



## Testimony

Before the Subcommittee on Government Efficiency,  
Financial Management and Intergovernmental Relations,  
Committee on Government Reform, House of  
Representatives

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# PURCHASE CARDS

## Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse

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Mr. Chairman, Members of the Subcommittee, and Senator Grassley:

I appreciate the opportunity to present follow-up information on our previous testimony<sup>1</sup> on internal control weaknesses related to use of the government purchase card at two Navy units. The Navy reported that it used purchase cards—Citibank MasterCard issued to civilian and military personnel—for more than 2.8 million transactions valued at \$1.8 billion in fiscal year 2001. As we previously reported, the Department of Defense (DOD) has increased the use of purchase cards with the intention of eliminating the bureaucracy and paperwork long associated with making small purchases and intends to expand the use of purchase cards over the next several years.

However, the benefits of the purchase card may be substantially reduced if controls are not in place to ensure its proper use. As the comptroller general testified<sup>2</sup> on March 6, 2002, following the events of September 11, reducing fraud, waste, and abuse is even more imperative to ensure that DOD's resources are available to meet national priorities such as homeland security and the war on terrorism. We believe that DOD, with its long-standing problems in financial management, must take steps to ensure the proper stewardship of the increasing amounts of taxpayer dollars devoted to its vital missions. Careful examination of the controls over the purchase card program is one aspect of ensuring that DOD is getting the most from every dollar.

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<sup>1</sup>U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-01-995T (Washington, D.C.: July 30, 2001).

<sup>2</sup>U.S. General Accounting Office, *DOD Financial Management: Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform*, GAO-02-497T (Washington, D.C.: Mar. 6, 2002).

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At this subcommittee's July 30, 2001, hearing, we testified on the results of our audit of key internal controls over purchase card activity at two Navy units based in San Diego—the Space and Naval Warfare Systems Command (SPAWAR) Systems Center and the Navy Public Works Center (NPWC).<sup>3</sup> Overall, we found a significant breakdown in internal controls over \$68 million<sup>4</sup> in fiscal year 2000 purchase card transactions, leaving these two units vulnerable to fraudulent, improper, and abusive purchases and theft and misuse of government property. We also reported that weak internal controls contributed to five recent cases of alleged purchase card fraud related to Navy purchase card programs in the San Diego area and investigated by the Naval Criminal Investigative Service (NCIS) and other cases that we referred to our own Office of Special Investigations for further review.

Our July 2001 testimony was followed by a report<sup>5</sup> in which we summarized our findings and offered 29 recommendations for improving Navy purchase card controls. We will report to you separately on the status of these 29 recommendations as part of our ongoing audit of the Navy's fiscal year 2001 purchase card activity.

The subcommittee and Senator Grassley asked us to perform a follow-up audit at the two Navy units and discuss the status of corrective actions. In addition, we were asked to follow up on the status of fraud cases that we reported on in July 2001 and any other fraud cases we identified as part of this follow-up audit. Today, I will discuss the results of our follow-up work, including (1) the purchase card control environment at the two Navy units' San Diego activities for fiscal year 2001 including any implemented or planned improvements, (2) the results of our test work on statistical

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<sup>3</sup>SPAWAR Systems Center and the Navy Public Works Center are working capital fund activities. SPAWAR Systems Center performs research, engineering, and technical support, and the Navy Public Works Center provides maintenance, construction, and operations support to Navy programs. Both of these Navy programs have locations throughout the United States. Our review focused on the purchase card program at the San Diego units only. For SPAWAR, this included SPAWAR Headquarters, which is located in San Diego, and SPAWAR Systems Center San Diego, which we will refer to collectively as SPAWAR Systems Center.

<sup>4</sup>SPAWAR Systems Center and NPWC made about \$75 million in fiscal year 2000 purchase card transactions. We audited the \$68 million of those purchases made by SPAWAR Systems Center and NPWC cardholders located in San Diego.

<sup>5</sup>U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-32 (Washington, D.C.: Nov. 30, 2001).

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samples of purchase card transactions at the two Navy units for the fourth quarter of fiscal year 2001, which identified continuing weaknesses in two critical areas, and (3) potentially fraudulent, improper, and abusive or questionable transactions made by the two Navy units during fiscal year 2001. In this testimony, we also report on the status of two cases investigated by our Office of Special Investigations as a result of our audit of NPWC and SPAWAR Systems Center purchase card activity for fiscal year 2000. Background information on the Navy purchase card program is included in appendix I.

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## Summary

For fiscal year 2001, internal controls at SPAWAR Systems Center and NPWC continued to be ineffective, leaving both units vulnerable to fraudulent, improper, and abusive purchases and to theft and misuse of government property. Both units had made some improvements in the overall control environment, primarily after the end of fiscal year 2001. Key improvements included reductions in the number of cardholders, an increase in the number of approving officials, an overall decrease in the aggregate monthly credit limits, and a decrease in purchase card usage.

At the same time, serious weaknesses remained in three key control environment areas, particularly at SPAWAR Systems Center. First, while both SPAWAR Systems Center and NPWC have taken steps to implement our recommendations regarding cardholder training and proper documentation of training, SPAWAR Systems Center still needs to do more to make sure all cardholders receive required training and to document the training taken by cardholders. For example, as of January 21, 2002 there was no documentation demonstrating that 146 cardholders had taken certain required training. As of February 15, 2002, SPAWAR Systems Center had suspended the accounts of only 5 of the cardholders who had not taken the required training. In contrast, NPWC has taken steps to provide cardholders and approving officials the necessary training and to assure itself that untrained personnel do not remain purchase card holders. On October 26, 2001, NPWC cancelled the cards of its 15 employees who had not complied with training requirements.

Second, both SPAWAR Systems Center and NPWC have recently made some efforts to implement new policies directed at improving internal review and oversight activities, which, as we previously testified, had been ineffective. Both units performed a Navy-mandated “stand-down” review of purchase card transactions, but neither performed an in-depth analysis of the selected transactions. We question SPAWAR Systems Center’s

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results in particular because it reported that it reviewed about 16,000 transactions and ultimately identified only one purchase that was not for a legitimate government purchase—a case in which the cardholder accidentally used the purchase card instead of a personal credit card. By comparison, our follow-up work identified numerous examples of potentially fraudulent, improper and abusive or questionable transactions that occurred in a similar time frame.

Third, we identified a significant impairment of management “tone at the top” at SPAWAR Systems Center during the last quarter of fiscal year 2001. The former commanding officer testified at the July 30, 2001, hearing before this subcommittee that the purchase card program at SPAWAR Systems Center had effective management controls and indicated that the trust SPAWAR Systems Center management had in its staff was an acceptable substitute for a cost-effective system of internal controls. Following the hearing, for the most part, the “tone at the top” at SPAWAR Systems Center was “business as usual.” In contrast, the commanding officer at NPWC was proactive in addressing the weaknesses we identified and took immediate action to address any improper or prohibited uses of the purchase card. In December 2001, the former SPAWAR Systems Center commanding officer was relieved of duty for findings of dereliction of duty and conduct unbecoming an officer in matters unrelated to the purchase card program.

We are encouraged by the commitment of the new commanding officer to ensure that an effective, well-controlled purchase card program is implemented at SPAWAR Systems Center. However, we remain concerned that there will be significant cultural resistance to change in the internal control environment. For example, up to the time we completed our fieldwork in February 2002, some cardholders and managers continued to rationalize the questionable purchases we brought to their attention—including expensive laptop carrying cases, Lego robot kits, clothing, food, and designer day planners—as discussed later in this statement. Such an attitude perpetuates an overall environment that tacitly condones possibly fraudulent, wasteful, abusive, or otherwise questionable spending of government funds.

The two basic internal controls over the purchase card program that we tested remained ineffective during the last quarter of fiscal year 2001 at the two units. Specifically, SPAWAR Systems Center did not have independent, documented evidence that it received and accepted items ordered and paid for with the purchase card for about 56 percent of its fourth quarter fiscal

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year 2001 transactions. NPWC significantly improved its adherence to this internal control, although its 16 percent failure rate is still too high. The improved results for NPWC are the result of management attention to this important control and increased training for cardholders. We again tested independent, documented certification of monthly purchase card statements and found that for the fourth quarter of fiscal year 2001, the two units continued to pay the monthly credit card bills without any independent review prior to payment to ensure transactions represented valid, necessary government purchases.

In addition, we attempted to test whether easily pilferable or sensitive items were being recorded in the units' property records to help prevent and detect theft, loss, and misuse of government assets. Our previous work showed that this was a serious problem. However, we were unable to perform those tests as part of our follow-up work because SPAWAR Systems Center, in accordance with a Navy policy change, recently revised its policy and no longer maintains accountability over easily pilferable items such as personal digital assistants and digital cameras. We disagree with the Navy and SPAWAR Systems Center policy and believe that property that is pilferable and easily converted to personal use should be accounted for. NPWC generally does not use purchase cards to buy pilferable items, and our statistical sample at NPWC did not identify any accountable property items.

In our June 30, 2001, testimony, we identified a number of potential fraud cases related to the two San Diego Navy units. We followed up on two of those cases, which highlighted the major role that poor internal control plays in fraud. In one case, we investigated about \$12,000 of potentially fraudulent fiscal year 2000 transactions related to the purchase card of a former NPWC employee. The purchases—made between December 20 and 26, 1999—included an Amana range, Compaq computers, gift certificates, groceries, and clothing. The cardholder's supervisor approved the purchase card statement that included these charges without reviewing it. NPWC also did not properly cancel this purchase card account after the cardholder had moved on to another organization within the Navy, and the cardholder subsequently used the purchase card for a personal car rental that was approved for payment by NPWC. This individual now works at the Pentagon.

We also followed up on the previously reported compromise in September 1999 of up to 2,600 purchase card accounts assigned to Navy activities in the San Diego area. Immediate cancellation of these accounts was

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imperative, especially since the weaknesses in controls over receipt and acceptance and certification of monthly statements at SPAWAR Systems Center and NPWC would severely hamper the detection of fraudulent purchases associated with compromised accounts. We reported that Navy investigators were only able to identify a partial list consisting of 681 compromised accounts. In December 2001, Navy notified us that all 681 compromised accounts identified in the July testimony were cancelled, including 22 active SPAWAR Systems Center accounts. However, no other action was taken by the Navy to identify or cancel the remaining over 1,900 compromised accounts. Our investigators subsequently identified the source of the compromised accounts as the database of a Navy vendor. In January 2002, the vendor provided our investigators with the entire listing of the 2,595 compromised accounts. We provided this list to the Navy and recommended that it immediately cancel the remaining 1,914 compromised account numbers. Included on the list were 78 SPAWAR Systems Center and 10 NPWC accounts that were active as of December 2001.

The specific internal control weaknesses at SPAWAR Systems Center and NPWC contributed to additional purchases during fiscal year 2001 that we believe are fraudulent, improper, abusive, or otherwise questionable. Most of the problem transactions were at SPAWAR Systems Center and had been approved and represented to us as being appropriate, proper uses of the purchase card. The number and severity of the problems we identified at NPWC were substantially less than at SPAWAR Systems Center. In addition, rather than dispute our findings on each transaction, NPWC showed a proactive response and not only concurred with our findings but immediately took action to help prevent future fraudulent, improper, or abusive transactions from occurring. As discussed in appendix II, our work was not designed to identify, and we cannot determine, the extent of fraudulent, improper, abusive, or otherwise questionable transactions.

We found a number of improper purchases at SPAWAR Systems Center and NPWC that were not permitted by law, regulation, or DOD policy. For example, we identified about \$8,500 in food and refreshments that should not have been purchased for SPAWAR Systems Center and NPWC employees. Without statutory authority, appropriated funds may not be used to furnish meals or refreshments to employees within their normal duty stations.<sup>6</sup> In most of these cases, it appears that the cardholders were aware of the prohibition on food purchases but made the purchases

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<sup>6</sup>72 Comp. Gen. 178, 179 (1993); 65 Comp. Gen. 508, 509 (1986).

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anyway. The monthly certification process failed to detect the improper food purchases. Moreover, while NPWC officials acknowledged the impropriety of the food purchases we identified, SPAWAR Systems Center officials indicated that most of the food purchases made by their cardholders were a legitimate government expense, a conclusion with which we disagree.

Further, we identified abusive or questionable purchases by SPAWAR Systems Center cardholders that were at an excessive cost, for a questionable government need, or both. For example, we identified purchases of day planners and calendars from commercial vendors, including calendar refills and designer leather holders purchased from Louis Vuitton and Franklin Covey. With the cost of a single Louis Vuitton day planner cover at about \$250, the issue of excessive cost and abuse is clear. Further, by law, government agencies are directed to purchase certain products, including day planners and calendars, from certified nonprofit agencies that employ people who are blind or severely disabled. The most expensive day planner available from these agencies costs about \$40. In addition, we identified about \$33,000 of abusive or questionable purchases from Franklin Covey of designer and high-cost leather briefcases, totes (purses), portfolios, Palm Pilot carrying cases, and wallets. Other examples include abusive and wasteful usage of cell phones, a trip for about 30 staff for an organizational meeting in Las Vegas, and clothing. We also identified abusive and possibly fraudulent purchases of luggage, Lego robot kits, and high-cost computer bags that were given away by SPAWAR Systems Center employees. Only one of the cardholders referred to in this testimony or our July 30, 2001, testimony had formal disciplinary action—in the form of removal of the purchase card—taken against them.

