Report No. D-2008-083 April 25, 2008

Inspector General

United States Department of Defense

Obligation of Funds for Ship Maintenance and Repair at the U.S. Fleet Forces Command Regional Maintenance Centers

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Acronyms

ASN (FM&C)	Assistant Secretary of the Navy (Financial Management and Comptroller)
CFFC	Commander, U.S. Fleet Forces Command
DoD FMR	DoD Financial Management Regulation
DON	Department of the Navy
IDIQ	Indefinite-Delivery/Indefinite-Quantity
JFMM	Joint Fleet Maintenance Manual
MSMO	Multi-Ship/Multi-Option
NAVSEA	Naval Sea Systems Command
PBIS	Program Budget Information System
RMC	Regional Maintenance Center
STARS	Standard Accounting and Reporting System

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

April 25, 2008

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
COMMANDER, U.S. FLEET FORCES COMMAND
COMMANDER, NAVAL SEA SYSTEMS COMMAND
COMMANDER, REGIONAL MAINTENANCE CENTERS

SUBJECT: Report on Obligation of Funds for Ship Maintenance and Repair at the U.S. Fleet Forces Command Regional Maintenance Centers (Report No. D-2008-083)

We are providing this report for information and use. We considered management comments on a draft of this report when preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Kenneth B. VanHove at (216) 706-0074, extension 245 or Ms. Carrie A. Wade at (216) 706-0074, extension 230. See Appendix B for the report distribution. The team members are listed inside the back cover.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Financial Auditing Service

Department of Defense Office of Inspector General

Report No. D-2008-083 **April 25, 2008**
(Project No. D2007-D000FC-0151.000)

Obligation of Funds for Ship Maintenance and Repair at the U.S. Fleet Forces Command Regional Maintenance Centers

Executive Summary

Who Should Read This Report and Why? DoD contracting officials and the Department of the Navy Regional Maintenance Center personnel involved in private contracting for ship maintenance and repair projects should read this report. This report is the first in a series addressing whether the Department of the Navy has obligated funds for ship maintenance and repair in accordance with applicable Federal and DoD regulations. The report discusses the business practices used to obligate funds for ship maintenance and repair projects at the three U.S. Fleet Forces Command Regional Maintenance Centers.

Background. Each fiscal year, the Department of the Navy receives Operation and Maintenance funding for ship maintenance and repair. Operation and Maintenance funds are available for obligation for one fiscal year. If funds are not obligated within that period, they are generally not available for obligation. For FY 2007, the Department of the Navy received approximately $3.8 billion in Operation and Maintenance funds for ship maintenance and repair. The Assistant Secretary of the Navy (Financial Management and Comptroller) provides Operation and Maintenance funds to: the Commander, U.S. Fleet Forces Command; the Commander, U.S. Pacific Fleet; and the Commander, Naval Sea Systems Command. The Commander, U.S. Fleet Forces Command is responsible for programming and budgeting resources for ship maintenance and repair at three Regional Maintenance Centers: the Mid-Atlantic in Norfolk, Virginia; the Southeast in Mayport, Florida; and the South Central in Ingleside, Texas.

Each Regional Maintenance Center is led by a commander and is responsible for the coordination and execution of ship repairs and modernization. Each Regional Maintenance Center is also responsible for the budgeting, procurement, contract administration, and technical direction for its assigned ships. The three U.S. Fleet Forces Command Regional Maintenance Centers use private contractors to complete ship maintenance and repair projects. They primarily use three types of contracts when contracting with the private sector for ship maintenance and repair projects: multi-ship/multi-option contracts, indefinite-delivery/indefinite-quantity contracts, and firm-fixed-price contracts. Regardless of the contract type utilized, the contracts, options, or orders serve as support for the obligation amounts recorded within the Navy's accounting system. The Department of the Navy uses the Standard Accounting and Reporting System as its official accounting system for recording the obligation of funds.

Results. The Mid-Atlantic, Southeast, and South Central Regional Maintenance Centers inappropriately obligated funds for contingent liabilities on ship maintenance and repair contracts. As a result of the inappropriate obligations, at least $103 million of U.S. Fleet Forces Command Operation and Maintenance funds were not available for other ship

maintenance and repair needs. The Assistant Secretary of the Navy (Financial Management and Comptroller) should issue guidance prohibiting the obligation of funds for contingent liabilities on ship maintenance and repair. The Commander, U.S. Fleet Forces Command should develop and implement a plan to monitor the obligation of funds at the Regional Maintenance Centers to ensure that the practice of obligating funds for contingent liabilities is discontinued and that amounts for these items are deobligated on current contracts. The Commander, Regional Maintenance Centers should discontinue the business practice of obligating funds for contingent liabilities. In addition, the Regional Maintenance Centers should deobligate funds on current contracts for the contingent liabilities. See the Finding section of the report for the detailed recommendations.

After communicating our concerns to the Assistant Secretary of the Navy (Financial Management and Comptroller) and the Naval Sea Systems Command legal counsels about the obligation of funds for contingent liabilities, the Assistant Secretary of the Navy (Financial Management and Comptroller) responded with a memorandum dated November 28, 2007. In the memorandum, they agreed with our conclusion that they should discontinue the business practice of obligating funds for award fees pools and growth pools. In addition, they indicated that the practice of obligating funds on miscellaneous documents for contingent liabilities had been discontinued.

