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BEFORE THE

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ON

FINANCIAL MANAGEMENT WITHIN THE DEPARTMENT OF DEFENSE

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Statement of the Honorable William J. Lynn
Under Secretary of Defense (Comptroller)/Chief Financial Officer
Department of Defense
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Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to discuss financial management within the Department of Defense. Let me say at the outset that Secretary Cohen is committed to financial management reform within the Department of Defense. Moreover, as the Chief Financial Officer for the Department of Defense, this is one of my top priorities. Reflecting the resolve of the Department's senior leadership, we have undertaken the most comprehensive reform of financial management systems and practices in the Department's history.

I am here today for two important reasons. First, I want to assure this Subcommittee and the American people that the Department of Defense is a good steward of the resources entrusted to it. Second, I am concerned that the Congress and the American people may not be aware of the comprehensive financial management reforms underway within the Department. Thus, I appreciate this opportunity to highlight for this Subcommittee the major initiatives underway to promote improved financial management throughout the Department while maintaining our forces at the highest level of readiness and effectiveness.

SOUND FINANCIAL MANAGEMENT MATTERS

Sound financial management is important within the Department of Defense for three main reasons:

First, sound financial management practices provide cost visibility. Knowing how much we are paying for what we are buying provides decision-makers, both field commanders and senior managers, with timely and accurate cost information needed to sustain maximum effectiveness. Additionally, accurate cost information is important to the Department's ability to apply funds more precisely to modernization, training, and investments, and to assess performance and evaluate programs.

Second, sound financial management controls include safeguards to better ensure that funds are expended for their intended purposes. These controls identify what was purchased and the quantities purchased before payments are made. As such, adequate financial management controls discourage and prevent fraud, waste and abuse.

Third, dependable financial operations support our troops. Accurate and timely payments to the contractors and vendors with whom we do business better ensures goods and services will be available when and where we need them. Equally, or perhaps more important, it instills confidence in our soldiers, sailors, airmen, marines, and our civilian employees, that their financial entitlements, as well as those of their families, will not be neglected even though they may be thousands of miles from their home.

FINANCIAL MANAGEMENT REFORM HAS CONSTRAINTS

Financial management in the Department of Defense is a work-in-progress designed to fulfill the needs of its leaders, meet statutory requirements, maximize efficiency and minimize fraud. There have been notable successes, but progress is slow in some areas. It is impossible to reverse decades-old problems overnight and some reforms will require several years to implement.

In moving forward, the Department's financial management reform must accommodate three unavoidable constraints:

First, the Department cannot stop its financial operations while it fixes outdated business practices and flawed systems. Every day, the Department must manage payrolls, pay contractors, and produce financial reports. These daily operating requirements impose a strong practical constraint on our plans for improving systems and business practices. There is no other organization in the United States, perhaps in the world, that is as large and diverse as the Department of Defense. The Department manages over a trillion dollars in assets and maintains hundreds of bases in over 100 countries and territories throughout the world. We have over two million active duty and reserve component personnel as well as 700,000 civilian employees. The size of the three Military Departments of the Department of Defense--Army, Navy and Air Force--collectively dwarf the largest organizations in the private sector as well as all other federal agencies. The size and complexity of the Department makes changing the Department's financial management a significant challenge. However, it is a top priority, and we have made enormous progress.

Second, lasting reform demands consensus and collaboration. Few solutions rest exclusively within the jurisdiction of the financial management community. The development of an infrastructure capable of providing more accurate and reliable financial management information and achieving auditable financial statements is a high priority of the Department. An infrastructure built around the integration and transfer of financial information between non-financial "feeder" systems and accounting systems (for example, property and inventory systems that feed information to accounting systems) is a Departmental goal and is necessary to enhance the sharing of information and to avoid redundant and sometimes conflicting data.

Third, legislation in the 1990's has changed the Federal Government's accounting requirements. More recent legislation requires audited financial statements from federal agencies. For the Department of Defense, this requires the Department to track financial data on items from their purchase to disposal in a more integrated process. No longer can we rely solely on separate systems monitoring separate categories. For example, if the Department purchased a patrol boat in 1975, we now must be able to identify when the boat was purchased; determine how much was paid for it and produce the original receipt;

track where it is being used; if it has been offered for resale through the surplus property program, and, if so, when it was sold and for how much. And, we must have supporting paperwork for all these transactions, sometimes up to 18 months after disposal or sale. Obtaining a clean financial opinion requires an integrated and complete audit trail for millions of DoD items, many purchased decades ago.

