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

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STATEMENT OF
WALTON E. SHELEY, DEPUTY DIRECTOR OF GAO'S
PROCUREMENT AND SYSTEMS ACQUISITION DIVISION
BEFORE THE
SUBCOMMITTEE ON MILITARY INSTALLATIONS AND FACILITIES
COMMITTEE ON ARMED SERVICES
U.S. HOUSE OF REPRESENTATIVES

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Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before your Subcommittee to discuss our work leading up to the GAO report titled "Better Management Needed in DOD to Prevent Fraudulent and Erroneous Contract Payments and to Reduce Real Property Maintenance Costs," PSAD-80-14, issued on January 9, 1980. We performed this work as part of our basic legislative authority to investigate the receipt, disbursement, and application of public funds.

The Comptroller General has directed that we increase our efforts to ensure that the Government gets what it pays for and that work set out in contracts is actually performed. In this review we wanted to determine whether Department of Defense (DOD) installations are susceptible to the same type of fraud and abuse problems that have plagued the General Services Administration. Since DOD contracts have the same potential for mismanagement, our review was designed to determine if (1) controls were adequate to ensure proper contract payments and (2) the required services were obtained economically. The contracts we audited at each installation were generally for recurring work, such as painting, building repair, floor covering, roofing, and paving.

WHAT DID WE FIND?

We found that contract administration at the Army, Navy, and Air Force installations we visited was not adequate to prevent intentional or unintentional overcharges. Several installations paid for much more work than was done; some ordered unnecessary work and accepted inferior work; and lower prices were not obtained at some because requirements forecasts were unrealistic, work specifications were inappropriate or poorly written, and price proposals were not properly analyzed.

Although we see no need for more laws or more procurement regulations, there is a need to enforce the current laws and regulations. We recommend that the Secretary of Defense see that the Secretaries of the Army, Navy, and Air Force strengthen controls over the procurement of maintenance and repair services.

DEPARTMENT OF DEFENSE POSITION

While the DOD comments were received too late to be printed in our report (we did not receive them until December 28, 1979, or 79 days after we asked for comments), the Department generally concurs in the findings and

recommendations in our report. DOD concedes that the deficiencies were, in general, a result of a failure to follow existing policy and guidance as published by the Secretary of Defense and the Service Secretaries. As we mention in our report, in most cases, when apprised of conditions through exit interviews, corrective actions had already been taken; were being taken, or were planned to be taken. Since the full text of DOD's comments were not received in time to be printed in our report, we have included them as an attachment to this statement.

SPECIFIC EXAMPLES

Our report contains a number of specific examples of the types of problems our auditors found when they actually attempted to physically verify contractor performance.

PHOTO #1 (See p. 5 of GAO report.)

Fort Sam Houston paid a contractor \$560 for painting 2,800 square feet of surface on this building. When our auditors went out to see the paint job, they found that the building was made of stone and that only 210 square feet were actually painted. The paint should have cost \$42.

PHOTO #2 (See p. 7 of GAO report.)

Fort Knox paid \$419 for painting this building, but obviously the work was not performed.

PHOTO #3 (Not in the GAO report.)

This is one of our auditors and a Fort Knox procurement official standing in a vacant lot that was once occupied by a building that had been demolished earlier. Yet the records would indicate that a building was still located on this lot and the solicitation asked contractors to bid on a nonexistent structure. Obviously, the incumbent contractor could unbalance his bid and bid a very low price for a building he knew he would never paint.