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## Scope and Methodology

We conducted our audit work from November 2001 through February 2002 in accordance with U.S. generally accepted government auditing standards, and we performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency. We briefed officials from the Department of Defense Purchase Card Program Management Office, Naval Supply Systems Command (NAVSUP), assistant secretaries of Navy for financial management (comptroller) and research development and acquisition, SPAWAR Systems Center, and NPWC on the details of our audit, including our objectives, scope, and methodology and our findings and conclusions. We referred instances of potentially fraudulent transactions that we identified during our work to our Office of



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Special Investigations for further investigation. Our control tests were based on stratified random probability samples of 50 SPAWAR Systems Center purchase card transactions and 94 NPWC transactions. We also reviewed a nonrepresentative selection of transactions using data mining intended to identify potentially fraudulent, improper, abusive, or otherwise questionable transactions. In total, we audited 161 SPAWAR Systems Center and 145 NPWC fiscal year 2001 transactions. Our work was not designed to identify, and therefore we did not determine, the extent of fraudulent, improper, or abusive transactions and related activities. Further details on our objectives, scope, and methodology are included in appendix II.

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## Some Improvements to Purchase Card Control Environment but Weaknesses Remain

In our follow-up audit, we found that both units had made some improvements in the overall control environment, primarily after the end of fiscal year 2001. However, the control environment at SPAWAR Systems Center continued to have significant weaknesses, while NPWC had made major strides towards a positive control environment. *GAO's Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999) state that, "A positive control environment is the foundation for all other standards. It provides discipline and structure as well as the climate which influences the quality of internal control." Our previous work found that a weak internal control environment at SPAWAR Systems Center and NPWC contributed to internal control weaknesses and fraudulent, improper, and abusive or questionable activity. In July 2001, we testified that the specific factors that contributed to the lack of a positive control environment at these two units included a proliferation of cardholders, ineffective training of cardholders and certifying officers, and a lack of monitoring and oversight. The following sections provide an update on the status of these conditions as well as information on several additional factors that affected the overall control environment at these Navy units.

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## Number of Cardholders Reduced but Significant Financial Exposure Continued

Although both units have reduced the number of cardholders, balancing the business needs of the unit with the training, monitoring, and oversight needed for a substantial number of cardholders remains a key issue. In October 2001, NAVSUP issued an interim change to its existing purchase card instructions to establish minimum criteria that prospective purchase card holders must meet before a purchase card account (including convenience check accounts<sup>7</sup>) can be established in the employee's name. The interim change issued by NAVSUP also established a maximum "span of control" of 5 to 7 cardholders to each approving official<sup>8</sup> and required that Navy activities establish local policies and procedures for approving and issuing purchase cards to activity personnel. The Navy's span of control requirement reflects guidance issued by the Department of Defense Purchase Card Program Management Office on July 5, 2001, shortly before the Subcommittee hearing. The revised guidance stated that, generally, an approving official's span of control—cardholders per approving official—should not exceed a ratio of 7 to 1. Neither of the two units increased the number of approving officials to meet the suggested ratio until well after the start of fiscal year 2002. Table 1 summarizes the progress made by both units.

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<sup>7</sup>Convenience checks, also referred to as accommodation checks, are used for vendors that do not have the capability to accept payment by credit card. For the Navy, each unit generally has one individual authorized to write convenience checks.

<sup>8</sup>The approving official is responsible for reviewing and verifying the monthly purchase card statements of the cardholders under their purview. The approving official is responsible for verifying that all purchases were necessary and for official government purposes in accordance with applicable policies, laws, and regulations. Unless otherwise specified, the approving official must also be the certifying officer for his/her cardholders and in that capacity must certify that the monthly purchase card statement is appropriate and ready for payment.

**Table 1: Number of Cardholders and Approving Officials at SPAWAR Systems Center and NPWC**

	SPAWAR			NPWC		
	9/21/00	9/21/01	1/21/02	9/21/00	9/21/01	1/21/02
Number of cardholders	1,153	950	793	292	226	185
Percent of employees who were cardholders	27%	22%	19%	17%	14%	12%
Ratio of cardholders to approving officials	1,153:1	950:1	4:1	42:1	32:1	4:1

Source: Citibank, SPAWAR Systems Center, and NPWC records.

The data in table 1 show that from September 21, 2000, to January 21, 2002, SPAWAR Systems Center had a net reduction in the number of cardholders of 360 (31 percent) and NPWC, 107 (37 percent). In addition, in fiscal year 2002, SPAWAR Systems Center increased the number of approving officials to 203 and NPWC, to 43. As a result, the approving official ratio for SPAWAR Systems Center and NPWC is now in line with DOD's criterion of no more than 7 cardholders per official. However, as of January 21, 2002, SPAWAR Systems Center still had 23 approving officials who were responsible for more than 7 cardholders and therefore did not comply with the DOD and Navy span of control requirements.

SPAWAR Systems Center records show that it significantly reduced the number of cardholders, primarily through canceling cards of those that did not need them and through employee attrition. According to SPAWAR Systems Center officials, some SPAWAR Systems Center purchase cards were canceled because of misuse; however, we were unable to determine from SPAWAR Systems Center records how many of the cards were canceled for this reason. We previously reported that SPAWAR Systems Center had a significant span-of-control issue with one approving official responsible for certifying monthly purchase card statements for all of its cardholders. According to Citibank and SPAWAR Systems Center records, effective for the billing period ending January 21, 2002, SPAWAR Systems Center increased from 1 to 203 the number of approving officials responsible for certifying monthly summary invoices. This change reduced SPAWAR Systems Center's average span of control to 4 cardholders to each approving official, which is in line with DOD and Navy guidelines. We did not perform any testing for fiscal year 2002 transactions to determine whether the approving officials were in place and performing effective

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reviews. SPAWAR Systems Center management told us that they are continuing to evaluate the number of cardholders and the impact any further cuts would have on management's ability to support operations and keep employees working efficiently.

NPWC reduced the number of its cardholders through employee attrition and by canceling the cards of individuals who no longer needed them, had not taken required training, or had misused the card. Specifically, on July 6, 2001, the agency program coordinator (APC) gave each business line manager an analysis of monthly purchase card usage data for each of the cardholders under his or her supervision. The business line managers were instructed to analyze cardholder monthly transaction volume and reduce the number of cardholders by eliminating those cardholders they believed no longer needed a purchase card. NPWC also recently increased its number of approving officials from 7 as of September 21, 2001, to 43 by January 21, 2002. This significant increase brought the ratio of cardholders to approving officials in line with DOD and Navy guidelines.

Another key factor in minimizing the government's financial exposure is assessing the monthly credit limits available to cardholders. The undersecretary of defense for acquisition and technology emphasized in an August 2001 memorandum to the directors of all defense agencies, among others, that not every cardholder needs to have the maximum transaction or monthly limit and that supervisors should set reasonable limits based on what each person needs to buy as part of his or her job. We concur with the undersecretary's statements and continue to recommend that cardholder spending authority be limited as a way of minimizing the federal government's financial exposure.

As shown in table 2, total financial exposure, as evidenced by monthly credit limits for SPAWAR Systems Center and NPWC cardholders, has decreased substantially.

**Table 2: SPAWAR Systems Center and NPWC Total Cardholder Credit Limits**

Dollars in millions		
Date	SPAWAR	NPWC
September 21, 2000	\$56.9	\$13.5
September 21, 2001	33.0	12.9
January 21, 2002	28.0	12.1
<b>Total reduction</b>	<b>50.8%</b>	<b>10.4%</b>

Source: Citibank, SPAWAR Systems Center, and NPWC records.

SPAWAR Systems Center reduced the overall credit limits of its cardholders by about \$29 million primarily by (1) eliminating nearly \$10 million of credit assigned to each of two cardholders and (2) reducing the net number of cardholders by 360. As we previously reported, most SPAWAR Systems Center cardholders had a \$25,000 credit limit, and no cardholder had a credit limit of less than \$25,000. We continue to believe that a \$25,000 minimum credit limit is more than most SPAWAR Systems Center cardholders need to perform their mission. This point is best demonstrated by the fact that even when we used SPAWAR Systems Center's reduced number of cardholders, the average monthly purchase card bill in fiscal year 2001 would have been less than \$5,000.

As shown in table 2, Citibank's records indicate that between September 21, 2000, and January 21, 2002, NPWC reduced its cardholder exposure from about \$13.5 million to \$12.1 million—a \$1.4 million reduction. NPWC achieved this reduction primarily by reducing by 107 the number of individuals who had purchase cards and by reevaluating cardholders' monthly credit limits. We previously reported that most NPWC cardholders were granted a monthly credit limit of \$20,000. Currently, about 20 NPWC cardholders have a credit limit of less than \$20,000, about 42 percent still have a \$20,000 credit limit, and the remaining cardholders have higher credit limits to meet job needs. Further, the average monthly purchase card bill (using the reduced number of cardholders) in fiscal year 2001 for NPWC cardholders would have been about \$11,500. On September 7, 2001, the NPWC agency program coordinator distributed spreadsheet analyses of individual cardholder actual monthly and average charges, along with suggested new monthly cardholder limits, to the respective cardholder's business line managers. The agency program coordinator required the business line managers to respond to the agency program coordinator with new limits for cardholders

by the close of business on September 21, 2001. At the exit meeting we held with NPWC officials, NPWC provided Citibank records documenting that NPWC further reduced its cardholder credit limits to \$5.6 million in February 2002.

In addition to the reductions in the number of cardholders and aggregate financial exposure, the dollar volume of transactions decreased significantly in fiscal year 2001 when compared to fiscal year 2000, as shown in table 3.

**Table 3: SPAWAR Systems Center and NPWC Purchase Card Spending, Fiscal Years 2000 and 2001**

Dollars in millions

	FY 2000 <sup>a</sup>	FY 2001 <sup>b</sup>	Reduction	Percent reduction
SPAWAR	\$45	\$39	\$(6)	13%
NPWC	\$30	\$25	\$(5)	17%

<sup>a</sup>SPAWAR Systems Center and NPWC used the purchase card in fiscal year 2000 to make a total of about \$75 million in acquisitions. About \$68 million of those acquisitions were made by cardholders located in San Diego.

<sup>b</sup>SPAWAR Systems Center and NPWC used the purchase card in fiscal year 2001 to make a total of about \$64 million in acquisitions. About \$50 million of those acquisitions were made by cardholders located in San Diego.

Source: Citibank, SPAWAR Systems Center, and NPWC records.

The NPWC agency program coordinator attributed a portion of this decrease to increased controls over the use of purchase cards, resulting in a reduction in unnecessary and improper card usage. Other reasons were a reduction in the number of projects worked on during fiscal year 2001 and the use of more contracts for goods and services, which are paid by means other than the purchase card. The SPAWAR Systems Center senior military contracting official told us that SPAWAR Systems Center's reduction in purchase card use is a result of a decrease in workload and an increase in concern over purchase card controls brought on as a result of our audit and the congressional hearing.

## Training of Cardholders

While both SPAWAR Systems Center and NPWC have taken steps to implement our recommendations regarding cardholder training and proper documentation of training, SPAWAR Systems Center still needs to do more

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to make sure all cardholders receive required training and to document the training taken by cardholders. We previously reported that the lack of documented evidence of purchase card training contributed to a weak internal control environment at these two units. GAO's internal control standards emphasize that effective management of an organization's workforce—its human capital—is essential to achieving results and is an important part of internal control. Training is key to ensuring that the workforce has the skills necessary to achieve organizational goals. In accordance with NAVSUP Instruction 4200.94, all cardholders and approving officials must receive purchase card training. Specifically, NAVSUP 4200.94 requires that prior to the issuance of a purchase card, all prospective cardholders and approving officials must receive training regarding both Navy policies and procedures as well as local internal operating procedures. Once initial training is received, the Instruction requires all cardholders to receive refresher training every 2 years. Further, in response to our previous audit and the July 30, 2001, hearing, NAVSUP sent a message in August 2001 to all Navy units directing them to train all of their cardholders concerning the proper use of the purchase cards on or about September 12, 2001.

SPAWAR Systems Center training records indicated that as of January 21, 2002, 146 cardholders either had not completed the NAVSUP-mandated training or had not produced a certificate evidencing completion of the training. In addition, 13 active cardholders had not satisfied the requirement to take refresher training every 2 years. SPAWAR Systems Center officials told us that they intended to suspend the accounts of cardholders who had not taken the required training; however, as of February 15, 2002, the accounts of only 5 cardholders had been suspended.

NPWC has taken well-documented steps to provide cardholders and approving officials the necessary training and to assure itself that untrained personnel do not remain purchase card holders. As a result of our previous audit findings in this area, NPWC held mandatory cardholder training sessions in June 2001 and July 2001, which all cardholders and their supervisors attended. In addition, NPWC presented NAVSUP-prepared training for all cardholders and approving officials in September 2001. The mandatory NAVSUP training addressed the issues of receipt and acceptance, spending limits, accounting, unauthorized or personal use of the card, policies and procedures, improper transactions, NPWC internal procedures, other required training, the NAVSUP and Citibank Web sites, and our findings from the previous purchase card testimony and related report. All but 15 of NPWC's cardholders and approving officials attended

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the mandatory NAVSUP training, and on October 26, 2001, NPWC canceled the 15 remaining cardholder accounts for noncompliance with the training requirements.

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## Monitoring and Oversight

Both SPAWAR Systems Center and NPWC have recently made some efforts to implement new policies directed at improving internal review and oversight activities, which, as we previously testified, were ineffective. We also testified that the Navy's purchase card policies and procedures did not require that the results of internal reviews be documented or that corrective actions be monitored to help ensure that they are effectively implemented. While still relatively ineffective, this area has great potential to strengthen the control environment at these two Navy units.

