debts collected by administrative offsets. When the Branch initiated an offset action through the paying office, the paying office manually prepared a "Bill of Collection Coordination," a DFAS Columbus Center form identifying an outstanding invoice on which a debt could be offset. The Branch then determined the amount of interest due, based on the number of days from the date of the first demand letter through the offset request date. However, the Branch should have calculated the interest based on the number of days from the date of the first demand letter through the date that the offset was made. Sometimes as many as 27 days elapsed before the offset was made. While the amount of interest lost on small debts was minimal, it could be significant for larger debts. Interest lost on two debts in our sample exceeded $2,000.

In addition to the ineffective procedures used to assess interest, the quality review checklist used to evaluate employee performance each quarter did not ensure an adequate review of interest calculations. Particularly, the checklists applicable to administrative offsets did not require management to verify the date of collection (the date the check was issued or should have been issued to the contractor). Therefore, these quality reviews did not ensure that the technicians were calculating interest correctly.

Pursuing Debts Identified by Contractors

The Branch did not promptly send demand letters, as required by FAR subpart 32.610, when contractors reported that they owed debts to DoD. Branch policy allowed technicians up to 60 days to issue demand letters. The extended period was to allow the contractors to voluntarily pay by check or request an offset. The technicians took as many as 187 days to send an initial demand letter.

We could not determine the total number and amount of debts recognized by contractors but not reported by the Branch because the Branch did not establish them as debts until the technicians sent initial demand letters. (The Branch technicians did not enter credit memorandums into the Demand Letter Tracking System until the 60-day grace period had expired.) Based on our sample, at least 48 of the 495 debts were the result of credit memorandums; the 48 debts totaled $11.6 million. Because of the 60-day grace period, the Government lost $133,100 in interest on the 48 sample debts.

Delays in pursuing debt collection may contribute to

- o loss of timely availability of program funds,
- o increased difficulty in collecting debts, or
- o actual monetary loss to the Government.

The 60-day grace period contradicts both the FAR and guidance from the Director, Defense Procurement, which require prompt requests for payments. Credit memorandums should be treated in the same manner as all other contractor debts, and demand letters should be sent within 5 days after the credit memorandums are received.

Monitoring Debt Collection Activities

The Branch did not have an adequate system to monitor debt collection activities. Instead of relying on the automated Demand Letter Tracking System to monitor debts, the Branch used the case files to evaluate the adequacy of collection activities. Management selected open debts from the "Bill of Collection List" and used a quality review checklist to evaluate collection efforts documented in the case files. Because case files were used to monitor collection procedures, reviews were limited to once each quarter, were performed on a limited number of debts, and did not identify systemic problems.

The Demand Letter Tracking System could not have been used to effectively monitor collection procedures because an estimated 70.7 percent of the debt records contained errors. Technicians input incorrect dates of collection activity, did not update the tracking system when collection activity occurred, and used incorrect codes. For example, of the 495 debts in our sample, the technicians entered 193 incorrect closed dates in the tracking system; this date is important because it can be used to verify the accuracy of the accrued interest. Figure 2 shows the number of errors identified in selected data fields. Ineffective controls over the types of information that could be input into the data fields caused the high error rate.

Field Name	Date of First Demand Letter	Date Collected	Date Cancelled	Date Received at the Branch	Date Closed
Number of Errors	42	150	36	112	193
Field Name	Request for Demand Code	Debt Offset	Interest Amount	Debt Reason Code	Debt Disputed
Number of Errors	67	93	73	59	35

Source: Statistical Sample of 495 Demand Letter Tracking System Debt Records

Figure 2. Errors Found in Selected Data Fields of the Demand Letter Tracking System for Debts in the Statistical Sample

Because the Branch did not have an adequate system to monitor debts, collection procedures were not always adequate. The Branch sent an estimated 22.7 percent of the demand letters late, assessed interest incorrectly on 189 sampled debts, and could not provide the accountable stations with a list of active debts in the FY 1994 inventory (see Finding A). A system to monitor and track each debt would allow the Branch to send demand letters on time, assess and collect interest, and provide lists of open debts to the appropriate accountable station. The Demand Letter Tracking System, if properly maintained, could provide this needed oversight.

Recommendations and Management Comments

C. We recommend that the Chief, Accounts Receivable Branch, Defense Finance and Accounting Service Columbus Center:

1. Enforce procedures requiring amounts collected to be applied to interest before principal, and revise the quality review checklist to require managers to evaluate how the staff applies the amounts collected.

Management Comments. DFAS concurred with Recommendation C.1. The DFAS Columbus Center will enforce the requirement, train staff members on the correct offset procedures, and change the Accounts Receivable Quality Review Checklist to reflect correct procedures. DFAS estimated completion of these actions by December 1995.

2. Pursue collection on debts for which the uncollected accrued interest exceeded $50 and collections were made by offsets.

Management Comments. DFAS concurred with Recommendation C.2. If legally permissible, the DFAS Columbus Center will initiate collection on the $561,000 of debts that were improperly closed.

3. Implement procedures to:

a. Assess interest until the date a check is issued, when calculating interest on debts collected by offsets.

Management Comments. DFAS concurred with Recommendation C.3.a. The Chief, Accounts Receivable Branch, DFAS Columbus Center, will issue interim guidance until the Accounts Receivable Desk Procedures are revised in December 1995.

b. Record credit memorandums upon receipt, and issue demand letters within 5 days of receipt.

Management Comments. DFAS concurred with Recommendation C.3.b. The Chief, Accounts Receivable Branch, DFAS Columbus Center, will establish a log to record the receipt of credit memorandums and will issue procedures requiring staff to issue demand letters within 5 days after receiving credit memorandums. DFAS estimated completion of this action by December 1995.

4. Develop a system to monitor debt collection and validate all data input to the Demand Letter Tracking System.

Management Comments. DFAS concurred with Recommendation C.4. The DFAS Columbus Center is evaluating the feasibility of updating the Demand Letter Tracking System and using the Mechanization of Contract Administration Services System to monitor debt collection. DFAS estimated completion of this action by December 1995.

Finding D. Managing Individual Debts

Although the DFAS centers generally managed individual debts effectively, some improvements were needed to maximize collection of individual debts. Specifically, collections at the DFAS Indianapolis Center were delayed by inefficient procedures used to validate debts transferred from the payroll systems; all DFAS centers stopped charging interest and penalties when debts were transferred to collection agencies; and the DFAS Indianapolis Center did not promptly post amounts collected to the correct appropriations. As a result, debts remained outstanding longer, the Government lost funds, and at least $24.1 million was returned to the U.S. Treasury rather than to DoD appropriations.

Responsibilities for Collecting Individual Debts

In January 1991, DFAS was designated as the agency responsible for debt management and collection activities within DoD. Before that date, the Military Departments collected individual debts. In this report, individual debts are debts owed by former active duty and Reserve Service members, former DoD civilian employees, and private citizens. (In-service debts, which are incurred by military and civilian personnel currently employed by DoD, are managed by payroll offices and are not discussed in this report.)

Individual debts are accounted for in the DDMS, a standardized system for managing debts at each of the DFAS centers. DFAS can effectively oversee individual debts (unlike contractor debts) because the DDMS was initially designed to track debts owed by individuals. The DDMS records debts; issues demand letters; assesses interest, penalties, and administrative charges; and tracks referrals to consumer credit reporting agencies, collection agencies, the Internal Revenue Service (IRS), the Department of Justice, and the Defense Manpower Data Center. (The Defense Manpower Data Center matches debtors' names against other Federal payroll records.)

DFAS Headquarters oversees the DDMS and the DFAS centers and issues guidance on debt management. Individual debts are managed by the DFAS Denver, Indianapolis, Cleveland, and Kansas City Centers.

Debt collection efforts begin with providing due process to the debtor. The debtor is notified of the debt through a demand letter. Up to three letters may be sent to the individual before other action (such as referring debts to collection agencies, consumer credit reporting agencies, or the Defense Manpower Data Center) is taken. The first demand letter informs the individual of the outstanding debt; requests payment; and outlines the terms of interest, penalties, and administrative charges. If needed, two additional letters are sent at 30-day intervals.

