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GAO

Report to the Ranking Minority Member,
Subcommittee on Oversight of
Government Management and the
District of Columbia, Committee on
Governmental Affairs, U.S. Senate

December 1995

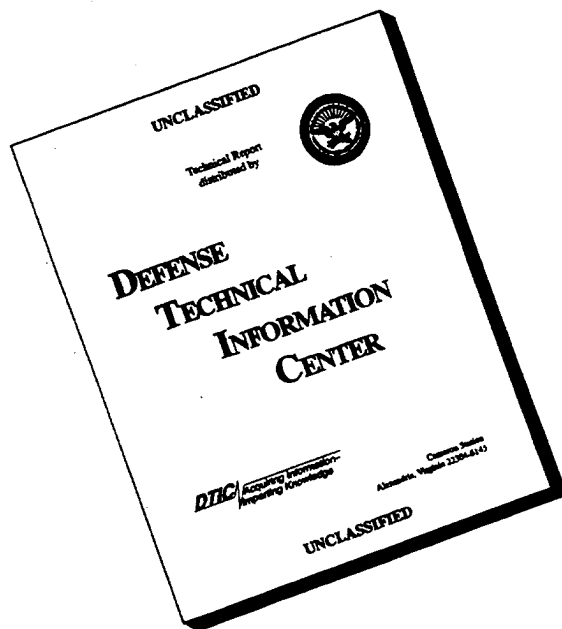
MILITARY SEALIFT COMMAND

Weak Controls and Management of Contractor-Operated Ships



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United States
General Accounting Office
Washington, D.C. 20548

**National Security and
International Affairs Division**

B-265707

December 12, 1995

The Honorable Carl Levin
Ranking Minority Member
Subcommittee on Oversight of
Government Management and the
District of Columbia
Committee on Governmental Affairs
United States Senate

Dear Senator Levin:

This report responds to your request that we review the Military Sealift Command's management of its contractor-operated ships. Our review focused on whether the Military Sealift Command has (1) an adequate system of management controls in place to oversee contractors and prevent abuses and (2) sufficient oversight to ensure contractual requirements are being met.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days after its issue date. At that time, we will send copies to the Secretaries of Defense and the Navy; the Commander, Military Sealift Command; and other interested parties. We will also make copies available to others upon request.

Please contact me on (202) 512-5140 if you or your staff have any questions. Major contributors to this report are listed in appendix II.

Sincerely yours,

Mark E. Gebicke
Director, Military Operations
and Capabilities Issues

Executive Summary

Purpose

Two cases involving the Military Sealift Command's (MSC) contractor-operated ships illustrate the dangers of poor management controls and the resulting too-heavy reliance on contractors' integrity. One case involved fraudulent overtime practices by the crew members of a ship management company, and the second case involved the severe deterioration and improper crewing of MSC's sealift tankers. As a result of GAO's 1994 report on the sealift tankers,¹ the Ranking Minority Member of the Subcommittee on Oversight of Government Management and the District of Columbia, Senate Committee on Governmental Affairs, asked GAO to examine MSC's contractor-operated ship programs. Specifically, GAO determined whether MSC has adequate management controls (1) to oversee contractors and prevent contract abuses and (2) to ensure contractual requirements are being met.

Background

To carry out its mission, MSC uses a combination of government and privately owned ships with civilian crews who work either directly for MSC or for MSC's contract-operators. This report focused on 40 of MSC's 69 contractor-operated ships. These 40 ships were in the 5 programs where MSC awarded long-term contracts for 3 or more ships. These programs include maritime prepositioning ships, T-5 tankers, oceanographic survey ships, T-AGOS surveillance ships, and fast sealift ships. MSC spends over \$400 million per year to operate and maintain these 40 ships. In fiscal year 1994 alone, MSC spent \$93.8 million to maintain and repair these ships.

Results in Brief

MSC's internal controls are inadequate to oversee its contractor-operated ship programs. As a result, MSC is vulnerable to contract abuse. MSC lacks basic internal controls in its verification of crew-performed repairs, in its review of invoices for subcontracts, and in its supervision of overhaul work. MSC does not verify that it has received the goods or services it is paying for, in part because there is a disconnect between headquarters reviewers and field-level personnel, whose main concern is the operation but not the cost of the ships' repair. Also, though MSC's Comptroller is responsible for coordinating MSC's internal control program, he does not have the authority to ensure that MSC's system of internal controls is sufficient and is being adhered to.

MSC also lacks sufficient oversight to ensure that contractual requirements are met. MSC has no guidelines for systematically establishing personnel

¹U.S. Navy/Military Sealift Command: Weak Contract Administration Led to Unsafe and Poorly Maintained Ships (GAO/OSI-94-27, Aug. 31, 1994).

requirements such as citizenship and security requirements. Neither does it systematically compare contractual requirements with contractors' performance in obtaining security clearances and trustworthiness evaluations for crew members. Finally, MSC does not have a formal system to identify and implement best practices that could be used to improve the contractors' performance or reduce the programs' cost.

MSC's fragmented lines of organizational authority represent a significant impediment to sound management controls. MSC has acknowledged such organizational problems and plans to designate program managers and establish formal lines of accountability.

Principal Findings

MSC's Internal Controls Are Inadequate to Prevent Overpayments for Ship Repairs

In two programs, MSC does not require contractors to adequately document that minor repairs are actually accomplished. GAO's review of minor repair reports, which list repairs to be applied toward contract-defined thresholds, found that contractors for three programs were overstating these reports in various ways. One contractor was billing MSC for the straight time hours of its regular crew, when only overtime hours are reimbursable. Another contractor was wrongfully claiming cleaning jobs as reimbursable. A third contractor was billing twice for the same jobs. After the contractors for two of these three programs met their minor repair thresholds, they were reimbursed by MSC for all minor repairs. One was paid \$685,946 for fiscal years 1991 through 1995. The second was paid \$741,360 in fiscal year 1994 alone. At the time of GAO's review, MSC had not yet determined whether the contractor for the third program had met its minor repair threshold.

For some programs, MSC's review of invoices for subcontracted work is also insufficient to prevent excessive payments by MSC. First, MSC does not uniformly require contractors to provide invoices with supporting documentation that would indicate that prices are fair and reasonable. For example, GAO found that one contract required the contractor to submit evidence of competitive bidding with every subcontract and that the MSC field unit had deducted amounts from the contractor's invoices for inadequate documentation.

For another contractor, on the other hand, GAO found no supporting documentation with invoices that would indicate whether prices were fair and reasonable. In one case, MSC had approved an invoice for \$3,560 to "provide labor, tools and material necessary to replace twenty (20) lampshades . . . [and] relamp and repair as necessary" without any evidence of whether this work had been awarded competitively, why it had not been done by the ship's crew, or how extensive the work was. GAO also found that MSC had paid a subcontractor \$260 per lamp to repair 10 lamps and replace their lampshades, when it could have purchased new lamps for \$210 each (excluding the cost of installation). A qualified electrician, who is part of the ship's crew, could easily have performed this repair at about half the labor rate charged by the subcontractor.

For two programs, MSC headquarters invoice reviewers could rely on available field staff to verify that the subcontracted work was done or that it was reasonably priced. However, in only one program are field staff involved in the invoice review process.

One MSC contract requires that the contractor obtain MSC approval before subcontracting for industrial assistance that costs more than \$25,000. However, this contractor split large jobs into smaller ones and thereby circumvented this requirement. In one instance, the contractor submitted 71 separate invoices totaling \$202,294 for welding-related work; 18 of these invoices were submitted on the same day. MSC has known about this practice since 1990 but has not taken any action to prevent it.

Also, even though a ship's overhaul can cost MSC up to \$6 million, MSC does not always have assurance that repair work, particularly unforeseen repairs not specified in overhaul contracts, is completed or is reasonably priced. This lack of assurance is due in part to the fact that MSC has no agencywide requirement for its representatives to be present during ship overhauls. When an MSC representative is not present during an overhaul, MSC is relying entirely on the integrity of the contract operator to protect the government's interest.

At MSC, internal controls to prevent contractor fraud and abuse are weak in many cases. In response to the Chief Financial Officers Act of 1990, the Secretary of Defense directed that senior managers play a more active role in identifying, reporting, and correcting poor internal controls. However, though MSC's Comptroller is responsible for the coordination of MSC's internal control program, he does not have direct authority to ensure the sufficiency of these controls or their implementation.

Management Control Weaknesses Impede MSC's Efforts to Effectively Manage Its Ship Programs

MSC does not have standard procedures for developing personnel requirements in its contracts. For example, while most contractors are required to submit the resumes of key personnel to MSC for approval before the personnel are assigned to a ship, one contractor is not. Also, a similar inconsistency exists for the requirement that crew members be U.S. citizens. Finally, MSC has not provided guidance or standardized procedures to be used in establishing security requirements for crew members. As a result, key contract requirements have inadvertently been left out in some cases, and MSC has no assurance that its ships' crew members are qualified, trustworthy, and properly cleared.

No one person or office in MSC is responsible for tracking trustworthiness evaluations and security clearances for all MSC's contractor-operated ship programs to ensure that contractors comply with contract requirements. People from the Office of Security, the Operations Office, and the Operating Contracts Division are involved with the security clearances and trustworthiness evaluations of ship crews, but communication among these offices is poor. As a result, MSC cannot ensure that contractual requirements for crews to be trustworthy or appropriately cleared are being met.

The contractor-operated ship programs GAO reviewed used two different contracting methods to control ship maintenance and repair costs. However, MSC has no formal system for comparing the two contracting methods to determine whether one method is more cost-effective than the other and therefore should be used for all of MSC's contractor-operated ship programs.

MSC's program managers rely on legal, contracting, engineering, accounting, and security personnel who are located in different departments in MSC and report to the heads of their individual departments. This fragmented organization has contributed to MSC's failure to ensure that its contractors comply with their contracts. MSC was planning a reorganization beginning in October 1995 to "clarify accountability, responsibility, and authority" for its ship programs.

