
Office of Inspector General

Audit Report

**REPORT ON READY RESERVE FORCE
SHIP MANAGERS' CONTRACTS**

Maritime Administration

Report Number: MA-2000-096
Date Issued: May 12, 2000





**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

Office of Inspector General

Memorandum

Subject: **ACTION:** Report on Ready Reserve
Force Ship Managers' Contracts
MA-2000-096

Date: May 12, 2000

From: Alexis M. Stefani
Assistant Inspector General for Auditing

Reply to
Attn. of: JA-40

To: Maritime Administrator

This report presents the results of our audit of Ready Reserve Force (RRF) Ship Managers' Contracts. Our objective was to evaluate the Maritime Administration's (MARAD) procedures and controls relating to the requirements, specifications, award, and administration of the ship managers' contracts. This audit was initiated during a joint investigation by the Department of Transportation, Office of the Assistant Inspector General for Investigations, the Federal Bureau of Investigation and the Department of Defense (DOD).

The investigation identified fraud and kickbacks involving contracts to maintain RRF vessels. As a result, a ship manager voluntarily withdrew from the program and several of the ship manager's employees were convicted for accepting kickbacks to influence the award of subcontracts. In many of the kickback schemes, ship manager employees recouped the money by submitting fraudulently inflated invoices to MARAD for ship repair work. Two MARAD employees have been convicted of receiving gratuities from subcontractors in exchange for actual or promised favorable treatment on ship repair subcontracts.

The scope of our audit and the methodology used to achieve our objective are discussed in Exhibit A.

BACKGROUND

In 1976, a Memorandum of Agreement between MARAD and DOD established the RRF as a component of the National Defense Reserve Fleet. RRF vessels are maintained in a heightened state of readiness and can be activated on 4 to 30 day notices from DOD to meet shipping requirements during national emergencies. As of March 2000, the RRF was composed of 91 militarily useful vessels with an

estimated value of \$1.58 billion. Two of the 91 RRF vessels are shown in Figure 1.

Figure 1: RRF Vessels Cape Race and Cape Ray Located in Norfolk, VA

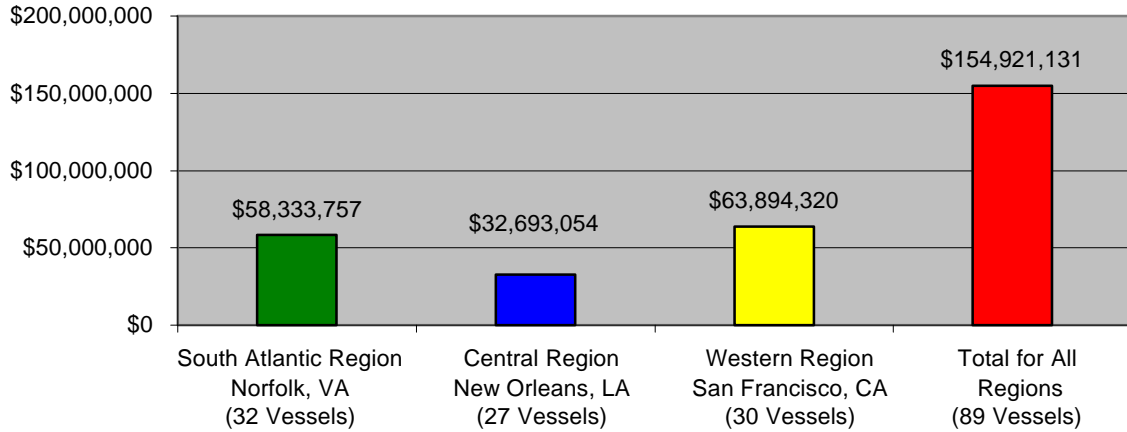


MARAD administers RRF vessel acquisition, upgrade, activation, maintenance, operations, and subsequent deactivation through ship manager contracts and general agency agreements. Ship manager contracts are awarded to ship management companies, through competitive bids, to maintain vessels in the RRF. General agency agreements are issued to ship management companies and are used under certain circumstances, including the acquisition of a new vessel or the termination of a ship manager contract. General agents are assigned to maintain vessels based on MARAD's determination of their technical expertise and on an as needed basis.