Department of the Navy internal controls were not effective, and we found a material internal control weakness: existing Department of the Navy guidance does not clearly define what constitutes a specific and definite need when obligating funds on ship maintenance and repair contracts. See the Finding for further details on the material internal control weakness.

Management Comments and Audit Response. We received comments from the Assistant Secretary of the Navy (Financial Management and Comptroller) concurring with our recommendations. The comments were responsive to the issues we identified in our report, and no additional comments are needed. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

Each fiscal year, the Department of the Navy (DON) receives Operation and Maintenance funding for ship maintenance and repair. Operation and Maintenance funds are available for obligation for one fiscal year. If funds are not obligated within that period, they are generally not available for obligation. For FY 2007, the DON received approximately $3.8 billion in Operation and Maintenance funds for ship maintenance and repair. The Assistant Secretary of the Navy (Financial Management and Comptroller) [ASN(FM&C)] provides the Operation and Maintenance funds to: the Commander, U.S. Fleet Forces Command (CFFC); the Commander, U.S. Pacific Fleet; and the Commander, Naval Sea Systems Command (NAVSEA). The CFFC is responsible for programming and budgeting resources for ship maintenance and repair at:

- Mid-Atlantic Regional Maintenance Center, Norfolk, Virginia;
- Naval Submarine Support Facility, Groton, Connecticut;
- Norfolk Naval Shipyard, Norfolk, Virginia;
- Portsmouth Naval Shipyard, Portsmouth, New Hampshire;
- Southeast Regional Maintenance Center, Mayport, Florida;
- South Central Regional Maintenance Center, Ingleside, Texas; and
- Trident Refit Facility, Kings Bay, Georgia.

This report is the first in a series addressing whether the DON has obligated funds for ship maintenance and repair in accordance with applicable Federal and DoD regulations. This report discusses the business practices used to obligate funds for ship maintenance and repair projects at the three CFFC Regional Maintenance Centers (RMC). The three CFFC RMCs use private contractors to complete ship maintenance and repair projects. The office of the Commander, Regional Maintenance Centers in Norfolk, Virginia was established on October 1, 2007, to lead the RMCs in developing and supporting standardized maintenance processes.

Funds Authorization and Accounting Systems. The DON uses the Program Budget and Information System (PBIS) and the Standard Accounting and Reporting System (STARS) automated financial systems to account for ship maintenance and repair funds. Each quarter, the DON uses PBIS to transfer budget authority for ship maintenance and repair funds to the CFFC and other organizations that, in turn, send the funds to the RMCs.[1] The RMCs then have the authority to obligate funds on behalf of the CFFC. The RMCs obligate funds in STARS, the official accounting system used by the DON to record obligations. According to a CFFC representative, STARS information should be reconciled to PBIS at the end of each fiscal year.

[1] Budget authority is the authority that becomes available during the year to enter into obligations that result in immediate or future outlays of Government funds.

Regional Maintenance Centers. The RMCs are operational shore activities led by an RMC commander. Each RMC is responsible for the coordination and execution of ship repairs and modernization. RMCs are also responsible for the budgeting, procurement, contract administration, and technical direction of their assigned ships. Each RMC includes the following offices:

Finance Office. The finance office manages budgetary controls and obligates funds for the RMCs. It also performs tri-annual reviews of obligations to ensure their validity.

Contracts Office. Contracting officers monitor contractor performance based on feedback from the waterfront operations personnel. Contracting office personnel are responsible for creating and approving contracting actions, such as contract modifications.

Waterfront Operations Office. The waterfront operations office plans ship maintenance and repair projects, coordinating with private contractors. It also provides oversight for all contractor work accomplished aboard ships. The waterfront operations office has maintenance teams to monitor performance of ship maintenance and repair projects. The maintenance teams consist of a port engineer, a project manager, and a production supervisor, among others.

Ship Maintenance and Repair Contracts. The Mid-Atlantic, Southeast, and South Central RMCs use three types of contracts when contracting with the private sector for ship maintenance and repair projects: multi-ship/multi-option (MSMO) contracts, indefinite-delivery/indefinite-quantity (IDIQ) contracts, and firm-fixed-price contracts. Regardless of the contract strategy used, the contracts, options, or orders serve as support for the obligation amount recorded within STARS.

MSMO. MSMO contracts are most commonly used. They are cost-reimbursable contracts awarded to a prime contractor. NAVSEA awards these contracts for the base year plus several option years. Ship maintenance and repair activities use the contract for the repairs to an entire ship class.[2] Each ship maintenance and repair project represents a contract option, and the RMC contracting officer exercises these options by creating modifications to the contracts. The RMCs work with contractors to plan and execute the work for each option.

IDIQ. IDIQ contracts provide for an indefinite quantity of supplies and services over a fixed period. The RMC awards contracts to contractors for a period of time, and the RMC prepares individual delivery orders for services when needed.

Firm-Fixed-Price. Firm-fixed-price contracts are for supplies and services performed at a fixed price and are not adjusted for the contractor's costs in performing the contract. The Southeast RMC uses this contract type for ship maintenance and repair projects; however, the Southeast RMC plans to replace firm-fixed-price with MSMO contracts as the firm-fixed-price contracts expire.