Recommendations

GAO is making a number of recommendations to the Secretary of Defense to strengthen MSC's internal controls and to improve its oversight of contractor operations. For example, GAO is recommending that MSC institute procedures to improve its verification of crew-performed repairs and its review of subcontractor invoices. To assist in the implementation

of these and GAO's other recommendations, GAO is also recommending that MSC consider expanding the responsibilities of MSC's Comptroller or creating a new position, which would include the current Comptroller's duties. Further, GAO is recommending that MSC's program managers assign an individual responsibility for contract provisions, such as those dealing with trustworthiness and security clearances. In addition, GAO is recommending that the Commander of MSC instruct his personnel to discuss and evaluate ways of identifying and implementing best practices into their contractor-operated ship programs.

Agency Comments

In official oral comments, the Department of Defense (DOD) generally agreed with GAO's recommendations. DOD partially concurred with the findings but disagreed with the conclusion that internal controls are weak. DOD did agree that there are opportunities for further improvements in the internal controls applied to contractor operation of MSC ships and said it has already implemented remedial measures. DOD also stated that in view of the unusual procurement situations highlighted in the report, the Commander of MSC is focusing additional attention on risk analysis and the design of appropriate internal controls.

GAO continues to believe that MSC does not have an adequate system of controls over its contractor-operated ships. Recent fraudulent practices of a former MSC contractor and the continuing investigation by federal law enforcement agencies into MSC operations support GAO's conclusion that MSC's internal controls are inadequate.

Contents

Executive Summary		2
Chapter 1		10
Introduction	MSC's Contractor-Operated Ships	10
	Maintenance and Repair of Contractor-Operated Ships	15
	Objectives, Scope, and Methodology	15
Chapter 2		18
MSC's Internal Controls Are Inadequate to Prevent Overpayments for Ship Repairs	Inadequate Documentation and Review of Crew-Performed Repairs Have Led to Overpayments	18
	Documentation Submitted With Invoices Is Insufficient to Ensure That Subcontractors' Prices Are Fair and Reasonable	22
	MSC Does Not Consistently Verify That Overhaul Work Is Done and Prices Are Reasonable	28
	MSC's Internal Controls Are Weak	30
	Conclusions	30
	Recommendations	30
	Agency Comments and Our Evaluation	31
Chapter 3		32
Management Control Weaknesses Impede MSC's Efforts to Effectively Manage Its Ship Programs	MSC Does Not Have Standard Procedures to Develop Personnel Requirements	33
	MSC Does Not Ensure That Contractors Comply With Requirements for Crew Trustworthiness and Security Clearances	35
	No Systematic Approach to Identify and Implement Best Practices	38
	Fragmented Lines of Authority Impede Sound Management Controls	40
	Conclusions	41
	Recommendations	42
	Agency Comments and Our Evaluation	42
Appendixes	Appendix I: Ships Visited During Our Review	44
	Appendix II: Major Contributors to This Report	45
Tables	Table 1.1: MSC's Fleet as of June 1, 1995	10
	Table 3.1: Processing Time for 29 Trustworthiness Evaluations	37
	Table 3.2: Trustworthiness Evaluations for One Contractor	37

Figures

Figure 1.1: Contractor-Operated Ships	12
Figure 2.1: Example of the Type of Lamp Repaired by a Subcontractor	25

Abbreviations

CFO	Chief Financial Officer
DCMC	Defense Contact Management Command
DOD	Department of Defense
GAO	General Accounting Office
MSC	Military Sealift Command

Introduction

The Military Sealift Command (MSC) provides ships for fleet support; special missions; and strategic sealift of equipment, supplies, and ammunition to sustain U.S. forces worldwide. While MSC uses a combination of government and privately owned ships to carry out this mission, all these ships have civilian crews who work either directly for MSC or for MSC's contract operators.

MSC's Contractor-Operated Ships

This report deals with contractor-operated ships, which account for 69 of the 200 ships in MSC's fleet (see table 1.1). Our review specifically focused on 40 ships in the 5 programs where MSC awarded long-term charter contracts for 3 or more ships.¹ These programs include maritime prepositioning ships, T-5 tankers, oceanographic survey ships, T-AGOS surveillance ships, and fast sealift ships (see fig. 1.1). MSC spends over \$400 million per year to operate and maintain these 40 ships. This figure includes payments for leasing the 18 privately owned ships in the group.

Table 1.1: MSC's Fleet as of June 1, 1995

Force	Total number of ships	Contractor-operated ships	Type of ship reviewed	Number of ships reviewed
Strategic sealift ^a				
Active	56	43	T-5 tankers	5
			Maritime prepositioning	13
Inactive	89	10	Fast sealift	8
Naval fleet auxiliary ^b	39	10	T-AGOS	10
Special mission support ^c	14	4	Oceanographic	4
Miscellaneous	2	2		0
Total	200	69		40

^aThe strategic sealift force rapidly transports U.S. military forces and their equipment in the event of a war or contingency, and then transports the supplies needed to keep the forces armed, fed, and supplied for combat.

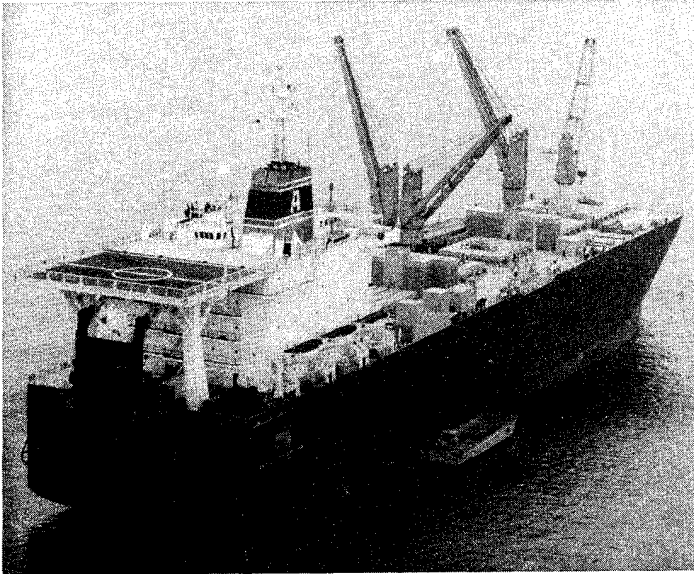
^bThe naval fleet auxiliary force provides support and services to U.S. Navy combatant ships worldwide. Services include towing, underway replenishment, and submarine detection.

^cThe ships of the special mission support force carry out a variety of highly specialized missions, including missile tracking, cable laying and repairing, and oceanographic and hydrographic surveying.

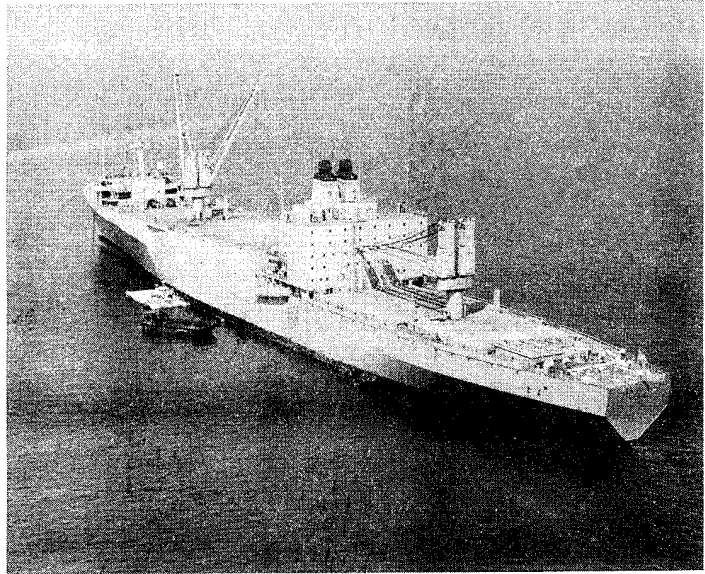
¹Twenty of the contractor-operated ships that we did not review are under short-term charters. The remaining nine ships are operated by seven different contractors.

