

GAO

Testimony

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

For Release on Delivery
2:00 p.m. Tuesday,
October 8, 2002

PURCHASE CARDS

Navy Vulnerable to Fraud and Abuse but Is Taking Action to Resolve Control Weaknesses

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

Thank you for the opportunity to discuss the internal controls over the Navy's purchase card program. This Subcommittee held hearings in July 2001 and March 2002 that identified substantial internal control weaknesses at two Navy units in San Diego, California.¹ As a result of those hearings and your continued concern about fraud, waste, and abuse at the Department of Defense (DOD), this Subcommittee and Senator Grassley requested more comprehensive audits of DOD's purchase card use. In response to that requested work, this testimony and the related report² released today focus on the Navy-wide purchase card program. Details on our objectives, scope, and methodology are included in that report. On July 17, 2002, we testified³ before this Subcommittee and issued a report⁴ concerning purchase card control weaknesses that left the Army vulnerable to fraud, waste, and abuse. We will report to you separately on the results of our Air Force purchase card audit.

For a number of years, DOD has been promoting departmentwide use of purchase cards, and their use has dramatically increased. DOD reported that in fiscal year 2001, more than 230,000 civilian and military cardholders made about 10.7 million purchase card transactions valued at over \$6.1 billion. The Navy has the second largest purchase card program in DOD with about 25,000 cardholders, 2.8 million transactions, and \$1.8 billion in purchases in fiscal year 2001. Purchase card transactions include acquisitions at or below the \$2,500 micropurchase limit as well as for payments on contracts. The benefits of using purchase cards versus traditional contracting and payment processes are lower transaction processing costs and less "red tape" for both the government and the vendor community. We support the use of a well-controlled purchase card

¹U.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), and *Purchase Cards: Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, [GAO-02-506T](#) (Washington, D.C.: Mar. 13, 2002).

²U.S. General Accounting Office, *Purchase Cards: Navy Vulnerable to Fraud and Abuse but Is Taking Action to Resolve Control Weaknesses*, [GAO-02-1041](#) (Washington, D.C.: Sept. 27, 2002).

³U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Army Vulnerable to Fraud, Waste, and Abuse*, [GAO-02-844T](#) (Washington, D.C.: July 17, 2002).

⁴U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Army Vulnerable to Fraud, Waste, and Abuse*, [GAO-02-732](#) (Washington, D.C.: July 17, 2002).

program to streamline the government's acquisition processes. However, it is important that agencies have adequate internal control in place to protect the government from fraud, waste, and abuse.

Summary

We previously reported that significant breakdowns in internal control at two Navy sites⁵ left those units vulnerable to fraud, waste, and abuse. Today, I am here to report that the control weaknesses we identified at the two Navy units in San Diego were representative of systemic Navy-wide purchase card control weaknesses that have left the Navy vulnerable to fraudulent, wasteful, and abusive use of purchase cards. Our current audit work at the Atlantic Fleet, Pacific Fleet, Naval Sea Systems Command, and the Marine Corps showed that during fiscal year 2001, the Navy had not established an effective internal control environment. At the individual transaction level, we also identified a substantial number of purchases for which cardholders and approving officials at selected units assigned to those commands had not adhered to key internal control activities and that were not in accordance with valid requirements, policies, and procedures. The weaknesses we identified in the control environment and the breakdown in specific internal control activities resulted in potentially fraudulent, improper, and abusive transactions not being prevented or identified promptly.

Since we first reported on the Navy's purchase card control weaknesses, the Navy has been taking actions to improve the purchase card control environment and improve cardholder adherence to key purchase card control procedures. The Navy has also taken more aggressive actions to identify fraudulent, improper, and abusive or questionable purchase card acquisitions. Many of these improvements have been implemented in the last few months and others have not yet been fully implemented. Thus, while we have not assessed the impact of the Navy actions, the Navy actions demonstrate that it is acting to improve the purchase card program. However, to fully achieve the benefits of the purchase card program, the Navy will need to make a sustained effort that focuses on cultural change, and provide the infrastructure necessary to build a purchase card program with a robust set of internal controls. Navy major command and unit management must also actively promote the importance of a strong system of accountability that is necessary to provide reasonable assurance that the

⁵GAO-01-995T and GAO-02-506T .

program is operating as intended. As discussed in the report released today, DOD generally concurred with our recommendations to improve the control environment; to strengthen key internal control activities; and to increase attention to preventing potentially fraudulent, improper, and abusive or questionable transactions.

Weak Purchase Card Control Environment Contributed to Ineffective Controls, but Management Has Taken Positive Steps

We found that the Navy and Marine Corps units we audited had not established an effective internal control environment in fiscal year 2001, and although significant improvements have been made, further action in several areas is necessary. Specifically, we found that in fiscal year 2001, these locations did not effectively (1) evaluate whether approving officials had responsibility for a reasonable number of cardholders, (2) limit purchase card credit limits to historical procurement needs, (3) ensure that cardholders and approving officials were properly trained, (4) utilize the results of purchase card program monitoring efforts, and (5) establish an infrastructure necessary to effectively monitor and oversee the purchase card program. As a result of our July 30, 2001, testimony, the Navy and DOD have taken significant actions to improve purchase card controls, including reducing the number of Navy cardholders by over 50 percent and establishing a DOD Charge Card Task Force to further improve the purchase card processes and controls.

Improvement Initiatives Signal Proactive “Tone at the Top”

Since the July 30, 2001, congressional hearing, the DOD Comptroller, the DOD Purchase Card Program Office, and Naval Supply Systems Command (NAVSUP) have issued a number of directives and policy changes citing previous audit findings and the need to improve both the purchase card control environment and adherence to control techniques. Specifically, in response to our November 2001 report, the Navy has taken action or said it plans to implement all 29 of our recommendations to improve controls over the purchase card program. While we believe that some of the Navy’s actions to implement our recommendations are not sufficient to achieve the necessary changes, its planned and implemented actions to date are a significant step forward.