[2] A ship class is a group of ships of similar design.

Objectives

Our overall audit objective was to evaluate whether the DON correctly obligated funds for ship maintenance and repair. Specifically, we tried to determine whether the DON has obligated funds for ship maintenance and repair in accordance with applicable federal and DoD regulations. See Appendix A for a discussion of the scope and methodology and prior coverage related to the objective.

Review of Internal Controls

We identified a material internal control weakness as defined by DoD Instruction 5010.40, “Managers’ Internal Control (MIC) Program Procedures,” January 4, 2006. Specifically, existing DON guidance does not clearly define what constitutes a specific and definite need when obligating funds on ship maintenance and repair contracts. Implementing all recommendations in this report will correct this weakness. A copy of the final report will be provided to the senior official responsible for internal controls in the Department of the Navy.

Obligations for Contingent Liabilities

The Mid-Atlantic, Southeast, and South Central Regional Maintenance Centers inappropriately obligated funds for contingent liabilities on ship maintenance and repair contracts because its business practices did not comply with established laws and regulations. As a result of these inappropriate obligations, at least $103 million of Commander, U.S. Fleet Forces Command Operation and Maintenance funds were not available for other ship maintenance and repair needs.

Obligation Process

Each quarter, CFFC provides ship maintenance and repair budget authority to the Mid-Atlantic, Southeast, and South Central RMCs, which allows them to commit or obligate funds. Commitments are the administrative reservation of funds in anticipation of an obligation. The amount recorded as a commitment is the estimated cost of goods or services. Obligations are recorded when the Federal Government enters into a legally binding agreement for the payment of specific goods and services. This can occur when an agency places an order or signs a contract. Federal laws, DoD regulations, and DON guidance address the amount to be recorded as an obligation and when to obligate funds.

Section 1501, Title 31, United States Code. Section 1501, title 31, United States Code (31 U.S.C. 1501) states that an amount should only be recorded as an obligation when supported by documentary evidence of an agreement between an agency and another party. The obligation must be made within the period of the appropriation's availability and must be used for specific goods to be delivered or services to be provided.

Section 1502, Title 31, United States Code. Section 1502, title 31, United States Code (31 U.S.C. 1502) states that the balance of an appropriation is available to pay expenses incurred during the time the appropriation was available for obligation. The balance may also be used to complete contracts made within the period the appropriation was available for obligation.

DoD Regulation 7000.14R, "DoD Financial Management Regulation," Volume 3, Chapter 8, "Standards for Recording and Reviewing Commitments and Obligations," November 2000. The DoD Financial Management Regulation (DoD FMR) states that a contingent liability should be recorded as an obligation when a modification is executed or an adjustment is made based on the occurrence of an event that determines the amount of the liability. In addition, the regulation states that when a contract is awarded, an obligation should be recorded for the total estimated cost provided by the contract. For cost-plus-award-fee contracts, the obligation for the award fee should not be recorded until the fee has been earned.

Joint Fleet Maintenance Manual, Volume 7, "Contracted Ship Maintenance." The Joint Fleet Maintenance Manual (JFMM) states that it is extremely important that unobligated funds be returned to the CFFC as soon as any excess is identified so that funds may be applied to other requirements before the appropriation expires. If additional funds are required for the completion of contract changes after the end of the fiscal year, the RMCs are to request the funds from the CFFC. Contract modifications that are outside the scope of the contract are chargeable to funds current at the time the modification is authorized. The JFMM also states that it is the responsibility of the maintenance team to authorize contracting officers to commit funds for growth work.[3]

DON, Navy/Marine Corps Award-Fee Guide, July 2004. The award fee guide states that an amount for a potential award fee should be committed as a contingent liability prior to the determination that the award fee has been earned. Obligation of the earned award fee amount occurs after the contractor's performance is evaluated and a contract modification has been issued.

Contingent Liability Obligations

The Mid-Atlantic, Southeast, and South Central RMCs inappropriately obligated funds for contingent liabilities on ship maintenance and repair contracts. Contingent liabilities are a set of circumstances that create the possibility of a future loss. The circumstance will ultimately be resolved when one or more events occur or fail to occur. A contingent liability should be committed as an estimated amount for additional obligations that probably will materialize. The commitment of the contingent liability becomes an obligation once there is a binding agreement for specific goods and services. Table 1 provides a breakdown of the contingent liability obligations we found, identified by type.

Table 1. Obligations for Contingent Liabilities

Contingent Liabilities	Obligation Documents	Obligation Amount
Award Fee Pools[4]	395	$ 48,564,904
Growth Pools	125	39,098,860
Reservation Pools	44	1,065,378
Premium Pools	34	4,896,348
Miscellaneous Documents	3	9,874,428
Total		**$103,499,918**

Award Fee Pools. RMC contracting officers obligated approximately $48.6 million on 395 MSMO contract modifications for award fee pools prior to the

[3] Growth work is any additional work that is identified after contract award or finalization that is related to a work item included in the contract award.

