THE USE AND ABUSE OF GOVERNMENT CREDIT CARDS AT THE DEPARTMENT OF THE NAVY

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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THE USE AND ABUSE OF GOVERNMENT CREDIT CARDS AT THE DEPARTMENT OF THE NAVY

TUESDAY, OCTOBER 8, 2002

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2247, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, and Schakowsky.

Staff present: Bonnie Heald, staff director; Henry Wray, senior counsel; Dan Daly, counsel; Dan Costello, professional staff member; Chris Barkley, clerk; Ursula Wojciechowski and Juliana French, interns; David McMillen, minority professional staff member; and Jean Gosa, minority clerk.

Mr. HORN. We are going to swear in people, so I'm going to start on panel two. And panel one is Senator Grassley, and that will come when he gets here.

So let me just get Greg Kutz, Special Agent John Ryan, Rear Admiral Robert Cowley and Special—let's see, the Honorable Dionel Aviles, Assistant Secretary of the Navy for Financial Management, Comptroller. And come behind the table there, and if you would please raise your right hand—and any staff that are going to whisper in your ear. And the clerk will also get the ones in the back.

[Witnesses sworn.]

Mr. HORN. I want to get the staff because they will be wonderful people to put in the hearing.

So a quorum being present, this hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

Today's hearing is on the use and misuse of government-issued credit cards at the Department of the Navy. This hearing is the fifth in a series of subcommittee hearings to examine the purchase card and travel card programs at the Department of Defense. These programs were created to save taxpayers' money by streamlining the government's cumbersome procurement and travel procedures. However, over the past year-and-a-half, this subcommittee has heard so many examples of fraudulent and abusive use of these programs that it is impossible to know whether the programs have saved any money at all.

Up to now, the Department of Defense has failed miserably to monitor the use of these cards. One employee who went on a $12,000 shopping spree at the government's expense was never disciplined. As I remember, it was a Navy person; and then she was dropped off by the Army. In fact, she was promoted. Others have used their government-guaranteed credit cards to buy such items as jewelry, expensive radios, designer briefcases and flowers. Travel cards, which are to be used for only official government travel expenses, have been used at gentlemen's clubs, gambling casinos, cruise ships, and, as you will hear today, even at brothels.

You will also hear the failure to review one cardholder's statement, allowed that employee to make more than $250,000 in unauthorized and illegal purchases over a 10-month period. That employee spent thousands of dollars on Internet purchases, prepaid toll tags, remote-controlled helicopters, and even a dog.

Until the subcommittee began this investigation 1½ years ago, no one seemed to notice these abuses or seemed to care. Records were missing. Equipment bought with the government credit cards was nowhere to be found. Monthly bills were rubber stamped for payment by overworked officials, who were responsible for hundreds of monthly credit card statements in addition to their other duties.

The subcommittee focused on the Department of Defense because this one Department accounts for 65 percent of all purchase and travel cards issued by the entire Federal Government. Since the subcommittee began this investigation with the able help of the Accounting Office headed by the Comptroller General of the United States, the Department of Defense has taken several significant steps to strengthen its control over the purchase card program. The Department has cut the number of credit cards it issues. It has also limited the number of accounts each approving officer panels. In addition, the Department is developing a plan that will provide a foundation for credit card programs throughout the department. Meanwhile, the Departments of the Army and Navy have rewritten their purchase card policies and procedures manuals.

The Department of Defense is also beginning to gain better control over its travel card program. Deadbeat employees who fail to pay their travel card bills will get their wages garnished. Those who write bad checks to pay their credit card bills will lose those cards.

These are all the steps in the right direction, but much more needs to be done. It will take a sustained effort from the Secretary's office down to the local commanders and supervisors to clean up this mess. And that is precisely what Congress expects and the American taxpayers demand.

That said, I will welcome our witnesses today and I will look forward to discussing strategies for resolving this egregious situation. I happened to be in the Pentagon this morning and Secretary Rumsfeld and I had a number of comments on this. He is outraged by what's going on; and when the war is over, why, I think he will really move things along.

So we have Mr. Grassley, who has worked on this with us, and we're glad to have him here.

[The prepared statement of Hon. Stephen Horn follows:]

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Opening Statement
Chairman Stephen Horn,
Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations
October 8, 2002

A quorum being present, this hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

Today's hearing is on the use and misuse of government-issued credit cards at the Department of the Navy. This hearing is the fifth in a series of subcommittee hearings to examine the purchase card and travel card programs at the Department of Defense.

These programs were created to save taxpayers' money by streamlining the Government's cumbersome procurement and travel procedures. However, over the past year and a half, this subcommittee has heard so many examples of fraudulent and abusive use of these programs that it is impossible to know whether the programs have saved any money at all. Up to now, the Department of Defense has failed miserably to monitor the use of these cards. One employee, who went on a $12,000 dollar shopping spree at the Government's expense, was never disciplined. In fact, she was promoted. Others have used their Government-guaranteed credit cards to buy such items as jewelry, expensive radios, designer briefcases and flowers. Travel cards, which are to be used for official Government travel expenses, have been used at gentlemen's clubs, gambling casinos, cruise ships and, as you will hear today, even at brothels. You will also hear how the failure to review one cardholder's statement allowed that employee to make more than $250,000 dollars in unauthorized and illegal purchases over a 10-month period. That employee spent thousands of dollars on Internet purchases, prepaid toll tags, remote controlled helicopters, and even a dog.

Until the subcommittee began this investigation, no one seemed to noticed these abuses, or seemed to care. Records were missing. Equipment bought with the Government credit cards was nowhere to be found. Monthly bills were rubber-stamped for payment by overworked officials who were responsible for hundreds of monthly credit card statements -- in addition to their other duties. The subcommittee focused on the Department of Defense, because this one department accounts for 65 percent of all purchase and travel cards issue by the entire Federal Government.

Since the subcommittee began this investigation with the able help of the General Accounting Office, the Department of Defense has taken several significant steps to strengthen its control over the purchase card program. The department has cut the number of credit cards it issues. It has also limited the number of accounts each approving officer handles. In addition, the department is developing a plan that will provide a foundation for credit card programs throughout the department. Meanwhile, the Departments of the Army and the Navy have re-written their purchase card policies and procedures manuals.

The Department of Defense is also beginning to gain better control over its travel card program. Deadbeat employees who fail to pay their travel card bills will get their wages garnished. Those who write bad checks to pay their credit card bills will lose those cards.

These are all steps in the right direction. But much more needs to be done. It will take a sustained effort from the Secretary's office down to the local commanders and supervisors to clean up this mess. And that is precisely what Congress expects and the American taxpayers demand.

That said, I welcome our witnesses today, and I look forward to discussing strategies to resolve this egregious situation.

Senator GRASSLEY. Mr. Chairman, did you want me to start?
Mr. HORN. Yes.

STATEMENT OF HON. CHARLES GRASSLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Senator GRASSLEY. Thank you very much. I am sorry I missed your opening comments, or at least part of them. This is our fourth and final hearing on the joint oversight investigation of the Department of Defense credit card abuse. It has obviously been an honor and privilege for me to conduct oversight with the distinguished company that you make, Mr. Chairman. From day one, this has been a team effort and you have been a leader. With you up front in the driver's seat, we have accomplished much of our mission. We have done everything in our power to ensure that the taxpayers' money is spent wisely; most importantly, according to law. Our success is due to your outstanding leadership, and I thank you from the bottom of my heart. When you step down at the end of the session, you will be missed, especially by this Senator from Iowa.

Your departure will leave a gaping hole in our frontlines, and it is going to be very hard to fill it. Courage is in such short supply in the area of congressional oversight. As I have repeatedly stated, you have put the glare of the public spotlight on a very dark corner of the Pentagon. In a huge bureaucracy, like the Pentagon is, daylight is never welcome. In fact, it is feared and hated. But shedding light on a problem like credit card abuse is the heart and soul of oversight. Our purpose from the beginning was to determine the scope of abuse and then figure out how to put a stop to it all. You have so graciously provided the venue where we could do what had to be done.

Mr. Chairman, we started this investigation more than 2 years ago. Yes, it's true we have come a long ways. We have seen the promised land, but we're not yet there. We have much more work to do before we get to the end of the road. At our first hearing July 30, 2001, we examined a sample of fiscal year 2000 purchase card transactions collected from two Navy organizations in the San Diego area. We found zero controls, extensive abuse, and total disregard for accountability. The Navy dismissed our findings as a few, in their words, "unique and isolated cases." Not to worry, we were told. We don't have a problem, is what the Navy said. And obviously the implication was one rotten apple doesn't make the whole barrel bad.

Then we had our second hearing 8 months later, March 13, this year. We went back to the same two Navy units for a second look. We examined a more current sample of fiscal year 2001 transactions. And guess what we found? Results were the same, or maybe even worse. No effective controls, extensive abuse, and no accountability. After this go-around, the Navy started singing a different tune. Yes, we have a problem is kind of what they said. And I hope those words were spoken with sincerity and not just for our benefit.

Mr. Chairman, our second hearing hit home hard. Department of Defense and other government agencies started scrambling for cover. Six days after our second hearing, Secretary Rumsfeld set up a charge card task force to clean up the mess. And I have thanked

Secretary Rumsfeld for his quick action on that. He seems like a Secretary of Defense—as he stated in his September 10, 2001 speech at the Navy War College, that, you know, we're spending the taxpayers' money. I never really heard a Secretary of Defense much concerned about that. And this Secretary of Defense wants to get more bang for our dollar.

And particularly when you're in an economy of winning a war—I mean, when you're in an effort to win the war on terrorism, or any other war, we all have to be pulling together, and that obviously includes the people with credit cards in the Defense Department.

Now, after that charge card task force was set up, then 2 months later, on May 7 this year, the Office of Management and Budget announced a crackdown on credit card abusers. OMB threatened to close 2 3/10 million government credit accounts unless the agencies involved started controlling employee abuses. Inspectors general throughout the government launched a series of investigations directed at suspected credit card abuse. Then we had mandatory salary offsets, involuntary paycheck deductions taking effect. Offsets reduced Bank of America's annual credit card loss from $20 million per year down to $4 million a year. So all the people at the Department of Defense violating and misusing credit cards were dragged then, in a sense, to the teller's window with cash in hand to pay long, overdue bills.

Then, Mr. Chairman, we had our third hearing, July 13, this year. We examined a much larger sample of Army travel and purchase card transactions made in fiscal year 2001 along with some from this fiscal year 2002. Once again, we got the same results: No controls, extensive abuse, no accountability.

After our third hearing, I was contacted by my distinguished colleague from West Virginia, Senator Byrd. He had seen the news coverage of your hearing, Mr. Chairman, and wanted to put a stop to the abuse. The use of Defense Department travel cards to pay for lap dancing at Bottoms Up Lounge really got Senator Byrd energized. He suggested that we team up on a credit card amendment on the Department of Defense appropriation bills. And that was a golden opportunity, and I grabbed it because of the respect that he has in the U.S. Senate to get things done.

Our amendment does several things. It puts the lid on Department of Defense credit cards, fiscal year 2003, at 1½ million. It makes credit card checks mandatory. It requires disciplinary action for abuse, and prohibits the use of credit cards in places like the Bottoms Up Lounge, and casinos.

Our amendment was adopted by the Senate July 31. So, Mr. Chairman, as I said at the beginning, we have come a long ways. We have accomplished a lot. We have had an impact. We have good momentum, but the final outcome is obviously, like so many things in government, still in doubt. We are definitely moving in the right direction, but we don't have change itself. Real reform is still somewhere down the road.

We must be certain that our impact is lasting and meaningful, and I would like to see a permanent solution. But how do we get from where we are today to a more lasting solution?

In a moment Mr. Greg Kutz—and I hope I'm pronouncing his name right—of the General Accounting Office will be presenting his report on Navy and Air Force travel and purchase card transactions. Mr. Kutz is about to tell us the same story we heard at hearing No. 1, hearing No. 2, and hearing No. 3.

The same identical pattern of abuse is apparent in this new General Accounting Office data. So the problems, Mr. Chairman, are systemic. This time we looked at a much bigger sample and, once again, the results are strikingly similar. Once again, the bottom line is the same: no controls, extensive abuse, no accountability. Failure rates for the Navy and Marine Corps on a standardized set of control tests were near 100 percent in key areas. Admittedly, the Air Force did slightly better. Overall, the General Accounting Office gave the Air Force a grade of C. The Army, Navy, and Marine Corps, by comparison, earned a grade of F.

The new data did, however, point up one slight variation in pattern of abuse. The General Accounting Office once again found thousands of dollars in new travel card charges for lap dancing at gentlemen's clubs like the Cheetah Club. However, this time around there was a new twist. The General Accounting Office found abuse taken to new depths. The General Accounting Office discovered thousands of dollars in travel card charges for the procurement of services from prostitutes in Nevada. At least 53 Navy, Marine, and Air Force personnel got their official travel cards swiped at such places as Salt Well, Madam Butterfly and the Chicken Ranch.

The reports delivered today by Mr. Kutz constitute the final phase of our oversight investigation. That means the General Accounting Office's work is just about done. For over 2 years now, the GAO has been hammering away at a hunk of the Department of Defense iron on the congressional anvil. That is exactly what the GAO was set up to do, and they did it well.

So it makes me happy to see the General Accounting Office doing its job. The GAO has been conducting a root canal operation that has been slow, methodical, very unpleasant, especially for credit card abusers and those responsible for curbing that abuse. The General Accounting Office's persistent probing at bases all around the country has created a lot of pressure and, of course, apprehension.

The General Accounting Office, as we know, has fangs and has sunk them deeply into this problem. But all of a sudden, Mr. Chairman, when you lower your gavel and close this hearing, the pressure will drop to zero or close to it. So that worries me. What's going to happen? So in shifting gears in order to keep moving down the road toward credit card reform, we must do that: shift gears. I don't want to see all of your good work go down the tubes. I don't want to see the Department of Defense credit card operation get back to business as usual. I don't want all the good work to amount to nothing more than some simple ripple on the proverbial Pentagon pond. I will do everything possible to keep that from happening, but I am going to need all the help we can get.

Thankfully, Mr. Chairman, I now think I know where the help may come from, because we have a new team coming on the field to play. The new team has a new coach, and the new coach has a

new philosophy on how the game is supposed to be played. The new coach's name is Joe Schmitz. He is the newly appointed Inspector General of the Defense Department. He seems to speak softly, but I think he carries a big stick. Until now the Department of Defense IG has been AWOL on the credit card abuse, and that's changing fast. Under Joe Schmitz, the Inspector General is going to be proactive. The future looks brighter.

The IG looks like he is really ready to grab the bull by the horns, and the man who is supposed to get the job done is Army Colonel Bill Kelley. He works for Mr. Schmitz. Colonel Kelley strikes me as a person who intends to succeed. He wants accountability as much as I do. The future of our oversight work may now be in Colonel Kelley's hands.

Colonel Kelley is proceeding cautiously one step at a time. He envisions a plan with four phases. Phase one is essentially complete. His data mining operation is already up and running. Data mining is nothing more than a computer program that can search through a pool of transactions and identify and cull out suspicious charges. These are then subjected to further examination. In the first cut, Colonel Kelley's data mining operation checked 12 million purchase card transactions made between October 2000 and December 2001. Some 12,257 charges made by 1,571 cardholders got flagged. They just didn't smell right. More may be added to that list.

As the data miners drilled deeper and checked out these charges, 62 potential fraud cases popped up onto the radar screen. Criminality ranged from $15 all the way up to 1.7 million. All 62 cases have been referred to the Department of Defense criminal investigative units, the Defense Criminal Investigative Unit, the Naval Criminal Investigative Unit, the Criminal Investigative Division of the Army, and the Office of Special Investigations, Air Force. Forty of these cases were already known to authorities. That's a reality check. It tells us that the Department of Defense data mining operation works according to the specs.

Colonel Kelley's data mining also discovered another important piece of information. While the Department of Defense authorities were aware of 40 of the 62 suspected fraud cases detected by data miners, most, if not all, were dead in the water. Nothing was being done. But no longer. Action is now underway across the board. In addition, Colonel Kelley's data miners uncovered hundreds of unauthorized and improper charges. These have been referred to senior management for possible disciplinary action. Now that's a description of phase one.

I will go to phase 2. The more current sample of 7 million purchase card transactions will be surveyed covering the period January 2002 to August 2002. The scope of this review will be expanded to include overseas locations and nonappropriated funds activities. Data mining will be extended to travel card transactions during phase 3.

Negotiations are already underway with the Bank of America to obtain data for some 35 million transactions starting in September 2002 and looking back 16 months. There's a problem with the Bank of America, because they want $12,000 for the data package; it seems to me they could contribute that to the Federal Government. But I am not involved in those negotiations.

Colonel Kelley thinks that $12,000 is a ripoff, and he believes that access to that data is provided for under the travel card contract, and wants the banks to hand it over free of charge.

So then we go to phase 4, which I would say is the automatic pilot approach of colonel Kelley. This is going to be more challenging. The goal is to set up a real-time, continuous, sustained, data mining operation covering all credit card transactions. Colonel Kelley wants to put data mining on auto pilot, and the final solution then must still be worked out in to the future somewhere. So it's not entirely on paper at this point and we don't have a schedule for it yet, but Colonel Kelley hopes that the Department of Defense and the General Services Administration can work together to create such long-term solutions.

GSA is very impressed with the Department of Defense data mining operation and is working hard to create a comparable governmentwide data mining operation. He says that Commerce and Treasury Departments are ready to jump on the bandwagon, but that's just the beginning.

So you have seen some benefit of your investigations just within the Department of Defense, Mr. Chairman, extending into other departments of government already. Phase 4 is the key, of course, to effective oversight down the road. What we're talking about, Mr. Chairman, is moving from today's snapshots in time, like those done by the Department of Defense and the General Accounting Office, to a fully automated data mining operation. Colonel Kelley believes we have the wherewithal to do it right and to do it soon. It's technically feasible. We just need to find the money, the people, and the organization to get the job done. Once the cardholders understand their transactions are under constant surveillance, all the abuse will come to a screeching halt.

That may be naive for me to say that, but at least ongoing checks are going to keep it to a very minimum. There are always a few clever ones out there, of course, who will figure out some way of gaming the system.

Now, Mr. Chairman, as I have said at other hearings, there's a value to hearing government credit cards, and we began these hearings by emphasizing that fact. So I will end on the same note. Government credit cards can work in the right kind of environment. The thinking behind credit cards at the Department of Defense is good: reduce paperwork, save money and streamline the process; make it quicker and easier for the troops to carry out the mission.

When the Defense Department started down the credit card road, the whole idea was to adopt the best practices of the commercial sector. In the private sector, credit cards are a big success. That's because the control environment is very, very good. Somebody is always minding the store. Bills are reconciled and paid promptly. And in corporate America, if you abuse your credit card, you either lose it or get fired. So there's a need for trust and accountability.

The control environment in the Pentagon is entirely different. That very key point has been repeatedly hammered home at each of our hearings. Every shred of evidence presented by Mr. Kutz and the General Accounting Office clearly indicates that there are no effective controls in place today and little or no accountability.

Since credit cards are low-control financial instruments, credit cards require a high level of trust and accountability. Trust and accountability have to be the cornerstone of any successful credit card program. The total absence of credit checks for the Department of Defense cardholders erodes trust and it breeds mistrust and it invites abuse.

The General Accounting Office data invariably shows that the worst abusers have had bad credit records stretching way back in time, records that are ignored by the Pentagon managers. The standard credit check should be a starting point, just like it is in the private sector. A clean report means you get a card. A bad report means no card. A satisfactory credit check, then, of course is a building block for trust and confidence.

Department of Defense's no-credit-card-check policy is history, I hope, because it will be dead if the Byrd-Grassley amendment is adopted in conference and becomes the law of the land. Issuing credit cards willy-nilly , with no credit checks, no controls, no accountability, and monthly spending limits of up to $100,000 is a recipe for disaster. It just doesn't work. It leaves the door wide open to fraud and abuse. If the Department of Defense wants this program to succeed, then the Department of Defense needs to get on the stick and make the controls work. With effective controls and with some accountability, credit cards will work like they're supposed to work.

Mr. Chairman, I am glad to be with you one last time on this issue. I would like to wish you well in retirement. And I hate to say it, but this is a bid farewell, at least not for a friendship, but our working relationship as Members across the Rotunda. So I say good luck and Godspeed to you. It has been a privilege working with you, and I thank you for your outstanding leadership.

[The prepared statement of Senator Grassley follows:]

TESTIMONY, Final Report Card on DOD Credit Card Abuse:
Consistent Patterns, Systemic Problems
By Senator Chuck Grassley, Ranking Member, Senate Finance Committee
Subcommittee on Government Efficiency, Financial Management
And Intergovernmental Relations
Committee on Government Reform
U.S. House of Representatives
October 8, 2002

Chairman Horn's Contributions to Oversight

Mr. Chairman, this is our fourth and, perhaps, our final hearing on the joint oversight investigation of Department of Defense (DOD) credit card abuse.

It has been an honor and privilege for me to conduct oversight in such distinguished company.

From day one, this has been a team effort, and you have been our leader. With you up front in the driver's seat, we have accomplished our mission. We have done everything in our power to ensure that the taxpayers' money is spent wisely and according to law.

Our success is due largely to your outstanding leadership. I thank you from the bottom of my heart.

When you step down at the end of the session, you will be missed – especially by the Senator from Iowa.