In addition, the DOD Comptroller appointed a Charge Card Task Force, which issued its final report on June 27, 2002. The report identified many of the control weaknesses we identified in this and previous reports and testimonies. In the report, the DOD Comptroller stated that this “...is an excellent first step in an on-going process to continually seek ways to

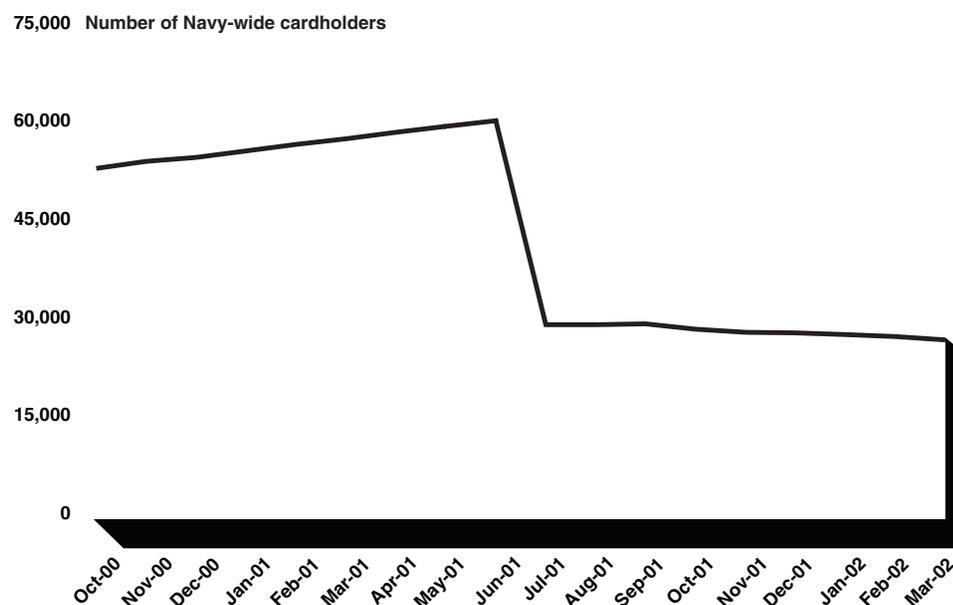
improve charge card programs. We must continue to identify new ways of reducing the government's cost of doing business while at the same time ensuring that we operate in a manner that preserves the public's trust in our ability to provide proper stewardship of public funds." The Task Force report included a number of recommendations, including establishing a purchase card concept of operations; accelerating the electronic certification and bill paying process; improving training materials; identifying best practices in areas such as span of control and purchase card management skill sets; and establishing more effective means of disciplining those who abuse purchase cards. These recommendations address many of the concerns that we previously identified and provide management at the Pacific Fleet, Atlantic Fleet, Naval Sea Systems Command (NAVSEA), and the Marine Corps the opportunity to take a proactive role in correcting control weaknesses and ensuring that the purchase card remains a valuable tool.

Number of Cardholders Significantly Reduced but Approving Official Span of Control Remains an Issue

Although the Navy significantly reduced the number of purchase cards since our July 30, 2001, testimony, it continued to have approving officials who were responsible for reviewing more cardholder statements than allowed by either DOD or Navy guidance, the later of which limits the number of cardholders that an approving official should review to seven. The convenience of the purchase card must be balanced against the time and cost involved in the training, monitoring, and oversight of cardholders. It must also be balanced against the exposure of the Navy to the legally binding obligations incurred by those cardholders. The proliferation of purchase cards and high cardholder to approving official ratios increase the risks associated with the purchase card program. In response to the July 2001 hearing, DOD's Director of Procurement instructed the directors of defense agency procurement and contracting departments on August 13, 2001, to limit purchase cards to only those personnel who need to purchase goods and services as part of their jobs. As a result of this heightened concern, the Navy reduced the number of cardholders by more than half from about 59,000 in June 2001 to about 28,000 by September 2001. In October 2001, the Navy followed up the initial reduction in cardholders with an interim change to the NAVSUP existing purchase card instructions that established minimum criteria for prospective purchase card holders. As shown in figure 1, the Navy continued to reduce the number of cardholders and was down to about 25,000 as of March 2002. Agency

program coordinators⁶ at the commands we audited told us that the reduction was a result of (1) employee attrition and (2) cancellation of cards of individuals who no longer needed them.

Figure 1: Change in Number of Navy-wide Cardholders, October 2000 to March 2002



Source: General Services Administration

NAVSUP's interim change limiting purchase cards also established a maximum ratio of seven cardholders to each approving official,⁷ and required that Navy and Marine Corps units establish local policies and

⁶NAVSUP Instruction 4200.94 authorizes agency program coordinators to administer the purchase card program within their designated units, establish credit limits, and authorize the issuance of cards to Navy employees. The agency program coordinator also serves as the communication link between the purchase card issuing bank and the unit.

⁷The approving official is responsible for reviewing and verifying the monthly purchase card statements of the cardholders under his or her purview. The approving official is responsible for verifying that all purchases were necessary and were made 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.

procedures for approving purchase cards and for issuing them to activity personnel. The Navy's requirement of a maximum seven to one ratio of cardholders to an approving official is consistent with guidance issued by the Department of Defense Purchase Card Joint Program Management Office on July 5, 2001, shortly before the congressional hearing last summer.

At the four locations we audited, the average ratio of cardholders to approving officials was in line with the DOD and Navy limit of seven cardholders per approving official. This average, however, masks the wide range of ratios across units, including those that far exceeded the DOD and Navy prescribed ratio of cardholders to approving officials. The problem with a high cardholder to approving official ratio remains especially acute at NAVSEA, which at some locations used one approving official to certify a single payment for all the unit's cardholders. This resulted in a number of approving officials certifying monthly bills for more than 100 cardholders that contained thousands of transactions and regularly exceeded \$1 million a month.