Interest accrues on the outstanding principal from the date of the first demand letter and is assessed at the prevailing U.S. Treasury rate on all debts that are 30 days overdue. Individuals are assessed a 6-percent penalty for debts that have been outstanding for more than 90 days. DFAS also charges the debtor a $15 administrative fee when referring debts to collection agencies and the IRS. The $15 administrative fee is based on FY 1991 data and does not reflect the actual cost of referring the debts. However, DFAS is updating its cost analysis for processing delinquent debts.

During most of FY 1994, individuals remitted payments to the DFAS centers or to U.S. Treasury lockboxes in St. Louis, Missouri. Currently, most payments are sent to lockboxes. Collections are also made through collection agencies and are offset against Federal sources, such as income tax refunds and retirement payments. For up to 5 years after the appropriation expires, collections on debts should be returned to the appropriation where the funds were originally disbursed. After 5 years, any funds collected must be returned to the general fund of the U.S. Treasury. Interest and penalties must always be credited to the general fund of the U.S. Treasury.

Validating Debts Transferred from Payroll Systems

Validating debts transferred from payroll systems caused problems for most DFAS centers. One center had a significant backlog of active Army debts that were pending validation, and potentially erroneous debts from the Reserve and Air National Guard were accepted in DDMS without any validation.

Of the four DFAS centers responsible for managing individual debts, the DFAS Indianapolis Center had the largest volume of debts and managed approximately 60 percent ($242 million) of the $404 million in individual debts owed to DoD in FY 1994. The DFAS Indianapolis Center experienced substantial delays in collecting debts because it implemented procedures to validate each debt transferred to DDMS from the active Army payroll system. Those debts had to be validated before DFAS could begin debt collection procedures. The validation procedures used by the DFAS Indianapolis Center were time-consuming, and included manually verifying the existence of the debts as well as recomputing the amount of overpayments and benefits. The DFAS Indianapolis Center needs to implement a more effective process for validating debts before transferring them to DDMS.

However, none of the DFAS centers had validated $3.6 million in debts that consisted of life insurance premiums for former members of the Reserve and Air National Guard before pursuing collection efforts.

Active Army Payroll System. The DFAS Indianapolis Center's debt validation procedures delayed collections on Army debts because employees could not efficiently process the high volume of debts received from the active Army payroll system. This occurred because the DFAS Indianapolis Center manually validated each debt transferred from the active duty payroll system before pursuing any collection efforts.[5] These time-consuming procedures, which included recomputing separation pay benefits to eliminate invalid debts, delayed collection actions by as much as 13 months. As a result, the DFAS Indianapolis Center accumulated a backlog of $13.6 million in debts in suspense at the end of FY 1994. That backlog remained at $14.1 million through March 1995 because new debts were received as quickly as debts were validated. Figure 3 shows the debts in the backlog.

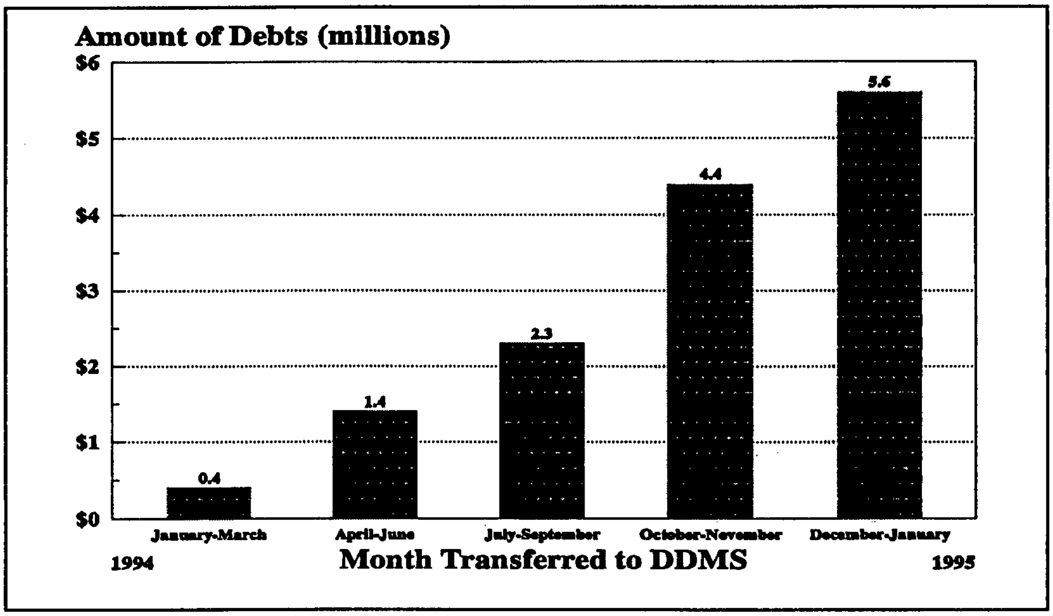

Figure 3. Distribution of $14.1 Million Backlog of Debts Transferred from the Active Army Payroll System and Requiring Validation as of March 1995

We recognize the need to ensure that collection action is pursued only on valid debts; however, a more efficient process is needed to reduce the backlog. In January 1995, DFAS developed a plan that included system changes to speed the validation process at the DFAS Indianapolis Center. Those changes, although recently approved, have not been implemented. Consequently, the backlog remains. One proposed action, to suspend collection efforts on debts that are not cost-effective to collect, should help reduce the backlog. Certain types of debts could be canceled because they are invalid; other debts could be grouped and validated as a unit, rather than on a case-by-case basis, or grouped by dollar value so that the largest debts will be validated first.

[5]Office of the Inspector General, DoD, Audit Report No. 95-059, "Process Used to Separate Military Personnel from Active Service," December 19, 1994, recommended that the DFAS centers validate debts before recording them in DDMS. However, the process was expected to involve a high degree of automation.

Reserve and Air National Guard Payroll Systems. During FY 1994, DFAS centers incorrectly charged $3.6 million to Service members for life insurance premiums that the Government paid after the Service members had separated from the Army, Air Force, and Marine Corps Reserves and the Air National Guard. The insurance premiums were paid because the personnel offices did not promptly notify the payroll offices when members separated, and the payroll systems continued to accrue these charges. In some cases, 37 months passed before separations were posted in the pay records and life insurance charges were discontinued. As a result, the DFAS centers pursued and collected over $900,000 during FY 1994 for life insurance premiums from members who had separated from the Reserves or the National Guard.

Generally, the demand letters sent to the reservists were the first notification that the reservists owed DoD for life insurance premiums. Because these debts were caused by the Services and not by the former Service members, the DFAS Indianapolis Center requested and received approval from DFAS Headquarters to cancel the debts in FY 1994. Although the debts were canceled in December 1994, subsequent premium charges continued to be recorded in DDMS. DFAS Headquarters has requested that the DFAS General Counsel determine whether to cancel the life insurance premium charges that are accruing, and discontinue charging the former Service members for these debts. In addition, the Debt Avoidance Task Force, composed of representatives from DoD Components, found that debts consisting of life insurance premiums were not cost-effective to collect. The Debt Avoidance Task Force plans to recommend policy changes that should minimize the number of invalid debts created for life insurance premium charges.

Accruing Interest and Penalty Charges on Delinquent Debts

The DFAS centers did not continually accrue interest and penalty charges on outstanding debts or use the appropriate interest rate when individuals had more than one debt. This occurred because the DDMS was incorrectly programmed. Interest and penalty charges were stopped when debts were transferred to collection agencies or referred to the IRS for collection. Also, only one interest rate was used to assess interest. As a result, DoD understated the amount of interest and penalties due on FY 1994 individual debts by an estimated $23.8 million.

FMR, volume 5, chapter 29, "Debt Collection Requirements," requires accruing and assessing interest, penalties, and administrative charges on all debts owed to DoD Components.

We estimated that during FY 1994, interest on outstanding debts was understated by $11.1 million and penalties were understated by $12.7 million, for individual debts transferred to collection agencies.

