

# Inspector General

United States  
Department of Defense



## Obligation of Funds for Ship Maintenance and Repair at the U.S. Pacific Fleet Maintenance Activities

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## Acronyms and Abbreviations

BOA	Basic Ordering Agreement
CBO	Congressional Budget Office
DON	Department of the Navy
FMR	Financial Management Regulation
GAO	Government Accountability Office
IDIQ	Indefinite-Delivery/Indefinite-Quantity
IG	Inspector General
JFMM	Joint Fleet Maintenance Manual
MSMO	Multi-Ship/Multi-Option
NAVSEA	Naval Sea Systems Command
NMD	Naval Maintenance Database
PACFLT	U.S. Pacific Fleet
PHNSY & IMF	Pearl Harbor Naval Shipyard and Intermediate Maintenance Facility
PSNS & IMF	Puget Sound Naval Shipyard and Intermediate Maintenance Facility
RMC	Regional Maintenance Center
STARS	Standard Accounting and Reporting System



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November 26, 2008

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL  
MANAGEMENT AND COMPTROLLER)  
NAVAL INSPECTOR GENERAL  
COMMANDER, U.S. PACIFIC FLEET

SUBJECT: Report on Obligation of Funds for Ship Maintenance and Repair at the U.S. Pacific  
Fleet Maintenance Activities (Report No. D-2009-025)

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, we do not require any additional  
comments.

We appreciate the courtesies extended to the staff. Please direct questions to Mr. Kenneth  
B. VanHove at (216) 706-0074, extension 245 or Ms. Carrie A. Wade at (216) 706-0074,  
extension 230. The team members are listed inside the back cover.

*Patricia A. Marsh*

Patricia A. Marsh, CPA  
Assistant Inspector General  
Defense Business Operations





# Results in Brief: Obligation of Funds for Ship Maintenance and Repair at the U.S. Pacific Fleet Maintenance Activities

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## What We Did

Our overall audit objective was to evaluate whether the Department of the Navy correctly obligated funds for ship maintenance and repair. Specifically, we determined whether the Department of the Navy obligated funds for ship maintenance and repair in accordance with applicable Federal and DoD regulations. This report is the second in a series that addresses the obligation of funds for ship maintenance and repair contracts. The first report focused on ship maintenance and repair activities funded by the Commander, U.S. Fleet Forces Command. This report focuses on ship maintenance and repair activities funded by the Commander, U.S. Pacific Fleet. See Appendix A for a discussion of the scope and methodology and prior coverage related to the objective.

## What We Found

The Commander, U.S. Pacific Fleet maintenance activities inappropriately obligated funds without identifying a specific, definite need for contingent liabilities on ship maintenance and repair contracts. Because of the inappropriate obligations, approximately \$94.8 million of U.S. Pacific Fleet Operation and Maintenance funds were not available for other ship maintenance and repair needs.

In addition, 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 prohibit the obligation of funds without a specific, definite need on ship maintenance and repair contracts. See the Finding for further details on the material internal control weakness.

## What We Recommend

The Assistant Secretary of the Navy (Financial Management and Comptroller) should:

- Issue guidance and implement a plan to monitor the obligation of funds at all ship maintenance and repair activities to ensure that the practices of obligating funds for award fees and growth, reservation, and overtime pools for ship maintenance and repair contracts are discontinued and that the amounts for these items are deobligated on current contracts.
- Issue guidance and implement a plan at all ship maintenance and repair activities to monitor the obligation of funds at year-end on miscellaneous documents to ensure that only funds for specific, definite needs are obligated and amounts for these items are deobligated on current miscellaneous documents.

The Commander, U.S. Pacific Fleet should establish guidance that requires its activities to return unobligated Operation and Maintenance funds at year-end in accordance with the Joint Fleet Maintenance Manual.

## Client Comments and Our Response

We received comments from the Assistant Secretary of the Navy (Financial Management and Comptroller) and the Commander, U.S. Pacific Fleet agreeing with our recommendations.