Your departure will leave a gaping hole in our front lines, and it's going to be very hard to fill it. Courage is in such short supply around here.

As I have repeatedly stated, you have put the glare of the public spotlight on a very dark corner of the Pentagon.

In a huge bureaucracy like the Pentagon, daylight is never welcome. In fact, it is feared and even hated.

But shedding light on a problem like credit card abuse is the heart and soul of oversight.

Our purpose from the beginning was to determine the scope of abuse and then figure out how to put a stop to it. You have so graciously provided the venue where we could do what had to be done.

Progress and Accomplishments

Mr. Chairman, we started this investigation more than two years ago. Yes, it's true, we have come a long way. We have seen the Promised Land, but we are not there yet. We have much more work to do before we get to the end of the road.

At our **first hearing** on July 30, 2001, we examined a sample of FY2000 purchase card transactions collected from two Navy organizations in the San Diego area.

We found zero controls, extensive abuse and a total disregard for accountability.

The Navy dismissed our findings as a few "unique and isolated" cases. Not to worry, the Navy said. We don't have a problem. One rotten apple doesn't make the whole barrel bad.

Then came our **second hearing** 8 months later – on March 13, 2002.

We went back to the same two Navy units for a second look. We examined a more current sample of FY2001 transactions.

Well, guess what? The results were the same or worse: no effective controls, extensive abuse, and no accountability.

After this go around, the Navy started singing a different tune: "Yes, we have a problem." I hope those words were spoken with sincerity and not just for our benefit.

Mr. Chairman, our second hearing hit home hard. DOD and other government agencies started scrambling for cover.

--Six days after our second hearing, Secretary Rumsfeld set up a Charge Card Task Force to clean up the mess.

--Two months later – on May 7, 2002 – the Office of Management and Budget (OMB) announced a crackdown of credit card abusers.

OMB threatened to close 2.3 million government credit card accounts unless the agencies involved started controlling employee abuses.

--Inspectors General throughout the government launched a series of investigations directed at suspected credit card abuse.

--Mandatory salary offsets – involuntary paycheck deductions – began to take effect.

Offsets reduced Bank of America's annual credit losses from $20 million per year to $4 million per

year.

--DOD scofflaws were dragged to the teller's window with cash in hand to pay long-overdue bills.

At our **third hearing** on July 17, 2002, we examined a much larger sample of Army travel and purchase card transactions made in FY2001 along with some FY2002 data.

Once again, we got the same results: No controls, extensive abuse, and no accountability.

Byrd-Grassley Amendment

After our third hearing, I was contacted by my distinguished colleague from West Virginia, Senator Byrd. He had seen the news coverage of our hearing and wanted to put a stop to the abuse.

The use of DOD travel cards to pay for "lap dancing" at the Bottoms Up Lounge really got him energized.

Senator Byrd suggested that we team up on a credit card amendment on the DOD appropriations bill. That was a golden opportunity, and I grabbed it.

Our amendment does several things.

It puts a lid on DOD credit cards in FY 2003 at 1.5 million. It makes credit checks mandatory. It requires disciplinary action for abuse, and prohibits the use of credit cards in places like the Bottoms Up Lounge and casinos.

Our amendment was adopted by the Senate on July 31, 2002.

Future Uncertainties

So Mr. Chairman, as I said at the beginning, we have come a long way. We have accomplished a lot. We have had an impact.

We have good momentum, but the final outcome is still in doubt. We are definitely moving in the right direction, but we don't have change itself.

Real reform is still somewhere down the road.

We must be certain that our impact is lasting and meaningful. I would like to see a permanent solution.

But how do we get from where we are today to a more lasting solution?

GAO's Latest Findings

In a moment, Mr. Greg Kutz of the General Accounting Office (GAO) will be presenting his report on Navy and Air Force travel and purchase card transactions.

Mr. Kutz is about to tell us the same story we heard at hearing number 1, hearing number 2 and hearing number 3. The same identical pattern of abuse is apparent in the new GAO data.

Mr. Chairman, the problems are systemic.

This time we looked at a much bigger sample. But once again, the results are strikingly similar.

Once again the bottom line is the same: No controls, extensive abuse, and no accountability.

Failure rates for the Navy and Marine Corps on a standardized set of control tests were near 100 percent in key areas.

Admittedly, the Air Force did slightly better.

Overall, the GAO gave the Air Force a grade of C. The Army, Navy, and Marine Corps, by comparison, earned a grade of F.

The new data did, however, point up one slight variation in the pattern of abuse.

The GAO once again found thousands of dollars in new travel card charges for lap dancing at gentlemen's clubs like the Cheetah Club.

However, this time around there was a new twist. The GAO found abuse taken to new depths.

GAO discovered thousands of dollars in travel card charges for the procurement of services from prostitutes in Nevada.

At least 53 Navy, Marine, and Air Force personnel got their official travel cards swiped at such places as the Salt Well, Madam Butterfly, and the Chicken Ranch.

The reports delivered today by Mr. Kutz constitute the final phase of our oversight investigation. That means the GAO's work is just about done.

For over two years now, the GAO has been hammering away on a hunk of DOD iron on the congressional anvil. That is exactly what the GAO was set up to do, and they did it well.

It makes me happy to see the GAO doing its job.

The GAO has been conducting a root canal operation. It has been slow, methodical, and very unpleasant -- especially for the credit card abusers and those responsible for curbing their abuses.

The GAO's persistent probing at bases all around the country has created a lot of pressure and apprehension. GAO has fangs, and it has sunk them deeply into the problem.

Pressure Drops to Zero After Hearing

But all of a sudden, Mr. Chairman, when you lower your gavel and close this hearing, the pressure will drop to zero – or close to it.

That worries me. What will happen then?

Time to Shift Gears

In order to keep moving down the road toward credit card reform, we need to shift gears.

I don't want to see all our good work go down the tubes. I don't want to see the DOD credit card operation get back to "business as usual."

I don't want all our good work to amount to nothing more than a ripple on the proverbial Pentagon pond.

I will do everything possible to keep that from happening. But I am going to need all the help I can get.

Thankfully, Mr. Chairman, I now think I know where the help may come from.

DOD IG Gets Proactive

A new team is coming on to the field of play. The new team has a new coach. And the new coach has a new philosophy on how the game is supposed to be played. The new coach's name is Joe Schmitz. He is the newly appointed Inspector General (IG) at the Defense Department.

Mr. Schmitz seems to speak softly, but he carries a big stick.

Until now, the DOD IG has been AWOL on credit card abuse. But that's changing fast. Under Joe Schmitz, the IG is getting proactive.

The future looks so much brighter.

The IG looks like he is ready to grab the bull by the horns. And the man who is supposed to get the job done is Army Colonel Bill Kelley. He works for Mr. Schmitz.

Colonel Kelley strikes me as a person who intends to succeed. He wants accountability as much as I do.

The future of our oversight work may now be in Colonel Kelley's hands.

Search For Long-Term Solution

Colonel Kelley is proceeding cautiously – one step at a time. He envisions a plan with four phases.

Phase one is essentially complete.

His data mining operation is already up and running.

Data mining is nothing more than a computer program that can search through a pool of millions of transactions and identify and cull out suspicious charges. These are then subjected to further examination.

In the first cut, Colonel Kelley's data mining operation checked 12 million purchase card transactions made between October 2000 and December 2001.

Some 12,257 charges made by 1,571 cardholders got "flagged." They just didn't smell right. More may be added to the list.

As the data miners "drilled" deeper and checked out these charges, 62 potential fraud cases popped up on the radar screen.

Criminality ranged from $15.00 all the way up to $1.7 million.

All 62 cases have been referred to DOD's criminal investigative units: DCIS [Defense Criminal Investigative Service], NCIS [Naval Criminal Investigative Service], CID [Criminal Investigative Division - Army], and OSI [Office of Special Investigations - Air Force].

40 of these cases were already known to authorities. That's a reality check. It tells us that the DOD data mining operation works according to specs.

Colonel Kelley's data miners also discovered another important piece of information.

While DOD authorities were aware of 40 of the 62 suspected fraud cases detected by data miners, most – if not all – were dead in the water. Nothing was being done. No longer. Action is now underway across-the-board.

In addition, Colonel Kelley's data miners uncovered "hundreds" of unauthorized and improper charges. These have been referred to senior management for possible disciplinary action.

In Phase Two, a more current sample of 7 million purchase card transactions will be surveyed covering the period January 2002 to August 2002. The scope of this review will be expanded to include overseas locations and non-appropriated fund activities.

During Phase Three, data mining will be extended to travel card transactions.

Negotiations are already underway with Bank of America to obtain data for some 35 million transactions, starting in September 2002 and looking back 16 months.

A problem has arisen because Bank of America wants $12,000.00 for the data package.

Colonel Kelley thinks that's a rip off. Colonel Kelley believes that access to that data is provided for under the travel card contract and wants the bank to hand it over free of charge.

Putting Data Mining on Auto-Pilot

The final phase – **Phase Four** – will be more challenging. The goal is to set up a real-time, continuous, sustained data mining operation covering all credit card transactions.

Colonel Kelley wants to put data mining on auto-pilot or something like that.

The final solution is still out in the future somewhere. We don't know when we might get there.

Colonel Kelley hopes that DOD and GSA [General Services Administration] can work together to create a long-term solution.

GSA is so far very impressed with the DOD data mining operation and is working hard to create a comparable government-wide data mining operation.

He says that the Commerce and Treasury Departments are ready to jump on the bandwagon. But that's just the beginning.

Phase Four is the key to effective oversight down the road.

What we are talking about, Mr. Chairman, is moving from today's snap shots in time – like those done by DOD and GAO, to a fully automated data mining operation.

Colonel Kelley believes that we have the wherewithal to do it right now today. It's technically feasible. We just need to find the money, the people, and right organization to get the job done.

Once the cardholders understand that their transactions are under constant surveillance, all the abuse will come to a screeching halt – at least it will be held to a very minimum.

There are always a few clever ones out there who know how to game the system.

Value of Government Credit Cards

Mr. Chairman, we began these hearings by emphasizing the importance of government credit cards.

I would like to end on that same note.

Government credit cards can work in the right kind of environment.

The thinking behind the DOD credit cards is good: reduce paperwork, save money, and streamline the process. Make it quicker and easier for the troops to carry out the mission.

When DOD started down the credit card road, the whole idea was to adopt the best practices of the commercial sector.

In the private sector, credit cards are a big success. That's because the control environment is good. Somebody is always "minding the store." Bills are reconciled and paid promptly. In corporate America, if you abuse your card, you either lose it or get fired.

Need for Trust and Accountability

The control environment at the Pentagon is entirely different.

That very key point has been repeatedly hammered home at each of our hearings.

Every shred of evidence presented by Mr. Kutz and the GAO clearly indicates that there are no effective controls in place today and little or no accountability.

Since credit cards are low control financial instruments, credit cards require a high-level of trust and accountability. Trust and accountability must be the cornerstone of any successful credit card program.

The total absence of credit checks for DOD cardholders erodes trust. It breeds mistrust and invites abuse.

The GAO data invariably shows that the worst abusers have bad credit records stretching way back in time - records that are ignored by Pentagon managers.

A standard credit check should be the starting point - just like in the private sector. A "clean" report means you get a card. A "bad" report means no card. A satisfactory credit check is the building block for trust and confidence.

DOD's no-credit-check policy is history, I hope. It will be dead if the Byrd-Grassley amendment is adopted in conference and becomes the law of the land.

Issuing credit cards "willy nilly" with no credit checks, no controls, no accountability, and monthly spending limits of up to $100,000.00 is a recipe for disaster. It just doesn't work. It leaves the door wide open to fraud and abuse.

If DOD wants this program to succeed, then DOD needs to get on the stick and make the controls work.

With effective controls and some accountability, credit cards will work like they are supposed to work.

Progress on XXXXXX Case

Mr. Chairman, before I conclude my testimony today, I am happy to report some forward movement on the XXXXXX case.

I discussed this case in great detail at the last hearing.

As you may remember, her government credit cards were used to make a large number of fraudulent purchases.

I testified that the Naval Criminal Investigative Service [NCIS] had really dropped the ball and allowed the evidence trail to go cold.

Well. All that has now changed. The new IG, Joe Schmitz, has assured me that this case will now get the attention it needs and deserves.

Closing Remarks

Mr. Chairman, that concludes my statement.

I would like to wish you well in retirement. I hate to say it, but I must now bid you farewell.

Good luck and God Speed. It has been an honor and privilege working with you. Thank you for your outstanding leadership.

Mr. HORN. Thank you very much, Senator. You have a lot of things on your plate in the Senate where you chair a major committee. And you will have to keep on with our friends, and the General Accounting Office will have to keep on when they get the attention of the administration on this. When you think of all the problems we have in America with families that don't have enough things to eat on the table.

So we thank you for coming and we will ask our panel two, which is Greg Kutz, Director of Financial Management and Assurance, U.S. General Accounting Office; Special Agent John Ryan, Assistant Director, Office of Special Investigations, U.S. General Accounting Office; and Rear Admiral Robert Cowley, Deputy for Acquisition and Business Management Research Development and Acquisition, Office of the Assistant Secretary of the Navy.

We now have the ranking member here, Mrs. Schakowsky, the gentlewoman from Illinois, who takes a great interest in these fraudulent type of activities within the Federal Government when a lot of people in Illinois, just as California, could use that money for valid things. But right now, we're talking about people who are doing invalid and fraudulent things. So glad to have you here.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. As we conclude the hearing on this issue in this Congress, I believe we have made considerable progress. These hearings have exposed major flaws in a relatively new program. These hearings have developed a clear understanding of the causes for those problems and we are in the process of setting out clear solutions to many of the problems that program management uncovered in these investigations.

The GAO has been extremely helpful in developing the materials for these hearings, as well as keeping us well informed as how the investigations progressed. Our staffs have worked together in a collegial fashion, with the clear intent of carrying out our institutional obligations. These hearings are a model for how our Founding Fathers envisioned congressional oversight.

I will be and have been seeking, Mr. Chairman, every opportunity to credit you for this and for your great work. It's my understanding that our staffs are working on a report, and if time permits we'll be able to bring that report before the full committee tomorrow.

Despite GAO's indications in today's testimony that there is some improvement at the Navy, I find the lack of management oversight and control of the travel and purchase card programs at the Navy an embarrassment. From our first hearing to the GAO report before us today, the Navy has abdicated its managerial responsibility.

At our first hearing on purchase cards at the Navy Space Research Center in San Diego, the commander of the Center told the subcommittee that his organization had effectively managed the purchase card program for 10 years. He went on to say, "We firmly believe the purchases being made are for legitimate government purchases and ultimately benefit our customers."

At that hearing, GAO reported on improper purchases, including home improvement items from Home Depot, numerous items from Wal-Mart laptop computers, Palm Pilots, DVD players, an air conditioner, clothing, jewelry, eye glasses, pet supplies, and pizza.

The GAO reported at the Space Warfare Center, "The control breakdowns related to the frauds were so pervasive that the total amount of these frauds could not be determined."

Is this what the Navy calls a well-run program? We were told later that the commander who made those statements was gone, only to discover that "gone" meant that he had changed offices. Is that what the Navy calls accountability?

At our next hearing nearly 9 months later, it was more of the same. The Navy insisted the program was well run, and GAO found purchases like Lego robot kits and Palm Pilots. To make matters worse, many of the items purchased with government purchase cards could not be found when the GAO went to look for them. The Navy explained that it was Navy policy not to inventory items that are easily stolen. Is this what the Navy calls responsibility? I couldn't believe that was true.

And when the representatives of the Defense Department testified before us, I asked if that was DOD policy and was assured it was not. Despite what DOD said, the Navy still doesn't believe it needs to keep track of $500 cameras or $300 Palm Pilots.

Ethical standards at an agency are set at the top. Where is the Navy command in setting these ethical standards? The problems in the government travel card program are somewhat different, and here Congress must shoulder some of the blame. Congress passed a law that required agencies to issue government travel cards for all employees traveling on official business. We have learned that unlike the business environment, which was the model for this legislation, government travel is quite different. Nowhere is this more apparent than at DOD, where default and delinquency rates are well above the civilian average, and the Navy is among the worst in DOD.

As we all know, many of the men and women who put their lives on the line to defend our freedom and security are quite young. Many of them are just out of high school, with little experience with independence and responsibility. We then ship them around the world, often on commercial airlines, and give them a government credit card to pay the way.

We put guns into the hands of these men and women, and then give them extensive training on how to use those guns properly. We put many of our Nation's most closely guarded secrets of national security into the hands of these men and women, and make sure they are well aware of the consequences of divulging those secrets. But we put these powerful financial instruments into their pockets and provide no training in how to manage them, and there is no consequence for misuse.

This is a management failure. There is one thing that comes up over and over at DOD, at the Education Department and at HUD. The management of these agencies was happy to get rid of the employees in the contracting offices and happy to get rid of the complications of providing employees with cash for government travel. However, management then turned its back on these programs. It is not surprising that these programs are in trouble.

The Navy should be ashamed of the contents of the GAO testimony before us today. Just listen to a few of the conclusions:

Critical internal controls were ineffective. Little evidence cardholders screened for required vendors. Little evidence of independent receipt and acceptance of item purchased. Little evidence that monthly purchase cards were reconciled prior to payment. Major commands failed to maintain accountability for pilferable items. Potentially fraudulent, improper, and abusive transaction.

The testimony on travel cards is much the same. Delinquency rates are high. Write-offs are substantial. Soldiers pay with bad checks. Travel cards are misused and no one is held accountable. The list goes on and on.

The Navy is not the only agency with these problems, but there is no solace in having company in disgrace. The ethical standards are set at the top by those who come before us to testify, and the failures reported by the GAO are an embarrassment that these managers should feel as deeply as those caught in the act. Just as it is our patriotic duty to do whatever is necessary to protect this Nation and to guarantee its security, it is also our patriotic duty to ensure that every taxpayer dollar spent is accounted for.

Those precious dollars represent the hard work of the American public and must be spent wisely and with responsibility to ensure that our Armed Forces are capable of carrying out the important and challenging missions with which they are charged.

Mr. Chairman, I appreciate your indulgence in allowing this lengthy opening statement. Thank you.

Mr. HORN. We have Mr. Kutz as the Director for Financial Management and Assurance, U.S. General Accounting Office.

STATEMENTS OF GREG KUTZ, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GENERAL ACCOUNTING OFFICE; SPECIAL AGENT JOHN RYAN, ASSISTANT DIRECTOR, OFFICE OF SPECIAL INVESTIGATIONS, U.S. GENERAL ACCOUNTING OFFICE; AND REAR ADMIRAL ROBERT COWLEY, DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT, RESEARCH DEVELOPMENT AND ACQUISITION, OFFICE OF THE ASSISTANT SECRETARY OF THE NAVY

Mr. KUTZ. Mr. Chairman and Representative Schakowsky, it is a pleasure to be here to discuss our audit of the Navy purchase card program first. With me is Special Agent John Ryan from our Office of Special Investigations.

DOD has the largest purchase card program in the Federal Government. As of July 2002, DOD had 212,000 purchase cards, which is about 55 percent of the Federal Government's total.

Today I will discuss our fourth in a series of audits of the DOD purchase card program. My testimony includes the results of our audit of the Navy, which includes the Marine Corps. I want to thank the Navy and Marine Corps for their cooperation throughout this audit.

The bottom line of my testimony is that the control breakdowns that we identified at the two units in San Diego are indicative of systemic Navy-wide problems. As a result, the Navy purchase card program is vulnerable to fraud, waste and abuse.

My testimony has three parts: first, the overall control environment for the purchase card program; second, the effectiveness of

key internal controls; and third, fraudulent, improper, and abusive activity.

First, for fiscal year 2001 and into 2002, we found a weak overall control environment. The Navy has not provided for an adequate infrastructure to effectively oversee and manage the purchase card program. Specifically, we found approving officials with unreasonable spans of control, excessive spending limits, inconsistent and ineffective training, and weak or nonexistent monitoring and auditing.

The Navy has taken significant actions to improve the control environment over the program. Some of the more significant steps include, as shown on the poster board, reducing the number of purchase cards from 59,000 to 25,000, a reduction of nearly 60 percent; corresponding improvements in the span of control for approving officials to cardholders; reductions in spending limits at the four commands that we audited by about $140 million; improvements in the training program; and actions taken or planned on all 29 of our recommendations from our November 2001 report and a commitment to take action on the recommendations in our report that's being issued today. Continuation of these improvements would further improve management of the program.

Second, for fiscal year 2001, based on statistical sampling, we found key internal controls failed from 58 to 98 percent of the time. For example, oftentimes approving officials certified the monthly bill for payment without examining cardholder supporting documents. For many of the Navy fraud cases identified in our report, the certification of the monthly bill by the approving official was nothing more than a rubber stamp. Another area of concern at one location was missing documentation. Specifically, Camp Lejeune was unable to identify support for 29 transactions for $50,000. These unsupported purchases included vendors such as rental car companies, gift stores, and a stereo store.

We continued to find accountability problems for property purchased with the credit card, including items such as computers and digital cameras. On a positive note, Camp Lejeune was able to find all 16 items from our statistical samples.

However, the three Navy case study sites could not locate 35 of 98 property acquisitions from our samples. For example, for one large computer buy at the Atlantic Fleet, they could not confirm the location of 187 computers and 87 flat panel monitors.

