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United States Government Accountability Office  
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June 26, 2012

The Honorable Carl Levin  
Chairman  
The Honorable John McCain  
Ranking Member  
Committee on Armed Services  
United States Senate

Subject: *DOD Financial Management: Improvements Needed in Prompt Payment Monitoring and Reporting*

The Prompt Payment Act, as amended, requires executive-branch agencies, including the Department of Defense (DOD), to pay late-payment penalties when they do not pay their invoices for commercial payments on time. DOD's Prompt Payment Act implementing regulations provide that DOD components should take advantage of discounts offered when a contract or invoice allows an economically justified discount for early payment.<sup>1</sup> Given concern that DOD sometimes incurred late-payment penalties and had not taken full advantage of prompt-payment discounts, the committee report accompanying the 2012 national defense authorization legislation directed that GAO review and report on the issue.<sup>2</sup> To address this requirement, and as agreed upon with your offices, our objectives were to (1) determine whether DOD's process for monitoring and reporting on its late-payment penalties and discounts lost accurately reflected the extent of such penalties paid and discounts lost and (2) report on any causes DOD identified for incurring late-payment penalties and forgoing prompt-payment discounts.

To address our first objective, we analyzed applicable laws, regulations, and DOD documents to identify requirements related to prompt payments, reviewed documentation, and interviewed officials to obtain explanations and clarifications on DOD's process and controls for tracking and reporting on late-payment penalties and discounts lost across DOD. To address our second objective, we interviewed DOD officials and reviewed documentation, including the problems and corrective actions DOD reported on its financial operations metrics briefings, to determine DOD's identified causes of late-payment penalties incurred and discounts lost.

We conducted this performance audit from October 2011 to June 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan

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<sup>1</sup>Generally, the Prompt Payment Act requires agencies to make payment no later than 30 days after the date they receive an invoice or by a contractually established payment date. The Department of the Treasury establishes the rate used to calculate late-payment penalties. A discount is considered to be economically justified if the discount terms effectively equal or exceed the interest the federal government charges on overdue debt that it is owed.

<sup>2</sup>S. Rep. No.112-26, at 151 (June 22, 2011).

and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Results in Brief

We found that while DOD has a process in place for monitoring and reporting on late-payment penalties, this process has significant flaws and omissions that result in incomplete and inaccurate data, thereby limiting the effectiveness of the process. Specifically, DOD's performance measure, or metric, for late-payment penalties did not include about \$54 billion of commercial payments subject to the Prompt Payment Act, and DOD did not assess the data for accuracy or completeness. In addition, at the time of our review, DOD was not monitoring or reporting on discounts lost across the department because, DOD officials stated, the metric had consistently met its goal. The deficiencies we found in DOD's process for monitoring and reporting on late-payment penalties and discounts lost significantly increase the risk to the accuracy and completeness of reported data, thus preventing DOD officials and congressional oversight committees from obtaining the reliable and comprehensive data they need for assessing the extent of any issues concerning late-payment penalties and discounts lost across DOD. According to DOD officials and reports, a major contributor to late-payment penalties incurred and discounts lost was the late receipt of documents necessary to validate receipt and acceptance of goods or services and make payments. We are recommending that DOD establish procedures for identifying all DOD systems that process commercial payments, validating completeness and accuracy of late-payment penalty metric data, and monitoring discounts lost. In commenting on a draft of our report, DOD concurred with our recommendations and cited planned corrective actions to address the issues that gave rise to our recommendations.

## Background

DOD makes most of its commercial payments to vendors and contractors through systems operated by the Defense Finance and Accounting Service (DFAS), the finance and accounting organization for DOD.<sup>3</sup> In general, such payments are made after matching an invoice with (1) a signed contract, purchase order, or other contractual document, to ensure that the purchase of goods or services was authorized; (2) a receiving/acceptance report, to ensure that the goods or services ordered have been received or accepted, or both; and (3) the official accounting records, to ensure that funds have been obligated and are available for use.