Cardholder Credit Limits Exceed Procurement Needs

While total financial exposure as measured in terms of purchase card credit limits has decreased in the units we audited, it continues to substantially exceed historical purchase card procurement needs. Limiting credit available to cardholders is a key factor in managing the purchase card program and in minimizing the government's financial exposure. Therefore, to determine the maximum credit available, we analyzed the credit limits available to both cardholders and approving officials.⁸

None of the units we visited tied either the cardholder's or the approving official's credit limit to the unit's historical spending. Rather, they often established arbitrary credit limits of \$10,000 to \$25,000. In some instances, we found cardholders and approving officials who had credit limits that far exceeded historical spending needs. For example, as of September 2001,

⁸There are two credit limits that can restrict a cardholder's ability to use a purchase card—the approving official's credit limit and the cardholder's credit limit—both of which are set by the unit agency program coordinator. A cardholder's credit limit is the maximum amount that a cardholder can purchase in a billing cycle, normally 1 month. An approving official's credit limit is the maximum amount that all the cardholders who report to an approving official may spend. However, the available credit limit of the approving official cannot exceed the sum of the credit limits available to all of the cardholders he or she authorizes for payment.

we identified over 60 cardholders with \$9.9 million⁹ credit limits, and more than 2,300 approving officials with \$9.9 million credit limits at the four commands we audited. As shown in table 1, the four commands that we audited had credit limits that clearly exceeded historical needs.

Table 1: Historical Purchases vs. Credit Limits for Selected Navy Commands and Marine Corps

Command	Atlantic Fleet	Pacific Fleet	NAVSEA	Marine Corps
Credit limits as of March 2002	\$128 million	\$159 million	\$199 million	\$454 million
Fiscal year 2001 average monthly purchase activity	\$14 million	\$11 million	\$22 million	\$19 million
Ratio of credit limit ^a to average fiscal year 2001 monthly expenditures	9 to 1	14 to 1	9 to 1	24 to 1

^aCredit limit is as of March 2002 to reflect the reduction in credit limits made by the commands.

Source: GAO analysis of Citibank data provided by Navy.

Navy Units Lacked Documented Evidence of Training

Most of the units we audited did not have documented evidence that their purchase card holders had received the initial or supplemental training required by the Navy purchase card program guidance. 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. The instruction also requires all cardholders and approving officials to receive refresher training every 2 years. While acknowledging this need, the Navy does not have a database that would enable agency program coordinators to monitor training for cardholders and approving officials. Therefore, the Navy does not have a systematic means to determine whether NAVSUP Instruction 4200.94 or its directives are being carried out.

⁹The maximum credit limit allowed by NAVSUP Instruction 4200.94 is \$9.9 million.

We found that from about 56 percent¹⁰ of the fiscal year 2001 transactions at the Marine Corps to about 87 percent¹⁰ of the transactions at the Atlantic Fleet were made by cardholders or approved for payment by approving officials for whom there was no documented evidence of either initial training or refresher training at the time the transaction was made. Management at all four locations told us that they require all cardholders to receive training prior to receiving their purchase cards. Not all managers were as confident that cardholders and approving officials received follow-up training. Without a centralized training database, it would be extremely difficult to track when each cardholder needed the required 2-year refresher training.

Further, for training to be effective, it should be tailored to provide the knowledge needed for the different tasks in purchase card management. However, we found that, even though the functions performed by the agency program coordinators, approving officials, and cardholders are substantially different, the training course curriculum for the three positions was identical. The NAVSUP and major commands did not have specific guidance or training concerning the role and responsibilities of agency program coordinators or approving officials.

Monitoring and Oversight Need Improvement

We found evidence that the four units we audited conducted reviews of the fiscal year 2001 purchase card program. However, we did not find that they used the results of those reviews to resolve identified internal control weaknesses. Further, an August 2001 NAVSUP-mandated review of 12 months of purchase card transactions did not identify the extent of potentially fraudulent, improper, and abusive or questionable transactions identified in either Naval Audit Service or GAO audits. Specifically, based on the results of the reviews conducted by the units we audited, we question the design and performance of the review. Its results do not indicate a thorough and critical analysis of the nature and magnitude of the control weaknesses and of the extent to which fraudulent, improper, and abusive or questionable transactions were occurring during the period reviewed. The four major commands that we audited represented that they reviewed about 1,225,000 transactions but reported that they found only 1,355 purchases—about 0.1 percent of the transactions reviewed—that

¹⁰The numbers represent point estimates for the population based on our sampling tests. The estimated percentages have 95 percent confidence intervals of plus or minus 13 percentage points or less.

were for personal use, or for prohibited items, or were not a bona fide mission requirement. In our statistical sample of 624 fiscal year 2001 transactions we found 102 potentially fraudulent, improper, and abusive or questionable transactions—about 15 percent of the transactions audited. Furthermore, we found numerous examples of abusive and improper transactions (discussed in more detail in the following section of this testimony) as part of our data mining. In response to this issue, command level agency program coordinators told us that they did not have sufficient time to perform their transaction reviews.

Human Capital Resources Are Insufficient for Effective Monitoring and Oversight

The Navy has not provided sufficient human capital resources to enable effective monitoring of purchases and to develop a robust oversight program. The three key positions for overseeing the program and monitoring purchases are the command-level agency program coordinator, the unit-level agency program coordinator, and the approving official. During the period of our review, none of the major command agency program coordinators we audited worked full time in that position. This is despite the fact that they were responsible for managing procurement programs that incurred between 227,000 and 380,000 transactions totaling from about \$137 million to about \$268 million annually. Further, these agency program coordinators were responsible for managing the procurement activities of cardholders who were located not only on the East and West Coasts of the United States but in some instances on other continents. In addition, these part-time major command coordinators generally had one or two staff in their immediate office—who were also assigned other responsibilities—that helped monitor the program. Considering that the major command agency program coordinators are responsible for procurement programs involving hundreds of thousands of transactions and hundreds of millions of dollars, the human capital resources at the major command level are inadequate.

