



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION



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B-214856

APRIL 13, 1984

The Honorable J. James Exon
United States Senate

Dear Senator Exon:

Subject: Prices Paid for Supply Items Purchased
by Contractors that Operate and Maintain
Tankers for the U.S. Navy's Military
Sealift Command (GAO/NSIAD-84-90)

In response to your March 21, 1983, request, we made a limited review of the procedures the U.S. Navy's Military Sealift Command (MSC) uses to reimburse two contractors for maintaining and operating 18 tanker ships. You asked us to make the review because you had received information alleging that MSC was being overbilled by as much as 115 percent for maintenance and repair items for these tankers. You also asked that our investigation cover whether the contractors purchased items competitively and used small businesses, how MSC administered the contracts to assure only needed items were bought and delivered to the ships, and the rationale and economies for different support arrangements.

During and at the conclusion of our review, we briefed your Office on the progress and results of our limited work. We agreed that because our work did not support the allegation, further investigation by us would not be productive. Accordingly, as also agreed, we have summarized our results in this report.

On the basis of our limited work, we did not find instances of overpricing or purchases of unneeded items. This does not mean, however, that the person who informed you of overpricing did not actually observe that condition. Because that person could not identify specific transactions to trace, we made a judgment sample of invoices to test MSC's invoice review procedures and the contractors' buying practices. MSC officials told us that their review procedures provide reasonable assurance that inefficient or wasteful methods are not being used by contractors. For example, an engineering specialist reviews all contractors' reimbursement invoices and verifies prices and need for unfamiliar items on a spot-check basis. Also, the two contractors provided us with reasonable explanations for their noncompetitive purchases.

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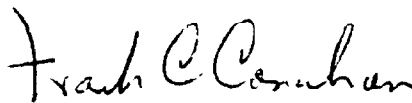
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Details on each of the topics you asked us to cover, as well as our work scope and methodology, are contained in the enclosure.

Because we did not observe any conditions that adversely affected either MSC or its contractors and are not making any recommendations, we did not submit this report to them for official review and comment. However, we did discuss the report's contents with both MSC and the contractors during our exit conferences and they stated that our facts are accurate and complete.

As arranged with your Office, copies of this report are being sent to the Secretary of Defense, the Secretary of the Navy, the Commander of the Military Sealift Command, the two contractors concerned, and other interested parties.

Sincerely yours,

A handwritten signature in cursive script that reads "Frank C. Conahan".

Frank C. Conahan
Director

Enclosure

PRICES PAID FOR SUPPLY ITEMS
PURCHASED BY CONTRACTORS THAT
OPERATE AND MAINTAIN TANKERS FOR MSC

BACKGROUND

Our review was concerned with 18 tankers--9 operated and maintained by Trinidad Corp. and 9 by Marine Transport Lines, Inc. (MTL). The 18 tankers are only a small portion of MSC's fleet which, as of May 20, 1983, totaled 142 ships. The contractors deliver cargoes worldwide and, in addition, one to five of these tankers are assigned intermittently to the Near Term Prepositioning Force (NTPF) at Diego Garcia in the Indian Ocean. MSC pays the contractors a fixed per diem rate for operating the tankers and also reimburses them on a dollar-for-dollar basis for specified repairs, maintenance, and equipage items such as gangways, lifejackets, refrigerators, and office furniture.

SCOPE AND METHODOLOGY

We interviewed the person who brought this information to your attention and complied with your wish that the person's anonymity be protected. However, this person could not provide detailed information, such as dates, invoice numbers, part numbers, names of vendors, and prices, so that we could positively identify the items alleged to be overbilled.

We performed work at MSC Headquarters, Washington, D.C., and at the offices of Trinidad in Philadelphia, Pennsylvania, and of MTL in New York, New York.

We interviewed MSC officials to learn their procedures for reviewing and approving invoices submitted by the contractors for reimbursement. Because specific items were not identified as overbilled, we made a judgment sample of 25 invoices from MSC files. These invoices were submitted by the contractors and reimbursed by MSC during calendar year 1983. Ten of the invoices were Trinidad's and 15 were MTL's; together they covered 70 suppliers' invoices for 564 items. We selected these invoices to test MSC procedures for assuring reasonableness of prices and need for items. Only if there were instances in our sample of either overpricing or of unneeded items purchased, would we select additional invoices to review.

In tracing specific purchases of reimbursable items through MSC's invoice review procedures, we verified eight purchase prices by telephoning the vendors to ascertain whether their

prices to Trinidad and MTL were the same as those claimed for reimbursement. We relied on MSC's engineering expertise to assure us that the items purchased were needed for the tankers' operation.