The office of the Deputy Chief Financial Officer (DCFO) monitors DOD performance measures and various aspects of DOD's financial operations through its monthly financial operations metrics, including the ratio of late-payment penalties paid per million dollars in payments.<sup>4</sup> As part of its metrics process, each year the DCFO works with DFAS to establish goals—including Prompt Payment Act goals—towards improved efficiencies, financial stewardship, and productivity in its financial operations. DFAS compiles the results of its financial operations metrics (metric data), and each month the DCFO tracks the metric data—including data on late-payment penalties—and compares them against DOD's goals. The metric data are scored and receive a "green" rating when they meet the goal, and a "yellow" or "red" rating—depending on severity—when they do not. Each month, DFAS

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<sup>3</sup>Systems that make DOD commercial payments and that are not operated by DFAS include those currently being implemented by the Army, Navy, and Air Force.

<sup>4</sup>The process for monitoring DOD financial operations using metrics is documented by the DCFO's Performance Measurement Team in its *Performance Measurement Team Handbook*.

officials, the DCFO, and other DOD officials meet to discuss DOD-wide metric data that received a “red” or “yellow” rating, determine the causes for metric data that do not meet the goals, and agree on any corrective actions to address them. Metric data that meet or exceed the goals and receive a “green” rating are generally not discussed at these monthly meetings.

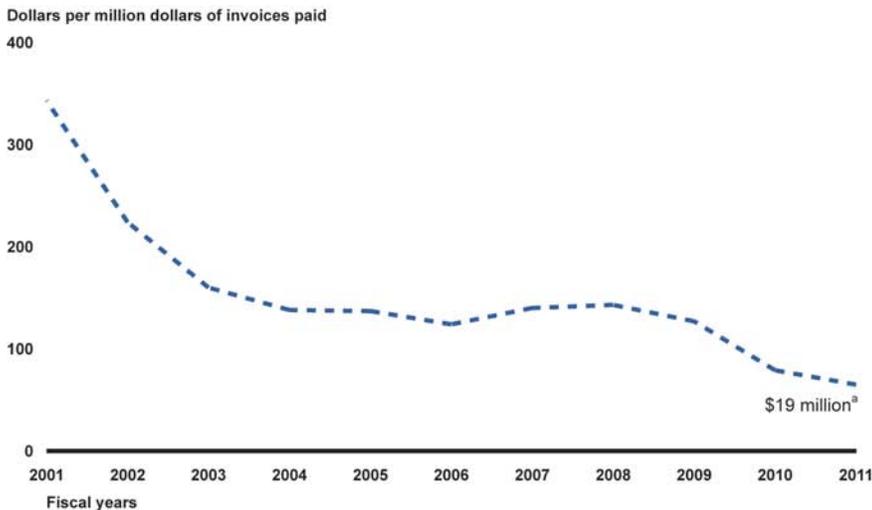
**Incomplete and Inaccurate Data Undermine DOD’s Prompt Payment Act Monitoring**

In our review of DOD’s monitoring of payments related to the Prompt Payment Act, we found deficiencies in the completeness and accuracy of the data used to monitor and report on late-payment penalties. The late-payment penalty metric data did not include nine systems that process commercial payments, and the metric data had not been validated. Regarding discounts lost, we found that monitoring had not been conducted DOD-wide since fiscal year 2007 and that there were deficiencies in the completeness of the data DOD provided us from systems within DOD’s components.

Deficiencies in the Monitoring Process for Late-Payment Penalties

We found deficiencies in both the completeness and accuracy of the data the DCFO uses to monitor and report on late-payment penalties. These deficiencies limit the effectiveness of DOD’s monitoring and reporting process. According to DCFO reports, the ratio of late-payment penalties paid to million dollars of invoices paid has decreased 81 percent since 2001, from an average of \$343 in penalties in fiscal year 2001 to \$65 in fiscal year 2011 (see fig. 1).

**Figure 1: Late-Payment Penalties Paid per Million Dollars of Invoices Paid (DFAS Systems Only), Fiscal Years 2001–2011**



Source: DOD.

Note: Data are from September 2011 financial operations metric briefing.

<sup>a</sup>Total dollar amount for fiscal year 2011 based on DFAS-provided data does not include late-payment penalties for non-DFAS systems.