Referrals to Collection Agencies. System prompts for DDMS to charge interest and penalties were deactivated when debts were transferred to collection agencies. Also, collection agencies did not assess interest and penalties on debts. Although collection agencies effectively collected debts, these charges should have continued to accrue while debts were being pursued.

The estimated $23.8 million in interest and penalty charges represented 58.2 percent of the total interest, penalties, and administrative charges that should have been assessed in FY 1994. These charges could have given debtors an incentive to remit payments; also, the Government lost funds that could have been recouped from interest and penalty charges. Procedures should be revised to continue to accrue charges in DDMS so that DFAS can collect all funds owed to the Government.

In response to our suggestion, DFAS Headquarters approved a systems change so that interest will continue to be assessed when debts are transferred to collection agencies. The systems change, approved in April 1995, should resolve the interest issue. However, penalties continue to be undercharged.

Referrals to the Internal Revenue Service. Interest and penalty charges did not continue to accrue when debts were referred to the IRS for collection. When debts were referred to the IRS for offset against an individual's income tax refund, the DDMS closed the debts. When debts were closed, they were removed from the accounting records, but were referred to the IRS for up to 10 years after the first demand letter. The accounts were reopened when collections were made for debts previously closed, but interest and penalty charges were not retroactively assessed. DFAS should update the account balances (principal debt amount, interest, and penalty charges) for each debtor before sending the annual referral list to the IRS.

Interest Rates on Multiple Debts. When debtors have multiple debts, DDMS uses the rate of the initial debt to compute interest charges. Interest should be based on the rates applicable at the time the debt is identified. Multiple debts accounted for 22 percent of all debts in FY 1994. Although DFAS Headquarters approved a systems change in November 1994, that change had not been programmed into DDMS as of April 1995. As a result, incorrect interest rates continued to be used for individuals with more than one debt.

Returning Collections to Appropriations

Collections resulting from debts owed by individuals were sometimes returned to the U.S. Treasury's Miscellaneous Receipts Account or posted to a suspense account instead of being returned to the originating appropriations.

Funds Returned to the U.S. Treasury. The DFAS centers did not designate the correct appropriations when collections were returned. Rather, DFAS designated all collections for the U.S. Treasury, regardless of whether the correct appropriation was cited. As a result, $24.1 million was returned to the U.S. Treasury instead of to the appropriations from which the funds were originally disbursed. DFAS Headquarters took this action in order to expedite conversion to the DDMS from various systems throughout DoD. An additional $200 million in debts that were recorded in the old systems may have been incorrectly returned to the U.S. Treasury's Miscellaneous Receipts Account because of this policy. In the meantime, the Services could not obligate funds when they became available through debt collections.

The FMR, volume 5, requires DFAS to credit collections to the original appropriation if collected before the appropriation is canceled. If debts are collected after the appropriation has been canceled, the Treasury Financial Manual requires collections to be returned to the U.S. Treasury's Miscellaneous Receipts Account 3200: "Collections of Receivables from Canceled Accounts."

Posting Collections to the Correct Appropriation. The DFAS Indianapolis Center generally did not make timely deposits to the U.S. Treasury. Inefficient procedures caused delays in posting to the appropriations from which the funds were originally disbursed. As a result, the Army could not obligate current funds when they became available.

During most of FY 1994, the DFAS Indianapolis Center manually processed checks, posted the funds in a suspense account, and manually updated DDMS before transferring the funds to the correct appropriation. Because the technicians could not readily identify the appropriations, the DFAS Indianapolis Center accumulated a backlog of $2.2 million in collections that was not promptly posted to the correct appropriations. However, as a result of our audit, the DFAS Indianapolis Center changed its procedures and began using the U.S. Treasury lockbox for depositing collections.

Although this change expedited the deposit process, posting to the accounting records continued to be delayed. For example, the DFAS Indianapolis Center took as long as 273 days to process collections received from the IRS. The funds were directly deposited into the Federal Reserve Bank, but because the lockbox system interfaced only with DDMS, the technicians had to manually research and post more than 21,000 debts valued at $12 million, which were collected by offsets to income tax refunds during FY 1994. Delays in posting collections to the accounting records prevented the Services from obligating funds, since collections not posted to the appropriation in the same year resulted in a loss of new obligational authority.

Recommendations, Management Comments, and Audit Response

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

1. Develop and implement a plan for validating debts before transferring the debts from the active Army payroll system. This plan should include linking the Defense Debt Management System to the payroll and personnel system; pursuing only those debts that exceed a dollar threshold; grouping debts by dollar value in order to focus on high-dollar debts; and sorting debts by reason for the debt in order to evaluate them as a group rather than individually.

Management Comments. DFAS concurred with Recommendation D.1. Upgraded interfaces between Army personnel and pay systems will eliminate the need for the DFAS Indianapolis Center to validate debts. DFAS estimated completion of this action by September 1997. Annually, beginning in October 1996, DFAS will review the thresholds for pursuing the most cost effective debts. DFAS has already validated larger debts and has evaluated debts by reason code.

2. Make systems changes in the Defense Debt Management System to:

a. Continue to assess interest and penalty charges on debts transferred to collection agencies and debts referred to the Internal Revenue Service for offsets of income tax refunds.

Management Comments. DFAS partially concurred with Recommendation D.2.a. The Defense Debt Management System will be changed to retroactively accrue interest and penalties on debts transferred to collection agencies and on active debts referred to the IRS. DFAS will not assess interest and penalties on closed debts referred to the IRS, since that would overstate accounts receivable; those debts are not likely to be collected. DFAS estimated completion of this action by December 1996.

Audit Response. Management comments were not fully responsive. We agree that continuing to accrue interest and penalties on debts that are not likely to be collected overstates the amounts due. However, interest and penalties should be retroactively assessed each year when DFAS refers the debts to the IRS. We request that DFAS reconsider its position on assessing interest and penalties on closed debts.

b. Use the appropriate interest rates for debtors who owe more than one debt.

Management Comments. DFAS concurred with Recommendation D.2.b. Appropriate interest rates will be charged when individuals have incurred multiple debts in different years. DFAS also commented that the number of individuals with debts incurred in different years is not significant. DFAS estimated completion of this action by December 1996.

Audit Response. DFAS comments were fully responsive. Although the number of individuals with debts incurred in different years was small, DoD regulations require interest charges to be based on the rates in effect at the time the debt is identified.

3. Fully automate the process of posting all collections to the correct appropriation.

Management Comments. DFAS concurred. The office developing the interim migratory accounting system will establish an interface to post collections to the correct appropriations. DFAS estimated completion of this action by September 1997.

Management Comments Required

Management is requested to comment on the items indicated with an X in the following table.

Table 5. Management Comments Required on Finding D

Recommendation Number	Organization	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issue
D.2.a.	Headquarters, DFAS	X	X	X	Program results

Part II - Additional Information

Appendix A. Scope and Methodology

Scope and Methodology

We evaluated the policies and procedures established by Headquarters, DFAS, to pursue, collect, record, and report on debts owed to the DoD. We also evaluated the debt collection procedures and practices in existence at the DFAS Denver, Columbus, and Indianapolis Centers during FYs 1994 and 1995. Specifically, we assessed:

o how accounts receivable were established in the DDMS and reported to the U.S. Treasury;

o how debts were pursued by DFAS centers;

o how payments were collected, safeguarded, deposited, recorded, and reported; and

o how access to the data and the DDMS was controlled and maintained.

As part of our review to evaluate the effectiveness of collection procedures for contractor debts, we tested debt transactions that were open during FY 1994. Open transactions included active and inactive debts from prior periods as well as debts that were incurred or closed during FY 1994. From DDMS and the Demand Letter Tracking System at the DFAS Columbus Center, we statistically selected contractor debt transactions, and we compared the information in the two data bases to the debtors' case files and to applicable laws and regulations. We used that comparison to determine the accuracy of the data bases and the timeliness of collection efforts. We also statistically selected individual debt transactions from DDMS at the DFAS Denver, Indianapolis, Cleveland, and Kansas City Centers. Individual debt transactions were also compared to the information in the debtors' case files and tested for accuracy as well as timeliness. Appendix D describes our statistical sampling methodology.