We also previously testified that, although the SPAWAR Headquarters Command inspector general (IG) reviewed purchase card transactions generated by Headquarter cardholders during fiscal year 2000 and prepared a draft report summarizing the results of this review, the final report had not been issued at the conclusion of our fieldwork for the July 30, 2001, testimony. The final report<sup>9</sup> of this review was issued on July 19, 2001, and identified many of the internal control findings discussed in our prior review; however, the IG's report did not identify the kind of abusive transactions we identified. Also, on August 13, 2001, the Command IG began a limited review of the 2 most recent months of purchase card activity for Headquarters cardholders. The summary findings, which were released in a report dated October 16, 2001, have many of the internal control findings discussed later in this statement and similarly point to the need for clear, comprehensive policies, procedures, and training to resolve many of the control weaknesses and instances of questionable transactions. The IG also reported that it found some "transactions that appeared to be either 'excessive' or may have been of questionable good judgment," but did not provide examples of these potentially abusive transactions. The IG also reported that several cardholders had stated that they felt uncomfortable making purchases, but did not want to tell their supervisor "no" and suffer potentially adverse career consequences.

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<sup>9</sup>SPAWAR Headquarters Command Inspector General, *Review of International Merchant Purchase Authorization (IMPAC) Card at SPAWAR*, 98-16 (San Diego, Calif.: July 19, 2001).



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At the July 30, 2001, hearing we reported that the Naval Audit Service had conducted an audit of the NPWC purchase card program for which a report had not been issued. The Naval Audit Service completed its audit in December 2000 and reviewed transactions primarily occurring from March 1999 through August 2000. The Naval Audit Service issued its report<sup>10</sup> over 1 year later, on January 10, 2002. Some of the Naval Audit Service findings are of the same nature and significance as the findings reported in our previous testimony, although the Naval Audit Service report did not identify the improper or abusive transactions we discussed. The Naval Audit Service concluded that management of the purchase card program at NPWC was not sufficient to ensure the integrity of the command's purchase card program and that NPWC's internal operating procedures did not clearly define duties and responsibilities or adequately control the various processes involved in purchase card transactions. Further, the Naval Audit Service reported that maintenance and repair services were obtained on a "piece-meal" basis instead of being aggregated and performed as entire projects, which resulted in NPWC not taking advantage of its buying power to obtain discounts on its recurring purchases.

Further, in August 2001, following the July 30, 2001, purchase card congressional hearing, NAVSUP directed all Navy units to review 12 months of purchase card transactions. In response to this requirement, both SPAWAR Systems Center and NPWC reviewed samples of transactions, although neither performed an in-depth analysis of the selected transactions. For example, SPAWAR Systems Center told us that it reviewed 16,393 of the 45,318 transactions for the 9-month period ended July 2001. According to SPAWAR Systems Center, its stand-down review identified 187 split purchases and 9 transactions that initially appeared questionable or suspicious. After completing their review, SPAWAR Systems Center officials concluded that only one of these nine transactions was not for a legitimate government purpose, because the cardholder in question accidentally used the purchase card instead of a personal credit card. However, we question whether the stand-down review was designed and performed to be a thorough and critical analysis of the nature and magnitude of the control weaknesses and the extent to which fraudulent, improper, or abusive transactions were occurring during the 9-month period reviewed. Our own statistical sample of 50 transactions from just the last 3 billing cycles of fiscal year 2001 found one potentially fraudulent

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<sup>10</sup>Naval Audit Service, *Management of Purchase Card Program at Public Works Center, San Diego, CA*, N2002-0023 (Washington, D.C.: Jan. 10, 2002).

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and subsequently disputed purchase and a total of 11 abusive or improper transactions on the monthly statements for 9 cardholders. Furthermore, as detailed later, we found numerous examples of abusive and improper transactions occurring in the first nine billing cycles of fiscal year 2001.

NPWC's stand-down review subjected 9,099 transactions out of 50,850 for the 12-month period ended August 31, 2001, to a documentation review. The review identified several cases of potential improper use and 320 cases of potential split purchases. However, the primary finding related to the use of the card for prohibited acquisitions of "noncommonly used" hazardous materials. NPWC estimated that approximately 600 of the transactions reviewed violated the Navy's prohibition against using the purchase card to acquire noncommonly used hazardous materials. Specifically, Navy purchase card policies and procedures require that prior to acquiring potentially hazardous materials, cardholders must first determine that a requested purchase meets the definition of a commonly used hazardous material and that the materials are carried on the unit's Authorized Use List. If the requested purchase does not meet the "commonly used" definition, the hazardous materials are to be procured by other means that bring the hazardous material under the control of a Hazardous Substance Management System (HSMS). Compliance with these requirements would then help ensure the safe storage, use, and disposal of the hazardous materials.

NPWC found that cardholders were using the purchase card to acquire noncommonly used hazardous materials such as bacterial control agents and toxic, corrosive solvents used to descale and deodorize sewage systems. Such hazardous material purchases were not being subjected to the required controls and, consequently, NPWC had no assurance that the approximately 600 reported purchases were stored, used, and disposed of in a safe and environmentally acceptable manner. To alleviate this problem, NPWC is working with the Fleet Industrial Supply Service to coordinate the maintenance and control of Navy hazardous materials. NPWC's identification and proactive attitude towards resolving this matter again demonstrate a positive control environment.

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## Management “Tone at the Top” Was Significantly Impaired at SPAWAR Systems Center

GAO’s internal control standards<sup>11</sup> state that management plays a key role in demonstrating and maintaining an organization’s integrity and ethical values, “especially in setting and maintaining the organization’s ethical tone, providing guidance for proper behavior, removing temptations for unethical behavior, and providing discipline when appropriate.” At the time we began our follow-up review, the SPAWAR Systems Center commanding officer not only did not demonstrate a commitment to improving management controls but openly supported the status quo. Consequently, the lack of a positive control environment continued. In contrast, the commanding officer at NPWC continued to support a proactive attitude in addressing the weaknesses we identified and took immediate action to address any improper or prohibited uses of the purchase card. It is not surprising that, given these differences in the management tone at the two units, we continued to find numerous examples of potentially improper, abusive, and otherwise questionable use of the purchase card at SPAWAR Systems Center, while we found few such cases at NPWC.

The former SPAWAR Systems Center commanding officer testified on July 30, 2001, that the purchase card program at SPAWAR Systems Center had effective management controls and an honest and trustworthy workforce. The commanding officer went on to incorrectly characterize our audit approach and findings by stating that there was not a pervasive and serious abuse and fraud problem at SPAWAR Systems Center and that over 99.98 percent of purchases made by cardholders were for legitimate government purposes. The commanding officer did not acknowledge that the serious weaknesses in SPAWAR Systems Center’s system of internal controls over the purchase card program left SPAWAR Systems Center vulnerable to the types of abusive and improper transactions that we found and that such abuses could occur without being detected.

Upon his return to San Diego following the hearing, the commanding officer held an “all-hands” meeting at a SPAWAR Systems Center auditorium that cardholders, approving officials, and managers were particularly encouraged to attend “... to clarify the substantial differences between the perception of problems reported in the press and the reality of the situation.” At the meeting, the commanding officer showed a videotape

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<sup>11</sup>U.S. General Accounting Office, *GAO’s Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999).

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of the entire congressional hearing. By denying that these weaknesses resulted in undetected misuse of purchase cards, the commanding officer effectively diminished the likelihood that substantive changes would be implemented or, if implemented, taken seriously. The underlying message of his testimony, his subsequent “all hands” meeting, and his meetings with us, was that the trust SPAWAR Systems Center management had in its staff was an acceptable substitute for a cost-effective system of internal controls.

The commanding officer was relieved of duty in December 2001 for matters unrelated to the purchase card program. The admiral in charge of SPAWAR held a nonjudicial punishment hearing on December 8, 2001, and found that the commanding officer had violated two articles of the Uniform Code of Military Justice, including dereliction of duty and conduct unbecoming an officer. The admiral issued the commanding officer a Punitive Letter of Reprimand, relieved him of his command at SPAWAR Systems Center, and endorsed his request for retirement from the Navy.

The new commanding officer at SPAWAR Systems Center now has an opportunity to set a “tone at the top” that reflects a true commitment to establishing a positive control environment. Based on our discussions with the commanding officer and some of the actions we have observed, we are encouraged by her commitment to ensure that an effective, well-controlled purchase card program is implemented at SPAWAR Systems Center. At the same time, we remain concerned that there will be significant cultural resistance to change in the internal control environment. For example, up to the time we completed our fieldwork in February 2002, some cardholders and managers continued to rationalize the questionable purchases we brought to their attention—including expensive laptop carrying cases, Lego robot kits, clothing, food, and designer day planners—as discussed later in this statement. Such an attitude perpetuates an overall environment that tacitly condones possibly fraudulent wasteful, abusive, or otherwise questionable spending of government funds.

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## Critical Internal Controls Remained Ineffective

Basic internal controls over the purchase card program remained ineffective during the last quarter of fiscal year 2001 at the two units we reviewed. Based on our tests of statistical samples of purchase card transactions, we determined that the two key transaction-level controls that we tested were ineffective, rendering SPAWAR Systems Center and NPWC purchase card transactions vulnerable to fraudulent and abusive purchases and theft and misuse of government property. As shown in table

4, the specific controls that we tested were (1) independent, documented receipt and acceptance of goods and services and (2) independent, documented review and certification of monthly purchase card statements.

**Table 4: Estimate of Fiscal Year 2001 Transactions That Failed Control Tests<sup>a</sup>**

Navy units in San Diego	Breakdowns in key purchase card controls <sup>a</sup>	
	Independent, documented receipt of items purchased	Proper certification of purchase card statements for payment
	Percent failure	Percent failure
SPAWAR Systems Center	56%	100% <sup>b</sup>
NPWC	16%	100% <sup>c</sup>

<sup>a</sup>The numbers represent point estimates for the population based on our sampling tests. The confidence intervals for our sampling estimates are presented in appendix II of this testimony.

<sup>b</sup>For the last quarter of fiscal year 2001, SPAWAR Systems Center continued to have only one certifying officer for almost 1,000 cardholders. This unacceptable span of control led us to conclude that all transactions selected as part of our statistical sample were not properly reviewed and approved by a certifying officer.

<sup>c</sup>Our statistical testing identified one transaction that was reconciled by the cardholder and approving official prior to payment. The projected error rate was 99.9 percent, which we rounded to 100 percent.

In addition, we attempted to test whether the accountable items—easily pilferable or sensitive items—included in some of the transactions in our samples were recorded in the units’ property records to help prevent theft, loss, and misuse of government assets. However, we were unable to perform those tests because SPAWAR Systems Center had recently changed its policy and no longer maintains accountability over easily pilferable items such as personal digital assistants and digital cameras. Further, our statistical sample at NPWC did not identify any accountable property items.

**NPWC Made Significant Improvements in Independent Receipt and Acceptance, While SPAWAR Systems Center Results Were Unchanged**

SPAWAR Systems Center did not have independent, documented evidence that they received and accepted items ordered and paid for with the purchase card, which is required by Navy policy. That is, they generally did not have a receipt for the acquired goods and services that was signed and dated by someone other than the cardholder. As a result, there is no documented evidence that the government received the items purchased or that those items were not lost, stolen, or misused. Based on our testing, we estimate that SPAWAR Systems Center did not have independent,

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documented evidence to confirm the receipt and acceptance of goods and services acquired with the purchase card for about 56 percent of its fourth quarter fiscal year 2001 transactions. We previously reported a 65 percent control failure rate for fiscal year 2000.

NPWC improved its adherence to the internal control of documenting independent receipt and acceptance of items acquired with a purchase card, although its 16 percent failure rate in this control technique remained unacceptable. We previously testified that NPWC generally did not have documented independent receipt and acceptance for goods and services and reported a 47 percent control failure rate for fiscal year 2000. The improved results for NPWC are the result of management attention to this important control and increased training for cardholders.

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### Review and Certification of Monthly Purchase Card Statements Remained a Significant Weakness at Both Units

Throughout fiscal year 2001, SPAWAR Systems Center and NPWC still did not properly review and certify the monthly purchase card statements for payment. We previously reported that SPAWAR Systems Center and NPWC approving officials who certify the monthly purchase card statements for payment generally rely upon the silence of a cardholder to assume that all purchase card transactions listed on the monthly statements are valid government purchases. However, this process does not compensate for the fact that a cardholder might have failed to forward corrections or exceptions to the account statement in a timely manner or, even worse, may not have reviewed the statement. As a result of the breakdown of this control, for the fourth quarter of fiscal year 2001, SPAWAR Systems Center and NPWC were paying the monthly credit card bills without any independent review of the monthly cardholder statements prior to payment to verify that the purchases were for a valid, necessary government need.

Under 31 U.S.C. 3325 and DOD's *Financial Management Regulation*,<sup>12</sup> disbursements are required to be made on the basis of a voucher certified by an authorized agency official. The certifying official is responsible for ensuring (1) the adequacy of supporting documentation, (2) the accuracy of payment calculations, and (3) the legality of the proposed payment under the appropriation or fund charged. The certification function is a preventive control that requires and provides the incentive for certifying officers to maintain proper controls over public funds. It also helps detect

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<sup>12</sup>DOD *Financial Management Regulation*, Volume 5, Chapter 33, "Accountable Officials and Certifying Officers."