We also found that the major commands we audited did not provide the subordinate level agency program coordinators and approving officials with the time, training, tools, or incentives—also human capital resources—needed to perform their monitoring responsibilities necessary for the operational success of the program. Rather, the responsibilities of approving officials and many subordinate level agency program coordinators fell into the category of “other duties as assigned.”

Further, we found that approving officials and most agency program coordinators generally had other duties of higher priority than monitoring

purchases and reviewing cardholders' statements. This was especially true for approving officials, some of whom were engineers and computer technicians, whose annual ratings generally did not cover their approving official duties. One subordinate level agency program coordinator told us that she knew that some approving officials did not review the cardholder statements because (1) some cardholders make thousands of purchases in a month, and (2) the approving officials have other responsibilities. Another agency program coordinator told us that some agency program coordinators and approving officials fear that questioning certain purchases could be career-limiting decisions. Further, neither the Navy nor the major commands have established a position description, or an adequate statement of duties or other information on the scope, duties, or specific responsibilities for subordinate level agency program coordinators and approving officials.

Critical Internal Controls Were Ineffective

Basic internal controls over the purchase card program were ineffective at the units in the major commands we audited during fiscal year 2001 primarily because they were not effectively implemented. Based on our tests of statistical samples of purchase card transactions, we determined that key transaction-level controls were ineffective, rendering the purchase card transactions at the units we audited vulnerable to fraudulent and abusive purchases and to the theft and misuse of government property. The problems we found primarily resulted from inadequate guidance and a lack of adherence to valid policies and procedures. The specific controls that we tested were (1) screening for required vendors, (2) documenting independent receipt and acceptance of goods and services, (3) documenting cardholder reconciliation and approving official review prior to certifying the monthly purchase card statement for payment, and (4) recording pilferable property in accountable records. As shown in table 2, the failure rates for the first three attributes that we tested ranged from 58 percent to 98 percent respectively for the Atlantic Fleet units in Norfolk for documenting independent receipt and acceptance obtained with a purchase card, and reconciling and reviewing cardholder statements prior to certifying them for payment. Most transactions in our statistical sample did not contain pilferable property. Thus, we are not projecting the results of that test to the population of transactions that we tested at those units.

Table 2: Estimate of Fiscal Year 2001 Transactions That Failed Control Tests

	Percent breakdowns in key purchase card controls ^a		
	Screening for required vendors	Independent, documented receipt of items purchased	Proper reconciliation and certification of purchase card statements for payment
Atlantic Fleet units in the Norfolk, VA area	88	58	98
Pacific Fleet units in the San Diego, CA area	70	59	80
NAVSEA units in the Norfolk, VA area	90	67	86
Marine Corps Base at Camp Lejeune, NC	89	59	94

^aThe numbers represent point estimates for the population based on our sampling tests. The estimated percentages have 95 percent confidence intervals of plus or minus 13 percentage points or less.

Source: GAO testing and statistical analysis of Navy purchase card transaction files.

Little Evidence Cardholders Screen for Required Vendors

Despite DOD and Navy requirements to give priority to certain required vendors, we found that the failure rate to document the necessary screening of purchases ranged from about 70 percent at the Pacific Fleet to about 90 percent at NAVSEA. Because of the units' failure to document screening for statutory vendors, the Navy and Marine Corps do not know the extent to which cardholders failed to acquire items from these required vendors. The Navy's purchase card instructions require that prior to using the purchase card, cardholders must document that they have screened all their intended purchase card acquisitions for availability from statutory sources of supply. These sources of supply include vendors qualifying under the Javits-Wagner-O'Day Act (JWOD), Federal Prison Industries, and DOD's Document Automation and Production Service (DAPS). JWOD vendors are nonprofit agencies that employ people who are blind or have other severe disabilities. JWOD vendors primarily sell office supplies and calendars, which often cost less than items sold by commercial vendors.

Little Evidence of Independent Receipt and Acceptance of Items Purchased

The units we audited generally did not have evidence documenting that someone independent of the cardholder received and accepted items ordered and paid for with a purchase card, as required by NAVSUP Instruction 4200.94. That is, the units generally did not have a receipt, invoice, or packing slip 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. Some units have developed a system using ink stamps that need to be completed to document receipt and acceptance; however, these systems have not been implemented effectively. While some of the items for which these units did not have independent documented receipts were consumable office supplies, other items that failed this key internal control test included laptop computers, digital cameras, and personal digital assistants, which could be subject to theft or misuse.

Little Evidence That Monthly Purchase Card Bills Were Reconciled and Reviewed Prior to Certification and Payment

We found little evidence of cardholder reconciliation or approving official reviews to confirm that cardholders had reconciled the monthly purchase card transactions back to the supporting documents throughout fiscal year 2001. Because certification is necessary for payment, it is likely to occur whether or not cardholders and approving officials have performed required reconciliations and reviews. Thus, when we tested whether the cardholder reconciled the monthly statement and whether the approving official reviewed the monthly statement, we did not simply look for a physical or electronic signature on a form. Rather, for this test we considered that proper reconciliation and review occurred if:

- the cardholder signed and dated the monthly bill¹¹ before it was paid, and the monthly bill contained any markings or notes indicating the amounts billed had been compared to a credit card receipt, invoice, packing slip, or a purchase log, and
- the approving official's review of the cardholder's monthly statement was signed and dated prior to certification for payment, and there were virtually any markings or notes on the monthly statements evidencing that review.

¹¹In pencil, ink, or electronically.