The Department's current leadership is committed to making financial management reform a hallmark of its stewardship. Progress to date has been substantial, and the Department is determined to successfully complete this historically significant reform effort.

PROGRESS ON FINANCIAL MANAGEMENT REFORM

Our pivotal agent for accomplishing needed financial management reforms is the Defense Finance and Accounting Service (DFAS). The DFAS has made remarkable progress since its formation in 1991. As the largest finance and accounting firm in the world, the DFAS now processes a monthly average of nearly 10 million payments to DoD personnel; 1.2 million commercial invoices; 600,000 travel vouchers/settlements; 500,000 savings bond issuances; and 122,000 transportation bills of lading, with monthly disbursements averaging $24 billion. Given the magnitude of these operations even a small percentage of errors can result in large numbers.

When the Military Services turned over their finance and accounting operations to the DFAS in 1991, they also turned over numerous problems that they had been dealing with, some allegedly since the formation of the Continental Army. In response to the many problems, we have undertaken the most comprehensive reform of financial management systems and practices in the Department's history. Financial operations have been consolidated, the number of noncompliant finance and accounting systems have been significantly reduced, standard systems have been designated, ambitious deployment schedules have been established and implemented, and business practices have been reengineered to adopt best practices from both the private and government sectors. Let me discuss some of these accomplishments.

Consolidation of Financial Management Operations

The DFAS is consolidating over 330 financial management field sites scattered throughout the world into five centers and 20 operating locations, saving $120 million annually. Through these consolidations, the Department is able to eliminate redundancy and unnecessary management layers, facilitate standardization, improve the accuracy and timeliness of our financial operations, enhance service to customers, increase productivity, and provide better financial management support to the Department's decision-makers.

Consolidation of Finance and Accounting Systems

To remedy the problem of numerous, incompatible and noncompliant finance and accounting systems, the DFAS has embarked on a major streamlining effort of our financial systems. As of October 1998, 109 finance and accounting systems were operating--down from 324 systems in 1991, a 66 percent reduction. Finance systems have been reduced from 127 to 18, with a goal of dropping to just 9 by 2003. Accounting systems are down from 197 to 91, with a goal of 23 or fewer by 2003. By the year 2003, the Department expects to pay and account for its over 2 million service members, 2.2 million retirees and annuitants, over 600,000 civilian employees, and 200,000 contracts using just 32 finance and accounting systems--a 90 percent reduction.

These system objectives compare very favorably with the private sector. A recent study of the number of finance and accounting systems used by the Top 10 Fortune 500 companies showed that, on average, each of these companies has approximately 147 finance and accounting systems--compared to the 32 planned for the Department. Further, not one of these companies had ongoing initiatives on the same scale or magnitude as the Department of Defense.

The objective of the Department's initiative, however, is not simply to reduce the number of the financial management systems. The consolidation, standardization, and modernization of the Department's financial management systems is meant to enable the Department to eliminate its outdated noncompliant financial management systems and replace them with financial management systems that provide more accurate, timely, and meaningful financial management information to decision-makers. These efforts also are producing other benefits, such as improved processes and significant cost savings.

Efficiencies

As a result of a number of initiatives, the DFAS has significantly reduced its personnel requirements and its operational costs, creating more efficient and economical operations without a degradation in services provided.

Between FY 1993 and FY 1999, personnel levels that the DFAS inherited from the DoD Components should decrease by 38 percent, from 31,000 personnel in FY 1993, to approximately 19,000 personnel by the end of FY 1999. By FY 2003, it is projected that the DFAS will reduce its personnel levels by another 3,000 personnel, to 16,000. Thus, over the ten-year period from FY 1993 to FY 2003, the DFAS will have achieved a 48 percent reduction in its personnel levels.