We reviewed FY 1993 and 1994 Annual Statements of Assurance and risk assessments prepared by each DFAS center to determine whether those centers had identified and reported any material management control weaknesses related to debt management.

We also reviewed the actions taken to correct deficiencies identified in prior audit reports.

Limitations on Audit Scope. We did not review debts owed by foreign countries, debts owed to the U.S. Army Corps of Engineers (USACE), or debts owed by military and civilian personnel currently employed by DoD. Debts owed by foreign countries are managed by the Defense Security Assistance Agency and are not governed by the Debt Collection Act or the FAR. We did not review USACE debts because the U.S. Army Audit Agency verified the accuracy of accounts receivable (debts owed to the USACE) and evaluated debt management practices as part of its audit of the USACE FY 1993 financial statements. In addition, the USACE Internal Review Office conducted a followup review on debt management practices during FY 1995. Debts incurred by in-service personnel were excluded because those debts are managed and collected through the payroll systems. Other organizations (the General Accounting Office, the Army Audit Agency, and the DFAS Denver Center's Internal Review Office) were also auditing various aspects of the DoD civilian and military payroll systems.

Use of Computer-Processed Data. To achieve the audit objectives, we relied on computer-processed data generated by the DDMS and the Demand Letter Tracking System at the DFAS Columbus Center. Test results and our review of system controls for contractor debts showed an error rate that caused us to doubt the data's validity. However, when these data are reviewed in context with other available evidence, we believe the opinions, conclusions, and recommendations in this report are valid.

Audit Period, Standards, and Locations. This economy and efficiency audit was made from July 1994 through April 1995 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, the audit included such tests of management controls as were considered necessary. Appendix G lists the organizations visited or contacted.

Technical Assistance. Specialists assigned to the Inspector General, DoD, assisted in planning, evaluating, and projecting the results of statistical samples used during this audit.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to have management control techniques in place to ensure that events are occurring as desired and to have a program in place to evaluate those controls.

Scope of Review of Management Control Program. We determined whether DFAS complied with DoD Directive 5010.38. Specifically, we reviewed DFAS management controls over establishing and recording debts; issuing demand letters; assessing interest, penalties, and administrative fees; referring debts to outside organizations; suspending collection actions; receiving, posting, and reporting remittances; and writing off uncollectible debts. We also determined the extent to which DFAS evaluated its management controls over debt management and collections, and the results of any self-evaluation.

Adequacy of Management Controls. We identified material management control weaknesses as defined by DoD Directive 5010.38. DFAS management controls for assessing fees, referring debts to outside organizations, and reporting remittances were not adequate to optimize collections and accurately report debts. Recommendations A.1. through A.4., B.1.a., B.2., and C.4., if implemented, will correct the weaknesses and could result in potential monetary benefits of $561,000 (see Appendix F). A copy of the report will be provided to the senior official responsible for management controls at DFAS.

Adequacy of DFAS Self-Evaluation. DFAS officials identified various aspects of debt management and collections as assessable units based on the organizational structure at each DFAS center. Each center conducted vulnerability assessments and assigned a low or medium risk to each assessable unit. The DFAS Cleveland and Kansas City Centers conducted detailed reviews, but found no material management control weaknesses. Weaknesses in the Annual Statements of Assurance were primarily external audit findings. In our opinion, DFAS officials did not correctly identify the risk associated with debt management and collections because the standard assessment forms did not contain specific questions about debt management or deposit controls.

Appendix B. Summary of Prior Audits and Other Reviews

General Accounting Office

Report No.	Report Title	Date
NSIAD-94-245 (OSD Case No. 9742)	Overpayments and Underpayments at Selected Contractors Show Major Problem	August 5, 1994
NSIAD-94-106 (OSD Case No. 9602)	Millions in Overpayments Returned by DoD Contractors	March 14, 1994

Inspector General, DoD

Report No.	Report Title	Date
95-234	Department of Defense Compliance with Federal Tax Reporting Requirements	June 14, 1995
95-059	Process Used to Separate Military Personnel From Active Service	December 19, 1994
94-144	Controls Over Two Contract Payments at the Defense Finance and Accounting Service Columbus Center	June 20, 1994
94-119	Accounts Receivable for DoD Materiel	June 3, 1994
AFU 94-02	Followup Review of Recovery of Funds Due the Government as a Result of Contract Debts	April 22, 1994
94-082	Financial Management of the Defense Business Operations Fund	April 11, 1994
94-054	Fund Control Over Contract Payments at the Defense Finance and Accounting Service Columbus Center	March 15, 1994

94-023	Payment Errors Related to Operations Desert Storm and Desert Shield	December 23, 1993
93-134	Principal and Combining Financial Statements of the Defense Business Operations Fund for FY 1992	June 30, 1993
92-021	Debt Collection and Deposit Controls	December 13, 1991

Army Audit Agency

Report No.	Report Title	Date
SR 94-481	FY 93 Financial Statements of the U.S. Army Corps of Engineers	June 30, 1994

Air Force Audit Agency

Report No.	Report Title	Date
94058019	Compliance Review - Refunds Receivable	January 27, 1995
100-0-14	Interest Assessed on Debts Owed to the Air Force	January 22, 1990

Appendix C. Consolidation of Debt Management

Beginning in January 1991, DFAS assumed operational control of the finance and accounting centers operated by the Military Departments and Defense agencies. Operational control includes responsibility for debt management and collection activities throughout DoD.* As the designated debt collection agency for DoD, DFAS is required to aggressively collect debts and annually report on the management of debt collection activities to Congress.

As recommended in Inspector General, DoD, Audit Report No. 92-021, "Debt Collection and Deposit Controls," December 13, 1991, DFAS has centralized its management of debt collection functions and developed uniform operating procedures.

Managing DoD Debts. DFAS has standardized its debt collection policies and procedures, debt management system, and organizational structure, and has centralized debt collection activities.

Standardized Debt Management Policies and Procedures. DFAS incorporated consistent standards for managing individual debts into DoD Regulation 7000.14-R, "Department of Defense Financial Management Regulation" (FMR), volume 5, "Disbursing Policy and Procedures," December 1993. Volume 5 canceled all previously issued DoD instructions and Military Department regulations on debt management, and required all DoD Components to follow the same procedures for pursuing individual debts.

Consolidated DoD-wide regulations for contractor debts have not been issued, but the proposed policies and procedures are included in the draft of FMR, volume 10, "Contract Payment Policy and Procedures."

Automated Debt Management System. DFAS selected the Air Force Departmental Accounts Receivable System as the consolidated DoD-wide debt management system, and renamed it the Defense Debt Management System (DDMS). The DDMS became fully operational during FY 1994. Although the DDMS was initially designed to track debts owed by individuals who were not in an active Federal Government payroll system, the DFAS Denver Center modified it to track contractor debts as well. The DFAS Denver Center has used the system since 1987 and maintains and operates it.

Implementation of DDMS was gradually phased in at the other four DFAS centers: the DFAS Columbus Center in August 1992, the DFAS Kansas City Center in December 1992, the DFAS Cleveland Center in April 1993, and the DFAS Indianapolis Center in December 1993. Each center inputs data into the DDMS and is fully responsible for monitoring, tracking, and reporting on the status of its debts.

*DFAS is not responsible for contractor debts owed to the U.S. Army Corps of Engineers, Civil Works Program. The U.S. Army Corps of Engineers manages and reports on those debts.

Standardized Organizational Structure. DFAS Headquarters oversees the various DFAS centers and issues guidance on debt management activities. Each DFAS center has an established debt management unit and assigned areas of responsibility. The DFAS Denver Center is responsible for pursuing debts incurred by Air Force personnel. The DFAS Indianapolis Center pursues debts of Army personnel. The DFAS Cleveland Center pursues debts of Navy personnel and retirees. The DFAS Kansas City Center pursues debts of Marine Corps personnel. The DFAS Columbus Center pursues all debts incurred by contractors, and debts owed to the Defense Business Operations Fund and the Defense Commissary Agency.

