

August 2009

UNITED STATES  
MERCHANT MARINE  
ACADEMY

Internal Control  
Weaknesses Resulted  
in Improper Sources  
and Uses of Funds;  
Some Corrective  
Actions Are Under  
Way



GAO

Accountability \* Integrity \* Reliability



Highlights of [GAO-09-635](#), a report to congressional committees

## UNITED STATES MERCHANT MARINE ACADEMY

### Internal Control Weaknesses Resulted in Improper Sources and Uses of Funds; Some Corrective Actions Are Under Way

#### Why GAO Did This Study

The U.S. Merchant Marine Academy (Academy), a component of the Department of Transportation's Maritime Administration (MARAD), is one of five U.S. service academies. The Academy is affiliated with 14 non-appropriated fund instrumentalities (NAFI) and two foundations.

GAO was asked to determine whether there (1) were any potentially improper or questionable sources and uses of funds by the Academy, including transactions with its affiliated organizations; (2) was an effective control environment with key controls in place over the Academy's sources and uses of funds; and (3) were any actions taken, under way, or planned to improve controls and accountability. GAO analyzed selected transactions from fiscal years 2006, 2007, and 2008 to identify improper or questionable sources and uses of funds and reviewed documents and interviewed cognizant officials to assess the Academy's internal controls, and identify corrective actions to improve controls.

#### What GAO Recommends

GAO makes a series of recommendations directed at improving internal controls and accountability at the Academy and to address issues surrounding the improper and questionable sources and uses of funds. The Department commented that MARAD will produce a comprehensive strategy and corrective action plan to address our recommendations.

View [GAO-09-635](#) or [key components](#). For more information, contact Jeanette Franzel at (202) 512-2600 or [franzelj@gao.gov](mailto:franzelj@gao.gov).

#### What GAO Found

GAO identified numerous instances of improper and questionable sources and uses of funds by the Academy and its affiliated organizations. These improprieties and questionable payments GAO identified demonstrate that, while MARAD and the Academy have been taking action to improve the Academy's internal controls, the Academy did not have assurance that it complied with applicable fund control requirements, including the Antideficiency Act (ADA). Further, the Academy had numerous breakdowns in its important stewardship responsibilities with respect to maintaining accountability over the receipt and use of funds. For example, GAO identified improper and questionable midshipmen fee transactions related to: (1) fee collections and uses of fees unrelated to goods and services provided to all midshipmen, (2) fee collections that exceeded the actual expense to the Academy for the goods or services, and (3) the use of accumulated excess midshipmen fees for improper and questionable purposes.

GAO found that a weak overall control environment and the flawed design and implementation of internal controls were the root causes of the Academy's inability to prevent or effectively detect numerous instances of improper and questionable sources and uses of funds. Specifically, GAO found that there was a lack of awareness or support for strong internal control and accountability across the Academy at all levels and risks, such as those that flow from a lack of clear organizational roles and responsibilities and from significant activities with affiliated organizations. The internal control weaknesses GAO identified were systemic and could have been identified in a timely manner had Academy and MARAD management had a more effective oversight and monitoring regimen. For example, GAO found that the Academy did not routinely prepare financial reports and information for use by internal and external users.

GAO found that various actions were taken and in process that were intended to improve the Academy's internal controls, including actions to address issues of accountability with its affiliated organizations. For example, a permanent position of Assistant Chief Financial Officer (CFO) for the Academy was established in March 2009 with direct reporting responsibility to the MARAD CFO. This action provides a senior financial official at the Academy with authority to conduct needed oversight and monitoring of financial activities on a real time basis. Further, following discussions GAO had with Department and MARAD officials, the MARAD CFO took steps to secure and protect accumulated reserves held in commercial bank accounts of an affiliated organization. However, even though MARAD and the Academy have taken actions, much more needs to be done, including determining the amount of midshipmen fees that were used to cover official Academy expenses, performing a comprehensive analysis of the risks posed by the Academy's organizational structure and its relationships with its affiliated organizations, and establishing and implementing policies, procedures, and internal controls over many Academy activities.

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## Abbreviations

ADA	Antideficiency Act
DRM	Department of Resource Management
FCO	Fiscal Control Office
GMATS	Global Maritime and Transportation School
NAFI	Non-appropriated fund instrumentality
MARAD	Maritime Administration
MWR	Morale, welfare, and recreation
SP&C	Sail, Power and Crew Association

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United States Government Accountability Office  
Washington, DC 20548

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August 10, 2009

The Honorable Patty Murray  
Chairman  
The Honorable Christopher S. Bond  
Ranking Member  
Subcommittee on Transportation, Housing and Urban Development,  
and Related Agencies  
Committee on Appropriations  
United States Senate

The Honorable John W. Olver  
Chairman  
The Honorable Tom Latham  
Ranking Member  
Subcommittee on Transportation, Housing and Urban Development,  
and Related Agencies  
Committee on Appropriations  
House of Representatives

The U.S. Merchant Marine Academy (Academy), one of five United States service academies, is located in Kings Point, New York, and provides 4-year undergraduate educational programs for men and women (midshipmen) to become shipboard officers and leaders in the transportation field. Graduates from the Academy receive Bachelor of Science degrees and U.S. Coast Guard licenses as deck or engineering officers, or both, and a commission in the U.S. Naval Reserve or another uniformed service. For the most recent academic year ending June 2009, there were about 940 Academy midshipmen. The Academy is a component within the Department of Transportation's Maritime Administration (MARAD). The Academy also is affiliated with 14 non-appropriated fund instrumentalities (NAFI) and two private foundations.

A February 2008 MARAD report on the Academy's fiscal years 2006 and 2007 activity concluded that the Academy lacked adequate controls to comply with laws and regulations governing the obligation and expenditure of federal resources, and identified possible Antideficiency Act (ADA) violations.<sup>1</sup> An ADA violation occurs when a federal officer or

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<sup>1</sup> Report to the Deputy Secretary of Transportation, Internal Controls Review of the U.S. Merchant Marine Academy, February 6, 2008, from the Maritime Administrator.

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employee incurs obligations or makes expenditures in excess or in advance of appropriations or employs personal services, among other things.<sup>2</sup> Appendix IV provides more detail on the requirements of the ADA.

In light of these issues, you requested that we determine whether there (1) were any potentially improper or questionable<sup>3</sup> sources and uses of funds by the Academy, including transactions with its affiliated organizations; (2) was an effective control environment with key controls in place over the Academy's sources and uses of funds, including transactions with its affiliated organizations; and (3) were any actions taken, under way, or planned to improve internal controls and accountability over the Academy's funds and other resources.

To address the first two objectives, we reviewed the 2008 MARAD report and selected laws, regulations, policies, and procedures related to the Academy and its affiliated organizations' operations and related financial activities. We obtained an understanding of the sources and uses of funds for the Academy and its NAFIs, including the Academy's appropriated funds. We assessed the Academy's internal controls against our *Standards for Internal Control in the Federal Government* and related guidance.<sup>4</sup> We also interviewed staff and officials from the Department of Transportation (the Department), Office of Inspector General for the Department, MARAD, the Academy, and its affiliated organizations to obtain an understanding of their roles and responsibilities, the internal control environment at the Academy, and controls over the Academy's sources and uses of funds with its affiliated organizations. We obtained a database of Academy expenses at the transaction level covering fiscal years 2006 and 2007, the time period covered by MARAD's February 2008 internal

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<sup>2</sup> 31 U.S.C. §§ 1341-42, 1349-51, 1511-19.

<sup>3</sup> We considered transactions associated with sources and uses of funds to be questionable if (1) the source of funds was not supported by sufficient documentation to enable an objective third party to determine the purpose of the funds received or there was a possible violation of law, regulation, or policy, or (2) the use of funds was not supported by sufficient documentation to enable an objective third party to determine if it was a valid use of government funds or there was a possible violation of law, regulation, or policy.

<sup>4</sup> GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999); *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001); *Guide for Evaluating and Testing Controls Over Sensitive Payments*, [GAO/AFMD-8.1.2](#) (Washington, D.C.: May 1993); and *Strategies To Manage Improper Payments: Learning From Public and Private Sector Organizations*, [GAO-02-69G](#) (Washington D.C.: October 2001).

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control review, and analyzed the transactions to identify indications of improper or questionable sources and uses of funds. We also analyzed midshipmen fees collected by one of the Academy's NAFIs and the use of those midshipmen fees for calendar years 2006 and 2007, and other sources and uses of funds for fiscal years 2006 to 2008. On the basis of this information and analytical procedures, we selected transactions that appeared to have a higher risk of being improper. We reviewed available documentation supporting selected transactions and also obtained explanations from Academy and NAFI officials for these transactions. The results of our work are not generalizable to the population of transactions as a whole because we selected transactions on a nonstatistical basis. Consequently, there may be other improper or questionable sources and uses of funds that our work did not identify.

To address our third objective, we obtained relevant documentation on actions taken, under way, or planned, including an October 2007 MARAD order establishing the Academy's Fiscal Oversight and Administrative Review Board.<sup>5</sup> We also interviewed officials from the Department, the Office of Inspector General for the Department, MARAD, and the Academy to obtain information on actions taken, under way, or planned. Additional details on our scope and methodology are in appendix I.

We conducted this performance audit from June 2008 to August 2009 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 findings and conclusions based on our audit objectives.

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## Background

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### Academy and NAFI Relationships

The Academy is headed by a Superintendent. The Superintendent reports directly to the head of MARAD, the Maritime Administrator. MARAD, an agency of the Department, is responsible for overseeing and monitoring the Academy. A Deputy Superintendent and four Assistant Superintendents—Administration, Regimental Affairs, Academic Affairs,

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<sup>5</sup> Maritime Administrative Order No. 150-3, October 1, 2007.

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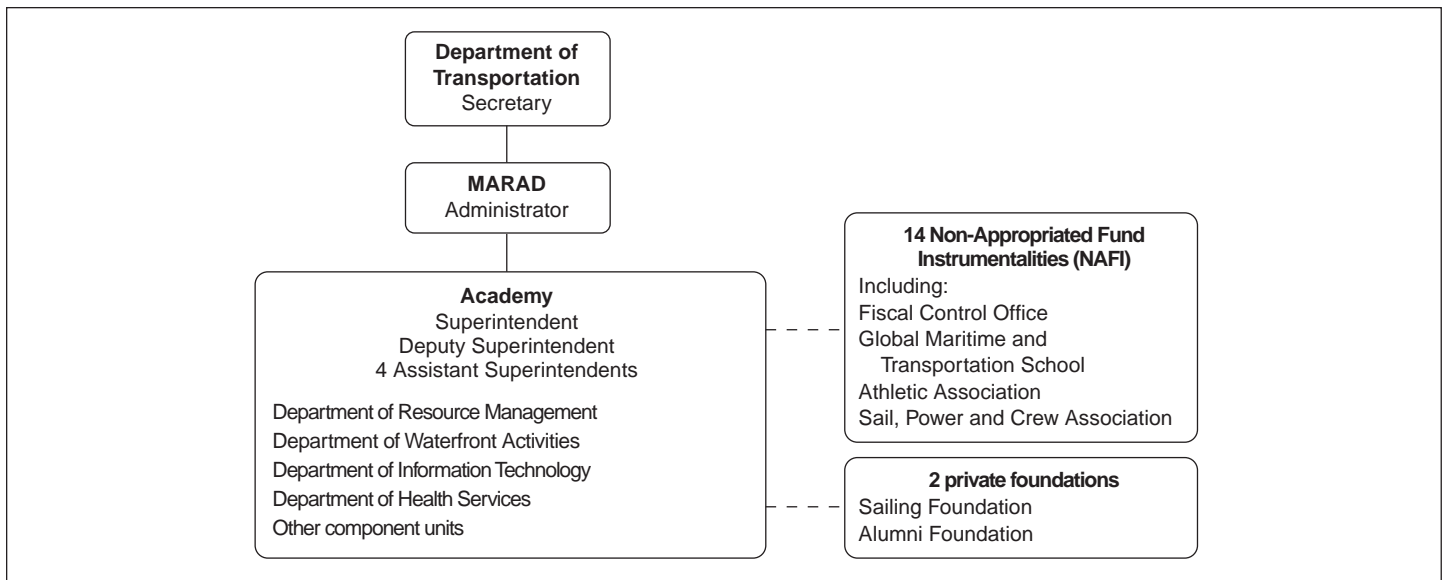
and Plans, Assessment, and Public Affairs—report directly to the Superintendent and are the principal officials responsible for carrying out the Academy’s operations. Academy components with respect to the issues discussed in this report include the following.