## Recommendations Table

Client	Recommendations Requiring Comment	No Additional Comments Required
Assistant Secretary of the Navy (Financial Management and Comptroller)		1.a., 1.b.
Commander, U.S Pacific Fleet		2.

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# Introduction

## Objectives

Our overall audit objective was to evaluate whether the Department of the Navy (DON) correctly obligated funds for ship maintenance and repair. Specifically, we determined whether the DON 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.

## Background

Each fiscal year, the 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 \$4.2 billion in Operation and Maintenance funds for ship maintenance and repair. The Assistant Secretary of the Navy (Financial Management and Comptroller) provides the Operation and Maintenance funds to the Commander, U.S. Fleet Forces Command; the Commander, U.S. Pacific Fleet (PACFLT); and the Commander, Naval Sea Systems Command (NAVSEA). The Commander, PACFLT is responsible for programming and budgeting resources for ship maintenance and repair at:

- Pearl Harbor Naval Shipyard and Intermediate Maintenance Facility (PHNSY & IMF), Pearl Harbor, Hawaii;
- Puget Sound Naval Shipyard and Intermediate Maintenance Facility (PSNS & IMF), Bremerton, Washington;
- Southwest Regional Maintenance Center (RMC), San Diego, California; and
- U.S. Naval Ship Repair Facility, Yokosuka, Japan.<sup>1</sup>

This report is the second 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 U.S.-based PACFLT maintenance activities. The three maintenance activities use private contractors to complete ship maintenance and repair projects. The office of the Commander, Regional Maintenance Centers in Norfolk,

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<sup>1</sup> NAVSEA did not report any Multi-Ship/Multi-Option contracts, Indefinite-Delivery/Indefinite-Quantity contracts, or Basic Ordering Agreements located at the U.S. Naval Ship Repair Facility in Japan.

Virginia, was established on October 1, 2007, to lead the RMCs and related maintenance activities in developing and supporting standardized maintenance processes.

## **Funds Authorization and Accounting Systems**

The DON uses the Program Budget and Information System and the Standard Accounting and Reporting System (STARS) automated financial systems to account for ship maintenance and repair funds. Each quarter, the DON uses the Program Budget and Information System to transfer budget authority<sup>2</sup> for ship maintenance and repair funds to PACFLT and other organizations that, in turn, send the funds to the maintenance activities. The maintenance activities then have the authority to obligate funds on behalf of PACFLT. The maintenance activities obligate funds in STARS, the official accounting system used by the DON to record obligations.

## **Ship Maintenance and Repair Contracts**

The PHNSY & IMF, PSNS & IMF, and Southwest RMC use three types of contractual strategies 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 basic ordering agreements (BOA). 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 common ship class.<sup>3</sup> Each ship maintenance and repair project represents a contract option, and the contracting officer exercises these options by creating modifications to the contracts. The activities 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 activity awards contracts to contractors over a specified period, and the activity prepares individual delivery or task orders for goods or services when needed.

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<sup>2</sup> 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.

<sup>3</sup> A ship class is a group of ships of similar design.

## **BOA**

A BOA is a written instrument of understanding that contains terms and clauses applying to future contracts over a specified period. The agreement includes a specific description of supplies or services to be provided and methods for pricing, issuing, and delivering future orders under the BOA.

## **Contingent Liabilities**

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. Some contingent liabilities related to ship maintenance and repair contracts include award fee pools, growth pools, reservation pools, overtime pools, and funds obligated on miscellaneous documents.

### ***Award Fee Pool***

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 or 30 days after the completion of the work to evaluate contractor performance and decide how much contractors have earned, based on the contractor's progress to date. Depending on their performance level, contractors can receive all or a portion of the award fee pools.

### ***Growth Pool***

Growth pools are usually 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 maintenance activity personnel, the maintenance activities can use growth pool funds to complete work related to any work item during a ship maintenance and repair project.

### ***Reservation Pool***

The Regional Maintenance Officer memorandum, "Reservation Business Rules," November 22, 2006, defines a reservation pool as "known work which cannot be fully defined in advance." The reservation pools are work item specific.

