GAO

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General Accounting Office
Washington, D.C. 20548

Accounting and Information Management Division

B-258185

January 23, 1995

Mr. Scot M. Faulkner
Chief Administrative Officer
House of Representatives

Dear Mr. Faulkner:

This letter responds to the September 16, 1994, request from the former Director, Office of Support Operations, Non-Legislative and Financial Services, that we provide our views on whether it is appropriate to make purchase order or contract payments based solely on a receiving report or other documentary evidence of receipt and acceptance, such as a computer listing discussed in the proposal. As described in the request letter, the administrative office was streamlining its payment processes and had proposed eliminating the vendor's invoice as a required document needed to authorize payment. To supplement the descriptions of the proposal, we contacted the administrative office's staff to obtain more detail. However, we did not perform any tests of the current system, and, consequently, our response only addresses the proposal conceptually and does not address whether the present system is capable of accommodating the proposal.

We have issued guidance on accounting, internal controls, and related matters in its Policy and Procedures Manual for Guidance of Federal Agencies. Title 7, "Fiscal Procedures," of this manual covers payment processing and related internal controls. Title 7 identifies three typical steps to assure that proper payment is authorized: (1) the acquisition of goods or services was properly authorized, evidenced by a purchase order, contract, or other authorization, (2) the goods or services ordered have been delivered and accepted, evidenced by a receiving and inspection report, and (3) a claim has been made against the government, evidenced by receipt of an invoice or bill. Vendors' billing and government payment systems have been traditionally designed and operated with the invoice being the primary document initiating the payment process. Title 7, however, does not preclude payment from being authorized without an invoice.[1] We believe successful implementation of alternative control features, such as envisioned in your proposal, can offer equivalent assurances to that now provided by relying on an invoice.

[1]In the case of executive branch agencies, an exception from any of the above three steps may be subject to GAO approval.

When changing to a system which no longer requires invoices, care is needed to ensure that adequate controls are in place and properly functioning to permit authorization of only proper payments. Three specific internal control items that should be given special attention when changing to such a system are: (1) payment is initiated only after receipt of goods and services and is authorized only after matching the types and quantities of goods and services received and accepted with those ordered, (2) controls exist to insure against duplicate payment should a vendor mistakenly seek payment for goods or services for which payment has already been made, and (3) payments are made to coincide with the due dates and take advantage of the discount terms. A payment system which does not use invoices can provide an adequate basis for the proper amounts due vendors if internal controls, especially in these three items, are effectively operating. These essential internal controls are discussed below.

First, in a typical payment system, to determine whether, and for what amount, payment should be authorized, an invoice initiates the matching of types and quantities of goods and services received and accepted, as shown on the receiving report, with the types and quantities of goods and services ordered on the purchase order or contract. Without an invoice, care must be taken to assure that the matching will occur promptly and that payment will be authorized in accordance with the agreed upon terms, including those appropriate for taking discounts.

Based on the information provided us, there are two basic types of payments subject to the proposal, those made under maintenance contracts and those based on purchase orders. (Purchase order acquisitions involve only discrete goods or services.) Under purchase order acquisitions, the proposal requires the receiving and inspection report to be the document initiating the payment process. As we understand the proposal, once the report is completed and forwarded to the administrative office, the information on types and quantities received is then to be reconciled to the related amounts on the purchase order, and the receiving report is canceled (marked or otherwise designated as having previously been the basis for payment) to prevent reuse. Also, as we understand the proposal, when discrepancies arise, they are to be researched and resolved promptly. If no discrepancies exist, payment is to be authorized for the quantities received and accepted based on the terms contained in the purchase order, which includes prices and discounts. (The purchase orders or underlying contracts are required to contain the complete terms of the agreement, including quantities, prices, discounts terms, and payment due dates.[2])

The administrative staff explained that verification of receipt of services under the maintenance contracts differs from such verification under purchase order acquisitions. Vendors are required to periodically maintain various equipment, either on a schedule (based on the type of equipment and the amount of use) or when requested if the equipment does not operate properly. After the service period elapses, the proposal calls for the automated system to generate a list of all maintenance payments due vendors under contract each month. In effect, this list functions as a receiving report and initiates the payment process. Since the cost of servicing is based on a per item cost, this list also includes all the items of equipment each vendor services. The staff explained that controls exist to ensure the integrity of the data in the list. For the proposal to provide adequate control, it will be essential that this is the case. We were told that periodically, the equipment items on hand are counted and compared with those on the list (physical inventory) to ensure that the items are still in service; and that discrepancies must be researched and the list and payments adjusted, if necessary. In addition, the staff indicated that each vendor would be asked to verify monthly the list of equipment items it services.

The second area of concern is the risk of duplicate payment, which we believe would be higher in the first few months after implementation. Both the vendors and the administrative staff have been using invoices to generate payments and are familiar with processing them. Consequently, if a vendor mistakenly submits an invoice on a previously paid purchase, the staff may attempt to process it for payment.

The staff explained that the system proposed will have several controls to prevent duplicate payment. As we understand the system, one such control is activated during the initial voucher examining phase. Before payment is made, a voucher examiner is required, among other things, to verify that the resulting disbursement will not exceed the funds available for the purchase order. In performing this verification, the examiner should see that the amounts have already been paid and preclude the further processing of the invoice for payment.

[2]Executive branch agencies subject to the Prompt Payment Act of 1982, as amended, which may consider streamlining their payment system, would need assurance that all contracts and purchase orders contain payment due date provisions. Under that act, invoice receipt dates are a major factor in determining payment due dates if the contract or purchase order is silent regarding payment timing.

The staff further stated that should the voucher examiner not detect that payment has already been made, the automated system is to preclude payment. After the voucher examiner approves a payment, the information is to be entered into the financial management system. An automated edit is performed to verify that funds are available for payment in the related purchase order or contract. If adequate funds are available, the system is to reduce the balance by the amount of the payment request and continue to process the item for payment. If, however, an invoice is mistakenly processed by an examiner on a previously paid purchase order or contract and the funds available are less than the payment request, the system is expected to automatically preclude the authorization for payment and hence stop further payment processing.

As we understand it, in the event an invoice for partial payment is mistakenly submitted for processing on a previously paid amount and the purchase order or contract continues to show available funds to cover the second payment, controls still exist to prevent the payment from being made. In this case, the administrative staff indicated that the examiner will not find (1) an uncanceled receiving report with which to complete a proper matching or (2) an available computer list of the vender serviced items with which to verify the items serviced. Therefore, payment processing will be stopped to research the discrepancy.

The last concern or risk is, if not properly controlled, initiating the payment process based on receiving and inspection reports could result in payment before the due date. Under certain circumstances, this early payment may result in interest income to the government. The staff believes that the government and the vendors will benefit because payments to vendors will be made to coincide more closely with an agreed upon due date subsequent to the actual receipt of goods and services. Also, vendors have told the staff that they are willing to renegotiate existing purchase orders to reflect greater discounts since their payments will be made sooner and their administrative burden would be reduced because they would not have to prepare invoices, forward them to your office, and await payment.

We hope this letter is helpful in deliberating changes to the payment system. If you and your staff have any questions or would like to discuss these matters further, please contact Bruce Michelson, Assistant Director, at (202) 512-9366.

Sincerely yours,

John W. Hill, Jr.

John W. Hill, Jr.
Director, Financial Management
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