- The Department of Resource Management (DRM) provides bookkeeping, payroll, and other administrative support services for the Academy. Further, for most of fiscal years 2006 and 2007, the director of DRM was also the head of the Fiscal Control Office (FCO) NAFI. During fiscal years 2006 and 2007, the Director of DRM reported to the Academy’s Deputy Superintendent. When the position of Deputy Superintendent was not occupied, the Director of DRM reported directly to the Superintendent.
- The Department of Waterfront Activities operates the waterfront area of the Academy’s property, maintains the *Kings Pointer* and other training vessels, and provides training to midshipmen. Further, the Department of Waterfront Activities collaborates with two NAFIs on waterfront related activities (the Sail, Power and Crew Association, and the Global Maritime and Transportation School (GMATS)), and the Sailing Foundation, a private non-profit foundation. The Director of Waterfront Activities reported to the Deputy Superintendent, or when that position was not occupied, the Director reported directly to the Superintendent.
- The Department of Information Technology provides information technology services for all Academy operations and midshipmen. The Director of Information Technology reported to the Deputy Superintendent or when that position was not occupied, the Director reported directly to the Superintendent.
- The Department of Health Services provides medical and dental services to midshipmen. The Director reported to the Assistant Superintendent for Administration as well as the Deputy Superintendent or the Superintendent.

An overview of the organizational relationships of the Department of Transportation, MARAD, selected components within the Academy, as well as the Academy’s affiliated NAFIs and foundations is provided in figure 1.



**Figure 1: Overview of Key Components Involved in Carrying out Academy and Academy-Related Activities**



Source: GAO.

The Academy carries out its mission and operations primarily using appropriated funds. The Academy’s 14 affiliated NAFIs operate using the proceeds from their own operations, rather than with appropriated funds. NAFIs are organizations that typically provide for the morale, welfare, and recreation (MWR) of government officers and employees. These are items and services that support the efforts of government employees and officers to carry out the government’s business by fulfilling their MWR needs. For example, tailoring, hair cuts, and laundry services provided by the Academy’s NAFIs are examples of MWR services that generally should not be paid from appropriated funds. In addition to the 12 MWR type NAFIs, the Academy has two other affiliated NAFIs. The Fiscal Control Office (FCO) provides bookkeeping, payroll, and other administrative support services and the Global Maritime and Transportation School (GMATS) provides training to other federal agencies and to the maritime industry. The activities of the FCO with respect to the issues discussed in this report include the following.

- The FCO was responsible for bookkeeping, payroll, and administrative support services for 12 of the other 13 NAFIs and also handled payroll for the Athletic Association. The Athletic Association handled its own bookkeeping, and the GMATS handled all of its own bookkeeping and payroll functions. The FCO was also responsible for the collection of all

midshipmen fees for the Academy and the payment of amounts to other NAFIs, vendors and others from the fees collected. The FCO also collected funds from GMATS that were provided for the use and benefit of the Academy. Further, the FCO was responsible for maintaining books and records for “prior years’ reserves” from the excess of midshipmen fees collected over payments made as discussed in this report. The FCO maintained various commercial checking accounts for activities related to its collection and payment responsibilities for Academy funds. The functions of the FCO and DRM staff and managers were interchangeable. The manager of the FCO (the same individual as the head of DRM) reported on FCO matters to the Deputy Superintendent or when that position was not occupied, the FCO manager reported directly to the Superintendent.

The Academy’s 14 affiliated NAFIs and 2 affiliated foundations are listed in table 1.

**Table 1: Listing of Merchant Marine Academy Non-Appropriated Fund Instrumentalities (NAFI) and Foundations and Their Purposes**

<b>14 affiliated NAFIs</b>	<b>Purpose</b>
• American Merchant Marine Museum	Maintain maritime museum.
• Athletic Association	Enhance midshipmen educational experience through participation in athletic activities.
• Chapel Fund	Provide funding to chaplains for conducting religious functions and services for midshipmen.
• Cultural Events	Promote midshipmen participation in cultural activities.
• Employees Association	Promote and support the interests of Academy employees.
• Faculty and Staff Housing	Administers faculty and staff housing.
• Fiscal Control Office (FCO)	Provide bookkeeping, payroll and other administrative support services for NAFIs.
• Global Maritime and Transportation School (GMATS)	Provide education and training to other federal agencies and to the maritime industry.
• Melville Hall	Provide dining, lodging, and meeting facilities.
• Midships Publications	Publish the official Academy yearbook.
• Music Program	Support Academy Choir, Glee Club, and Chapel Choir.
• Regimental Morale Fund Association	Support provision of morale, welfare, and recreation activities for midshipmen.
• Sail, Power and Crew Association (SP&C)	Promote boating, recreational, and sports activities.

<b>14 affiliated NAFIs</b>	<b>Purpose</b>
• Ship's Service Store	Provides books, uniforms, tailoring, barbering, and other services to midshipmen.
<b>2 affiliated foundations</b>	
• USMMA Alumni Foundation	Provides financial support for charitable, scientific, and educational purposes by raising and distributing funds from alumni.
• USMMA Sailing Foundation	Receives and administers charitable gifts from the general public in support of the Academy.

Source: GAO analysis.

Appendix II provides more detail on the relationships and financial activity between the Academy and its affiliated organizations.

## Academy Funding and Expenses

Table 2 shows the amount and sources of the Academy's funding for fiscal years 2006 and 2007. Amounts received by the Academy for capital improvement, totaling \$15.9 million and \$13.8 million for fiscal years 2006 and 2007, respectively, were to be used for capital assets, including certain related expenses.

**Table 2: Academy Sources and Amounts of Funding, Fiscal Years 2006 and 2007**

	<b>FY 2006</b>	<b>FY 2007</b>
<b>Annual funding</b>		
Appropriated funds allotted from MARAD for:		
Salaries and benefits	23,512,000	25,800,000
Other expenses	23,379,665	22,967,930
Reimbursable agreements <sup>a</sup>	1,650,473	4,759,769
Gifts and bequests <sup>b</sup>	2,151,046	2,615,871
Other	597,806	861,233
<b>Total annual funding</b>	<b>\$51,290,990</b>	<b>\$57,004,803</b>
<b>No-Year funding</b>		
Capital improvement funds <sup>c</sup>	15,932,920	13,848,894
<b>Total annual and no-year funding</b>	<b>\$67,223,910</b>	<b>\$70,853,697</b>

Source: GAO analysis of MARAD's unaudited Academy data.

<sup>a</sup>Reimbursable agreements are typically arrangements with another federal agency that contain the terms for providing goods or services on a reimbursable basis.

<sup>b</sup>Gifts and bequests represent donations from affiliated foundations.

<sup>c</sup>Capital improvement funds are provided under appropriations that remain available for an indefinite period.

The Academy's payments to NAFIs and total expenses for fiscal years 2006 and 2007 are shown in Appendix III. The Academy's payment activity with its 14 NAFIs was significant in relation to the Academy's total expenses. For fiscal year 2006 Academy expenses of \$55.7 million included \$9.6 million to its affiliated NAFIs, representing over 17 percent of total Academy expenses. Similarly, for fiscal year 2007, Academy expenses of \$62.0 million included \$13.4 million to its NAFIs, representing over 21 percent of total Academy expenses. Payments to NAFIs were generally classified in the Academy's financial records as contractual services; operations and maintenance; and gifts and bequests. The total amount of payments that the Academy made to its NAFIs in fiscal years 2006 and 2007 are shown in table 3.

**Table 3: Payments Made by the Academy to Affiliated NAFIs, Fiscal Years 2006 and 2007**

Dollars in thousands		
NAFIs	FY 2006	FY 2007
Fiscal Control Office	5,528.7	5,398.0
Global Maritime and Transportation School	1,428.9	4,609.1
Ship's Service Store	1,454.7	1,542.7
Athletic Association	534.9	1,201.4
Sail, Power and Crew Association	580.8	414.9
Music Program	45.6	139.2
Melville Hall	15.9	48.4
Regimental Morale Fund Association	15.0	45.0
Chapel Fund	10.9	5.6
American Merchant Marine Museum	-	1.0
Cultural Events	-	-
Employee Association	-	-
Faculty and Staff Housing	-	-
Midships Publications	-	-
<b>Total</b>	<b>\$ 9,615.4</b>	<b>\$13,405.3</b>

Source: GAO analysis of NAFI data.

## Midshipmen Fees

The Academy is to provide each midshipman with free tuition, room and board<sup>6</sup> as well as limited medical and dental care.<sup>7</sup> However, under MARAD regulations,<sup>8</sup> the Academy requires each midshipman to pay fees for items or services generally of a personal nature (hereafter “goods or services” or “personal items”) each academic year. The Academy treats all fees collected as non-appropriated funds when the good or service is provided by a NAFI, such as services for laundry and haircuts that are provided by the Ship’s Services Store, or by a department of the Academy, such as Information Technology that provides internet services and personal computers to the midshipmen. The FCO collects all midshipmen fees on behalf of the Academy and also makes payments to vendors and others from the fees collected. For fiscal years 2006 and 2007, the FCO collected about \$7 million in total midshipmen fees.<sup>9</sup> In the 2007-2008 academic year, fees collected represented \$15,560 per midshipmen over the course of a 4-year education and ranged in amount from \$2,410 to \$7,020, depending on class year. Details on midshipmen fee collections for fiscal years 2006 and 2007 are shown in table 4.

**Table 4: Categories of Midshipmen Fees, Fiscal Years 2006 and 2007 Collections, Total for the 2 Fiscal Years**

Categories of midshipmen fees	FY 2006 Collections	FY 2007 Collections	Total
Activity fees	\$ 874,222	\$ 864,370	<b>\$ 1,738,592</b>
Information technology	423,253	416,056	<b>839,309</b>
Computers	649,637	628,630	<b>1,278,267</b>
Medical	460,503	460,901	<b>921,404</b>
Laundry and tailoring	489,704	491,758	<b>981,462</b>
All other	593,940	631,677	<b>1,225,617</b>
<b>Total</b>	<b>\$ 3,491,259</b>	<b>\$ 3,493,392</b>	<b>\$ 6,984,651</b>

Source: GAO analysis of unaudited FCO data.

<sup>6</sup> 46 U.S.C. § 51314(a).

<sup>7</sup> 46 C.F.R. § 310.62(a).

<sup>8</sup> 46 C.F.R. § 310.62(b).

<sup>9</sup> Midshipmen are assessed fees for the academic year beginning July 1 and ending June 30. Our review of fee collections and uses of fees covered the Academy’s fiscal years ending September 30.