Third, given the weak controls, it is not surprising that we identified potentially fraudulent, improper, and abusive charges. The fraud cases in our report relate primarily to the Atlantic Fleet and Camp Lejeune. We found cardholder fraud, vendor fraud, and fraudulent usage of compromised purchase card accounts. One large case at the Atlantic Fleet in Norfolk included cardholders conspiring with at least seven vendors to submit about $89,000 in bogus and inflated invoices. Cardholders received bribes and kickbacks because of their positions as Navy buyers.

We also found that the Pacific Fleet provided five government purchase cards to employees of a private consulting firm. From March 1999 to November 2001, these five purchase cards were used for $230,000 of charges for airline tickets, hotels, rental cars, restaurants, flowers, and golf outings. This consulting company

used the purchase card to avoid paying State sales taxes and obtained the Federal Government discount on airline tickets and hotel rooms. Within a week of our inquiry, the Pacific Fleet canceled these cards. We have referred this company to DOD for further investigation.

Another case of potential vendor fraud related to 75 charges for $164,000 that the Navy paid for in advance of receiving the goods and services. Most of these charges were at or near the $2,500 micropurchase limit. We found that for two charges, no services were ever provided, while in other cases the actual services provided were far less than the $2,500 paid for by the Navy. For one $2,500 charge, the vendor's own records indicated that only $72 of services were ever provided.

These cases clearly demonstrate that the breakdowns in purchase card controls leave Navy and the DOD vulnerable to vendor fraud.

In addition to fraudulent purchases, we also identified a significant number of improper and abusive purchases. Examples as shown on the poster board are food, including $7,000 of charges at a Norfolk hotel for local NAVSEA employees; clothing, including slacks shirts and a leather flight jacket; cell phone waste and abuse, including monthly charges for a cell phone that had been returned to the vendor 13 months earlier; unneeded computers, including 22 purchased in April 2001 that were still in the original boxes in June 2002; designer leather goods, including totes and a folio that cost $300 at the Coach Store; 90 Palm Pilots costing $32,000, 14 of which had not been issued 20 months after the date of purchase; and Bose equipment, including $300 headsets used to listen to music and $350 clock radios purchased for officers' quarters. For these purchases, we generally found no documented justification. Rather, the Navy generally provided us with after-the-fact rationalization for the purchases.

We also found that the Navy has not maximized its buying power when using the purchase card. For 122 vendors, each with over $1 million of 2001 business, the Navy had not negotiated reduced price contracts. We believe that the Navy could better leverage its buying power and negotiate discounts with these vendors.

In summary, our testimony shows what can happen when financial management is broken and accountability is lost. The Navy has taken significant positive steps to improve the purchase card program. I applaud the Navy for their actions to date and their constructive approach to dealing with these issues.

Secretary Rumsfeld has noted that transforming DOD's processes could save 5 percent of DOD's budget, about $15 to $20 billion annually. One small example of that transformation would be improving the management of the purchase card program. Maximizing the benefits of this program could save DOD millions of dollars annually. As we have said before, the effectiveness of our military force is second to none. I would challenge the Navy to achieve that same level of success with its financial management, including that of the purchase card program.

Mr. Chairman, that ends my statement. Agent Ryan and I will be happy to answer questions after the Admiral goes.

[The prepared statement of Mr. Kutz follows:]

United States General Accounting Office

GAO

Testimony

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

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PURCHASE CARDS

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

Statement of Gregory D. Kutz, Director,
Financial Management and Assurance

John J. Ryan, Assistant Director,
Office of Special Investigations

GAO-03-154T

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 report[2] 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 testified[3] before this Subcommittee and issued a report[4] 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

[1]U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-01-995T (Washington, D.C.: July 30, 2001), and *Purchase Cards: Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-506T (Washington, D.C.: Mar. 13, 2002).

[2]U.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).

[3]U.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).

[4]U.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 sites[5] 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

[5]GAO-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

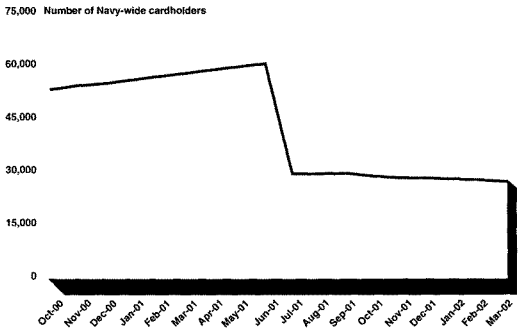
improve charge card programs. We must continue to identify new ways of reducing the government's cost of doing business while at the same time ensuring that we operate in a manner that preserves the public's trust in our ability to provide proper stewardship of public funds." The Task Force report included 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 coordinators[6] 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

[6]NAVSUP 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.

[7]The 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,

[8]There 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 million[9] 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

[a]Credit 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.

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

We found that from about 56 percent[10] of the fiscal year 2001 transactions at the Marine Corps to about 87 percent[10] 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

[10]The 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

[a]The 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 bill[11] 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.

[11] In 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:

- 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

[12] 63 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

[13]72 Comp. Gen. 178, 179 (1993); 65 Comp. Gen. 508, 509 (1986).

[14]65 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 form 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 internals 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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United States General Accounting Office

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Testimony

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TRAVEL CARDS

Control Weaknesses Leave Navy Vulnerable to Fraud and Abuse

Statement of Gregory D. Kutz
Director, Financial Management and Assurance

John J. Ryan
Assistant Director, Office of Special Investigations

GAO-03-148T

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

Thank you for the opportunity to discuss the Department of the Navy's (including the United States Marine Corps) internal controls over the government travel card program. This subcommittee held a hearing in May 2001 that identified substantial delinquencies and charge-offs related to the Department of Defense (DOD) travel card. As a result of your hearing and our work on internal control over purchase card transactions at two Navy sites,[1] and continuing concern about fraud, waste, and abuse in DOD's use of both travel and purchase cards, you requested more comprehensive audits of both programs. We previously testified on the Army travel card program in July 2002.[2] This written statement discusses the results of our Navy travel card program audit. We plan to follow up on this testimony and issue a detailed report with recommendations on the results of our audit. We will report to you separately on the results of our Air Force travel card audit.

The intent of the travel card program, which is administered by a contractor (Bank of America), was to improve convenience for the traveler and to reduce the government's costs of administering travel. During fiscal year 2001, the Navy had about $510 million in travel card charges and about 395,000 individually billed travel card accounts at the end of fiscal year 2001.[3] The individually billed travel card program is significantly different from the purchase card program in that cardholders are directly responsible for all charges incurred on their travel cards and the monthly bill is sent to the cardholder for payment. The cardholder is responsible for submitting a properly documented voucher and is reimbursed by the Navy for all valid expenses related to official

[1]U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-01-995T (Washington, D.C.: July 30, 2001); *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-32 (Washington, D.C.: Nov. 30, 2001); and q*Purchase Cards: Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-506T (Washington, D.C.: Mar. 13, 2002).

[2]U.S. General Accounting Office, *Travel Cards: Control Weaknesses Leave Army Vulnerable to Potential Fraud and Abuse*, GAO-02-863T (Washington, D.C.: July 17, 2002).

[3]The travel card program includes both individually billed accounts—that is, accounts held by and paid by individual cardholders based on reimbursement of expenses incurred while on official government travel—and centrally billed accounts that are used to purchase transportation or for the travel expenses of a unit and are paid directly by the government. This testimony covers transactions charged to individually billed accounts only.

government travel. In contrast, all purchase card charges are billed directly to the government for monthly payment.

Today, I will provide my perspective on (1) the reported magnitude and impact of delinquent and charged-off Navy travel card accounts for fiscal year 2001 and the first 6 months of fiscal year 2002, along with an analysis of related causes, (2) potentially fraudulent and abusive activity related to the Navy travel card during the same period, (3) whether abusive activity associated with the travel card is effectively linked to disciplinary actions and security clearances, (4) the effectiveness of the overall control environment and key internal controls for the Navy's travel program, and (5) the status of DOD and Navy corrective actions. Details on our scope and methodology are included in appendix I.

In summary, the Navy's average delinquency rate of about 12 percent over the last 2 years is nearly identical to the Army's, which has the highest delinquency rate in DOD, and about 6 percentage points higher than that of federal civilian agencies. The Navy's overall delinquency and charge-off problems, which have cost the Navy millions in lost rebates and higher fees, are primarily associated with lower-paid, enlisted military personnel. In addition, lack of management emphasis and oversight has resulted in management failure to promptly detect and address instances of potentially fraudulent and abusive activities related to the travel card program. For example, during fiscal year 2001 and the first 6 months of fiscal year 2002, over 250 Navy personnel might have committed bank fraud by writing three or more nonsufficient fund (NSF) checks to Bank of America, while many others abused the travel card program by failing to pay Bank of America charges and/or using the card for inappropriate transactions such as for prostitution and gambling. However, because Navy management was often not aware of these activities, disciplinary actions were not consistently taken against these cardholders. We also found a significant relationship between travel card fraud, abuse, and delinquencies and individuals with substantial credit history problems. For example, many cardholders whose accounts were charged off or put in salary offset[4] had bankruptcies and accounts placed in collection prior to receiving the card. The Navy's practice of authorizing a travel card to be issued to virtually anyone who asked for it compounded an already existing problem by giving those with a history of bad financial

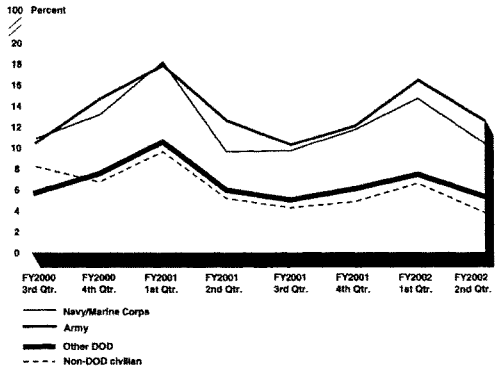
[4]This program, similar to a garnishment, allows DOD to collect amounts owed by payroll deduction.

management additional credit. While we found that Navy management had taken some corrective actions to address delinquencies and misuse, additional preventive solutions are necessary if Navy is to effectively address these issues.

Travel Card Delinquencies and Charge-offs

Most Navy cardholders properly used their travel cards and paid amounts owed to Bank of America in a timely manner. However, as shown in figure 1, the Navy's average delinquency rate was nearly identical to the Army's, which, as we have previously testified, is the highest delinquency rate in the government. The Navy's quarterly delinquency rate fluctuated from 10 to 18 percent, and on average was about 6 percentage points higher than that of federal civilian agencies. As of March 31, 2002, over 8,400 Navy cardholders had $6 million in delinquent debt.

Figure 1: Navy/Marine Corps v. Army, Other DOD, and Non-DOD Civilian Agencies' Travel Card Delinquency Rates for the 2 Year Period Ending March 31, 2002



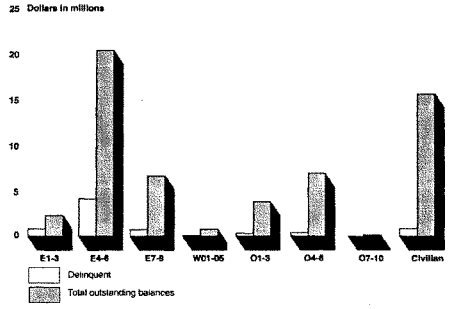
Source: Bank of America and General Services Administration data.

We also found substantial charge-offs of Navy travel card accounts. Since the inception of the travel charge card task order between DOD and Bank of America on November 30, 1998, Bank of America has charged off over 13,800 Navy travel card accounts with $16.6 million of bad debt. Recent task order modifications allow Bank of America to institute a salary offset against DOD military personnel members whose travel card accounts were previously charged off or are more than 120 days past due. As a result, as of July 31, 2002, Bank of America had recovered $5.2 million in Navy government travel card bad debts. The high level of delinquencies and charge-offs have also cost the Navy millions of dollars in lost rebates, higher fees, and substantial resources spent pursuing and collecting past due accounts. For example, we estimate that in fiscal year 2001, delinquencies and charge-offs cost the Navy $1.5 million in lost rebates,

and will cost about $1.3 million in increased automated teller machines (ATM) fees[5] annually.

As shown in figure 2, the travel cardholder's rank or grade[6] (and associated pay) is a strong predictor of delinquency problems. We found that the Navy's overall delinquency and charge-off problems are primarily associated with young, low- and mid-level enlisted military personnel with basic pay levels ranging from $12,000 to $27,000.

Figure 2: Navy Delinquent and Total Outstanding Travel Card Balances for Military and Civilian Employees as of September 30, 2001



Source: GAO analysis of Bank of America data.

According to Navy officials, low- and mid-level enlisted military personnel comprise the bulk of the operational forces and are generally young, often deployed, and have limited financial experience and resources. It is therefore not surprising to see a higher level of outstanding balances and delinquent amounts due for these personnel. Figure 2 also shows that, in

[5]For each cash withdrawal at ATMs, cardholders are charged a fee of a set amount or percentage of the amount of the withdrawal.

[6]A more detailed explanation of each of these grades along with their associated basic pay rates is provided in appendix II.

contrast, the delinquency rate for civilians employed by the Navy is substantially lower. As of September 30, 2001, the delinquency rate of low- and mid-level enlisted personnel was almost 22 percent, compared to a Navy civilian rate of slightly more than 5 percent. This rate is comparable to the non-DOD civilian delinquency rate of 5 percent.

The case study sites we audited exhibited this pattern. For example, at Camp Lejeune, a principal training location for Marine air and ground forces, over one-half of the cardholders are enlisted personnel. Representative of the Navy's higher delinquency rate, Camp Lejeune's quarterly delinquency rate for the 18-month period ending March 31, 2002, averaged over 15 percent and was close to 10 percent as of March 31, 2002. In contrast, at Puget Sound Navy Shipyard, where the mission is to repair and modernize Navy ships, civilian personnel earning more than $38,000 a year made up 84 percent of total government travel card holders and accounted for 86 percent of total fiscal year 2001 travel card transactions. This site's delinquency rate had declined to below 5 percent as of March 31, 2002.

In combination with these demographic factors, a weak overall control environment, flawed policies and procedures, and a lack of adherence to valid policies and procedures contributed to the significant delinquencies and charge-offs. Further discussion of these breakdowns is provided later in this testimony.

Potentially Fraudulent and Abusive Travel Card Activity

Our work identified numerous instances of potentially fraudulent[7] and abusive activity[8] related to the travel card. During fiscal year 2001 and the first 6 months of fiscal year 2002, over 5,100 Navy employees wrote at least one nonsufficient fund (NSF), or "bounced" check, to Bank of America as payment for their travel card bills. Of these, over 250[9] wrote 3 or more NSF checks, a potentially fraudulent act.[10] Appendix III provides a table summarizing 10 examples, along with more detailed descriptions of selected cases in which cardholders might have committed fraud by writing 3 or more NSF checks to Bank of America. These 10 accounts were subsequently charged-off[11] or placed in salary offset or voluntary fixed payment agreements with Bank of America.

We also found that the government cards were used for numerous abusive transactions that were clearly not for the purpose of government travel. As discussed further in appendix I, we used data mining tools to identify transactions we believed to be potentially fraudulent or abusive based upon the nature, amount, merchant, and other identifying characteristics of the transaction. Through this procedure, we identified thousands of suspect transactions. Table 1 illustrates a few of the types of abusive transactions and the amounts charged to the government travel card in fiscal year 2001 and the first 6 months of fiscal year 2002 that were not for valid government travel. Government travel cards were used for purchases in categories as diverse as legalized prostitution services, jewelry,

[7]We considered any scheme or pattern of activity related to the use of the travel card, in apparent violation of federal or state criminal code, as a potentially fraudulent activity.

[8]We considered abusive travel card activity to include (1) personal use of the card—any use other than for official government travel—regardless of whether the cardholder paid the bill and (2) cases in which cardholders were reimbursed for official travel and then did not pay Bank of America, thus benefiting personally. In both types of activities in which the cardholder did not pay the bill, we considered abuses to include those situations in which cardholders' accounts were eventually charged off by Bank of America, or referred to salary offset or a fixed pay agreement. Some of the travel card activity that we categorized as abusive would be potentially fraudulent if it can be established that the cardholder violated any element of federal or state criminal code.

[9]Of the over 250 cardholders who wrote 3 or more NSF checks, 100 had accounts that were eventually charged off or put in salary offset.

[10]Knowingly writing checks against closed accounts or writing three or more NSF checks is potential bank fraud under 18 U.S.C. 1344. Further, it is a violation of the Uniform Code of Military Justice article 123a when a soldier makes, draws, or utters (verbally authorizes) a check, draft, or order without sufficient funds and does so with intent to defraud.

[11]Some cardholders whose accounts were charged off have since been referred to the salary offset program or entered into fixed payment agreement with Bank of America.

gentlemen's clubs, gambling, cruises, and tickets to sporting and other events. The number of instances and amounts shown includes both cases in which the cardholders paid the bills and instances in which they did not pay the bills.

Table 1: Examples of Navy-wide Abusive Travel Card Activity, Fiscal Year 2001 through March 31, 2002

Category	Examples of vendors	Number of transactions	Dollar amount
Legalized brothels	James Fine Dining, Chicken Ranch	80	$13,250
Jewelry	Kay Jewelers, Zales Jewelers	199	20,800
Gentlemen's clubs	Spearmint Rhino, Mr. Magoo's Lounge, Cheetah's Lounge	247	28,700
Gambling, including Internet	www.proccy2, Seinpost Holding, GCA (cash advance)	80	34,250
Cruises	Carnival, Disney, Norwegian, Princess	72	38,300
Entertainment (sporting events, theatre, concerts)	NY Yankees, LA Lakers, Atlanta Braves, Phantom of the Opera, other Ticketmaster purchases	502	71,400

Source: GAO analysis of Bank of America data.

We found that 50 cardholders used their government travel card to purchase over $13,000 in prostitution services from two legalized brothels in Nevada. Charges were processed by these establishments' merchant bank, and authorized by Bank of America, in part because a control afforded by the merchant category code (MCC),[12] which identifies the nature of the transactions and is used by DOD and other agencies to block improper purchases, was circumvented by the establishments. In these cases, the transactions were coded to appear as restaurant and dining or bar charges. For example, the merchant James Fine Dining, which actually operates as a brothel known as Salt Wells Villa, characterizes its services as restaurant charges, which are allowable and not blocked by the MCC control. According to one assistant manager at the establishment, this is done to protect the confidentiality of its customers. Additionally, the account balances for 11 of the 50 cardholders purchasing services from these establishments were later charged off or put into salary offset. For

[12]MCCs are established by the banking industry for commercial and consumer reporting purposes. Currently, about 800 category codes are used to identify the nature of the merchants' businesses or trades, such as airlines, hotels, ATMs, jewelry stores, casinos, gentlemen's clubs, and theatres.

example, one sailor, an E-2 seaman apprentice, charged over $2,200 at this brothel during a 30-day period. The sailor separated from the Navy, and his account balance of more than $3,600 was eventually charged off.

We also found instances of abusive travel card activity where Navy cardholders used their cards at establishments such as gentlemen's clubs, which provide adult entertainment. Further, these clubs were used to convert the travel card to cash by supplying cardholders with actual cash or "club cash"[13] for a 10 percent fee. For example, we found that an E-5 second class petty officer circumvented ATM cash withdrawal limits[14] by charging, in a single transaction, $2,420 to the government travel card and receiving $2,200 in cash. Subsequently, the club received payment from Bank of America for a $2,420 restaurant charge. Another cardholder, an E-7 chief petty officer, obtained more than $7,000 in cash from these establishments. For fiscal year 2001 and through March 2002, 137 Navy cardholders made charges totaling almost $29,000 at these establishments.

These transactions represented abusive use of the travel cards that were clearly unrelated to official government travel. There should be no misunderstanding by Navy personnel that personal use of the card is not permitted. In fact, the standard government travel card used by most Navy personnel is clearly marked "For Official Government Travel Only" on the face of the card. Additionally, upon receipt of their travel cards, all Navy cardholders are required to sign a statement of understanding that the card is to be used only for authorized official government travel expenses.

However, as part of our statistical sampling results at the three sites we audited, we estimated that personal use of the government travel card ranged from almost 7 percent of fiscal year 2001 transactions at one site to over 26 percent at another site.[15] As shown in appendix V, cardholders who

[13]Club cash is used to tip dancers, waitresses, and bartenders, but cannot be exchanged for currency.

[14]Typically, the ATM limit for a 1-month cycle is set at $500 for a standard card and $200 for a restricted card.

[15]We considered personal use to include (1) any transaction charged to the government travel card that was not supported by a valid travel order and (2) any transaction for which the Navy was unable to provide supporting documentation. The following are the personal use estimates for the 3 case study locations: Camp Lejeune, U.S. Marine Forces Atlantic, 26.6 percent; Patuxent River Air Station, Air Systems Command, 10.8 percent; and Puget Sound Naval Shipyard, Sea Systems Command, 6.6 percent.

abused the card but paid the bill also used the government travel cards for the same transaction types discussed in table 1.

Personal use of the card also increases the risk of charge-offs related to abusive purchases, which are costly to the government and the taxpayer. Our work found that charged-off accounts included both those of (1) cardholders who were reimbursed by the Navy for official travel expenses but failed to pay Bank of America for the related charges, thus pocketing the reimbursement, and (2) those who used their travel cards for personal purchases for which they did not pay Bank of America. Appendix IV provides a summary table and supporting narrative describing examples of abusive travel card activity where the account was charged off or placed in salary offset or voluntary fixed payment agreements with Bank of America.