[4] A pool is a sum of money put away for a particular purpose.

awards being earned. An award fee pool is an amount of funds used as an incentive for the contractor to meet various performance measures. An award fee board meets biannually to evaluate contractor performance and decide how much contractors have earned, based on their progress to date. Depending on their performance level, contractors can receive all or a portion of the award fee pools.

On all 395 MSMO contract modifications, the contracting officers included the entire potential award fee pool within the amount awarded on the contract modification. The contract award amount corresponded to an obligation amount recorded in STARS. This shows that the entire award fee pool was obligated at the time the contract was awarded, before the contractor earned the award fee. For example, the Mid-Atlantic RMC contracting officers obligated $2.1 million for the award fee pool, on a contract modification awarded for $21.4 million, prior to the contractor earning the fee.

Growth Pools. RMC contracting officers obligated approximately $39.1 million on 125 MSMO contract modifications for growth pools. Growth pools are a percentage added to the total value of the contract amount for anticipated unknown work. Each ship maintenance and repair project consists of multiple work items or tasks required to complete repair of the ship. According to RMC personnel, the RMCs can use growth pool funds to complete work related to any work item during a ship maintenance and repair project. In one example, at the Mid-Atlantic RMC, contracting officers obligated approximately $2.3 million, almost 10 percent of the award amount, in a growth pool prior to the identification of the work on a contract modification.

According to RMC officials, historical data covering repairs made to a common class of ship supported the growth pool amounts. We did not find evidence of the historical data in the contract files that would support the growth pool amounts. When the contracting officers responsible for the contracts were asked to provide other historical support for the growth pool amounts, they were unable to do so. In addition, the contract files did not identify what work would be completed using the growth pool funds.

A contracting officer at the Mid-Atlantic RMC stated that a Technical Analysis Report supported the growth pool percentage.[5] When a Technical Analysis Report was available for review, the report provided a statement that the growth pool percentage applied was fair and reasonable, but it did not contain data to support this determination.

Reservation Pools. RMC contracting officers at the Mid-Atlantic and South Central RMCs obligated approximately $1.1 million on 44 MSMO contract modifications, firm-fixed-price contracts, and IDIQ contracts for reservation pools. According to the Regional Maintenance Officer memorandum, "Reservation Business Rules," November 22, 2006, a reservation pool is "known work which cannot be fully defined in advance." The reservation pools are work-item specific. An example from a contract modification of a reservation pool for one work item is as follows:

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[5] A Technical Analysis Report is a documented examination and evaluation by the Government of the contractor's proposal for reasonability.

> Provide 250 man-days of labor and $50,000 of material to Assist Ship's Force in accomplishment of work beyond the capability of Ship's Force as directed by the SUPERVISOR. Total cost greater or less than above man-day and dollar amounts, when authorized, will be subject to an equitable adjustment.

When questioned, NAVSEA officials stated that the reservation pools were for emergent work and were based on historical averages for similar repairs to ships of the same type. We did not find evidence in support of the historical averages in the contract files reviewed for MSMO contract modifications. There was also no support for the estimated labor and materials used for the reservation pool. When the contracting officers responsible for the contracts were asked to provide support for the reservation pool amounts, they were unable to do so. Although reservation pool amounts were associated with specific work items, the reservation amounts were for work that may or may not occur.

Premium Pools. Mid-Atlantic RMC contracting officers obligated approximately $4.9 million on 34 MSMO contract modifications for premium pools related to anticipated overtime work. According to the contracting officers, premium pools fund overtime work for any work item completed during the entire ship maintenance and repair project. For example, contracting officials awarded and obligated approximately $665,000 for a premium pool for one contract modification prior to the need for the overtime work. The contract files for the contract modifications reviewed did not contain support for the amount of estimated overtime work included in the premium pool. The specific work items the premium pool funds were associated with were not included in the contract files reviewed. When the contracting officers responsible for the contracts were asked to provide support for the premium pool amounts, they were unable to do so.

Miscellaneous Documents. In September 2006, finance officials at the Mid-Atlantic and Southeast RMCs obligated approximately $9.9 million on three miscellaneous documents for anticipated needs on existing contracts. The RMCs use miscellaneous documents to obligate funds that are not associated with a specific contract or modification. This practice reserves a pool of money for future RMC needs and avoids the need to request funds from the CFFC. The CFFC was unaware that the obligations made by the RMCs were not for valid FY 2006 needs. According to a CFFC representative, the CFFC relies on the obligation reviews performed at the RMCs to determine the validity of the obligations.

Documentation supporting the obligation of funds at fiscal year-end on miscellaneous documents was either insufficient or nonexistent. For example, at the Mid-Atlantic RMC, $3 million was obligated on a miscellaneous document on September 30, 2006. According to an e-mail from an RMC finance officer, the $3 million consisted of approximately $1.6 million in obligations for material overruns, $750,000 in anticipated growth work, $325,000 related to a pending legal claim, and $320,000 for growth actions in progress. However, the documentation provided did not support the obligation amounts as of September 30, 2006. On September 19, 2007, $2 million was deobligated from this document, further supporting our conclusion that the obligation amount on

September 30, 2006 did not represent a valid specific need of the RMC at that time.