While these data show a significant drop in late-payment penalties as a proportion of invoice amounts paid, in our analysis of DOD data used to support this reporting, we found that the trend may be misleading because in compiling the late-payment penalty metric data, DFAS did not consider late-payment penalties on about \$54 billion in payments subject to the Prompt Payment Act from nine systems (see table 1). These systems were all systems that process commercial payments. According to DOD officials, the nine systems we identified

whose data were not considered in the late-payment penalty metric are systems run and operated by DOD components and not DFAS.

**Table 1: DOD Systems and Payment Amounts Considered and Not Considered in the Late-Payment Penalty Metric, Fiscal Year 2011**

Dollars in millions		
<b>System name</b>	<b>Payments considered in late-payment penalty metric (from DFAS systems)<sup>a</sup></b>	<b>Payments not considered in late-payment penalty metric (from nine non-DFAS systems)<sup>a</sup></b>
Mechanization of Contract Administration Services (MOCAS)	\$161,298.6	
Computerized Accounts Payable System–Windows (CAPS-W)	39,525.4	
U.S. Army Corps of Engineers Financial Management System (CEFMS)		28,047.9
Enterprise Business System (EBS)	23,721.9	
Automated Voucher Examining and Disbursing System (AVEDS)	18,396.7	
Integrated Accounts Payable (IAPS)	18,388.0	
OnePay (OP)	18,104.1	
TRICARE Oracle Federal Financials (OFF)		16,869.8
Standard Automated Voucher Examination System (SAVES)	6,056.8	
Defense Enterprise Accounting and Management System (DEAMS)		4,374.3
General Fund Enterprise Business System (GFEBS)		2,528.7
Transportation Financial Management System (TFMS)	2,333.1	
Military Sealift Command Financial Management System (MSC-FMS)		1,625.8
Financial Accounting and Budget System (FABS)	1,119.7	
Defense Agencies Initiative (DAI)		474.3
Nonappropriated Fund Information Standard System (NAFISS)		370.8
Transportation Management System (TMS)		119.1
Computerized Accounts Payable System–Clipper (CAPS-C)	7.3	
Navy Enterprise Resource Planning (ERP) System		– <sup>b</sup>
<b>Total<sup>c</sup></b>	<b>\$288,951.5</b>	<b>\$54,410.6</b>

Source: GAO analysis of DOD data.

<sup>a</sup>Commercial payments reported by DOD as subject to the Prompt Payment Act.

<sup>b</sup>Navy ERP could not provide the amount of commercial payments subject to the Prompt Payment Act because it does not systematically identify whether commercial payments are subject to the Prompt Payment Act.

<sup>c</sup>Due to rounding, the total amounts do not equal the sum of the individual system amounts in the table.

While DFAS reported a total of about \$19 million in late-payment penalties for fiscal year 2011 (see fig. 1), these data are incomplete because the DCFO did not consider the complete population of commercial payments when reporting late-payment penalties in fiscal year 2011. For example, DOD provided us information that indicates that the nine non-DFAS systems we identified incurred almost \$2 million in late-payment penalties in 2011, bringing fiscal year 2011 late-payment penalties to almost \$21 million. Although DOD took steps to include some of these commercial payments in the data for its late-payment penalty

metric during the course of our work,<sup>5</sup> additional payments and late-payment penalties that are associated with non-DFAS systems may still be unidentified.

We also found—and DOD officials confirmed—that the DCFO does not assess its late-payment penalty metric data for accuracy or completeness. *Standards for Internal Control in the Federal Government* states that for organizational performance measures, controls should be in place to validate the propriety and integrity of the measures.<sup>6</sup> Further, the DCFO handbook states that successful measures need to be reliable, and should be verified to ensure that they represent the desired data. Although the late-payment penalty amounts provided to us are relatively small compared to DOD’s total commercial payment amounts, we are unable to conclude as to the completeness and accuracy of the \$21 million in late-payment penalties due to questions about the completeness of the population of systems that process commercial payments and the lack of validation and verification control. In addition, these issues prevent DOD officials and congressional oversight from obtaining reliable and comprehensive data on the extent of any issues concerning late-payment penalties across DOD.