Furthermore, as detailed by the 10 examples in appendix V, we also found instances in which cardholders used their travel cards for personal purposes, but paid their travel card bills when they became due. For example, an E-5 second class petty officer reservist, whose civilian job was with the U.S. Postal Service, admitted making phony charges of over $7,200 to operate his own limousine service. In these transactions, the sailor used the travel card to pay for bogus services from his own limousine company during the first few days of the card statement cycle. By the second day after the charges were posted, Bank of America would have deposited funds—available for the business' immediate use—into the limousine business' bank account. Then, just before the travel card bill became due, the limousine business credited the charge back to the sailor's government travel card and repaid the funds to Bank of America. This series of transactions had no impact on the travel card balance, yet allowed the business to have an interest-free loan for a period. This pattern was continued over several account cycles. Navy officials were unaware of these transactions until we brought them to their attention and are currently considering what, if any, action should be taken against the cardholder.

Abusive Travel Card Activity Not Consistently Linked to Disciplinary Action and Security Clearances

We did not always find documented evidence of disciplinary actions taken by Navy commanders and supervisors against cardholders who wrote NSF checks or had their accounts charged off or placed in salary offset. Of the 57 cardholders fitting these categories that we selected through data mining, we did not find any documented evidence that 37 had been disciplined. For example, a lieutenant commander (O-4) with the Naval Air Reserve used his travel card for personal purchases in California and frequent personal trips to Mexico. The individual did not pay his account when due and was placed in salary offset in October 2001. Although the agency program coordinator (APC) responsible for program oversight had apprised management of this officer's abuse of the travel card, and had initiated actions to take away the cardholder's security clearance, management had not taken any administrative action against this cardholder. In addition, of the 10 individuals who abused the card but paid their bills, only 1 was disciplined. Appendixes III, IV, and V provide further details of the extent of disciplinary actions taken against some of the cardholders we examined.

In addition, we found that 27 of these same 57 travel cardholders we examined whose accounts were charged off or placed in salary offset as of March 31, 2002, still had active secret or top-secret security clearances in August 2002. Some of the Navy personnel holding security clearances who have had difficulty paying their travel card bills may present security risks to the Navy. DOD rules provide that an individual's finances are one of the factors to be considered in whether an individual should be entrusted with a security clearance. However, we found that Navy security officials were unaware of these financial issues and consequently could not consider their potential effect on whether these individuals should continue to receive a security clearance. We have referred cases identified from our audit to the U.S. Navy Central Adjudication Facility (commonly referred to as Navy CAF) for its continued investigation.

Key Internal Control Breakdowns

For fiscal year 2001, we identified significant breakdowns in key internal controls over individually billed travel cards. The breakdowns stemmed from a weak overall control environment, a lack of focus on oversight and management of the travel card program, and a lack of adherence to valid policies and procedures. These breakdowns contributed to the significant delinquencies and charge-offs of Navy employee account balances and potentially fraudulent and abusive activity related to the travel card. In contrast, one Navy unit we audited with a low average delinquency rate (4 percent) attributed its relative success to constant monitoring of delinquencies and to some monitoring of inappropriate travel card use.

We found that in fiscal year 2001, management at the three case study locations we audited focused primarily on reducing delinquencies. In general, management placed little emphasis on controls designed to prevent, or provide for early detection of, travel card misuse. In addition, we identified two key overall control environment weaknesses: (1) the lack of clear, sufficiently detailed Navy travel card policies and procedures and (2) limited internal travel card audit and program oversight. First, the units we audited used DOD's travel management regulations (*DOD Financial Management Regulation*, volume 9, chapter 3) as the primary source of policy guidance for management of Navy's travel card program. In many areas, the existing guidance was not sufficiently detailed to provide clear, consistent travel management procedures to be followed. Second, as recognized in the DOD Inspector General's March 2002 summary report[16] on the DOD travel card program, "[b]ecause of its dollar magnitude and mandated use, the DOD travel card program requires continued management emphasis, oversight, and improvement by the DOD. Independent internal audits should continue to be an integral component of management controls." However, no internal review report had been issued since fiscal year 1999 concerning the Navy's travel card program.

We found that this overall weak control environment contributed to design flaws and weaknesses in a number of management control areas needed for an effective travel card program. For example, many problems we identified were the result of ineffective controls over issuance of travel cards. Although DOD's policy allows an exemption from the requirement to use travel cards for certain groups or individuals with poor credit histories, we found that the Navy's practice was to facilitate Bank of America issuing travel cards—with few credit restrictions—to all applicants regardless of whether they have a history of credit problems. For the cases we reviewed, we found a significant correlation between travel card fraud, abuse, and delinquencies and individuals with substantial credit history problems. The prior and current credit problems we identified for Navy travel card holders included charged-off credit cards, bankruptcies, judgments, accounts in collections, and repeated use of NSF checks.

[16]Department of Defense Office of Inspector General, *Acquisition: Summary of DOD Travel Card Program Audit Coverage*, D-2002-065 (Washington, D.C.: Mar. 18, 2002).

Also, a key element of internal control, which, if effectively implemented, may reduce the risk and occurrence of delinquent accounts, is frequent account monitoring by the APC. However, some APCs, who have the key responsibility for managing and overseeing travel card holders' activities, were essentially set up to fail in their duties. Some were assigned APC responsibilities as collateral duties and given little time to perform these duties, while other full-time APCs had responsibilities for a large number of cardholders. When an APC is unable to focus on managing travel card usage because of the high number of cardholders or the extent of other duties, the rate of delinquency and potentially abusive and fraudulent transactions is adversely affected. For example, at Camp Lejeune, where the delinquency rate was over 15 percent, the six APCs we interviewed were given the role as "other duty as assigned," with most spending less than 20 percent of their available time to perform their APC responsibilities.

In addition, a lack of management focus and priority on ensuring proper training for APCs resulted in some APCs being unfamiliar with the capabilities of Bank of America's credit card database that would help them to manage and oversee the travel card program. For example, one APC did not know that she could access reports that would help identify credit card misuse and thus enable the responsible supervisors or commanders to counsel cardholders before they became delinquency problems. With the large span of control, minimal time allotted to perform this duty, and lack of adequate training, we found that APCs generally were ineffective in carrying out their key travel card program management and oversight responsibilities.

In contrast, a Navy unit we visited—Patuxent River—showed that constant monitoring of delinquency by a knowledgeable APC contributed to a lower delinquency rate. The APC at this unit had responsibility for approximately 1,200 to 1,500 active travelers monthly, but APC duties were her only responsibility. The APC informed us that she constantly monitored the government travel card program. For example, she reviewed delinquency reports several times a month to identify and promptly alert cardholders and supervisors about the status of delinquent accounts. She also told us that less frequently, but still on a monthly basis, she monitored transactions in the Bank of America database for improper and abusive uses of the card and sent out notices to the cardholders and the cardholders' supervisors if such transactions were identified. She also

emphasized the use of the split disbursement payment process[17] (split disbursements) whenever possible. Consequently, the delinquency rate for this unit was consistently lower than the Navy-wide rate and the civilian agency rate.

Another area of weakness in internal controls relates to the process over the cancellation and/or deactivation of cards in case of death, retirement, or separation from the service. These ineffective controls allowed continued use of the government travel card for personal purposes, which in some instances led to charge-offs, thereby contributing to increased costs to the government. For example,

- In one Navy unit, a cardholder died in October 1999. However, ineffective controls over the notification process resulted in the APC not being aware that this had occurred. Therefore, the APC did not take actions to cancel this individual's government travel card account. Consequently, in October 2000, when the old card was about to expire, Bank of America mailed a new card to the address of record. When the card was returned with a forwarding address, the bank remailed the card and the personal identification number used to activate the card to the new address without performing other verification procedures. The card was activated in mid-December 2000, and within a month, 81 fraudulent transactions for hotel, food, and gas totaling about $3,600 were charged to the card. In January 2001, in the course of her monthly travel card monitoring, the APC noticed suspicious charges in the vicinity of the cardholder's post-of-duty. The APC took immediate action to deactivate the card, thus preventing additional charges from occurring. Upon learning of the cardholder's death from further discussion with the cardholder's unit, the APC immediately reported the case to a Bank of America fraud investigator. Investigations revealed that a family member of the cardholder might have made these charges. No payment was ever made on this account, and the entire amount was subsequently charged off. We referred this case to the U.S. Secret Service Credit Card Task Force for further investigation and potential prosecution.

- A chief warrant officer (W-3) at Naval Air Systems Command Atlantic repeatedly used his travel card after his retirement on December 1, 2000. The cardholder currently works for a private company. The cardholder used the government travel card, since his retirement, to make charges

[17]Split disbursement is a payment method by which cardholders elect to have all or part of their reimbursements sent directly to Bank of America.

totaling $44,000 for hotels, car rentals, restaurants, and airline tickets. In a number of instances, the cardholder was able to obtain the government rate—which can be substantially lower than the commercial rate—for lodging in San Diego, Philadelphia, and Cincinnati. Because the Navy does not routinely monitor cardholders' transaction reports for abusive activity and because this particular account was always paid in full, they did not detect the abusive activity. Bank of America data showed that the cardholder's account was still open in early September 2002 and thus available for further charges.

- In another instance, a mechanic trainee at the Puget Sound Naval Shipyard was convicted of a felony conviction for illegal possession of a firearm in October 2000 and placed on indefinite suspension by his employer in November 2000. However, neither the security office, which took action against the employee, nor the office where the individual worked notified the APC to cancel or deactivate the cardholder's government travel card account. Following his suspension, the cardholder used the government travel card to make numerous cash withdrawals and gas purchases totaling almost $4,700. The APC was not aware of these abusive charges until the monthly delinquency review identified the account as being delinquent. The account balance of $1,600 was subsequently charged off in January 2002. Although security officers at the Puget Sound Naval Shipyard referred the case to Navy CAF in October 2000, our work indicated as of August 2002, the suspended employee continued to maintain a secret clearance, despite the account charge-off and felony conviction.

Table 2 summarizes our statistical tests of four key control activities related to basic travel transaction and voucher processing at three Navy locations. We concluded that the control was effective if the projected failure rate was from 0 to 5 percent. If the projected failure rate was from 6 to 10 percent, we concluded that the control was partially effective. We considered controls with projected failure rates greater than 10 percent to be ineffective.

Table 2: Results of Testing of Key Internal Controls

	Percentage of failure			
Navy unit	Travel orders are approved prior to travel	Travel voucher reimbursements are accurate	Travel vouchers are submitted within 5 days of travel completion	Travel vouchers are paid within 30 days of submission
Camp Lejeune, U.S. Marine Forces Atlantic	11	33	11	3
Patuxent River Air Station, Air Systems Command	3	35	36	1
Puget Sound Naval Shipyard, Sea Systems Command	49*	40	34	1

Note: The numbers in the table represent point estimate percentages for the number of failures in the population based on our sampling tests. The confidence intervals for our sampling estimates are presented in appendix I of this testimony.

*The high failure rate is attributable to management's failure to maintain copies of the original signed travel orders, which were sent to the travelers.

Source: GAO analysis.

Although we found significant failure rates at all three case study sites for the requirement that vouchers be filed within 5 working days of travel completion, this did not have an impact on these units' delinquency rates. However, we found substantial errors in travel voucher processing that resulted in both overpayment and underpayment of the amount that cardholders should have received for their official travel expenses. At times, these errors were substantial in comparison with the total voucher amounts. For example, we found data entry errors that resulted, in one case, in an overpayment of more than $1,700 to the traveler. In another case, failure to carefully scrutinize supporting documentation resulted in an overpayment to a traveler of more than $1,000 for cell phone calls, for which the traveler did not submit detailed documentation to support what were claimed to be calls made for business purposes. As a result of our work, the Navy unit has taken actions to recover these overpayments.

Corrective Actions

DOD has taken a number of actions focused on reducing delinquencies. For example, the Department of the Navy had established a goal of a delinquency rate of no more than 4 percent.[16] Beginning in November 2001,

[16]For this delinquency rate calculation, the Navy is using the number of delinquent accounts compared to the total number of active accounts. The dollar amount method we used to calculate delinquency rates is the industry standard and was also used by the DOD Charge Card Task Force.

DOD implemented a system of wage and retirement payment offset for many employees. It also began encouraging the use of split disbursements—a payment process by which cardholders elect to have all or part of their reimbursements sent directly to Bank of America. This payment method is a standard practice of many private sector employers. Although split disbursements have the potential to significantly reduce delinquencies, this payment process is strictly voluntary at DOD. According to Bank of America, split disbursements accounted for 30 percent of total payments made by Navy employees in June 2002. This rate represented a large increase over fiscal year 2001, when only 16 percent of Navy payments were made through split disbursements. As a result of these actions, the Navy experienced a significant drop in charged-off accounts in the first half of fiscal year 2002.

The Navy has also initiated actions to improve the management of travel card usage. The Navy has a three-pronged approach to address travel card issues: (1) provide clear procedural guidance to APCs and travelers, available on the Internet, (2) provide regular training to APCs, and (3) enforce proper use and oversight of the travel card through data mining to identify problem areas and abuses. Further, to reduce the risk of card misuse, the Navy has also begun to deactivate cards while travelers are not on travel status and close a number of inactive cards, and plans to close inactive cards semi-annually to eliminate credit risk exposure. The Navy is also pursuing the use of "pre-funded" debit or stored value cards for high-risk travelers—funds would be available on the cards when travel orders were issued in an amount authorized on the order.

Further, the DOD Comptroller created a DOD Charge Card Task Force to address management issues related to DOD's purchase and travel card programs. We met with the task force in June 2002 and provided our perspectives on both programs. The task force issued its final report on June 27, 2002. To date, many of the actions that DOD has taken primarily address the symptoms rather than the underlying causes of the problems with the program. Specifically, actions to date have focused on dealing with accounts that are seriously delinquent, which are "back-end" or detective controls rather than preventive controls. To effectively reform the travel program, DOD and the Navy will need to work to prevent potentially fraudulent and abusive activity and severe credit problems with the travel card. We are encouraged that the DOD Comptroller recently took action to deactivate the travel cards of all cardholders who have not been on official government travel within the last 6 months. However, additional preventive solutions are necessary if DOD is to effectively address these issues.

To that end, we will be issuing a related report in this area with specific recommendations, including a number of preventive actions that, if effectively implemented, should substantially reduce delinquencies and potentially fraudulent and abusive activity related to Navy travel cards. For example, we plan to include recommendations that will address actions needed in the areas of exempting individuals with histories of financial problems from the requirement to use a travel card; providing sufficient infrastructure to effectively manage and provide day-to-day monitoring of travel card activity related to the program; deactivating cards when employees are not on official travel; taking appropriate disciplinary action against employees who commit fraud or abuse of the travel card; ensuring that information on travel card fraud or abuse of cardholders with secret or top-secret security clearances is provided to appropriate security officials for consideration in whether such clearances should be suspended or revoked; and moving towards mandating use of the split disbursement payment process. The defense authorization bill for fiscal year 2003 passed by the Senate reflected a move in this direction. This bill would change the voluntary use of split disbursements by authorizing the Secretary of Defense to require that any part of an employee's travel allowance be disbursed directly to the employee's travel card issuer for payment of official travel expenses. The defense authorization bill for fiscal year 2003 passed by the House does not contain comparable authority. As of September 12, 2002, the bill (H.R. 4546) was in conference.

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

Contact and Acknowledgments

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Appendix I: Scope and Methodology

We used as our primary criteria applicable laws and regulations, including the Travel and Transportation Reform Act of 1998,[1] the General Services Administration's *Federal Travel Regulation*,[2] and the *DOD Financial Management Regulations*, Volume 9, *Travel Policies and Procedures*. We also used as criteria our *Standards for Internal Control in the Federal Government*[3] and our *Guide to Evaluating and Testing Controls Over Sensitive Payments*.[4] To assess the management control environment, we applied the fundamental concepts and standards in our internal control standards to the practices followed by management at our three case study locations.

To assess the magnitude and impact of delinquent and charged-off accounts, we compared the Navy's delinquency and charge-off rates to those of other DOD services and agencies and federal civilian agencies. We also analyzed the trends in the delinquency and charge-off data from the third quarter of fiscal year 2000 through the first half of fiscal year 2002. In addition, we obtained and analyzed Bank of America data to determine the extent to which Navy travel card holders wrote NSF checks to pay their travel card bills. We also obtained documented evidence of disciplinary action against cardholders with accounts that were in charge-off or salary offset status or had NSF checks written in payment of those accounts. We accepted hard copy file information and verbal confirmation by independent judge advocate general officials as documented evidence of disciplinary action.

[1]Travel and Transportation Reform Act of 1998 (Public Law 105-264, Oct. 19, 1998) includes requirements that federal employees use federal travel charge cards for all payments of expenses of official government travel and that employees be reimbursed within 30 days of submitting proper travel vouchers. The act also allows for the offset of pay for employees with undisputed travel card charge delinquencies in an amount up to 15 percent of the amount of disposable pay of the employee for a pay period.

[2]*Federal Travel Regulation*, 41 Code of Federal Regulations, chapters 300-304, issued by the Administrator of General Services, governs travel and transportation allowances and relocation allowances for federal civilian employees.

[3]*Standards for Internal Control in Federal Government* (GAO/AIMD-00-21.3.1) was prepared to fulfill our statutory requirement under 31 U.S.C. 3512 (c), (d), the Federal Managers' Financial Integrity Act, to issue standards that provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

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

We also used data mining to identify Navy individually billed travel card transactions for audit. Our data mining procedures covered the universe of individually billed Navy travel card activity during fiscal year 2001 and the first 6 months of fiscal year 2002, and identified transactions that we believed were potentially fraudulent or abusive. However, our work was not designed to identify, and we did not determine, the extent of any potentially fraudulent or abusive activity related to the travel card.

To assess the overall control environment for the travel card program at the Department of the Navy, we obtained an understanding of the travel process, including travel card management and oversight, by interviewing officials from the Office of the Undersecretary of Defense (Comptroller), Department of the Navy, Defense Finance and Accounting Service (DFAS), Bank of America, and the General Services Administration, and by reviewing applicable policies and procedures and program guidance they provided. We visited three Navy units to "walk through" the travel process, including the management of travel card usage and delinquency, and the preparation, examination, and approval of travel vouchers for payment. We also assessed actions taken to reduce the severity of travel card delinquencies and charge-offs. Further, we contacted one of the three largest U.S. credit bureaus to obtain credit history data and information on how credit scoring models are developed and used by the credit industry for credit reporting.

To test the implementation of key controls over individually billed Navy travel card transactions processed through the travel system—including the travel order, travel voucher, and payment processes—we obtained and used the database of fiscal year 2001 Navy travel card transactions to review random samples of transactions at three Navy locations. Because our objective was to test controls over travel card expenses, we excluded credits and miscellaneous debits (such as fees) from the population of transactions used to select a random sample of travel card transactions to audit at each of the three Navy case study units. Each sampled transaction was subsequently weighted in the analysis to account statistically for all charged transactions at each of the three units, including those that were not selected.

We selected three Navy locations for testing controls over travel card activity based on the relative amount of travel card activity at the three Navy commands and at the units under these commands, the number and percentage of delinquent accounts, and the number and percentage of charged-off accounts. Each of the units within the commands was selected because of the relative size of the unit within the respective command.

Table 3 presents the sites selected and the universe of fiscal year 2001 transactions at each location.[5]

Table 3: Universe of Fiscal Year 2001 Travel Transactions at Navy Units Tested

Navy unit tested	Number of fiscal year 2001 travel transactions*	Dollar value of fiscal year 2001 travel transactions*
Camp Lejeune, U.S. Marine Forces Atlantic	14,209	$ 1,747,316
Patuxent River Air Station, Air Systems Command	179,547	20,335,864
Puget Sound Naval Shipyard, Sea Systems Command	80,583	11,025,669

*Transactions represent charges for sales and cash advances and exclude credits and fees.

Source: GAO analysis based on Bank of America data.

We performed tests on statistical samples of travel card transactions at each of the three case study sites to assess whether the system of internal control over the transactions was effective, as well as to provide an estimate, by unit, of the percentage of transactions that were not for official government travel. For each transaction in our statistical sample, we assessed whether (1) there was an approved travel order prior to the trip, (2) the travel voucher payment was accurate, (3) the travel voucher was submitted within 5 days of the completion of travel, and (4) the travel voucher was paid within 30 days of the submission of an approved travel voucher. We considered transactions not related to authorized travel to be abuse and incurred for personal purposes. The results of the samples of these control attributes, as well as the estimate for personal use—or abuse—related to travel card activity, can be projected to the population

[5]The universes from which we selected our samples included some transactions that were not supported by travel orders or vouchers, such as personal charges made by a cardholder. We excluded such transactions from our selections used to test travel order, voucher, and payment process controls. However, we included such transactions to project the percentage of personal use transactions.

of transactions at the respective test case study site only,[6] not to the population of travel card transactions for all Navy cardholders.

Table 4 shows the results of our test of the key control related to the authorization of travel (approved travel orders were prepared prior to dates of travel).