Chapter 1
Introduction

Figure 1.1: Contractor-Operated Ships



Maritime Prepositioning Ship

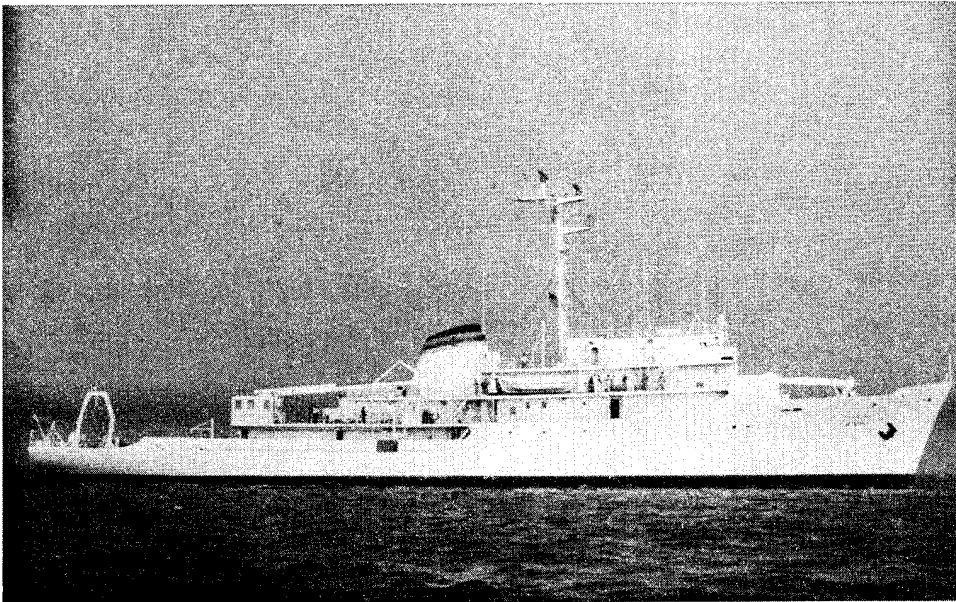


Fast Sealift Ship

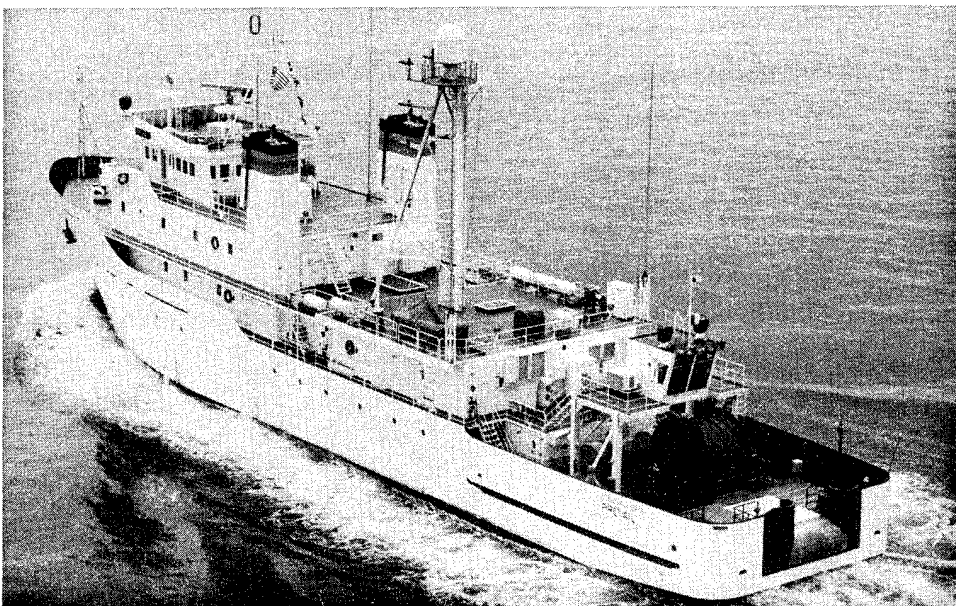


T-5 Tanker

Chapter 1
Introduction



Oceanographic Survey Ship



T-AGOS Surveillance Ship

Maritime Prepositioning Ships

Maritime prepositioning ships rapidly deliver urgently needed Marine Corps equipment and supplies to a theater of operations during a war or contingency. These 13 privately owned ships are divided into three squadrons located in the Atlantic, Pacific, and Indian Oceans and carry everything from tanks and ammunition to food, water, and fuel. Each squadron can support a U.S. Marine Corps Expeditionary Brigade of 17,300 troops for 30 days. The maritime prepositioning ships were among the first ships to arrive in Saudi Arabia during Operation Desert Shield and in Somalia during Operation Restore Hope.

T-5 Tankers

The primary mission of the five privately owned T-5 tankers is point-to-point delivery of refined petroleum products to Department of Defense (DOD) users throughout the world. In addition, two of the tankers are equipped with modular fuel delivery systems, which allow them to refuel combatant ships at sea. At 30,000 tons displacement, the T-5 tankers are 3,000 tons larger than the contractor-operated sealift tankers that we reported on last year.² In addition, the T-5s have ice-strengthened hulls and are approximately 10 years newer than the sealift tankers.³ During Operations Desert Shield and Desert Storm, MSC tankers provided fuel to naval fleet units operating in the Red Sea, the Persian Gulf, and the Gulf of Oman.

Fast Sealift Ships

The mission of the eight government-owned fast sealift ships is to provide rapid surge capability to U.S. armed forces throughout the world. They are the fastest roll-on/roll-off cargo ships in the world and are designed to carry bulky Army equipment such as tanks and helicopters. Combined, the eight ships can carry almost a full Army mechanized division.

The fast sealift ships are normally maintained in a reduced operating status, with skeleton crews who perform preventive and corrective maintenance and basic operational checks. All eight ships are assigned to Fast Sealift Squadron One, in New Orleans, Louisiana, and they can be activated and underway from ports on the U.S. East and Gulf Coasts in 96 hours. Each of the fast sealift ships made up to seven trips to Saudi Arabia during Operations Desert Shield and Desert Storm. They were also involved with Operation Restore Hope.

²U.S. Navy/Military Sealift Command: Weak Contract Administration Led to Unsafe and Poorly Maintained Ships (GAO/OSI-94-27, Aug. 31, 1994).

³By the time we completed our review, the sealift tankers were no longer part of MSC's active fleet.

T-AGOS Ocean Surveillance Ships

The mission of 7 of the 10 government-owned T-AGOS ships is to locate and track submarines. The remaining three have been converted to do counterdrug missions. These ships are homeported in Little Creek, Virginia, and Pearl Harbor, Hawaii, and are monitored by MSC field organizations located at these homeports. The T-AGOS ships operate towed array sensor systems to gather submarine acoustical data, especially to locate new and quieter submarines.

Oceanographic Ships

The mission of the four government-owned oceanographic ships is to support worldwide oceanographic survey programs with acoustical, biological, physical, and geophysical research. Their precision sonar systems permit continuous charting of a broad strip of ocean floor. The research conducted by these ships helps to improve the Navy's undersea warfare and enemy ship detection capabilities.

Maintenance and Repair of Contractor-Operated Ships

MSC's contract operators are tasked with providing personnel, equipment, tools, and supplies to maintain MSC's ships. They use three different levels of maintenance and repair to keep MSC's ships operational. The first level of maintenance and repair is performed by the ship's crew. It includes preventive maintenance and minor mechanical and electrical repairs. This work may be done during regular or overtime hours, and it may or may not be reimbursable under the terms of the applicable contract.

The second level of maintenance and repair is industrial assistance, which is done by subcontractors. This work is beyond the capability of the ship's crew but does not require an overhaul. The subcontractors may actually maintain or repair the ship's equipment, or a technical representative may provide expertise to the ship's crew. Industrial assistance is usually reimbursable, either directly or through a budgeted system of payments.

Overhauls are the third level of maintenance and repair. They can be scheduled, as required by Coast Guard regulations, or unscheduled, for example, to repair a damaged propeller. Since none of the MSC contract operators we reviewed function under firm fixed-price contracts, overhauls are directly reimbursable.

Objectives, Scope, and Methodology

The Ranking Minority Member of the Subcommittee on Oversight of Government Management and the District of Columbia, Senate Committee on Governmental Affairs, asked us to examine the Military Sealift

Command's contractor-operated ship programs. Specifically, we determined whether MSC has adequate management controls (1) to oversee contractors and prevent abuses and (2) to ensure contractual requirements are being met.

To determine whether MSC has adequate oversight of the maintenance and repair work done on its contractor-operated ships, we reviewed MSC's engineering and maintenance and repair instructions, files, and manuals, including the Engineering Operations and Maintenance Manual. We also reviewed maintenance and repair invoices, visited a sample of ships, and interviewed responsible MSC personnel. We used the ships' operational schedules to visit ships that were about to complete an overhaul. For four of the five programs we were able to visit a ship that was in for overhaul, but this was not possible for the T-5 tankers. Therefore, we visited a tanker that was in its full operational status. (App. I lists the ships that we visited.) During our ship visits, we interviewed crew members, contractor and shipyard officials, MSC field personnel, and Coast Guard and American Bureau of Shipping inspectors. We visited several fast sealift ships because they were all located at the same port.

To determine MSC's effectiveness in establishing and administering contract requirements, we reviewed the contracts for each of the ship programs and compared and contrasted the requirements contained in those contracts. We then discussed the contract differences with cognizant MSC officials to determine why the differences existed and to determine what, if any, standardized procedures these officials used to establish and administer program requirements. We also reviewed numerous MSC instructions dealing with funding, billing, and invoice certification. We reviewed the Department of Defense's National Industrial Security Program Operating Manual and MSC's security and crew qualification files to verify the suitability of the crew members on MSC's contractor-operated ships.

To determine the effectiveness of MSC's current organizational structure, we met with various MSC officials and discussed their responsibilities with regard to MSC's contractor-operated ship programs. We also reviewed MSC's Standard Operating Manual, the draft proposal "Reinventing MSC," and the MSC Commander's June 1, 1995, update to the reinvention proposal. We then discussed the reorganization initiative with MSC's current program managers. We did not address this area in depth because MSC's reinvention management team and its working groups had not developed the program

Chapter 1
Introduction

management organization's structure by the time we completed our audit work.

We conducted our work between July 1994 and August 1995 in accordance with generally accepted government auditing standards.

MSC's Internal Controls Are Inadequate to Prevent Overpayments for Ship Repairs

An ongoing joint investigation by the Federal Bureau of Investigation and the Naval Criminal Investigative Service has led to guilty pleas by four former employees of MSO, Inc., an MSC contractor that operated 10 oceanographic vessels. The investigation revealed that these employees had fraudulently altered overtime records of other MSO employees (crew members), changing nonreimbursable overtime charges to overtime charges that are reimbursable. It is estimated that these fraudulent overcharges amounted to millions of dollars during a 3-year period. This case shows that oversight and basic internal controls are fundamental for any entity to ensure that payments are made accurately and correspond to goods and services actually received.

During our review of MSC's contractor-operated ship programs, we found that those who approve and pay bills do not verify that MSC has received the goods or services it is paying for. Part of the reason for this practice is a disconnect between headquarters-level invoice reviewers and field-level personnel, whose main concern is the operation but not the cost of the ships' repair. In fiscal year 1994 alone, MSC spent \$93.8 million to maintain and repair the ships in the five contractor-operated programs we reviewed. Given the large amounts of money spent on maintenance and repairs, it is imperative that MSC have effective controls over these expenditures. MSC lacks controls in three general areas: verification of crew-performed repairs, review of invoices for subcontracts, and oversight of repair work performed during overhauls. Though MSC's Comptroller is responsible for coordinating MSC's internal control program, he does not have the authority to ensure that MSC has a sufficient system of internal controls that is being adhered to.