Three MARAD regional offices (Norfolk, Virginia; New Orleans, Louisiana; and San Francisco, California) administer the ship managers' contracts and general agency agreements. During the time of our review, 57 vessels were maintained under ship manager contracts and 32 vessels were maintained under general agency agreements. Two vessels were assigned for training purposes and are not maintained by either a ship manager or general agent. After we completed our review, MARAD awarded new ship manager contracts to nine ship management companies. According to MARAD, the majority of these new contracts are scheduled to be phased in by the end of May 2000.

Work orders authorizing ship managers to incur reimbursable costs for required maintenance and repairs on RRF vessels are approved by MARAD. During Fiscal Year (FY) 1999, ship managers and general agents obligated \$155 million for maintenance and repair of MARAD's RRF. Figure 2 shows funds obligated by each MARAD regional office during FY 1999.

Figure 2: Total Fiscal Year 1999 Obligations by Region for Maintenance and Repair by Ship Managers and General Agents



RESULTS-IN-BRIEF

Our review showed that MARAD has implemented effective policies and procedures relating to the requirements, specifications and award of the ship managers’ contracts. Specifically, we determined that each ship manager contract contained requirements for maintaining the RRF vessels and clearly defined work to be performed. In addition, each ship manager contract was awarded based on sufficient competition and proper cost and technical evaluations.

A sharp contrast exists between MARAD’s implementation of procedures and controls for awarding ship managers’ contracts and its procedures and controls for administering ship managers’ contracts and general agency agreements. We found MARAD has not fully adhered to its procedures and practices for administering the ship managers’ contracts and general agency agreements.

Specifically, MARAD has not followed existing procedures to ensure that payments to general agents are for actual costs incurred. MARAD’s Central and Western Regions paid \$63.7 million during FYs 1998 and 1999 to general agents without documentation that costs were incurred. By making funds available to general agents before subcontractor payments are due or services are rendered, we estimate that the Government incurred approximately \$150,000 in interest costs because funds were transferred from the United States Treasury prematurely.

In addition, MARAD has not followed existing procedures to ensure that payments to ship managers relate to cited work orders and vessels, and do not duplicate previously paid invoices. For the 1,847 invoices reviewed totaling

\$20,422,948, we identified 4 instances, totaling \$104,554, where invoices were paid for work not related to the work order cited on the invoice and 3 instances, totaling \$99,268, of invoices that were paid twice. These instances indicate a breakdown in internal controls.

We also found that work orders did not adequately describe the work authorized, making it difficult for MARAD personnel to validate payments during the invoice review process. For 94 of the 121 (78 percent) work orders and work order revisions reviewed, we found that the description of the work authorized was not specific enough to verify the actual work performed or items received.

In addition, we found that work orders were not closed timely, allowing ship managers to use funds from open work orders for unrelated work. For 3,685 work orders initiated in FYs 1993 through 1995, 72 totaling \$931,166 remain open even though no expenditures were recorded in either FY 1998 or 1999 for these particular work orders.

Further, MARAD does not ensure that ship managers justify awarding noncompetitive subcontracts. MARAD discontinued ship manager purchasing system reviews when the old ship managers' contracts expired in June 1998. Our review of 46 sole-source subcontracts, totaling \$2,302,009, showed that 34, totaling \$1,836,154, were awarded without required documentation to justify the award. We also identified 11 instances of ship managers and general agents splitting purchase orders to avoid exceeding \$2,500, thereby circumventing the requirement to solicit competitive bids.

To address the above issues, we are recommending that MARAD strengthen its controls by implementing effective procedures and practices for administering ship managers' contracts and general agency agreements. We recommend that MARAD:

1. Instruct regional employees on existing procedures for processing invoices and provide sufficient oversight to ensure that these procedures are followed.
2. Provide detailed, self-explanatory work statements, specifications or descriptions on all work orders.
3. Periodically review open and inactive work orders to identify those that should be closed, and reprogram any remaining funds.
4. Reinstate periodic reviews of ship manager procurement actions that would look for documentation justifying sole-source subcontractor awards and indications of split purchases.