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## Improper and Questionable Sources and Uses of Funds

Our review identified instances of improper and questionable sources and uses of funds by the Academy and its affiliated NAFIs, some of which violated laws, including the ADA. Specifically, we identified improper and questionable sources and uses of midshipmen fees and questionable financial activity associated with GMATS and other NAFIs. The improper and questionable activities and transactions that we identified demonstrate the Academy did not have assurance that it complied with applicable fund control requirements, including those in the ADA. Further, the Academy could not effectively carry out its important stewardship responsibilities with respect to maintaining accountability over the collection and use of funds, including assuring that funds were collected and used only for authorized purposes. As discussed in this report, the primary causes of these improper and questionable sources and uses of funds can be attributed to a weak control environment and the flawed design and implementation of internal controls at the Academy, including inadequate oversight and monitoring by the Academy and MARAD.

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## Improper and Questionable Collection and Use of Midshipmen Fees

MARAD regulations provide that the Academy can collect fees from all midshipmen to pay for “personal” goods and services. However, we found a number of improper and questionable activities concerning the Academy’s and its affiliated NAFIs’ collection and use of midshipmen fees. Specifically, we identified improper and questionable midshipmen fee-related transactions with respect to: (1) collections for goods and services that were not the midshipmen’s responsibility, (2) collected amounts that exceeded the actual expense to the Academy for the goods or services provided to the midshipmen, and (3) the use of accumulated fee reserves for questionable purposes. We also identified improper and questionable uses of the fees collected.

## Fee Collections and Uses of Fees not Related to Goods and Services Provided to All Midshipmen

For fiscal years 2006 and 2007, the Academy collected fees of approximately \$7 million from midshipmen. We nonstatistically selected four midshipmen fee categories for review. We found that the total fees collected for these four midshipmen fee categories of about \$1.5 million were questionable because they did not appear to be items of a personal nature to each midshipman, but rather, expenses that would normally be paid by the Academy from appropriated funds. Specifically, over the 2006 and 2007 fiscal years, we found that the Academy collected questionable midshipmen fees for waterfront activities, processing services, information technology services, and medical services. We also identified potentially improper payments from these questionable fee collections totaling approximately \$1.2 million that were paid to NAFIs and vendors, including the Sail, Power and Crew Association (SP&C) for waterfront

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activities, the FCO for processing services, and vendors for information technology services. There may be other improper and questionable collections and uses of midshipmen fees that our review did not identify. To the extent these collections and the uses of these funds improperly covered Academy expenses that are chargeable to Academy appropriations, the Academy improperly augmented its appropriated funds, which may have resulted in violations of the ADA, 31 U.S.C. §1341(a), by incurring obligations or expenditures in excess of available appropriations.<sup>10</sup> We did not independently assess the amount of such improper augmentations.<sup>11</sup>

- **Waterfront activities:** We found that for the 2006 and 2007 fiscal years, a total of \$318,187 was collected from all midshipmen for these activities. All fees collected for waterfront activities do not represent personal midshipmen services that qualify as chargeable to all midshipmen because not all midshipmen used the Academy's waterfront facilities. For example, such waterfront activities as sailing competitions, varsity water sport teams, and power vessel training are elective activities in the Academy's curriculum for midshipmen.
- **Processing services:** We found that for the 2006 and 2007 fiscal years, the FCO collected \$65,712 from the midshipmen for FCO's processing services. The FCO retained all processing fees without adequate supporting documentation for how the amount collected was determined, why a processing fee was due, or why the amount should be funded by collections from all midshipmen. Processing expenses incurred by FCO represent administrative expenses. The administrative expenses may be attributable to services provided by FCO to midshipmen. However, without adequate supporting documentation, we could not make such a determination.
- **Information technology services:** We found that for the 2006 and 2007 fiscal years, the Academy collected \$839,309 from the midshipmen for

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<sup>10</sup> The Academy can avoid ADA violations resulting from improper augmentations if it adjusts its appropriations accounts by charging them for such expenses, provided sufficient amounts are available in the accounts. It could transfer available unobligated balances to the non-appropriated fund accounts or account for the constructive receipt and use of the non-appropriated funds to the extent that the Department can exercise some legal authority to receive and use them absent additional appropriations.

<sup>11</sup> In addition, by collecting amounts that are used to cover expenses that are more accurately characterized as tuition, room, or board, the Academy may have violated the statutory prohibition on charging midshipmen for such expenses. *See* 46 U.S.C. § 51314.

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information technology services. Such services are not all “personal” to the Academy’s midshipmen. However, the Academy used these fees to support operations of the Department of Information Technology that are otherwise funded by Academy appropriations.

- **Medical services:** We found that for the 2006 and 2007 fiscal years the Academy used \$2,293,884 in appropriated funds to pay for medical and dental services for midshipmen under a contractual agreement with a local hospital. However, it also collected \$288,813 in midshipmen fees for the same services. Academy officials did not provide us with any support for how the annual amounts assessed midshipmen for contracted hospital services were determined. The midshipmen fees collected were, according to Academy officials, held by the FCO in a reserve for “rainy-day” purposes. We were told by the same officials that the fees collected from the midshipmen represented the amount the Academy believed to be necessary to cover possible rate adjustments under the contract with the hospital. We reviewed the payments by the Academy to the hospital for the years 2006 and 2007 and found that the amounts paid based on actual usage were less than the estimated expense per the contract.

#### Midshipmen Fee Collections Exceeded Actual Expenses

In addition to assessing and collecting fees unrelated to goods or services that are personal to all midshipmen, we found that the Academy collected fees from midshipmen that exceeded its actual expenses for providing goods or services to its midshipmen. For example, the Academy collected \$2,400 from each plebe midshipman during fiscal years 2006 and 2007 for computers, including a printer and peripheral equipment. For the 2006 and 2007 fiscal years, available records show the Academy collected a total of \$1,278,266 from the midshipmen in fees for these personal computers and related equipment. Over the same period, the Academy paid a total of \$863,859 to vendors for computers and related equipment—leaving an excess of \$414,407 in collections over the related expenses. Thus, the amount collected from the midshipmen for computers represented 148 percent of the actual expense to the Academy for these items over a 2-year period. Academy officials told us they were aware of these excessive collections, but did not take action to refund excess collections or reduce fees charged the midshipmen for this equipment, but instead chose to utilize the excess collections to support its operations.



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Questionable Use of Excess  
Midshipmen Fee Collections

The Academy, using the FCO, had inappropriately used “off-book” reserves accumulated from the excess of midshipmen fees collected over payments made to vendors and others for goods and services.<sup>12</sup> For example, a “Superintendent’s Reserve” was created and used to make discretionary payments authorized by the Academy Superintendent.<sup>13</sup> Our review of available records determined that for the 3 years ended September 30, 2008, deposits to the “off-book” reserves totaled \$1,325,669 and payments and transfers from the account totaled \$605,347, with a balance of \$999,315 at September 30, 2008. We found no evidence that the \$605,347 in payments from these “off-book” reserves were for purposes consistent with the fee collections.

Consequently, we consider the entire \$605,347 in payments from these reserves as questionable and, to the extent used to cover Academy expenses, constitute an improper augmentation of the Academy’s appropriations, which result in violations of the ADA, 31 U.S.C. §1341(a) if the obligations incurred exceed available appropriations. For example, use of the excess fee amounts to support the Academy’s Department of Information Technology constitutes an improper augmentation of the Academy’s appropriation for its operations. We did not independently assess the amount of such improper augmentations.

As summarized in table 5, and briefly discussed in the text that follows the table, our analysis of FCO’s records of 10 payments selected on a nonstatistical basis illustrates the types of questionable payments made from FCO’s accumulation of excess midshipmen fees from prior years’ midshipmen fee reserves during the 3-year period ending September 30, 2008, on behalf of the Academy.

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<sup>12</sup>After the end of an academic year, the FCO typically transferred the excess of midshipmen fees collected over payments made to a commercial bank account that was not reflected in the books and records of the Academy (“off-book”). FCO tracked the accounts’ transaction activity using off-line (“cuff”) records.

<sup>13</sup> Our review identified 3 separate “Superintendent’s Reserves” in operation at the Academy. This superintendent’s reserve was created from excess fees collected from midshipmen; another superintendent’s reserve was created from appropriated funds inappropriately “parked” with the FCO; and a third superintendent’s reserve was used for funds received from GMATS as payments for its use of Academy facilities.

**Table 5: Examples of Questionable Payments from the Prior Years' Midshipmen Fee Reserves by the FCO NAFI on Behalf of the Academy**

Payment no.	Amount	Payee	Description	Date
1	\$ 4,965	Blackbaud	Accounting system for FCO	July 23, 2008
2	59,464	FCO	Payroll cost for an Academy employee	October 25, 2007
3	3,000	[name of individual redacted]	Settlement of complaint	September 27, 2007
4	42,000	American Merchant Marine Museum	Start up Museum NAFI	September 26, 2007
5	68,708	FCO	Adjustment to payroll expense of the Regimental Morale Fund Association NAFI	June 27, 2007
6	4,000	Campus Speak	Education program on alcohol for midshipmen	February 5, 2007
7	7,245	Weight Watchers International	Weight control program	January 11, 2007
8	53,093	FCO—Academy Midshipmen Fees Account	To transfer prior years' midshipmen reserve money to current year's midshipmen fees account	September 21, 2006
9	2,700	Hendrickson Truck Center	Automatic tire chain system for Academy ambulance	August 18, 2006
10	71,833	GTSI Corporation	Portion of payment for computer equipment lease	December 15, 2005
	<b>\$317,008</b>	<b>Total</b>		

Source: GAO analysis.

1. **Blackbaud accounting system for the FCO:** This system is used by FCO to provide bookkeeping services for the 12 NAFIs for which the FCO provides such service. The total consulting fee and installation cost for the system, per a February 2008 contract, between the vendor and the FCO was \$75,000. As a NAFI system, the entire cost of the new system should have been funded using non-appropriated funds. Through January 2009, we found that payments of \$51,173, including the \$4,965 payment we reviewed, were made to the vendor using midshipmen fees. An additional \$10,581 was paid using Academy appropriated funds, \$5,963 was paid using FCO funds, and \$5,963 was paid using GMATS funds. Academy officials said that midshipmen fees as well as Academy appropriated funds were used to partially fund the system because other funding was not available at the time to pay the Blackbaud invoices.
2. **Payroll costs for Academy employee:** An Academy official said that the payment was to transfer funds from the midshipmen fee account to the FCO's account to cover the payroll for the upcoming fiscal year for an Academy employee that reported directly to the Academy's academic dean.

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3. Settlement of complaint: The payment support consisted of a copy of the check stub with the notation “Settlement fee for EEO complaint.” No documentation was provided to us to support why such a payment should be funded using midshipmen fees.
  4. Donation to start-up Museum NAFI: The payment support consisted of a copy of the payment stub with the notation “To start-up Museum NAFI.” No documentation was provided to us on how the payment related to fees collected from midshipmen.
  5. Payroll for Regimental Morale Fund Association NAFI: The support for this payment was a check stub with the explanation: “To cover the amount due to FCO for Morale Fund payroll according to a June 30, 2006 FCO analysis.” No information was provided as to why payroll of the Regimental Morale Fund Association NAFI would be paid from midshipmen fees. We were told that of 45 employees of the Morale Fund, 25 were paid from non-appropriated funds, 19 were paid from appropriated funds, and 1 was paid with a combination of appropriated and non-appropriated funds. The payment support indicates that the payment is for adjustments to the payroll costs for several of the persons paid from non-appropriated funds.
  6. Education program on alcohol: Payment was for an educational program for the midshipmen on alcohol. Academy officials did not provide any explanation as to why this item of expense was not considered as an ordinary and necessary expense of the Academy payable from appropriated funds.
  7. Weight control program: Payment was for “At Work Series,” a Weight Watchers International program. However, we were provided with no information on either why this item was not considered a personal expense of the midshipmen in the weight control program, or why the item was not considered a necessary expense of the Academy payable from appropriated funds.
  8. Transfer to current year’s midshipmen fees account: The only documentation supporting this payment was a copy of the payment voucher with the explanation “transfer prior year computer money to current.” An FCO official told us that the payment was to transfer prior year midshipmen fees for computer services—excess of collections over payments made for goods and services—to the current years midshipmen fees account to be used to pay for numerous invoices to the Academy from a provider of information technology services. Academy officials did not provide any information on why expenses

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payable from the Academy's appropriated funds would be paid from midshipmen fees collected.