Inadequate Documentation and Review of Crew-Performed Repairs Have Led to Overpayments

For three of MSC's contractor-operated ship programs, MSC has included in its contracts predetermined dollar amounts for crew-performed minor repairs that are to be done as part of the contracts' fixed price. According to the contracts, these predetermined amounts, or "minor repair thresholds," can be met in three ways. Contractors can apply toward the thresholds (1) overtime and straight time performed by extra crew (beyond those normally required), (2) overtime by the regular crew performing minor repairs, and (3) industrial assistance (work done by subcontractors, not by the ships' crews). Contractors are to report how they meet their thresholds in minor repair reports. After contractors meet these minor repair thresholds, they can be reimbursed by MSC for all minor repairs. According to the contracts, the cleaning of the ship and preventive

maintenance are part of the fixed price. They are not to be included in the contractors' minor repair reports.

In our review of minor repair reports, we found that, because of either inadequate supporting documentation, inadequate review, or both, contractors were meeting their thresholds in ways that are not allowed by the contracts or listing the same jobs more than once. Contractors for these three programs were essentially overstating their minor repair reports in the following ways:

- The contractor for one ship program was including in its minor repair reports the straight time hours of its regular crew.
- The contractor for a second program was including cleaning jobs in its minor repair reports.
- The contractor for a third program was listing the same jobs twice in its minor repair reports.

For all three programs, the contractors were not submitting supporting documentation that matched their minor repair reports. According to an MSC instruction, proper knowledge of receipt or disposition of goods/services during the invoice certification process will reduce the chances of fraudulent claims being paid. However, MSC reviews minor repair reports and invoices for over-threshold repairs without adequate supporting documentation to show that work was done.

Contractors for two of the three programs had been paid by MSC for over-threshold repairs. As of October 10, 1995, one of the contractors had received \$685,946 from MSC for over-threshold repairs for fiscal years 1991 through 1995. MSC paid a second contractor \$741,360 for over-threshold repairs for fiscal year 1994 alone. At the end of our review, MSC had not yet calculated whether the contractor for the third program had met or exceeded its minor repair thresholds. MSC had no plans to recover amounts for jobs that should not have been included as minor repairs.

MSC Failed to Detect Overstatement of Minor Repair Reports

The contract operator for the first of the three programs we discussed above included in its minor repair reports the straight time hours of its regular crew, but at the end of the 5-year contract period, MSC was not aware of this practice. MSC had never requested or reviewed the complete supporting documentation for the contractor's minor repair reports during the 5-year contract period that would have uncovered this practice. For the life of the contract, the contractor reported nearly \$6 million in

crew-performed repairs in their minor repair reports. Of this amount, MSC reimbursed the contractor \$685,946 for over-threshold minor repairs.

MSC's contract allows its contractor to apply to the minor repair threshold repairs done by the ship's regular crew while on overtime but not during straight-time work hours. Because MSC does not require the contractor to submit supporting documentation, however, it has no proof that the contractor has not manipulated the reporting of overtime.

Field staff for this program told us that, at a recent meeting with MSC headquarters personnel, they had recommended that the contractor be required to submit crew overtime sheets as supporting documentation for its minor repair reports. However, MSC headquarters personnel have taken no action in response to this recommendation.

For this program, we requested supporting documentation from the contractor for one ship's minor repair report, which totaled \$25,859 and covered about 5 months. We reviewed this documentation to verify that the crew had actually listed this overtime work on their timesheets. We found that for this minor repair report, \$8,406 of repairs had been performed by the ship's regular crew during straight-time hours. Another \$860 was unsupported by crew overtime sheets. When we disclosed our findings to program officials, they stated that they were unaware that the contractor was not complying with the contract and said that they would investigate the matter further.

It is particularly important that MSC fully review supporting documentation for the minor repair reports because the Naval Criminal Investigative Service has found erroneous overtime documentation practices on the part of ship contract operators. These practices involved (1) ship officers' fraudulent rewriting of crew members' overtime sheets, (2) the contractor's application of nonreimbursable work toward the minor repair thresholds, and (3) the doublebilling of MSC for the same hours of work. During our review, we also found instances of doublebilling and the application of nonreimbursable work toward minor repair thresholds.

MSC Allows Inclusion of Cleaning Jobs in Minor Repair Reports

Another contractor was including cleaning jobs, which are nonreimbursable, in its minor repair reports. MSC did not require documentation that would have allowed it to verify that the contractor's crew had actually done the work or that the work was in fact minor repairs, rather than cleaning and maintenance work. The contracting

officer told us that MSC did not request this documentation because the paperwork was excessive and burdensome for MSC. According to the contract, the cleaning and maintenance of the ship are paid for in the fixed-price portion of the contract. Cleaning and maintenance work is not to be included in the contractor's listing of minor repairs; nor is it to be billed as a reimbursable expense.

While the contract contains a list of sample minor repairs, it does not contain a similar list of cleaning jobs. We asked contracting officials whether such lists might clarify what jobs can and cannot be claimed as minor repairs and therefore be reimbursable. They told us that the contract was already too specific and that adding such a list would be adversarial to the contractor because distinguishing between cleaning and minor repairs is by nature subjective.

During our review, we requested that the contractor for this second ship program provide supporting documentation for one of its minor repair reports. We reviewed this documentation for three ships for a 3-month period. We traced the contractor-generated list of minor repairs back to original timesheets filled out by the crew members. For one ship, we found that of the \$15,897 the contractor claimed to meet its minor repair threshold, \$3,202 (or 20 percent) was unsupported by crew overtime sheets.

In addition to this unsupported work, we found that at least 24 of the 131 jobs listed as minor repairs appeared to be cleaning or preventive maintenance. That is, 24 jobs—which cost \$2,445—were for wiping up oil; defrosting the icebox; cleaning the galley, oven, staterooms, and pantry; lubricating hoses; rotating stores; waxing floors; sweeping the deck; entering timesheet data; and other similar cleaning and preventive work. When MSC's invoice reviewer approved this list of minor repairs, he deducted only one job, which entailed waxing the decks. This deduction was for \$487.65.

For the other two ships' lists of minor repairs, we found that the contractor had similarly claimed cleaning and maintenance jobs as minor repairs. These included sweeping, picking up trash, removing dust and dirt, stripping and waxing decks, and cleaning the galley and a shower, among others. For these two ship reports, the MSC reviewer made no deductions at all.

**MSC's Invoice Review
Process Does Not Ensure
Minor Repair Reports'
Accuracy**

In our review of minor repair reports for a third ship program, we found numerous instances in which the supporting documentation did not match the jobs listed in the minor repair reports. For example, we found instances in which the contractor had listed the same jobs twice. In addition, we found instances in which the contractor had claimed work done by individual crew members, but its minor repair report did not include timesheets as documentation to verify that these crew members were actually aboard the ships and had done the work as claimed.

MSC personnel for this ship program review minor repair reports for "engineering content only." That is, they review these reports only to verify that the costs are reimbursable under the contract, not to verify the accuracy of the reports or to take steps that would detect duplicate listings.

**Documentation
Submitted With
Invoices Is
Insufficient to Ensure
That Subcontractors'
Prices Are Fair and
Reasonable**

Not only is MSC's oversight of crew repairs inadequate, but its review of invoices for subcontracted work (second-level maintenance) is insufficient to prevent excessive payments by MSC. First, MSC does not uniformly require contractors to provide supporting documentation with their invoices that would indicate that prices are fair and reasonable. Second, MSC headquarters invoice reviewers generally do not rely on available field staff to verify that the subcontracted work was done or that it was reasonably priced.

**Requirements for
Supporting Documentation
for Invoices Are
Inconsistent**

Included in all of MSC's contracts for the operation of its ships are clauses stating that the government is obligated to pay only the costs it deems are "fair and reasonable." In only one of its contracts, however, does MSC include requirements for the contractor to submit documentation with its invoices that would allow the invoice reviewer to determine whether the price of the goods or services is fair and reasonable. In this one contract, MSC states that without such documentation, it will not reimburse the contractor.

According to MSC, its subcontract review for one contractor was heightened because this contractor's purchasing system is not reviewed by the Defense Contract Management Command (DCMC), which is part of the Defense Logistics Agency. DCMC declined to review this contractor's purchasing system because the dollar value of its subcontracts was so low.

MSC stated that for all but this one contract, MSC has required the contractors to maintain DCMC-approved purchasing systems.

We analyzed the April 1995 DCMC audit of a contractor for two of the ship programs in our review. The DCMC auditors evaluated, among other things, whether the contractor had awarded subcontracts competitively and performed adequate price analysis and negotiations. At the end of its review, DCMC approved the contractor's purchasing system. However, it noted several weaknesses in this system and recommended corrective action. For example, DCMC found that only 54.5 percent of the contractor's purchase orders had been awarded competitively. For purchase orders under \$25,000, only 48 percent had been awarded competitively. Finally, DCMC found that for awards without competition, 63 percent of the purchase order files neglected to include detailed evidence of effective price analysis or negotiation. Among the agency's recommendations was that the contractor "assure that effective price analysis is performed for each applicable single-sole source purchase order over \$10,000 and to a lesser degree those under \$10,000." The contractor notified MSC that it intended to implement DCMC's recommendations.

Despite the weaknesses revealed in the DCMC audit of this contractor, MSC has not adjusted its oversight of the contractor's awarding of subcontracts under \$25,000. On the basis of what is submitted by the contractor to support subcontract invoices, the MSC invoice reviewer has no way of knowing whether the subcontract was awarded competitively or not. Neither does the supporting documentation show whether or how the contractor determined that prices were fair and reasonable. We asked the invoice reviewer for this program whether he had ever made deductions based on his determination that the price charged was not reasonable. He said that he only remembered questioning the reasonableness of price in two cases, in 1991 and 1992. One involved whether a technical representative had flown first class or coach, and the other involved whether the technical representative had rented the appropriate rental car. In neither case did the invoice reviewer determine that a deduction was necessary. We believe that these cases involved determining allowability of costs rather than reasonableness of costs. That is, under the terms of MSC's contracts with its ship operators, government regulations on travel apply. Allowing a technical representative to fly first class and drive a luxury rental car would violate the terms of MSC's contracts.