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fraudulent and improper payments, including unsupported or prohibited transactions, split purchases, and duplicate payments. Further, section 933 of the National Defense Authorization Act for Fiscal Year 2000 requires the Secretary of Defense to prescribe regulations that ensure, among other things, that each purchase card holder and approving official is responsible for reconciling charges on a billing statement with receipts and other supporting documentation before certification of the monthly bill.

We previously reported that NAVSUP policy is inconsistent with the purpose of certifying vouchers prior to payment and made recommendations to revise the policy appropriately. Navy agreed with our recommendations concerning the need to change this portion of the purchase card instruction.

For the last quarter of fiscal year 2001, SPAWAR Systems Center continued to have only one approving official to certify for payment the monthly purchase card statements of almost 1,000 cardholders. This unacceptable span of control led us to conclude that all transactions selected as part of our statistical sample were not properly reviewed and approved by a certifying officer. NPWC also continued to inappropriately certify purchase card statements for payment before receiving cardholder assurance that the purchases were proper. Our review of purchase card transactions disclosed that no significant change in this process had taken place during the fourth quarter of fiscal year 2001, and we therefore identified a 100 percent failure rate for this control at SPAWAR Systems Center and NPWC.

However, in keeping with its proactive attitude, instead of waiting for NAVSUP to issue its new purchase card payment certification procedures, the NPWC agency program coordinator issued local guidance in December 2001 that requires approving officials, prior to certifying their summary invoice for payment, to obtain notifications from cardholders that their statements do not include disputed items. The guidance also indicates that approving officials and cardholders should conduct ongoing reviews during the month of the transactions in their purchase card accounts using Citidirect online services. While this does not fully implement the recommendation that we made in our November 30, 2001 report,<sup>13</sup> this is a positive interim step. Given the significant reduction in individual

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<sup>13</sup>GAO-02-32.

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approving officials' span of control this measure provides NPWC an opportunity to strengthen this control.

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**Citing Policy Change,  
SPAWAR Systems Center  
Failed to Maintain  
Accountability for Pilferable  
Items**

We disagree with a change in SPAWAR Systems Center policy that eliminated the accountability of certain property items considered to be pilferable. Recording items in the property records that are easily converted to personal use and maintaining serial number and bar code control is an important step in ensuring accountability and financial control over such assets and, along with periodic inventory, in preventing theft or improper use of government property. We previously testified that most of the accountable items—easily pilferable or sensitive items—in our samples for fiscal year 2000 were not recorded in property records.

On August 1, 2001, the Department of the Navy changed its definition for what constitutes pilferable property. Unlike the previous policy, which was prescriptive in identifying what was pilferable, the new policy provides commanding officers with latitude in determining what is and what is not pilferable. Specifically, the new policy defines pilferable to be an item—regardless of cost—that is portable, can be easily converted to personal use, is critical to the activity's business/mission, and is hard to repair or replace. Citing the "hard to repair or replace" criteria in the new policy, on November 1, 2001, SPAWAR Systems Center determined that only computer systems and notebook/laptop computers would be considered pilferable items. Thus, based on our fiscal year 2000 and 2001 audit work, SPAWAR Systems Center did not maintain accountability over numerous sensitive and pilferable items, such as digital cameras and personal digital assistants (PDA), leaving them subject to possible theft, misuse, or transfer to personal use.

SPAWAR Systems Center's new commanding officer and executive director told us that they do not believe that it is cost beneficial to account for and track these assets, but instead rely on supervisory oversight and personal employee trust to provide the necessary accountability of these assets. The commanding officer and the executive director stated that SPAWAR Systems Center is a diversified organization in which its scientists and engineers are working on as many as 1,000 different projects at any one time, which would make it difficult to keep track of these lower cost items. We acknowledge the important mission that SPAWAR Systems Center serves, but we also believe that the diverse nature of its operations is one of the key reasons why SPAWAR Systems Center needs to maintain accountability of its pilferable items. As discussed later in this testimony,



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we believe that SPAWAR Systems Center's lack of accountability over items that are pilferable contributed to several abusive and questionable purchases.

Although NPWC also had the opportunity to redefine what constitutes pilferable property, NPWC did not institute a similar policy change. Unlike SPAWAR Systems Center, NPWC generally does not use the purchase card to buy property items that are pilferable or easily converted to personal use. As a result, our sample of fourth quarter fiscal year 2001 NPWC transactions did not include any accountable items.

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## Status of ERP Implementation at SPAWAR Systems Center

SPAWAR Systems Center officials stated that they have implemented a new Enterprise Resource Planning (ERP) system that is designed to address most of the weaknesses that we identified in our July 2001 testimony. Once effectively implemented, the ERP system would facilitate on-line review, reconciliation, and monitoring of credit card activity. The system would also result in reduced storage needs because ERP requires receipt and acceptance documentation to be scanned into a database storage container. However, our limited assessment of the control environment identified several weaknesses. Although the new system has the stated capability to address the weaknesses we identified in the purchase card program, until it is effectively implemented and individuals comply with purchase card policies and procedures, SPAWAR Systems Center has little assurance that the weaknesses we previously identified will be corrected or mitigated.

For example, the implementation of the ERP system at the time of our review did not provide for an adequate separation of duties or proper certification of purchase card transactions for payment. Specifically, a systems administrator with high-level administrative access privileges on the system performed both cardholder and approving official duties. In addition, the administrator pushed transactions through the system as an approving official without the required cardholder reconciliation or any knowledge of the transactions. Further, the administrator, who performed approving official duties, did not review the transactions to determine if they complied with Navy policies and procedures. That responsibility remained with the existing approving official; however, as we previously testified about the manual process, we found no evidence that the approving official verified compliance. SPAWAR Systems Center officials stated that by the end of February 2002, the administrator should no longer have these duties because all of the newly designated approving officials

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will have completed the required ERP training. We have not verified this corrective action or whether the approving officials are properly performing their duties.

In assessing the control environment, we attempted, but were unable, to obtain documentation such as (1) the DOD Information Technology Security Certification and Accreditation Process (DITSCAP)<sup>14</sup> for the system and (2) formal procedures on granting and removing access to the ERP. First, SPAWAR Systems Center officials stated that the certification and accreditation for the ERP system was not complete and that it was currently operating under interim authority. The DITSCAP would give an indication as to whether SPAWAR Systems Center had established its information security requirements and whether the system implementation meets the established security requirements. Second, although SPAWAR Systems Center had an informal process for granting and removing system access, these procedures had not yet been formally documented. Establishing such formal control procedures helps ensure that authorized users have the appropriate access to perform their job duties.

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## Potentially Fraudulent, Improper, Abusive, and Questionable Transactions

We identified numerous examples of improper, abusive, or questionable transactions at SPAWAR Systems Center during fiscal year 2001. Given the weaknesses in the overall internal control environment and ineffective specific internal controls, it is not surprising that SPAWAR Systems Center did not detect or prevent these types of transactions. In fact, most of the transactions that we identified as improper, abusive, or questionable at SPAWAR Systems Center were approved and represented to us as being an appropriate, proper use of the purchase card. In contrast, using the same data mining techniques at NPWC, the number and severity of the problems we identified were substantially less than at SPAWAR Systems Center. In addition, rather than dispute our findings on each transaction, NPWC showed a proactive response and not only concurred with our findings but immediately took action to prevent future improper or abusive transactions from occurring. As discussed in appendix II, our work was not designed to identify, and we cannot determine, the extent of fraudulent, improper, and abusive or otherwise questionable transactions.

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<sup>14</sup>DOD Instruction 5200.40, December 30, 1997, and OPNAV Instruction 5239.1B, November 9, 1999, requires any DOD system that collects, stores, transmits, or processes unclassified or classified information to comply with the DITSCAP process to establish a more secure system operations.

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Further, our review of SPAWAR Systems Center and NPWC transactions for potentially fraudulent, improper, and abusive or otherwise questionable purchases was limited and not intended to represent the population of SPAWAR Systems Center and NPWC transactions. Specifically, we reviewed a total of 161 SPAWAR Systems Center and 145 NPWC fiscal year 2001 transactions and performed additional analysis of related activity at three specific vendors as discussed in appendix II. To test those transactions and related activity, we examined all available documentation supporting the transactions, and when necessary we interviewed NPWC and SPAWAR Systems Center staff. To put the number of transactions that we reviewed into perspective, during fiscal year 2001 SPAWAR Systems Center and NPWC processed a total of about 83,000 transactions. Thus, the potentially fraudulent, improper, and abusive or questionable transactions we identified relate to the 306 transactions and associated activity we reviewed. We cannot project the extent of potentially fraudulent, improper, or abusive transactions for SPAWAR Systems Center or NPWC to the entire population of fiscal year 2001 transactions. See appendix II for a more detailed discussion of our objectives, scope, and methodology.

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## Potentially Fraudulent Transactions

We considered potentially fraudulent purchases to include those made by cardholders that were unauthorized and intended for personal use. Some of these instances involved the use of compromised accounts, in which an actual Navy purchase card or an active account number was stolen and used to make a fraudulent purchase. Other cases involved vendors charging Navy purchase cards for unauthorized transactions.

Both SPAWAR Systems Center and NPWC had policies and procedures that were designed to prevent the payment of fraudulent purchases; however, our tests showed that although both units made some improvements, particularly NPWC, they did not implement the controls as intended. For example, as discussed previously, controls were ineffective for independent verification of receipt and acceptance and proper review and certification of monthly statements prior to payment. Fraudulent activities must therefore be detected after the fact, during supervisor or internal reviews, and disputed charge procedures must be initiated to obtain a credit from Citibank. Table 5 shows examples of potentially fraudulent transactions that we identified at SPAWAR Systems Center. Using the same audit techniques, we did not find documented evidence of potentially fraudulent NPWC transactions for fiscal year 2001. However, as noted previously, our tests were not designed to identify all fraudulent transactions, and considering the control weaknesses identified at

SPAWAR Systems Center and NPWC, and the substantial number of compromised accounts discussed later, fraudulent transactions may have occurred during fiscal year 2001 and not have been detected.

**Table 5: Examples of Potentially Fraudulent Purchase Card Transactions at SPAWAR Systems Center**

Type of items purchased	Vendor	Total amount	Source
Car rentals	Dollar Rent a Car	\$338	Cardholder
Unknown	Kids R Us	\$826	Compromised account
Phone calls	800-Collect	\$516	Compromised account
Unknown	Car Club	\$9,486	Compromised account
Adult entertainment, other Internet purchases	Paycom.net, Ibillcs.com	\$285	Unknown
Unknown	Safety product vendor	\$10,600	Vendor

The fact that all of the unauthorized transactions in table 5 were authorized for payment by SPAWAR Systems Center clearly demonstrates the lack of an effective review and monthly certification process. SPAWAR Systems Center officials told us that they were aware of all of these potentially fraudulent transactions and eventually received a credit from either the vendor or Citibank or reimbursement from the cardholder, but in some cases after many months. For example, the car rental transaction related to a SPAWAR Systems Center employee who stated that she had inadvertently used the purchase card rather than a personal credit card. However, it took the employee 5 months to reimburse the government for this personal and unauthorized charge. Three of the examples in table 5 relate to the 2,595 Navy purchase card compromised accounts discussed below. The card numbers used to make the internet purchases were not on the list of compromised accounts. These cardholders reported to Citibank that the transactions were unauthorized, and Citibank provided credits to their accounts for disputed amounts up to three months after SPAWAR Systems Center paid the bill. The \$10,600 of potentially fraudulent charges represent numerous unauthorized charges, many of which were about \$500 each, during fiscal year 2001 by a safety product vendor that SPAWAR Systems Center paid despite the fact that no goods were received. As of

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January 21, 2002, SPAWAR Systems Center had not received a credit from the bank or the vendor for about \$3,100 of the unauthorized charges.

In our July 2001 testimony, we identified about \$12,000 in potentially fraudulent fiscal year 2000 transactions on the purchase card of a former NPWC employee. NPWC Command Evaluation staff researched the potentially fraudulent charges, and NPWC eventually disputed them and recovered the full amount from the bank. Our Office of Special Investigations conducted an investigation of the suspect employee to determine if these transactions were indeed fraudulent. This investigation identified the following.

- The purchases occurred primarily between December 20 and 26, 1999, and included an Amana range, Compaq computers, gift certificates, groceries, and clothes. Based on our research, most of the merchants noted that these were not phone orders and someone presented the purchase card in question to make the purchases.
- The cardholder brought the January 2000 credit card statement, with the above charges on the bill, to her supervisor for his approval and signature. According to the supervisor, the cardholder told him that she needed the statement signed immediately because she was late in processing it. The supervisor signed the credit card statement without reviewing it.
- The cardholder claims to have disputed the charges on January 31, 2000. Citibank indicated that it did not receive the dispute documentation until August 23, 2000, and the bank did not credit the Navy for these charges until April 2001.
- Based on an examination of the handwriting specimens by the U.S. Secret Service Forensic Services Division, the fraudulent purchase receipts were probably signed by someone other than the cardholder and all appear to have been signed by the same individual.
- The Amana range was bought with a gift card that was purchased in the name of the cardholder's alleged ex-boyfriend's mother.
- The cardholder left NPWC to work for the U.S. Pacific Fleet from June to November of 2000 and now works at the Pentagon. After leaving work on her last day at NPWC, the cardholder improperly used the NPWC purchase card—which should have been canceled—for a personal automobile rental that was initially paid by NPWC and subsequently reversed through a credit from Citibank. The cardholder was supposed to, but has not yet, repaid Citibank the \$358 owed.
- The cardholder also misused a government travel card by purchasing three airline tickets for personal use. The cardholder partially repaid

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the cost of the tickets but had a remaining balance of \$379. The Bank of America has written off the balance of the cardholder's account.