Centralized Collections. To shorten the time needed to return funds to the U.S. Treasury, each DFAS center requests that debtors send their payments to U.S. Treasury lockboxes in St. Louis, Missouri. Payments to the lockboxes are immediately deposited in a Federal Reserve Bank. Through systems interface, the DFAS Denver Center accesses the U.S. Treasury system daily and updates the collections in DDMS.

Accounting for Debts. The DFAS centers are responsible for all individual debts transferred to DDMS; this includes posting collections and write-offs to the appropriate account, as well as reporting those debts to the U.S. Treasury. The responsible funding stations maintain the official accounting records for contractor debts. The DFAS Columbus Center acts as the collection agent, pursues and collects the debts, and notifies the funding stations of final actions. The funding stations report contractor debts and collections to their respective DFAS centers. Each DFAS center then consolidates this information and reports it to the U.S. Treasury.

Contracting Out. In April 1995, the DFAS Commercial Activities Program Steering Group began a study to determine whether contracting out the debt management function currently performed by the DFAS centers would be more cost-effective. The study is scheduled for completion in September 1996.

Appendix D. Statistical Sampling Methodology

Three statistical samples were selected, two for debts owed by contractors and one for debts owed by individuals. A description of each sampling plan follows.

Sampling Plan A. Contractor Debts in the Defense Debt Management System

Sampling Purpose. The statistical sampling plan makes estimates of five elements for the debts maintained by the DFAS Columbus Center:

o collection action or followup on debts,

o demand letters not issued or issued in an untimely manner,

o debts not transferred to a collection agency,

o debts not added to the "List of Contractors Indebted to the United States," and

o incorrect debt information in the Defense Debt Management System.

The sample results provide data to evaluate the number of errors, the time periods involved, and the amounts of debt on which interest is charged.

Universe Represented. The audit involved debts on contracts paid by the DFAS Columbus Center and other paying offices. The audit covered outstanding debts open in FY 1994. The base population included 2,887 debts totaling $3.4 billion as the original debt amount and $909,928 in accrued interest.

Sampling Design. A stratified sample was designed by age of debt to evaluate the process of debt collection and the effect of time on interest. The overall sample consisted of 460 debts; however, 16 debt folders were not located or had inadequate documentation. In this statistical analysis, those folders were evaluated as having no errors.

Confidence Interval Table. The values in Table D-1 represent the number of debts with errors and the percentage of incorrect debts for the DDMS population.

Table D-1. Confidence Interval: Statistical Projections for Contractor Debts in the Defense Debt Management System

	98-Percent Confidence Interval		
	Lower Bound	Point Estimate	Upper Bound
No Collection Action or Followup on Debts			
Debts With Errors	1,380	1,469	1,562
Percentage of Incorrect Debts	47.8%	50.9%	54.1%
Demand Letters Not Issued Promptly			
Debts With Errors	393	440	494
Debts Not Transferred To Collection Agencies			
Debts With Errors	407	455	508
Debts Not Added to "List of Contractors Indebted to the United States"			
Debts With Errors	214	250	508
Incorrect Debt Information			
Debts With Errors	930	1,004	1,083
Percentage of Incorrect Debts	32.2%	34.8%	37.5%

Statement on Confidence Interval. With 98-percent confidence, the population of DDMS contractor debts has errors in the specific analysis from each lower bound to each upper bound, respectively. In addition, the overall confidence level for the five analyses simultaneously is 90 percent.

Sampling Plan B. Contractor Debts in the Demand Letter Tracking System

Sampling Purpose. The statistical sampling plan makes estimates of three elements for the audit of the DFAS Columbus Center:

o interest not collected,

o the proportion of debts in the computerized debt tracking system that have at least one error, and

o the percentage of debts having one or more late demand letters.

The sample results provide data to evaluate the number of errors, time periods involved, and the amounts of debts on which interest and penalties are charged.

Universe Represented. The audit involved debts on contracts paid by the Mechanization of Contract Administration Services System. The audit covered outstanding debts of more than $50 that were open in FY 1994. The base population included 3,563 debts totaling $387.5 million as the original debt amount and $575,670 in interest.

Sampling Design. A stratified sample was designed by age of debt to evaluate the process of debt collection and the effect of time on interest. The original sample consisted of 502 debts; however, 7 debts were not in the scope of this audit, and an additional 13 debt folders were not located. The overall sample consisted of 495 debts (502 debts minus 7 debts), and the 13 missing folders were evaluated as having no errors.

Confidence Interval Table. The values in Table D-2 represent errors caused by incorrectly assessing interest, issuing demand letters, and inputting data into the Demand Letter Tracking System.

Table D-2. Confidence Interval: Statistical Projections for Debts in the Demand Letter Tracking System

	98-Percent Confidence Interval		
	Lower Bound	Point Estimate	Upper Bound
Interest Not Collected	$85,493	$561,208	$1,036,922
Debts With Errors	2,402	2,520	2,640
Percentage of Incorrect Debts	67.5%	70.7%	74.2%
Debts With Late Demand Letters	20.5%	22.7%	24.9%

Statement on Confidence Interval. With 98-percent confidence, the population of the Demand Letter Tracking System for contractor debts has errors in the specific analysis from each lower bound to each upper bound, respectively. In addition, the overall confidence level for the three analyses simultaneously is 90 percent.

Sampling Plan C. Individual Debts in the Defense Debt Management System

Sampling Purpose. The statistical sampling plan estimates the shortage of interest and penalties caused by improper calculation methods at DFAS. The sample results provide data for use in evaluating interest calculations, the time periods involved, and the amount of debts on which interest and penalties are charged.

Universe Represented. The audit included debts incurred by out-of-service personnel and reported in DDMS. The entire audit covered outstanding debts of more than $25 that were open in FY 1994; however, estimates for interest and penalties in the base population exclude two types of debt. These are debts connected with Servicemen's Group Life Insurance and temporary write-offs of debts referred to the IRS. The base population included 319,101 debts, totaling $428.2 million in original debt and $17.1 million in interest, penalties, and administrative fees.

Sampling Design. A stratified sample was designed by age of debt to evaluate the effect of time on interest and penalties. The overall sample consisted of 364 individual debts; however, 41 debts were temporary write-offs and were not appropriate for interest and penalty projections. Statistical analysis was applied to 323 debts, although 37 debt folders were not located. For statistical purposes, these missing folders were evaluated as having no errors.

Confidence Interval Table. The values in Table D-3 represent the amount of interest and penalties not assessed on individual debts in the DDMS population.

Table D-3. Confidence Interval: Statistical Projections for Individual Debts in the Defense Debt Management System

	95-Percent Confidence Interval		
	Lower Bound	Point Estimate	Upper Bound
Shortage of Interest (Millions)	$ 3.56	$11.11	$18.66
Shortage of Penalties (Millions)	$ 4.84	$12.67	$20.50
Percentage of Shortage (Total Interest, Penalties, and Administrative Fees)	33.3%	58.2%	69.6%

Statement on Confidence Interval. With 95-percent confidence, the population of DDMS individual debts has a shortage of interest and penalties from each lower bound to each upper bound, respectively. In addition, the overall confidence level for interest and penalties simultaneously is 90 percent.