In terms of constant dollars, DFAS' cost of operations has decreased from approximately $1.8 billion in FY 1995 to a projected $1.6 billion in FY 1999--almost a 13 percent reduction. When compared to the operations of the Department as a whole, the DFAS budget equates to approximately six-tenths of one percent of the Department's budget. This is about one-half the industry average of 1.2 percent. These savings in operating costs are being offset, in part, by the need to invest in new systems and technology in order to meet today's new requirements and challenges.

Outsourcing

Competition within the government and with the private sector also has been utilized to improve financial services and save money. Changes implemented by the DFAS, as a result of competition studies, have produced annual savings of $23 million through the streamlining of administration operations, facilities, logistics, and the consolidation of debt and claims management and vendor payments. Other reforms to the contractor payment and audit process have helped increase the accuracy rate of payments, expedited the settlement of overhead rates and the closeout of contracts, and are playing an instrumental role in the initiative to improve the procurement process, with a goal of becoming paperless early in the next century.

We also are using public-private competition (the A-76 process) to improve functions and reduce costs. Within the financial community, we have on-going A-76 studies in several critical areas, such as Defense Commissary Agency accounting, transportation accounting, depot maintenance accounting, and civilian and retiree/annuitant payroll.

To date, approximately one-third of the DFAS operations, measured in terms of costs, have been either outsourced, competed for outsourcing, or are in the process of an outsourcing competition.

Financial Management Policies

The Department is replacing approximately 70,000 pages of separate, and often conflicting, Defense organizational regulations with a single standard "Department of Defense Financial Management Regulation." To date, approximately 31,000 pages have been eliminated. In order to ensure the widest possible distribution of the policies contained in this regulation, the regulation has been made available on the Internet and on CD-ROM.

In addition to consolidating and eliminating duplicate and conflicting guidance, the Department also has promulgated more stringent and responsible guidance in a number of financial management areas. Such policies include, but are not limited to:
(1) requirements to establish obligations for unmatched disbursements, negative unliquidated obligations and in-transit disbursements; (2) the requirement to record obligations in the official accounting systems within 10 days of incurrence; (3) the establishment of DoD Component responsibilities and requirements for reconciling contract payments; (4) the requirement to review and validate obligations at least three times annually; (5) the requirement to cease payments should accounts go in the red;
(6) the requirement to implement the United States Government Standard General Ledger structure; (7) the requirement to prevalidate payments at levels below those required by statute; (8) the establishment of rules for and responsibilities of the DFAS and the DoD Components for the preparation of various financial reports; as well as other policies.

Internal Controls

To strengthen internal controls, the Department implements checks, balances, and approval requirements for transactions that affect resources. Internal controls minimize the Department's susceptibility to mismanagement within its finance and accounting operations. The Department strives to incorporate the appropriate levels of verification without requiring excessive resources or hampering the ability to complete the mission.

Over the past 12 months, we have taken significant actions to improve our internal controls, including:

- Enacting a 100 percent review of our vendor pay systems to determine who has access and at what levels, ensuring that the necessary separation of duties exists;

- Strengthening in-house reviews to detect improper alterations of receiving reports; and

- Enhancing fraud awareness and prevention training for vendor pay employees.

Operation Mongoose

Another internal control initiative is the creation of Operation Mongoose to detect and correct potential internal control weaknesses. This initiative uses the combined efforts of the DFAS, the Defense Manpower Data Center, and the Department of Defense Inspector General's Office, including the Defense Criminal Investigative Service, to develop fraud indicators that can be spotted by discrepancies among systems. This program collects and compares data throughout the Department, detects the presence of anomalies within the Department's systems and examines appropriate records to determine if applicable anomalies are a result of fraud. If fraud is found, the Department vigorously pursues criminal charges against those responsible for the fraud. The objective of Operation Mongoose is to establish a permanent structure to detect and prevent fraud by reducing the opportunity for the concealment of crimes and actively seeking it out, rather than waiting for it to surface by chance, be identified by informants, or be detected by random reviews. Operation Mongoose has identified and recovered $20 million in erroneous, duplicative, or fraudulent payments. Despite isolated occurrences, we are succeeding in closing the door on fraud.