On March 23, 2000, we met with MARAD’s Deputy Administrator, the Director of the Office of Acquisition, the Director of the Office of Ship Operations, a member of MARAD’s Chief Counsel, and their respective staffs to discuss a draft of this report. We also met with MARAD senior management on May 11, 2000. MARAD officials concurred with our findings and recommendations presented in the report.

FINDINGS AND RECOMMENDATIONS

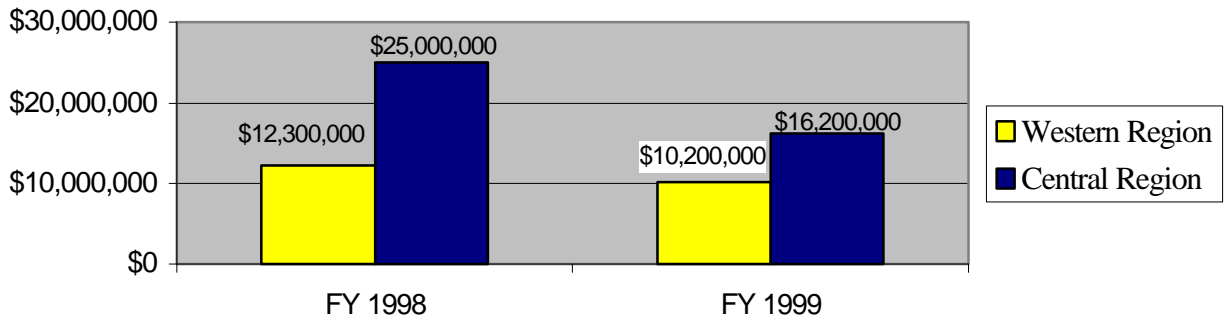
Finding A. Failure to Follow Internal Controls Creates Vulnerabilities to Fraud

MARAD has not followed existing procedures to ensure that payments to general agents are for actual costs incurred. In addition, MARAD has not followed existing procedures to ensure that payments to ship managers relate to cited work orders and vessels, and do not duplicate previously paid invoices. We also found that work orders did not fully describe the work authorized, making it difficult for MARAD personnel to validate payments during the invoice review process. Further, work orders were not closed timely, allowing the opportunity for ship managers to use funds from open work orders for unrelated work.

MARAD Made Payments to General Agents Before Costs Were Incurred

We found that MARAD’s Central and Western Regions paid \$63.7 million during FYs 1998 and 1999 to general agents without documentation that costs were incurred, as shown in Figure 3.

Figure 3: Fiscal Years 1998 and 1999 Invoices Paid Without Documentation That Costs Were Incurred



MARAD procedures, which are more stringent than the Code of Federal Regulations, allow general agents to request funds for costs incurred, but not paid. The general agents’ requests must be accompanied by supporting documentation,

which includes subcontractor or supplier invoices or other verification that work has been completed or that costs have been incurred. The general agents must then use the funds to pay subcontractors or suppliers in the following 2-week period.

However, MARAD personnel in the Central and Western Regions did not follow procedures and issued funds to general agents without proper support that the costs were incurred. For example, MARAD personnel in the Central Region paid a general agent \$154,634 based on a listing of items or services the general agent planned to procure in the future. MARAD personnel in the Central Region believed that procedures allowed them to advance funds to general agents without supporting documentation that costs were incurred.

Because general agents requested funds well ahead of payments due to subcontractors, we estimate that the Government incurred \$150,000 in interest costs because funds were transferred from the United States Treasury prematurely. For example, a general agent requested and received a cash advance of \$51,434 to purchase parts in December 1998. The general agent received a subcontractor invoice for the parts in June 1999 and issued a check to the subcontractor in August 1999, 8 months after funds were transferred from the United States Treasury.