The facts of this case demonstrate a complete breakdown in internal controls, particularly in the area of proper review and certification of monthly statements. The individual who approved the payment to Citibank for these fraudulent charges told us that he signed off on the January 2000 statement without reviewing it to determine if the transactions were valid. It is unclear whether the credit NPWC ultimately received was the result of the Citibank investigation of the case or NPWC's determining some time after payment of the bill that the charges were fraudulent. NPWC also did not properly cancel the purchase card account of this cardholder after the cardholder had moved on to another organization within the Navy. Further, NPWC paid the purchase card bill that included this cardholder's personal automobile rental, a clear indication that the monthly review and certification of bills was not being done. Finally, as of February 6, 2002, no disciplinary actions had been taken against this cardholder. Our Office of Special Investigations referred this case back to the Naval Criminal Investigative Service for further investigation and, if warranted, prosecution.

We also followed up on the previously reported September 1999 compromise of up to 2,600 purchase card accounts assigned to Navy activities in the San Diego area. We reported that Navy investigators were able to identify only a partial list consisting of 681 compromised accounts. We recommended that the Navy act immediately to cancel all known active compromised accounts. In December 2001, Navy notified us that all 681 compromised accounts we identified in the July testimony were cancelled, including 22 active SPAWAR Systems Center accounts. However, no other action was taken by the Navy to identify or cancel the remaining nearly 2,000 accounts that were compromised in September 1999. Our investigators subsequently identified the source of the compromised accounts as the database of a Navy vendor, which provided NCIS with the names of its former employees who were possible suspects in the theft of data. In January 2002, the vendor provided our investigators with the entire list of the 2,595 compromised accounts. We provided this list to the Navy and recommended that it immediately cancel the remaining 1,914 compromised account numbers. We found that 78 SPAWAR Systems Center and 10 NPWC compromised accounts were active as of December 2001. As noted previously, 3 of the examples of potentially fraudulent SPAWAR Systems Center activity reported in table 5 involved these compromised accounts.

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As we reported in our previous testimony, as of January 2001, at least 30 of the nearly 2,600 compromised account numbers were used by 27 alleged suspects to make more than \$27,000 in fraudulent transactions for pizza, jewelry, phone calls, tires, and flowers. However, with the lack of effective controls over independent receipt for goods and services and proper review and certification of purchase card statements for payment that we identified at the two units, it will be difficult, if not impossible, for the Navy—including SPAWAR Systems Center and NPWC—to identify fraudulent purchases as they occur, or to determine the extent of the fraudulent use of compromised accounts. On December 11, 2001, the NCIS case on the compromised Navy purchase card numbers was presented to the U.S. Attorney's Office, Southern District of California, San Diego, for prosecution. The U.S. Attorney's Office declined prosecution of the case due to the low known dollar loss of \$28,734. The NCIS case was closed on December 20, 2001.

The following are other cases of potential fraudulent activity.

- A fraud hotline call alerted NPWC to a case involving two NPWC employees, an air conditioning equipment mechanic—who was a purchase card holder—and his supervisor. The alleged fraud includes the element of collusion, which internal controls generally are not designed to prevent. However, adequate monitoring of purchase card transactions, along with the enforcement of controls—such as documentation of independent confirmation of receipt and acceptance and recording of accountable items in property records—will make detection easier. In this case, the cardholder allegedly made fraudulent purchase card acquisitions during the period of April 1999 through December 1999 to obtain electronic planners, leather organizers, a digital camera, a scanner/printer, and various cellular telephone accessories for himself and his supervisor. These items totaled more than \$2,500. NPWC initiated administrative action and gave a notice of proposed removal to the cardholder on August 15, 2000, and to the supervisor on August 1, 2000. Both employees resigned after they had repaid the Navy nearly \$6,000 but before formal removal. Criminal actions were not taken against the individuals.
- SPAWAR Systems Center's Command Evaluation is currently investigating purchases made by cardholders in one of SPAWAR Systems Center's divisions. This is an ongoing investigation focused on transactions made during the period August 2000 through April 2001. Preliminary findings resulted in a request from Command Evaluation to the SPAWAR Systems Center agency program coordinator to suspend

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purchase card authority for all cardholders and approving officials in the affected division until the investigation is completed.

- Our Office of Special Investigations is conducting a further investigation of about \$164,000 in transactions during fiscal year 2001 between SPAWAR Systems Center and one of its contractors for potentially fraudulent activity. The SPAWAR Systems Center division responsible for these purchase card transactions is the same department that SPAWAR Systems Center's Command Evaluation is currently reviewing, as discussed in the previous bullet. This case is discussed in more detail in the following section on improper purchases.

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## Improper Transactions

We identified transactions for SPAWAR Systems Center and NPWC that were improper, including some that involved the improper use of federal funds. The transactions we determined to be improper are those purchases intended for government use, but are not for a purpose that is permitted by law, regulation, or DOD policy. We also identified as improper numerous purchases made on the same day from the same vendor that appeared to circumvent cardholder single transaction limits. *Federal Acquisition Regulation* and NAVSUP Instruction 4200.94 guidelines prohibit splitting purchase requirements into more than one transaction to avoid the need to obtain competitive bids on purchases over the \$2,500 micropurchase threshold or to circumvent higher single transaction limits for payments on deliverables under requirements contracts. We identified these improper transactions as part of our review of about 161 SPAWAR Systems Center and 145 NPWC fiscal year 2001 transactions and related activity. We identified most of these transactions as part of our data mining of transactions with questionable vendors, although several were identified as part of our statistical sample.

## Transactions Not Permitted by Law, Regulation, or DOD Policy

The Federal Acquisition Regulation, 48 C.F.R. 13.301(a), provides that the governmentwide commercial purchase card “may be used only for purchases that are otherwise authorized by law or regulations.” Therefore, a procurement using the purchase card is lawful only if it would be lawful using conventional procurement methods. Under 31 U.S.C. 1301(a), “[a]ppropriations shall only be applied to the objects for which the appropriations were made . . .” In the absence of specific statutory authority, appropriated funds may only be used to purchase items for official purposes, and may not be used to acquire items for the personal benefit of a government employee. As previously discussed NPWC identified approximately 600 transactions that violated the Navy’s prohibition against using the purchase card to acquire noncommonly used



hazardous materials. As shown in table 6, we found examples of purchases that were not authorized by law, regulation, or policy.

**Table 6: Transactions Not Permitted by Law, Regulation, or Policy**

Type of items purchased	Unit	Example vendors	Nature of improper transaction	Total transaction amounts
Food and refreshments	Both	Admiral Kidd Catering, Omni Hotel, Expressly Gourmet, Dave's Snack Bar, Embassy Suites	Not authorized by law	\$ 8,500
Clothing	SPAWAR	Sport Chalet, Twig's Alaskan Gifts	Not authorized by law; see additional clothing in table 8	\$282
Luxury rental cars (e.g., Lincoln Town Car)	NPWC	Enterprise, Courtesy, Fuller	Not in accordance with DOD policy; abusive	\$7,028
Contracted services	SPAWAR	Telecommunications contractor	Not in accordance with Navy policy; potentially fraudulent	\$164,143
Convenience check	SPAWAR	U.S. Postal Service	Not in accordance with DOD policy; abusive	\$347,120
Printing services	SPAWAR	Kinko's	Not in accordance with policy to use the Defense Automated Printing Service	\$3,763
Sales tax	SPAWAR	Numerous	Not authorized by law	\$283

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*Food.* We found a number of purchases of food at SPAWAR Headquarters, SPAWAR Systems Center and NPWC that represent an improper use of federal funds. Without statutory authority, appropriated funds may not be used to furnish meals or refreshments to employees within their normal duty stations.<sup>15</sup> Free food and other refreshments normally cannot be justified as a necessary expense of an agency's appropriation because these items are considered personal expenses that federal employees should pay for from their own salaries.<sup>16</sup> In January 2000, the General Services Administration (GSA) amended the government travel regulations to permit agencies to provide light refreshments to employees attending conferences involving travel. In response to GSA's action, DOD amended the Joint Travel Regulation (JTR) and Joint Federal Travel Regulation (JFTR) to permit similar light refreshments for DOD civilian employees and military members. In April 2001, DOD clarified the JTR/JFTR rule to permit light refreshments only when a majority of the attendees (51 percent or more) are in travel status.<sup>17</sup> The following food purchases should not have been paid for with appropriated funds.

- Three instances in which NPWC purchased primarily meals and light refreshments for employee-related activities, including team meetings, at a cost of about \$4,100. The supporting documentation we were provided initially by NPWC showed these purchases to be the rental of rooms for meetings. However, after our further inquiry of the Admiral Kidd Catering Center we found that a large portion of the purchases were related to food and refreshments including luncheon buffets. Officials from the Admiral Kidd Catering Center indicated that the invoices for these events do not show the food purchases because they knew that the Navy is not allowed to pay for food at these conferences.
- Five instances in which SPAWAR Headquarters or Systems Center cardholders purchased primarily light refreshments for employee team meetings or training sessions when less than a majority of the attendees were on travel, at a total cost of about \$1,000.

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<sup>15</sup>72 Comp. Gen. 178, 179 (1993); 65 Comp. Gen. 508, 509 (1986).

<sup>16</sup>65 Comp. Gen. 738, 739 (1986).

<sup>17</sup>For purposes of this testimony, we determined a purchase of food to be improper if it did not comply with the JTR/JFTR light refreshment rule. However, we have some questions about the validity of this rule and therefore do not necessarily conclude that food purchases in accordance with this rule are proper. We are currently working on a legal decision concerning the validity of the GSA and DOD light refreshment policies.

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- One transaction in which a SPAWAR Headquarters program management office had a 2-day off-site meeting at a San Diego hotel for about 20 staff, and SPAWAR Headquarters provided all participants with lunch and refreshments. The cardholder provided us with documentation indicating that SPAWAR Headquarters spent \$2,400 to rent a room at the hotel where the meeting was held. The assistant program manager told us that the \$2,400 charge was just for the meeting room rental. However, we obtained documents directly from the hotel, which were signed by the assistant program manager, that prove that SPAWAR Headquarters paid about \$1,400 for lunch and refreshments for both days. Furthermore, by comparing the hotel's copy of the event confirmation form with the copy of the same form provided by SPAWAR Headquarters, it appeared that the form had been altered to indicate that the \$2,400 was only for rent. After briefing SPAWAR Headquarters and System Center management of our findings, the SPAWAR Headquarters inspector general opened an investigation of this matter that is still ongoing.

*Clothing.* We identified several purchases of clothing by SPAWAR Systems Center employees that should not have been purchased with appropriated funds. According to 5 U.S.C. 7903, agencies are authorized to purchase protective clothing for employee use if the agency can show that (1) the item is special and not part of the ordinary furnishings that an employee is expected to supply, (2) the item is essential for the safe and successful accomplishment of the agency's mission, not solely for the employee's protection, and (3) the employee is engaged in hazardous duty. Further, according to a comptroller general decision dated March 6, 1984,<sup>18</sup> clothing purchased pursuant to this statute is property of the U.S. government and must only be used for official government business. Thus, except for rare circumstances in which a clothing purchase meets stringent requirements, it is usually considered a personal item that should be purchased by the individual.

For the transactions that we tested, we found that several SPAWAR Systems Center employees had purchased clothing, such as a lightweight hooded jacket, long pants, and a shirt that should have been purchased by

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<sup>18</sup>63 Comp. Gen. 245, 247 (1984). In requesting the comptroller general's approval of the purchases, the agency represented that "the parkas would be labeled as [agency] property, centrally controlled, and issued and reissued to employees only for job requirements." SPAWAR Systems Center officials have not made a similar representation.

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the employees with their own money. One of the cardholders told us that he believed his purchases of clothing were appropriate because other SPAWAR Systems Center employees were also purchasing clothing. As a result of this statement, we expanded our analysis and found that during fiscal year 2001 SPAWAR Systems Center cardholders purchased about \$4,400 worth of socks, gloves, parkas, jackets, hats, shirts, and sweatpants from REI and Cabela's that appear to also be improper. Because we did not test each of these transactions to determine if they were adequately justified, we included the \$4,400 as questionable clothing purchases in table 8.

*Luxury car rentals.* We identified 34 fiscal year 2001 purchases totaling \$7,028 in which NPWC could not support the representation that rentals of Lincoln Town Cars or similar luxury cars were for individuals authorized to obtain a luxury car. DOD policy provides that only four-star admirals and above (or equivalent) qualify to rent such luxury vehicles. Our analysis of NPWC's fiscal year 2001 purchase card transactions for rentals of commercial vehicles disclosed 42 instances of rentals of luxury vehicles (e.g., Lincoln Town Cars and Cadillac DeVilles). NPWC cardholder documentation showed that only 8 of the 42 rentals were for four-star admirals. In the other 34 instances, cardholder documentation either disclosed that a rental of a Lincoln Town Car or similar vehicle was for a Navy captain or lower-ranking admiral, or the documentation was insufficient to determine who rented the automobile. As a result of its inappropriately renting the Lincolns and other luxury cars, we estimated that NPWC spent about \$2,000 more than it would have if NPWC had rented an automobile that was consistent with DOD policy. Consistent with NPWC's proactive approach, the day after we brought this issue to management's attention, controls and procedures were put in place to resolve this issue. Because these purchases were at an excessive cost, they also fall under the definition of abusive transactions.