Appendix E. Laws and Regulations Reviewed

Public Law 89-508, "Federal Claims Collection Act of 1966"

Public Law 97-365, "Debt Collection Act of 1982"

Public Law 101-510, "National Defense Authorization Act of Fiscal Year 1991," November 5, 1990

Public Law 102-172, section 8138, "Department of Defense Appropriations Act, 1992"

Title 31, United States Code, section 3720A, "Reduction of Tax Refund by Amount of Debt"

Title 4, Code of Federal Regulations, chapter II, "Federal Claims Collection Standards," revised January 1, 1994

Office of Management and Budget Circular No. A-129, "Policies for Federal Credit Programs and Non-tax Receivables," January 1993

Federal Acquisition Regulation subpart 32.6, "Contract Debts," July 25, 1991

Treasury Asset Management Manual, "Managing Federal Receivables," July 1994

Defense Federal Acquisition Regulation Supplement, subpart 232.6, "Contract Debts," 1991 Edition

DoD Regulation 7000.14-R, "Department of Defense Financial Management Regulation," volume 4, "Accounting Policy and Procedures," January 1995

DoD Regulation 7000.14-R, "Department of Defense Financial Management Regulation," volume 5, "Disbursing Policy and Procedures," December 1993

DoD Regulation 7000.14-R, "Department of Defense Financial Management Regulation," volume 7A, "Military Pay Policy and Procedures for Active Duty and Reserve Pay," August 1994

DoD Manual 7220.9-M, "DoD Accounting Manual," as amended March 18, 1987

DoD Directive 5118.50, "Defense Finance and Accounting Service," November 26, 1990

DoD Directive 7045.13, "DoD Credit Management and Debt Collection Program," October 31, 1986

Appendix F. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
A.1. - A.4.	Management controls and compliance with regulations and laws. Improves reporting of contractor debts as accounts receivable.	Nonmonetary.
B.1.a., B.1.c., B.2.	Management controls and compliance with regulations and laws. Allows management to optimize collections and report debts more accurately and promptly.	Nonmonetary.
B.1.b.	Economy and efficiency. Reduces processing time if demand letters and statements of account are automated.	Undeterminable. Savings will depend on number of documents processed.
C.1. - C.3.	Compliance with regulations and laws. Establishes procedures to properly apply collections and pursue debts, and improves the accuracy of interest calculations and debt collections.	Applying collections to interest before principal would have resulted in $561,000 put to better use by depositing in the U.S. Treasury.
C.4.	Management controls. Increases the reliability of the Demand Letter Tracking System and provides oversight for monitoring staff activities and reporting accounts receivable.	Nonmonetary.
D.1., D.3.	Economy and efficiency and compliance with laws and regulations. Reduces the workload and speeds debt collection.	Undeterminable. Reducing the time needed to validate debts could allow funds to be obligated.
D.2.	Program results. Assists in managing and collecting debts.	Nonmonetary.

Appendix G. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Director of Accounting Policy, Washington, DC
Washington Headquarters Services, Washington, DC

Defense Organizations

Defense Finance and Accounting Service, Arlington, VA
  Defense Finance and Accounting Service Center, Cleveland, OH
    Defense Accounting Office, Arlington, VA
    Defense Accounting Office, Philadelphia, PA
    Operating Location, Norfolk, VA
  Defense Finance and Accounting Service Center, Columbus, OH
    Naval Shipyard Office, Philadelphia, PA
  Defense Finance and Accounting Service Center, Denver, CO
    Defense Accounting Office, Kelly AFB, TX
    Defense Accounting Office, Kirkland AFB, NM
  Defense Finance and Accounting Service Center, Indianapolis, IN
    Defense Accounting Office, Missile Command, Huntsville, AL
    Defense Accounting Office, Armament, Munitions, and Chemical Command, Rock Island, IL
  Defense Finance and Accounting Service Center, Kansas City, MO
Defense Logistics Agency, Alexandria, VA
Defense Manpower Data Center, Monterey, CA
Department of Defense Dependents Schools, Arlington, VA
Uniformed Services University of the Health Sciences, Bethesda, MD

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller), Washington, DC
U.S. Army Corps of Engineers, Washington, DC
U.S. Army Audit Agency, Alexandria, VA

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller),
  Washington, DC
Office of the General Counsel, Arlington, VA
Comptroller, Naval Air Systems Command, Arlington, VA
Naval Aviation Supply Office, Philadelphia, PA
Naval Shipyard, Philadelphia, PA
Naval Shipyard, Norfolk, VA

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller),
  Director of Accounting and Banking, Washington, DC
Colorado Air National Guard

Non-Defense Federal Organizations

General Accounting Office
  National Security and International Affairs Division, Washington, DC
  Dallas Regional Office, Dallas, Texas

Non-Government Organizations

Payco Collection Agency, Dublin, OH
CSC Collection Agency, Houston, TX

Appendix H. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense for Personnel and Readiness
Assistant to the Secretary of Defense (Public Affairs)
Director, Washington Headquarters Services
Director, Administration and Management

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, Department of the Air Force

Other Defense Organizations

Director, Defense Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, Defense Mapping Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Nuclear Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

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

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

OCT 12 [illegible]

DFAS-HQ/F

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, INSPECTOR GENERAL, DoD

SUBJECT: DoD IG Draft Audit Report, "Debt Collection and Deposit Controls in the Department of Defense," dated June 30, 1995 (Project No. 4FH-0054)

Your memorandum of June 30, 1995, provided the subject draft report for review and comment. We have reviewed the report, and our comments are included in the attachment.

If additional information is required, my point of contact is Mr. Ernie D'Ercole, DFAS-HQ/FCD, at (703) 607-1588.

for [signature]
Roger W. Scearce
Brigadier General, USA
Deputy Director for Finance

Attachment:
As stated

Final Report
Reference

Draft Report
DEBT COLLECTION AND DEPOSIT CONTROLS
IN THE DEPARTMENT OF DEFENSE
PROJECT NO. 4FH-0054

- DFAS Response to Audit Background: The DOD IG draft audit report at Table 1 appears to erroneously portray "receivables" as "debts". It should be noted that all receivables are not considered bad and past due, however use of the term "debt" has a negative connotation. Receivables are a normal occurrence of many business areas of the Department, and most are properly liquidated. Thus, receivables should not be characterized unilaterally as debts. The proper focus, on which the audit report should concentrate throughout, is "delinquent receivables" rather than "outstanding receivables" (mistakenly identified as "debt"). — Table 1 revised

- Recommendation A.1: We recommend that the Director, Defense Finance and Accounting Service establish specific policy on reconciling contractor debts managed by the Accounts Receivable Branch and the Debt Management Division at the Defense Finance and Accounting Service Columbus Center with accountable stations' records.

- DFAS Response: Concur. DFAS-HQ provided specific policy to the Director, Defense Finance and Accounting Service - Columbus Center (DFAS-CO), by letter dated September 26, 1995, concerning the reconciliation of contractor debts. DFAS-CO has developed and will now provide a Debt Portfolio Reconciliation Worksheet which will be sent by October 31, 1995, and quarterly thereafter to all accountable stations for reconciliation purposes. As noted in the DFAS comments to Finding A.2., DFAS-CO/FD is developing a Systems Change Request (SCR) to the Defense Debt Management System (DDMS) which will allow DFAS-CO/FD to retrieve data by the accountable station identification number for future reconciliation purposes.

  ESTIMATED COMPLETION DATE: October 1995

- Recommendation A.2: We recommend that the Director, Defense Finance and Accounting Service include all essential fields (such as the accountable station identification number) in the Defense Debt Management System that are needed for reconciling contractor debt information.

- DFAS Response: Concur. DFAS-CO/FD, by December 31, 1995, will develop and submit the necessary SCR for the DDMS to include all essential fields to enable DFAS-CO to retrieve data by accountable station identification number.

  ESTIMATED COMPLETION DATE: September 1996

- Recommendation A.3: We recommend that the Director, Defense Finance and Accounting Service modify the Standard Accounting and Reporting System, in conjunction with the Assistant Secretary of the Navy (Financial Management and Comptroller), to properly report receivables.

- DFAS Response: Concur. An accounts receivable module, which will properly account for and report receivables, is in the planning stages. This was initiated as a part of the overall improvement to the accounting module to attain full Federal Managers Financial Integrity Act and Chief Financial Officers Act compliance. This work is being accomplished under contract, and a project completion date of August 1997 has been established. However, it is intended that the accounts receivable module be an early deliverable, and implementation to effect correction of accounts receivable accounting and reporting is expected to precede final project completion.

  ESTIMATED COMPLETION DATE: August 1997

- Recommendation A.4: We recommend that the Director, Defense Finance and Accounting Service identify all systems that do not account for receivables due from contractors and instruct the affected accountable stations to develop alternative methods of reporting receivables.