MARAD Paid Invoices for Work Not Related to Work Order Cited

We identified four instances totaling \$104,554 where MARAD paid invoices for work not related to the work order cited on the invoice. To initiate a maintenance or repair action, MARAD issues a work order, which obligates funds and authorizes the ship manager to incur expenses for the needed action. When authorized work is completed, the ship manager submits an invoice for payment. MARAD's invoice review procedures require that both the Assistant Contract Officer Technical Representative (Marine Surveyor) and the Administrative Contracting Officer review the invoice to ensure that the work was authorized by and clearly linked to the work order.

However, MARAD personnel did not consistently follow invoice review procedures that require invoices be supported by documentation linking the work authorized to the cited work order. For example, the South Atlantic Region paid a ship manager \$68,000 for work not authorized by the work order from which it was paid. The work authorized on the work order was for elevator lift wires, and the invoice paid was for the repair of the starboard diesel engine. The work order authorizing the repair of the starboard diesel engine did not have the funds needed to pay the invoice amount.

MARAD Paid Invoices Twice

We also identified three instances, totaling \$99,268, of MARAD paying invoices twice. For example, although the Marine Surveyor is required to review each invoice to ensure that it has not been paid previously, a general agent submitted duplicate invoices for \$27,036 and was paid twice by MARAD's South Atlantic Region. We brought the duplicate payment to the attention of MARAD in November 1999, and corrective action was initiated in January 2000. These payment lapses indicate a breakdown in internal controls.

MARAD Cannot Verify Payments With Work Performed or Items Received

For 94 of the 121 (78 percent) work orders and work order revisions reviewed, we found that the description of the work authorized was not specific enough to verify the actual work performed or items received. For example, one work order for a ship manager in the South Atlantic Region showed "Reimburse Ship Manager for costs associated with the management/maintenance/repair of the Cape Domingo. Category G: ROS Project (ROS Incidentals)." The work order and five revisions, totaling \$1,271,212, listed no specific task or project.

Funds Are Not Made Available to Meet Other Needs

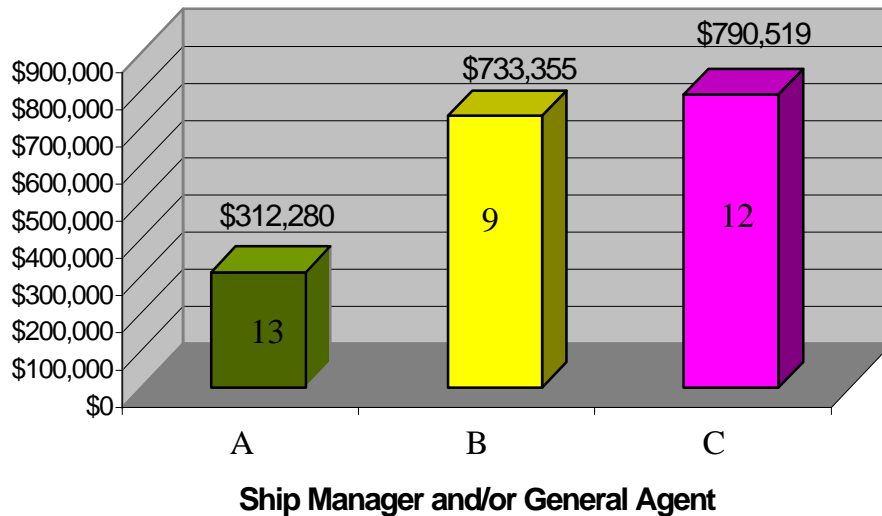
Further, we found that 72 work orders initiated in MARAD's South Atlantic and Western Regions during FYs 1993 through 1995, totaling \$931,166, remain open even though no expenditures were recorded in either FY 1998 or 1999 for these particular work orders. For example, \$45,000 was obligated to work order 42 in March 1995 for ship manager staff expenses. The last invoice for this work order was paid in September 1997. A total of \$42,797 remains available on the work order. If these work orders were closed, MARAD headquarters could re-obligate the money to meet other needs.