Disbursements

A problem disbursement occurs when an expenditure has not been reconciled with official accounting records. DoD problem disbursements, once totaling $34.3 billion, have been reduced to $10.9 billion as of February 1999. Although the Department considers its problem disbursements a matter to be taken seriously, almost all such expenditures involved were proper and were made only after a Department official confirmed that the subject goods or services were received and that payment was in accordance with a valid contract. That notwithstanding, the Department has extensive efforts underway to improve its disbursement process.

Prevalidation, the process of matching a disbursement to an obligation before (rather than after) a payment is made, has helped to reduce problem disbursements. Thresholds for applying prevalidation have been established at each DFAS center. To assist in reducing problem disbursements, thresholds for applying prevalidation are being gradually lowered until all payments will be prevalidated.

In addition to prevalidation, the Department currently is implementing a system called the Defense Cash Accountability System (DCAS) that will automate the interservice disbursing process. When fully implemented, the disbursement voucher data will be collected electronically under one central system and distributed electronically to be available for posting to the accounting systems. The cycle time will be reduced from over 90 days to 2 days. The first phase of DCAS implementation began in March 1999 and DCAS is expected to be fully on-line by the end of 2000.

To assist in better understanding problem disbursements, attached are answers to frequently asked questions about problem disbursements.

Information Infrastructure

The DFAS is establishing a Corporate Information Infrastructure to support the use of common data elements for the collection, storage, and retrieval of finance and accounting data; support the use of common transactions; and support the movement of common transactions and data among systems. This reform is an ambitious effort to standardize and electronically share acquisition data between the acquisition and financial management communities. This effort will greatly improve the interactions between DoD procurement systems and the financial systems that process and account for the payments of the Department's acquisitions.

The DFAS also is working toward ensuring that all its systems are Year 2000 (Y2K) compliant. The overall goal has been to provide a coordinated effort that ensures no DoD financial management system is adversely affected by Year 2000 problems. Consolidation of the Department's finance and accounting systems has substantially reduced the cost of fixing the Y2K problem. The DFAS is on track to complete all Y2K-related programming for its finance and accounting systems, including the platforms, or hardware, on which these applications operate, and is expected to be fully Y2K compliant by May 31, 1999. The financial management community also is working diligently with the other functional communities to ensure incoming data streams are compliant as well.

Exchange of Financial Information

In addition to consolidating operations and reducing systems, the Department's financial management community has over 150 initiatives underway to improve and streamline financial management and improve the timeliness and accuracy of its accounting data. For example, the DFAS is promoting the paperless exchange of financial information through Electronic Document Management, Electronic Funds Transfer, and Electronic Data Interchange initiatives such as:

- Electronic Document Management World Wide Web applications. Electronic document access enables on–line, real–time access to documents needed to perform bill paying and accounting operations. This allows for contracts, government bills of lading, and payment vouchers to be stored in electronic file cabinets and shared between DFAS activities. Another application avoids unnecessary printing of reports by converting them into electronic format for on–line analysis, reconciliation, and reporting. Electronic data access technology also is being used to enhance the control and management of documents needed for bill paying operations, regardless of the format of the document.
- Electronic Funds Transfer (EFT). EFT is reducing the cost of disbursements. Over 98 percent of DoD civilian employees and military members paid by DoD have their pay directly deposited into their accounts. The direct deposit participation rate for travel payments is now over 90 percent. In 1998, 74 percent of the number of major DFAS contract payments, accounting for 89 percent of total contract dollars disbursed, were made by EFT. This percentage is expected to continue to increase.
- Electronic Data Interchange (EDI). The DFAS is using EDI to send remittance information directly to vendors and currently is working to receive and process EDI contracts and contract modifications into finance and accounting systems.

FUTURE PLANS FOR FINANCIAL MANAGEMENT REFORM

The 1998 Financial Report of the United States Government (formerly known as the Consolidated Financial Statements of the U.S. Government) was released on March 31, 1999. The Congress and the Administration initiated the development of this financial report in order to create an additional tool for policy-makers and to provide an additional source of financial information for the public. The publication of this second annual financial report represents one component of the Administration’s continuing efforts to improve the management and efficiency of the United States Government, and to provide the American public with information about their government’s assets, liabilities and operations.