9. Tire chain system for Academy ambulance: Academy officials did not provide us with any information on why this item was not considered a necessary expense of the Academy payable from appropriated funds, rather than from funds collected through midshipmen fees.
10. Computer equipment lease: The \$71,833 in midshipmen fee reserves was paid toward a \$106,217 installment on a 3-year computer equipment lease (under a "lease to purchase agreement"). The balance of the installment payment was paid with current year midshipmen fees. Payments totaled \$318,651 under this agreement and the amount funded with prior years' midshipmen fees was \$178,050 (including the \$71,833 above) and \$140,601 was funded with current year midshipmen fees over 3 fiscal years. An Academy official told us that prior years' and current year's midshipmen fees were used for these payments because "the Academy did not have sufficient appropriated funds to dedicate to this purchase." Academy officials did not provide any information on why amounts payable from the Academy's appropriated funds would be paid, in part, from midshipmen fees collected.

The Academy did not provide us with any information as to why excess fees collected from all midshipmen and transferred to prior years' reserves were considered an appropriate source of funds for any of these payments.

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### Questionable Financial Activity with GMATS and Other NAFIs

We found that the Academy (1) improperly entered into sole-source agreements with GMATS to provide training services to other federal agencies and (2) inappropriately accepted and used GMATS funds. In addition, we found other improper and questionable transactions, including the Academy's obligating and transferring appropriated funds to the FCO in order to preserve or "park" the funds for future use, and the Athletic Association NAFT's retention of fees paid to this NAFTI for use of the Academy's property.

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Improper Contracting for  
GMATS NAFI Training to Other  
Agencies

During fiscal years 2006 and 2007, the Academy improperly entered into over \$6 million in agreements with GMATS to provide training services to other federal agencies on a non-competitive basis by GMATS. The Academy accepted interagency orders under the Economy Act<sup>14</sup> as legal authority for its use of sole-source procurements. Based on our review of the transactions between the Academy and GMATS, we concluded that the Academy's non-competitive awards to GMATS and the lack of proper contractual agreements under the Federal Acquisition Regulation may be improper procurements.<sup>15</sup> For example, the Department provided us with no documentation to support a legitimate justification for the Academy's non-competitive awards to GMATS. Although the services were provided by GMATS to the Academy (that, in turn, provided the services to other federal agencies under the Economy Act) under what likely constitute improper non-competitive contracts, the Department did not provide us with information supporting its reimbursements to GMATS of approximately \$6 million for its costs under these agreements.<sup>16</sup>

GMATS Funds Used to  
Improperly Augment Academy  
Funds

During 2006 and 2007, the Academy also received funds from the GMATS NAFI and directed the GMATS NAFI to make payments on the Academy's behalf without clear legal authority. Specifically, in fiscal years 2006 and 2007, we found that the FCO received \$193,022 and \$186,113, respectively, which were described in GMATS records as annual contributions for the benefit of the Academy of 5 percent of GMATS's gross profits. The records of GMATS further described these amounts as funds to be utilized by the Academy for incremental costs incurred from GMATS's use of the Academy's campus facilities. The Academy did not have records or analysis of whether the amount received bore any relationship to estimated or actual costs the Academy may have incurred. We also found that GMATS made payments to the FCO that were held in a reserve for subsequent disbursement at the direction of Academy officials. We were told that the payments to the FCO were to compensate the Academy for various items such as use of the engineering lab; use of the ship's bridge simulator, a specialized training device; and use of a professor's time—all for GMATS business. According to GMATS records, the amount paid by

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<sup>14</sup> 31 U.S.C. § 1535.

<sup>15</sup> B-289605.2, July 5, 2002; B-235742, Apr. 24, 1990; 68 Comp. Gen. 62 (1988); 64 Comp. Gen. 110 (1984)

<sup>16</sup> B-199533, Aug. 25, 1980; 58 Comp. Gen. 94, 100 (1978).

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GMATS for these items totaled \$52,124 in 2006; Academy officials told us that this practice was discontinued in 2007.

In February 2008, the Administrator reported to the Deputy Secretary of Transportation that the use of these reserves may have violated the ADA's prohibition on obligating or expending amounts in excess of available appropriations.<sup>17</sup> We found that the Academy also may have violated the "Miscellaneous Receipts" statute, 31 U.S.C. § 3302(b),<sup>18</sup> by failing to immediately deposit all the funds received from GMATS into the general fund of the U.S. Treasury.<sup>19</sup> Further, the use of the Superintendents Reserve fund for official Academy expenses appears to constitute an improper augmentation of the Academy's appropriated funds, which results in violations of the ADA, 31 U.S.C. § 1341(a), if the obligations incurred exceed available appropriations.

Improper Use of Contracting to  
"Park" Funds That Would  
Otherwise Expire

We found that the Academy improperly entered into agreements with the FCO NAFI to prevent a cumulative total of almost \$389,000 in annual appropriations from expiring ("parking funds") at the ends of fiscal years 2006 and 2007. The Academy later transferred the \$389,000 to the FCO for future use rather than allowing the funding to expire in accordance with the appropriation account closing law, 31 U.S.C. § 1553. For example, one agreement for \$200,000 stated that the purpose was to provide accounts payable services to the Academy during fiscal year 2007 year-end. These agreements were improper because there was no underlying economic substance to them and there was not any description of deliverables under the agreement, such as a statement of work. We were told that the agreement with FCO was entered into to reserve funds at the end of the year that would otherwise have expired.

We also found that, of the \$389,000 received from the Academy, FCO used approximately \$175,000 to subsequently pay for items of expense and, at the direction of MARAD, returned \$214,000 to the Academy in March 2008. In addition, we found that in October 2007, FCO transferred \$270,000 from

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<sup>17</sup> 31 U.S.C. § 1341(a)

<sup>18</sup> Absent other specific statutory authority, all officers of the government receiving funds for the benefit of the government must promptly deposit such funds into the general fund of the U.S. Treasury.

<sup>19</sup> In a September 3, 2008, letter to the Department's General Counsel, we solicited information and the Department's legal views on this potential violation, but the Department has not responded.

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this reserve to the FCO's payroll checking account for what FCO officials described as a "payroll loan". The loan was repaid in full on December 11, 2007. However, Academy officials told us they did not have any support and that their inquiries on this issue had not produced an explanation as to why Academy resources would be used for a loan to the FCO. We were told by FCO officials that the transactions were based on a need for the funds as determined by staff and that no formal loan documents or other written supporting documentation existed.

The Secretary of Transportation reported to the President, the Congress, and the Comptroller General in March 2009, numerous unidentified transactions in fiscal years 2005, 2006, and 2007, totaling \$397,740, as violations of section 1341(a)(1)(B) of the ADA, which prohibits the involvement of the government in a contract or obligation before an appropriation is made.<sup>20</sup> As discussed above, the Academy recorded obligations against its fixed-year appropriated funds to reflect transfers to the FCO, via a MARAD "Form 949." MARAD officials investigated transactions occurring in fiscal years 2005, 2006, and 2007 to determine if these transfers constituted illegal "parking" of fiscal year appropriations and violations of the ADA.<sup>21</sup> They found that the executed forms, in a net amount totaling \$397,740, did not represent bona fide needs of the Academy for specific goods or services at the time they were made and, therefore, did not reflect valid obligations.<sup>22</sup> Recording invalid obligations against current fixed-year appropriations for the purpose of using the appropriations in a subsequent year constitutes illegal parking of the funds.

Questionable Billing and  
Payment Transactions Related  
to Use of the Training Vessel  
*Kings Pointer*

We found questionable billing and payment transactions related to the use of the Academy's training ship and other Academy boats. Specifically, we found that the SP&C NAFI, and not the Academy, billed the user of the *Kings Pointer*, GMATS. The GMATS NAFI used the Academy's 224-foot training vessel, the *Kings Pointer*, as well as other Academy vessels, to provide training and education to other organizations or individuals from

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<sup>20</sup> Heads of agencies are required to report immediately to the President and the Congress violations of the ADA. A copy of the report must be transmitted concurrently to the Comptroller General, 31 U.S.C. §1519, 1351.

<sup>21</sup> Our review of transactions covered only fiscal years 2006 and 2007.

<sup>22</sup> MARAD found that the Academy recorded additional invalid obligations on the MARAD Form 949, but after the MARAD investigation, the funds were returned as improper payments and credited to Academy appropriation accounts.

the marine community during fiscal years 2006 and 2007. GMATS remitted payments to the Academy for the use of its vessels, for which the Academy then remitted a portion of the funds to another Academy NAFI (the Sail, Power and Crew Association) and retained a portion. Available records show that of the \$366,906 the Academy received for use of the *Kings Pointer* during fiscal years 2006 and 2007, the Academy made payments totaling \$217,848 to SP&C. The portion of fees the Academy received that were remitted to the SP&C varied from about 50 percent of receipts to over 70 percent based on directions received from SP&C. However, no documentation was provided to support the amount or percentages of these Academy payments to the SP&C. Further, we found that the Academy may have violated the “Miscellaneous Receipts” statute, 31 U.S.C. §3302(b), by failing to immediately deposit all the funds received from GMATS into the general fund of the U.S. Treasury. Finally, without adequate supporting documentation, the entire \$217,848 in Academy payments to the SP&C related to the outside use of the *Kings Pointer* during fiscal years 2006 and 2007 is questionable.

**Table 6: Questionable Payment Transactions Related to the GMATS’s Use of the *Kings Pointer*, Fiscal Years 2006 and 2007**

Transactions	FY 2006	FY 2007	Total
GMATS payments to the Academy	\$166,153	\$200,753	<b>\$366,906</b>
Academy payments to SP&C	\$ 96,388	\$121,460	<b>\$217,848</b>
Funds retained by Academy	\$ 69,765	\$ 79,293	<b>\$149,058</b>

Source: GAO analysis of unaudited Academy, SP&C, and GMATS data.

**Questionable Use of Academy Property, Payments to Academy Employees, and Retention of Fees by Athletic Association NAFI**

We found that the Athletic Association NAFI operated camps and clinics on Academy property and that the Athletic Association NAFI, and not the Academy, was compensated for the use of government property. We also found that instructors who were compensated in part by the Academy participated in these commercial activities on Academy property in return for a share of the proceeds from those activities.

During fiscal year 2008, the Athletic Association collected \$94,077 in fees for conducting athletic camps and clinics. Of the funds collected, \$72,847 was paid to instructors, \$19,327 was retained by the Athletic Association as a facility fee, and \$1,903 was either retained by the Athletic Association or used for other payments not identified in our review.

According to Athletic Association staff, \$62,122 of the \$72,847 paid to instructors were payments for fee-sharing arrangements with 6



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Academy Payroll Activities  
Contributed to Three Separate  
Violations of the ADA

instructors, 5 of whom are current or former Academy employees. Further, an Academy official described the Athletic Association's retention of \$19,327 as being essentially the net profit from the camps and clinics that was retained as a facility fee. However, no portion of the \$19,327 was paid to the Academy for the use of the Academy's facilities.