Our testing revealed that documented evidence of adequate cardholder reconciliation or approving official review of cardholder transactions did not exist for most of our sample transactions. Examples of inadequate documentation included missing statements, invoices, signatures, and dates, or a lack of evidence of cardholder reconciliation or approving official review. Without such evidence, we—and the program coordinators, who are required to semiannually review approving official records—cannot determine whether officials are complying with review requirements. We found numerous instances of purchases that had not been adequately reviewed and reconciled to the monthly statements, but in which the statements were, nonetheless, certified for payment. For example, at Camp Lejeune, we found 29 transactions totaling over \$50,000 for which the Marine Corps was unable to provide any supporting documentation concerning what was purchased or whether the items purchased had a legitimate government use.

Major Commands Failed to Maintain Accountability for Pilferable Items

We found accountable items acquired with purchase cards were often not recorded in property records of the units we audited. In addition, officials at three of the four major commands could not locate some of the property items included in our statistical samples. While some or all of the items might, in fact, be at the installations we audited, officials could not provide conclusive evidence that they were in the possession of the government. Unrecorded property and items that cannot be located indicate a weak control environment and problems in the property management system. Consistent with GAO's internal control standards, DOD's *Property, Plant and Equipment Accountability Directive and Manual*, which was issued in draft for implementation on January 19, 2000, requires accountable property to be recorded in property records as it is acquired. Accountable property includes items that can be easily pilfered, such as computers and related equipment, and cameras. Entering such items in the property records is an important step to help assure accountability and financial control over these assets and, along with periodic inventory, to deter theft or improper use of government property. Table 3 contains the results of our review of property management records and inspection of accountable property.

Table 3: Accountable Property Items Not Recorded in Property Books

Command/Base	Transactions with property items	Transactions with items not in property book	Transactions with items the command could not locate
Atlantic Fleet units in Norfolk, VA	35	15	12
Pacific Fleet units in San Diego, CA	42	23	15
NAVSEA units in Norfolk, VA	21	14	8
Marine Corps Base at Camp Lejeune, NC	16	8	0

Source: GAO analysis of stratified random samples from Navy and Marine Corps purchase card transaction files.

Potentially Fraudulent, Improper, and Abusive or Questionable Transactions

We identified numerous purchases at the installations we audited and through our Navy-wide data mining that were potentially fraudulent, improper, and abusive or questionable. However, our work was not designed to identify, and we cannot determine, the extent of potentially fraudulent, improper, and abusive or otherwise questionable transactions. Considering the control weaknesses identified at each unit audited, it is not surprising that these transactions were not detected or prevented. In addition, the existence of similar improper, abusive, and questionable transactions in our Navy-wide data mining of selected transactions provides additional indications that a weak control environment and ineffective specific controls exist throughout the Navy.

Potentially Fraudulent Purchases

We considered potentially fraudulent purchases to include those made by cardholders that were unauthorized and intended for personal use. Potentially fraudulent purchases can also result from compromised accounts in which a purchase card or account number is stolen and used to make a potentially fraudulent purchase. Potentially fraudulent transactions can also involve vendors charging purchase cards for items that cardholders did not buy. The Navy and the major commands we audited had policies and procedures that were designed to prevent and detect potentially fraudulent purchases. For example, as discussed previously, approving officials are required to review the supporting documentation for each transaction for legality and proper government use of funds. However, our testing showed that these control activities had not been implemented as intended.

Although collusion can circumvent what otherwise might be effective internal control activities, a robust system of guidance, internal control activities, and oversight can create a control environment that provides reasonable assurance of preventing or quickly detecting fraud, including collusion. However, in auditing the Navy's internal control at units assigned to four major commands during fiscal year 2001, we did not find the processes and activities were operating in a manner that provided such assurance. The following examples illustrate the cases we described in the report that we released today.

- An approving official's failure to review a cardholder's statement on a timely basis contributed to an Atlantic Fleet cardholder making over \$250,000 in unauthorized purchases between September 2000 and July 2001. In July 2001, when a command supply official began reviewing the cardholder's monthly statements, he noticed that over \$80,000 of those charges were unsupported. Included in those unsupported charges were numerous transactions with suspicious vendors. After command supply officials asked the cardholder about the unsupported purchases, the cardholder admitted to making thousands of dollars of illegal Internet purchases and illegally purchasing EZ Pass prepaid toll tags, expensive remote control helicopters, and a dog. The Navy decided to prosecute the cardholder, and a court martial is pending.
- An approving official's failure to review a cardholder's statements and the cardholder's failure to keep evidence of what was purchased contributed to an Atlantic Fleet cardholder fraudulently using his purchase card from January 2000 through October 2000 to purchase an estimated \$150,000 in automobile, building, and home improvement supplies. The cardholder sold some of the items to generate cash. According to Navy investigators, the cardholder destroyed many of the requisitions, receipts, and purchase logs for the stolen items in an attempt to cover up his actions. In addition, according to Navy criminal investigators, if the monthly purchase card billing statements had been properly reviewed, the cardholder's fraudulent activities would have been exposed. In exchange for pleading guilty to multiple counts of larceny and other criminal violations, the cardholder's jail time was reduced to 24 months.
- An approving official's failure to adequately review a cardholder's statement contributed to two Atlantic Fleet cardholders conspiring with at least seven vendors to submit about \$89,000 in fictitious and inflated invoices. The cardholders had the vendors ship supply items to an

Atlantic Fleet warehouse, and the personal items directly to their residences. The cardholders also had vendors inflate the price and or quantity of items purchased. According to Naval Criminal Investigative Service (NCIS) investigators, the cardholders would sell, use, and barter the illegally obtained items, while the vendor sales representatives received inflated sales commissions and an estimated \$3,000 to \$5,000 in Navy property that was given to them as bribes. One vendor sales representative who admitted to conspiring to supply false invoices said that he could not get sufficient business until he altered the invoices like the other vendors. According to the caller who informed the NCIS of the illegal activity, it was common knowledge that the cardholders were getting kickbacks because of their positions as Navy buyers. Based on the results of the NCIS investigations, one of the cardholders received 24 months confinement and a bad conduct discharge while the other received a 60-day restriction and reduction in rank.