Table 4: Estimate of Fiscal Year 2001 Transactions That Failed Control Tests for Approved Travel

	Approved travel order	
Navy unit tested	Number of failed Transactions	Estimated failure rate (95% confidence interval)
Camp Lejeune	11 of 96	11.5% (5.9%, 19.6%)
Patuxent River Air Station	3 of 96	3.1% (0.6%, 8.9%)
Puget Sound Naval Shipyard	47 of 96	49.0% (38.6%, 59.4)%

Source: GAO analysis

Table 5 shows the results of our test for effectiveness of controls in place over the accuracy of travel voucher payments.

[6]At Camp Lejeune, we found that 38 of 143 transactions appeared to be personal (projecting to an estimated 26.6 percent with a 95 percent confidence interval from 19.5 percent to 34.6 percent). At Patuxent River Air Station, we found that 13 of 120 transactions appeared to be personal (projecting to an estimated 10.8 percent with a 95 percent confidence interval from 5.9 percent to 17.8 percent). At Puget Sound Naval Shipyard, we found that 8 of 121 transactions appeared to be personal (projecting to an estimated 6.6 percent with a 95 percent confidence interval from 2.9 percent to 12.6 percent).

Table 5: Estimate of Fiscal Year 2001 Transactions that Failed Control Tests for Accurate Travel Voucher Payments

	Effective voucher review and accurate reimbursement to traveler	
Navy unit tested	Number of failed transactions	Estimated failure rate (95% confidence interval)
Camp Lejeune	14 of 43	32.6% (19.1%, 48.5%)
Patuxent River Air Station	34 of 96	35.4% (25.9%, 45.8%)
Puget Sound Naval Shipyard	38 of 96	39.6% (29.8%, 50.1%)

Source: GAO analysis

Table 6 shows the results of our tests of two key controls related to timely processing of claims for reimbursement of expenses related to government travel—timely submission of the travel voucher by the employee and timely approval and payment processing.

Table 6: Estimate of Fiscal Year 2001 Transactions that Failed Control Tests for Timely Submission and Processing of Travel Vouchers

	Timely voucher submission by employee (5-day rule)		Timely reimbursement to the traveler (30-day rule)	
Navy unit tested	Number of failed transactions	Estimated failure rate (95% confidence interval)	Number of failed transactions	Estimated failure rate (95% confidence interval)
Camp Lejeune	11 of 96	11.5% (5.9%, 19.6%)	3 of 96	3.1% (0.6%, 8.9%)
Patuxent River Air Station	35 of 96	36.5% (26.9%, 46.9%)	1 of 96	1.0% (0.03%, 5.7%)
Puget Sound Naval Shipyard	33 of 96	34.4% (25.0%, 44.8%)	1 of 96	1.0% (0.03%, 5.7%)

Source: GAO analysis

To determine if cardholders were reimbursed within 30 days, we used payment dates provided by DFAS. We did not independently validate the accuracy of these reported payment dates.

We briefed DOD managers, Navy managers, including the Assistant Secretary of the Navy (Financial Management and Comptroller) officials, unit commanders, and APCs; and Bank of America officials on the details

of our audit, including our findings and their implications. We incorporated their comments where appropriate. We did not audit the general or application controls associated with the electronic data processing of Navy travel card transactions. We conducted our audit work from January 2002 through September 2002 in accordance with U.S. generally accepted government auditing standards, and we performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency. Following this testimony, we plan to issue a report, which will include recommendations to DOD and the Navy for improving internal controls over travel card activity.

Appendix II: Navy Personnel Grade, Rank, and Associated Basic Pay Rates

Tables 7, 8, and 9 show the grade, rank (where relevant), and the associated basic pay rates for fiscal year 2001 for the Navy's and Marine Corp's military personnel and civilian personnel.

Table 7: Navy Military Grades, Ranks, and Associated Basic Pay Rates for Fiscal Year 2001

Military grade	Military rank	Fiscal year 2001 pay
Enlisted personnel		
E-1 to E-3	Seaman recruit to seaman	$11,976 to $14,973
E-4 to E-6	Petty officer 3rd class to 1st class	$17,931 to $26,860
E-7 to E-9	Chief petty officer to master chief petty officer	$31,739 to $45,514
Officers*		
WO-2 to WO-4	Warrant officer	$37,722 to $53,514
O-1 to O-3	Ensign to lieutenant	$27,398 to $44,649
O-4 to O-6	Lieutenant commander to captain	$54,476 to $83,982
O-7 to O-10	Admiral	$98,257 to $127,695

*Officers' ranks include warrant officers (denoted by WO) and commissioned officers (denoted by O)

Source: U.S. Navy.

Table 8: Marine Corp Military Grades, Ranks, and Associated Basic Pay Rates for Fiscal Year 2001

Military grade	Military rank	Fiscal year 2001 pay
Enlisted personnel		
E-1 to E-3	Private to lance corporal	$11,871 to $15,093
E-4 to E-6	Corporal to staff sergeant	$17,675 to $26,018
E-7 to E-9	Gunnery sergeant to sergeant major or master gunnery sergeant	$31,533 to $46,646
Officers*		
WO-1 to WO-5	Warrant officer	$32,098 to $59,587
O-1 to O-3	2nd lieutenant to captain	$25,653 to $45,120
O-4 to O-6	Major, lieutenant colonel, and colonel	$56,951 to $85,628
O-7 to O-10	General	$98,484 to $130,200

*Officers' ranks include warrant officers (denoted by WO) and commissioned officers (denoted by O)

Source: U.S. Navy.

Table 9: Navy Civilian Grades and Associated Basic Pay Rates for Fiscal Year 2001

Civilian grade	Fiscal year 2001 pay
General schedule employees	
GS-1 to GS-3	$16,181 to $20,093
GS-4 to GS-5	$22,559 to $25,241
GS-6 to GS-8	$28,131 to $34,625
GS-9 to GS-12	$38,240 to $55,455
GS-13 to GS-15	$65,949 to $91,667
Senior executive service	
ES-01 to ES-06	$111,650 to $125,700

Note: Basic pay rates shown are the midpoint of the range of pay for each grade and does not factor in locality pay received in geographic areas with higher cost-of-living.

Source: Office of Personnel Management.

Appendix III: NSF Checks Written to Bank of America

Table 10: Examples of Cases in Which Cardholders Wrote Three or More NSF Checks During Fiscal Year 2001 and the First 6 Months of Fiscal Year 2002 and Accounts Were Subsequently Charged Off or Referred to Salary Offset or Voluntary Fixed Pay Terms

Card-holder	Total amount (number) of NSF checks	Total amount charged-off (CO), in salary offset (SO) or voluntary fixed pay (FP)	Grade	Unit	Credit history problems	Documented disciplinary action
1	$61,004 (12)	SO — $20,535	E-5	U.S. Pacific Fleet, Honolulu	Multiple bankruptcies and numerous charge-offs prior to card issuance	Administrative counseling/warning
2	37,150 (15)	FP — $4,094	E-6	Naval Recruiting, Omaha	Multiple judgments and merchandise repossession prior to card issuance	None
3	23,894 (9)	SO — $11,310	E-6	U.S. Marine Corps, Marine Aircraft Group 12, Japan	Charged-off and referral to collection prior to card issuance; one account in collection and one charged off prior to card issuance	Dishonorable discharge for misconduct directly related to travel card misuse
4	22,873 (11)	CO — $2,579	E-4	U.S. Transportation Command, Illinois	None prior to card issuance	Prosecution pending for travel card misuse and absence without leave
5	20,052 (9)	CO — $4,589; account in SO	E-5	Mobile Inshore Undersea Warfare, San Jose	Charged-off account prior to card issuance; delinquencies since card issuance	None; promotion to E-6 after charge-off; pending investigation for desertion, theft and issuance of NSF checks
6	18,148 (13)	CO — $7,229	GS-11	Navy Inventory Control Point – Mechanicsburg	Bankruptcies and charge-offs prior to card issuance; delinquencies since card issuance	None; cardholder retired
7	10,908 (16)	CO — $1,381	E-5	Navy Seals, San Diego	None prior to card issuance; delinquencies since card issuance	Administrative action related to travel card abuse; honorable discharge
8	8,231 (6)	SO — $4,530; account paid off Sept. 2002	E-8	U.S. Marine Corps, Camp Lejeune	Charged-off account prior to card issuance	Counseling; article 15 pending for credit card misuse
9	5,785 (4)	CO — $4,923	E-4	Navy and Marine Corps Reserve Center, Bessemer	Bankruptcies and judgment prior to card issuance; serious delinquencies since card issuance	None
10	3,250 (12)	CO — $5,347; account in FP	E-4	Naval Air Warfare Center, Patuxent River	Bankruptcy and charged-off account prior to card issuance; delinquencies since card issuance	None

Note: NSF includes those accounts with nonsufficient funds, closed accounts, stop payment orders, and those accounts not located.

Source: GAO analysis.

The 10 cardholders in table 10 wrote a total of 107 checks that were returned by Bank of America because they were NSF, drawn on closed accounts, and/or had payments stopped for other reasons. These checks totaled over $211,000. Eight of the 10 cardholders had significant credit problems prior to card issuance, such as charged-off multiple bankruptcies, charged-off credit card accounts, accounts in collection, and serious delinquencies. Two of the cardholders did not have credit problems prior to card issuance, one of which, experienced serious financial problems after issuance of the Bank of America travel card. The following provides detailed information on some of these cases.

- Cardholder #1 was a petty officer second class with the U.S. Pacific Fleet in Honolulu. The cardholder wrote 12 NSF checks totaling more than $61,000 for payment on his Bank of America travel card account. These checks were written partly to cover charges incurred while on official travel, but records showed that the cardholder made many more charges at convenience stores, restaurants, gas stations, and travel agencies in the vicinity of his hometown. An examination of the cardholder's credit history also revealed that, prior to receiving his government travel card in May 2000, the cardholder filed multiple bankruptcies and had multiple charge-offs. Despite his financial history, the cardholder was issued a standard card, with a credit limit of $5,000, instead of a restricted card with a lower credit limit.

  From March 2001 through December 2001, the cardholder wrote about one NSF check a month, with three of these NSF checks totaling more than $12,500 written in the month of December 2001 alone. Industry regulations require that an account be credited immediately upon receipt of a check. Consequently, when Bank of America posted the NSF checks, the accounts appeared to have been paid, which provided credit to the cardholder to make additional purchases. Thus, by writing NSF checks, and submitting NSF payments over the phone, which Bank of America had to credit to his travel card account, the petty officer was able to, in effect, increase his credit limit to more than $20,000—a practice known as "boosting." He used each of these successive increases in his effective credit limit to charge additional items on his travel card. However, despite the repeated NSF checks written throughout 2001, the individual was able to continue making charges through December 2001.

  Bank of America subsequently notified the cardholder's APC of the NSF check problems. Because the cardholder was considered a good sailor, he was given administrative counseling for potential fraud and abuses related to his travel card. The terms of the administrative counseling specified that

the cardholder would face a court-martial and be separated from the Navy in case of continued abuse of the credit card or any other misconduct.

- Cardholder #5 is a petty officer (E-05) assigned to the Naval Reserve Forces in San Jose. Prior to receiving the Bank of America travel card in June 2000, the individual had a number of unpaid accounts with other creditors. The individual was given a restricted card with a credit limit of $2,000, which should have been issued in "inactive" status and only activated when needed for travel. However, records showed that the cardholder was able to make about 130 separate purchases and ATM transactions in the vicinity of his hometown while not on official travel. These transactions totaled more than $5,000. In addition, from September 2000 through December 2001, the cardholder wrote eight NSF checks and one stop payment check totaling $20,051 to Bank of America. During fiscal year 2001, not a single valid payment was made to the Bank of America for this account. The cardholder had an unpaid balance of $4,922 at the time his account was charged off in July 2002. The cardholder also had three other unrelated charge-offs in July 2002.

  We found no documentation that disciplinary actions had been taken against the cardholder. The APC assigned to the cardholder told us that he had received little training for his APC responsibility, which is a collateral duty. He recalled advising the cardholder once to pay off his travel card balance. Although a Bank of America official informed us that access to NSF check information had been available to APCs since 2000, the APC said he was not aware of the NSF checks written by the cardholder. The APC also informed us that he was not aware that the cardholder's account was charged off until he was notified by Bank of America. Despite having his Bank of America account charged-off and other financial problems, the cardholder was recently promoted from petty officer second class (E-5) to petty officer first class (E-6).[1] His account had been referred to salary offset.

[1]Subsequent to his promotion, the cardholder did not report to duty. His command is taking action to declare him a deserter. He is also a subject of law enforcement agencies' investigations.

Appendix IV: Abusive Travel Card Activity Where Accounts Were Charged Off or Placed in Salary Offset

Table 11: Examples of Abusive Travel Card Activity Where Accounts Were Charged-Off or Placed in Salary Offset

Card-holder	Grade	Unit	Total amount charged-off (CO) or in salary offset (SO)	Transactions contributing to charge-off or salary offset	Credit history problems	Documented disciplinary action
1	E-5	U.S. Marine Corps Reserve, Camp Lejeune	CO – $19,971	Did not use reimbursement to pay travel card charges; numerous large cash withdrawals	Account charge-offs, referral to collection agency, and other account delinquency prior to card issuance	None; court-martial being considered
2	E-7	Naval Shore Intermediate Maintenance Activity, Mayport	SO – 11,190	ATM withdrawals totaling $15,000 from October 2000 through July 2001; nearly $7,000 in cash and other expenses at Platinum Plus and Mr. Magoo gentlemen's clubs	Bankruptcy, account charge-offs and serious credit card delinquency prior to card issuance	None
3	E-4	LeMoore Naval Air Station	CO – 8,036	Over $6,250 of computer equipment from Best Buy and other Web sites	Numerous unpaid accounts prior to card issuance and charge-off on the American Express card	Administrative discharge in lieu of court-martial for misuse of the travel card and other offenses
4	O-5	Naval and Marine Corps Reserve Center, Washington, D.C.	SO – 5,678	Over $700 worth of candles and cookware; over $1,400 charged to D.B. Entertainment, which owns Baby Dolls and other adult entertainment clubs	Numerous account charge-offs, delinquencies, and bankruptcy prior to card issuance	None
5	E-3	Marine Forces Reserve, San Diego	CO – 4,041	$3,800 at local restaurants and $1,400 in ATM withdrawals over a 2-month period	Serious delinquencies, unpaid accounts, and referrals to collection agencies prior to card issuance	Court-martialed for misuse of the government travel card; appeal ongoing
6	O-6	Naval and Marine Corps Reserve Center, Washington, D.C.	CO – 3,511	$2,000 in cash withdrawals and nearly $1,500 at local grocery and drug stores	None	None
7	WS-10[a]	Puget Sound Naval Shipyard, Naval Sea Systems Command	CO - 3,243	Numerous personal charges, including groceries, gasoline, cash advances, and $150 at Bethel Animal Hospital	None prior; serious credit card delinquencies and mortgage foreclosure in 2001 and 2002	Removal from employment due to unauthorized absence and travel card misuse
8	GS-12	Naval Air Systems Command, Patuxent River	SO – 1,202	Airline tickets totaling $608	Serious delinquencies, account charge-offs, mortgage foreclosure in 2000, bankruptcies prior to and since card issuance	None

Card-holder	Grade	Unit	Total amount charged-off (CO) or in salary offset (SO)	Transactions contributing to charge-off or salary offset	Credit history problems	Documented disciplinary action
9	O-05	Marine Forces Reserve, New Orleans	SO – 1,674	Car rental transactions and numerous charges at local restaurants	Serious delinquencies prior to and since card issuance	None
10	E-06	U.S. Marine Corps, Camp Lejeune	CO – 672	Unauthorized use of card for charges associated with permanent change of station move	Serious delinquency and bad debts at the time of card issuance	None

*Wage supervisors designation used to denote supervisory workers on hourly salary.

Source: GAO analysis.

Eight of the 10 cardholders included in table 11 had significant credit problems prior to card issuance, such as charged-off credit card accounts, mortgage foreclosures, bankruptcies, serious delinquencies, unpaid accounts, and referrals to collection agencies. One cardholder had similar problems subsequent to issuance of the Bank of America travel card.

- Cardholder #1 was a sergeant (E-05) with the U.S. Marine Corps Reserve assigned at Camp Lejeune. Despite a history of credit problems, which included several charged-off and delinquent commercial credit accounts, Bank of America issued the cardholder a standard card, with a credit limit of $10,000, in March 2000. The cardholder was deployed to Europe in August 2000 and his credit limit was increased to $20,000. Within a month of his deployment, the cardholder had charged $10,700 to the card, including $8,500 in ATM withdrawals. Although the cardholder received reimbursements for his travel expenses, he failed to settle his account in full. In December 2000, the cardholder informed the APC that his account was 30 days past due and promised to pay the full outstanding balance. He again failed to do so and his account balance of $11,467 went delinquent in January 2001. The APC did not deactivate the travel card account but put the cardholder in "mission critical" status and raised the credit limit to $25,000 so the cardholder would have access to funds to return to the United States. Consequently, when the account was closed on February 8, 2001, the outstanding balance had increased to $19,971. The APC admitted to us that he failed to carefully monitor this account. No disciplinary action was taken against the cardholder, who had returned to civilian life; however, judicial action against the cardholder is pending. We have referred this matter to the DOD's Office of Inspector General for appropriate action.

In addition, our review indicated that the cardholder might have filed a fraudulent travel voucher in January 2001. This travel voucher claimed reimbursement for expenses in Germany over the holiday period from late December 2000 to early January 2001, allegedly for official purposes. However, Bank of America data showed that the government travel card belonging to this cardholder was used to make transactions in the vicinity of the traveler's hometown during this holiday period. It appeared that the cardholder might have returned to the United States for the holiday, yet continued to claim expenses as if he was still in Germany, a potentially fraudulent act.

- Cardholder # 3 was a petty officer third class assigned to the LeMoore Naval Air Station in California. Our review indicated that the cardholder had numerous unpaid cable, medical, and communication accounts and serious delinquency of more than $5,000 on his personal credit card account prior to receiving the travel card. The unit to which the cardholder was assigned had a policy of activating the government travel card only when a cardholder travels. However, from February through April 2001, while not on travel, the cardholder purchased over $6,250 worth of electronic and computer equipment from Best Buy and various Web sites using the government travel card. The cardholder did not pay his balance and thus came to the attention of the APC when his name appeared in the delinquency report. Upon determining that the cardholder was able to use the card when not on travel, the APC contacted Bank of America, which was unable to inform the APC as to who had activated the account. The cardholder's balance of more than $8,000 was charged off, and he was granted an administrative separation in lieu of a court-martial for offenses unrelated to the travel card misuse, including absence without leave, making false statements, and stealing government property of less than $100.

- Cardholder #4 was a commander (O-05) with the Naval Reserves assigned to the Naval and Marine Corps Reserve Center in Washington, D.C. Our review showed that Bank of America issued the cardholder a standard card in May 2000, although the cardholder's credit history indicated serious financial problems before and at the time of card issuance. For example, in October 1998, the cardholder filed Chapter 7 bankruptcy with only $37,169 in assets against $542,063 in liabilities. Further, in January 2000, right before the Bank of America card was issued, an account with a balance of more than $30,000 was charged off. This high-ranking Navy officer continued, since the issuance of the government travel card, a pattern of delinquencies on numerous accounts, and in one instance had merchandise repossessed for nonpayment.

During fiscal year 2001 and the first 3 months of fiscal year 2002, the cardholder used the government travel card to make numerous personal transactions. Transactions included more than $1,400 to D.B. Entertainment, which owns Baby Dolls Saloon, a gentlemen's club in Dallas, and more than $700 to Wearever cookware and Partylite Gifts, a manufacturer of candles and candle accessories. A delinquency letter was sent to the cardholder on August 9, 2002, when the account was 120 days past due; however, no documentation existed to indicate that any action was taken prior to this date. Although the cardholder had been placed in salary offset, no other disciplinary action had been taken against the cardholder.

Appendix V: Abusive Travel Card Activity Where Cardholders Paid the Bills

Table 12 shows cases of travel card use for personal expenses where the cardholder paid the bill.

Table 12: Examples of Abusive Travel Card Activity Where the Cardholders Paid the Bills

Card-holder	Unit	Grade	Vendor	Amount	Nature of transaction	Documented disciplinary action
1	PEO Theatre Air and Surface, Naval Sea Systems Command, Washington D.C.	GS-15	Seinpost Holdings	Over $23,000 in charges	35 transactions for Internet gambling	Written reprimand
2	Mobile Inshore Undersea Warfare, Newport	E-5	Cardholder's Limousine Service	8,622	Bogus charges of $7,222 to cardholder's own limousine company	None
3	Portsmouth Naval Shipyard	WG-10[a]	Herbal Life	6,758	17 purchases of vitamins and health supplements	None
4	Naval Undersea Warfare Center, Newport	ND-05[b]	Carnival Cruise	3,790	Alaskan cruise for 2 for 7 nights	None
5	U.S. Naval Academy, Annapolis	MIDN[c]	Best Buy	2,442	Home electronics	None
6	U.S. Marine Corps, Camp Pendleton	E-07	United Vacation	1,326	United Airlines plane ticket for cardholder's spouse	None
7	U.S. Marine Corps, Camp Pendleton	E-06	DeAngelo Tax Service	800	For preparation of 1997 through 2000 tax returns	None
8	Naval Reserves Forces Command, Virginia	E-07	Ticketmaster	460	4 concert tickets to the Backstreet Boys	None
9	Norfolk Naval Air Station	E-04	Fredricks of Hollywood	184	Women's lingerie	None
10	Naval Medical Research Center, San Antonio	E-4	GTEAir	148	Airplane telephone call	None

[a]Wage grade system used for workers who are on hourly salary.