### ***Overtime Pool***

Overtime pools fund overtime work for any work item completed during the entire ship maintenance and repair project.

### ***Miscellaneous Documents***

Miscellaneous Documents are obligation documents used to obligate funds that are not associated with a specific contract or modification. Funds available at year-end are obligated to a miscellaneous document. When a need for those funds occurs in the next fiscal year, funds are deobligated from the miscellaneous document and reobligated to pay for other contract requirements.

# Obligation of Funds for Contingent Liabilities

The PHNSY & IMF, PSNS & IMF, and Southwest RMC maintenance activities inappropriately obligated funds without identifying a specific, definite need for contingent liabilities on ship maintenance and repair contracts because their business practices did not comply with established laws and regulations. Because of these inappropriate obligations, approximately \$94.8 million of PACFLT Operation and Maintenance funds were not available for other ship maintenance and repair needs.

## Obligation Process

Each quarter, PACFLT provides ship maintenance and repair budget authority to its maintenance activities, which allows the activities 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. A contingent liability should represent a commitment of funds for the estimated amount of 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. Federal laws, DoD regulations, and DON guidance identifies when to obligate funds and what constitutes an obligation.

### ***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 time 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 (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), volume 7, “Contracted Ship Maintenance,” states that it is extremely important that unobligated funds be returned to PACFLT as soon as any excess is identified so 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 activities are to request the funds from PACFLT. 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.<sup>4</sup>

### ***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**

During calendar year 2007, the maintenance activities followed established business practices and obligated funds for several types of contingent liabilities before the existence of a specific, definite need on ship maintenance and repair contract actions. These liabilities included funds obligated for award fee pools, growth pools, reservation pools, overtime pools, and miscellaneous documents. The business practice of obligating funds for contingent liabilities on ship maintenance and repair contract actions did not comply with established laws and regulations. Specifically, 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. The following table provides a breakdown of the type of contingent liability obligations we found, the number of contract actions that included the contingent liability type, and the total obligation amount by contingent liability type.

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<sup>4</sup> 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.

### Obligations for Contingent Liabilities

Contingent Liabilities	Contract Actions	Obligation Amount
Award Fee Pools	960	\$28,082,998
Growth Pools	354	63,463,769
Reservation Pools	26	654,865
Overtime Pools	19	645,530
Miscellaneous Documents	12	1,940,517
<b>Total</b>	<b>1,371</b>	<b>\$94,787,679</b>

### ***Award Fee Pools***

Contracting officers at the three maintenance activities inappropriately obligated approximately \$28.1 million on 960 MSMO contract modifications for award fee pools prior to the contractors earning the awards. The obligation of award fee pools violates the DoD FMR, volume 3, chapter 8, and the DON, Navy/Marine Corps Award-Fee Guide because contracting officers obligated funds before the contractor earned the award fee. Maintenance activity personnel believed that funds to pay for the award fee would not be available when the contractor earned the fee. Therefore, they obligated the award fee pools in advance. For example, the Southwest RMC contracting officers obligated approximately \$1 million for the award fee pool, on a contract modification awarded for \$10.7 million, prior to the contractor earning the fee. The maintenance activities should obligate the amount of the award fee earned by contract modification after completion of the work and after the award fee official determines the amount earned.

### ***Growth Pools***

Contracting officers at the three maintenance activities inappropriately obligated approximately \$63.5 million on 341 MSMO contract modifications and 13 IDIQ orders for growth pools. The obligation of growth pools violates 31 U.S.C. 1501, DoD FMR, volume 3, chapter 8, and the JFMM because the maintenance activities did not identify the specific work at the time of the obligation. Maintenance activities obligated funds without a sufficient description of the specific products or services needed to support the growth pool amounts. For example, a Business Clearance Memorandum supporting one contract modification stated:

Funding put against this WI [work item] becomes a contract obligated pool reservation for undefinitized growth work that is encountered during the availability<sup>5</sup>. . . The ACO [Administrative Contracting Officer] backed into this dollar amount after definitization of all other TYCOM [Type Commander] funded WIs. The ACO determined amount for this growth pool reservation is \$401,594.