- DFAS Response: Concur. DFAS Centers have reviewed their current operational systems and identified where deficiencies in reporting contractor refund receivable debts exist. DFAS-HQ has provided guidance on May 12, 1995, regarding accounting for contractor debts on the basis of demands for payment or, when otherwise necessary, the use of the DDMS reported amounts as an alternative support for amounts of contractor debts included in accounting reports. Action has been taken by the Centers to include all contractor debts in systems where the accounting capability exists or use other alternate accounting records. New accounting capability will not be implemented in systems not intended for retention.

  ESTIMATED COMPLETION DATE: Completed.

- Recommendation B.1.a: We recommend that the Director, Defense Finance and Accounting Service incorporate guidance into the DoD Financial Management Regulation, Volume 10, chapter 18, "Contract Debt Collection," to require the Defense Finance and Accounting Service Columbus Center to pursue collections in accordance with time limitations specified in title 28 and title 31 of the United States code.

- DFAS Response: Concur. Title 28 and title 31 of the United States Code will be reviewed and instructions will be provided to DFAS-CO to insure that collections are made in accordance with the limitations specified in these titles. Appropriate guidance for Titles 28 and 31 will be incorporated in the initial DoD Financial Management Regulation, Volume 10, Chapter 18.

  ESTIMATED COMPLETION DATE: December 1995

- Recommendation B.1.b(1): We recommend that the Director, Defense Finance and Accounting Service update the Defense Debt Management System to produce standard demand letters and statements of account for all contractor debts.

- DFAS Response: Partially concur. DFAS-CO/FD, Debt Management Division, does not issue a standard demand letter for contractor debt because they are issued on a case-by-case basis, with the data in each letter being different. However, SCRs are currently being programmed by DFAS- DE to redesign the contractor billing statements and generate them systematically thus eliminating the current manual process.

  ESTIMATED COMPLETION DATE: June 1996

- Recommendation B.1.b(2): We recommend that the Director, Defense Finance and Accounting Service update the Defense Debt Management System to produce exception reports on each problem category.

- DFAS Response: Concur. DFAS-CO is working with DFAS-DE (lead Center) to design reports that will assist the former in performing its job. These reports also are used by DFAS-CO in providing assistance to the Services and the Defense Logistics Agency in the contractor debt area.

  ESTIMATED COMPLETION DATE: June 1996

- Recommendation B.1.b(3): We recommend that the Director, Defense Finance and Accounting Service update the Defense Debt Management System to track debts that have exceeded the six-year statute of limitations but are available for administrative offset through the 10-year statute of limitations period.

- DFAS Response: Concur. On July 27, 1995, DFAS-CO began using a new report, Inventory of Debts with Expired Statute of Limitations Date, to track debts that have exceeded the six-year statute of limitations. Even though the six-year statute of limitations has expired on these debts, they are available for administrative offset through the 10-year statute of limitation period.

  ESTIMATED COMPLETION DATE: Completed.

- Recommendation B.1.c: We recommend that the Director, Defense Finance and Accounting Service notify accountable stations to write off debts that exceed the six-year statute of limitations.

- DFAS Response: Concur. Since November 1993, DFAS-CO/FD had procedures in place to notify the accountable stations to write off debts that exceed the six-year statute of limitations. A new report, started on July 27, 1995, (cited in response to recommendation B.1.b.) has enhanced this process. Furthermore, DFAS-CO/FD provides this information to the procurement contracting office and administrative contracting office.

  ESTIMATED COMPLETION DATE: Completed.

- Recommendation B.2.a: We recommend that the Chief of the Debt Management Division, Defense Finance and Accounting Service Columbus Center establish and monitor performance standards for each critical collection technique. Critical techniques should include transferring debts to collection agencies and to the Department of Justice, as well as adding contractors' names to the List of Contractors Indebted to the United States.

- DFAS Response: Concur. Since July 1994, the Chief, Debt Management Division (DFAS-CO/FD), has used a monthly report, Report on Contracts Receivables, to monitor workload data. This report is broken down by staff accountant which allows the Division Chief to review the work of each individual. DFAS-CO/FD continually reviews performance standards for each critical technique and where necessary establishes new standards as required. Furthermore, DFAS-CO/FD also advises DFAS Indianapolis of the notification to write off debts, because they maintain and publish the List of Contractors Indebted to the United States Government.

  ESTIMATED COMPLETION DATE: Completed.

- Recommendation B.2.b: We recommend that the Chief of the Debt Management Division, Defense Finance and Accounting Service Columbus Center develop procedures to identify debts approaching the six-year statute of limitations and ensure that all appropriate collection techniques are used to collect those debts.

- DFAS Response: Concur. On July 27, 1995, DFAS-CO implemented new procedures and started using the report as noted in response to recommendation B.1.b(3) to identify debts approaching the statute of limitations timeframe. These desk procedures are aggressively followed by DFAS-CO/FD in pursuing the collection of debts. In addition, the Chief of the Debt Management Division (DFAS-CO/FD), uses this report as a management tool to track the collection process by each individual on the DFAS-CO/FD staff. DFAS-CO/FD also notifies DFAS Indianapolis of the notification to write off debts, because they maintain and publish the List of Contractors Indebted to the United States Government.

  ESTIMATED COMPLETION DATE: Completed.

- Recommendation B.2.c: We recommend that the Chief of the Debt Management Division, Defense Finance and Accounting Service Columbus Center implement procedures to notify accountable stations to write off debts for which the six-year statute of limitations has expired.

- DFAS Response: Concur. DFAS-CO implemented procedures on July 27, 1995, to notify the accountable stations to write-off debts for which the six-year statute of limitations has expired as well as any disposition of a debt which includes payment in full and cancellation of a debt. The report and process cited in response to recommendation B.1.b. applies.

  ESTIMATED COMPLETION DATE: Completed.

- Recommendation B.2.d: We recommend that the Chief of the Debt Management Division, Defense Finance and Accounting Service Columbus Center monitor inputs to the Defense Debt Management System to ensure that all contractor debt transactions and status changes are accurate and timely.

- DFAS Response: Concur. The key to updating collections and status changes in the DDMS for contractor debt is contingent upon the system to accurately calculating interest, generating acceptable demand letters and billing statements. SCRs, to achieve these requirements, are currently in the programming stages which when complete will allow collections to update accurately and status changes to be monitored for accuracy.

  ESTIMATED COMPLETION DATE: December 1995

- Recommendation C.1: We recommend that the Chief of the Accounts Receivable Branch, Defense Finance and Accounting Service Columbus Center enforce procedures requiring amounts collected to be applied to interest before principal, and change the quality review checklist to evaluate how the staff applies the amounts collected.

- DFAS Response: Concur. The Chief, Accounts Receivable Branch, DFAS-CO will enforce procedures requiring amounts collected to be applied to interest before principal. The Accounts Receivable Desk Procedure 901, Module 11, addresses this issue. DFAS-CO will train the accounts receivable accounting technicians on the correct procedures for initiation of an offset. The Accounts Receivable Quality Review Checklist will be updated to reflect correct procedures.

  ESTIMATED COMPLETION DATE: December 1995

- Recommendation C.2: We recommend that the Chief of the Accounts Receivable Branch, Defense Finance and Accounting Service Columbus Center pursue collection on debts for which the uncollected accrued interest exceeds $50 and collections were made by offsets.

- DFAS Response: Concur. As stated in our reply to Recommendation C.1, the Chief of the Accounts Receivable Branch, DFAS-CO will enforce procedures requiring amounts collected to be applied to interest before principal. Accounts receivable training on the correct procedures for initiating an offset will eliminate the improper posting of partial collections. Furthermore, DFAS-CO will investigate the legality of pursuing collection of the $561,000 identified as a result of DFAS-CO not following correct procedures. If pursuit is determined to be legal and amounts material, collection action will be initiated.

  ESTIMATED COMPLETION DATE: December 1995

- Recommendation C.3.a: We recommend that the Chief of the Accounts Receivable Branch, Defense Finance and Accounting Service Columbus Center implement procedures to assess interest until the date a check is issued when calculating interest on debts collected by offsets.