Academy payroll activities contributed to three separate violations of the ADA. First, the Academy incurred approximately \$525,000 more for salaries and benefits in fiscal year 2006 than the \$23,512,000 appropriated for its salaries and benefits.<sup>23</sup> The payments were for performance awards that Academy personnel earned in fiscal year 2006 that the Academy erroneously charged against fiscal year 2007 appropriations. Academy officials told us the amounts could not be corrected with prior year's funds because the Academy lacked a sufficient unobligated balance in its fiscal year 2006 salaries and benefits appropriation to transfer the charge from the fiscal year 2007 appropriations. This resulted in a violation of the ADA,<sup>24</sup> which was included in the Secretary's reports of March 9, 2009, to the President and the Congress that included multiple ADA violations.

Second, in March 2009 the Secretary of the Department of Transportation reported to the President and the Congress that the Department violated section 1342 of the ADA, which prohibits the acceptance of voluntary services and the employment of personal services. Specifically, it determined the Academy paid over \$4 million in both fiscal years 2006 and 2007 under agreements with the FCO for illegal personal services from the Academy's NAFIs that were provided by as many as 90 employees who performed exclusively Academy functions, and reported to Academy supervisors. These expenses were recorded as contracted services in the Academy's books and records. The Secretary concluded that many agreements called for the employment of personal services, which are characterized as an employee-employer relationship.

For example, an agreement between the FCO and the Academy for information technology services, dated November 14, 2006, and as modified through August 16, 2007, provided that the Academy would pay FCO \$941,681 during fiscal year 2007 for services described in the

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<sup>23</sup> Public Law Number 109-115 (Nov. 30, 2005) appropriated \$122,249,000 in fiscal year 2006 under the MARAD Operations and Training account, of which \$23,512,000 (after a 1 percent rescission) was for salaries and benefits of Academy employees.

<sup>24</sup> 31 U.S.C. §1517(a)(2), 1341(a).

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agreement as professional services to the Department of Information Technology, and administrative support services. A supporting schedule to the agreement detailed the annual salaries for 11 staff by name, the general schedule (GS) equivalent grade for each staff except 1, the amounts for the salaries of 2 NAFI contractors, and amounts for fringe benefits and cost of living adjustments. The information technology agreement covered all the staffing needs for the Academy's Department of Information Technology except for one individual. Thus, through this agreement the Academy paid 100 percent of the salary and benefit costs for all 11 FCO staff and the full cost of the NAFI contractors listed. Each of the staff covered by the agreement with the FCO performed Academy functions under the supervision of a government employee, but the expense for their services was classified as contract services and not as payroll.

A similar agreement for services related to athletics, dated November 14, 2006 as modified through August 16, 2007, between the FCO and the Academy provided that the Academy would pay the FCO \$481,132 during fiscal year 2007 for services described in the agreement as professional services to the Academy's Department of Athletics. The supporting schedule to the agreement detailed the annual salary amount for 32 staff by name and amounts for fringe benefits and cost of living adjustments. The Academy was responsible for 40 to 100 percent of the total cost by individual. These expenses were also classified as contract services and not as payroll.

We asked Academy and MARAD officials for an analysis supporting the portion of the payroll that was assigned to the Academy under the agreement for information technology and athletics services. We were told by the Academy's Assistant CFO and the MARAD CFO that there was no overall analysis that would support the distribution of amounts between the Academy's appropriated funds and NAFI expense for the payroll covered by any of the agreements between the Academy and the FCO.

In addition to the issues discussed above, the Secretary reported in the March 2009 report to the President and the Congress that the Academy also violated section 1342 of the ADA over the past 4 years by employing about 50 adjunct professors under illegal personal services contracts valued at \$2.4 million. The Academy funded these services out of the Academy's fiscal year appropriations that were unavailable for salaries.

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## Weak Control Environment and Flawed Academy Internal Controls

We found that a weak overall control environment and the flawed design and implementation of internal controls were the root causes of the Academy's inability to prevent, or effectively detect, the numerous instances of improper and questionable sources and uses of funds discussed previously. Specifically, we found the Academy lacked an accountability structure that clearly defined organizational roles and responsibilities; policies and procedures for carrying out its financial stewardship responsibilities; an oversight and monitoring process; and periodic, comprehensive financial reporting. We found that there was little evidence of awareness or support for strong internal control and accountability across the Academy at all levels, and risks, such as those that flow from a lack of clear organizational roles and responsibilities and from significant activities with affiliated organizations, that were not addressed by Academy management. The internal control weaknesses we identified were systemic and could have been identified in a timely manner had Academy and MARAD management had in place a more effective oversight and monitoring regimen. Further, we found that the Academy did not routinely prepare financial reports and information for use by internal and external users that could have helped to identify the improper and questionable sources and uses of funds.

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## Risks Posed by Academy and NAFI Relationships Are Not Adequately Managed

An entity's organizational accountability structure provides the framework within which its activities for achieving its mission objectives are planned, executed, and controlled. The process of identifying and analyzing risk is a critical component of effective internal control. GAO's Internal Control Implementation Tool<sup>25</sup> provides that management should periodically evaluate its organizational structure and the risks posed by its reliance on related parties and the significance and complexity of the activities it undertakes. Further, as discussed previously, one of the primary requirements of the ADA is to establish accountability for the obligations and expenditure of federal funds. In carrying out its mission operations, the Academy has close relationships with its 14 affiliated NAFIs and 2 foundations. Therefore, it is important for the Academy to recognize and appropriately manage the risks posed by the organizational and transactional relationship between it and its NAFIs. These risks and the volume of activities between the Academy and the NAFIs should have

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<sup>25</sup>*Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001).

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signaled to Academy management that there was a need for strong oversight and accountability over these activities and relationships.

Our review indicated that 11 NAFIs do not have approved governing documents, such as charters and by-laws, and the remaining 3 NAFIs with approved governing documents perform some duties and functions which fall outside of the narrow scope of authority set out in those documents. Further, the relationships between the Academy and its 14 NAFIs are complex, and we found that they often involve numerous financial transactions, the business purpose of which is frequently not readily apparent. As such, it is not always clear where the respective responsibilities of the Academy and its NAFIs begin and end.

In addition, we found that the Academy did not address the risks posed by its organizational structure, including not establishing a system of checks and balances over the sources and uses of funds with its NAFIs. Further, the inappropriate practices and improper use of Academy resources by Academy managers that we found occurred and continued for years. For example, the collection of questionable midshipmen fees for hospital services, among others: the accumulation of excess fees “off-books” in commercial bank accounts for discretionary or “rainy day” purposes: and the preserving or “parking” of Academy appropriated funds with the FCO, all occurred within a culture of lax accountability involving both Academy and NAFI management that was accepting of these types of activities.

Further, the risks posed by the Academy’s relationship with its NAFIs led to improper transactions. For example, as previously discussed in this report, GMATS provided a percentage of its profits each year to the FCO for the benefit and use of the Academy. However, there was no agreement covering these transactions. We also found insufficient review of the Academy’s use of GMATS funds and no indication that there was consideration of the legality or appropriateness of those transactions. There was also insufficient consideration of the legal and internal control ramifications of Academy agreements with the FCO for personal services. As previously discussed in this report, the services provided by these agreements totaled over \$4 million per year, which represented about 17 percent of the annual Academy appropriation for salaries and benefits. Also, the Academy did not provide us with information on the authority for establishing the prior years’ reserves, or the rules, policies, and procedures for operation of the reserves, including, for example, specifics on authorized uses of the funds.

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## Financial Reporting Not Comprehensive and Did Not Address All Legal Requirements

*Standards for Internal Control in the Federal Government*<sup>26</sup> provides that for an agency to run and control its operations, it must have relevant, reliable information, both financial and non-financial. For example, those charged with governance should have timely information on the amount and sources of the Academy's resources. This includes information on the Academy's appropriated funds as well as funds it receives from other sources, such as midshipmen fees and receipts from affiliated organizations for goods and services provided to them by the Academy.

If such information had been produced routinely by the Academy and made available to decision makers and those charged with governance, they may have identified red flags that signaled the need for attention. For example, financial reports for the Academy that provided detailed financial information may have signaled the need for inquiry as to the reasons for such things as the Academy annually paying approximately \$4 million from appropriated funds for contracted personal services and reflecting such expenses as other than payroll in its books and records.

## Academy Did Not Routinely Prepare Financial Reports

We found that for fiscal years 2006 and 2007, the Academy did not routinely prepare financial reports separately presenting information on all its financial activities, including its sources and uses of funds, and amounts due to and from others. The Academy's activities are included in MARAD's financial reports, but its activity and balances are not separately identified.<sup>27</sup> As a result, users of MARAD's financial reports could not readily identify the sources and uses of funds attributable to the Academy or the amounts due to and from others by the Academy. Such information is typical in financial reports and statements.

We found that the Academy prepared and reported selected financial information from time to time for use by its managers. However, Academy officials told us that such reports were sporadic, unreliable, and were not used for decision making. For example, the head of the Academy's Department of Information Technology told us that, among other things, the expense and obligation information that he received was typically not timely and that the information provided to him was inaccurate and could not be relied upon. An Assistant Superintendent told us that he did not typically receive financial information on the significant business activities

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<sup>26</sup> GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

<sup>27</sup> MARAD's financial information is included in the Department's annual audited financial statements that are contained in its performance and accountability reports.

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Academy Did Not Comply with Congressional Reporting Requirements

that he was responsible for, including a \$6 million, 5-year contract for medical services with a local hospital. We also found that comprehensive financial reports on Academy activities and balances were not routinely prepared and made available for review by Academy or MARAD management.

The Academy did not fully comply with a legal requirement to annually provide the Congress with a statement of the purpose and amount of all expenditures and receipts. We reviewed the reports submitted to the Congress for fiscal year 2008 and found that the reports included some, but not all expenditure and receipt information. For example, the reports included information on gifts and bequests received and tuition receipts by GMATS. However, the reports did not include any information on gifts and bequests received by the Academy and paid to others,<sup>28</sup> receipts and expenditures of GMATS, or midshipmen fees collected or expenditures made from the fees collected by FCO. The inquiry and analysis necessary to prepare and file a complete report may have provided information to address the issues we discussed previously in this report involving GMATS and midshipmen fees. The MARAD CFO told us in August 2008 that the Academy would take actions to include information for all NAFIs and midshipmen fee activities in future reports to the Congress. However, we were subsequently told that such information was not included in the May 2009 report that accompanied the Department's budget justification document because the necessary analysis had not been completed. MARAD officials subsequently told us that they would submit an amended report with this data.

Further, we found that the Department did not comply with a 1994 legal requirement to annually report to Congress any changes in midshipmen fee assessments for "any item or service" in comparison with fees assessed in 1994.<sup>29</sup> We identified changes in the nature and the amount of fees collected by the Academy from 1994 forward that were not reported by the Department to the Congress. A MARAD official told us that changes in the

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<sup>28</sup> In 2008, MARAD questioned the authority of the Academy to accept gifts or donations exceeding \$2,500, which was the maximum amount delegated by the Secretary and MARAD for acceptance. MARAD requested and Congress granted unlimited authority to MARAD to accept gifts for the Academy and the NAFIs in the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, Pub. L. No. 110-417, div. C, title XXXV, §3506(g), 122 Stat. 4356, 4764 (October 14, 2008).

<sup>29</sup> 46 U.S.C. § 51314(b). Congressional notification of any changes to the fees or changes since 1994 is also required by the statute.

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fees had occurred since 1994, but he did not know why the reports had not been filed. Had changes in midshipmen fees over the last 15 years been reported to the Congress, red flags may have been raised about the increases and the total amount of midshipmen fees being charged that could have been addressed by those charged with oversight and monitoring. Further, a systematic process to identify changes in midshipmen fees from year to year and to report the changes to those officials charged with reporting to the Congress on these matters may have functioned as an important early detection control.