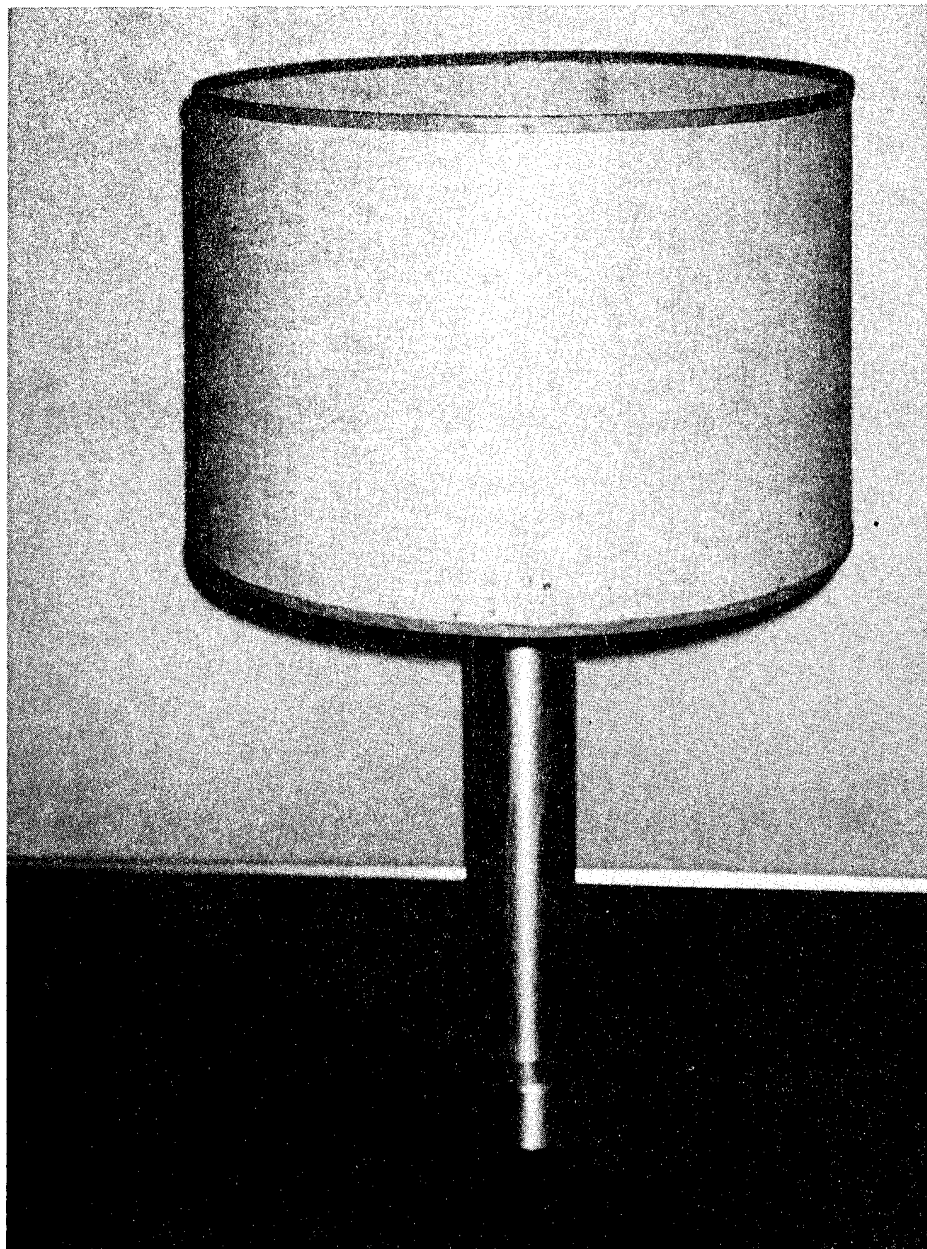
On the other hand, during our review of invoices for the ship program that does require documentation of fair and reasonable prices, we found that

invoices consistently included evidence of competitive bidding or a justification for a sole-source subcontract. We also found several cases in which an MSC field unit had deducted amounts from the contractor's invoices for inadequate documentation. For example, the field unit had deducted amounts for repairs and for repair parts because documentation did not indicate that the charges were fair and reasonable. We also saw a case in which the field unit deducted fax and telephone charges because the contractor had not submitted a statement explaining the nature of calls made to ensure the calls had been made for official government business. By contrast, for the contractor whose subcontracting weaknesses were cited by DCMC, we saw an invoice for \$1,456.73 for telephone calls for a 3-day period. The invoice contained no indication of whether any of these calls were for official government business, yet the invoice was approved for payment.

In our review of this same contractor's invoices, we found an invoice whose price appeared excessive. This invoice was for \$3,560 to "provide labor, tools and material as necessary to replace twenty (20) lampshades . . . [and] relamp and repair as necessary." The invoice included no evidence of whether this work had been awarded competitively, why it had not been done by the ship's crew, or how extensive the work was. Before approving this invoice for payment, the MSC invoice reviewer did not seek further information from the contractor. When we asked for an explanation of this invoice, the invoice reviewer said that he did not know whether the lamps had been repaired or whether the lampshades had simply been replaced.

After we requested supporting documentation from the contractor on this invoice, we found that MSC had paid \$260 per lamp to repair 10 lamps and replace their lampshades, when it could have purchased new lamps for \$210 each (excluding the costs of installation). Work on the other 10 lamps was less extensive, ranging from simply replacing the lampshades to replacing the toggle switches and/or modifying the lamp bases. (See fig. 2.1 for an example of the type of lamp repaired.) We also found that the ship's crew includes a qualified electrician whose overtime labor rate is about half that charged by the subcontractor.

**Figure 2.1: Example of the Type of
Lamp Repaired by a Subcontractor**



On another ship in this program, lampshades were replaced by the third assistant engineer, also at an hourly overtime rate about half that charged by the subcontractor. The master and the chief engineer on this ship stated that they could see no reason to use subcontractors to repair lamps because it is such a simple task and fully within the crew's capability.

MSC Field Staff Generally Not Involved in the Invoice Review Process

MSC headquarters personnel who review invoices do not know whether goods have been delivered or services provided, as dictated in MSC invoice certification instructions. In their review of invoices, headquarters personnel are ensuring that what is charged by the contractors is allowable under the terms of the contract. However, they are not ensuring that parts were actually delivered or work was actually done. In effect, these reviewers are relying heavily on the integrity of the contractors and are essentially approving all invoices for items or services allowed by the contract.

Field personnel, who could be used to personally verify that work has been done at reasonable costs, are primarily concerned with the condition and operation of the ships. A senior-level official from one field unit told us that when he wants something fixed, cost is not his main concern. On one program, MSC field personnel do not see invoices reflecting the cost of work performed as a result of their recommendations.

In two of the five contractor-operated ship programs, field staff are located near the ships and visit them regularly. These personnel could be used to verify that work billed MSC has been done and is reasonably priced. They could easily check work performed on the ships as part of their routine inspections. For one program, field staff are already reviewing invoices.

No Controls to Prevent Contractors From Circumventing Requirement to Receive MSC's Prior Approval for Subcontracts

The MSC contracting officer has no visibility over many large-dollar repair expenditures for one ship program. MSC's contract with its contract operator on this program requires that the contractor first obtain MSC approval before subcontracting for industrial assistance that costs more than \$25,000. This requirement is intended to help MSC ensure that it receives fair and reasonable prices for large repair jobs and that the work is needed. Because the contractor for this program breaks large jobs down into multiple smaller ones, it is evading the contractual requirement to obtain the contracting officer's prior approval. Contractor officials told us that they routinely split jobs into segments because these ships needed to be ready to go to sea with 4 days' notice. They said that they split jobs into

pieces because obtaining the MSC contracting officer's approval delays payment to the subcontractor.

During our review, we found that MSC has known about this practice since 1990. In a 1990 memorandum to MSC's Contracts and Business Management Directorate the former director of engineering at MSC stated that "although Contractors are required to obtain Contracting Officer approval for subcontracts in excess of \$25,000, there are many instances where Contractors have instituted procedures that evade compliance." These procedures, he said, included issuing multiple work orders, each less than \$25,000, to a single subcontractor. During our review, we asked MSC officials whether they had taken any action to prevent contractors from issuing multiple work orders and thereby evade the requirement to seek MSC's prior approval. They said they had not.

In one case, the contract operator split a job totaling \$143,740 into 18 separate jobs, each under the \$25,000 threshold. This work was for ship cleaning¹ that was done by the same subcontractor on the same ship over a 3-month period. After we requested that the contractor provide us with evidence that this work had been competitively awarded, we found that the contractor had obtained quotations from three subcontractors on the price per square foot for cleaning the ship. The contractor awarded the work to the lowest bidder based on a single price quotation. It then split the job into 18 smaller ones involving the cleaning of different parts of the ship.

In another case, this same contractor submitted 71 separate invoices totaling \$202,294 for welding-related work done by one subcontractor on one ship over a 4-month period. In many cases, multiple invoices were submitted to MSC on the same day. For example, 9 invoices were submitted on December 2, 1994; 12 were submitted on December 30, 1994; 18 were submitted on January 5, 1995; and 12 were submitted on February 10, 1995. Despite this pattern of billing, the MSC person responsible for reviewing these invoices said that he was not aware of the contractor's practice of splitting large jobs into smaller ones.

During our review, we asked the contractor to provide documentation showing which of these 71 jobs had been competitively bid or justified as sole source. He was able to show that only 30 had been awarded competitively and that 7 had been awarded sole source because they were

¹Normal ship cleaning is covered by the per diem payment under the contract, but in this case, the cleaning was required due to stevedore damage and was therefore reimbursable.

related to competitively bid work. The contractor did not supply documentation on the other 34 jobs.