#### DCFO Is Not Monitoring Discounts Lost DOD-Wide

The DCFO has not monitored discounts lost at the DOD-wide level since fiscal year 2007 and does not have procedures to evaluate the risk and magnitude of discounts lost to determine whether it should resume monitoring discounts lost in DOD-wide metrics if the risk increases beyond an acceptable level. *Standards for Internal Control in the Federal Government* states that separate evaluation of controls is useful, and that the scope and frequency of such evaluations should depend primarily on risk assessments and the effectiveness of ongoing monitoring procedures. Officials stated the DCFO ceased monitoring discounts lost because the metrics consistently delivered results that ranked “green” (i.e., met their goal) and no longer warranted DOD-wide monitoring. However, as reflected in figure 2, we found that the reported discounts-lost metric only met its goal of 4 percent for 2 months in fiscal year 2007.

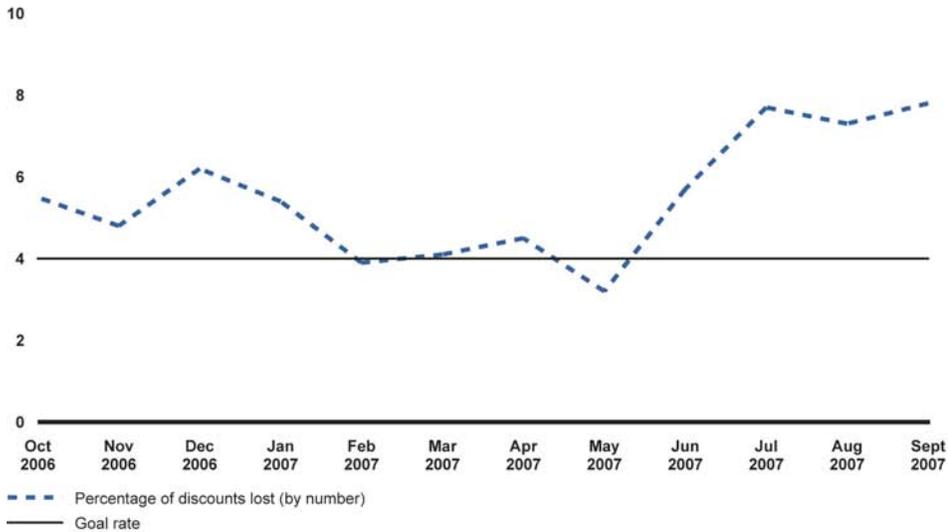
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<sup>5</sup>For example, DOD started including commercial payments from the U.S. Army Corps of Engineers Financial Management System in the December 2011 metric.

<sup>6</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999). These standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing areas at greatest risk of fraud, waste, abuse, and mismanagement.

**Figure 2: Percentage of the Number of Offered Discounts Lost in Fiscal Year 2007**

Percent per million dollars of invoices paid



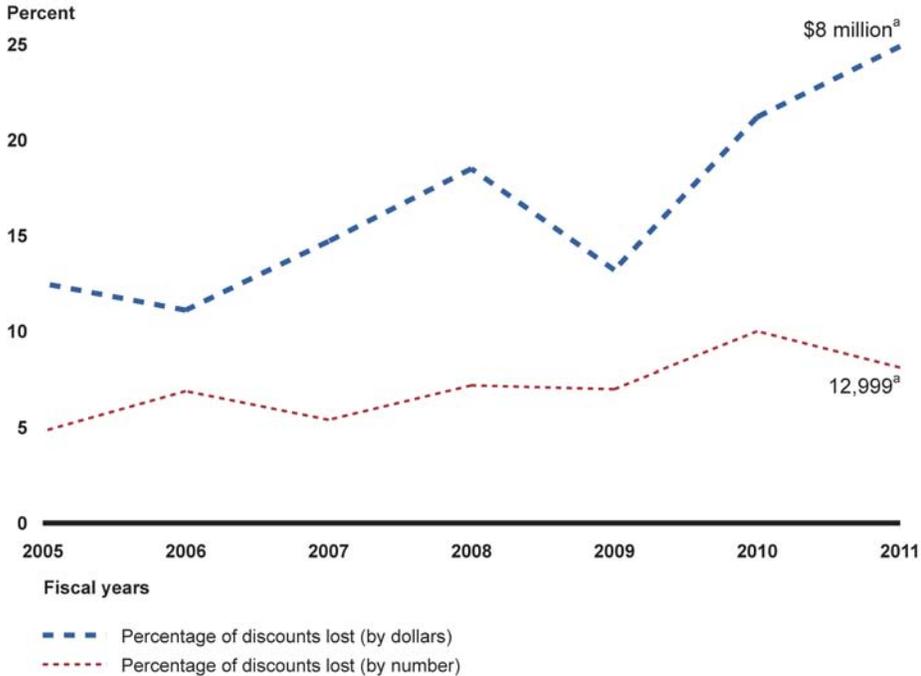
Source: DOD.