Earlier in March 1999, the Department released its financial statement. In fact, the Department released eleven separate financial statements. These included separate financial statements for the Army General Funds, Army Working Capital Fund, Army Corps of Engineers Civil Works Program, Navy General Funds, Navy Working Capital Fund, Air Force General Funds, Air Force Working Capital Fund, Defense Logistics Agency Working Capital Fund, Defense Finance and Accounting Service Working Capital Fund, Military Retirement Trust Fund, as well as an overall statement for the Department as a whole. Of these eleven statements, the auditors said that only one--the Military

Retirement Trust Fund--was sufficient to earn a "clean" audit opinion symbolizing that the amounts reported meet acceptable auditing standards.

The results of these audited financial statements indicate that there is a need for further improvements in our financial management. To build on the progress to date, and to continue to improve DoD financial management, the Department must vigorously advance both a long-term and a short-term strategy.

Long-Term Strategy

Our long-term strategy recognizes that a lasting effective financial management reform solution requires a Defense-wide management information overhaul. This is necessary because our systems currently are not up to the task. Over the last few years, the Department streamlined its numerous incompatible finance and accounting systems by eliminating over 200 systems that did not comply with current accounting standards. More recently, the Department has been developing an architectural blueprint for Defense financial management reform and, in the fall of 1998, presented the first comprehensive "Financial Management Improvement Plan" for the Department. The plan touches on almost all aspects of accounting and finance within the Department. It includes, for the first time, an accounting and finance concept of operations that describes the manner in which the Department intends to carry out its accounting and finance operations in the future, and is a major step in meeting our financial management reform objectives. Our long-term strategy focuses on reengineering or replacing existing systems with systems that are compliant with new federal accounting standards and that will interface well with the Department's other financial and non-financial systems. Our objective is to transform our accounting systems and the many feeder systems that support them, with FY 2003 as our target date for completing the overhaul of our accounting systems.

Achieving accurate and acceptable financial management reports requires enormous efforts from all functional communities within the Department--not just the financial management community. Only 20 percent of the data needed for sound financial information originates in systems under the control of the financial management community. The remainder originates in non-financial feeder systems--most notably logistics, acquisition, personnel, and medical systems. Therefore, much of our effort must, and does, involve working with those other communities to upgrade their systems and to improve their interfaces with the Department's financial management systems. While this cooperative endeavor is well underway, much additional effort will be required to successfully complete the undertaking.

The "Financial Management Improvement Plan" that was submitted to the Congress last fall was only the first step. The Department intends to expand and refine the plan and continue to update it on an annual basis. The plan was developed to do more than just meet various reporting requirements. The Department fully intends to use the plan to guide the transition and evolution of its financial management improvement initiatives.

Short-Term Strategy

While system changes are the long-term solution, there is much that we can, and must, do between now and FY 2003. Our short-term strategy recognizes that. We are developing interim methodologies that will allow the Department to achieve a satisfactory level of compliance in its major accounts and attain more favorable audit opinions on the Department's financial statements.

To succeed in this effort, the Department has fully engaged in a partnership with the Office of Management and Budget (OMB), the General Accounting Office (GAO) and the Office of the Inspector General (OIG) for the Department of Defense. We are working, on a collaborative basis, to identify major obstacles that must be overcome for the Department to be successful; developing interim solutions to the Department's systemic problems; and applying accounting and auditing standards in ways that make sense for the unique requirements of the Department of Defense.

Major deficiencies that prevented the Department from receiving a favorable audit opinion in the past have been identified. Alternative methodologies to deal with these deficiencies have been developed and coordinated with the OMB, GAO, and OIG. To implement these alternatives, plans detailing short-term strategies for solutions to each of the deficiencies have been developed along with the identification of responsible parties and milestone dates needed to support accomplishment of the Department's goal. To ensure we stay on track, applicable organizations within the Department are being asked to report on their progress, and, as appropriate, update these plans on a regular basis.

The Department has hired contractors (CPA firms) to assist in its efforts. The Department also is developing more detailed policy guidance to assist the various DoD Components in identifying and reporting additional information not previously required. Further, the Department is examining various internal processes to identify gaps or deficiencies in its current information flow processes and developing interim approaches to overcome those deficiencies pending the modification of existing systems and/or the introduction of new systems.