[b]Scientific and engineering career path equivalent to GS-14 to GS-15.

[c]Midshipmen are cadets in training to become Navy officers. They may receive stipends while in college.

Source: GAO analysis.

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Mr. HORN. This is Rear Admiral Cowley, Deputy for Acquisition and Business Management, Research Development and Acquisition, Office of the Assistant Secretary of the Navy. Admiral, we are glad to have you here.

Admiral COWLEY. Mr. Chairman and distinguished members of the committee, thank you for the opportunity to discuss the Department of the Navy's purchase card program. I am Rear Admiral Bob Cowley, Deputy for Acquisition and Business Management for the Assistant Secretary of the Navy for Research Development and Acquisition. In this capacity I am responsible for the establishment of the Department of Navy policies and oversight for the purchase card program.

I am aware of and I am very concerned about the internal control and oversight issues identified by the General Accounting Office regarding the Department of the Navy purchase card program.

First let me say that I believe increasing the effectiveness of the Department of Navy purchase card operations and improving internal controls and oversight, thus preventing waste, fraud and abuse, are synonymous. Let me assure you that the Department of the Navy personnel and the purchase card program have been working diligently to streamline purchasing and improve controls and oversight.

The Department of the Navy continues to aggressively address the policy training and internal control weaknesses identified by the General Accounting Office. Over the past 6 months, we have implemented many improvements. Specifically, we have established and reinforced and engaged in supporting from the top; made progress on implementing the DOD task force recommendations; reinforced and strengthened our written purchase card policies and procedures; completely revised and distributed training materials; enforced compliance with internal controls, including span of control and credit limits; and increased the use of technology to detect misuse and abuse.

The Department recognizes that proper management and compliance of any program must be led from the top. We have engaged Department leadership in taking a proactive role in oversight, discipline, and setting a supportive command environment. The command environment which sets high expectations for integrity, program compliance, and prudent use of taxpayers' dollars is absolutely critical to the success of the program. The Navy's high standards have been clearly communicated to the Department's command leadership.

The Department of the Navy has established and proactively enforces control for the oversight and management of the program, from the major command level to the local activity cardholder. We have set the span of control to be no more than seven cardholders per one approving official. All Department of the Navy approving officials are now compliant with this control. Credit limits have been reduced to be more in line with historic spending patterns, thus minimizing the potential for fraud and misuse.

Finally, the Department of the Navy has implemented an internal data mining capability using commercial off-the-shelf software. This software emulates the methodology and criteria employed by the General Accounting Office to uncover questionable trans-

actions. I am confident the program management policies, procedures, and controls that are now in place are addressing the program weaknesses highlighted by the General Accounting Office, and are comparable to the best practices of the private industry.

In conclusion, the purchase card is a vital acquisition tool for our service members and civilian employees. I commend the General Accounting Office for identifying opportunities for the Department of the Navy to improve our program and I am committed to the continuous improvement of the program.

Mr. Chairman, that concludes my statement and I will be pleased to answer your questions, sir.

Mr. HORN. I am going to start with you, Admiral, in terms of some questions. Admiral, how extensive is the fraud and abuse in the Navy's purchase card program? Do we know?

Admiral COWLEY. Sir, we have implemented a data mining capability, as I just indicated. And in addition, we also are pursuing another recommendation from the General Accounting Office to engage the Naval Audit Service in a periodic forensic audit program that will allow us to assess the effectiveness of our management controls and to allow us to build a program baseline against which we can identify trends in our performance and begin to get our arms around the actual extent of the conduct.

Mr. HORN. Well, you don't sound like you've got a lot of sanctions here. What sort of sanctions have you imposed on people in your command?

Admiral COWLEY. Individual commanders, commanding officers, and supervisors are empowered to administer the disciplinary process on a case-by-case basis. Disciplinary and other actions in response to purchase card misconduct is a matter of command and supervisory discretion. And what the Navy is doing in this area, specifically the Office of the Judge Advocate General and the Office of the Assistant Secretary of the Navy for Manpower and Reserve Affairs, is developing a set of guidelines to be used by commanders, commanding officers and supervisors. Without dictating which action must be taken, it will provide them with guidelines in dealing with purchase card misconduct in the future.

Mr. HORN. Admiral, how many captains are below you in the Research Development and Acquisition group?

Admiral COWLEY. How many captains are below me?

Mr. HORN. Yes.

Admiral COWLEY. There are three.

Mr. HORN. What has happened to them now and what kind of supervisory network do they have for their command?

Admiral COWLEY. None of them are in a command position, sir. They are in staff positions.

Mr. HORN. So they're staff. So where's the first line under you?

Admiral COWLEY. The first line under us is the eschelon 2 command, sir.

Mr. HORN. I couldn't hear you. What?

Admiral COWLEY. The eschelon 2 command.

Mr. HORN. How many in that command?

Admiral COWLEY. We have Naval Sea Systems Command, the Naval Air Systems Command, Space and Naval War Systems Com-

mand, the Naval Supplies Systems Command, and the Naval Facilities Command.

Mr. HORN. In your capacity, and you are testifying, what kind of supervisory actions have they taken in their particular command?

Admiral COWLEY. Beginning over a year ago, there have been a series of communications to the commanders requiring that they certify the internal controls in place at their commands, and, in addition, require that they certify the training of the individual participants in each of the watch stations in the purchase card program. They have in fact come in with those certifications.

Mr. HORN. Does anybody check—at what level does somebody check to see that this isn't frivolous, and all the rest of the things we have seen in this organization. What has been told? So what do you see there?

Admiral COWLEY. The management controls are within the discretion of the commanders. However, as indicated earlier, in line with assessing the proper management, we are beginning a program of—with the Naval Audit Service for periodic surprise forensic audit to ensure that indeed, these controls are in fact implemented and are in fact operative on an ongoing basis.

Mr. HORN. What enlisted type or officer type do your supervisors look at, the people in that command? I mean, we have to get down to the nitty-gritty. Nothing's going to happen—it isn't the way I see it—with the Navy unless they get with it. There are millions of dollars down the drain, and everybody's coming up here all the time with the authorizing and the appropriating committee, saying we need all this money for getting all this research and development and acquisition. That's your bailiwick over there. And the question is, where do you get a little money which you could use and put it to the research development? So what is the best way to get at this? You've got two captains that are staff. So how many people report to them?

Admiral COWLEY. It's a very small number on our staff.

Mr. HORN. Well, I'm sure it might be, but even on that, who signs off on that—you, the captains, is there somebody else involved?

Admiral COWLEY. We have an APC, an Activity Program Coordinator, who reviews the purchase card program within the Office of the Assistant Secretary of the Navy for Research Development and Acquisition.

Mr. HORN. So the Assistant Secretary, then, has the way of looking at the paper and seeing if it's not very quick? And is that the way it works with the Assistant Secretary?

Admiral COWLEY. The purchase card programs are set up within each command activity and are monitored on the basis of each command activity. I know I can address the programs on a number of the ships. In fact, they are set up—the supply officer, who is usually an O4 or O5 oversees the purchase card program. Each activity has, depending upon the person populating the command activity, established programs with what stations.

Mr. HORN. Representative Terry has asked us to ask this question of Navy witnesses, and here it is: Is the Navy aware that it could use outside companies with expertise in the credit card business to assist it in gaining better control of the credit card pro-

grams? Has the Navy ever used such type of organization? Do you think it's worthwhile to explore and get something done?

Admiral COWLEY. Yes, sir, we do believe that. In fact we have two prototypes currently ongoing where we have procured data mining software, the same software used by the General Accounting Office, to allow us to review suspect purchases. So we are pursuing technology solutions to better enable us to manage the program; yes, sir.

Mr. HORN. Admiral, we continue to hear reports from the General Accounting Office that the Navy loses computers. They aren't alone in the executive branch. I think we had 1,000 disappear in IRS. And that's the tax collector. And flat panel monitors, digital cameras, video equipment, the list goes on and on. Why doesn't the Navy believe in accounting for expensive items such as these that can be easily stolen?

Admiral COWLEY. We do believe in accounting for expensive items that are pilferable or easily convertible to personal use. We believe records should be kept. In the past our instruction has not been in alignment with the financial management regulation or with the DOD regulation. We are bringing our instruction in alignment with those regulations which will require for accounting of those pilferable items.

Mr. HORN. What is your highest figure that you consider an expensive one and one that ought to be looked at?

Admiral COWLEY. The capital threshold is $5,000. However, my concern with picking a particular dollar threshold would be the level at which people would then account for the material. Rather, we would rather have the individual commanding officers look at material, regardless of dollar value, that would fall into that pilferable material category; material which is critical to their mission accomplishment or is otherwise hard for them to repair and replace.

Mr. HORN. I take it these are computers that are lap computers.

Admiral COWLEY. They may be, sir.

Mr. HORN. Where people can carry it and off it goes?

Admiral COWLEY. That would be included.

Mr. HORN. And the digital cameras and the flat panel monitors and the videotaping, some people have a great basement where they must have had all this equipment in there. It's the taxpayers'. And the taxpayers say, gee, I would love a little bit like that, but you can't.

Mr. KUTZ. Mr. Chairman, if I could add, one of the things that gets at your previous point is the fact that the management of this program is very decentralized. What happens with this program happens far, far outside the Beltway. This is not an inside-the-Beltway program. The spending is going on and the control of property is far outside. It is at the bases and the commands across the country.

And I believe that the admiral's position that the Navy believes this should be accounted for may be true as an organization, but if you actually go out there to the locations in the field, that view isn't necessarily shared across the Navy. And that becomes one of the challenges the admiral faces in instituting change here, is that the culture right now is that this is not important and this is not

something people are evaluated on. This is not something the NAvy has ever done before.

So that is going to be a challenge for them to actually get accountability for this property, because for years people have not been doing it.

Mr. HORN. And it's very tough to break into the culture.

Mr. KUTZ. And it is very difficult with the purchase card, when you are buying in some cases one or two items versus having it received at a central warehouse, to establish that accountability. What it requires is the purchaser to make a phone call or call the property book people and make sure that the property is actually entered into the property records and bar-coded. So it takes an extra step you wouldn't necessarily have when you have centralized receiving of property.

Mr. HORN. Admiral, how do you plan to ensure that the changes you're making will result in a long-term improvement of the purchase card program?

Admiral COWLEY. Well, we have included in our enhanced training, in our improved training requirement for accounting pilferable material, and we intend to use our forensic audit program to ensure compliance with the management controls that are in place.

Mr. HORN. Is anybody trying to get in the Naval Academy at Annapolis? Is there an ethics question? Is there a fraud bit? It seems to me if you're going to have very fine—and you do have very fine people there, but they need to know that if you're going to be a naval officer, you've got to be aware of your responsibilities, and what sanctions, and how you would deal with it. That's reality.

Now, does anybody know whether Annapolis has any of this, before these young people get out in the Pentagon or the base or whatever it is? That's where it starts.

Admiral COWLEY. Yes, sir.

Mr. HORN. And if you miss it, they'll say, hey, we do this all the time and that's baloney. You've got to cut through it and you've got to make sure that the money put to it by the taxpayers will still be around until somebody's walking off with it. So that's our worry.

I went to many a hearing like this with Admiral Rickover and my counterpart, Mr. Chet Hollifield, and he turned Annapolis—the Navy Academy at Annapolis—around, and so did Admiral Rickover, and they made a major contact in the feeling there.

And so I just would suggest that you might in what—you're talking with the Secretary of the Navy, he's a first-rate person, and he might want to take a look at this and say what kind of ethics, what kind of this and that ought to be at least one credit in the Annapolis. Same with West Point. And that would help. Then people would know, gee, there is something out there besides just leaping up ladders.

So, Mr. Ryan, you've been a very able person, checking all of these things. You investigated a company that the Navy paid in advance for goods and services that were never provided. I believe the company is Digital Wizards in San Diego. Isn't that fraud? Shouldn't we be investigating all the Digital Wizard's business transactions with the Federal Government?

Mr. RYAN. Mr. Chairman, based on previous testimony we had given, the full committee asked us to look into Digital Wizard. The

committee sent a letter to Digital Wizard, asking for their work papers that directly related to the transactions submitted for those $2,500 transactions. At the time there were 75 transactions that we needed to look at. We sent agents to San Diego. We looked at the paperwork as associated to those transactions. And it was troubling to us because we truly believed, based on the paperwork that we saw, that the government was paying and not receiving what they should have been getting. Several transactions that were $2,500, there was no work papers to support that anything was done. Other transactions for $2,500 had support papers for, as Mr. Kutz said $75; some for $600; some for a $1,000. So based on that, Agent Hill and the SPAWAR's people started to look at those 75 transactions. We truly believe, just based on that 75, that the government was overcharged $34,000.

We also uncovered during the course of the investigation——

Ms. SCHAKOWSKY. Mr. Chairman, if you will yield, is this for product or for services?

Mr. RYAN. Services. Also during the course of the investigation, we looked at—we found an additional 120 transactions that we felt needed to be investigated. We passed those on to SPAWAR. After consultation with the staffs, we contacted DCAA.

Mr. HORN. DCAA is the Defense Contract Agency.

Mr. RYAN. We contacted them. We're discussing Digital Wizard with them with their field people in California. They have other contracts in excess of $10 million with SPAWAR. We believe that DCAA should look into all the transactions associated with Digital Wizard.

Mr. HORN. Mr. Kutz, anything you want to add on this?

Mr. KUTZ. In addition to the vendor possibly taking advantage—and again it's potential fraud, I don't know if we can conclude it's fraud at this point, a vendor possibly taking advantage of the situation—the Navy is at fault for not looking to see that they ever received the goods and services. For each one of these transactions in violation of the Navy's own policy, they were paid in advance; in other words, they ran them against the credit card before the services were provided, and then nobody ever checked to see whether $2,500 was ever provided in services.

So the Navy is also at fault here, in addition to potentially a vendor being responsible for this whole situation.

Mr. HORN. Mr. Kutz, through your work on this issue, do you think that the Navy really knows the extent of fraud, waste and abuse in its purchase card program?

Mr. KUTZ. As the admiral said, with respect to the fraud that's out there that they're aware of, that there are investigations that are outstanding or cases that have been closed, they don't know what they know. In other words, they don't know what cases are out there. And he's talking about trying to put together some sort of a data base that can accumulate that information for purposes of learning and understanding what kinds of fraud have been perpetrated over time.

They also don't know what they don't know. And that is the more troubling part here with the kind of control environment that you have over the purchase card program, is that the amount of unknown fraud that the preventive and detective controls are not

catching could be significant, could be much more than what they actually know. So at the end of the day, they don't know in total, but the more troubling part is they need to do a better job of knowing what they know, which are the cases outstanding. And I believe that they agree with us. We have made a recommendation to them on that, and I am hopeful they will implement that recommendation.

Mr. HORN. You found that the Navy has taken appropriate disciplinary action against the cardholders, but who else in the misuse of their purchase cards? And did it slop over into other services or——

Mr. KUTZ. With respect to discipline on the purchase card program, our report says we found no evidence of disciplinary action against anyone that had improper or abusive charges. We did find evidence when there was fraud, they did take actions. There were investigations and prosecutions and people have gone to jail. But for the improper or abusive charges, there has been no evidence of disciplinary action. I believe in one case, a cardholder had their card taken away.

So I would say based on our work, there has not been disciplinary action, and certainly that is something we have recommended that they take a strong look at. Try to get some guidelines out there for some suggested possible disciplinary action for different kinds of offenses that the commands can use so we can see some sort of consistency of application of discipline.

But again, you have an environment right now where people out there know they can get away with it and nothing has happened to date. I would say for the improper charges—we talked about the Lego toy robots, the clothes, food, etc., I am not aware of—except for one case of the leather flight jacket—any money being repaid to the Federal Government.

Mr. HORN. Do you believe the Defense Department's management of its cellular telephones is an area in which there may be extensive waste and abuse?

Mr. KUTZ. Yes, that is something we have seen across the services. In my opening statement, I mentioned the case where they had turned the cell phone in 13 months earlier but were still paying the monthly cell phone charge. We have also seen lots of abuse of the cell phones where people are improperly using them for personal calls, business.

We saw for SPAWAR—Mr. Ryan and I both looked at—that they handed out 60 or 70 cell phones to contractors who then were using them uncontrolled. And again, given that the contractors weren't given any instructions as to how to use the cell phones, they were using them for friends and family.

The control problems are out there. There are some units that have done a better job of controlling this. But Mr. Chairman, the issue is nobody is looking at the monthly bill to make sure that the charges on there are for official government telephone calls. We have hundreds of dollars of cell phone calls coming in on individual monthly statements that are very questionable.

Mr. HORN. Mr. Kutz, we have seen delinquency rates ranging from 10 percent to 18 percent in the Navy and Army travel card programs. Delinquency at civilian agencies appear to average from

4 to 8 percent. How do these rates compare to corporate travel programs?

Mr. KUTZ. You are speaking of the travel program?

Mr. HORN. Yes.

Mr. KUTZ. With respect to the travel program, the Navy's and the government rates, as far as we can see—and the government rates are significantly higher than private-sector corporate travel programs. The banks were unwilling or unable to give us the information on what their actual delinquency rates were, and I guess that is proprietary information. But based on discussions with one company who does not want to be disclosed, their delinquency rate was less than 1 percent.

At the General Accounting Office, our rates fluctuate between zero and 1 percent. But to be fair to the services, I don't think that would be a proper comparison. We have a much different demographic makeup of our people that hold credit cards, as do corporations. And so I believe that the rate that the services have tried to shoot for is 4 percent, which we have no evidence of whether that is good or bad, but given what we have at this point, that may be a reasonable delinquency rate for them.

Mr. HORN. Mr. Ryan, in one of the cases you investigated, fraud was committed on a government travel account held by a cardholder who had died in 1999. Can you explain how these charges were made and why the account was not shut down?

Mr. RYAN. Yes. That was a travel card account. What had happened was the cardholder was killed. At the same time of his death, there was the reissuing of his travel card. What had happened was the travel card went to his address that he had at the time he had died. However, his family had moved.

It was forwarded back to the bank with a forwarding address, at which time the bank immediately sent the card to the forwarding address. Family members got ahold of the card, activated it through an automated system, and proceeded to use the card. It was due to the attention of the APC at the time who noticed that the card was being used in the vicinity of where the cardholder lived, contacted the commander, the commander advised the APC that the gentleman had died. But in the meantime the card was used extensively for fraud.

We investigated it and were able to take pictures from the ATM machine, provide those pictures and the other evidence to the Secret Service in the region where the fraud took place, and it is my understanding they are investigating it.

Mr. HORN. Now I yield to the gentlewoman from Illinois and the ranking member, Ms. Schakowsky.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman.

I heard you say, Admiral Cowley, that you do believe that cameras and Palm Pilots, etc., should be inventoried and tracked, etc. But it was my understanding, Mr. Kutz, that last week when staff met, that was one of the GAO recommendations, but I thought that the Navy was in disagreement. Am I misunderstanding that? In disagreement with that recommendation? I'm just confused about where we really stand on that.

Mr. KUTZ. I believe initially they were in disagreement with that, but I believe now they would concur, and they are going to adopt the DOD-wide policy.

Ms. SCHAKOWSKY. So beginning now, going forward? Or has that been—because that has not been my understanding, that you are going to look at those transactions.

Admiral COWLEY. Ma'am, my staff has looked at a draft of the instruction that would bring us in line with the DOD regulation and the financial management regulation, and I expect that will be issued within the near term. So we will be in compliance.

Ms. SCHAKOWSKY. How soon is near term, because we keep having these hearings, and we keep hearing the same thing over and over again?

Admiral COWLEY. Ninety days, ma'am.

Ms. SCHAKOWSKY. Within 90 days that will be the policy, and then you will begin to track those?

Admiral COWLEY. No, ma'am. We expect to aggressively pursue this and begin to track it as the training and information is put out to our individual cardholders.

Ms. SCHAKOWSKY. So what is the 90 days?

Admiral COWLEY. It's for the instruction to be signed.

Ms. SCHAKOWSKY. But you will begin implementing this plan immediately?

Admiral COWLEY. Yes, ma'am, through our Department of the Navy Business Office, which is the program manager for the purchase card.

Ms. SCHAKOWSKY. Some of my colleagues have suggested that on these kinds of purchases, like the Bose clock radios, the designer leather goods, the $2,200 flat-panel monitors, etc., that officers like yourself should be held financially responsible for these abuses, or that we should hold the approving officer financially responsible for improper purchases. What do you think of those kind of proposals that somebody is going to pay?

Admiral COWLEY. I believe that is within the discretion of the individual commanders, commanding officers and the supervisors over those officers.

Ms. SCHAKOWSKY. Has that ever happened?

Admiral COWLEY. I have no knowledge of that, ma'am.

Mr. KUTZ. Representative Schakowsky, there is one case where there was a leather flight jacket purchased that, after we discussed it with the individual involved, they repaid it, but as part of our work, we have only seen it once.

Ms. SCHAKOWSKY. That is the individual cardholder who paid it back? Is that what you are saying?

Mr. KUTZ. I believe it was the person who authorized the cardholder to do it in that case.