- DFAS Response: Concur. The Chief of the Accounts Receivable Branch, DFAS-CO will implement procedures to use the payment due date as the collection date for computing interest when performing salary offset. Interim guidance will be issued to effect this change and the Accounts Receivable Desk Procedures will be revised accordingly.

  ESTIMATED COMPLETION DATE: December 1995

- Recommendation C.3.b: We recommend that the Chief of the Accounts Receivable Branch, Defense Finance and Accounting Service Columbus Center, implement procedures to record credit memorandums upon receipt, and issue demand letters within five days of receipt.

- DFAS Response: Concur. The Chief of the Accounts Receivable Branch, DFAS-CO will implement procedures by establishing a log to record the receipt of all credit memoranda. DFAS-CO will revise current procedures to require issuance of a demand letter within five work days of receipt of a credit memorandum that is not accompanied by a check. Interim guidance will be issued to effect this change.

  ESTIMATED COMPLETION DATE: December 1995

- Recommendation C.4: We recommend that the Chief of the Accounts Receivable Branch, Defense Finance and Accounting Service Columbus Center develop a system to monitor debt collection and validate all data input to the Demand Letter Tracking System.

- DFAS Response: Concur. DFAS-CO is investigating the feasibility of updating the Accounts Receivable Demand Letter Tracking System to reflect changing needs. DFAS-CO also is researching the feasibility of using the Mechanization of Contract Administration System on-line functions to monitor debt collection.

  ESTIMATED COMPLETION DATE: December 1995

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- Recommendation D.1: We recommend that the Director, Defense Finance and Accounting Service develop and implement a plan for validating debts before transferring the debts from the active Army payroll system. This plan should include linking the Defense Debt Management System to the payroll and personnel system; pursuing only those debts that exceed a dollar threshold; grouping debts by dollar value in order to focus on high-dollar debts; and sorting debts by reason for the debt in order to evaluate them as a group rather than individually.

- DFAS Response: Concur.

A. Linking the DDMS to payroll and personnel systems: Currently interfaces exist between the pay systems and DDMS; however, the validation effort is being accomplished in the Debt and Claims Management Function because necessary upgrades to interfaces between the Army personnel and DFAS pay systems are not yet completed resulting in numerous invalid debts being passed to DDMS. We believe upon completion of the interfaces between the pay and personnel systems the majority of invalid debts will be avoided and thus the validation effort would no longer be required.

ESTIMATED COMPLETION DATE: September 1997

B. Pursuing only those debts that exceed a dollar threshold: DDMS has thresholds established to pursue only those debts deemed cost effective. Management will review these thresholds annually; however, current review has been held in abeyance until the completion of the Commercial Activities Study in the Debt and Claims Management Function.

ESTIMATED COMPLETION DATE: October 1996

C. Grouping debts by dollar value in order to focus on high-dollar debts: Debts are currently validated based on age and dollar value.

ESTIMATED COMPLETION DATE: Completed

D. Sorting debts by reason for the debt in order to evaluate them as a group rather than individually: Debts are validated by debtor rather than by type of debt so that we adhere to current individual collection standards. However, the DFAS Debt Avoidance Project does look at debts by debt reason and is taking aggressive action within the DoD to determine the root cause of debts in an effort to preclude debts from occurring.

ESTIMATED COMPLETION DATE: Completed.

- Recommendation D.2.a: We recommend that the Director, Defense Finance and Accounting Service make systems changes in the Defense Debt Management System to continue to assess interest and penalty charges on debts transferred to collection agencies and debts referred to the Internal Revenue Service for offset of income tax refunds.

- DFAS Response: Partially concur.

A. Collection Agencies: For those debts referred to a collection agency, DDMS prompts for interest and penalties are turned off at the time of referral because:

1. The collection agencies assess the charges.

2. Reconciliation of DDMS to the collection agency system would be impossible. Collection agencies collect and adjust amounts due continuously during the month, but only report collections to DFAS at the end of each month, at which time we are able to make adjustments to debtor records. Also, most debts referred to collection agencies are also referred to the Internal Revenue Service (IRS). Because the collection agency charges its own collection fee on top of the amount we refer, the collection agency is pursuing a different amount than the IRS or DFAS. The resulting adjustments in the event of a collection present an enormous challenge to reconciliation.

3. As stated in the audit report, a system change release to DDMS was approved so that interest will accrue retroactively upon return of the account from the collection agency. We will also amend the system to retroactively assess penalty charges.

ESTIMATED COMPLETION DATE: December 1996

B. Internal Revenue Service. Referrals to the IRS differ radically from referrals to collection agencies. Referrals to collection agencies consist of "active" debts currently being pursued for collection. Referrals to the IRS consist of approximately 65% "active" debts, and 35% "closed" debts on which collection action was terminated due to small amounts (less than $100), debtors could not be located, and other reasons required by the Federal Claims Collection Standards. However, IRS will offset any refund for a debt over $25 if the debtor files a tax return, and a refund becomes payable. Regardless of the amount of the debt, offset occurs on only 38% of debts referred by DoD.

1. Active debts referred to the IRS include all charges assessed up until the time of referral. Debts may be referred only once a year. After referral, IRS regulations

prohibit an increase to the amount referred. Therefore, on a weekly basis as the IRS reports offsets to DFAS, we will assess interest and penalties retroactively on active debt balances the same way we will assess debts referred to collection agencies.

2. Closed debts referred to the IRS were terminated by regulation, but in most cases, referral to the IRS is allowed. By the time these closed debts reach the once-a-year IRS referral, they have been subjected to several demand letters, referred to the credit bureau network, and referred to at least one collection agency. When all these actions fail to effect collection, little can be done but to write off the debt. In the majority of cases, accrual of interest and penalties on closed debts referred to the IRS would have to be written off at a future date. Again, the result would be false reporting of accounts receivable which would be written off at a future date.

ESTIMATED COMPLETION DATE: December 1996

- Recommendation D.2.b: We recommend that the Director, Defense Finance and Accounting Service make systems changes in the Defense Debt Management System to use the appropriate interest rates for debtors with more than one debt.

- DFAS Response: Concur. As noted in the audit report, corrective action was taken in November 1994 by approval of a SCR. The SCR ensures that a debtor with a debt entered in one calendar year, and one or more debts entered in different calendar years, will be assessed interest on each debt based on the rate in effect for the year the debt was established. The Department of Treasury establishes the rate for each year on January 1. The current interest rate is 3% this has not changed since January 1, 1994. The impact of this change is minimal since the number of debtors having debts entered in different calendar years is insignificant, as shown below:

DFAS Center	Debtors	Debtors with Multiple debts	Percent
Cleveland	45,243	97	00.2
Denver	47,022	2,057	04.3
Indianapolis	166,184	3,032	01.8
Kansas City	20,076	175	00.8

ESTIMATED COMPLETION DATE: December 1996

- Recommendation D.3: We recommend that the Director, Defense Finance and Accounting Service fully automate the process of posting all collections to the correct appropriation.

- DFAS Response: Concur. The DDMS produces a daily report, "Voucher Summary for Collections", which summarizes collections by appropriations, by debtor, by reject, and an overall summary. This report is used for updating respective Center level accounting and reporting systems. We have contacted the development office for the interim migratory accounting system to establish an interface which will programmatically process the posting of collections to correct appropriations in the new Department of Defense accounting system.

  ESTIMATED COMPLETION DATE: September 1997

- Potential Monetary Benefits C.1 - C.3:

  Description of Benefit - Compliance with regulations and laws. Establish procedures to properly apply collections and pursue debts, and improves the accuracy of interest calculations and improves collections.

  Amount and Type of Benefit - Applying collections to interest before principal would have resulted in $561,000 put to better use by depositing in the U.S. Treasury.

- DFAS Response: As previously identified, we will investigate the legality of collecting the $561,000 and if procedurally correct we plan to agree with the Potential Monetary Benefit to the U.S. Treasury account.

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INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Debt Collection and Deposit Controls in the Department of Defense

B. DATE Report Downloaded From the Internet: 12/10/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): **OAIG-AUD (ATTN: AFTS Audit Suggestions)**
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D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ **Preparation Date 12/10/99**

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