Regional Maintenance Center Business Practices

RMC business practices did not comply with established laws and regulations when obligating funds for ship maintenance and repair contracts. Specifically, the RMCs obligated funds for award fee pools, growth pools, reservation pools, and premium pools prior to the existence of a specific, definite need. In addition, finance officers at two RMCs obligated funds at fiscal year-end for anticipated needs of the next fiscal year on miscellaneous documents. These business practices violate 31 U.S.C. 1501, the DoD FMR, the JFMM, and the DON, Navy/Marine Corps Award-Fee Guide. In addition, the obligation of funds may have violated 31 U.S.C. 1502.

Obligation of Award Fee Pools. The obligation of award fee pools violates the DoD FMR, volume 3, chapter 8 and the DON, Navy/Marine Corps Award-Fee Guide because the obligation occurs before the award fee is earned. According to the DON, Navy/Marine Corps Award Fee Guide, a contract modification obligates funds for the award fee amount after the Award Fee Evaluation Board determines the fee earned by the contractor. RMC personnel believed that funds to pay for the award fee would not be available at the time the fee was earned. Therefore, they obligated the award fee pools in advance. The RMCs should obligate the amount of the award fee earned by contract modification after the award fee board determines the award fee amount earned.

Obligation of Growth Pools. The obligation of funds for the growth pools violates 31 U.S.C. 1501 and the DoD FMR, volume 3, chapter 8. Although the pool is associated with the cost of ship maintenance and repair projects, growth pools are not associated with specific work items or tasks. In addition, the obligation of funds may violate 31 U.S.C. 1502, because the obligation is for anticipated needs that may occur after the appropriation expires. Also, the obligation of funds for growth pools violates the JFMM, which specifies that RMCs may only commit funds for growth work. In order to have funds available when the additional work is necessary, the RMCs are obligating funds before the requirements are known or a sufficient description of the specific products or services needed has been developed. The RMCs should obligate funds by contract modification for growth work, only at the time of identification, with contracting officer approval, and with a negotiated price for the work.

Obligation of Reservation Pools. The obligation of funds for reservation pools violates 31 U.S.C. 1501 and the DoD FMR, volume 3, chapter 8, because the work is not specific or fully defined, but merely anticipated at the time the funds are obligated. In addition, the obligation of funds may violate 31 U.S.C. 1502, because the obligation is for anticipated needs that may occur after the appropriation expires. The Regional Maintenance Officer memorandum, "Reservation Business Rules," states that reservation pools are "for work that cannot be fully defined." The RMCs obligated funds for reservation pools in advance, so that funds would be available when the work became necessary. The RMCs should obligate funds for reservation work by contract modification at the time of identification, with contracting officer approval, and with a negotiated price for the work.

Obligation of Premium Pools. The obligation of funds for premium pools violates 31 U.S.C. 1501 and the DoD FMR, volume 3, chapter 8, because the obligations were not work-item specific. In addition, the obligation of funds may violate 31 U.S.C. 1502, because the obligation is for anticipated work that may or may not be necessary. The RMCs obligated funds for premium pools based on the overall cost of the ship maintenance and repair project in order to ensure that funds would be available if the need for overtime work arose. The RMCs should obligate funds for overtime work by contract modification, at the time of identification of the required overtime work, and with contracting officer approval.

Obligation of Miscellaneous Documents. The obligation of funds at fiscal year-end on miscellaneous documents in anticipation of specific, definite needs violates 31 U.S.C. 1501; the DoD FMR, volume 3, chapter 8; and the JFMM. In addition, the obligation of funds may violate 31 U.S.C. 1502, because the obligation is for anticipated needs that most likely will occur after the appropriation has expired. CFFC officials indicated that the obligation of funds at year-end required documentation supporting a specific and definite need of the fiscal year for which it was obligated. The JFMM requires organizations to return funds not obligated at year-end to the CFFC. In addition, the JFMM requires approval from the CFFC or a higher office for the use of prior year funds in the current year. The RMCs should obligate, by contract modification, prior-year funds for valid needs at the time the need is identified and after CFFC or higher level approval.

DON Position. RMC officials indicated that they adopted these business practices because they believed that otherwise, funds would not be available from the CFFC when valid needs arose. The following e-mail from a project manager to a contracting officer illustrates the pressure placed on RMC officials to obligate funds or risk the loss of funds in the future:

> . . . we need to obligate funds IMMEDIATELY. The front office just pulled my ear, Fleet frowns on a large sum of unobligated funds, makes it difficult for MARMC [Mid-Atlantic Regional Maintenance Center] to receive additional funding. . .

In addition, NAVSEA officials indicated that waiting for approval for the use of these funds would cause unnecessary delays in work performance. By obligating funds for contingent liabilities on contract modifications, the contracting officers and other RMC personnel do not have to wait on the approval and receipt of funds requested from the CFFC, thereby avoiding the future loss of funds and anticipated work delays.

Mid-Atlantic RMC legal counsel requested an official DON position regarding the obligation and use of pools on MSMO contracts. However, neither the ASN (FM&C) nor NAVSEA legal counsel provided the RMCs with any guidance that either supported or disputed the practice of obligating funds for these pools, which allowed the improper business practices to continue. At all locations visited, RMC representatives indicated the need for resolution on whether funds should be obligated for award fee pools, reservation pools, growth pools, premium pools, or miscellaneous documents.