MSC Does Not Consistently Verify That Overhaul Work Is Done and Prices Are Reasonable

MSC headquarters personnel review overhaul work packages and discuss them in detail with representatives from the contract operators' engineering staffs before overhaul subcontracts are solicited and awarded. However, even though a ship's overhaul can cost MSC up to \$6 million, MSC does not always have an MSC representative on-site during the overhauls to ensure that work contained in these work packages is actually done and that unforeseen repairs not specified in overhaul contracts are completed or are reasonably priced. This lack of assurance is due at least in part to the fact that MSC has no agencywide requirement for its representatives to be present during ship overhauls. This presence during an overhaul enables a representative of MSC to observe the condition of items of equipment when these items are opened and inspected and to determine the extent of needed repairs. In addition, the presence of an MSC representative enables MSC to monitor the extent of the repairs to prevent unneeded work. When an MSC representative is not present during an overhaul, MSC is relying entirely on the integrity and professionalism of the contract operator to protect the government's interest.

Even when MSC representatives are present, the amount of involvement among them, contract operators' representatives, and shipyard personnel varies because MSC has no written guidelines governing the authority and responsibilities of its representatives. For the three contractor-operated programs whose ships are owned by the government, we found that some MSC representatives significantly contributed to the contracting officer's ability to enforce the terms of MSC's contracts and to ensure that repairs were made in the best interest of the government. Other MSC representatives' contributions were not as significant.

Even though an MSC presence during overhauls helps to protect the government's interest, having an MSC representative on-site did not always ensure that MSC obtained negotiated prices on change orders. During one overhaul, we found that for \$271,755 of a total \$544,135 (about 50 percent) in change orders, the contract operator's and the shipyard's estimates were identical. For \$427,111 of this change order work (about 78 percent), the "negotiated" prices between the shipyard and the contract operator were the shipyard's estimated prices. The lack of clear written guidance on the authority and responsibilities of the MSC representative contributed to MSC's failure to obtain negotiated prices on this overhaul. Because the MSC

representative did not independently estimate change orders, MSC had no assurance that it did not pay excessive prices.

During this overhaul, the MSC representative was simply providing the administrative contracting officer with a statement that funds were available for the work. He was not preparing independent government estimates. Such independent estimates form the basis on which the government can challenge prices charged by the shipyard.

MSC does not have written guidance to address the oversight of work done by its contract operators' "extra" crew members during overhauls. During overhauls, MSC's ships maintain skeleton crews to monitor alteration, maintenance, and repair work and to provide security for the ships. However, MSC sometimes authorizes its contractors to retain additional crew members during overhauls when the contractors can provide justification for the special work requiring their retention. MSC has no written guidance regarding oversight responsibilities for this work, and it has not established procedures for taking deductions if the authorized work is not completed.

An MSC representative for one ship program told us that he routinely inspects the work of additional crew members during overhauls. However, the benefit of these inspections is questionable for two reasons. First, MSC does not use these inspections as a basis for taking contract payment deductions. The MSC representative who actually inspects the approved work items does not receive or review the bill for this work, and no one at MSC asks for the results of his inspection when the bill for the work is reviewed. Second, MSC does not require the contractor to obtain prior approval when changing the work items used to justify the extra crew members. The contracting officer for this program told us that she does not see why the contractor cannot deviate from the special work items it submitted as justification for its extra crew members.

We visited one ship from this program on the last day of its overhaul. During that visit we observed, as did an MSC representative, that many of the work items used to justify the ship's extra crew had been only partially completed or not completed at all. According to the MSC representative, this was not an isolated case, since on other overhauls he found that the work used to justify the extra crew had not been completed. Later that day we were told by the ship's master and chief mate that the work items had changed, and we were given a handwritten list of changes that had not been approved by MSC. Until that time, the MSC representative had not

known what jobs the extra crew members were actually doing. At the end of our review, MSC had still not received a bill for this work, 10 months after the completion of the overhaul.

MSC's Internal Controls Are Weak

As we discuss in this chapter, MSC's internal controls to prevent the possibility of contractor fraud and abuse are weak in many cases. MSC's Comptroller is responsible for the coordination of MSC's internal control program. However, according to the MSC Comptroller, he does not have direct authority to ensure the sufficiency of these controls or their implementation.

In 1990, Congress mandated governmentwide financial management reform by enacting the Chief Financial Officers (CFO) Act (P. L. 101-576). This act was based at least in part on the finding of Congress that "billions of dollars are lost each year through fraud, waste, abuse, and mismanagement among the hundreds of programs in the Federal Government." The Secretary of Defense has recognized that the CFO Act is a vehicle for improving DOD's financial operations. He has therefore directed that senior managers throughout DOD play a more active role in identifying, reporting, and correcting poor internal controls. This does not appear to have occurred at MSC.

Conclusions

MSC's oversight of ship repairs for its contractor-operated ships is inadequate to prevent overcharges. MSC lacks basic internal controls that would help to ensure that MSC is paying reasonable prices for work that is actually being done. Specifically, MSC lacks basic internal controls in its supervision of overhaul work, in its verification of crew-performed repairs, and in its review of invoices for subcontracts. Furthermore, though MSC's Comptroller is responsible for coordinating its internal controls, this person has no authority over internal controls throughout the agency.

Recommendations

We recommend that the Secretary of Defense direct the Commander of MSC to take the following actions:

- Institute MSC-wide procedures to ensure that contractors are (1) accurately reporting how they meet contract-defined thresholds for crew-performed minor repairs, (2) submitting adequate documentation with invoices for MSC to determine that prices are fair and reasonable, and (3) obtaining

prior MSC approval for subcontracted work above thresholds required by the contracts.

- When practical, require that MSC representatives verify, through spotchecks, that minor repairs and industrial assistance paid for by MSC have actually been done and recommend deductions if necessary. These spotchecks could be done by MSC personnel as part of their normal inspections.
- When practical, require an MSC representative to verify, based upon physical observation, the satisfactory completion of work performed at various stages of overhauls of MSC contractor-operated ships.
- Provide written guidance defining the roles, responsibilities, and authority of MSC representatives in protecting the government's interests during overhauls and other major repair work.
- Consider expanding the responsibilities of MSC's Comptroller or creating a new position for a financial management expert to oversee the implementation of the above recommendations. If a new position is created, this person should report directly to the Commander of MSC. In addition to the existing duties of the Comptroller, this person would be responsible for setting minimal internal controls for all aspects of financial management throughout MSC and overseeing the implementation of these controls. The responsibilities of this position would be similar to those of a Chief Financial Officer established under the CFO Act of 1990.

Agency Comments and Our Evaluation

In official oral comments, DOD partially concurred with the report and generally agreed with our recommendations. However, DOD generally disagreed with the details of the report and the conclusion that internal controls are weak. DOD did agree that there are opportunities for further improvements in the internal controls applied to contractor operation of MSC ships and said it has already implemented remedial measures. DOD also stated that in view of the unusual procurement situations highlighted in the report, the Commander of MSC is focusing additional attention on risk analysis and design of appropriate internal controls.

We continue to believe, based on the findings discussed in this chapter, that MSC does not have an adequate system of internal controls in place. Recent fraudulent practices of a former MSC contractor and the continuing investigation by federal law enforcement agencies into MSC operations support our conclusion that MSC's internal controls are inadequate.

Management Control Weaknesses Impede MSC's Efforts to Effectively Manage Its Ship Programs

Effectively managed programs have three things in common. First, program requirements are carefully and systematically established based on past experience and input from customers and knowledgeable people throughout the organization. Second, responsibility for monitoring program performance and ensuring that programs meet the established requirements is clearly delineated. Third, program managers are constantly looking for ways to improve program performance and to reduce costs. During our review, however, we found that MSC does not have the organizational structure or the standardized procedures necessary to effectively manage its contractor-operated ship programs. MSC does not have guidelines for systematically establishing personnel requirements such as citizenship and security requirements. Neither does it systematically compare contractual requirements with contractors' performance in obtaining security clearances and trustworthiness evaluations for crew members. Finally, MSC has no formal system to coordinate ideas to improve the contractors' performance or reduce the programs' costs.

Because its own management controls are weak, MSC relies heavily on its operating contractors to prevent contract abuses. The dangers of such a heavy reliance on contractors have been demonstrated through MSC's past experiences. For example, a now defunct ship management company billed and collected payments from MSC for fraudulent overtime aboard MSC's oceanographic ships. In another case, MSC management's poor oversight resulted in the deteriorated and unsafe condition of its sealift tankers and in the crewing of these ships with significant numbers of personnel who had been convicted of felonies. We reported on the condition of the sealift tankers and their crews in a 1994 report.¹

MSC's fragmented lines of organizational authority represent a significant impediment to sound management controls. MSC recognized the problems caused by its current organizational structure and planned to begin implementing a new program management structure on October 1, 1995. Under MSC's new structure, accountability that was previously divided among various MSC headquarters departments and field levels will reside with a single individual, the program manager.

¹U.S. Navy/Military Sealift Command: Weak Contract Administration Led to Unsafe and Poorly Maintained Ships (GAO/OSI-94-27, Aug. 31, 1994).

MSC Does Not Have Standard Procedures to Develop Personnel Requirements

Despite the fact that MSC's contract provisions can affect a ship program's operation for 20 years or more,² MSC does not have standard procedures to develop personnel requirements in its contracts. The personnel from MSC's Operations Office, who are responsible for coordinating contract requirements with the ship's sponsors, told us they do not follow checklists or standard procedures to ensure that important personnel requirements are not overlooked. Neither do they routinely consult existing contracts for other programs prior to the award of new contracts. As a result of this lack of standard procedures, MSC failed to review the resumes of some ships' crews, and some ships did not have U.S. citizenship, security clearance, or trustworthiness requirements for their crews.

Guidelines to Establish Crew Qualification Requirements Are Lacking

MSC has no guidelines to ensure that crew qualification requirements are consistently established. Qualified crew are critical, especially in situations such as underway refueling, where the chance of a collision at sea is significantly increased. Therefore, it is essential for ship owners, operators, and those who charter ships to take precautions to ensure that the crews are qualified.