We reviewed contract files; reports by the New York and Philadelphia Regions of the Defense Contract Administration Services (DCASR) on the two contractors' purchasing systems; and our report to the Congress entitled Build and Charter Program for Nine Tanker Ships (B-174839, August 15, 1973) and discussed the background, contracting rationale, and operations of the NTPF with MSC officials.

We reviewed 23 invoices at the two contractors' offices. At MTL we reviewed 13 of the 15 invoices selected at MSC. At Trinidad we selected and reviewed 10 invoices. These 23 invoices covered 65 purchases for 464 items. We also reviewed requisitions, purchase orders, and vendors' invoices and interviewed company officials to obtain their purchasing procedures and their reasons for noncompetitive purchases.

Our review was made in accordance with generally accepted government audit standards.

RESULTS

Reasonableness of prices paid by the contractors and reimbursed by MSC

For the 53-month period ended October 13, 1983, the 18 tankers required an average of about \$2.7 million a month in reimbursed costs. MSC procedures require contractors to obtain prior approval for subcontracts that exceed \$25,000 and for purchases of individual items with unit prices over \$5,000.

Our limited test of invoices did not disclose any evidence to support the allegation of overbilling. In every transaction we reviewed, the prices claimed for reimbursement by Trinidad and MTL were the same as those paid to their vendors.

Competitive purchase of items

Neither of the contractors purchased the majority of supplies on a competitive basis. Of the 65 purchases reviewed 7, or 11 percent, were competitive and 58, or 89 percent, were noncompetitive.

Trinidad and MTL officials told us that their purchasing practices are the same for both commercial and military fleets and that they attempt to make competitive buys where

practicable. However, they said that because military items are sometimes urgently needed and they do not have sufficient time to seek competition, these purchases must be noncompetitive. In addition, they explained that many items are only available on a sole-source basis from the manufacturer. Other reasons for making noncompetitive purchases were (1) vendors have historically provided dependable service and items at fair prices, (2) vendors are close to the vessel, (3) products are of good quality, (4) vendors are authorized distributors, and (5) competition is not economical for small quantity purchases.

Additional information was provided by MTL's fleet director:

"MTL's need to buy replacement repair parts and equipment for nine Sealift Class tankers is dictated by the contract as part of our responsibility in keeping the vessels and their equipment in operational readiness to meet all the contingencies that the vessels might be required to carry out as directed by the Military Sealift Command.

"In many cases, MTL has utilized preferred vendors to supply certain material. A review of previous orders on record will show that some regularly utilized vendors do in fact offer better discounts than other vendors which will reflect in some price reduction and subsequent savings. MTL has recognized this and developed discounts with certain vendors over the years which reflects in direct savings to MSC and not MTL.

"There are occasions when location of the vessel, availability and urgency for the material will be more important than bottom line price. This is a decision that is made frequently by the MTL Purchasing Department which, on your initial review, may not reflect all the facts."

Contractors' use of small businesses

As MTL reported to the federal government, 45 percent of its dollar expenditures for its military fleet were to small businesses. This percentage included both nonreimbursable items, such as subsistence, and reimbursable items, such as repairs and maintenance. An MTL purchasing official said that the company continuously tries to increase its business with these concerns.

Trinidad's purchasing system was reviewed by DCASR, Philadelphia. DCASR recommended in its October 27, 1980, report to the MSC contracting officer that Trinidad comply with the utilization and reporting requirements of the government's small business subcontracting program. DCASR found that Trinidad had not (1) submitted reports, (2) established a program for exploring these concerns as prospective sources, or (3) appointed a liaison officer.

A Trinidad official told us that the company does not report to the government the amount of purchases from small businesses. Also, Trinidad has not initiated a special program for small businesses but will make purchases from them if it is advantageous. Its purchasing officials believe that the maritime industry does not lend itself to set-aside subcontracting for small businesses.

MSC's controls for assuring that
only needed items are bought and
delivered to the ships

An engineering specialist in MSC's Engineering Office is responsible for reviewing all invoices. The specialist said that all invoices are reviewed for reasonableness of prices and unusual parts or quantities. The specialist relies on experience with marine items and the type of vessel involved to identify any unusual purchases. In addition, on a spot-check basis, the specialist verifies prices and need for unfamiliar items by contacting suppliers and the contractors, researching parts catalogues, and asking other MSC engineers for pertinent data. The Chief of Tanker Engineering in MSC's Engineering Office told us MSC generally relies on the contractors' good business and supply practices for reasonableness of prices and need for items. Also, MSC can refuse to reimburse contractors for items considered unreasonably priced or unneeded. We observed that several such minor refusal actions, concerning need, did take place with invoices in our sample.