*Prepayment of goods and services.* We also identified 75 SPAWAR Systems Center purchase card transactions, for about \$164,000 with a telecommunications contractor, that appear to be advance payments for electrical engineering services. Section 3324 of title 31, United States Code, prohibits an agency from paying for goods or services before the government has received them (with limited exceptions). Further, Navy purchase card procedures prohibit advance payment for goods and services, except in cases such as subscriptions and post office box rentals. SPAWAR Systems Center project managers gave us with several conflicting explanations of the nature of the arrangement with the contractor, first

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indicating that the charges were for time and materials and later stating that each purchase was a fixed-fee agreement. No documentation was provided to support either explanation. We were also told by SPAWAR Systems Center employees that the purchase card was used to expedite the procurement of goods and services from the contractor because the preparation, approval, and issuance of a delivery order was too time-consuming in certain circumstances.

For all 75 transactions, we found that the contractor's estimated costs were almost always equal or close to the \$2,500 micropurchase threshold. Because we found no documentation of independent receipt and acceptance of the services provided or any documentation that the work for these charges was performed, these charges are also potentially fraudulent. We therefore referred the SPAWAR Systems Center purchase card activity with this contractor to our Office of Special Investigations for further investigation.

*Convenience checks.* We found that SPAWAR Systems Center improperly used convenience checks in fiscal year 2001, which ultimately resulted in NAVSUP canceling the use of these checks at SPAWAR Systems Center in November 2001, after we made inquires concerning the number of SPAWAR Systems Center convenience checks issued that exceeded the \$2,500-per-check limit. Convenience checks are charged directly to the government purchase card account and are used to pay vendors and other government agencies that do not accept the purchase card. According to the SPAWAR Systems Center agency program coordinator, two Citibank convenience check accounts were established in December 1998, presumably before NAVSUP changed its policy allowing only one account per unit. The SPAWAR Systems Center head of supply and contracts canceled one of these accounts on November 15, 2001, after we made inquires concerning SPAWAR Systems Center's convenience check usage.

We found that the two employees responsible for these two accounts had issued 187 checks during fiscal year 2001, 30 of which were in excess of the \$2,500 limit for individual checks, for a total of over \$347,000. The checks that exceeded the \$2,500 limit were issued to pay for postage meter charges, various services to vendors who were sole source providers, and training. After we made inquires to the DOD Purchase Card Program Office regarding the propriety of SPAWAR Systems Center's writing convenience checks in excess of \$2,500, NAVSUP canceled SPAWAR Systems Center's convenience check privileges on November 20, 2001. We also believe the use of convenience checks for over \$2,500 purchases is not economical

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because of the 1.25 percent fee charged per transaction. For example, SPAWAR Systems Center used convenience checks to make one purchase of \$10,000 for postage, which resulted in a fee of \$125.

*Printing.* In addition, we identified several instances in which SPAWAR Systems Center did not adhere to DOD's policy to use the Defense Automated Printing Service (DAPS) to perform all printing jobs. Further, the Navy's purchase card list of prohibited or special-approval items states that cardholders are prohibited from buying printing or duplication services from entities other than DAPS. In two of the transactions that we audited, SPAWAR Systems Center paid about \$3,800 to Kinko's for printing manuals.

*Sales tax.* We identified eight instances of sales taxes paid on SPAWAR Systems Center purchases. Payment of sales tax for the purchase of goods and services for the government is not authorized by law. According to SPAWAR Systems Center employees, these sales tax payments generally occurred when the vendors did not know how to process a nontaxable transaction.

## Split Purchases

Our analysis of the population of fiscal year 2001 transactions made by one or more cardholders on the same day from the same vendor, which appeared to circumvent cardholder single transaction limits, identified about \$7.5 million in SPAWAR Systems Center potential split purchases and nearly \$3 million in NPWC potential split purchases. The *Federal Acquisition Regulation* and Navy purchase card policies and procedures prohibit splitting a purchase into more than one transaction to avoid the requirement to obtain competitive bids for purchases over the \$2,500 micropurchase threshold or to avoid other established credit limits. Once items exceed the \$2,500 micropurchase threshold, they are to be purchased in accordance with simplified acquisition procedures, which are more stringent than those for micropurchases.

Our analysis of the population of fiscal year 2001 SPAWAR Systems Center and NPWC transactions identified a substantial number of potential split purchases. To determine whether these were, in fact, split purchases, we obtained and analyzed the supporting documentation for 30 potential split purchases at SPAWAR Systems Center and 20 potential split purchases at NPWC. We found that in many instances, cardholders made multiple purchases from the same vendor within a few minutes or a few hours for items such as computers, computer-related equipment, cell phone services, and small contracts that involved the same, sequential, or nearly sequential

purchase order and vendor invoice numbers. Based on our analyses, we concluded that 13 of the 30 SPAWAR Systems Center and 10 of the 20 NPWC purchases that we examined were split into two or more transactions to avoid micropurchase thresholds. Table 7 provides several examples of cardholder purchases that we believe represent split purchases intended to circumvent the \$2,500 micropurchase limit or other cardholder single transaction limit.

**Table 7: Examples of Potential SPAWAR Systems Center and Navy Public Works Center San Diego Split Purchases**

Navy unit	Vendor	Date	Charge	Items purchased	Cost of items	Indicator of split purchase
SPAWAR	Nextel Wireless	7/17/2001	10 charges	Cell phone service	\$24,482	10 separate charges of about \$2,500 each to pay July monthly bill
SPAWAR	World Wide Technology	9/05/2001	1	Computer equipment	\$1,938	Computer equipment resides within the cabinet
			2	Cabinet	\$2,214	
SPAWAR	CompUSA	9/11/2001	1	Software	\$2,240	Orders placed only minutes apart for similar products
			2	Software	\$1,160	
NPWC	Construction Fence Rental	7/12/01	1	Security fence	\$2,442	Rental of security fence on the same day for the same construction project
			2	Security fence	\$2,310	
			3	Security fence	\$75	
NPWC	Comlogic NCC Computers	9/17/2001	1	Computer	\$2,495	Multiple charges on the same day for items listed on the same authorization
			2	Computer parts	\$1,401	
			3	Computer software	\$149	
NPWC	Union Electric Motors	7/5/2001	1	Custom control panel and components	\$2,485	Purchases were on the same day and vendor invoice was sequentially numbered; vendor said transactions were part of single sale
			2	Additional component for control panel	\$885	

Note: All cardholders making these transactions had \$2,500 single-transaction limits.

By circumventing the competitive requirements of the simplified acquisition procedures, we believe that in many instances SPAWAR

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Systems Center and NPWC may not be getting the best prices possible for the government. As a result, these split purchases are likely increasing the cost of government procurements using the purchase card and, thus, at least partially offsetting its benefits.

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## Abusive and Questionable Transactions

We identified numerous examples of abusive and questionable transactions at SPAWAR Systems Center during fiscal year 2001. Several of the improper transactions for NPWC discussed previously are also abusive or questionable; however, we found no other abusive items related to NPWC in our statistical sample or data mining. We defined abusive transactions as those that were authorized, but the items purchased were at an excessive cost (e.g., “gold plated”) or for a questionable government need, or both. Questionable transactions are those that appear to be improper or abusive but for which there is insufficient documentation to conclude either. For all abusive or questionable items, we concluded that cardholders purchased items for which there was not a reasonable and/or documented justification.

Many of the purchases we found to be abusive or questionable fall into categories described in GAO’s *Guide for Evaluating and Testing Controls Over Sensitive Payments* (GAO/AFMD-8.1.2, May 1993). The guide states: “Abuse is distinct from illegal acts (noncompliance). When abuse occurs, no law or regulation is violated. Rather, abuse occurs when the conduct of a government organization, program, activity, or function falls short of societal expectations of prudent behavior.” Table 8 shows the potentially abusive and questionable transactions we identified at SPAWAR Systems Center for fiscal year 2001.

Further, several of these items fall into the category of pilferable items, which, as discussed previously, SPAWAR Systems Center no longer records in its property records and therefore does not maintain accountability over them. For example, the cell phones and headset are items that could easily be converted to personal use without detection as they are not subject to bar coding and periodic inventory. In addition, items that may have limited use on one project could be made available for use on other projects, if their existence and location were recorded in centralized property records. Such visibility could serve to avoid duplicative purchases as well as provide the control needed to help prevent misuse of government property.



**Table 8: Abusive and Questionable Transactions at SPAWAR Systems Center**

Type of items purchased	Example vendors	Nature of transaction	Abusive/questionable	Total amount
Room rental and refreshments	Bally's in Las Vegas	Organization meeting for about 30 staff members in Las Vegas	Questionable	\$2,308
Cellular phones and services	Nextel, SprintPCS, AT&T Wireless	Abusive and uneconomical procurement, physical control, and usage of services	Abusive and questionable	\$74,936
Clothing (see also table 6)	Cabela's, REI, Sport Chalet	Purchase of personal items such as socks, gloves, parkas, jackets, hats, shirts, and sweatpants	Questionable	\$4,668
Luggage	The Luggage Center	Numerous wallets, passport holders, backpacks, neck pouches, and other items given away	Abusive	\$775
Designer leather goods	Louis Vuitton, Franklin Covey	Purchase of designer and high-cost leather briefcases, totes, portfolios, day planners, palm pilot cases, wallets, and purses	Abusive and questionable; improper for nonmandatory source of supply	\$33,054
Computer bags	SkyMall	Purchase of computer bags at an excessive cost, two given away	Abusive	\$731
Headset	Bose	High-cost headset purchased, questionable need	Abusive	\$299
Lego "Mindstorm" robots	Toys R Us	Four computer robot kits given away or at employee's home	Abusive	\$800

*Room rental and refreshments.* We identified meeting room rental and refreshments at Bally's, a hotel and casino in Las Vegas, which is a questionable transaction. This charge was related to a trip for about 30 staff members from SPAWAR Headquarters. SPAWAR officials told us that the trip was an organizational meeting to work out the details of a planned merger of two program management working groups. According to SPAWAR Headquarters officials, the staff members who attended the organizational meeting spent the first morning of the 3-day trip at Nellis Air Force Base discussing issues related to an ongoing project involving a test and evaluation squadron. The cost of the transaction we reviewed was about \$2,300, and we estimate the total cost of the trip was between \$15,000 and \$20,000. For the specific transaction we reviewed, we found that the same control weaknesses we reported earlier applied, including lack of independent receipt of goods and proper certification of the monthly bill. There was no documentation showing that this transaction had been authorized in advance or that management had fully considered the cost of this trip and potentially less costly alternatives.

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GAO's *Guide for Evaluating and Testing Controls Over Sensitive Payments* notes the importance of the control environment and the need for effective controls related to sensitive payments. A trip for about 30 employees to a Las Vegas hotel and casino for 3 days at a significant cost to the government is clearly sensitive and should be subjected to a high level of scrutiny, with clear documentation and approval in advance of the event. We would expect to see authorization in advance of the procurement by someone at a higher level than the most senior individual involved in the event—in this case, a captain. We found no documented justification to indicate a valid need for this 3-day meeting to be held in Las Vegas nor did we find an evaluation of the cost-benefit of having the meeting in Las Vegas versus alternative sites. Thus, we question whether the entire cost of the trip was a prudent expenditure of government funds. We did not review the travel vouchers and related documentation for the other component costs of the trip such as airfare, rental cars, or hotel bills; however, in estimating the total cost of the trip, we reviewed available documentation related to travel card usage from Bank of America.

*Cell phone usage.* We found significant breakdowns in controls at SPAWAR Systems Center over the use of cell phones and related services, resulting in abusive and wasteful expenditures of government resources. In addition, we found a proliferation of cell phone agreements, with the purchase card being used to purchase equipment and services from more than 40 different cell phone companies at a total cost of \$341,000 for fiscal year 2001. According to SPAWAR Systems Center management, they have a master cell phone contract with AT&T Wireless. However, lack of management oversight and a large number of available purchase cards has resulted in individuals with purchase cards or their supervisors deciding who needs a cell phone, which cell phone company to use, and what type of calling plan to purchase. For all but one of the transactions that we audited, we did not find any evidence that the monthly cell phone bills had been independently reviewed to ensure the transactions were reasonable and for valid government purposes.

In the large case we audited, we identified a \$24,000 monthly bill for about 200 Nextel cell phones and related services that were acquired to provide a voice communication system for coordination and control among various groups during a demonstration and test of a military wide area relay network. The Nextel phones were selected for evaluation as an alternative not for their standard cellular phone-to-phone capability, but for their “group-talk” feature, which provides a wireless “walkie-talkie” like capability for preprogrammed work groups. One of the key control failures

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with this cell phone procurement was related to SPAWAR Systems Center's handing out cell phones to project team members and government contractors without keeping an inventory of who had each cell phone. Contractors that used these government cell phones told us that SPAWAR Systems Center officials brought a box of 60 or 70 cell phones to a meeting and handed them out to contractors that were part of the team. The contractors told us that SPAWAR Systems Center provided them with no instructions on proper use of the cell phone. The approximately 200 cell phones were not physically controlled and SPAWAR Systems Center did not have a list of who had the cell phones. Based on further investigation, we found that these contractors were using the cell phones to call friends and family and to conduct other personal business. Based on our review of the bills for this Nextel account—which totaled about \$74,000 during fiscal year 2001—we estimated that about \$9,200 was spent on long distance and other local telephone calls, which was not the primary intended purpose of these cell phones.