Note: Data are from fiscal year 2007 financial operations metric briefings.

For the systems it operates, DFAS tracks both the number of discounts lost and the dollar value of the discounts lost, and reports its findings to the managers of DOD activities. While these figures are useful for management, they are not discussed at DFAS's monthly meeting with the DCFO, and thus fall outside of the DCFO's monitoring process.

Although the DCFO stopped monitoring discounts lost, DFAS provided us information that indicates the ratios of both the number and dollars of discounts lost have generally been increasing (see fig. 3). Discounts lost, as a percentage of the number of discounts offered, equaled 8 percent in fiscal year 2011, twice the fiscal year 2007 DCFO goal of 4 percent, which was the last goal set by the DCFO for discounts lost. DFAS currently has a goal for the number of discounts lost of 5 percent. The DFAS data further show that although the ratio of the number of discounts lost decreased from fiscal years 2010 to 2011, the ratio of the dollars of discounts lost increased to 25 percent. DFAS currently has a goal for the percentage of discounts lost in dollars of 4 percent.

**Figure 3: Percentage of the Value and Number of Offered Discounts Lost, Fiscal Years 2005–2011**



Source: DFAS.

Note: Data are from DFAS metrics data.

<sup>a</sup>Total dollar amount and number of discounts lost for fiscal year 2011 based on DFAS-provided data does not include discounts lost for non-DFAS systems. In addition, the goal amounts for both the percentage of dollars and numbers of discounts lost are not shown because they vary and have not been set or monitored by the DCFO since fiscal year 2007.

Although the ratios for discounts lost have generally been increasing, the amount of discounts lost is relatively small compared to DOD’s total commercial payment amounts. DFAS provided us information that indicates that there was about \$8 million in discounts lost for fiscal year 2011. However, as with the late-payment penalty metric, we found that for discounts lost, DFAS did not include about \$78 billion in commercial payments subject to the Prompt Payment Act<sup>7</sup> both from systems that it operates and does not operate. DOD-provided information, covering some of the systems not included,<sup>8</sup> indicates almost \$700,000 in discounts lost in fiscal year 2011, bringing the fiscal year 2011 discounts lost to almost \$9 million. However, because DOD has not established procedures to identify and include all systems that process commercial payments, we are unable to conclude as to the completeness and accuracy of the almost \$9 million in DOD-identified discounts lost. In addition, these issues prevent DOD officials and congressional oversight committees from obtaining reliable and comprehensive data on the extent of any issues concerning discounts lost across DOD. Absent DOD-wide monitoring of discount information, potential cost savings may be missed.

<sup>7</sup>The Navy ERP system, accounting for about \$1 billion in fiscal year 2011 commercial payments, could not provide an amount subject to the Prompt Payment Act.

<sup>8</sup>The Navy ERP system, as well as EBS, which accounts for \$24 billion in fiscal year 2011 commercial payments subject to the Prompt Payment Act, could not provide an amount for discounts lost.

## **DOD-Reported Causes for Late-Payment Penalties Incurred and Discounts Lost**

On the basis of our discussions with DOD officials and our review of reports, we found DFAS's late receipt of necessary documents was a major contributor to late-payment penalties and discounts lost. The documents DOD officials most often cited in this regard were receiving reports, which are used to confirm DOD's receipt or acceptance, or both, of goods or services ordered and which must be submitted to DFAS before payment can be made. DOD officials told us that one of the reasons receiving reports are often late is reports are often mailed by DOD components to DFAS rather than submitted electronically. As part of its metric reporting process, DFAS tracks the reasons for the payment of late-payment penalties on commercial payments that DFAS's systems process. DFAS reported that for the payments it made in fiscal year 2011, 57 percent of the late-payment penalties were due to a delay in DFAS's receiving contract, invoice, and receipt and acceptance information from DOD components, contractors, and vendors, and 23 percent were caused by DFAS processing delays and a backlog of invoices to process. DOD reported that as it continues to deploy the Wide Area Workflow and take other measures, it will see a decline in late-payment penalties because of efficiencies gained with the electronic transmission of contract documents.<sup>9</sup> Such efficiencies gained may similarly improve DOD's ability to take advantage of discounts offered and thus realize cost savings.