- We also found that in March 1999 the Navy inappropriately issued five government purchase cards to individuals who did not work for the government. These individuals worked for a consulting company that occasionally provided services to the Navy. NAVSUP Instruction 4200.94 limits the Navy purchase card to authorized government personnel in support of official government purchases. Between March 1999 and November 2001 these individuals used the Navy purchase cards to make purchases totaling about \$230,000 with vendors including airlines, hotels, rental car companies, gas stations, restaurants, a florist, and golf courses. We discovered these charges in November 2001 as part of our data mining for suspicious transactions at the Pacific Fleet. Within a week of our inquiries to the Pacific Fleet concerning the charges on these accounts, the Pacific Fleet agency program coordinator instructed Citibank to (1) immediately deactivate the accounts and (2) close the accounts once the balances were paid.

While the consulting company ultimately paid Citibank for all charges made with those cards, the consulting company was 30 days past due on the account 28 times during the 38 months that the accounts were open. Further, the Navy was contractually liable for all purchases made with the cards and would have been responsible for payment if the consulting company had failed to pay. The risk to the Navy was real because, when the Navy had Citibank deactivate the accounts in November, the company, which still owed \$8,600, threatened to withhold payment unless the Navy reopened the accounts. In addition, the consulting company contacted Citibank directly and tried to assume

control of the accounts by claiming the company had “spun off from the Navy.” While the consulting company did eventually pay Citibank, it was not until March 2002—4 months after the accounts were deactivated.

Our Office of Special Investigations researched some of the charges and found that, by using a Navy purchase card, the consulting company avoided paying state sales taxes and obtained discounts at airlines and hotels that are typically offered only to the federal government. The airline discounts are particularly advantageous because airlines offer the federal government significantly discounted tickets that are not encumbered with the penalties and limitations that are imposed upon private sector companies and the general public. Finally, Citibank does not bill the Navy interest on past due accounts. Thus, by using the Navy purchase card, the company avoided paying interest on these accounts that were regularly past due. Based on the results of our work, we referred this case to DOD for further investigation.

Navy’s Fraud Database Does Not Include Key Data

We attempted to obtain examples of other potentially fraudulent activity in the Navy purchase card program from NCIS in Washington, D.C. NCIS investigators acknowledged that they have investigated a number of purchase card fraud cases; however, their investigation database does not permit a breakdown of fraud cases by type, such as purchase cards. Purchase card program officials and NCIS officials said that they had no information on the total number of purchase card fraud investigation cases throughout the Navy that had been completed or were ongoing. Based on our identification of a number of fraudulent and potentially fraudulent cases at the installations that we audited, we believe that the number of cases involving fraudulent and potentially fraudulent transactions could be significant. Without such data, the Navy does not know the significance, in numbers or dollar amounts, of fraud cases that have been or are being investigated and is hampered in taking corrective actions to prevent such cases in the future.

Improper Purchases and Transactions

Our audit work at the four commands and our Navy-wide data mining identified numerous examples of improper transactions. Improper transactions are those purchases that, although approved by Navy officials and intended for government use, are not permitted by law, regulation, or DOD policy. We identified three types of improper purchases:

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- Purchases that do not serve an authorized government purpose.
 - Split purchases, in which the cardholder circumvents cardholder single-purchase limits. The *Federal Acquisition Regulation* guidelines prohibit splitting purchase requirements into more than one transaction to avoid the need to obtain competition on purchases over the \$2,500 micropurchase threshold. Cardholders also split purchases to circumvent higher single-transaction limits for payments on contracts exceeding the micropurchase threshold.
 - Purchases from improper sources as previously discussed. Various federal laws and regulations require procurement officials to acquire certain products from designated sources such as JWOD vendors. The JWOD program is a mandatory source of supply for all federal entities. The improper transactions that resulted from purchasing items from nonstatutory sources were previously discussed in the section on adherence with control procedures.

We believe that if the Navy better monitored the vendors with which its cardholders conducted business, the Navy could minimize its number of improper purchases. Such monitoring could also provide the Navy the opportunity to leverage its purchase volume and negotiate discounts with frequently used vendors.

Purchases That Do Not Serve an Authorized Government Purpose

We found several instances in which cardholders purchased goods, such as clothing, that were not authorized by law or regulation. 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 be applied only 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. The following are improper transactions we identified as part of our review of fiscal year 2001 transactions and related activity at the four commands and as part of our Navy-wide data mining of transactions with questionable vendors.

- We identified a Pacific Fleet cardholder who used the purchase card in January 2001 to buy a \$199 leather flight jacket as a personal gift for an

official visitor. SECNAV Instruction 7042.7J specifically identifies flight jackets as a prohibited personal gift to a visitor. In November 2001, when we questioned the Deputy Commander concerning the flight jacket, he told us that the purpose of the gift was to recognize the individual's contributions to the Navy's San Diego installations. The Deputy Commander subsequently told us that the personnel involved with the gift were counseled, and that he, the Deputy Commander, had reimbursed the Navy for the jacket in January 2002.