Although four of the five ship program contracts we reviewed require contractors to submit the resumes of key personnel to MSC for approval before the personnel are assigned to a ship, the fifth ship program's contracts do not. An MSC official in charge of the fifth ship program told us that MSC did not need to review the resumes of crew members. He said that contractors should not crew their ships with improperly licensed crew members because they could be fined by the Coast Guard. However, for one program that required resumes, the contractor did attempt to crew its ships with improperly licensed crew members. After its review of resumes, MSC rejected two of the contractor's nominees for master positions because they did not have the proper licenses and had never served as chief mates on the program's ships.

Citizenship Requirements Overlooked

MSC's lack of standard procedures contributed to a routine citizenship requirement clause being left out of the contracts for one contractor-operated ship program. While contracts for four of the ship programs we reviewed included clauses requiring all crew members to be

²The T-5 tanker contracts run for 20 years, and the maritime repositioning ship contracts run for 25 years. Contracts for both these programs were written as 5-year contracts with a series of 5-year options. However, MSC generally exercises the options because it would incur large termination costs if it did not.

U.S. citizens, the fifth program did not include this clause. The contracts for this fifth program were signed in October 1982 and April 1983, just months after one of the other programs had signed contracts requiring all crew members to be U.S. citizens, in August 1982. Military and civilian officials in MSC's Pacific and Far East Offices expressed concern that all personnel aboard T-5 tankers were not U.S. citizens, and following the Persian Gulf War, MSC tried to add citizenship clauses to the T-5 contracts. When the contractor refused, MSC dropped the issue. The contract for this program still does not require all its crew members to be U.S. citizens, and only Coast Guard regulations limit the number of foreign nationals on these ships.³

While MSC's contracts for its other four contractor-operated ship programs require all the contractors' personnel assigned to ships to be U.S. citizens, they do not require the contractors' shore personnel to be U.S. citizens. MSC field personnel for one program said that MSC's failure to include this clause for shore personnel was an oversight on MSC's part. These field personnel said that the contractor, aware of this loophole, had proposed a port engineer who was not a U.S. citizen. However, this person was disapproved because a foreign national cannot hold a security clearance and thus would not have been able to deal with any ship maintenance or repair work that involved classified material.

**MSC Has No Guidelines for
the Establishment of
Security Clearance
Requirements in Contracts**

Contracts for all five of the ship programs we reviewed require at least some security clearances for the ships' crew members. However, no one at MSC has established guidelines for the inclusion of security clearance requirements in contracts. As a result, a key contract requirement was inadvertently left out in one case.

Four of the ship programs we reviewed had security clearance requirements in their original contracts. The fifth program added security clearance requirements during the ninth year of its contracts through contract modifications. These modifications required all corporate officers and the master, chief mate, and radio operator of each ship to have secret clearances.

³Coast Guard regulations allow 25 percent of the unlicensed crew members on U.S. flag ships to be foreign nationals.

No Trustworthiness Evaluations for Three Ship Programs Despite Concerns About Sabotage

Although the contracts for all five ship programs require some crew members to hold security clearances, only the T-AGOS and oceanographic ships' contracts require noncleared crew members to pass trustworthiness evaluations.⁴ Some MSC officials stated that these two ship programs have more stringent requirements for trustworthiness evaluations because of their sensitive missions.

However, the program manager for another program stated that security requirements for his ship program were based on the fact that the ships are subject to sabotage. Trustworthiness evaluations determine the loyalty of an individual by checking whether the individual has committed any prior act of sabotage, espionage, treason, or terrorism. For the three ship programs that do not require trustworthiness evaluations for their unlicensed crew members, MSC does not collect or review any background information about these crew members. The Coast Guard does require mariners working aboard U.S. vessels to hold merchant mariner documents that include a criminal record check every 5 years. However, MSC does not spot-check these documents. If MSC ships are subject to sabotage, trustworthiness evaluations should be required of all its ship crew members.

MSC Does Not Ensure That Contractors Comply With Requirements for Crew Trustworthiness and Security Clearances

No office in MSC is responsible for tracking trustworthiness evaluations and security clearances for MSC's contractor-operated ship programs to ensure that contractors are complying with contract requirements. MSC's Office of Security, Operations Office, and Operating Contracts Division are involved with the security clearances and trustworthiness evaluations of ship crews,⁵ but communication among these offices is poor. As a result, MSC cannot ensure that its crews are trustworthy or appropriately cleared, and untrustworthy individuals may be assigned to ships with sensitive missions for extended periods of time before they are removed. Though we did not document any unauthorized disclosures of classified material by contractor employees, we did find that 300 crew members who were later found to be untrustworthy had been assigned to MSC's ship programs for the time it took to conduct the trustworthiness evaluations. In one

⁴Like security clearance investigations, trustworthiness evaluations involve national agency checks of Federal Bureau of Investigation and other agency records to divulge negative information such as drug and alcohol abuse and felony convictions. However, trustworthiness evaluations do not require the extensive follow-up that security clearances require because crew members undergoing these evaluations do not have access to classified material.

⁵MSC makes its trustworthiness evaluations after receiving input from the Defense Investigative Service Personnel Investigations Center, which conducts background investigations.

case, it took 23 months to determine that a crew member was untrustworthy.

Trustworthiness Evaluations Completed Years After Crew Are Allowed to Sail on Ships

Three separate offices in MSC headquarters have distinct roles in maintaining information on contractor-operated ship crews. The Operating Contracts Division and the Operations Office maintain crew lists. The Office of Security maintains a list of trustworthy contractor personnel. However, no one from any of these three offices compares these lists to ensure that all crew members are trustworthy. In addition, the Office of Security does not track the length of time between the date the contractor submits the crew members' original paperwork to MSC and the date MSC completes trustworthiness evaluations. As a result, crew members who may sail aboard MSC contractor-operated ships as soon as their trustworthiness paperwork has been submitted may be found much later to be untrustworthy.

Over the last 8 years, MSC's Office of Security has completed trustworthiness evaluations for approximately 2,900 of the crew members on its contractor-operated ships. It has found that 300 of these crew members did not meet the trustworthiness criteria contained in the Navy's security instruction and thus had to be removed from MSC's ships.

Because the Office of Security destroys its original records after it makes trustworthiness determinations, we could not determine how long these 300 untrustworthy individuals had been assigned to the MSC ships with sensitive missions before they were removed. We were able, however, to determine how long it took to do 29 evaluations. We did this by matching a contractor's active crew list to MSC's trustworthiness file. Until MSC makes its trustworthiness evaluation, the contractor's active crew list contains the dates the crew members' forms were submitted. Once the evaluation is made, these original dates are lost because they are changed to the date of the completed evaluation. Therefore, we had to match an old crew list (containing the dates the forms had been submitted) to recently completed evaluations in MSC's trustworthiness file. Eight of the 29 evaluations were completed within 4 months. However, in three of the five cases in which MSC determined that the crew members were untrustworthy, the evaluations took 10 or more months to complete (see table 3.1). During the intervening months, the untrustworthy crew members were eligible to sail on MSC ships with the most sensitive missions. Crew members who require security clearances are not assigned to MSC's ships until their clearances have been completed.

Chapter 3
Management Control Weaknesses Impede
MSC's Efforts to Effectively Manage Its Ship
Programs

Table 3.1: Processing Time for 29 Trustworthiness Evaluations

Time to process evaluations	Trustworthy crew members	Untrustworthy crew members
2 to 3 months	4	0
4 months	4	0
5 to 9 months	9	2
10 to 15 months	7	2
23 months	0	1
Total	24	5

Even though more than 10 percent of the crew members MSC evaluated over the last 8 years were found to be untrustworthy and were removed from its ships, trustworthiness evaluations are still processed slowly. For example, when we matched one contractor's August 1994 crew list to MSC's trustworthiness evaluation file (updated through March 1995), we found that MSC had completed 255 of the 341 evaluations required for the contractor's crew members, but it had not completed the remaining 86 evaluations (see table 3.2). The trustworthiness evaluation forms for 21 of the 86 crew members were submitted in 1994. However, the forms for one crew member had been submitted in August 1989, and MSC had still not completed its evaluation in March 1995, almost 6 years later.

Table 3.2: Trustworthiness Evaluations for One Contractor

Year	Number of evaluations completed by year	Number of evaluation packages submitted but not completed by year
1995	8	^a
1994	47	21
1993	44	17
1992	30	21
1991	45	17
1990	20	9
1989 or earlier	61	1
Total	255	86

^aBecause we used an August 1994 crew list, our analysis did not contain any packages submitted in 1995. However, eight packages for members of the 1994 list who had submitted their paperwork in 1994 or earlier were completed in 1995.

In addition, four of the contractor's shore personnel had access to the ships with sensitive missions, even though they did not have security clearances and were not required by the contract to undergo trustworthiness evaluations.

MSC's trustworthiness evaluations for crew members on ships in MSC's other sensitive program were delayed as well. We reviewed January 1995 crew lists for all four ships in this program and found that MSC had completed only 39 of the 94 required trustworthiness evaluations.

MSC Does Not Ensure That Contractual Requirements for Security Clearances Are Complied With

While we did not document any unauthorized disclosures of classified material by the employees of MSC's contract operators, we found that MSC is vulnerable to unauthorized disclosures because it is not consistently enforcing requirements for its security clearances. All of MSC's contract operators must obtain their required clearances from the Defense Industrial Security Clearance Office, but MSC does not monitor all its contract operators to ensure that they are complying with this requirement. For one program, MSC keeps lists of the contractors' cleared personnel in three different places—the Office of Security, the Operating Contracts Division, and the Operations Office. However, for another program, no one at MSC keeps track of the contractor's cleared personnel. There was confusion about who was responsible for this tracking, and when we interviewed personnel from MSC's Office of Security, Operating Contracts Division, Engineering Directorate, and Operations Office, we found that none of them had documentation showing that the officers on the ships held the proper clearances. In addition, when we visited one of this program's ships, the master told us that only he and the radio officer had secret clearances. The contract required the chief mate to have a secret clearance as well.

Even when MSC does receive clearance letters from the contractors, it does not verify the clearances with the Defense Industrial Security Clearance Office or compare the clearance letters with the contractor's active crew lists to ensure the clearance lists are complete. Therefore, MSC cannot verify that all its contractor personnel and crew members have appropriate security clearances.