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<sup>5</sup> An availability is the period of time a ship is assigned to undergo maintenance or repair by a repair activity.

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. For example, on September 26, 2007, PSNS & IMF contracting officers obligated approximately \$3.8 million in a growth pool prior to the identification of the work 5 days before the funds would have expired. According to maintenance activity officials, historical data covering repairs made to an entire 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. The maintenance activities should obligate funds by contract modification for growth work, only at the time of identification of the work, with contracting officer approval of the work, and with a negotiated price for the work.

### ***Reservation Pools***

Contracting officers at the PHNSY & IMF and the Southwest RMC maintenance activities inappropriately obligated approximately \$655,000 on 19 MSMO contract modifications and 7 IDIQ orders for 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 maintenance activities obligated funds for reservation pools so funds would be available when the work became necessary. The following is an example from a contract modification of a reservation pool for one work item:

Provide 20 mandays [sic] of labor and \$20,000 of material to accomplish electrical repairs not previously identified in this work item, when directed by the SUPERVISOR. Total cost greater or less than above manday [sic] and dollar amounts when authorized will be subject to an equitable adjustment.

At the conclusion of our prior audit,<sup>6</sup> DON officials stated that each maintenance activity used historical evidence to support cost estimates for reservation pools. We did not find evidence to support the historical averages in the contract modification or contract file for the estimated labor and materials used for the reservation pools. Officials also stated that the maintenance activities used historical evidence maintained in the Naval Maintenance Database (NMD) to plan and execute ship maintenance and repair projects. Both the Government (maintenance teams and contracting officers) and contractors access NMD to manage and execute maintenance work items. While some historical data existed in NMD, the system did not have the ability to collect or present the data to support the use of the reservation pools in accordance with guidance set forth in the Regional Maintenance Officer memorandum, "Reservation Business Rules," November 22, 2006.

Although reservation pool amounts were associated with specific work items, the reservation amounts were for work that may or may not occur. The maintenance activities should obligate funds for reservation work by contract modification at the time

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<sup>6</sup> DoD Inspector General Report No. D-2008-083, "Obligation of Funds for Ship Maintenance and Repair at the U.S. Fleet Forces Command Regional Maintenance Centers," April 25, 2008.



of identification of the work, with contracting officer approval of the work, and with a negotiated price for the work.

### ***Overtime Pools***

Southwest RMC contracting officers inappropriately obligated approximately \$646,000 on 19 MSMO contract modifications for overtime pools related to anticipated overtime work. The obligation of funds for overtime 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 Southwest RMC obligated funds for overtime 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. For example, contracting officials awarded and obligated approximately \$333,000 for an overtime pool for one contract modification before identifying a need for the overtime work. The contract files for the contract modifications reviewed did not contain support for the estimated overtime pool. In addition, the overtime pool funds were not always associated with a specific work item. The Southwest RMC should obligate funds for overtime work by contract modification upon identification of need for the work and with contracting officer approval.

### ***Miscellaneous Documents***

In September 2007, a finance official at PHNSY & IMF inappropriately obligated approximately \$1.9 million of FY 2007 funds on 12 miscellaneous documents for anticipated needs during the next fiscal year on existing contracts. The obligation of funds at fiscal year-end on miscellaneous documents in anticipation of a specific, definite need violates 31 U.S.C. 1501; JFMM, volume 7; and the DoD FMR, volume 3, chapter 8. 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. PHNSY & IMF used miscellaneous documents to obligate funds that were not associated with a specific contract or modification. According to the PHNSY & IMF finance official, management instructed the finance official to obligate the funds and he elected to obligate these funds to miscellaneous documents. Obligating the funds to the miscellaneous documents allowed PHNSY & IMF to use FY 2007 funds in the next fiscal year for within scope-growth on existing contracts. In FY 2008, FY 2007 funds were deobligated from 9 of the 12 miscellaneous documents. Of 12 miscellaneous documents, 4 had a combined remaining balance of approximately \$223,000. A remaining balance is an indication that there was no immediate need for the funds when they were obligated.

