

**VOLUME 10, CHAPTER 1: “FINANCIAL CONTROL OF VENDOR AND CONTRACT PAYMENTS”**

**SUMMARY OF MAJOR CHANGES**

All changes are denoted by **blue font**.

Substantive revisions are denoted by an asterisk (\*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by ***bold, italic, blue and underlined font***.

The previous version dated **July 2016** is archived.

<b>PARAGRAPH</b>	<b>EXPLANATION OF CHANGE/REVISION</b>	<b>PURPOSE</b>
All	Updated hyperlinks and formatting to comply with current administrative instructions.	Revision
010202	Deleted duplicative information that is already located in the Government Accountability Office Standards for Internal Control.	Deletion
010203	Clarified language regarding the usage of electronic commerce, digital signatures, and electronic records storage.	Revision

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## CHAPTER 1

**FINANCIAL CONTROL OF VENDOR AND CONTRACT PAYMENTS**

## 0101 GENERAL

## 010101. Purpose

This chapter sets forth policy necessary to ensure internal controls are adequately established per stated laws and regulations for the entitlement and payment of goods and services. In addition, contract clauses have been outlined that may impose limitations on entitlement to financing or invoice payments. Department of Defense (DoD) officials are responsible for ensuring DoD organizations maintain control of payments made to vendors and contractors. Internal control and limitation requirements are necessary to ensure payments are based on terms and conditions contained in accepted purchase orders, contracts, and unilateral and bilateral modifications.

## 010102. Authoritative Guidance

The importance of internal controls is addressed in many statutes, regulations, and DoD executive documents, which include the Federal Managers' Financial Integrity Act ([FMFIA](#)); [Office of Management and Budget \(OMB\) Circular A-123](#); Volume 1, Chapter 3; and [DoD Instruction 5010.40](#).

## 0102 INTERNAL CONTROLS

## 010201. Statutory Compliance

The FMFIA establishes overall requirements with regard to internal controls, whereas the DoD Component Head is charged with establishing controls to reasonably ensure that:

- A. Obligations and costs are in compliance with applicable laws;
- B. Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- C. Revenues and expenditures, applicable to DoD operations, are properly recorded and permit the preparation of reliable financial and statistical reports to maintain accountability over assets.

## \*010202. Federal Standards

The FMFIA requires the Government Accountability Office (GAO) to issue standards for internal control in Government. Refer to [GAO Standards for Internal Control](#) in the Federal Government. These GAO standards 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. In implementing these standards, financial managers are responsible for developing the detailed policies, procedures, and practices for contract and vendor pay entitlement operations and ensuring they are built into, and are a continuous integral part of, ongoing operations. The OMB prescribes policies and standards for executive departments and agencies to follow in developing, operating, maintaining, evaluating, and reporting on financial management systems (see OMB Circular A-123, [Appendix D](#)).

\*010203. Regulatory Compliance

It is DoD policy to make payments and collections that are timely and accurate in accordance with applicable laws and regulations. These laws and regulations include requirements for identification, reporting, and reduction of improper payments (refer to Volume 4, Chapter 14 and Volume 5, Chapter 6). In addition, financial managers with responsibilities for ensuring internal controls are established and functioning properly to comply with this policy must:

A. Create, document, and maintain an organizational structure and business processes that appropriately segregate assigned duties, emphasize adherence to policies and procedures, and employ sound internal accounting and system access controls;

B. Implement finance and accounting systems that comply with the federal financial management systems requirements, maintain accurate and complete accounting and entitlement records from contract execution through closeout, and monitor the causes of late payments and interest penalties. The complete listing of financial management system requirements is in the [Business Enterprise Architecture](#), maintained by the Chief Management Officer. Efforts to develop or modify a critical financial management system must be subject to the compliance process (see Volume 1, Chapter 3);

C. Establish systematic controls that provide adequate audit trails to allow the tracing of financial events from source documents to general ledger account balances through successive levels of summarization and financial reports/statements. Ensure all transactional data is processed using accurate coding, and errors are researched and corrected;

D. [Utilize electronic processes and digital signatures, as prescribed by OMB Circular A-130, Appendix II](#), whenever possible and in the best interest of the Government;

E. Employ systems that ensure the authenticity of electronically-transmitted data, including the electronic signature. Such controls must provide reasonable assurance that deliberate or inadvertent manipulation, modification, or loss of data during transmission is detected;

F. Ensure prevalidation and payment documentation to vendors and contractors is retained in accordance with Volume 1, Chapter 9 and is readily available to support future audit efforts. Original payment documentation, and associated supporting documentation, must also be retained in accordance with Chapter 8, paragraph 080401. The documentation must be of sufficient quality to allow an independent third party, such as an outside auditor, to

understand and verify the basis of the prevalidation and the payments. [Electronic record storage requires adequate controls to ensure that integrity of the digital images accurately represents the corresponding paper documentation and detects changes to an original digital image.](#) The retention of documentation, both paper and electronic records, is the responsibility of the certifying officer; and

G. Implement finance and accounting data structures that comply with the Standard Financial Information Structure and the Standard Line of Accounting (see Volume 1, Chapter 4).

010204. Periodic Reviews

Managers with responsibilities for determining entitlements, authorizing, or executing payments and collections must:

A. Periodically (minimum annually) validate cash management and payment performance quality and effectiveness; and

B. Periodically (minimum annually) test effectiveness of internal controls, document results of testing, and take necessary corrective actions (see OMB Circular A-123).