AUDIT EFFORTS BY DOD

Early in our performance of this work we gave our preliminary findings to DOD; and on February 13, 1979, the Assistant Secretary of Defense, Comptroller, directed all four DOD internal audit agencies (the Defense Audit Service, the Army Audit Agency, the Air Force Audit Agency, and the Naval Audit Service) to carefully scrutinize certain activities which might be susceptible to perpetration of fraud. The number of audit reports generated as of May 16, 1980, are as follows:

Defense Audit Service	4
Army Audit Agency	25
Air Force Audit Agency	26
Naval Audit Service	<u>5</u>
TOTAL	<u>60</u>

These auditors found, in general, the same types of problems we identified. By way of example, I would like to quote from the Army Audit Agency's advisory report for field commanders:

"Our audit disclosed that acquisition and contract administration functions at the installation level needed to be strengthened. Improvements were needed in (i) developing contract specification and determining requirements (ii) improving the use of blanket purchase agreements and imprest funds, (iii) preparing Government cost estimates, (iv) performing and documenting inspections of contractor performance, and (v) certifying contractor invoices for payment."

"The overall shortage of full-time inspectors and the lack of well trained contracting officer representatives contributed to the causes of the contract administration and surveillance conditions noted during the audit. However, many installation level problems occurred primarily because key installation personnel (Commanders, Contracting Officers, Contracting Officer Representatives and Facilities Engineers and their inspectors) did not enforce prescribed procedures and controls, or their contract administration efforts were not organized. A major reason for the lack of organization was that local commands did not develop criteria explaining and establishing contract administration responsibilities. Compliance with prescribed procedures and development of local criteria and guidance would reduce administrative costs and incidences of paying contractors for unsatisfactory work or for work not performed."

"Contracting officer representatives and inspectors seemed to rely on contractor integrity rather than inspecting work first-hand. As a result, contractors were often paid for substandard performance or non-performance. Inspections and surveillance were inadequate or not performed at all on many contracts. Contracting officer representatives and inspectors did not maintain adequate files or prepare reports to document inspections when made. And when reports were made, they did not reach the contracting officers for appropriate action. Some contracts did not have adequate damage clauses to force performance or default the contractor. We found that contracting officer representatives and inspectors were often unaware of their individual responsibilities and/or the specifications of the contracts they were responsible for inspecting."

AREAS NEEDING INCREASED VIGILANCE

Fraud in the Government is a multifaceted problem despite continual efforts to improve the ability to combat fraud and related irregularities. Two areas needing increased vigilance and close scrutiny are contracting out and increased reliance on contractor compliance.

Contracting out

A trend in the Government has been to contract for support functions instead of relying on in-house military or civilian personnel. Experience has shown that local-level contracts are vulnerable to fraud primarily in the contract administration phase. When contract administration is weak, contractors have defrauded the Government by billing for services not performed or supplies not delivered. In some instances, they have also bribed Government personnel responsible for inspecting contract performance to help carry out fraudulent activities. As more support functions are contracted out, the opportunities for fraud will increase. Consequently, there should be more investigative activity in this area.

Increased Reliance on
contractor compliance

The Government and especially the Department of Defense have substantially reduced the number of people who inspect supplies and services. As a result, greater responsibility is placed on contractors to deliver acceptable products or services. In theory, this practice should be effective to ensure continued acceptable quality, but it assumes the Government can rely on the integrity of its contractors. However, investigations have shown numerous attempts by contractors to increase their profits or minimize their losses, "cutting corners" by using substandard materials and falsifying documents. In many cases, quality assurance personnel were either given inadequate time or were lax in carrying out their duties. As a result, increasing the reliance on contractors to police their own quality control may result in increased fraud.

We are continuing our efforts in this type of audit work. On May 2, 1980, we distributed to all GAO divisions and offices a general audit program for locally awarded procurements. This program is a compilation of the audit techniques used by our auditors and Air Force auditors in performing the work we have discussed this morning.

This concludes my statement, Mr. Chairman. I would be happy to respond to your questions.