Conclusion

The RMCs have inappropriately obligated at least $103 million of CFFC funds, making them unavailable for other ship maintenance and repair needs. By inappropriately obligating funds for contingent liabilities, the CFFC and DON received an inaccurate representation of available funds and were unable to make informed decisions on ship maintenance and repair priorities. Although some DON personnel have suggested that the practice of obligating funds in advance for award fees and contingent liability pools will decrease costs and shorten ship maintenance response time, there is no evidence to support these statements. These opinions also do not exempt the RMCs from complying with Federal law, DoD regulations, and other applicable guidance. The DON needs to issue guidance regarding the use of these business practices for MSMO contracting in order to ensure that business practices are implemented that follow established laws and regulations. In addition, as the agency responsible for programming and budgeting resources, the CFFC should prohibit the practice of obligating funds for all contingent liabilities for which they are the responsible command.

Management Actions

After communicating our concerns to ASN(FM&C) and NAVSEA legal counsels about the obligation of funds for contingent liabilities, ASN(FM&C) responded with a memorandum dated November 28, 2007. In the memorandum, ASN(FM&C) agreed with our conclusion that it should stop the business practice of obligating funds for award fees pools and growth pools. In addition, ASN(FM&C) indicated that the practice of obligating funds on miscellaneous documents for contingent liabilities had been discontinued.

Recommendations and Management Comments

1. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller):

A. Issue guidance prohibiting the obligation of funds for award fee pools, growth pools, and premium pools for ship maintenance and repair contracts.

B. Issue guidance prohibiting the obligation of funds for contingent liabilities at year-end on miscellaneous documents for ship maintenance and repair contracts.

C. Issue guidance that prohibits the current practice of obligating funds for reservation pools.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred and stated that the DON will issue guidance by May 31, 2008 prohibiting the current practice of obligating funds for award fee pools, growth pools, premium pools, and reservation pools. In addition, the DON will issue policy prohibiting the obligation of funds on miscellaneous documents.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments were responsive and conform to requirements; no additional comments are needed.

2. We recommend that the Commander, U.S. Fleet Forces Command:

A. Develop and implement a plan to monitor the obligation of funds at the Regional Maintenance Centers to ensure that the practice of obligating funds up front for award fees, growth pools, and premium pools for ship maintenance and repair contracts is discontinued and that amounts for these items are deobligated on current contracts.

B. Develop and implement a plan to monitor the obligation of funds at year-end on miscellaneous documents to ensure that only specific and definite needs of the year ending are obligated.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) provided comments on behalf of the Commander, U.S. Fleet Forces Command. The Assistant Secretary of the Navy concurred and stated that the Commander will develop and implement plans to monitor the obligation of funds for award fee pools, growth pools, and premium pools and the obligation of year-end funds on miscellaneous documents. In addition, the Commander will ensure that funds are deobligated on current contracts that were inappropriately obligated. The plans will be developed and implemented by July 15, 2008.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments were responsive and conform to requirements; no additional comments are needed.

3. We recommend that the Commander, Regional Maintenance Centers:

A. Discontinue the obligation of award fee pools and obligate the fee when earned.

B. Discontinue the obligation of funds for growth pools, premium pools, and miscellaneous documents.

C. Deobligate funds that have been inappropriately obligated for award fee pools, growth pools, reservation pools, premium pools, and miscellaneous documents on current contract actions.

D. Revise guidance established in the Regional Maintenance Officer memorandum, "Reservation Business Rules," November 22, 2006, to comply with established laws and regulations.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) provided comments on behalf of the Commander, Regional Maintenance Centers. The Assistant Secretary of the Navy concurred and stated the Commander will issue a directive to the Regional Maintenance Center community on or before July 15, 2008. This directive will require the RMC community to discontinue the inappropriate obligation practices cited in this recommendation and deobligate funds on current contracts that were inappropriately obligated.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments were responsive and conform to requirements; no additional comments are needed.

Other Matters of Interest

We identified two errors in the CFFC FY 2006 budget reporting process during the course of the audit. The two errors identified were:

Ship Depot Maintenance Fund Classifications. For each CFFC ship repair organization, the certified year-end amount shown in the PBIS should match the year-end obligation amounts reported in STARS. For FY 2006, the overall totals between STARS and PBIS matched. However, a difference of $124 million was identified for one category of ship maintenance and repair funds. When questioned, a CFFC comptroller official explained that the amount was incorrectly classified in STARS. This error caused STARS to underreport obligations for ship depot maintenance funds for the overhaul category.

Certified Year-End Maintenance Data. The CFFC provides certified year-end FY 2006 ship depot maintenance dollar values to the ASN(FM&C) each year. The ASN(FM&C) uses the reported amounts to support the budget for ship depot maintenance funds in future years. For FY 2006, CFFC certified that it spent $1.384 billion for the restricted availability category of ship depot maintenance funds.

When questioned, CFFC officials said that the amount provided to the ASN(FM&C) was incorrect and should have been $1.577 billion. As a result, CFFC certified to the ASN(FM&C) $193 million less than what was actually spent for restricted availability ship depot maintenance funds by the CFFC in FY 2006.