0103 PREVALIDATION

010301. General

Prevalidation, as defined in [Public Law 104-61 Sec. 8102](#), is the process of matching the planned disbursement with a recorded obligation before the financing or invoice payment is made, and is intended to minimize the occurrence of problem disbursements and Antideficiency Act violations (see Volume 14, Chapter 2).

A. Obligations (and any adjustments) must be established and recorded for the amounts of orders placed and contracts awarded that will require payment in the current or some future accounting period, as prescribed in Volume 3, Chapters 8 and 15.

B. Liabilities for payment, including accounts payable, must be established as prescribed in Volume 4, Chapters 8 and 9.

C. Prior to payment, the undisbursed balance of each applicable obligation must be sufficient to cover the amount of the planned disbursement, as well as all previously scheduled disbursements (see Volume 3, Chapter 11).

D. Situations may occur when an entitlement office receives a payment request before fund managers have recorded the obligation in the accounting system, resulting in the inability to accomplish prevalidation. Policy addressing this situation exists in Volume 3, Chapter 8 (paragraphs 081401 and 081402) and it directs the accounting office to immediately record an obligation based upon valid and proper obligation documents in its possession for amounts that

are \$2,500 or less. If the dollar amount is greater than \$2,500, the accounting office must take the actions required to remedy the unrecorded obligations as outlined in Volume 3, Chapter 8 (section 0814).

E. Prevalidation must ensure validation of the line of accounting associated with the planned disbursement with the line of accounting on the obligating document before the financing or invoice payment is made.

#### 010302. Thresholds

The following thresholds have been established for Non-Mechanization of Contract Administration Services (non-MOCAS) and MOCAS payments.

A. All non-MOCAS payments must be prevalidated.

B. The following prevalidation thresholds must be used for MOCAS payments:

1. All dollar value payments made on contracts awarded after fiscal year (FY) 2004 must be prevalidated; and

2. For contracts issued during FY 2004 and prior, payments greater than \$5,000 must be prevalidated.

#### 0104 PAYMENT LIMITATIONS

The following contract clauses, when applicable, may impose limitations on entitlement to financing or invoice payments.

##### 010401. Limitation on Undefined Contracting Actions

A. According to Defense Federal Acquisition Regulation Supplement (DFARS) [217.7401\(b\)](#), “definitization” means the agreement on, or determination of, contract terms, specifications, and price, which converts the undefinitized contract action to a definitive contract. Also, [DFARS 217.7401\(d\)](#) states an “undefinitized contract action” means any contract action for which the contract terms, specifications, or price are not agreed upon before performance is begun under the action. Examples are letter contracts, orders under basic ordering agreements, and provisioned item orders for which the price has not been agreed upon before performance has begun.

B. In accordance with [Federal Acquisition Regulation \(FAR\) 16.603-4](#), letter contracts must include [FAR clause 52.216-24](#) among others. Under the terms stated in this clause, the maximum amount of the Government’s obligation is the amount specified in the clause. However, if a contractor submits a qualifying proposal before 50 percent of the not-to-exceed price has been obligated by the Government, then the limitation on obligations before definitization may be increased to no more than 75 percent (see [DFARS 217.7404-4](#) and [DFARS 252.217-7027](#)).

However, some exceptions apply for purchases of initial spares and contingency operations, as well as humanitarian or peacekeeping operations. See [DFARS 217.7404-5](#) for additional information.

010402.           Limitation of Cost or Funds

A.           The basic requirements for contract funding are described in FAR subpart [32.7](#), and supplemented by [DFARS 232.7](#). No officer or employee of the Government may create or authorize an obligation in excess of the funds available, or in advance of appropriations, unless otherwise authorized by law (see Volume 14, Chapter 2). Before executing any contract, the contracting officer must obtain written assurance from the responsible fiscal authority that adequate funds are available, or expressly condition the contract upon availability of funds, in accordance with [FAR subpart 32.703-2](#).

B.           Fully-funded, cost-type contracts may include [FAR clause 52.232-20](#), or incrementally-funded, cost-type contracts may include [FAR clause 52.232-22](#). Under the terms stated therein, the Government's obligation to the contractor (and the contractor's obligation to perform) is generally limited to the funds allotted to the contract. Both FAR contract clauses require the contractor to notify the contracting officer 60 days (or as otherwise directed by the contract) prior to the date when it is expected that incurred costs will exceed 75 percent (or 85 percent if specified by the contract) of contract estimated costs for fully-funded cost contracts or amounts allotted to the contract for incrementally-funded cost contracts.

010403.           Limitation on Withholding of Payments

In accordance with [FAR subpart 32.111\(b\)\(2\)](#), supply; research and development; service; time and materials; or labor hour contracts, that include two or more terms that authorize temporary withholding of amounts otherwise payable, must include [FAR clause 52.232-9](#). Under the terms stated therein, the total amount that may be withheld at any one time must not exceed the greatest amount that may be withheld under any one clause or the contract schedule term amount at the time. This limitation does not apply to withholding under any clause related to employee wages, the recovery of overpayments, withholdings not specifically provided for by the contract, or to any withholding for which the contracting officer determines the limitation would not be appropriate.

010404.           Limitation of Government's Obligation

In accordance with [DFARS 232.705-70](#), incrementally-funded, fixed-price contracts (one or more incrementally-funded contract line items) must include [DFARS 252.232-7007](#). Under the terms stated therein, the Government's obligation to the contractor for the incrementally-funded contract line item number(s) (and the contractor's obligation to perform) is limited to the funds allotted. The contract clause requires the contractor to notify the contracting officer 90 days (or as otherwise directed by the contract) prior to the date when the work will approximately reach 85 percent of the amount then allotted.