For example, one short-term strategy involves reporting the value of property, plant, and equipment. The GAO estimates that the value of the property owned by the Department is four times the value of property and equipment owned by the rest of the Federal Government combined. Stated differently, the Department of Defense has approximately 100 times more property than the average federal agency. As a result of new government-wide standards that became effective in FY 1998, the Department now is being asked to report a value for this general property, plant, and equipment that is based on the initial purchase price, and record depreciation for the asset since the initial acquisition date. The problem is that much of this property was acquired decades ago, some over a century ago, and many of the original documents needed to substantiate the initial acquisition cost of these properties no longer are available. Therefore, we are working with the auditors, and have hired private accounting firms, to develop an acceptable method for establishing a value where adequate documentation does not exist.

Another action involves quantifying the Department's long-term future liabilities, such as projected future costs of health care for current and future Department of Defense military retirees, projected future environmental cleanup costs of Defense properties, and projected future disposal costs of weapons and hazardous materials. These are liabilities that the Department may not be required to pay until 10, 20, or 40 or more years in the future, and that, until recently, the Department was not required to report. Clearly, it will be a difficult task to identify and report the amount of these long-term future liabilities. But, it is the right thing to do, and we intend to do it.

FINANCIAL MANAGEMENT TRAINING AND PROFESSIONAL DEVELOPMENT

The challenges that I have discussed with respect to improving our financial management processes and systems are enormous. Moreover, these challenges coincide with a period of considerable turbulence, as we face continued downsizing and turnover. To respond to these challenges, the Department is placing an even greater focus on training and professional development.

Today's financial management workforce is well qualified and highly motivated, but tomorrow's must be even better. We need to prepare the next generation of financial management leaders. To that end, we are developing professional standards for our financial managers. Such standards include recommended education and training requirements, participation in continuing professional education programs, and perhaps some form of professional certification. Our goal is to ensure that as individuals are promoted, they attain and exceed desired core competencies in financial management.

The pursuit of desired professional standards would help better ensure that we can continue to produce high quality financial managers. It also would demonstrate quality in an objective and measurable manner that would be visible both to the Department's leaders, the Congress and to the American public. In short, greater attention to professional training and development is good, not only for the Department's financial management community, but for the Department as a whole.

CLOSING

From the President on down, the Administration has demonstrated that it recognizes the importance of sound financial management practices. Within the Department of Defense, we recognize the extent and severity of financial management deficiencies and the need to address these deficiencies. This requires a concerted improvement effort across the entire Department, not just the financial community. Given where we were in 1991, and the obstacles we faced, the progress we have made so far has been extraordinary. Notwithstanding the formidable nature of our remaining challenges, we have set a high, but achievable, objective for ourselves, and we will continue our efforts to correct weaknesses and improve the reliability of our financial information. We look forward to continuing to work with this Congress to achieve the goals and objectives associated with financial management reform efforts.

PROBLEM DISBURSEMENTS
FREQUENTLY ASKED QUESTIONS (AND ANSWERS)

Problem Disbursements

QUESTION: What is a problem disbursement?

ANSWER: The Department considers negative unliquidated obligations and unmatched disbursements to be problem disbursements.

- To better understand problem disbursements, it is helpful to provide a brief summary of the Department's disbursement process. The Department's policies provide for an obligation to be established at the time a contract is signed or a good or service is ordered. When the good or service is received, the applicable organization verifies the receipt of the good or service (usually via a receiving report). When the vendor or contractor submits a bill, the paying office is required to verify that an obligation exists (this process is called prevalidation) and that the goods or services have been received (by obtaining a copy of the receiving report), prior to paying the bill. When the paying office is the same office (co-located) as the accounting office, the payment is matched to the applicable obligation at the time of payment.

- However, if the paying office is different than the accounting office, after the above steps have been completed and the payment has been made, the paying office must forward the payment information to the accounting office where the payment is matched to the related obligation. Prior to the time that the payment information is received by the accounting office, the payment is said to be in-transit, or an in-transit disbursement. Once the payment information has been received and matched to the applicable obligation, the payment is called a matched disbursement. If the payment information is received and matched to a specific obligation but the amount of the payment is more or less than the amount of the obligation, a positive or negative unliquidated obligation is said to exist and an adjustment to the obligation is required to bring the obligation in line with the payment. However, if the payment information received by the accounting station is incomplete, inaccurate or otherwise not in sufficient detail to allow the accounting office to clearly identify the specific obligation involved this is called an unmatched disbursement. (This could be caused by a simply keypunch error or by various systems problems.) The Department considers negative unliquidated obligations and unmatched disbursements to be problem disbursements.