The JFMM requires organizations to return funds not obligated at year-end to PACFLT. In addition, the JFMM requires approval from PACFLT or a higher office for upward obligations. By obligating funds to miscellaneous documents, PHNSY & IMF did not have to return those funds to PACFLT at year-end and did not obtain approval for upward obligations in FY 2008 as required by the JFMM. The Commander, PACFLT should establish guidance to match the JFMM and require the maintenance activities to return unobligated funds at year-end to COMPACFLT.

## **Conclusion**

The three U.S.-based PACFLT maintenance activities have inappropriately obligated approximately \$94.8 million of ship maintenance and repair funds for contingent liabilities, making them unavailable for other ship maintenance and repair needs. We did not find any instances where maintenance activities obligated funds for anything other than ship maintenance and repair projects. However, by inappropriately obligating funds for contingent liabilities, PACFLT and the DON received an inaccurate representation of available funds. As a result, PACFLT and the DON were unable to make informed decisions on ship maintenance and repair priorities. The DON needs to issue guidance prohibiting the obligation of funds for contingent liabilities to ensure that the proper procedures are implemented in accordance with established laws and regulations. In addition, as the agency responsible for programming and budgeting resources, PACFLT should prohibit the practice of obligating funds for all contingent liabilities for which they are the responsible command.

## **Client Actions**

In DoD Inspector General Report No. D-2008-083, "Obligation of Funds for Ship Maintenance and Repair at the U.S. Fleet Forces Command Regional Maintenance Centers," April 25, 2008, the Assistant Secretary of the Navy (Financial Management and Comptroller) agreed with our recommendations that U.S. Fleet Forces Command maintenance activities should stop the business practice of obligating funds for contingent liabilities related to award fees, growth pools, reservation pools, overtime pools, and miscellaneous documents. Similarly, during the audit, PACFLT officials agreed with our conclusions and initiated actions to discontinue the business practices of obligating funds for contingent liabilities at PACFLT maintenance activities for award fee pools, growth pools, reservation pools, and overtime pools. In addition, PACFLT officials indicated that they had deobligated the inappropriately obligated funds on current contracts.

## **Client Comments on the Finding and Our Response**

The Assistant Secretary of the Navy (Financial Management and Comptroller) and the Commander, U.S. Pacific Fleet provided comments on the finding. For the full text of the Assistant Secretary of the Navy (Financial Management and Comptroller) and the Commander, U.S. Pacific Fleet comments, see the Clients Comments section of the report.

### ***Client Comments***

The Assistant Secretary of the Navy and the Commander, U.S. Pacific Fleet agreed with the finding concerning the recording of obligations of funds for contingent liabilities including award fee pools, growth pools, reservation pools, premium pools, and miscellaneous documents.

### ***Our Response***

We appreciate the comments on the finding from the Assistant Secretary of the Navy (Financial Management and Comptroller) and the Commander, U.S. Pacific Fleet.

## **Recommendations, Client Comments, and Our Response**

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

**a. Issue guidance and implement a plan to monitor the obligation of funds at all ship maintenance and repair activities to ensure that the business practices of obligating funds up-front for award fees, growth pools, reservation pools, and overtime pools for ship maintenance and repair contracts are discontinued and that amounts for these items are deobligated on current contracts.**

### ***Assistant Secretary of the Navy Comments***

The Assistant Secretary of the Navy (Financial Management and Comptroller) agreed and stated that fiscal policy has been issued addressing award fees, growth pools, reservation pools, and overtime pools for ship maintenance contracts. He also stated that his office would immediately task the U.S. Pacific Fleet and U.S. Fleet Forces Command to implement procedures to monitor ship maintenance and repair obligations. He indicated that Fleet guidance would be developed and implemented by December 15, 2008.