- We identified purchases of clothing by NAVSEA that should not have been made with appropriated funds. Generally, agencies may not use appropriated funds to purchase clothing for civilian employees. One exception is 5 U.S.C. 7903, which authorizes agencies 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, 1984,¹² clothing purchased pursuant to this statute is property of the U.S. government and must only be used for official government business. Thus, clothing purchases, except for rare circumstances in which the purchase meets stringent requirements, are usually considered personal items for which appropriated funds should not be used. In one transaction, a NAVSEA cardholder purchased polo shirts and other gifts for a "Bring-Your-Child-to-Work Day" at a total cost of about \$1,600.
- As part of our data mining of Navy-wide purchase card transactions, we identified two purchases in which cardholders purchased Bose headsets at \$300 each. The headsets were for personal use—listening to music—while taking commercial airline flights and, therefore, should not have been purchased with the Navy purchase card.
- At NAVSEA, we identified charges to hotels in Newport News and Portsmouth, Virginia, totaling about \$8,000 for locally based NAVSEA employees to attend meetings at which they were inappropriately

¹²63 Comptroller General Decisions 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."

provided meals and refreshments at the government's expense. The cardholders told us that they authorized the hotels to bill for audiovisual equipment and conference room rental. The cardholders said the hotel was not authorized to bill for food. However, despite the cardholders' assertions, the detailed bills showed that the hotels charged NAVSEA about \$7,000 for meals including breakfasts, lunches, and snacks. Pursuant to 31 U.S.C. 1301(a), "[a]ppropriations shall be applied only 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. For example, without statutory authority, appropriated funds may not be used to furnish meals or refreshments to employees within their normal duty stations.¹³ 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.¹⁴

Split Purchases

Another category of improper transaction is a split purchase, which occurs when a cardholder splits a transaction into segments to avoid the requirement to obtain competition for purchases over the \$2,500 micropurchase threshold or to avoid other established credit limits. The *Federal Acquisition Regulation* prohibits splitting a purchase into more than one transaction to avoid the requirement to obtain competition for purchases over the \$2,500 micropurchase threshold. Navy purchase card instructions also prohibit splitting purchases to avoid other established credit limits. Once items exceed the \$2,500 threshold, they are to be purchased through a contract in accordance with simplified acquisition procedures that are more stringent than those for micropurchases.

Our analysis of data on purchases at the four major commands we audited and our data mining efforts identified numerous occurrences of potential split purchases. In addition, internal auditors at all four commands that we audited identified split purchases as a continuing problem. In some of these instances, the cardholder's purchases exceeded the \$2,500 limit, and the cardholder split the purchase into two or more transactions of \$2,500 or

¹³72 Comp. Gen. 178, 179 (1993); 65 Comp. Gen. 508, 509 (1986).

¹⁴65 Comp. Gen. 738, 739 (1986).

less. For example, a Camp Lejeune cardholder made eight transactions totaling about \$17,000 on the same day to purchase combat boots.

All the commands that we audited represented that the practice of splitting transactions to circumvent the micropurchase threshold was a problem. As we previously reported, by circumventing the competitive requirements of the simplified acquisition procedures, the commands may not be getting the best prices possible for the government. For the Navy to reduce split transactions, it will need to monitor the vendors with whom cardholders are conducting business.

Better Management of Transactions With Frequently Used Vendors Could Result in Additional Savings

The Navy has not proactively managed the purchase card program to identify opportunities for savings. Purchase card sales volume has grown significantly over the last few years with the Navy now using the purchase card to procure nearly \$2 billion a year in goods and services. We believe that the Navy could better leverage its volume of purchases and negotiate discounts with frequently used vendors. For example, during fiscal year 2001, the Navy paid over \$1 million each to 122 different vendors using the purchase card. In total during fiscal year 2001, the Navy paid those 122 vendors more than \$330 million. However, the Deputy Director of the Navy eBusiness Operations Office told us that, despite this heavy sales volume, the Navy had not negotiated reduced-price contracts with any of the vendors.

As previously stated, the benefits of using purchase cards versus traditional contracting and payment processes include lower transaction processing costs and less red tape for both the government and the vendor. Through increased analysis of purchase card procurement patterns, the Navy has the opportunity to leverage its high volume of purchases and achieve additional savings from vendors by negotiating volume discounts similar to those the General Service Administration (GSA) has negotiated in its Multiple Award Schedule program. Under GSA's Multiple Award Schedule, participating vendors agree to sell their products at preferred customer prices to all government purchasing agents. According to the Deputy Director of the Navy's eBusiness Operations Office, 74 of the 122 vendors with which the Navy spent more than \$1 million using the purchase card during fiscal year 2001 did not participate in the Multiple Award Schedule program. In addition, the opportunity existed for the Navy to negotiate additional savings from the 48 vendors that participated in the Multiple Award Schedule. GSA encourages agencies to enter into blanket purchase agreements (BPAs) and negotiate additional discounts with Multiple Award Schedule vendors from which they make recurring purchases.

By analyzing Navy-wide cardholder buying patterns, the Navy should be able to achieve additional savings by identifying vendors and vendor categories for which it uses the purchase card for a significant amount of money and negotiating discounts with them. For example, during fiscal year 2001, the Navy spent about \$65 million with 5 national computer vendors (i.e. Dell, Gateway, CWD Computer Centers, Micro Warehouse, and GTSI), \$22 million with 3 office supply companies (i.e. Corporate Express, Staples, and Office Depot), and \$9 million with 2 national home improvement stores (i.e. Home Depot and Lowe's). While 8 of these 10 vendors participate in GSA's Multiple Award Schedule program, the Navy could not tell us whether its purchases from these vendors were made using that program's preferred price schedules. Further, considering the Navy's volume of purchases, it is reasonable to assume that it could negotiate additional savings with these and other vendors if it used historical purchase card sales data as a bargaining tool.

Abusive and Questionable Purchases

We identified numerous examples of abusive and questionable transactions at each of the four installations we audited. We defined abusive transactions as those that were authorized, but in which the items were purchased at an excessive cost (e.g., "gold plated") or for a questionable government need, or both. Abuse can be viewed when a government organization, program, activity, or function falls short of societal expectations of prudent behavior. Often, improper purchases such as those discussed in the previous section are also abusive.