No Systematic Approach to Identify and Implement Best Practices

When we talked to MSC's program managers, they told us that MSC does not have a formal system for them to get together, share ideas, and evaluate the costs of different contracting techniques. As a result, MSC may be missing opportunities to implement best practices. For example, the contractor-operated ship programs we reviewed used two different contracting methods to control ship maintenance and repair costs. However, no one at MSC has compared the two contracting methods to determine whether one method is more cost-effective than the other and

therefore should be adopted for all of MSC's contractor-operated ship programs.

Under one method, MSC uses a yearly budget to predict the maintenance and repair costs of its T-5 tankers. The operating contractor submits a proposed budget to MSC 30 days prior to each annual operating hire period. This proposed budget is based on historical costs and planned maintenance that will be completed in the following year. Personnel from MSC's Engineering and Contracting Directorates review the proposed budget and develop their own estimates. MSC and the contractor then negotiate a final budget through a contract modification. The contractor must submit quarterly reports that separate parts and technical representative services for 24 different maintenance and repair categories. At the end of the year, the Defense Contract Audit Agency audits the contractor's actual maintenance and repair costs based on a stratified statistical sample of invoices. If actual costs exceed budgeted costs, MSC reimburses the contractor. If budgeted costs are higher than actual costs, the contractor credits MSC.

When we reviewed one year's records for the T-5 tankers we found that three ships were under budget, and two were over budget. The actual maintenance and repair cost for all T-5 tankers combined was within 6 percent of the budget. According to the contracting officer, because this process worked so well on the T-5 tankers, he later incorporated it into most of his contracts for the maritime repositioning ships.

In awarding contracts for three other contractor-operated ship programs, MSC uses a threshold method to control its maintenance and repair costs. This method, however, has not accurately predicted maintenance and repair costs, and it does not attempt to do so. It attempts only to set a fixed price for a portion of the repair costs.

Under the threshold method, MSC sets a level of maintenance for the contractor to accomplish each month. This threshold is generally expressed in terms of a number of overtime hours of work to be done by a particular crew member—often the second engineer. The threshold method of controlling costs offers less flexibility than the budget method used on the T-5 tankers and maritime repositioning ships because unlike the budget, the threshold remains constant over the life of these short-term⁶ contracts.

⁶While the maritime repositioning ships and T-5 tankers have 25- and 20-year contracts, respectively, the fast sealift, T-AGOS, and oceanographic ships have 3- to 5-year contracts.

Contractors do not always submit monthly maintenance reports, as required under the threshold method, and the level of maintenance and repair reported is rarely close to the threshold level. Consolidated maintenance and repair figures vary among programs and contractors, but the fiscal year 1994 figures for one ship program were almost twice the threshold level. The maintenance and repair cost for each ship in that program was 59 to 175 percent more than the ship's threshold level. The second program was 13 percent over threshold for the contract period. MSC awarded a new contract for the third program on May 23, 1995, but as of October 10, 1995, MSC still could not determine whether the operator under the previous contract was over or under the threshold. This was largely due to contractor delays in submitting reports.

While the threshold method controls costs by setting a fixed price for all work up to the threshold level, maintenance and repair work above the threshold is fully reimbursable, and the contractors are not required to obtain prior approval for this work. MSC plans to expand its thresholds in the future by including preventive maintenance, cleaning, and other work that is excluded under the current thresholds. However, if MSC does not accurately predict the costs of this excluded work and increase the threshold amounts appropriately, the contractors could quickly reach the threshold levels and then be fully reimbursed for all additional work.

Fragmented Lines of Authority Impede Sound Management Controls

Until November 28, 1994, MSC had not formally designated program managers for any of its contractor-operated ship programs. However, on that date MSC's Commander directed the head of the Operations Office to formally appoint program managers for several ship programs. As a result, two individuals from the Operations Office were designated as program managers for the five contractor-operated ship programs we reviewed. One individual was designated as the program manager for the T-5 tankers and the fast sealift ships. The other was designated as program manager for the oceanographic, maritime repositioning, and T-AGOS ships.

Since these program managers are not assigned any staff outside the Operations Office, they rely on MSC's various headquarters and field organizations to cooperate in developing and administering their program requirements. That is, the legal, contracting, engineering, accounting, and security personnel who administer various parts of the contractor-operated ship programs are all located in different departments in MSC and report to the heads of their individual departments. Also, ship programs that are contractor-operated are not collocated but, rather, are

spread out over several departments. Such an organization is not conducive to the uniform administration of contracts or to the dissemination of best practices. Ultimately, it has contributed to MSC's failure to ensure that its contractors comply with their contracts. Specifically, MSC's fragmented lines of authority have hindered enforcement of trustworthiness and security provisions.

Personnel Frustrated by MSC's Organization

Some MSC personnel we talked to were very frustrated with MSC's unclear lines of authority, especially with the chain of command for contracting issues. The contracting officer's representative for one program told us that upper-level management provides minimal leadership and the contracting officer's representative has little authority to act independently.

Until recently, another program did not even have a contracting officer's representative. The contracting officer for that program designated a person in the Operations Office to serve as his contracting officer's representative on October 28, 1994. However, this person did not sign his authorization letter until August 29, 1995, the day after we had discussed our completed review with MSC officials.

MSC's Proposed Actions to Improve Accountability

MSC is planning a reorganization to "clarify accountability, responsibility, and authority" for its ship programs. Under the proposed reorganization, six program managers will oversee MSC's ship programs. Unlike the current program managers, these new program managers will have authority over staff members assigned to their programs from the field and from the Operating Contracts Division and the Engineering Directorate. MSC's new program management structure was scheduled for implementation beginning in October 1995.

Conclusions

MSC's plan to designate program managers and to establish formal lines of accountability from personnel in the field and from the Operating Contracts Division and the Engineering Directorate directly to the program managers will improve communication within ship programs and should improve MSC's ability to monitor contractors' compliance with the terms of their contracts. However, MSC still will not have a system in place to systematically establish personnel requirements and to identify and implement best practices. The use of standardized procedures and best contracting practices is important for all ship programs, but it is especially

critical for contractor-operated ship programs where a single contract may remain in effect for 20 years or more.

Recommendations

We recommend that the Secretary of Defense direct the Commander of MSC to take the following actions:

- Develop and require the use of standardized procedures by program managers and their staffs whenever possible to establish personnel requirements in their contracts.
- As part of MSC's upcoming reorganization, direct program managers to clarify accountability by (1) assigning a specific individual responsibility for each contract requirement and (2) periodically checking that contract provisions, such as those dealing with trustworthiness and security clearances, are correctly administered and met.
- Instruct program managers and contracting personnel to meet to discuss and evaluate ways to identify and implement best practices into their contractor-operated ship programs.

Agency Comments and Our Evaluation

DOD concurred with the recommendations contained in this chapter. However, it did not concur with our findings that (1) MSC does not have standard procedures to develop personnel requirements and (2) MSC has no systematic approach to identify and implement best practices. In addition, DOD only partially concurred with our findings that (1) MSC does not ensure that contractors comply with requirements for crew trustworthiness and security clearances and (2) fragmented lines of authority impede sound management.

In disagreeing with the finding concerning standard procedures for personnel requirements, DOD stated that MSC evaluates lessons learned from operating contracts before issuing solicitations for new contracts. It also stated that while MSC does not require 100 percent of its tanker crews to be U.S. citizens, currently, all of them are. We maintain that MSC's failure to require 100 percent citizenship on its T-5 tankers indicates that MSC does not always evaluate lessons learned from other ship operating contracts. In contracts signed less than a year before the T-5 tanker contracts, MSC required that 100 percent of the maritime prepositioning ships' crews be U.S. citizens. Furthermore, in contracts signed after the T-5 tanker contracts, MSC required that all crew members be U.S. citizens on T-AGOS, fast sealift, and oceanographic ships. Although all the crew members now on the tankers are U.S. citizens, this was not the case in the past. For

Chapter 3
Management Control Weaknesses Impede
MSC's Efforts to Effectively Manage Its Ship
Programs

example, past crews have included citizens from Romania and Yemen. In addition, there is no guarantee 100 percent of the future crew members will be U.S. citizens, since that is not an MSC requirement.

In disagreeing with the finding concerning best practices, DOD stated that best practices are shared, but the budgeting system used for the maritime prepositioning ship and T-5 tanker programs is not appropriate for other ship programs because the circumstances and contract terms are different. In our report, we acknowledged the differences between the T-5 tankers and maritime prepositioning ships and the rest of the contractor-operated ships we reviewed. However, these differences do not preclude the sharing of best practices between the programs. Furthermore, MSC has not done a cost comparison between the two different methods of controlling maintenance and repair costs.

Although DOD partially concurred with our finding concerning MSC's tracking of crew trustworthiness and clearances, it said that trustworthiness evaluations are done by the Defense Investigative Service and the reports should be destroyed following final action. As our report points out, trustworthiness determinations are made by MSC, not by the Defense Investigative Service. Although the Defense Investigative Service reports MSC uses during the trustworthiness evaluation process must be destroyed after a final determination is made, MSC can and should track whether or not crew members have trustworthiness evaluations.

Although DOD partially concurred with our finding concerning fragmented lines of authority, it stated that lines of authority have always delineated responsibilities for contractor-operated ships. We maintain that the lines of authority and responsibility were not always clearly delineated in the past, particularly regarding contracting officers' representatives.

Ships Visited During Our Review

Name	Type	Location
USNS Bold	T-AGOS	Norfolk, Va.
USNS Kane	Oceanographic	Jacksonville, Fla.
M/V 2nd Lt. John P. Bobo	Maritime prepositioning	Norfolk, Va.
M/V Richard G. Matthiesen	T-5 tanker	Charleston, S.C.
USNS Altair	Fast sealift	New Orleans, La.
USNS Algol	Fast sealift	New Orleans, La.
USNS Bellatrix	Fast sealift	New Orleans, La.
USNS Pollux	Fast sealift	New Orleans, La.
USNS Regulus	Fast sealift	New Orleans, La.

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