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### Limited Oversight and Monitoring In Place to Assure Effective Accountability over Academy Resources

*Standards for Internal Control in Federal Government* provides that an entity's control environment should include management's framework for monitoring program operations to ensure its objectives are achieved. However, the absence of effective oversight by MARAD contributed directly to the opportunity for improper practices and questionable activities and payments and for the continuation of such practices over long periods of time without detection. Our review found a number of instances in which effective oversight procedures could have helped identify and address the Academy fund control deficiencies we discussed previously. For example, we found that MARAD did not have or did not enforce basic prevention and detection controls such as requiring periodic financial reports of Academy's sources and uses of funds or performing high level analytical reviews of reported revenues and expense of the Academy. Also, MARAD did not enforce the existing policies for monitoring of NAFL activities, such as the requirements for submission and review of annual audited financial statements for each NAFL.<sup>30</sup>

We found a wide range of activities between the Academy and its 14 NAFLs that lacked transparency and for which there was insufficient review and consideration by Academy and MARAD officials. Some of these activities were reflected in the Academy's books and records, and some were apparent only from looking beyond the form of the transaction to find underlying cross subsidies and barter arrangements. For example, we found there were no independent reviews, either by the Academy, by MARAD officials, or by both, conducted before entering into agreements for training services that were provided to external federal agencies by GMATS and not the Academy.

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<sup>30</sup> MARAD Order No. 400-11, August 14, 2000.

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## Inadequate Accountability over Capitalizable Assets

Our analysis of costs charged against the Academy's no-year capital improvement appropriation identified some costs that were recorded as repairs and maintenance expenses that appeared to represent capitalizable assets.<sup>31</sup> For example, under the no-year capital improvement appropriation, we identified \$779,731 of recorded expenses in 2007 for payments to one vendor for items of furniture and equipment. The MARAD CFO told us that he was aware that timely reviews were not performed of the Academy's expenses in either 2006 or 2007. Such reviews are important because of the large amount of capital improvement projects at the Academy and could have identified items that should have been capitalized with necessary adjustments made before the books were closed for the year and financial and budgetary reports prepared. The Academy received \$15.9 million and \$13.8 million for fiscal years 2006 and 2007, respectively, in no-year appropriations for its capital improvement projects.<sup>32</sup>

At our request MARAD reviewed selected categories of expenses for fiscal years 2006 and 2007 and identified \$3,380,528 for 2006, and \$1,695,670 for 2007 (including the \$779,731 described above) that should have been capitalized as assets. The payments were appropriately funded using the Academy's no-year appropriations. These officials told us that adjustments to correct for the errors of \$5,076,198 were made during fiscal year 2009. MARAD also identified additional expenses of \$1,459,103 and \$1,972,622 for 2006 and 2007, respectively, which were improperly funded with the no-year capital improvement appropriation. In June 2009, these officials told us that adjustment to correct for these errors would also be considered before the close of fiscal year 2009 in conjunction with the other matters that we identified in this report that may require adjustment to the Academy's appropriation accounts.

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<sup>31</sup> According to Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, the criteria for an item to be capitalized as an item of property, plant, or equipment asset are that the item have an estimated useful life of 2 years or more, not be intended for sale in the ordinary course of operations, and be acquired or constructed with the intention of being used, or being available for use, by the entity. Repairs and maintenance expenses are typically recognized in the year when they are incurred, whereas the cost of capitalizable assets are recognized as expenses in the years in which the asset is used.

<sup>32</sup> These funds are provided by no-year appropriation accounts which remain available for an indefinite period.



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## Lack of Controls and Accountability over the Collection and Use of Midshipmen Fees

The Academy lacked adequate procedures and controls to maintain effective accountability over the amounts charged to midshipmen and to ensure that midshipmen fees collected were used only for their intended purpose— covering the costs of goods or services provided to the midshipmen that are generally of a personal nature. The Academy has no policy on what midshipmen fees activity and balances should be reflected in its official records and reports or what is properly excludable. As discussed previously, these deficiencies resulted in the Academy’s charging midshipmen fees for items that were not of a personal nature and in amounts that were in excess of the related expenses for the goods or services. Further, the treatment of midshipmen fee activities “off-book” did not provide necessary accountability for the collection and use of the fees.

We also found that the FCO’s records did not consistently support the activity in the midshipmen fee accounts. DRM, FCO, and Academy staff and officials, as well as the Academy’s Assistant CFO informed us that the support we requested for specific transactions could not be located, including memorandums from staff and officials describing or authorizing fees or supporting amounts collected or paid. We were also told that the activities reflected in the bank accounts that held the prior years’ reserves were not reconciled to FCO records for any month in the 3 years covered by our review. We found that reports provided to us for monthly activity— increases and decreases—in reserve balances for each of the separate categories did not always reflect complete information on the sources and uses of the reserves. For example, we found that the FCO’s September 2007 activity report for the prior years’ reserves account included transactions that reduced the reserve account balances for 4 of the 8 reserve sub accounts by a total of \$100,000, but did not identify the payee or other information on the use of funds. FCO staff told us that this difference was due to an error. The Academy’s Assistant CFO told us that no further documentation or explanation for this activity was available.

As indicated, the FCO was responsible for paying bills using midshipmen fees that were presented for processing by officials with responsibility for Academy departments such as Health Services and Information Technology as well as requests for payments from the Academy’s Superintendent and other officials. However, we found that FCO staff did not appropriately question the items presented for payment to determine the sufficiency of the support for the payment that was requested.

## Lack of Accountability over GMATS Training Activities and Funding

The Academy entered into agreements to provide training services to other federal agencies that were provided by GMATS and not the Academy. Federal accounting standards provide that an entity should recognize revenue and expenses when the entity provides goods or services to another entity in an exchange, such as by contracting to provide training to another entity.<sup>33</sup> However, we found that the Academy recognized revenue and expenses even though it was not a party to the exchange of services and resources. These improperly recognized revenues and expenses were reflected in MARAD's budget and financial reports. Further, the Academy paid GMATS for the funds received from other federal agencies when reviewing and approving officials did not have proper support for the payments. A summary of the revenue and expenses that the Academy recorded for transactions between GMATS and other federal agencies is shown in table 7.

**Table 7: Revenue and Expense Recognized by the Academy from Agreements between GMATS and Other Federal Agencies, Fiscal Years 2006 and 2007**

Accounting records of Academy	FY 2006	FY 2007
Revenue – from other federal agencies <sup>a</sup>	\$1,650,473	\$4,759,769
Expense – payments to GMATS <sup>b</sup>	\$1,428,948	\$ 4,609,113

Source: GAO analysis of unaudited Academy data.

<sup>a</sup>Amounts per the Academy's data. These amounts represent funds received from federal agencies for training provided by a non-federal entity, GMATS.

<sup>b</sup>Amounts per the Academy's data. These amounts represent payments by the Academy to GMATS for funds received by the Academy from federal agencies.

In addition, the Academy did not provide proper accountability for the acceptance and use of annual contributions from GMATS by using another NAFI, the FCO, as recipient of the funds on behalf of the Academy. Neither the receipt nor the use of those funds was reflected in the Academy's accounting records. Further, the amounts accepted for the Academy by the FCO from GMATS were not supported by appropriately detailed billings or analysis from the Academy to GMATS. Instead, the amounts of contributions paid from GMATS to the Academy were unilaterally determined by GMATS and were paid to the FCO and, at times, directly to vendors on behalf of the Academy.

<sup>33</sup> Statement of Federal Financial Accounting Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

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**Controls Ineffective in Preventing Improper Accruals and “Parking” Funds**

Federal accounting standards provide that entities should establish accruals only for amounts expected to be paid as a result of transactions or events that have already occurred.<sup>34</sup> Further, federal appropriation law provides that such accruals, which are legal obligations, must represent a bona fide need of the agency for the fiscal year in which the accrual is recognized and that there must be appropriations available to charge.<sup>35</sup> However, we found the Academy inappropriately recorded over \$389,000 during fiscal years 2006 and 2007. Academy officials accomplished these transactions by preparing agreements between the Academy and FCO using the Department’s form MA 949, Supply, Equipment or Service Order/Contract. We also found unauthorized and unsupported loans to the FCO from the Academy funds that were improperly “parked” with the FCO. The Academy lacks adequate controls to prevent these improper transactions.

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**No Policies or Procedures in Place for Usage Fee Revenues from the Training Vessel *Kings Pointer* and Other Academy Training Vessels**

We found the Academy lacked policies and procedures and adequate internal controls over the use of Academy training vessels. For example, controls did not specify required documentation or approval for payments with respect to the GMATS’s use of the Academy’s *Kings Pointer* during fiscal years 2006 and 2007, and the related transfer of funds to the SP&C NAFI. GMATS would pay the Academy for the full amounts billed by SP&C. However, the Academy would pay a portion of the funds received from GMATS to the SP&C. Academy payments to the SP&C for the use of the *Kings Pointer*, totaling \$217,848 for the 2-year period of our review, were questionable in that (1) they were determined on a case-by-case basis by the SP&C management and (2) no supporting documentation was provided for these payments. We also found that the usage rates for use of the Academy’s training vessels was not supported and not based on consideration of current costs of operation.

Billings to others for the use of government-owned property should be made by the government agency, in this case the Academy, that owns the property. The SP&C’s billing to others for the use of Academy-owned vessels and directing how much of the usage fees the FCO should remit to

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<sup>34</sup> Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*.

<sup>35</sup> 31 U.S.C. § 1502(a). Agencies may incur obligations against fixed-year appropriations before they expire only for bona fide needs that arise during the period of availability of the appropriation.

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the Academy and to itself demonstrates how intertwined the activities and personnel of the Academy's Waterfront Department were with those of the SP&C. Further, these activities, along with the Academy's payment of funds to the SP&C without sufficient support for those payments, illustrates the lack of control over the source and use of the Academy's financial resources.

We were also told that the underlying study and analysis to determine hourly usage fees charged for Academy marine asset use during fiscal years 2006 and 2007 was performed in 1996 or 1997. However, we were told that supporting documentation was not retained either for the initial rate study or for the rates in the updated 2004 and 2008 rate booklets. We also found that the hourly rates per the 2008 rate booklet did not change from those in the 2004 rate booklet and had not changed from those used in 1996-1997. Consequently, the Academy has no assurance that the usage fees cover the full cost of operating the *Kings Pointer* and other Academy-owned boats.

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### Lack of Policies and Procedures and Controls Over Use of Athletic Fees

Fees for the use of government-owned property should be the property of the agency that holds it, in this case the Academy. However, we found the Academy and its Athletic Association NAFI lacked policies and procedures and other internal controls to properly account for the uses of fees collected by the Athletic Association from conducting athletic camps and clinics using the Academy's athletic facilities.

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### Controls Ineffective in Preventing Improper Payroll-Related Transactions

We found that the lack of controls over Academy payroll activities resulted in the over expenditure of payroll in relation to appropriations and arrangements for illegal personal services. Also, for fiscal years 2006 and 2007, approximately half of the Academy's annual appropriations were designated for payroll; however, we found that internal controls over payroll were inadequate and did not reflect consideration of the limits on annual appropriations or the risks posed by errors or weaknesses in the administration of payroll activities.

For example, Academy internal controls did not prevent improper payroll-related transactions that violated the ADA. Specifically, MARAD stated that challenges in working with MARAD's own payroll process and systems contributed to delays in determining actual payroll expenses for Academy employees. The payroll for these federal employees is processed by the Academy's DRM using MARAD's existing arrangement with another federal agency as the payroll servicer.