Ms. SCHAKOWSKY. Let me ask you then about disciplinary action of any sort on the others who have been guilty not so much of fraud, but these kinds of abusive purchases. How can the Navy come before us in the face of only one example of an individual being in any way held accountable? What kind of a message does that send about how we manage our affairs and spend taxpayer dollars?

Admiral COWLEY. Well, ma'am, I can address several cases of fraud where individuals were in-fact court-martialed.

Ms. SCHAKOWSKY. Not fraud. I am talking about these kinds of clearly abusive purchases, not fraud. Are we going to just look the other way and say that is OK?

Admiral COWLEY. No, ma'am. We are not. As Mr. Kutz has indicated, this is a decentralized process, and as I indicated earlier, the Judge Advocate General and the Office of the Assistant Secretary of Navy for Manpower Reserve Affairs are, in fact, developing a schedule, a guideline for people to use in reviewing these cases, and without dictating actual action, they will provide commanders with a baseline from which to execute their disciplinary responsibilities.

Ms. SCHAKOWSKY. I don't know, with all due respect, you know, I have not been here a long time, but thanks to the chairman, even in the short period that I have been on this committee, we have had hearing after hearing, and we hear those kinds of word. Oh, we're going to begin to establish procedures that will then result in blah, blah, blah. And yet no one to date through the whole period—except for one person—of these hearings has ever been held accountable. And we are in a period of time—I don't mean to vent totally on you, Admiral, but here you are. But we have, you know, $300 billion a year in the Department of Defense, and we are about to likely add another $50 billion to that. And as the Senator from my State used to say, $34,000—this is not exact words—here and there, pretty soon $24,000 here, $24,000 there, you start to get real money. And it seems that everywhere you look there is $10,000, $100,000, $1 million. And pretty soon it adds up to real money.

And I am ready for someone to come back and not talk about process by saying, we have punished this many cases, and we have seen a reduction in this many cases of abuse, rather than constantly talking about what is going to be done.

When do you think you will be able to come back to us and say, we have disciplined so many people, and this is how much money we think we have saved the government as a result?

Admiral COWLEY. Ma'am, I'd like to be able to tell you that now. I believe the guidelines will be out in the December timeframe.

Ms. SCHAKOWSKY. And so then how soon will we be able to see results? If we held a hearing, unfortunately not with this chairman because of his retirement, but another hearing, when do you think that we will see some real results?

Admiral COWLEY. I think with the enhanced training that we have out there, I think in the near term. I'm not able to give an exact date, ma'am.

Ms. SCHAKOWSKY. Well, we will be back. Some of us will be back.

Mr. HORN. What is a near term and a long term in dealing with Congress? I mean, the reason they sent you here is they are going to give you another star if you can get through it all. Well, what are we talking about, 2 months, 3 months?

Admiral COWLEY. Six months, sir.

Mr. HORN. Six months?

Admiral COWLEY. Yes, sir.

Ms. SCHAKOWSKY. I see that there has been a reduction in the number of people that have credit cards. What has been the cri-

teria in reducing the numbers, and are any kind of credit checks involved in that? Are these more categorical rather than individual?

Admiral COWLEY. The needs of the commander are what informs the number of purchase cards out there. We have, in fact, as Mr. Kutz indicated, significantly reduced the number of cards, about 32 percent by my look, coming down from 29,000 to 22,000 cardholders, and that is based on the command's needs.

Ms. SCHAKOWSKY. Mr. Kutz, is this at all based on increased management controls, or is this categorical?

Mr. KUTZ. I would say it is a positive step. I believe that they went back and scrubbed who actually needed to have a card, and so they have done it based on an instructed, disciplined look, and it is a very positive step, and it provides them the ability to better control this program.

Ms. SCHAKOWSKY. But, again, would individuals be disqualified because of past behavior, or is it more this category of employee no longer needs a card?

Mr. KUTZ. It is not necessarily category. I think it is more that you don't need three people in a unit with a card, or you don't need people in a certain group, or you only need 1 card for every 40 people in a group or something; whereas I don't know anything with respect to how they have cut cards. We haven't seen evidence of cutting cards for the discipline or people misusing.

Ms. SCHAKOWSKY. Or prescreening?

Mr. KUTZ. No, they are not prescreening for that. No.

Ms. SCHAKOWSKY. Let me see if there were other questions that I have here.

Well, let me ask you Mr. Kutz, when we talk about the disciplinary action, how do you envision that DOD would appropriately deal with the discipline of abuse? Not fraud, I'm talking about abuse of the purchase card.

Mr. KUTZ. Well, what we've recommended is the guidelines that the admiral mentioned where they would develop some guidelines that commands could use to apply to various situations. The issue is going to be getting the commands to apply those guidelines in the real world when someone actually does an abuse and actually identify the abuse in the first place.

One thing that is interesting about the improper and abusive charges that you mentioned, that for the most part they were authorized. That's why they're not fraud, generally. So you have the cultural issue, too, about what should we and shouldn't we buy with taxpayer funds. We shouldn't necessarily be buying food, clothing, luggage, Lego toy robots, etc., with taxpayer funds.

Ms. SCHAKOWSKY. I have a letter that I am going to give to you, and after this I will ask the chairman if he wants to cosign, to begin an investigation on the issue of vendor fraud in the purchase card program, because it is clear from the little bit of look that you have given, that some vendors are submitting charges against purchase card accounts where no goods or services were delivered. And I think it is really important that we take a look at that to determine the extent of the problem and report back to us. But it sounds like you have begun to do a little bit of that look. I wonder if you wanted to comment on what you think we might find.

Mr. RYAN. I think in the situation we are dealing with purchase cards, I hear a lot of we're going to buy this program and we are going to do this and we're going to do that. I think that when you get down to it, where the rubber meets the road, it falls upon the employee to bring a new employee in who is trusted, can make good decisions, and is accountable for the actions that they get involved in. We see, a lot of the investigations that we looked at, that the approving official, the cardholder, they have questionable backgrounds. They have financial problems, bankruptcies, failure to pay their bills or not making good decisions. These are the agents of the government. These are the people that we're giving the card to to use to make the right decisions.

I think from the conversations I have had with the admiral, I think some of the ideas are wonderful about bringing in naval audit. I think it is great to have naval criminal investigators come in and join in a partnership to help the Navy identify the potential vendor fraud cases and the contractual fraud cases.

But I also think that it's important that establishing a good basis, a good foundation, the foundation starts with the people who are using the cards and approving these transactions. If we can start there and make improvements, I think the admiral is headed in the right direction by bringing naval audit in to do surprise audits on certain units, having the criminal investigators investigate potential fraud cases, see if there is intent. And I think it will lead to exactly the vendor fraud situation that you are asking us to look at, because we're going to have vendors that are billing two and three times, four times. You have vendors that are using the credit card to steal the government's money, because if the cardholder is not paying any attention, they are going to pay the bill. We're getting bills for services, and we're not going out and checking it.

So I think that what you are asking is what we have started to do. We have started to see. We have been able to work and do a lot of data mining and use that information to start to develop where we need to go.

Ms. SCHAKOWSKY. But one thing about what you just said gets back a little bit to the question I was asking earlier. Do any of these protocols, these new procedures that we're establishing, deal with checking out the individuals as opposed to saying within a unit only so many people get a credit card? Are we going to have a screening process for individuals so that we can prevent the fraud in the first place or the abuse in the first place?

Admiral COWLEY. Well, ma'am, we don't have a credentialing process to speak of. However, in the training material that we have recently distributed, there is a process whereby there is—the accepting official would nominate cardholders, nominates personnel to become cardholders. So indeed there is a process. The individual who best knows that employee or the individual nominated to become a cardholder would have some knowledge of them from their working with them daily.

Ms. SCHAKOWSKY. What do we know about the nominator, someone who makes the determination on who gets the cards? Look, I'm not interested in establishing some sort of a "Big Brother" routine here, but if we're putting in the hands of individuals the opportunity to use taxpayer dollars to a large extent, I want to know

that we have checked these people at some level and that there is some process at least that we look into their ability to exercise that authority correctly. It doesn't sound like anything in the new procedures you are setting up go to the individual level. I just want to suggest, based on what I'm hearing, that's a really important thing to do.

I have one more question. Mr. Kutz, you said something, and I did not quite get it; 58 to 90 percent of the time in something you checked. What was that?

Mr. KUTZ. That was our statistical samples over the basic controls we tested for screening for vendors, independent receipt and acceptance, proper approval of the credit card bill by the approving official. And that is where we found the failure rates of 58 to 98 percent. And that is where the documented evidence was not there to show that it was done for that percentage of the statistically selected transactions that we looked at. And again, there may be instances where the documentation—the person did it, but did not document it. But in many cases it was clear, based on discussions, span of control or whatever, that the people had not done their job with respect to the purchase card.

So that's a very high failure rate though, but consistent with what we reported on the Army 2 months ago.

Ms. SCHAKOWSKY. Right. But this is for services, whether or not services were rendered for the money that was spent?

Mr. KUTZ. That would be one—yes, because when you are doing the independent receipt and acceptance or the review of the monthly credit card bill, you would be making sure that goods and service were provided. So, yes. That would be an example and the fraud case that we talked about earlier would be an example of where those controls broke down.

Ms. SCHAKOWSKY. Admiral, when we're looking at 58 to 98 percent, that is a huge challenge in front of you. What is an acceptable number do you think? We're talking about 4 percent, but——

Mr. KUTZ. That was on delinquencies.

Ms. SCHAKOWSKY. On delinquencies. What is an acceptable rate? Obviously anything lower than that will show progress. Where are you aiming to get to?

Admiral COWLEY. I don't believe any number is an acceptable rate there, ma'am. I think we should continue to try to improve the process by identifying those vulnerabilities in the process——

Ms. SCHAKOWSKY. In some cases——

Admiral COWLEY [continuing]. And mediate them.

Ms. SCHAKOWSKY. In some cases almost 100 percent bad.

Admiral COWLEY. Yes, ma'am.

Ms. SCHAKOWSKY. We have a lot of work to do. Thank you.

Mr. HORN. The honorable Dionel Aviles, Assistant Secretary of the Navy, Financial Management and Comptroller, if you could come in and join the club. We will keep the three witnesses and add the Assistant Secretary.

The Assistant Secretary was nominated by President George Bush, June 12, 2001. He has had a rich career here in the executive branch. He served in the National Security Division of the Office of Management and Budget, and he has been a budget examiner for Navy procurement for their search and development pro-

grams, and he probably met the admiral somewhere in that. He was a program engineer in the private sector as well as the public sector.

So since you're the one that really knows financial management, and comptroller is a key position, if you could give us some thoughts on that and what you're doing in the Navy to either solve this thing of purchase cards and travel card and give us your thinking.

The Assistant Secretary and then——

STATEMENT OF DIONEL AVILES, ASSISTANT SECRETARY OF THE NAVY, FINANCIAL MANAGEMENT AND COMPTROLLER

Mr. AVILES. Thank you, Mr. Chairman.

Mr. HORN. Do you have to leave?

Mr. AVILES. Happy to defer to my fellow witnesses from GAO.

Mr. Chairman, thank you for the opportunity to discuss the Department of Navy Government Travel Charge Card Program and our recent efforts made to improve its performance.

I am Dionel Aviles, the Assistant Secretary of the Navy for Financial Management and Comptroller, and in this capacity I am responsible for the Department of Navy policies associated with the Government Travel Charge Card Program.

As you will likely hear from the GAO witnesses, there have been several instances of delinquency and misuse in the Navy's travel card program. I share your concerns about these problems and thank you for focusing attention to this most serious issue.

I would like to tell you about some of the corrective actions that we're taking to improve the program. As was discussed at a previous hearing, we use two types of travel accounts—centrally and individually billed—in our travel card programs. Since the individually billed accounts, those held by our sailors, marines and civilians, are the ones that involve the incidents of delinquency and misuse that we will hear about, I will confine my remarks to those accounts.

Individually billed accounts are issued by the bank in the name of the individual who is solely responsible for the timely payment of all charges made on the account with their personal funds. Cardholders sign an agreement that makes them personally responsible for payment in full of the amount indicated on the monthly statement. The overwhelming majority of our cardholders adhere to this agreement by using the travel card properly and paying the amount they owe promptly.

Regrettably a small percentage of our cardholders do not follow the rules or in some cases, due to circumstances they may not be able to control, are unable to pay their balances in a timely fashion. To address the problem, we are taking aggressive action to reduce incidents of misuse and delinquencies.

Examples of these efforts include, No. 1, strengthen controls. Last April we established a new delinquency goal for all commands of not more than 4 percent of the total dollars outstanding on our total of accounts being more than 60 days past the billing date. Commands failing to meet this goal are required to implement additional remedial actions that include deactivation of card accounts until just prior to an individual's travel, conducting spot checks for

inappropriate card use, and increasing spot checks if a pattern of possible misuse arises.

Earlier this year I sent out over 7,000 letters to each cardholder who was 60 days or more delinquent past the billing date, urging them to pay their bill, alerting them to the consequences of continued delinquency, and providing a point of contact in my office for questions.

Three, command attention. I have met with the senior leadership—this is at the two- and three-star admiral level—of all the major commands failing to meet the delinquency goal discussed above, requiring them to provide specific actions that they are taking to improve performance. These regular performance reviews will continue for commands that fail to meet the delinquency goal.

No. 4, deactivation upon transfer. I have directed that all commands include travel card managers in their personnel checkout procedures to ensure accounts do not remain active when cardholders depart an organization. This change should discourage the use of the card during permanent change of station moves, which normally take a longer period of time to reimburse than the temporary duty travel for which the card was intended.

Five, misclassification of merchants. I have asked that the DOD travel card program manager review and change potential erroneous merchant codes. You will hear from the GAO witnesses of cases where merchants with improperly classified codes are making it difficult for travel card managers to spot incidents of misuse.

No. 6, debit card option. We are working with the Department of Treasury to prepare a prefunded or debit travel card pilot program to determine if it may be a viable alternative to the current charge card program for at least some of our members. Last March the Under Secretary of Defense Comptroller established a charge card task force to evaluate the Department's purchase and travel card programs. The task force's preliminary recommendations for the travel card were released in June, and we are working to implement those recommendations. For example, we have begun a pilot program to identify potential misuse by monitoring unusual activity. Accounts identified for potential misuse are immediately deactivated until travel card managers or the cardholders are contacted to confirm the transactions.

To further automate this process, we have procured the same software used by the GAO to conduct their data mining efforts. We are canceling accounts with no activity for the proceeding 12 months. This effort has resulted in the cancelation of over 80,000 card accounts. These are in addition to over 40,000 accounts closed by previous Navy reviews.

Last May we held a training conference for more than 350 east coast travel managers, and we have scheduled another one for November for west coast managers, and I have over 300 attendees signed up. We are also developing tailored computer-based training for all cardholders, travel card managers, commanding officers, and supervisors.

Additionally, the task force recommended the use of the split disbursement method of payment. This is where a portion of the travel entitlement goes directly to the bank on behalf of the cardholder. The Navy strongly supports and encourages the use of split dis-

bursement and believes this can go a long way toward resolving delinquency issues.

Some of the problems experienced with the Government Travel Charge Card Program can be traced to its implementation. At its inception, many of the people in the Navy and the Marine Corps thought that every sailor, marine and civilian in the Department were required to have and use the travel card. Many commanders thought that we had contracted with the bank to manage this program, and their personal attention was not required. Many cardholders did not understand their ultimate obligation to pay their charge card bill and the restrictions placed on the use of the card. The confluence of these misperceptions helped to get us where we are today.

In closing, only the persistent and pervasive involvement of the Department of the Navy's senior leadership and commanders will improve this program. I can't promise you that the changes that we have made to date will be enough to correct all of the problems that you will hear about today. Indeed with this type of card, we will always have some level of delinquency and misuse. However, I do believe that we're changing perceptions about this program and beginning to fix some of its problems, and I promise you that I will not relent in focusing my personal attention on this problem.

Thank you, Mr. Chairman. This concludes my remarks, and I stand ready to answer any questions that you may have.

[The prepared statement of Mr. Aviles follows:]

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HOUSE GOVERNMENT
REFORM COMMITTEE

STATEMENT OF

THE HONORABLE DIONEL AVILES

ASSISTANT SECRETARY OF THE NAVY,

FINANCIAL MANAGEMENT AND COMPTROLLER

BEFORE THE

HOUSE GOVERNMENT REFORM COMMITTEE

GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND

INTERGOVERNMENTAL RELATIONS SUBCOMMITTEE

ON

NAVY TRAVEL CARD PROGRAM

OCTOBER 8, 2002

NOT FOR PUBLICATION
UNTIL RELEASED BY THE
HOUSE GOVERNMENT
REFORM COMMITTEE

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to discuss the Department of the Navy Government Travel Charge Card Program and recent changes made to improve performance. I am Dionel Aviles, Assistant Secretary of the Navy, Financial Management and Comptroller. In this capacity I am responsible for establishment of Department of the Navy policies and oversight for the Government Travel Charge Card Program.

The travel card program was intended to provide greater convenience and flexibility to the traveler and reduce the government's administrative costs. To the extent that much of the Navy and Marine Corps administrative infrastructure that supported travel has been reallocated to the operational forces, the government's costs have been reduced. However, it may also be true that a significant portion of the administrative activity required to manage the program may have also migrated to the operational forces.

The current travel card program consists of both centrally and individually billed accounts and the Department of the Navy uses both types of accounts in its charge card program. Centrally billed accounts are used to purchase commercial transportation or for the travel expenses of a unit and payments on these accounts are made directly by the government to the bank. The Department of the Navy's centrally billed accounts are well within the delinquency metric established by the Department of Defense, therefore, I will confine my remarks to the individually billed accounts.

Individually billed accounts are issued by the card contractor in the name of an individual, who is solely responsible for timely payment of charges made on the account. Individual

cardholders sign an agreement with the card contractor prior to issuance of a card agreeing to terms and conditions for its use. This agreement, as well as Department of Defense regulation, makes each cardholder personally responsible for payment, in full, of the amount indicated by a date specified on the monthly statement — usually one month after the close of the billing cycle. Most Department of the Navy cardholders adhere to this agreement by using the travel card properly and paying the amount they owe promptly. Regrettably, a small percentage (less than 3%) of all Department of the Navy cardholders do not follow the rules, or in some cases, due to circumstances they may not be able to control, are unable to pay their balances in a timely fashion. These cardholders are responsible for 9 percent of Navy card balances and 12 percent of Marine Corps card balances being delinquent. To address this problem, the Department of the Navy has taken aggressive action to reduce the incidents of misuse and delinquency in the travel card program. Some examples of these efforts include:

Strengthened Controls: In April of this year, I established a delinquency goal for all Department of the Navy commands of no more than 4.0 percent of the total dollars outstanding being more than 60 days past the billing date. Commands exceeding this metric are required to implement additional remedial actions that include deactivating travel card accounts until 10 days prior to an individual's travel; conducting spot checks for inappropriate card use; and increasing spot checks if a pattern that might indicate misuse is discovered.

Notification: Earlier this year, I sent letters to each Navy and Marine Corps cardholder who was 60 or more days past the billing date urging that they take action to resolve their

outstanding balance and alerting them to the consequences of continued delinquency. A total of 7,277 letters were sent and included a point of contact in my office to discuss any issues or concerns they might have with their travel card accounts.

Command Attention: I hold personal meetings with the senior leadership of the major commands failing to meet the Department of the Navy delinquency metric to discuss the actions they are taking to improve performance. These meetings will continue on a quarterly basis for all commands that exceed the delinquency metric and have proved to be a useful exchange of ideas on improving performance.

Deactivation Upon Transfer: I have directed that all Department of the Navy commands include travel card managers, or agency program coordinators (APCs), in their personnel check in/check out procedures to ensure cards do not remain active when individuals depart an organization. This change is intended to discourage use of the card during permanent change of station moves that may take a longer period of time to receive reimbursement than temporary duty travel. Because of recent reports of cards on deactivated accounts being used while members are in the process of changing duty stations, we are currently evaluating the situation to determine whether we could further prevent delinquency by closing, vice deactivating, them during periods of transit between duty stations. Upon check-in at the new command, the APC would request that the Bank of America reopen the account.

Blocking Inappropriate Use: I requested the Department of Defense Travel Card Program Manager obtain information from the card contractor as to how transactions are being

processed on travel cards with merchants that have been blocked for use within the Department of Defense travel card program. The merchant category code numbering scheme and the blocking of certain merchant codes was intended to be a risk mitigation tool available to the Department to prevent misuse of the card. However, reported cases of transactions processed against blocked merchant codes imply that this system may need more attention.

Misclassification of Merchants: I also requested that the Department of Defense Travel Card Program Manager review and change potential erroneous merchant codes. Reviews of the Department of the Navy travel card program have raised concerns about transactions made with merchants that appear to have improperly classified merchant category codes. The misclassification of these merchants makes it difficult for the travel card managers responsible for reviewing cardholder transactions to identify inappropriate charges.

Debit Card Option: The Department of the Navy has approached the travel card contractor to explore options with a debit or pre-funded card. Currently, the Navy is working with the Department of the Treasury to prepare a pre-funded travel card pilot program, to determine if such a card might be a viable alternative to the current charge card.

Targeted Reminders: The Department of the Navy prepared and coordinated with Bank of America to distribute a travel card reference guide for Navy cardholders. The guide contains several "do's and don'ts" regarding cardholder responsibilities, appropriate uses, and contact information specific questions. We have contacted Bank of America personnel and asked for a similar guide to be mailed to Marine Corps cardholders.