After communicating our concerns to CFFC staff, they recognized the errors and immediately corrected the information in their systems to reflect the correct amounts.

Appendix A. Scope and Methodology

We conducted this performance audit from March 2007 through February 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions, based on our audit objective.

We limited our review of the obligation of funds for ship maintenance and repair to Commander, U.S. Fleet Forces Command (CFFC) ship maintenance and repair organizations. This was because of the large number of ship maintenance and repair organizations within the DON, as well as the potential that the CFFC and U.S. Pacific Fleet organizations operate differently. To review the obligation of funds for ship maintenance and repair at the CFFC organizations, we determined that the primary type of funds used by shipyards, Regional Maintenance Centers (RMCs), and contractors is Operation and Maintenance, Navy, Ship Depot Maintenance. We then limited the scope of our review to funds obligated by the CFFC RMCs for private contracting in FY 2006 and in the first two quarters of FY 2007. The reason for this limitation was the high dollar value, volume of transactions, and number of contract actions awarded for cost-reimbursable contracts at the RMCs. There were three types of contract strategies used to award Operation and Maintenance, Navy, Ship Depot Maintenance funds to private contractors: multi-ship/multi-option (MSMO) contracts, indefinite-delivery/indefinite-quantity (IDIQ) contracts, and firm-fixed-price contracts.

To accomplish the audit objectives, we met with the following offices and reviewed the following data from March 16, 2000 through August 22, 2007:

- We met with representatives from the Assistant Secretary of the Navy (Financial Management and Comptroller), Office of the Chief of Naval Operations (N43), Naval Sea Systems Command, CFFC, Norfolk Naval Shipyard, Mid-Atlantic RMC, South Central RMC, and Southeast RMC.

- We reviewed funding documentation and budgetary reports to determine whether the amounts obligated for ship maintenance and repair contracts, modifications, and orders were fully supported by defined work.

- We reviewed applicable laws and regulations, including 31 U.S.C 1501; 31 U.S.C. 1502; the DoD FMR, the Joint Fleet Maintenance Manual and the Department of Navy, Navy/Marine Corps Award Fee Guide. These laws and regulations were reviewed to determine when obligations for ship maintenance and repair should be recorded and for what amount.

- We reviewed 1,561 MSMO modifications, 15 IDIQ orders, and three firm-fixed-price contracts for ship maintenance and repair, valued at over $622 million. Table 2 provides a breakdown of modifications, orders, and contracts reviewed at each regional maintenance center.

Table 2. Modifications, Orders, and Contracts Reviewed

Regional Maintenance Center	MSMO Modifications	Award Amount	IDIQ Orders	Award Amount	Firm-Fixed-Price Contracts	Award Amount
Mid-Atlantic RMC	1,324	$550,447,766	8	$13,243,265	-	-
South Central RMC	193	23,808,835	2	896,954	-	-
Southeast RMC	44	7,609,206	5	614,664	3	$25,698,708
Total	**1,561**	**$581,865,807**	**15**	**$14,754,883**	**3**	**$25,698,708**

Use of Computer-Processed Data. We did not evaluate the general and application controls related to the Command Financial Management System and Standard Accounting and Reporting System, which track amounts spent by individual ship repair organizations for ship depot maintenance. We did not evaluate the controls because the information was used only to develop an understanding of the fund obligation processes for ship maintenance and repair. The results of the audit were not affected by not evaluating the controls.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage on one aspect of the DoD Financial Management high-risk area.

Prior Coverage

During the last 5 years, the Government Accountability Office and the Congressional Budget Office have issued two reports discussing topics related to the obligation of funds for ship maintenance and repair. Unrestricted Government Accountability Office reports can be accessed at http://www.gao.gov. Unrestricted Congressional Budget Office reports can be accessed at http://www.cbo.gov.

Government Accountability Office

Report 03-275, "Improved Reviews Needed to Ensure Better Management of Obligated Funds," January 2003

Congressional Budget Office

Congressional Budget Office Review, "Review of Proposed Congressional Budget Exhibits for the Navy's Mission-Funded Shipyards," April 14, 2006

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director, Program Analysis and Evaluation

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Naval Inspector General
Auditor General, Department of the Navy
Commander, U.S. Fleet Forces Command
Commander, Naval Sea Systems Command
Commander, Regional Maintenance Centers

Department of the Air Force

Auditor General, Department of the Air Force

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform
House Subcommittee on National Security and Foreign Affairs, Committee on Oversight and Government Reform

Department of the Navy Comments

THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

March 7, 2008

MEMORANDUM FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Report on Obligation of Funds for Ship Maintenance and Repair at the U.S. Fleet Forces Command Regional Maintenance Centers (Project No. D2007-D000FC-0151.000)

This memorandum provides our comments in response to the subject report. Below, as requested in your cover memorandum of February 7, 2008, and in conformance with DoD Directive 7650.3, we have (1) stated our concurrence with each finding and recommendation, (2) described corrective actions taken or planned in response to the recommendations, together with completion dates for those actions, and (3) commented on the material internal control weakness identified at page 3 of your Draft Report.