Attachment



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

MANPOWER,
RESERVE AFFAIRS
AND LOGISTICS

17 DEC 1979

Mr. J. H. Stolarow
Director, Procurement and
Systems Acquisition Division
US General Accounting Office
Washington, D.C. 20548

Dear Mr. Stolarow:

This is in response to your letter of 10 October 1979 to the Secretary of Defense forwarding copies of the draft report, "Better Management Needed to Prevent Fraudulent and Erroneous Contract Payments and to Reduce Defense Real Property Maintenance Costs" (OSD Case #5294, Code 950469).

The draft report has been reviewed by this office and the headquarters of the Military Departments. Our comments resulting from these reviews are enclosed.

We appreciate the opportunity to review and comment on the draft report. The information presented therein will be helpful in our overall effort to improve the management and efficiency of the Department of Defense Real Property Maintenance Activities.

Sincerely,

Richard Danzig
Richard Danzig
Principal Deputy Assistant
Secretary of Defense (MRA&L)

Enclosure

GAO Draft Report Dated October 1979
(OSD Case 5294)

"Better Management Needed to Prevent Fraudulent and Erroneous Contract Payments and to Reduce Defense Real Property Maintenance Costs".

I. Position Summaries

A. GAO Position

GAO recommends that Secretary of Defense see that the Service Secretaries strengthen controls over the procurement of maintenance and repair services. In establishing more effective controls, the Services should consider deficiencies identified in this report and in ongoing internal audits.

B. Defense Position

The Department of Defense generally concurs in the findings and recommendations of this report. The deficiencies were, in general, a result of a failure to follow existing policy and guidance as published by the Secretary of Defense and the Service Secretaries. As noted in the report, in most cases, when apprised of conditions through exit interviews, corrective actions had already been taken, were being taken, or were planned to be taken.

II. Recommendations and Responses

Recommendation: Encourage the use of lump-sum contracts whenever practicable and economically advantageous.

Response: Concur. This office has initiated an Ad Hoc DoD Service Contract Group to increase the use of performance oriented firm-fixed price contracts.

Recommendation: Ensure that sufficient numbers of adequately trained personnel, are assigned to the inspection and contract administration functions.

Response: Concur in part. Within limited personnel resources, staffing criteria will be re-evaluated and increases made if warranted. Additionally, several courses have been initiated to better train inspectors and contract administration personnel to overcome the problems noted in the report.

Recommendation: Require that detailed inspection records, including measurements and calculations, be maintained in support of contract payments.

Response: Concur. Current regulations do require documentation of inspections of contract work. Restressing this requirement and the training mentioned above will alleviate the problem of non-compliance with existing regulations.

- Recommendation: Require routine, independent tests of each inspector's work.

Response: Do not concur. Supervisors and contracting officers are already required to do this and internal reviews, Inspector General and audit activities now treat maintenance contracting as a special interest item. By improving inspector training and strengthening internal audits in this area, corrective action can be accomplished without adding another layer of testing and evaluation by higher authority.

Recommendation: Ensure that proposed work is adequately planned before contract award and that specifications are clear and appropriate.

Response: Concur. Lapses in this area are generally the result of non-compliance with existing management and policy guidance. Re-emphasis and additional training of appropriate personnel should have a significant beneficial effect on the conditions noted in the report.

Recommendation: Strive to eliminate unbalanced bidding by improving requirements forecasts and/or utilizing contracting methods or bid evaluation techniques which are not susceptible to unbalanced bidding.

Response: Concur. To the extent possible, re-emphasis on this problem, coupled with additional training of both contract administration and planning personnel will assist in correcting the problem of unbalanced bids.

Recommendation: Continue to devote a portion of internal audit effort to local procurement activities.

Response: Concur. The Service Secretaries will be requested to continue to treat maintenance contracting as an item of special interest and to devote appropriate audit effort to ensure that the problems noted in the report are reduced to a minimum.

Recommendation: Action should also be taken to collect past overcharges identified in this review and in the Defense audits.

Response: Concur. Action has already been initiated to collect some overcharges and the Services will be advised to take action as appropriate to recoup funds identified in this report and those addressed in our own Defense audits.