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Further, the Academy used NAFI employees performing work for the Academy under Academy employees' supervision to assist in carrying out Academy mission functions. The FCO and other NAFIs would hire staff as employees of their own organizations and then contract with the Academy for a fee, which the NAFIs then used to pay the payroll and related expenses of the NAFI staff. Annually, the Academy would execute agreements with the NAFIs to provide the Academy with services using one of the Department's standard forms designed for use with external parties (MA 949, Supply, Equipment or Service Order/Contract). These expenses were recorded as contracted services in the Academy's books and records. There was insufficient consideration by Academy officials of the legal and internal control ramifications of these personal services agreements. The Administrator reported to the Deputy Secretary in his February 2008 report that the relationships between the Academy and individual employees appeared to constitute one of personal services, which reflect an employer-employee relationship instead of an independent contractual one. The expenses for the services provided by these agreements totaled over \$4 million per year, which represented about 17 percent of the annual Academy appropriation for salaries and benefits.

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## **Actions by the Department, MARAD, and the Academy to Address Certain Accountability and Internal Control Challenges**

Over the course of our review, we found that various actions were taken, and were in process, that were intended to improve the Academy's and its affiliated organizations' internal controls. For example, on October 1, 2007, MARAD established the Academy Fiscal Oversight and Administrative Review Board (Oversight Board).<sup>36</sup> The Oversight Board is chaired by the MARAD CFO and is charged with providing fiscal oversight and administrative management of the Academy in coordination with the Maritime Administrator and other MARAD and Academy officials. Another significant action was the creation in July 2008 of the position of Assistant Chief Financial Officer for the Academy with direct reporting responsibility to the MARAD CFO. This position was initially temporary, but made permanent in March 2009. It provides for a senior financial official at the Academy to conduct oversight and monitoring of Academy financial activities on a real time basis. This action, combined with much needed organizational support by MARAD officials, provides an important signal emphasizing a focus on the importance of financial accountability.

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<sup>36</sup> Maritime Administrative Order No. 150-3, October 1, 2007.

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MARAD also subsequently submitted a legislative proposal to Congress seeking authority to convert the NAFI positions to civil service employment positions. In the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009,<sup>37</sup> Congress provided the Administrator with authority to appoint current NAFI employees to competitive civil service positions for terms of up to 2 years. Further, MARAD submitted a legislative proposal to Congress seeking statutory authority to enter into personal services contracts with part-time adjunct professors. In the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009,<sup>38</sup> Congress provided the Administrator with temporary authority for the 2008-2009 academic year to contract with up to 25 individuals to provide personal services as adjunct faculty.

We also found that the Department and MARAD made a number of improvements in its controls during the course of our review. For example, following discussions with the Department's Chief Financial Officer, the MARAD CFO, and the Inspector General and staff during October 2008, the MARAD CFO shortly thereafter took steps to secure and protect the accumulated prior years' balances—held in commercial bank accounts—of midshipmen fees that totaled approximately \$1 million as well as excess funds from the current year's fees that also may be as much as \$1 million.

We also found that action has been taken or is under way on a number of other important issues as well, including:

- MARAD directed the Academy to stop facilitating reimbursable contracts on behalf of GMATS.
- A billing methodology for certain services provided by the Academy to GMATS is under development.
- The use of FCO to obtain over \$4 million a year in illegal personal services was discontinued in 2008.
- MARAD is working with Academy officials to address the inappropriate commingling of activities that we describe in this report involving the Academy athletics and waterfront departments and certain NAFIs.

In October 2008, the Maritime Administrator announced the selection of a new Superintendent. We met with the Superintendent, the MARAD CFO,

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<sup>37</sup> Pub. L. No. 110-417, div. C, title XXXV, § 3506(h), 122 Stat. 4356, 4765 (Oct. 14, 2008).

<sup>38</sup> Pub. L. No. 110-417, div. C, title XXXV, §§ 3506(a)-(f), 122 Stat. 4356, 4763 (Oct. 14, 2008).

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and the Academy's Assistant CFO to discuss the Academy's significant flaws in controls and the business risks that our work was identifying. We also communicated our view that the Academy should aggressively move forward with change efforts and not wait for a formal report from us with targeted recommendations for action. The Superintendent agreed with our suggestions.

On March 9, 2009, the Secretary reported several violations of the ADA at the Academy to the President, the Congress, and the Comptroller General, as required by the act. The Secretary estimated that the multiple violations totaled as much as \$20 million. Further, the Secretary reported that corrective and disciplinary action had been taken with respect to the officials responsible for the violations and that MARAD and the Academy had revised internal control procedures and taken actions and had other actions under way to improve internal controls at the Academy.

Finally, the Omnibus Appropriations Act, 2009, placed certain restrictions and limitations on the use of appropriations made for the Academy for fiscal year 2009.<sup>39</sup> For all apportionments made (by the Office of Management and Budget) of these appropriations for the Academy, the act required the Secretary to personally make all allotments to the MARAD Administrator, who must hold all of the allotments. In addition, the act conditioned the availability of 50 percent of the amount appropriated on the Secretary's, in consultation with the MARAD Administrator, completing and submitting to the congressional appropriations committees a plan on how the funding will be expended by the Academy.

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## Conclusion

The problems we identified concerning improper or questionable sources and uses of funds involving the Academy and its affiliated organizations, including the known and possible violations of the ADA described in this report, undermines the Academy's ability to carry out its basic stewardship responsibilities and to comply with the ADA and other legal and regulatory requirements, and may also impair its ability to efficiently achieve its primary mission—to educate midshipmen. These problems can be attributed to a weak overall control environment and the flawed design and implementation of internal controls. Revelations of such activities call into question the stewardship responsibilities of the Academy and signal failures of oversight and governance responsibilities. Moreover, such

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<sup>39</sup> Pub. L. No. 111-8, div. I, title I, 123 Stat. 524, 943 (Mar. 11, 2009).

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activities reflect unmitigated risks posed by the Academy's close organizational and transactional relationships with its NAFls, including the lack of clearly defined roles and responsibilities. If such improper and questionable activities are not prevented or detected in a timely manner, they may adversely impact the Academy's credibility.

The Academy, MARAD, and the Department have begun important steps to improve the control environment and address internal control weaknesses at the Academy, including new leadership at the top and newly energized oversight and monitoring practices. However, a comprehensive strategy for addressing these weaknesses and establishing internal control policies and procedures across virtually all aspects of the Academy's financial activities are not yet in place. Further, given the amount of improper and questionable uses of funds detailed in this report, MARAD and the Academy should consider recovering funds that were improperly paid. Vigilance by MARAD and the Department in their oversight and monitoring of the Academy and greater transparency in the Academy's relationships and transactions with its affiliated organizations will be crucial to achieving effective accountability over the Academy's funds and other resources. Sustained commitment to sound accountability practices by leaders and management at the Department, MARAD, and especially at the Academy will be critical to long-term success.

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## Recommendations for Executive Action

We make 47 recommendations to the Department of Transportation directed at improving internal controls and accountability at the Academy and to address issues surrounding the improper and questionable sources and uses of funds.

We recommend that the Secretary of the Department of Transportation take the following actions:

To determine whether the Academy complied with the ADA, we recommend that the following actions be taken:

- Determine whether legal authority exists to retain payments to the Academy from GMATS, both in Academy appropriations accounts and in commercial bank accounts of affiliated organizations, and if not, adjust the Academy's appropriations accounts to charge available Academy appropriations and expense accounts for the amount of official Academy expenses that were paid by funds received from GMATS or paid directly by GMATS on behalf of the Academy. To the



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extent that insufficient appropriations remain available for these expenses report ADA violations as required by law.

- Determine the amount of midshipmen fees that were used to cover official Academy expenses without legal authority to do so and adjust the Academy's accounts, as necessary, to charge available appropriations for such expenses. To the extent that insufficient appropriations remain available, report ADA violations as required by law.

To provide reasonable assurance that the Academy will comply with the ADA and other applicable laws and regulations, we recommend that the following action be taken:

- Perform a review of the funds control processes at the Academy and take actions to correct any deficiencies that are identified.

We recommend that the Secretary of the Department of Transportation direct the Administrator of MARAD, in coordination with the Superintendent of the Academy, to take the following actions:

To improve the design and operation of the internal control system at the Academy, we recommend that the following actions be taken:

- Establish a comprehensive risk-based internal control system that addresses the core causes and the challenges to proper administration that we identify in this report, including the risks and challenges that flow from the close organizational and transactional relationships between the Academy and its affiliated organizations and implement internal controls that address the elements of our *Standards for Internal Control in the Federal Government*, including the role and responsibilities of management and employees to establish and maintain a positive and supportive attitude toward internal control and conscientious management, and the responsibility for managers and other officials to monitor control activities.
- Implement a program to monitor the Academy's performance, including: reviews of periodic financial reports prepared by Academy officials; and reviews of the Academy's documentation and analysis from its review of its periodic financial reports and associated items, such as the results of its follow-up on unusual items and balances.

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To improve internal controls over activities with its affiliated organizations, we recommend that the Academy take the following actions:

- Perform a comprehensive review and document the results of an analysis of the risks posed by the Academy's organizational structure and its relationships with each of its affiliated organizations, including: address the inherent organizational conflicts of interest that we identify in this report regarding Academy managers having responsibility for activities with affiliated organizations that are in conflict with the managers' Academy responsibilities, and determine whether the current organizational structure should be maintained or whether an alternative organizational structure would be more efficient and effective, while at the same time reducing risk and facilitating improvement in internal control and accountability.
- Require that all affiliated organizations have approved governing documents and that the functions they will perform in the future are consistent with their scope of authority.
- Perform an analysis to identify each activity involving the Academy and its affiliated organizations and for each activity determine: the business purpose; the reason for Academy involvement; the business risk that each activity presents; and if the activity complies with law, regulation, and policy. Design a robust system of checks and balances for each activity with each affiliated organization that is consistent with the business risk that each activity presents considering, among other things, the nature and volume of the activities with each affiliated organization.
- Establish formal written policies and procedures for each activity involving the Academy and an affiliated organization and specify for each activity: the required documentation requirements, necessary approvals and reviews, and requirements for transparency (e.g., require regular financial reports for each activity for review and approval by Academy management and MARAD officials charged with oversight). Establish internal controls for each activity with each affiliated organization, including (1) the planned timing of performance of the control activity (e.g., periodic reconciliations of billings with collections); (2) the responsibilities for oversight and monitoring and the documentation requirements for those performing oversight and monitoring functions; and (3) the necessary direct, compensating and mitigating controls for each activity.

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To improve accountability and internal controls over midshipmen fee activities and to resolve potential issues surrounding the past collections and uses of midshipmen fees, the Academy should take the following actions:

- Perform an analysis to identify all midshipmen fee collections for fiscal years 2006, 2007, and 2008, to include: identifying those items for which the fee collected is attributable to (1) an activity between the midshipmen as customer and a NAFI as service provider (e.g., collections for haircuts); and (2) an activity between the midshipmen as customer and the Academy as service provider (e.g., collections for personal computers).
  - Determine if the (1) fee collected for each item was for a personal item of the midshipmen and consistent with law, regulation, and policy for such collections; (2) amount of the fee collected for each item was properly supported, based on, among other things, an analysis of the cost to the Academy for the good or service; and (3) amount collected exceeded the cost of the good or service.
  - Determine if any liability may exist for collections that (1) are not consistent with law, regulation, and policy as personal items of the midshipmen; (2) were not properly supported, in whole or part; and (3) exceeded the cost to the Academy for the good or service.
- Perform an analysis to identify all payment activity and other uses of the funds collected for midshipmen fees for fiscal years 2006, 2007, and 2008, to include: reviewing payment activity to identify the payees, amounts, and other characteristics of the uses of the funds collected and conducting a detailed review of payment activity and other uses (e.g., transfers to prior years' reserves) for items considered as high risk.
  - Review all questionable payments, and other questionable uses of funds, such as transfers to commercial checking accounts for the excess of collections over funds used, as well as the questionable payments that we identify in this report.
  - For each payment and other use of funds that is determined to be for other than a proper governmental purpose and that is not consistent with law, regulation, and policy, consider pursuing recovery from the organization or individual that benefited from the payment.