Findings/Recommendations and Corrective Actions Taken or Planned, with Completion Dates

We concur with your findings and recommendations concerning the recording of obligations of funds for contingent liabilities in accounting records involving award fee pools, growth pools, reservation pools, premium pools, and miscellaneous documents. This concurrence is made without conceding or challenging the accuracy of the "Obligation Amount" listed for the respective pools and stated as the sum total in Table 1 on page 5 of the Draft Report.

The planned corrective actions and their respective completion dates are as follows:

a. The Assistant Secretary of the Navy, Financial Management and Comptroller, will issue guidance (A) prohibiting the current practice of the premature obligation of funds for award fee pools, growth pools, and premium pools for ship maintenance and repair contracts, (B) prohibiting the obligation of funds for contingent liabilities at year-end on miscellaneous documents for ship maintenance and repair contracts, and (C) prohibiting the current practice and process for establishing reservations pools and directing that revised "Reservation Business Rules" be issued in compliance with established laws and regulations. This ASN (FM&C) guidance will be issued by 31 May 2008.

b. The Commander, U.S. Fleet Forces Command, will develop and implement plans to accomplish the following: (A) monitor the obligation of funds at the Regional Maintenance Centers to ensure that the current practice of the premature obligation of funds for award fee pools, growth pools, and premium pools for ship maintenance and repair contracts is discontinued, (B) monitor the obligation of funds at the Regional Maintenance Centers to ensure that amounts obligated for award fee pools, growth pools, and premium pools are deobligated on current contracts, and (C) monitor the obligation of funds at year-end on miscellaneous documents to ensure that only specific and definite needs of the year ending are obligated. These plans will be developed and implemented by 15 July 2008.

c. The Commander, Regional Maintenance Centers, will issue a directive to the RMC community to (A) discontinue the current practice on the premature obligation of award fee pools and to obligate the award fee only when earned upon the issuance of the Fee Determining Official's decision, (B) discontinue the current practice on the obligation of funds for growth pools, premium pools, and miscellaneous documents, and (C) deobligate funds that have been inappropriately obligated for award fee pools, growth pools, reservation pools, premium pools, and miscellaneous documents on current contracts. This directive will be issued on or before 15 July 2008. Additionally, CRMC will issue revised guidance on "Reservation Business Rules" to comply with established laws and regulations on or before 15 July 2008.

Comment on the Material Internal Control Weakness

The sole material internal control weakness identified in the Draft Report was that "existing DON guidance does not clearly define what constitutes a specific and definite need when obligating funds on ship maintenance and repair contracts." (Draft Report at page 3) The Draft Report then notes that the recommendations in the Report, if implemented, will correct this weakness. We understand this internal control weakness, agree with your assessment, and concur that the planned actions, in accordance with your recommendations, will correct this weakness.

Additional Comments for Clarification Purposes

There are two assertions in the Draft Report that warrant clarification. First, in the "Conclusion" on page 10 of the Draft Report, you state: "The RMCs have inappropriately obligated at least $103 million of CFFC funds, making them unavailable for other ship maintenance and repair needs. By inappropriately obligating funds for contingent liabilities, the CFFC and DON received an inaccurate representation of available funds and were unable to make informed decisions on ship maintenance and repair priorities." This statement is potentially misleading because it might be misunderstood as meaning that the prematurely obligated funds were used inappropriately for invalid purposes. We note that your Draft Report does not make any findings of, nor does it point to any evidence relating to, any fraud, malfeasance, or misuse of the actual funds appropriated for ship repair and maintenance. We have no reason to believe that such misconduct has occurred in the events covered by your Draft Report. To the best of our knowledge, while the funds at issue should have been accounted for as commitments, as opposed to obligations, all such funds were actually expended to pay for valid planning and production work budgeted for the repair and maintenance of U.S. Navy ships. Significantly, although the funds prematurely obligated may have been unavailable for certain newly identified needs, the subject funds had been obligated to address validated needs for ship repair.

The second assertion warranting clarification is on page 9 of the Draft Report, where you state: "Mid-Atlantic RMC legal counsel requested an official DON position regarding the obligation and use of pools on MSMO [Multi-Ship Multi-Option] contracts. However, neither the ASN (FM&C) nor NAVSEA legal counsel provided the RMCs with any guidance that either supported or disputed the practice of obligating funds for these pools, which allowed the improper business practices to continue." It should be noted that Mid-Atlantic RMC Counsel's request, although not formally presented to FM&C staff, was in part responsible for extensive and continuing communications between NAVSEA legal and contracts personnel and their counterparts at the RMCs on this very issue. These communications, in turn, ultimately resulted in the "Reservation Business Rules" issued by CRMC on 22 November 2006. As recommended at page 11 of the Draft Report, and as stated above, these business rules will be revised.

We appreciate this opportunity to comment on the Draft Report, consider your thoughtful recommendations, and implement the corrective actions in response to those recommendations.

DA Brook

Douglas A. Brook

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Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Financial Auditing Service prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

Paul J. Granetto
Patricia A. Marsh
Kenneth B. VanHove
Carrie A. Wade
Shelly M. Farber
Randall M. Critchlow
Daniel D. Carlquist
Sarah M. Beckwith
Annette D. Brown
Ellen Kleiman-Redden


Inspector General
Department of Defense