In addition to the Nextel contract, we also identified cell phone contracts with large monthly fees for phones that were either used infrequently or not at all. For example, we audited one account with five cell phones. The service for each phone included 500 minutes of airtime, and the basic service cost of each cell phone was \$50 a month. For the 3 months of activity we audited, we found that three of the five phones had either no voice activity or very little. For example, one of these cell phones had only 2 minutes of calls during a month that we audited. This is the equivalent of the government paying \$25 per minute for airtime.

We identified a number of other abusive and questionable charges including the following.

- One cardholder purchased \$775 of luggage including wallets, passport holders, backpacks, neck pouches, and other items. The cardholder told us that these items were used to carry or ship equipment to universities for outreach activities. At the end of the events, the individual told us that the items were given away. There is no documentation available showing the authorization and need to purchase this luggage for purposes of carrying or shipping equipment. This purchase appears abusive because a valid government need is neither apparent nor documented, particularly since the cardholder gave away government property that could easily be converted to personal use.

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- As part of our data mining, we identified purchases of day planners from commercial vendors, including calendar refills along with designer leather holders purchased from Louis Vuitton. By law, government agencies are directed to purchase certain products, including day planners and calendars, from certified nonprofit agencies that employ people who are blind or severely disabled. This program is referred to as the Javits-Wagner-O'Day (JWOD) program, which is intended to provide employment opportunities for thousands of people with disabilities to earn good wages and move toward greater independence. In addition, DOD's policy requires the use of JWOD sources, whether or not the procurement is made using a purchase card, unless the central JWOD agency specifically authorizes an exception. In this year's audit, we found that SPAWAR Systems Center employees had purchased three Louis Vuitton calendar refills for \$27 each, and we identified three purchases of Louis Vuitton calendar holders at a cost of \$255 each in fiscal year 2000. The most expensive JWOD calendar holders—specifically designed for DOD—cost about \$40.
  - In addition, we identified about \$33,000 in purchases from Franklin Covey of designer and high-cost leather briefcases, purses (totes), portfolios, day planners and refills, palm pilot cases, and wallets. For example, we found leather purses costing up to \$195 each and portfolios costing up to \$135 each. Many of these purchases are of a questionable government need and should be paid for by the individual. To the extent the day planners and calendar refills were proper government purchases, they were at an excessive cost and, as with the Louis Vuitton day planners, should have been purchased from a JWOD source at a substantially lower cost. Circumventing the JWOD requirements and purchasing these items from commercial vendors is not only an abuse and waste of taxpayer dollars, but shows particularly poor judgment and serious internal control weaknesses.
  - We identified the purchase of three computer bags from SkyMall at a cost of \$161 each, and another purchase of a computer bag at a store in Italy for almost \$250. All three computer bags were purchased by employees who were traveling on SPAWAR Systems Center business. The cost of these computer bag purchases is excessive compared to other standard bags we found purchased for \$25. In addition, the cardholder who purchased the SkyMall bags told us that one of the two bags, along with another bag purchased in a separate transaction, was given to non-SPAWAR Systems Center government employees working on the project.
  - We identified the purchase of a Bose headset at a cost of \$299. The cardholder told us that the headset was originally purchased for a

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project but had never been used on the project. The cardholder stated that he has used the headset to listen to music on official government travel aboard airplanes.

- We identified four Lego “Mindstorm” computer robot kits that were purchased at Toys R Us at a total cost of \$800. The SPAWAR Systems Center employee who requested that these robots be purchased initially told us that they were purchased as a learning tool for new professionals and junior engineers to learn cooperative behavior between robots and to conduct robotic research. However, during our interview, this SPAWAR Systems Center employee stated that at the time of these purchases his division did not have any new professionals scheduled to rotate through his assignment. Within 6 weeks of purchasing the kits, the employee removed all four from SPAWAR Systems Center, brought two of them to a local elementary school where he mentors an after school science club, and brought two to his home. We believe this purchase is abusive because there does not appear to be a valid government need for the purchase, and because the cardholder effectively gave away government property that could easily be converted to personal use. As part of the NAVSUP mandated stand-down transaction review, SPAWAR Systems Center also reviewed the transactions for the Lego robot kits and initially questioned their propriety. However, contrary to our conclusion that these purchases were abusive, SPAWAR Systems Center ultimately considered the Lego kits to be a valid government purchase.

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## Disciplinary Action Seldom Taken Against Cardholders Who Made Abusive Purchases

In our November 30, 2001, report<sup>19</sup> on the purchase card controls at SPAWAR Systems Center and NPWC, we recommended that action be taken to help ensure that cardholders adhere to applicable purchase card laws, regulations, internal control and accounting standards, and policies and procedures. Specifically, we recommended that the commander, Naval Supply Systems Command, revise NAVSUP Instruction 4200.94 to include specific consequences for noncompliance with purchase card policies and procedures. DOD did not concur with that recommendation and stated that existing Navy policy clearly identifies consequences for fraud, abuse, and misuse. We continue to believe that Navy needs to establish specific consequences for these purchase card problems because the Navy policy does not identify any specific consequences for failure to follow control

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<sup>19</sup>GAO-02-32.

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requirements. Enforcement of the consequences is also critical. For example, only one of the cardholders referred to in this testimony or our July 30, 2001, testimony had formal disciplinary or administrative action—in the form of removal of the purchase card—taken against them.

Thus, we reiterate our previous recommendation that the Navy enforce purchase card controls by establishing specific formal disciplinary and/or administrative consequences—such as withdrawal of cardholder status, reprimand, suspension from employment for several days, and, if necessary, firing. Unless cardholders and approving officials are held accountable for following key internal controls, the Navy is likely to continue to experience the types of fraudulent, improper, and abusive and questionable transactions identified in our work.

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## Conclusions

The weaknesses identified in the purchase card program at these two Navy units are emblematic of broader financial management and business process reform issues across DOD. The comptroller general testified on March 6, 2002, before the Subcommittee on Readiness and Management Support, Senate Committee on Armed Services, on the major challenges facing the department in its business process transformation efforts.<sup>20</sup> In light of the events of September 11, and the federal government's short- and long-term budget challenges, it is more important than ever that DOD get the most from every dollar spent. As Secretary Rumsfeld has noted, billions of dollars of resources could be freed up for national defense priorities by eliminating waste and inefficiencies in existing DOD business processes. The cultural issues we identified at SPAWAR Systems Center—such as the failure to acknowledge significant control weaknesses in the purchase card program, the parochial approach to program management without regard to broader Navy and DOD initiatives, and the lack of consequences on a personal or organizational level for failure to adhere to controls—are a major impediment to the improvements that are needed to stop wasteful and abusive purchases and ensure that taxpayer dollars are spent where national priorities dictate. In response to requests from this Subcommittee and Senator Grassley, we have ongoing audits related to the purchase and travel card programs at the Army, Navy, and Air Force and

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<sup>20</sup>U.S. General Accounting Office, *DOD Financial Management: Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform*, GAO-02-497T (Washington, D.C.: Mar. 6, 2002).

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plan to offer additional recommendations to strengthen the controls over these programs.

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## Contacts and Acknowledgments

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# Background

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The Navy's purchase card program is part of the Governmentwide Commercial Purchase Card Program, which was established to streamline federal agency acquisition processes by providing a low-cost, efficient vehicle for obtaining goods and services directly from vendors. According to GSA, DOD reported that it used purchase cards for more than 10.7 million transactions, valued at \$6.1 billion, during fiscal year 2001. The Navy's reported purchase card activity—MasterCards issued to civilian and military personnel—totaled about 2.8 million transactions, valued at \$1.8 billion, during fiscal year 2001. This represented nearly 30 percent of DOD's activity for fiscal year 2001. According to unaudited DOD data, SPAWAR Systems Center and NPWC made about \$64 million in purchase card acquisitions during fiscal year 2001. Because these two units have cardholders located outside the San Diego area, we limited our testing to only those SPAWAR Systems Center and NPWC cardholders who are located in San Diego, California. Those cardholders accounted for about \$50 million of SPAWAR Systems Center and NPWC's \$64 million in purchase card transactions.

SPAWAR Systems Center and NPWC are both working capital fund activities. SPAWAR Systems Center performs research, engineering, and technical support, and NPWC provides maintenance, construction, and operations support to Navy programs. Both of these Navy programs have locations throughout the United States. Our review focused on the purchase card program at the San Diego units only. For SPAWAR Systems Center, this included SPAWAR Headquarters, which is located in San Diego, and SPAWAR Systems Center San Diego.

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## Governmentwide Purchase Card Program Guidelines

Under the Federal Acquisition Streamlining Act of 1994, the *Defense Federal Acquisition Regulation Supplement* guidelines, eligible purchases include (1) micropurchases (transactions up to \$2,500, for which competitive bids are not needed); (2) purchases for training services up to \$25,000; and (3) payment for items costing over \$2,500 that are on the General Services Administration's (GSA) preapproved schedule, including items on requirements contracts. The streamlined acquisition threshold for such contract payments is \$100,000 per transaction. Accordingly, cardholders may have single-transaction purchase limits of \$2,500 or \$25,000, and a few cardholders may have transaction limits of up to \$100,000 or more. Under the GSA blanket contract, the Navy has contracted with Citibank for its purchase card services, while the Army and the Air Force have contracted with U.S. Bank.

The *Federal Acquisition Regulation*, Part 13, "Simplified Acquisition Procedures," establishes criteria for using purchase cards to place orders and make payments. U.S. Treasury regulations issued pursuant to provisions of law in 31 U.S.C. 3321, 3322, 3325, 3327, and 3335, govern purchase card payment certification, processing, and disbursement. DOD's Purchase Card Joint Program Management Office, which is in the office of the assistant secretary of the army for acquisition, logistics, and technology, has established departmentwide policies and procedures governing the use of purchase cards.

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## Navy Purchase Card Acquisition and Payment Processes

The NAVSUP is responsible for the overall management of the Navy's purchase card program, and has published the NAVSUP Instruction 4200.94, *Department of the Navy Policies and Procedures for Implementing the Governmentwide Purchase Card Program*. Under the NAVSUP Instruction, each Navy Command's head contracting officer authorizes purchase card program coordinators in local Navy units to obtain purchase cards and establish credit limits. The program coordinators are responsible for administering the purchase card program within their designated span of control and serve as the communication link between Navy units and the purchase card issuing bank. The other key personnel in the purchase card program are the approving officials and the cardholders.

### Approving Officials

If operating effectively, the approving official is responsible for ensuring that all purchases made by the cardholders within his or her cognizance were appropriate and that the charges are accurate. The approving official is supposed to resolve all questionable purchases with the cardholder before certifying the bill for payment. In the event an unauthorized purchase is detected, the approving official is supposed to notify the agency program coordinator and other appropriate personnel within the command in accordance with the command procedures. After reviewing the monthly statement, the approving official is to certify the monthly invoice and send it to the Defense Finance and Accounting Service for payment.

### Cardholders

A purchase card holder is a Navy employee who has been issued a purchase card. The purchase card bears the cardholder's name and the account number that has been assigned to the individual. The cardholder is expected to safeguard the purchase card as if it were cash.

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Designation of Cardholders	When a supervisor requests that a staff member receive a purchase card, the agency program coordinator is to first provide training on purchase card policies and procedures and then establish a credit limit and issue a purchase card to the staff member.
Ordering Goods and Services	Purchase card holders are delegated limited contracting officer ordering responsibilities, but they do not negotiate or manage contracts. SPAWAR Systems Center and NPWC cardholders use purchase cards to order goods and services for their units as well as their customers. Cardholders may pick up items ordered directly from the vendor or request that items be shipped directly to end users (requesters). Upon receipt of items acquired by purchase cards, cardholders are to record the transaction in their purchase log and obtain documented independent confirmation from the end user, their supervisor, or another individual that the items have been received and accepted by the government. They are also to notify the property book officer of accountable items received so that these items can be recorded in the accountable property records.
Payment Processing	<p>The purchase card payment process begins with receipt of the monthly purchase card billing statements. Section 933 of the National Defense Authorization Act for Fiscal Year 2000, Public Law 106-65, requires DOD to issue regulations that ensure that purchase card holders and each official with authority to authorize expenditures charged to the purchase card reconcile charges with receipts and other supporting documentation before paying the monthly purchase card statement. NAVSUP Instruction 4200.94 states that upon receipt of the individual cardholder statement, the cardholder has 5 days to reconcile the transactions appearing on the statement by verifying their accuracy to the transactions appearing on the statement and notify the approving official in writing of any discrepancies in the statement.</p> <p>In addition, under the NAVSUP Instruction, before the credit card bill is paid the approving official is responsible for (1) ensuring that all purchases made by the cardholders within his or her cognizance are appropriate and that the charges are accurate and (2) the timely certification of the monthly summary statement for payment by the Defense Finance and Accounting Service (DFAS). The Instruction further states that within 5 days of receipt, the approving official must review and certify for payment the monthly billing statement, which is a summary invoice of all transactions of the cardholders under the approving official's purview. The approving official is to presume that all transactions on the monthly statements are proper unless notified in writing by the purchase card holder. However, the</p>

presumption does not relieve the approving official from reviewing for blatantly improper purchase card transactions and taking the appropriate action prior to certifying the invoice for payment. In addition, the approving official is to forward disputed charge forms to the unit's comptroller's office for submission to Citibank for credit. Under the Navy's contract, Citibank allows the Navy up to 60 days after the statement date to dispute invalid transactions and request a credit.