Questionable transactions are those that appear to be improper or abusive but for which there is insufficient documentation to conclude either. We consider transactions to be questionable when they do not fit within the Navy guidelines on purchases that are acceptable for the purchase card program, and when there is not a reasonable or documented justification to acquire the item purchased. When we examined the support for questionable transactions, we usually did not find evidence of why the Navy or Marine Corps needed the item purchased. Consequently, the cardholder provided an after-the-fact rationale that the item purchased was not improper or abusive. To prevent unnecessary costs, these types of questionable purchases require scrutiny before the purchase, not after. The following examples illustrate our point.

- *Computer and related equipment exceeding documented need*—The Navy used the purchase card to pay for computer and computer-related items far in advance of its needs. Considering that computer prices

decrease over time while their capabilities improve, warehousing computers and related items is an especially ineffective use of government funds. Despite this time, price, and capability relationship, we found in our statistical sample that the Atlantic Fleet, Pacific Fleet, and NAVSEA purchased computers, monitors, and printers that were often not put to use until more than 12 months had passed. For example, the computers purchased by the Atlantic Fleet in September 2000 that were discussed in the section on pilferable property had Pentium III microprocessors. By the time the Atlantic Fleet issued some of those computers in January 2002, the manufacturer was selling computers with Pentium IV microprocessors at a cost of less than what the Atlantic Fleet had paid for the Pentium IIIs. Further, our statistical sample at the Atlantic Fleet identified 22 other computers that the Navy purchased in April 2001 that were unused and still in their original boxes in June 2002. Similarly, we found two \$3,500 laser printers purchased in September 2000 that were selected in our statistical sample of Pacific Fleet transactions still in their original boxes at a Pacific Fleet warehouse in January 2002.

- *Flat Panel Monitors*—Our statistical sample selected transactions containing 243 flat panel monitors purchased by the Atlantic Fleet, Pacific Fleet, NAVSEA, and Camp Lejeune. The cost of the monitors selected in our sample ranged from \$550 to \$2,200. Conversely, the 17-inch standard monitors selected in the sample cost about \$200. As we have reported in the past, we believe the purchase of flat panel monitors—particularly those that cost far in excess of standard monitors—to be abusive and an ineffective use of government funds in the absence of a documented need based on technical, space, or other considerations. Further, in our statistical sample, we found that some of the flat panel monitors that the Atlantic Fleet purchased were placed in a warehouse and not issued for more than a year after the Navy took possession. Warehousing flat panel monitors is especially inefficient because, like computers, as time passes the price of flat panel monitors decreases and technology increases. The flat panel monitors that we found still in the box cost the Navy \$709 each. As of June 2002, the GSA price for the same flat panel monitors was about \$480.
- *Designer Leather Goods*—In September and October 2000, NAVSEA made two separate transactions totaling nearly \$1,800 to obtain designer leather folios and PDA holders costing up to \$300 each made by Coach and Dooney and Bourke. Two of the folios were given away as gifts to a

visiting officer in the Australian Navy, while other designer items were personal preferences of the cardholders and requesting individuals.

- *Clock radios*—As part of our Navy-wide data mining, we inquired about a \$2,443 transaction with Bose Corporation on September 30, 2000. In response to that inquiry, the Navy command that made the purchase told us that it purchased seven Bose “Wave Radios” costing \$349 each. The command justified the purchase by stating that Navy regulations require all visiting office quarters to be supplied with a clock radio. While we do not question the need to supply visiting officer quarters with clock radios, we do question the judgment of purchasing \$349 clock radios when there are numerous models of clock radios costing about \$15.

Disciplinary Actions Seldom Taken Against Those Who Misuse the Purchase Card

Currently, the Navy has not established specific disciplinary and/or administrative consequences for failure to follow purchase card control requirements—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 or questionable transactions identified in our work. As part of this audit, we asked the agency program coordinators at each command that we audited (1) whether any cardholders referred to in this testimony were disciplined for improper, abusive, or questionable purchases, or (2) if the reduction in the number of cardholders could be attributed to individuals who lost the card because they made improper, abusive, or questionable purchases. According to the agency program coordinators, only one of the cardholders referred to in this testimony lost his card for improper, abusive, or questionable purchases, and no one has had any disciplinary actions taken against them for abusing the purchase card and obtaining personal preference items at additional expense to the government.

Conclusions

We support the use of a well-controlled purchase card program as a valuable tool for streamlining the government’s acquisition processes. However, the Navy program is not well controlled and as a result is vulnerable to fraud, waste, and abuse. The primary cause of the control breakdowns is the lack of adherence to valid policies and procedures. The control environment at the Navy has improved over the last year. For example, the Navy has reduced the number of cardholders by over 50

percent, from 59,000 to 25,000, thus improving the prospects for effective program management. However, further actions are needed to achieve an effective control environment. Specifically, leadership by major command and unit management and a strong system of accountability must be established and sustained for effective program control. Strengthening the control environment will require a commitment by the Navy to build a robust purchase card control infrastructure.

Our related report on these issues released today builds on the progress the Navy has made and includes recommendations that address the need for the Navy to strengthen the overall control environment and improve internal control activities. Our recommendations focus on the need for the Navy to improve (1) overall program management and its control environment, (2) guidance on the requirements for the specific control activities, and (3) procedures to help prevent fraudulent, improper, and abusive or questionable purchases.

In written comments on a draft of our related report, DOD concurred or partially concurred with our recommendations and described actions completed, underway, or planned to implement them. While DOD partially concurred with our recommendations dealing with linking the performance appraisals of purchase card officials to achieving performance standards, and maintaining accountability over pilferable property, the actions DOD has agreed to take will implement the most significant aspects of those recommendations. DOD also partially concurred with our recommendation concerning establishing a schedule of disciplinary actions to be taken against cardholders who make improper or abusive acquisitions, but stated that the Navy will examine whether actions the department has already taken will appropriately address improper or abusive use of purchase cards.

Mr. Chairman, Members of the Subcommittee, and Senator Grassley, this concludes my prepared statement. I would be pleased to answer any questions that you may have.

Contacts and Acknowledgments

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