### ***Our Response***

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

### ***Commander, U.S. Pacific Fleet Comments***

Although not required to comment, the Commander, U.S. Pacific Fleet stated that his office issued guidance to U.S. Pacific Fleet maintenance activities requiring them to return funds at year-end on over-obligated contracts and prohibiting the practice of obligating funds for contingent liabilities. He also stated that his office established an assessable unit titled “Ship Maintenance and Repair Program Management” to validate program integrity and strengthen internal management controls.

### ***Our Response***

We appreciate the comments from the Commander, U.S. Pacific Fleet and commend his office for the actions taken.

**b. Issue guidance and implement a plan at all ship maintenance and repair activities to monitor the obligation of funds at year-end on miscellaneous documents to ensure that only funds for specific, definite needs are obligated and amounts for these items are deobligated on current miscellaneous documents.**

### ***Assistant Secretary of the Navy Comments***

The Assistant Secretary of the Navy (Financial Management and Comptroller) agreed and stated that his office will immediately task the U.S. Pacific Fleet and U.S. Fleet Forces Command to implement procedures to monitor ship maintenance and repair

obligations, including the return of year-end unobligated funds. He indicated that Fleet guidance would be developed and implemented by December 15, 2008.

### ***Our Response***

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

### ***Commander, U.S. Pacific Fleet Comments***

Although not required to comment, the Commander, U.S. Pacific Fleet stated that his office issued guidance to PACFLT maintenance activities directing them to return funds at year end on current contracts that are over-obligated and that obligation of year-end funds on miscellaneous documents are now monitored to ensure compliance with sections 1501-1502, title 31, United States Code.

### ***Our Response***

We appreciate the comments from the Commander, U.S. Pacific Fleet and commend his office for the actions taken.

**2. We recommend that the Commander, U.S. Pacific Fleet establish guidance that requires its activities to return unobligated Operation and Maintenance funds at year-end in accordance with the Joint Fleet Maintenance Manual.**

### ***Commander, U.S. Pacific Fleet Comments***

The Commander, U.S. Pacific Fleet agreed and stated that his office has issued guidance to the PACFLT maintenance activities to return funds at year-end on current contracts that are over-obligated.

### ***Our Response***

The Commander, U.S. Pacific Fleet comments were responsive and conform to requirements; no additional comments are needed.

## Appendix A. Scope and Methodology

We conducted this performance audit from January 2008 through June 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 PACFLT maintenance activities. We limited our review because of the large number of ship maintenance activities, as well as the potential that the Commander, U.S. Fleet Force Command and the Commander, PACFLT activities operate differently. Our first report reviewed the U.S. Fleet Forces Command RMCs. This report is the second in a series that addresses the obligation of funds for ship maintenance and repair contracts.

To review the obligation of funds for ship maintenance and repair at PACFLT maintenance activities, we determined that the primary type of funds used by the maintenance activities is Operation and Maintenance. We then limited the scope of our review to funds obligated by PACFLT maintenance activities for private contracting in calendar year 2007. We limited our scope because of the high dollar value, volume of transactions, and number of contract actions awarded for cost-reimbursable contracts at the maintenance activities. Maintenance activities used three types of contractual strategies to award Operation and Maintenance funds: MSMO contracts, IDIQ contracts, and BOAs. We reviewed all of the MSMO contract modifications and a judgmental sample of IDIQ and BOA orders at the three maintenance activities for calendar year 2007.

To accomplish the audit objectives, we met with the following offices and reviewed the following data.

- We met with representatives from the Offices of the Commander, PACFLT, PHNSY & IMF, PSNS & IMF, and Southwest 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 JFMM; and the DON, 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 the contracting files supporting 1,730 MSMO modifications, 327 IDIQ orders, and 30 BOAs for ship maintenance and repair, valued at

over \$425.6 million. The table provides a breakdown of modifications and orders reviewed at each maintenance activity.