When MARAD personnel do not follow existing procedures, they compromise their ability to ensure that Federal funds are expended for items received or for work authorized and performed. When work orders do not fully describe work authorized, it is difficult for MARAD personnel to validate payments during the invoice review process. Also, when work orders are not closed timely, the opportunity exists for ship managers to use funds from these open work orders for unrelated work. Although we did not identify instances where ship managers and subcontractors submitted fraudulent invoices like those disclosed by the Assistant Inspector General for Investigations, the control weaknesses we identified contribute to an environment where there is an increased risk of fraud occurring.

Finding B. MARAD Does Not Ensure That Ship Managers Justify Awarding Noncompetitive Subcontracts

Our work showed that MARAD has not implemented effective procedures to ensure ship managers justify awarding noncompetitive subcontracts. Of 46 sole-source subcontracts we reviewed, ship managers awarded 34 (74 percent) without required documentation to justify the award. Figure 4 shows the amount of unjustified sole source procurements.

Figure 4: Amount of Unjustified Sole-Source Procurements



MARAD relies on ship managers to comply with the Federal Acquisition Regulation (FAR). In 1998, MARAD discontinued periodic reviews of ship manager and/or general agent procurement actions. However, we found a high incidence of ship managers that did not comply with the FAR by awarding subcontracts noncompetitively without required documentation justifying the awards. As a result, MARAD has limited assurance that Federal funds are expended in a manner that is most advantageous to the Government. Additionally, unjustified sole-source awards create the potential for improper business dealings between the ship managers and subcontractors such as kickbacks.

MARAD procedures allow ship managers with approved purchasing programs to award subcontracts for up to \$2 million without regional approval. Other ship managers can award subcontracts up to \$100,000 without MARAD approvals. Ship managers are required to solicit competitive bids for all subcontracts over \$2,500 and to award the work to the subcontractor whose bid is the most advantageous to the Government. If a subcontract is awarded without providing for full and open competition, the ship manager must justify the use of such action in writing. Justifications must demonstrate that use of the proposed subcontractor

is required because of unique qualifications or the nature of the acquisition and describe efforts made to solicit offers from as many potential sources as possible.

However, for the sole-source subcontracts reviewed, we found that ship managers awarded the majority without the required documentation justifying their actions. For example,

- One ship manager awarded a sole-source subcontract for \$471,000 without documenting efforts it made to solicit offers from as many potential sources as possible.
- One ship manager awarded a sole-source subcontract for \$8,688 only because the vendor had worked on the vessel for several years, establishing familiarity with the necessary work.

We also found that ship managers split orders to avoid the requirement for soliciting competitive bids. We identified 11 instances during FYs 1998 and 1999 where a ship manager split purchase orders into 2 or more to avoid exceeding \$2,500. For example, one ship manager operating in MARAD's Central Region split a purchase of more than \$9,000 into six purchase orders avoiding the competitive bidding process. The six purchase orders for general electrical work were all issued to the same vendor on the same day.

Recommendations

To address the above issues, MARAD needs to strengthen its controls by implementing effective procedures and practices for administering ship managers' contracts and general agency agreements. We recommend that MARAD:

1. Instruct regional employees on existing procedures for processing invoices and provide sufficient oversight to ensure that these procedures are followed. Existing procedures require that the Marine Surveyor and Administrative Contracting Officer review the invoice and supporting documentation citing that work was performed or items were received. Also, the work must be authorized by the cited work order and proper procedures should be taken to ensure that the invoice has not been previously paid.
2. Provide detailed, self-explanatory work statements, specifications or descriptions on all work orders.
3. Periodically review open and inactive work orders to identify those that should be closed, and reprogram any remaining funds.

4. Reinstate periodic reviews of ship manager procurement actions that would look for documentation justifying sole-source subcontractor awards and indications of split purchases.