On the basis of personal knowledge of items being purchased, the Assistant for Property Administration in MSC's Supply Office also reviews and approves prices for equipment items. According to this individual, because of the short delivery time for urgently needed items, contractors do not always obtain MSC approval before purchasing the items. Our review showed that sometimes these items were needed for the vessels to satisfy Coast Guard safety requirements. Also, this individual attempts to verify prices of items costing over \$1,500 by contacting the suppliers. However, because of a heavy workload these verifications are not always made. Periodically,

this individual inspects the tankers to assure that the equipage items purchased are on board.

In addition to these two reviews, a contracting specialist in MSC's Payment Certification Division, Office of the Comptroller, said that two contracting specialists and voucher examiners review all invoices for applicability to contract provisions, accuracy of computations, and adequacy of documentation.

MSC officials said that the review procedures for contractors' reimbursement invoices provide reasonable assurance that inefficient or wasteful methods are not being used by the contractors.

Rationale and economies for different support arrangements

There are basically two methods to provide the ocean transportation services MSC needs. One is to have the services performed by Navy personnel on Navy-owned ships that are supported by the Navy's supply system. The other method is to contract with the commercial maritime shipping industry to provide the services. MSC is following the government policy of reliance on the private sector by contracting for these services. According to MSC officials, the rationale is based primarily on a policy, not an economic, decision.

Contract operators have access to the Navy's supply system, according to an MSC official, only when needed parts are not available from other sources. According to an MTL official, MTL employees have limited knowledge of the Navy's supply system and use it only to obtain major items, such as propeller hubs and blades.

MSC uses various leasing or chartering arrangements rather than purchasing arrangements to acquire ships because Navy procurement funds are needed for higher priority combatant ship construction programs. By chartering, MSC can obtain the use of needed ships with operation and maintenance funds.¹

The type of support arrangement is based on who owns or operates the vessel. If the vessel is chartered as a "bare-boat," i.e., without a crew, and operated by another contractor who provides the crew, or if the vessel is government-owned and operated by a contractor, MSC pays the operating contractor a

¹This matter is also discussed in our August 1973 report and in our report entitled, Improved Analysis Needed to Evaluate DOD's Proposed Long-term Leases of Capital Equipment (GAO/PLRD-83-84, June 28, 1983).

per diem rate to operate the vessel and reimburses it for the costs of maintenance and repairs. According to an MSC official, MSC is responsible for assuring that the contract operator adequately maintains the vessel. Another arrangement is when a contractor owns or charters a vessel and operates it under a time charter, or a fixed-price arrangement. In this case, MSC pays the contractor a per diem rate that covers the costs for operating, maintaining, and repairing the vessel. An MSC official said that the owner/operator of a time-chartered vessel has a strong financial interest to adequately maintain the vessel.

As of August 18, 1983, 17 of the 18 contractor-operated tankers were either government-owned or bareboat chartered. According to an MSC official, the cost reimbursement arrangement for bareboat charters is the most prevalent because:

- Under the terms of the charter arrangement, the government bears the economic loss or liability if there is a degradation in the tanker's material condition or residual value. If the operating contract provides for a fixed-price per diem rate which includes maintenance and repairs, the operator would have an economic incentive to reduce these expenditures without suffering any long-range consequences.
- In a competitive procurement for a fixed price, potential operators would be unable to accurately prepare fixed-price offers for maintenance and repairs unless they were thoroughly familiar with the ship's design, individual components, and actual condition of the ship and its equipment. This could result in potential operators not submitting proposals or submitting proposals with unrealistically high prices to cover all contingencies.
- In a competitive procurement for a fixed price, potential operators must have accurate information about the intended use of ships to forecast a fixed price for maintenance and repairs. These costs vary significantly throughout the world. MSC, however, has difficulty in forecasting ship operations.

An MSC official informed us that 7 of the oldest of the 18 tankers were being replaced with new tankers. The contracts for these seven will be time charters. For example, on August 18, 1983, MSC contracted with Falcon Carriers, Inc., for a time charter of a new tanker, the Falcon Leader, which replaced the Columbia Class Neches--a bareboat chartered tanker operated by Trinidad. According to this MSC official, this time charter could initially result in significantly less operating costs

ENCLOSURE

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because it is a new ship and is covered by the builder's warranties. As noted above, the owner/operator time-charter arrangement benefits MSC because the operator, being the owner, has a strong financial incentive to maintain the tanker.