

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 * 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 June 2012 is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
010101	Updated the chapter’s purpose to be more representative of chapter’s focus and policy contained therein.	Updated
010102	Updated the chapter’s scope to be more representative of its applicability and its relationship to other related chapters in the Department of Defense Financial Management Regulation (DoD FMR).	Updated
010202	Added a Federal Standards paragraph under the Internal Control (IC) section, highlighting the Government Accountability Office issued IC standards.	Add
010203.B	Updated the reference to functional system requirements that reside under the Deputy Chief Management Officer within the Business Enterprise Architecture.	Updated
010301	Restructured the prevalidation policy paragraph into separate sections to distinguish key points.	Updated
010301.D	Added a reference to DoD FMR Volume 3, Chapter 8 under the Prevalidation section to add policy to address unrecorded obligations and the remedy that can be performed by the accounting office.	Add
010401	Provided Defense Federal Acquisition Regulation Supplement exceptions to the standard limitations involving undefinitized contracts.	Add
010402	Added contractor notification requirements under the Federal Acquisition Regulation when costs exceed the established cost estimate thresholds for both fully and incrementally-funded contracts.	Add

Table of Contents

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

0101 GENERAL 3

 *010101. Purpose 3

 *010102. Scope 3

0102 INTERNAL CONTROLS 3

 010201. Statutory Compliance 3

 *010202. Federal Standards 4

 *010203. Regulatory Compliance 5

 010204. Periodic Reviews 6

0103 PREVALIDATION 6

 *010301. General 6

 010302. Thresholds 7

0104 PAYMENT LIMITATIONS 7

 *010401. Limitation on Undefined Contracting Actions 7

 *010402. Limitation of Cost or Funds 8

 010403. Limitation on Withholding of Payments 8

 010404. Limitation of Government’s Obligation 8

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.

*010102. Scope

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. Volume 10 includes policies for issuing payments on entitlement; preparing payment vouchers; and keeping contract, disbursement and accounting records complete, consistent and accurate. Related policy and standards for recording obligations, resolving unmatched disbursements and negative unliquidated obligations, and posting budgetary accounting entries, respectively, are in Volume 3, Chapters 8, 11, and 15. Policy regarding accounting for payables is in Volume 4, Chapter 9. Policy regarding disbursement vouchers, accountable officials and certifying officers, respectively, is in Volume 5, Chapters 5 and 9. Antideficiency Act violations are addressed in Volume 14, Chapter 2.

0102 INTERNAL CONTROLS

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*](#), DoD Financial Management Regulation Volume 1, Chapter 3, and [*DoD Instruction 5010.40*](#).

010201. Statutory Compliance

The FMFIA establishes overall requirements with regard to internal controls where 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 Controls 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 (identified below), 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 on-going operations.

A. Control Environment. Management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management.

B. Risk Assessment. Internal controls should provide for an assessment of the risks the DoD faces from both external and internal sources.

C. Control Activities. Internal control activities help ensure that management's directives are carried out. The control activities should be effective and efficient in accomplishing DoD's control objectives. Examples of control activities include:

1. Top level reviews of actual performance;
2. Reviews by management at the functional or activity level;
3. Management of human capital;
4. Controls over information processing;
5. Physical control over vulnerable assets;
6. Establishment and review of performance measures and indicators;
7. Segregation of duties;
8. Proper execution of transactions and events;
9. Accurate and timely recording of transactions and events;

and

10. Access restrictions to and accountability for resources and records;

11. Appropriate documentation of transactions and internal controls.

D. Control Activities Specific for Information Systems

1. General Controls. This category includes entity-wide security program planning, management and control over data center operations, system software acquisition and maintenance, access security, and application system development and maintenance. The OMB prescribes policies and standards for executive departments and agencies to follow in developing, operating, maintaining, evaluating, and reporting on financial management systems (OMB Circular A-127-Revised, "Financial Management Systems"). Systems managers are responsible for ensuring that system controls are documented, tested, and certified for entitlement systems (refer to Volume 10, Chapter 17, paragraph 170102).

2. Application Controls. These controls are designed to help ensure completeness, accuracy, authorization, and validity of all transactions during application processing. Control should be installed at an application's interface with other systems to ensure that all inputs are received and are valid, and outputs are correct and properly distributed. An example is computerized edit checks built into the system to prevent a disbursement greater than the entitlement and available funding from occurring.

E. Information and Communication. Information should be recorded and communicated to management and others within the DoD who need it, and be in a form and within a time frame that enables them to carry out their internal control and other responsibilities. Effective communication should occur in a broad sense with information flowing down, across, and up the organization. In addition to internal communication, management should ensure there are adequate means of communicating with, and obtaining information from, external stakeholders that may have a significant impact on the DoD achieving its goals.

F. Monitoring. Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved. Internal controls should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. The monitoring should occur as a part of regular management, supervisory and staff activities, and may include comparisons and reconciliations, and reporting against established goals and strategic objectives.

*010203. Regulatory Compliance

It is the policy of DoD 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, section 0603). In addition, financial managers with responsibilities for ensuring internal controls are established and functioning properly to comply with this policy shall:

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 incurred. The complete listing of [financial management system requirements for payment management systems is in the *Business Enterprise Architecture*, maintained by the Deputy Chief Management Officer \(DCMO\)](#). Efforts to develop or modify a critical financial management system (see Volume 1, Chapter 3) shall be subject to the financial and feeder systems compliance process;

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; and

D. Employ systems that ensure the authenticity of electronically transmitted data, including the electronic signature. Such controls shall provide reasonable assurance that deliberate or inadvertent manipulation, modification, or loss of data during transmission is detected (see Volume 10, Chapter 17).

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, *Management's Responsibility for Internal Controls*](#)).

0103 PREVALIDATION

*010301. General

Prevalidation 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 081301 and 081302) and it directs the accounting office to immediately record a valid obligation based upon documents in its possession for amounts that are \$2,500 or less. If the accounting office records this obligation before payment, or if actions required to remedy unrecorded obligations greater than \$2,500 as outlined in Volume 3, Chapter 8 (section 0813) are performed, a subsequent prevalidation prior to making the disbursement is not required.

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 shall be prevalidated.

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

1. All **dollar value** payments made on contracts awarded after Fiscal Year (FY) 2004 are **to be** prevalidated.

2. **For** contracts issued during FY 2004 and prior, payments **greater** than \$5,000 are **to 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

In accordance with **Federal Acquisition Regulation (FAR) 16.603-4**, letter contracts shall 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 [Defense Federal Acquisition Regulation Supplement \(DFARS\) 217.7404-4](#) and related [DFARS clause 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](#). According to the [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.

*010402. Limitation of Cost or Funds

The basic requirements for contract funding are described in [FAR Subpart 32.7](#), and as supplemented by [DFARS Subpart 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 (see Volume 14, Chapter 2). The contracting officer shall expressly condition contracts on the availability of funds. 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\(b\)\(2\)](#), noncommercial supply, research and development, service, time and materials or labor hour contracts that include two or more terms that authorized temporary withholding of amounts otherwise payable shall include [FAR clause 52.232-9](#). Under the terms stated therein, the total amount that may be withheld at any one time shall not exceed the greatest amount that may be withheld under any one clause or contract Schedule term 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) shall include [DFARS clause 252.232-7007](#). Under the terms stated therein, the government's obligation to the contractor for the

incrementally-funded Contract Line Item Number(s) (CLIN(s)) (and the contractor's obligation to perform) generally 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.