<b>Modifications and Orders Reviewed</b>						
<u>Maintenance Activity</u>	<u>MSMO Modifications</u>	<u>Award Amount</u>	<u>IDIQ Orders</u>	<u>Award Amount</u>	<u>BOA Orders</u>	<u>Award Amount</u>
PHNSY & IMF	222	\$37,808,439	10	\$10,623,952	0	0
PSNS & IMF	259	62,635,104	14	6,958,840	0	0
SWRMC	1,249	274,730,565	303	30,534,631	30	\$2,287,800
<b>Total</b>	<b>1730</b>	<b>\$375,174,108</b>	<b>327</b>	<b>\$48,117,423</b>	<b>30</b>	<b>\$2,287,800</b>

## 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 prohibit the obligation of funds without a specific, definite need on ship maintenance and repair contracts. If implemented, the recommendations in this report will correct this weakness. We will provide a copy of this report to the senior Naval official responsible for internal controls in the Department of the Navy.

**Client Comments.** The Assistant Secretary of the Navy (Financial Management and Comptroller) and the Commander, U.S. Pacific Fleet agreed with our assessment of this internal control weakness and expect that the actions taken to date and their planned actions will correct the weakness.

**Our Response.** We commend the Assistant Secretary of the Navy (Financial Management and Comptroller) and the Commander, U.S. Pacific Fleet’s actions taken to date. We agree that these and the planned actions will correct the weakness.

## Use of Computer-Processed Data

We did not evaluate the general and application controls related to the STARS, which track amounts spent by individual maintenance activities for ship maintenance and repair. The audit results were not affected by not evaluating the controls. We did validate the reliability of STARS data used to support our review by comparing the STARS data to contract actions. This data was determined to be accurate and valid for the purpose of this audit.

## **Prior Coverage**

During the last 5 years, the Department of Defense Inspector General (DoD IG), the Government Accountability Office (GAO), and Congressional Budget Office (CBO) have issued three reports discussing topics related to the obligation of funds for ship maintenance and repair. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>. Unrestricted GAO reports can be accessed at <http://www.gao.gov>. Unrestricted CBO reports can be accessed at <http://www.cbo.gov>.

### ***DoD IG***

DoD IG Report No. D-2008-083, “Obligation of Funds for Ship Maintenance and Repair at the U.S. Fleet Forces Command Regional Maintenance Centers,” April 25, 2008

### ***GAO***

GAO Report No. 03-275, “Improved Reviews Needed to Ensure Better Management of Obligated Funds,” January 2003

### ***CBO***

CBO Review, “Review of Proposed Congressional Budget Exhibits for the Navy’s Mission-Funded Shipyards,” April 14, 2006





# Assistant Secretary of the Navy (Financial Management and Comptroller) Comments



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

October 6, 2008

## MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

Subj: REPORT ON OBLIGATION OF FUNDS FOR SHIP MAINTENANCE AND  
REPAIR AT THE U.S. PACIFIC FLEET MAINTENANCE ACTIVITIES  
(PROJECT NO. D2007-D00FC-0151.001)

This memorandum provides our comments in response to the subject report. Below, as requested in your cover memorandum of July 8, 2008, and in conformance with DoD Directive 7650.3, we have (1) addressed our concurrence with each finding, (2) provided comment on the recommendations and 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 4 of your Draft Report.

### Findings

We concur with your findings 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 "Contract Actions" of "Obligation Amount" listed for the respective pools and stated as the sum total in the table on page 7 of the Draft Report. These findings are consistent with the previous findings in DoD Inspector General Report No. D-2008-083, "Obligation of Funds for Ship Maintenance and Repair at U.S. Fleet Forces Command Regional Maintenance Centers."