DOD officials stated that contracts containing unclear descriptions of the items being purchased and unclear definitions of units of measure are a significant issue for a relatively few contracts that account for a relatively large amount in late-payment penalties.<sup>10</sup> For example, although a contract line-item may describe the unit of measure as "one lot," the lot may consist of a variety of items and quantities delivered over time. DOD officials further stated that multiple contract modifications had resulted in contracts having extremely complex line-item structures, causing invoice processing delays due to difficulties in comparing or associating the contractor invoices to the related contract line-item. The lack of clarity can result in ambiguity regarding both the items to accept and the amount to pay for each delivery, thereby causing DOD to incur late-payment penalties and miss opportunities to obtain discounts. DOD officials told us they were addressing these issues by providing training on writing contracts and issuing DOD-wide memorandums requiring contracts to clearly define the quantity and unit of measure of the product to be delivered.

### **Conclusions**

Although the amounts DOD provided us for late-payment penalties and discounts lost appear to be relatively small compared to the amount of DOD-reported commercial payments subject to the Prompt Payment Act, deficiencies in DOD's monitoring process prevent it from comprehensively and reliably reporting the magnitude of late-payment penalties and discounts lost DOD-wide. As DOD implements new systems run and operated by the components, the percentage of the complete data population processed by DFAS systems will decrease, and the potential gap between actual and reported amounts will increase if flaws and omissions in DOD's current process for monitoring these activities are not corrected.

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<sup>9</sup>The Wide Area Workflow is an interactive application that allows contractors and vendors to electronically submit invoices and receiving reports, and the federal government to inspect, accept, receive, and pay electronically.

<sup>10</sup>DOD analysis was done using late-payment penalties paid in fiscal year 2010.

## Recommendations for Executive Action

To ensure that the Department of Defense accurately reports and effectively monitors late-payment penalties and discounts lost on commercial payments subject to the Prompt Payment Act, we recommend that the Secretary of Defense direct the Deputy Chief Financial Officer, through the Office of the Under Secretary of Defense (Comptroller), to establish procedures for

(1) identifying all DOD systems that process commercial payments and assuring that the late-payment penalties metric data are compiled from the complete population of commercial payments subject to the Prompt Payment Act,

(2) validating the accuracy and completeness of the data compiled and reported as DOD's late-payment penalties metric, and

(3) monitoring discounts lost DOD-wide based on periodic risk assessments.

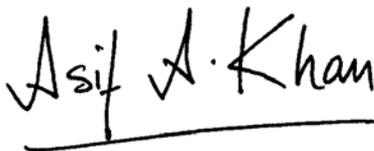
## Agency Comments and Our Evaluation

We provided a draft of this report to DOD for comment. In its written comments, which are reprinted in enclosure I, DOD concurred with all three of our recommendations. DOD also stated that it is taking actions to address our recommendations, which includes (1) identifying and reporting DOD-wide late payment penalty metrics beginning in October 2012; (2) assigning responsibility to each reporting entity for the accuracy, completeness, and validation of data reported; and (3) identifying and issuing procedures to address monitoring and reporting of discounts lost. If fully and effectively implemented, DOD's proposed actions should address the intent of our recommendations.

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We are sending copies of this report to the appropriate congressional committees; the Secretary of Defense, the Deputy Secretary of Defense, the Deputy Chief Management Officer, the Under Secretary of Defense (Comptroller), and other interested parties. In addition, this report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9869 or [khana@gao.gov](mailto:khana@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in enclosure II.



Asif A. Khan  
Director, Financial Management and Assurance

Enclosures

**Enclosure I: Comments from the Department of Defense**



COMPTROLLER

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

JUN 6 2012

Mr. Asif A. Khan  
Director, Financial Management and Assurance  
U.S. Government Accountability Office  
Washington, DC 20548

Dear Mr. Khan:

This is the Department of Defense (DoD) response to the Government Accountability Office (GAO) draft report GAO-12-662R, "DoD Financial Management: Improvements Needed in Prompt Payment Monitoring and Reporting," dated May 16, 2012 (GAO Code 197107). Thank you for the opportunity to respond.