QUESTION: Why does the Department have problem disbursements?

ANSWER: The primary reason that problem disbursements occur is because the applicable accounting office and the applicable disbursing office are not co-located and their automated systems cannot effectively communicate with each other. Therefore, the disbursing office must forward the payment information to the applicable accounting office where, in most instances, the disbursement is matched to the obligation. However, three different scenarios can occur when an accounting office attempts to match payment information received from a disbursing office. The payment information could match completely the obligation recorded in the accounting records. If so, the payment is matched and no further action is required. The payment information could match the obligation recorded in the accounting records, but the amount could be more or less than the amount of the obligation. If so, an adjustment is required to align the obligation with the actual costs. However, the payment information could fail to match any obligation recorded in the accounting records. If so, the payment is said to be an unmatched disbursement and further efforts are required.

QUESTION: What are the Department's policies regarding problem disbursements?

ANSWER: When a problem disbursement occurs, the Department's policies require manual research to gather the information needed to resolve the problem. If after appropriate research efforts, a problem disbursement is not resolved within six months, the Department's policies require that a new obligation be established for the payment. This requirement better ensures that payments are not made without a corresponding obligation.

QUESTION: What is the Department doing to eliminate problem disbursements?

ANSWER: Significant progress has been made in reducing the amount of problem disbursements. This progress has been achieved through manual intervention and research. However, the primary cause of problem disbursements is that automated systems used by the Department's applicable accounting and disbursing offices cannot effectively communicate with each other. The solution, therefore, is to better interface the applicable systems involved. That is what the Department is doing.

- The Department is pursuing a contract database that would be shared by two future standard systems--the Standard Procurement System and the Defense Procurement Payment System. The shared database would be the single source for all contract management, payment, and accounting data for contracts.

- For other than contracts, the Department is pursuing a similar approach whereby a standard disbursement system would be used throughout the Department and would be properly interfaced with the Department's accounting systems. Specifically, the

Department has an extensive business process reengineering effort under way to improve its disbursement process and its ability to match disbursements to obligations in a more timely manner.

- The Department anticipates that its business process reengineering effort, the implementation of the two new systems (the Standard Procurement System and the Defense Procurement Payment System) and its prevalidation initiative will be the catalysts for a continuation of a steady reduction in problem disbursements.

Negative Unliquidated Obligations

QUESTION: What is a negative unliquidated obligation?

ANSWER: A negative unliquidated obligation (often called a "NULO") is a payment (disbursement) that exceeds the amount of the original obligation. At the time a contract is let or a purchase order is entered into, an estimate of the cost is recorded as an obligation. Upon delivery of the good or service the actual amount of the payment may be more or less than the initial estimate (obligation). A positive unliquidated obligation occurs if the actual payment is less than the initial estimate (obligation) and a negative unliquidated obligation occurs if the actual payment is more than the original estimated cost (obligation).

QUESTION: Why does the Department have negative unliquidated obligations?

ANSWER: Negative unliquidated obligations occur because the organization ordering the good or service does not have perfect knowledge of the final price. This is similar to a car repair bill that might be more or less than the mechanic's initial estimate of repair costs. At the time you agree to allow the work to be performed, you have a reasonable estimate of the repair costs, but you do not know what will be the precise amount of the actual bill.

QUESTION: What are the Department's policies regarding negative unliquidated obligations?

ANSWER: When a final disbursement against a contract equals the original estimate of the costs (obligation) no further action is required. However, if the final payment (disbursement) is more or less than the original estimate (obligation), then an adjustment is necessary to bring the obligation and disbursement into agreement. If the payment (disbursement) is less than the original estimate (obligation), the Department's policies require that the obligation be reduced to the amount of the actual payment. This "frees up" the deobligated amounts to be used for other purposes. If the payment (disbursement) is more than the original estimate, the Department's policies require that the obligation be increased to the amount of the actual payment. This adjustment reduces the amount of funds that otherwise would be available for other purposes.