In March 2002, the Under Secretary of Defense (Comptroller) established a Charge Card Task Force to evaluate the Department's purchase and travel card programs and to develop recommendations for improvements. The Task Force's preliminary recommendations specific to the travel card program were released in June 2002. The Department of the Navy supports the recommendations of the Task Force and we are working to implement the following:

- Development of a process to monitor transactions by exception. The Navy recently began an initiative to identify potential card misuse and abuse by using reports provided by the card contractor to monitor transactions. Accounts that are identified with potential inappropriate activity are immediately deactivated until travel card managers or the cardholders are contacted to confirm the transactions are valid. The criteria used for these reviews include any retail transaction over $250 or any travel transaction, principally travel or lodging, over $2,500. To further automate this process, the Navy has procured the same software used by the General Accounting Office to conduct such data-mining efforts. Staff has been scheduled to attend formal training on the use of this tool and we intend to commence its use in the near future.

- As directed by the Under Secretary of Defense (Comptroller), the Navy was the first Department of Defense component to have unused accounts reviewed and cancelled by the card contractor. This effort, which commenced on September 18, 2002, resulted in the cancellation of 65,300 Navy accounts. A similar review of Marine Corps accounts was completed on September 27, 2002 with 18,733 accounts identified for closure. These

cancellations are in addition to the over 40,000 account closures that resulted from reviews carried out by Department of the Navy travel card program managers in previous efforts.

- The Task Force noted that a significant amount of travel card training material currently exists. To ensure Navy and Marine Corps APCs are aware of these resources, the Department of the Navy has conducted training conferences over the last two years. Recently, in May of this year, a conference was held in Norfolk for more than 350 East Coast managers. Another is scheduled this November for West Coast personnel with over 300 attendees registered to date. In addition, the Department of the Navy is developing computer-based training for distribution to cardholders, travel card managers, Commanding Officers, and supervisors.

The Task Force recommended requiring the use of the "split disbursement" method of payment. Under this method, the travel settlement organization forwards a portion of the travel entitlement directly to the card contractor on behalf of the traveler/cardholder. Due to its convenience for cardholders and because this payment method meets our goal of paying the card contractor as quickly as possible, the Department of the Navy has long supported, and strongly encouraged, the use of split disbursement. This method of payment has long been available as a payment option to Navy cardholders and the card contractor reports that almost one-quarter of Navy travel card payments are made in this manner. As was noted in the Task Force report, the Department will continue to take efforts as may be necessary to ensure split disbursements are used to reduce payment delinquencies.

I believe that some of the problems experienced with the government travel card can be traced to the implementation of the program. When the Department of Defense implemented the Travel and Transportation Reform Act (Public Law 105-264) in January 2000, many Navy and Marine Corps commands enthusiastically embraced use of the travel card. In some cases, commands authorized travel cards for military members and civilian employees who did not need cards or who may have lacked the financial sophistication necessary to use the charge cards properly.

The Travel and Transportation Reform Act, as implemented by the General Services Administration and Department of Defense regulation, provides the authority to exempt personnel from mandatory use, recognizing the need for flexibility in the management of the travel card program within the unique operational environment of the Department of Defense. Current Department of Defense regulations permit the exemption of an infrequent traveler, defined as one who travels two or less times per year, from mandatory use of the travel card. In order to give Commanding Officers and supervisors more discretion in determining which of their subordinates should have a travel card, I sought and received authority from the Under Secretary of Defense (Comptroller) to change the definition of an infrequent traveler within the Department of the Navy to one who travels four or less times per year. Subsequent to this action, the General Services Administration put into effect a similar exemption defining an infrequent traveler as one who travels five or less times per year. The Department of the Navy will adopt this change for all our commands in accordance with Department of Defense direction.

The Department of the Navy is committed to improving management of the government travel charge card program. The actions I have described are the initial efforts taken to reduce delinquency and misuse of travel cards. They are intended to focus command attention on the problem and provide commanders the tools and flexibility they need to manage the program effectively.

Mr. Chairman, this concludes my statement. I am pleased to answer any questions you or other committee members may have.

Mr. HORN. I have just one question for you, and then we will move back to the Comptroller General.

You're on the task force for the Navy. Were you also on the task force that the Secretary of Defense set up to deal with this?

Mr. AVILES. Yes, sir. That is Dr. Zakheim, the Under Secretary of Defense Comptroller, was charged by the Secretary of Defense to lead that effort, and so the Department of Navy did participate with the DOD staff in developing those recommendations for the task force.

Mr. HORN. Do you think since that task force is still going—isn't it?

Mr. AVILES. Yes, sir. They have reported out their initial recommendation. I don't know if it is going to remain a standing task force or whether the intent would be to stand that down and report back through our normal reporting chains on changes that we have made. In my case, for the travel card program that would be through the Under Secretary of Defense Comptroller's Office.

Mr. HORN. So you feel that you're moving along in the Navy. How about the Army and the rest?

Mr. AVILES. I don't have specific information with respect to changes that are being made for the Army and the Air Force, sir.

Mr. HORN. When will that defense one pull together and go after all the services and then come in with another recommendation?

Mr. AVILES. Sir, many of the task force recommendations were not specific to any individual services. So, for instance, encouraging the use of the split disbursement option, that applies to all services, that they are encouraging that; additional—making available additional training materials, ensuring that is available for all persons involved in the process, not just the program coordinators or travel card managers, but also commanding officers, individual cardholders, to ensure that everyone understands their responsibility under the program.

Mr. HORN. Does the Navy have any idea how extensive the fraud and abuse is in its travel card program?

Mr. AVILES. Mr. Chairman, I don't know that—I think that gets into what Mr. Kutz quantified as not knowing the unknowable. In many cases we rely upon safeguards that are built into the system, controls that are intended to prevent or preclude misuse of the card. For instance, merchant category codes that are intended to allow the travel card to be used only in certain types of activities, we have evidence where some of those codes have been misrepresented. Whether that was intentional on the part of the vendor or not, it has the practical effect of defeating that control.

Additionally, we rely heavily on agency program coordinators, those managers, to look at transactions after the fact to detect instances where the card may have been misused. But again, that is not a leading indicator, that is a lagging indicator. We depend heavily on those internal controls, the safeguards built into the card with respect to limitation requirements for preauthorization and merchant category codes, as the principal line of defense for preventing misuse.

Mr. HORN. I'm going to go now for Mr. Kutz of GAO, and then I will get back do you.

The General Accounting Office has done a fine job over the months, so tell us what you know about the travel card situation.

Mr. KUTZ. OK, Mr. Chairman, I will get right to our bottom line, which is that we did find significant breakdowns in controls over the Navy's travel program. These breakdowns contributed to substantial delinquencies and charge-offs and also contributed to fraudulent and abusive activity.

I'm going to talk about three parts here to our testimony: first, the delinquencies and charge-offs; second, fraud and abuse; and third, internal controls.

First, we found substantial delinquencies and charge-offs of Navy travel accounts. Most Navy travel cardholders properly used their card and paid the bill on time. However, as you can see on the posterboard, the Navy, which is the blue line, has a high delinquency rate. Following the blue line you will see that for the eight quarters ending March 31, 2002, the Navy's delinquency rate fluctuated between 10 and 18 percent.

Mr. HORN. Is the yellow the Army?

Mr. KUTZ. Yes, the yellow is the Army. And the Navy's rates here, as you can see, just about mirrored those of the Army. And the Army, as we mentioned those at the last hearing, is the highest in the Federal Government.

Navy's rates were also, as you can see, 6 percentage points higher than civilian agencies.

In addition, nearly $17 million of Navy accounts have been charged off. These delinquencies and charge-offs have cost the Navy millions of dollars in lost rebates, higher fees, and substantial resources spent pursuing and collecting past due accounts.

This second posterboard shows that we found the Navy's delinquency and charge-off problems relate to young, low- and midlevel enlisted military personnel. The high volume of travel and 20 percent delinquency rate for the E4 to E6 rank have had a significant impact on Navy's high delinquency rates. The E4 to E6 in the Navy are petty officers, and for the Marine Corps are corporals to staff sergeants. Pay levels for these personnel, excluding supplements such as housing, are $18,000 to $27,000 a year.

As Mr. Aviles noted, DOD, the Navy, and the major commands within the Navy have taken a number of actions to reduce the delinquencies. For example, the Wage and Salary Offset Program has resulted in nearly $20 million of collections of past due and charged-off balances, and about $5 million of that, Mr. Chairman, relates to the Navy and the Marines.

In addition, DOD has been working, as Mr. Aviles noted, on legislation that would authorize mandatory usage of the split payment disbursement process. We agree that mandating this process would significantly reduce the delinquencies at Navy and DOD.

Second, the fraud and abuse that were mention are extensive, with nearly 14,000 Navy accounts charged off in the last 3 years and thousands more delinquent. In addition, we estimate that 7 to 26 percent of the transactions at the 3 case study sites that we audited were not for official government travel.

Potential fraud related to individuals who wrote three or more nonsufficient funds checks to the bank as payment for their travel card bill. For the 18 months ending March 31, 2002, 5,100 Navy

personnel wrote NSF or bounced checks, while more than 250 may have committed bank fraud by writing 3 or more NSF checks to the Bank of America.

Abuse of the Navy travel card was significant with purchases of jewelry, adult entertainment, gambling, cruises and tickets to sporting events. For example, we identified 247 transactions for over $28,000 at gentlemen's clubs such as Mr. Magoo's in Jacksonville, Florida, and Cheetah's Lounge in Las Vegas. In addition, tickets were purchased to see the Los Angeles Lakers and the New York Yankees.

Fifty Navy personal also used their government travel cards to pay for prostitution at two Nevada brothels. One of these brothels is located near Fallon Naval Air Station. The 79 charges we identified at this brothel showed up on the credit card bill as bar or restaurant charges for James Fine Dining. However, based upon further investigation, these charges were for prostitution at a legalized brothel known as the Salt Wells Villa. Account balances for 11 of these 50 cardholders were later charged off or put into the salary offset program.

As we talked about today, we found little evidence of disciplinary action against Navy personnel that misused the travel card. Of the 57 cardholders with the most significant fraud and abuse that we looked at, 20 of them had evidence of disciplinary action. One cardholder who wrote $20,000 of NSF checks and had their account balance charged off was recently promoted.

Mr. HORN. Were these in the service or in the Civil Service?

Mr. KUTZ. Service. This was a service person.

Mr. HORN. OK. Now, as I've got it, you reported that 50 cardholders used their travel card to pay prostitutes, and another 147 made almost $29,000 worth of charges at gentlemen's clubs. Some of the charges were for very large dollar amounts. How could this go undetected, I would ask the Navy? Fallon is a naval air station, isn't it?

Mr. AVILES. That is correct, sir.

Mr. HORN. Well, it sounds like they have a great party out there. But the question comes, if it is the gentlemen's club, and it is serving a lunch or a dinner, the General Accounting Office wouldn't worry about that one, I take it.

Mr. KUTZ. If the travel card was used to buy a drink, that would not necessarily be an improper use of the card. Drinks and dinner, that would be an official usage of the card.

Mr. HORN. Well, any others you want to have, Special Agent Ryan? What have you found?

Mr. RYAN. A lot of things.

Mr. HORN. You look like a happy guy.

Mr. RYAN. Thank you, Mr. Chairman.

Mr. Chairman, what we would say is that there are several things. When we deal with the gentlemen's clubs, the gentlemen's clubs, in my opinion, are basically deceiving a lot of people when they conduct transactions by selling cash. They were signed up by a merchant bank as a merchant to do bar and restaurant charges. What we are finding in the cases not only with the Navy, but in the Army, and found them with the Air Force, too, is that they're selling cash to these soldiers for 10 percent. They are avoiding—

the soldier is avoiding being limited on the amount of cash that they can get because there are limits on his ATM withdrawals.

Then they are submitting these transaction slips, these merchants are submitting these transaction slips to the merchant bank for $600, $700 even $1,000, saying they provided food and drinks. That is just not true.

We found with the case with Salt Wells, because of the data mining techniques that we did with the Army, we decided to look at MCC codes because we felt there was deceptive MCC codes, and in this case we came across James Fine Dining under a bar merchant code. But the dollar amounts, as you mentioned, were very, very high, so we actually presumed that it was for gambling. We started doing our investigation and contacted the sheriff's departments in a lot of the counties that we were looking at and found out that they had never heard of James Fine Dining, but they were aware of a place in Fallon called Salt Wells Villas, which was a brothel.

We contacted the merchant bank and found out that James Fine Dining was another name that was used, and the reason we were told that they went to that was to provide confidentiality to the cardholders who were coming in and getting services.

I think in some respects there is a part of deception on the part of the merchant bank in disguising exactly what that merchant is doing. Salt Wells doesn't serve any food, they do serve drinks, but yet they classify it as James Fine Dining. We found a lot of instances like this, Chicken Ranch, Madam Butterfly's and other gentlemen's clubs selling cash, making statements to banks saying that they are providing food and drinks when in reality they are selling cash. And as part of the investigations that you asked us to look at——

Mr. HORN. Now, who has to relate that—which regulatory organ in Nevada or in the U.S. executive branch, who classifies these things?

Mr. RYAN. Well, as a criminal investigator for well over 20 years, I believe a false statement to a financial institution is a crime. I believe that when a merchant submits a transaction slip, he is making a false statement if you can prove that he never intended to provide, in this particular case, food and drinks. I believe that executive law enforcement should look at that.

Mr. Kutz and I have traveled to South Carolina and have discussed this exact issue with law enforcement personnel in that State, and I think they are taking it under advisement. I think that your hearings have uncovered this. And I think it is something that law enforcement should look at.

Mr. HORN. Mr. Secretary, why weren't these charges detected? Do we know? In that part? Did you get the report from GAO?

Mr. AVILES. Sir, we definitely got cueing from GAO with respect to these specific instances. I would note, however, particularly in the case that Special Agent Ryan has indicated, it was not readily apparent if this was not a restaurant because of the merchant category coding. I don't know what expectation we can have for an agency or an activity program coordinator, that card manager who may be hundreds of thousands of miles away at a different duty station, to understand the possibility that this was somehow being deceptively or erroneously being represented.

Mr. HORN. Do you think something can be done when you find these things, and if so, who would you—is it the bank people that have this classification?

Mr. AVILES. Yes, sir, yes. I have communicated with both the Department—the Defense Finance and Accounting Service and the travel card program manager for the Department of Defense with respect to this issue with transactions being processed against blocked merchant category codes, as you heard Mr. Kutz testify. There is no legitimate travel-related expense in a jewelry store, yet we have found instances where transactions have been processed at jewelry stores on a travel card. That is not supposed to happen.

We're asking them to take a look at that and help us understand how that can happen, and clearly in cases where we believe that the merchant is being either erroneously represented or deceptively using an erroneous category code to reveal the—to conceal the true nature of the business.

Mr. KUTZ. Mr. Chairman, with respect to the brothels, it was particularly difficult for them to catch, because the 49 individuals that went to the Salt Wells Villa in Fallon were all on official travel. They were not from the local command. They were from out of town on official travel on official orders. So that makes it particularly difficult to determine that they were misusing the credit card, because it would have appeared to an APC looking at transactions as if it were a restaurant.

Mr. AVILES. And please keep in mind many different commands were represented here, so it is not a single individual noticing a high degree of activity at a particular merchant.

Mr. HORN. The Navy could be considering activating cards when the cardholders travel, and then deactivating them when the travel assignment ends. What is the problem with that, or are you thinking about that?

Mr. AVILES. Sir, we have actually already implemented that for commands that are executing above our target delinquency metric of 4 percent. This was—our initial corrective actions were intended to try to address the high delinquency rates that we were observing, try to focus command attention to that. And as I indicated, two- and three-star admirals come and see me on a regular basis if their delinquency rate is high. Those are some spirited conversations with respect to how they intend to get back into alignment.

I would like to point out as an example, the deputy commander at CINC land fleet publishes delinquency statistics for subordinate commands in the fleet. This is an incredible motivating tool, I believe, when commanders understand that their seniors are taking a hard look at this, evaluating their performance, and posting it up there for the entire world to see. I have high hopes that this would result in much improved performance on delinquency.

I believe that by tackling delinquency first, it is usually a harbinger for other types of misuse. I don't want to put words in the GAO witness' mouth, but clearly if you have got a high delinquency, you may have other problems as well, so that is what we have been focused on.

Mr. HORN. So is that the best we can do on the travel cards?

Mr. AVILES. Absolutely not, sir. Absolutely not. Our current statistic for delinquency as we compute it for the month of September

2002 is that we are running about 8½ percent delinquency metric. So we're not where we need to be as a department. What I have indicated is that we are focusing command attention at the appropriate level. I am actively engaged to an extent that I think is somewhat disconcerting to some of the commanders in the Navy that I am paying so close attention to this, and I don't intend to let go.

This is nothing to be—excuse me—this program has the promise to deliver for us incredible flexibility and savings. I think, as I indicated earlier, there was tremendous misperception when it was rolled out that we were contracting this out and that individual commands didn't have to be involved. That is not the case.

Mr. HORN. Mr. Ryan, your General Accounting Office testimony notes that a second class petty officer reservist, whose civilian job was with the U.S. Postal Service, made phony charges on his government travel card and effectively floated a loan to his limousine company. Could you elaborate on this scheme and what has happened?

Mr. RYAN. In this particular case, a gentleman was granted a travel card. Our investigation determined that he filed and became owner of a limousine service. The evidence indicates that when he needed money, he would take his travel card and run it through his limousine service. The limousine service would then get the cash. Either he would pay it back, or if he got extra cash during the month, he would go ahead and do a credit back to his travel card account. In some cases he was delinquent, and he floated himself 60-day loans.

He was interviewed. He admitted it, that he used the card for personal use. He used it to go to vacation. He used it for cash. But the one thing about it, he was not charged off. He paid his bill. But he did—he was delinquent. He leads up to that 8 percent or 14 percent that we are talking about. He abused and misused his card.

Mr. HORN. Mr. Secretary, I think that putting something up on the command deck, or something where people can see it, is a good way to warn people. Do you think the Navy is going far enough in disciplining cardholders who blatantly misuse their cards for personal items, gentlemen's clubs and gambling? What is your thinking on that?

Mr. AVILES. Sir, as the admiral had indicated with the purchase card, when we discover incidents of misuse of either the travel card or the purchase card, we report that information to the appropriate chain of command for disciplinary action. It would be inappropriate for me to try and dictate a disciplinary outcome to satisfy my desires. We rely heavily upon military commanders to make those judgment calls.

In some cases with respect to travel card delinquency, there may be perfectly reasonable instances for that. One of the things that we have found with certain types of our intelligence units, a member will go on travel and, because of the nature of the assignment, be unable to file a travel claim in a timely fashion. If this happens on short notice, and he has not made prior arrangements for settlement of that account, he can find himself in a delinquent status.

The commander needs to be able to have some discretion, some ability to exercise judgment on a case-by-case basis as to who constitutes an abuse versus an innocent mistake.

Mr. HORN. Now, you are part of the people that are over in the Pentagon who have been cleared by the U.S. Senate? To what degree does the service command know about all of this? In other words, the Chief of Naval Operations, how much does he know?

Mr. AVILES. Sir, the Chief of Naval Operations and Commandant of the Marine Corps, we keep their staffs apprised of information within these programs. We have a component, as their individual commands are executing this, and I am the one that is meeting with these—we call them echelon two commands, those major commands—they come in to report their delinquency status, those staffs are apprised of our activities. Additionally, in cases of apparent misuse or severe delinquency on a card, those chains of commands are informed of our findings for appropriate action.

Mr. HORN. And you think the other services operate about the same way?

Mr. AVILES. I have no knowledge of how the Army and the Air Force operate, sir. I presume it is a similar situation.

Mr. HORN. I just wondered if the service line, all they have to do is send to a CINC, and they could handle a lot of these questions. And that would be the best way, if people are having a career in the Navy and they have to know that these fraud and waste things are important.

Mr. AVILES. Sir, I think it is consistent with any service culture that the commander sets the tone. As the admiral indicated in his statement, it is the tone from the top. If you understand that your superior looks at this and evaluates your performance on the basis of it, performance will generally improve.

Mr. HORN. Well, this has been an interesting afternoon, and we will probably have a hearing 3 or 4 months from now. So we would like to know, GAO, if we can get the next hearing on that and see where you might have looked again, or go to another part of another service or whatever. So I would hope that you would keep the heat on until we get it turned over. And maybe the civilian side also ought to be looked at so we can get things moving. So thank you.

I want to thank the people that have been helpful in putting this hearing together. Bonnie Heald is the staff director of the subcommittee; Henry Wray, the senior counsel; Dan Daly, the counsel—put your hand up. There he is. And Dan Costello, who is right next to me, professional staff that did most of the work on the questions; and Chris Barkley, got a lot to do after this one, and that is majority clerk. There he is. And Ursula Wojciechowski, intern. There she is. And Juliana French, another intern. They are down working below.

Minority staff, David McMillen, professional staff. He has been there for a while. And Jean Gosa is the minority clerk. And there you are.

The court reporters have been Nancy O'Rourke and Joe Strickland—it took a lot of people to keep after all of you. So thank you very much, and we now adjourn.

[Whereupon, at 4:05 p.m., the subcommittee was adjourned.]

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