The Department concurs with all three report recommendations. Our detailed responses are included in the enclosure. We support the need for a complete and accurate picture of DoD-wide interest payment penalties and discounts lost. The expansion of electronic commerce and other process improvements have reduced late payments and associated penalties over recent years. Systems modernizations have also moved more of our entitlement activity to systems where we have not, however, adequately captured and reported this information.

We plan to maintain non-appropriated fund instrumentalities (NAFIs) separately from our traditional reporting of the appropriated fund activities. Our procedures reflect the uniqueness of the NAFIs' missions, funding, oversight, and reporting responsibilities within the Department, along with the limited authorities and responsibilities assigned to the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) for the NAFIs. Our initial approach will be to confirm that prompt payment interest data is being collected, monitored, and reported within the responsible oversight entity, but not include the NAFIs' metric data as part of the OUSD(C)'s DoD enterprise metrics data.

My point of contact on this matter is Mr. M. Wayne Goff. He can be reached at [wayne.goff@osd.mil](mailto:wayne.goff@osd.mil) or at 703-602-0374.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark E. Easton".

Mark E. Easton  
Deputy Chief Financial Officer

Enclosure:  
As stated

GAO DRAFT REPORT DATED MAY 16, 2012  
GAO-12-662R (GAO CODE 197107)

“DOD FINANCIAL MANAGEMENT: IMPROVEMENTS NEEDED IN PROMPT  
PAYMENT MONITORING AND REPORTING”

DEPARTMENT OF DEFENSE (DOD) COMMENTS  
TO THE GAO RECOMMENDATIONS

**RECOMMENDATION 1:** The GAO recommends that the Secretary of Defense direct the Deputy Chief Financial Officer, through the Office of the Under Secretary of Defense (Comptroller) to establish procedures for identifying all DoD systems that process commercial payments and assuring that the late payment penalties metric data are compiled from the complete population of commercial payments subject to the Prompt Payment Act.

**DoD RESPONSE:** Concur. Procedures will be established to require the identification and reporting of DoD-wide late payment penalty metrics beginning October 1, 2012, to the extent the data is available within the respective systems. We expect some systems will require modifications in order to collect certain data elements necessary for the metric, and thus reporting from those systems will potentially be delayed until the necessary system modifications are completed.

**RECOMMENDATION 2:** The GAO recommends that the Secretary of Defense direct the Deputy Chief Financial Officer, through the Office of the Under Secretary of Defense (Comptroller) to establish procedures for validating the accuracy and completeness of the data compiled and reported as DoD’s late payment penalties metric.

**DoD RESPONSE:** Concur. Each Departmental reporting entity will be assigned responsibility within the aforementioned procedures for the accuracy and completeness of the data reported. These procedures will also address validating the data at the DoD enterprise level.

**RECOMMENDATION 3:** The GAO recommends that the Secretary of Defense direct the Deputy Chief Financial Officer, through the Office of the Under Secretary of Defense (Comptroller) to establish procedures for monitoring discounts lost DoD-wide based on periodic risk assessments.

**DoD RESPONSE:** Concur. In order to evaluate the risk and magnitude of discounts lost DoD-wide, we will initially identify the total universe of discounts lost to the extent possible given some limitations within the Department’s systems. Once this data is gathered and evaluated, we expect to issue cost-effective procedures addressing the monitoring and reporting requirements for discounts lost DoD-wide by October 1, 2012.

Enclosure

## **Enclosure II: GAO Contact and Staff Acknowledgments**

### **GAO Contact**

Asif A. Khan, (202) 512-9869 or [khana@gao.gov](mailto:khana@gao.gov)

### **Staff Acknowledgments**

In addition to the contact named above, Michael LaForge, Assistant Director; Justin Fisher; Patrick Frey; Maxine Hattery; Jason Kelly; Jason Kirwan; Laura Pacheco; J. Mark Yoder; and Leonard Zapata made key contributions to this report.

(197107)

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