QUESTION: What is the Department doing to eliminate negative unliquidated obligations?

ANSWER: As indicated above, negative unliquidated obligations occur because the organization ordering the good or service does not have perfect knowledge of the final price. Despite its best efforts, it is unlikely that the Department will know the final price of every item at the time it orders the applicable good or service. While the Department considers negative unliquidated obligations to be a matter to be taken seriously and addressed, there is no basis for concluding that the disbursements involved are erroneous payments or overpayments. Each disbursement is made only after a Department official confirms receipt of the subject goods or services and ensures that the payment is made in accordance with a valid contract.

Unmatched Disbursements

QUESTION: What is an unmatched disbursement?

ANSWER: An unmatched disbursement is a payment that cannot be matched to a specific obligation.

QUESTION: Why does the Department have unmatched disbursements?

ANSWER: Unmatched disbursements occur because the applicable accounting office and the applicable disbursing office are not co-located and their automated systems cannot effectively communicate with each other. As a result, even though a disbursing office verifies (prevalidates) the existence of an obligation and determines that the ordered goods or services have been received before paying the bill, the disbursing office cannot match the payment to the applicable obligation because the obligation is maintained at the applicable accounting office. Therefore, the disbursing office must forward the payment information to the applicable accounting office where, in most instances, the disbursement is matched to the obligation.

The primary reason that a payment may not be matched to an obligation by the applicable accounting office once the payment information arrives at the accounting station is that the information received by the accounting station is incomplete, inaccurate or otherwise not in sufficient detail to allow the accounting office to clearly identify the specific obligation involved. This could be caused by a simply keypunch error or by various systems problems.

QUESTION: What are the Department's policies regarding unmatched disbursements?

ANSWER: When an accounting office is unable to match the payment information to a specific obligation, the Department's policies require manual research to gather the information needed to match the payment to its specific obligation. This might be accomplished, for example, by obtaining a paper copy of the supporting documentation. However, if despite appropriate research efforts, a payment is not matched to a specific obligation within six months, the Department's policies require that a new obligation be established for the payment. This requirement better ensures that payments are not made without a corresponding obligation.

QUESTION: What is the Department doing to eliminate unmatched disbursements?

ANSWER: The Department is reengineering its systems to enhance their integration. This is expected to eliminate most of the existing problems that cause unmatched disbursements.

In-Transit Disbursements

QUESTION: What is an in-transit disbursement?

ANSWER: In-transit disbursements are those disbursements for which payment information has not yet been received by the accounting office. When the paying office is different than the accounting office, once the requested payment has been prevalidated, the presence of a validated receiving report has been confirmed, and the payment has been made, the paying office must forward the payment information to the accounting office so that the payment can be matched to the related obligation. Prior to the time that the accounting office receives the payment information, the payment is said to be in-transit, or to be an in-transit disbursement.

QUESTION: Why does the Department have in-transit disbursements?

ANSWER: In-transit disbursements occur only when the payment office is different than the accounting office. Although in-transit disbursements are deducted from the applicable cash balance when the disbursing office makes a payment, only the accounting office, and not the disbursing office, can match a payment to an obligation. Accordingly, the payment information must be forwarded to the appropriate accounting office to allow the disbursement to be matched with the applicable obligation by the accounting office.

QUESTION: What are the Department's policies regarding in-transit disbursements?

ANSWER: The Department's policies provide for disbursements to be recorded timely, and to be matched to applicable obligations. Accordingly, the Department's policies require payment information to be forwarded to the appropriate accounting office to be matched to the related obligation. If the accounting office does not receive the required payment information, the accounting office must pursue such information including manually researching required payment information. If such research does not allow the applicable disbursement to be matched to its related obligation, then the Department's policies require that a new obligation be established for the payment in question.

QUESTION: What is the Department doing to eliminate in-transit disbursements?

ANSWER: The Department is reengineering its disbursing and accounting systems to better enable the electronic transmission of payment data and supporting information to accounting offices, thus eliminating in-transit times and information handling problems.