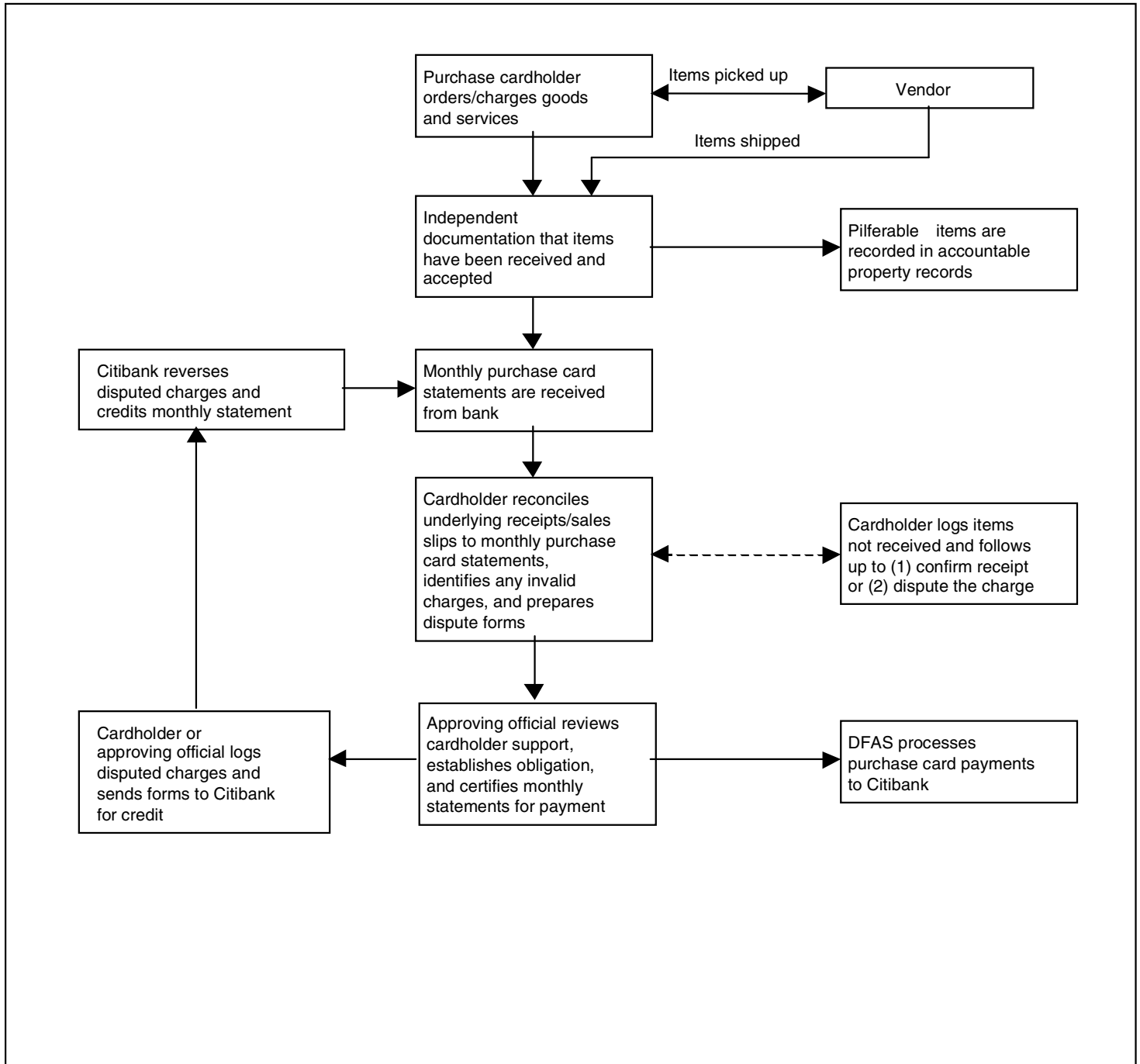
In our November 30, 2001, report<sup>21</sup> we recommended that the Navy modify its payment certification policy to require (1) cardholders to notify approving officials prior to payment that purchase card statements have been reconciled to supporting documentation, (2) approving officials to certify monthly statements only after reviewing them for potentially fraudulent improper and abusive transactions, and (3) approving officials to verify, on a sample basis, supporting documentation for various cardholder transactions prior to certifying monthly statements for payment. DOD concurred with this recommendation and stated the Navy would modify its payment certification procedures; however, as of February 26, 2002, Navy had not yet issued those changes to its procedures.

Upon receipt of the certified monthly purchase card summary statement, a DFAS vendor payment clerk is to (1) review the statement and supporting documents to confirm that the prompt-payment certification form has been properly completed and (2) subject it to automated and manual validations. DFAS effectively serves as a payment processing service and relies on the approving-official certification of the monthly payment as support to make the payment. The DFAS vendor payment system then batches all of the certified purchase card payments for that day and generates a tape for a single payment to Citibank by electronic funds transfer. Figure 1 illustrates the current design of the purchase card payment process for SPAWAR Systems Center and NPWC.

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<sup>21</sup>GAO-02-32.

Figure 1: SPAWAR and Navy Public Works Center Purchase Card Process



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# Scope and Methodology

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We reviewed purchase card controls for two Navy units based in San Diego, SPAWAR Systems Center and NPWC, and assessed changes that these two units made to their control environment since we notified the units of the problems with their respective purchase card programs in early June 2001. In addition we followed up on the status of fraud cases that we reported on in July 2001, and any other fraud cases we identified as part of this follow-up audit. Specifically, our assessment of SPAWAR Systems Center and the NPWC purchase card controls covered

- the overall management control environment, including (1) span of control issues related to the number of cardholders, (2) training for cardholders and accountable officers,<sup>22</sup> (3) monitoring and audit of purchase card activity, and (4) management’s attitude in establishing the needed controls, or “tone at the top;”
- tests of statistical samples of key controls over fourth quarter fiscal year 2001 purchase card transactions, including (1) documentation of independent confirmation that items or services paid for with the purchase card were received and (2) proper certification of the monthly purchase card statement for payment;
- to the extent feasible, substantive tests of accountable items in our sample transactions to verify whether they were recorded in property records and whether they could be found;
- data mining of the universe of fiscal year 2001 transactions to identify any potentially fraudulent, improper, and abusive or questionable transactions;<sup>23</sup>
- analysis and audit work related to invoices and other information obtained from three vendors—Cabela’s, REI, and Franklin Covey—from which, based on interviews with cardholders and our review of other

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<sup>22</sup>We also tested statistical samples of transactions to determine whether the two units had documented evidence that cardholders had received required purchase card training.

<sup>23</sup>We considered potentially fraudulent purchases to include those made by cardholders that were unauthorized and intended for personal use. The transactions we determined to be improper are those purchases intended for government use, but are not for a purpose that is permitted by law, regulation, or DOD policy. We also identified as improper numerous purchases made on the same day from the same vendor that appeared to circumvent cardholder single transaction limits. Many of the purchases we found to be abusive or questionable fall into categories described in GAO’s Guide for Evaluating and Testing Controls Over Sensitive Payments (GAO/AFMD-8.1.2, May 1993). The guide states that “Abuse is distinct from illegal acts (noncompliance). When abuse occurs, no law or regulation is violated. Rather, abuse occurs when the conduct of a government organization, program, activity, or function falls short of societal expectations of prudent behavior.”

transactions, we had reason to believe that SPAWAR Systems Center had made significant improper and abusive or questionable purchases during fiscal year 2001; and

- analysis of the universe of fourth-quarter fiscal year 2001 purchase card transactions to identify purchases that were split into one or more transactions to avoid micropurchase thresholds or other spending limits.

In addition, our Office of Special Investigations worked with DOD's criminal investigative agencies, Citibank, and credit card industry representatives to identify known and potentially fraudulent purchase card scams. Our Office of Special Investigations also investigated potentially fraudulent or abusive purchase card transactions that we identified while analyzing SPAWAR Systems Center and NPWC fiscal year 2001 purchase card transactions.

We used as our primary criteria applicable laws and regulations; our *Standards for Internal Control in the Federal Government*;<sup>24</sup> and our *Guide for Evaluating and Testing Controls Over Sensitive Payments*.<sup>25</sup> To assess the management control environment, we applied the fundamental concepts and standards in the GAO internal control standards to the practices followed by management in the four areas reviewed.

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## Statistical Sample of Internal Control Procedures

To test controls, we used a two-step sampling process for purchase card transactions that were recorded by Navy during the fourth quarter of fiscal year 2001. At SPAWAR Systems Center, we selected stratified random probability samples of 50 purchase card transactions from a population of 7,267 transactions totaling \$5,919,635. Because the majority of SPAWAR Systems Center transactions failed the control test we did not have to expand our sampling size. At NPWC, we initially selected a sample of 50 purchase card transactions from a population of 11,021 transactions

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<sup>24</sup>*Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1) was prepared to fulfill our statutory requirement under the Federal Managers' Financial Integrity Act to issue standards that provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

<sup>25</sup>*Guide for Evaluating and Testing Controls Over Sensitive Payments* (GAO/AFMD-8.1.2) provides a framework for evaluating and testing the effectiveness of internal controls that have been established in various sensitive payment areas.

totaling \$6,030,501. In light of NPWC’s improvements in the area of documenting independent receipt and acceptance, we increased our sample size of NPWC transactions to 94 to generate a more accurate assessment of the control failure rate at NPWC.

We stratified the each of the samples into two groups—transactions from vendors likely to represent purchases of computer equipment and other vendors. With this statistically valid probability sample, each transaction in the population had a nonzero probability of being included, and that probability could be computed for any transaction. Each sample element was subsequently weighted in the analysis to account statistically for all the transactions in the population, including those that were not selected. Table 9 presents our test results on three key transaction-level controls and shows the confidence intervals for the estimates for the universes of fiscal year 2001 purchase card transactions made by SPAWAR Systems Center and NPWC.

**Table 9: Estimate of Fiscal Year 2001 Transactions That Failed Control Tests<sup>a</sup>**

	Breakdowns in key purchase card controls	
	Independent, documented receipt of items purchased	Proper certification of purchase card statements for payment
	Percent failure	Percent failure
<b>Navy units in San Diego</b>		
SPAWAR Systems Center	56% (39-72%)	100% <sup>b</sup>
Navy Public Works Center	16% (9-27%)	100% <sup>c</sup> (93-100%)

<sup>a</sup>The projections represent point estimates for the population based on our sampling tests at a 95-percent confidence level.

<sup>b</sup>For the last quarter of fiscal year 2001, SPAWAR Systems Center continued to have only one certifying officer for almost 1,000 cardholders. This unacceptable span of control led us to conclude that all transactions selected as part of our statistical sample were not properly reviewed and approved by a certifying officer.

<sup>c</sup>Our statistical testing identified one transaction that was reconciled by the cardholder and approving official prior to payment. The projected error rate was 99.9 percent, which we rounded to 100 percent.

## Data Mining

In addition to selecting statistical samples of SPAWAR Systems Center and NPWC transactions to test specific internal controls, we also made nonrepresentative selections of SPAWAR Systems Center and NPWC transactions based on data mining of fiscal year 2001 transactions. The



purpose of the data mining procedures was twofold. Specifically, we conducted separate analysis of acquisitions that were (1) potentially fraudulent, improper, and abusive or otherwise questionable and (2) split into multiple transactions to circumvent either the micropurchase or cardholder transaction thresholds.

Our data mining for potentially fraudulent, improper, and abusive or questionable transactions was limited to cardholders who worked in San Diego and covered 36,216 fiscal year 2001 transactions totaling about \$26.1 million at SPAWAR Systems Center, and 46,709 fiscal year transactions totaling about \$23.9 million at the NPWC. For this review, we scanned the two units' San Diego-based activities for transactions with vendors that are likely to sell goods or services (1) on NAVSUP's list of prohibited items, (2) that are personal items, and (3) that are otherwise questionable. Our expectation was that transactions with certain vendors had a more likely chance of being fraudulent, improper, abusive, or questionable. Because of the large number of transactions that met these criteria we did not look at all potential abuses of the purchase card. Rather, we made nonrepresentative selections of transactions based on transactions with the vendors who fit these criteria. For example, we reviewed, and in some cases made inquires, concerning 162 transactions and other related transactions on the same monthly purchase card statement with vendors that sold such items as sporting goods, groceries, luggage, flowers, and clothing. While we identified some improper and potentially fraudulent and abusive transactions, our work was not designed to identify, and we cannot determine, the extent of fraudulent, improper, and abusive or questionable transactions.

Our data mining also included nonrepresentative selections of acquisitions that SPAWAR Systems Center and NPWC entered into during the period June 22, 2001, through September 21, 2001, that were potentially split into multiple transactions to circumvent either the micropurchase competition requirements or cardholder single transaction thresholds. We limited our data mining to this period because senior SPAWAR Systems Center and NPWC officials acknowledged to us in early June 2001 that cardholders had made split transactions and that they would attempt to correct the problem. Therefore, to allow the two units an opportunity to resolve this issue, we limited our review to transactions that occurred subsequent to SPAWAR Systems Center and NPWC's acknowledging a problem with splitting purchases.

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**Appendix II**  
**Scope and Methodology**

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We briefed DOD managers, including officials in DOD's Purchase Card Joint Program Management Office, and Navy managers, including NAVSUP, SPAWAR Systems Center, and NPWC officials, on the details of our review, including our objectives, scope, and methodology and our findings and conclusions. Where appropriate, we incorporated their comments into this testimony. We conducted our audit work from November 2001 through February 2002 in accordance with U.S. generally accepted government auditing standards, and we performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

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