MANAGEMENT COMMENTS

On March 23, 2000, we met with MARAD's Deputy Administrator, the Director of the Office of Acquisition, the Director of the Office of Ship Operations, a member of MARAD's Chief Counsel, and their respective staffs to discuss a draft of this report. We also met with MARAD senior management on May 11, 2000. MARAD officials concurred with our findings and recommendations presented in the report. MARAD officials also provided some points of clarification that we have incorporated into the report.

ACTION REQUIRED

In accordance with Department of Transportation Order 8000.1C, we would appreciate receiving your written comments within 15 days. Please indicate for each recommendation the specific action taken or planned and target dates for completion. If I can answer any questions or be of further assistance, please feel free to contact me at (202) 366-1992 or Tom Howard, Deputy Assistant Inspector General for Maritime and Departmental Programs, at (202) 366-5630.

Attachments (3)

#

SCOPE AND METHODOLOGY

We performed the majority of our fieldwork at MARAD Headquarters, Washington, D.C.; South Atlantic Region, Norfolk, Virginia; and Central Region, New Orleans, Louisiana. (See Exhibit B for listing of offices visited or contacted.) During the time of our review, 15 ship managers and general agents were responsible for managing the 89 RRF vessels, and MARAD obligated \$198 million and \$155 million in FYs 1998 and 1999, respectively, for maintaining these vessels.

Figure 5: Cape Knox and Cape Kennedy Located in New Orleans, LA.



To evaluate MARAD's procedures and controls relating to the requirements, specifications, and award of the ship managers' contracts, we reviewed requests for proposals and bid documents submitted by the potential ship managers. We also reviewed evaluation factors (cost, technical ability and past performance) used to award the contracts and documentation supporting the recommendations for awarding the current ship managers' contracts.

To evaluate MARAD's procedures and controls relating to contract administration, we interviewed MARAD personnel responsible for administering the ship managers' contracts. We also obtained and reviewed written policies and guidelines for the ship managers to accomplish their responsibilities included in the ship managers' contracts. Because work orders are the funding documents that authorize ship managers to perform required maintenance and repairs, we reviewed 121 work orders and revisions at MARAD's South Atlantic and Central Regional Offices and determined whether work orders described maintenance and repair tasks accurately and completely. We also reviewed 97 work orders initiated by MARAD's South Atlantic and Western Regional Offices during FYs 1993 through 1995 to determine how many remained open with available funding after all work had been completed.

EXHIBIT A
(Page 2 of 2)

Ship manager invoices provide the vehicle for ship managers to be reimbursed for incurred costs. We reviewed invoices at the two MARAD Regional Offices and three ship manager offices to determine whether invoices:

- Contained supporting documentation of subcontractor costs.
- Duplicated vendor invoices that had already been paid.

We reviewed procurement files at three ship manager offices to determine whether ship managers had solicited competition when required or provided documentation justifying sole-source procurements.

We performed our fieldwork in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States. We focused on ship manager activities from FY 1998 to present. Our review was conducted from May 1999 through April 2000.

LISTING OF OFFICES VISITED OR CONTACTED

MARAD Regional Offices Visited

Central Region, New Orleans, Louisiana
South Atlantic Region, Norfolk, Virginia

MARAD Regional Office Contacted

Western Region, San Francisco, California

RRF Vessels Visited

Cape Kennedy, Central Region
Cape Knox, Central Region
Cape May, South Atlantic Region
Cape Race, South Atlantic Region
Cape Ray, South Atlantic Region
Cape Washington, South Atlantic Region
Cape Wrath, South Atlantic Region

Ship Managers/General Agents Visited

American Overseas Marine Corporation, Quincy, Massachusetts
Intrepid Ship Management, New York, New York
Keystone Shipping Company, Bala Cynwyd, Pennsylvania

Subcontractors Contacted

Bay Ship and Yacht, Alameda, California
Boland Marine, New Orleans, Louisiana
Buck Kreihs, New Orleans, Louisiana
Economy Iron Works, New Orleans, Louisiana
Gulf Cooper, Port Arthur, Texas
Nautical Engineering, Oakland, California
Puglia Engineering, Alameda, California
San Francisco Dry Dock, San Francisco, California

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