### Recommendations and Corrective Actions Taken or Planned, with Completion Dates

We concur that guidance should be issued regarding the fiscal policies associated with recommendations 1A and 1B. OASN(FM&C) fiscal policy was issued on 22 August 2008 addressing award fees and growth, reservation and overtime pools for ship maintenance contracts. The procedures associated with the continual monitoring of ship maintenance contracts for compliance with the fiscal policy are appropriately addressed and managed by the allocation fund holder – U.S. Pacific Fleet and U.S. Fleet Forces Command. Therefore, my staff will immediately task the Fleets to implement procedures to address ship maintenance and repair obligation monitoring, including the aspects of

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recommendation (2) dealing with the return of year end unobligated funds. It is expected Fleet guidance will be developed and implemented by 15 December 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 prohibit the obligation of funds without a specific, definite need on ship maintenance and repair contracts." (Draft Report at page 4) This identified weakness is consistent with the findings of the previous DoD IG Report No. D-2008-083. Consistent with our response to that report, we understand this internal control weakness and agree with your assessment and believe the actions taken to date and planned actions detailed above will correct the weakness.

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

  
Douglas A. Brook

# Commander, U.S. Pacific Fleet Comments



DEPARTMENT OF THE NAVY  
COMMANDER  
UNITED STATES PACIFIC FLEET  
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08 Aug 2008

MEMORANDUM FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Subj: REPORT ON OBLIGATION OF FUNDS FOR SHIP MAINTENANCE AND  
REPAIR AT THE U.S. PACIFIC FLEET MAINTENANCE ACTIVITIES  
(PROJECT NO. D2007-D000FC-0151.001)

1. This memorandum provides our comments in response to the subject report. Below, as requested in your cover memorandum of July 8, 2008, and in conformance with COMPACFLT Instruction 5200.8A, we have (1) stated our concurrence with the findings and recommendation, (2) described corrective actions taken in response to the recommendations, and (3) commented on the material internal control weakness identified on page 4 of your Draft Report.

2. We concur with your findings and recommendation concerning the recording of obligations of funds for contingent liabilities in accounting records involving award fee pools, growth pools, reservation pools, overtime 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 the table on page 7 of the Draft Report. The corrective actions taken were as follows:

a. Commander, U. S. Pacific Fleet immediately deobligated funds associated with the contingent liabilities identified above.

b. Commander, U. S. Pacific Fleet issued guidance to PACFLT maintenance activities (A) directing maintenance activities to return funds at year end on current contracts that are over obligated and (B) prohibiting the practice of obligating funds for contingent liabilities for ship maintenance and repair contracts.

c. Commander, U. S. Pacific Fleet established a new assessable unit titled "Ship Maintenance and Repair Program Management" to validate program integrity and strengthen internal management controls. Obligation of year-end funds on miscellaneous documents and obligation of funds for contingent

liabilities are now monitored to ensure compliance with 31 U.S.C. 1501-1502.

d. Commander, U.S. Pacific Fleet had all corrective actions reviewed and certified by the COMPACFLT Comptroller, Legal Counsel, and Deputy Chief of Staff for Fleet Maintenance.

3. The sole material internal control weakness identified in the Draft Report was that "existing DON guidance does not prohibit the obligation of funds without a specific, definite need on ship maintenance and repair contracts." (Draft Report at page 4) 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 believe that our actions, which were in accordance with your recommendations, have corrected this weakness.

4. Additionally, there is one assertion in the Draft Report that warrants correction. In the section on Miscellaneous Documents on 9 of the report, you state "According to the PHNSY & IMF finance official, PACFLT instructed the finance official to obligate the funds and he elected to obligate these funds to miscellaneous documents." This is not an accurate report of what the financial analyst said, and it incorrectly implicates the degree and kind of involvement PACFLT had on this issue. The analyst reported he was under pressure internally (i.e. by his direct supervisor) to obligate funds at the end of the year. Specifically, there was pressure to get funding on contracts for growth during availabilities that would cross the fiscal year. He never received pressure from PACFLT to obligate funds on miscellaneous documents. In fact, PACFLT was not aware of the use of miscellaneous documents in this manner until after the fiscal year closed. Further, the moment PACFLT was aware, we immediately directed the deobligation of these funds, following that with the other actions described above.

5. We appreciate this opportunity to comment on the Draft Report, and your assistance in maintaining sound financial operations at COMPACFLT.

  
T. H. LEE  
Fleet Comptroller

Revised

## **Team Members**

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

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# Inspector General Department of Defense