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- Establish policies and procedures that require those charged by the Academy with the responsibility for midshipmen fee collections and payments to: (1) maintain detailed accounting records for all midshipmen fee activity that reflect accurate and fully supported information on collections, payments, and other activity that is consistent with document retention practices; (2) implement written review and approval protocols for all midshipmen fee collections and uses of funds consistent with policies and procedures established by the Academy and MARAD; and (3) provide monthly detailed reports of all midshipmen fee activity in the aggregate and by item to Academy and MARAD officials.
  - Establish policies and procedures and perform the necessary analysis to support annual reports to the Congress to address changes in “any item or service” in midshipmen fees from that existing in 1994 as required by law.
  - Establish written policy and criteria for determining the baseline items that are properly due from midshipmen for personal items, the amount of fees to be collected (based on underlying studies), and the approved uses of the fees collected.
  - Establish written policy for the underlying analysis that is required and the approvals that must be obtained before changes are made in the baseline of midshipmen fee items, or before a change is made in the amount of such fees, or in the approved uses of the fees collected.
  - Utilize the information obtained from the analysis of midshipmen fees collected in prior years and other work to determine the amount of midshipmen fees that should be charged to midshipmen for personal items in subsequent years.
  - Establish written policy for internal reviews of monthly reports of midshipmen fee activity and balances, identified anomalies, and questioned items as well as the results from the associated follow-up.
  - Perform an analysis to determine whether and, if applicable, the extent to which appropriated funds and midshipmen fees collected should be used to pay for contracted medical services.

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To improve internal controls over financial information, the Academy should take the following actions:

- Implement financial reporting policies and procedures that, among other things, will provide visibility and accountability to Academy activities and balances to facilitate oversight and monitoring, including: (1) periodic reporting of actual and budget amounts for revenues and expenses for the current and cumulative period; (2) periodic reporting of amounts for activity and balances with affiliated organizations in detail; and (3) identification of items of revenue and expense for each funding source, including annual and no-year appropriated funds and other collections.
- Implement comprehensive policies and procedures for the review of financial reports, to include requiring: reviews by the preparers of the financial reports as to their completeness and accuracy; evidence of departmental management reviews; and written records of identified anomalies and questioned items, as well as requirements for maintaining evidence of the results from associated follow-up on all identified anomalies and questioned items.
- Identify and evaluate the potential misstatements of amounts in the financial records for the Academy in fiscal years 2006, 2007, and 2008 to determine if restatement or reassurance of budget and financial reports and statements prepared from those records is appropriate, including:
  - \$5,076,198 of errors in accounting for repairs and maintenance expenses and capital additions, and \$3,431,725 of expenses that were improperly funded with no-year capital improvement appropriations;
  - \$6,410,242 and \$6,038,061 of recorded revenue and expenses, respectively, from GMATS training programs;
  - amounts for midshipmen fee collections and payment activity including effects on reported revenues, expenses, assets and liabilities; and
  - amounts for sources and uses of funds handled “off- book” that we identify in this report, including transactions in three Superintendent’s Reserves and with GMATS and FCO.

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- Implement policies and procedures to obtain the information necessary to timely comply with the requirement identified in this report for annual reports to the Congress that provides all expenditure and receipt information for the Academy and its affiliated organizations.

To improve accountability and internal controls over the acquisition of personal services from NAFIs, and to resolve potential issues surrounding past personal services activities and payments, the Academy should take the following actions:

- Perform an analysis to identify the nature and full scope of personal services activities and the associated sources and uses of funds to include a review of all questionable payments, including those that we identify in this report for personal services totaling more than \$8 million for fiscal years 2006 and 2007. For each such personal services arrangement: (1) determine if the amounts paid were consistent with the services received by the Academy; (2) quantify the amounts, if any, paid by the Academy for personal services that were not received by the Academy; and (3) document the decisions made with respect to any payments by the Academy for personal services that were not received, including decisions to seek recovery from other organizations for such amounts.
- Develop written policy guidance on acquiring services from NAFIs that complies with the requirements of law, regulation, and policy on the proper use of funds by the Academy.

To address funds held in commercial bank accounts of the FCO from prior years' reserves and Superintendent's Reserves and to resolve issues surrounding the past collections and uses of funds for excess midshipmen fee collections, the Academy should take the following actions:

- Perform an analysis to identify all activities in the prior years' and other reserves including all sources and uses of funds for fiscal years 2006, 2007 and 2008.
  - Review all the questionable payments and other activity, including payments that we identify in this report that according to FCO records total \$605,347.
  - For each payment that is determined to be for other than a proper governmental purpose and that is not consistent with law,

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regulation, and policy, consider pursuing recovery from the organization or individual that benefited from the payment.

- Investigate the unexplained \$100,000 transaction(s) in September 2007 per the off-line or “cuff” accounting records maintained by FCO and take actions as appropriate.
- Finalize actions to protect and recover Academy funds held in commercial bank accounts by the FCO from current and prior years’ midshipmen fees that totaled approximately \$2 million at September 30, 2008.
- Require that: (1) bank reconciliations be prepared for all activity in the commercial bank accounts of the FCO used for these reserves during fiscal years 2006, 2007 and 2008; (2) documentation be prepared for all questionable items as well as the related follow-up; and (3) going forward such bank reconciliations be timely prepared and independently reviewed by Academy staff with no direct involvement in the reconciliations or the activity in the bank accounts.

To improve internal controls over activities with GMATS, the Academy should take the following actions:

- Perform an analysis to identify all activities between the Academy and the NAFI, GMATS, during fiscal years 2006 and 2007 and determine for each activity: the nature of the activity; the amounts collected by the Academy or others for the benefit of the Academy; the nature and amounts paid, by the Academy or by others for the benefit of the Academy from the funds collected; the business purpose; the reason for Academy involvement; and if the activity complies with law, regulation, and policy.
- For each payment that is determined to be for other than a proper governmental purpose and that is not consistent with law, regulation, and policy, consider pursuing recovery from the organization or individual that benefited from the payment.
- Establish formal written policies and procedures that, among other things, specify the allowable activities and transactions between the Academy and GMATS, and details the necessary approvals and reviews required for each activity.
- Establish targeted internal controls for each direct and indirect activity between the Academy and GMATS.

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To improve internal controls over accruals and to resolve potential issues surrounding past “parking” of appropriated funds, the Academy should take the following actions:

- Perform an analysis to identify all activities involving accrual accounts used to “park” appropriated funds with the FCO, including all sources and uses of funds for fiscal years 2006 and 2007.
- For each payment that is determined to be for other than a proper governmental purpose, consider pursuing recovery from the organization or individual that benefited from the payment.
- Establish written policy guidance on the accrual of items of expense at year-end.
- Establish targeted internal controls that, among other things, provide the criteria for accruals, specify the documentation requirements for accruals, and provide management’s review and approval procedures.

To improve internal controls over activities from usage of the training vessel—*Kings Pointer* and other Academy-owned boats—by others, the Academy should take the following actions:

- Perform an analysis to identify all activity involving the use of the *Kings Pointer* and Academy-owned boats by others, including all sources and uses of funds for fiscal years 2006 and 2007.
  - Identify and recover the cost of any unreimbursed non-governmental uses, to the extent authorized by law.
  - For each payment, including payments to affiliated organizations, that is determined to be for other than a proper governmental purpose and that is not consistent with law, regulation, and policy, consider pursuing recovery from the organization or individual that benefited from the payment.
- Establish written policies and procedures to govern the use of the Academy-owned training vessel the *Kings Pointer* and other boats, including addressing issues for ship’s crews, insurance, security, billing procedures, and other responsibilities.
- Perform or contract out for a comprehensive usage-rate study to establish usage rates. Such a study should include (1) consideration of the full cost to the Academy of the training vessels and other boats,



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including salaries and benefits of Academy personnel, major repairs, routine maintenance, non-routine maintenance and long-term repairs, fuel and dockage; and (2) identification of indirect expenses and imputed costs as appropriate (e.g., depreciation).

- Establish policy for the timing and extent of the analysis required for periodic updates to the usage-rate study.
- In coordination with the Department or MARAD legal counsel, as appropriate, determine if the Academy had the legal authority to retain and use any collections from the use of the Academy-owned training vessel the *Kings Pointer* and other boats; otherwise, deposit them in the general fund of the U.S. Treasury.

To improve internal controls over camps and clinics operated by the Athletics Association NAFFI or others on Academy property, the Academy should take the following actions:

- Perform an analysis to identify practices at the Academy involving camps and clinics operated by the Athletics Association or others using Academy property and other assets. Document the nature and scope of such activities, including all sources and uses of funds for fiscal years 2006 and 2007 and take corrective action on any improper transactions.
- Establish written policies and procedures for camps and clinics operated by the Athletics Association NAFFI or others on Academy property.
- Establish targeted internal controls that include: approvals required; costs to be recovered by the Academy; requirements (such as advance approval) for participation by Academy employees in the activities; and other matters of importance such as, insurance requirements, security, and required accountings to be provided to the Academy on the sources and uses of funds from each event.

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To improve internal controls over processing of vendor invoices and accounting for repairs and maintenance expenses and additions to capital assets, the Academy should take the following actions:

- Perform an analysis to identify the causes of the errors in the recording of repairs and maintenance expenses that should have been capitalized totaling \$5,076,198, and \$3,431,725 of expenses that were improperly funded with the no-year capital improvement appropriation, during fiscal years 2006 and 2007.
- Establish written policies and procedures for repairs and maintenance expenses and capital asset additions that require: (1) periodic reviews of recorded amounts for repairs and maintenance expenses and capital asset additions to identify and timely address issues requiring management attention; and (2) correction of errors before financial reports are prepared from the books and records.
- Establish policies and procedures for periodic reporting of financial information for repairs and maintenance expenses and capital additions to assist users in monitoring these items as well as the funding sources—annual appropriations or no-year appropriations for long-term improvement projects.

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## Agency Comments and Our Evaluation

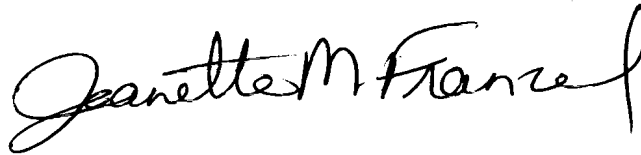
We received written comments from the Department of Transportation on a draft of this report (see app. V). The Department stated that the Academy and MARAD have initiated many corrective actions to address the internal control weaknesses identified in our draft report and that management at the Academy, MARAD, and the Department take very seriously our findings and recommendations. The Department also stated that MARAD will produce a comprehensive strategy and corrective action plan to address all of the internal control weaknesses, as well as a detailed response to each recommendation. The Department also separately provided technical comments that we incorporated, as appropriate.

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As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. We will then send copies to other appropriate congressional committees, the Secretary of Transportation; the Administrator, Maritime Administration; and the Superintendent, United States Merchant Marine Academy. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

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If you or your staff have any questions concerning this report, please contact me at (202) 512-2600 or [franzelj@gao.gov](mailto:franzelj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix VI.

A handwritten signature in black ink that reads "Jeanette M. Franzel". The signature is written in a cursive style with a large, looping initial "J".

Jeanette M. Franzel  
Managing Director  
Financial Management and Assurance

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# Appendix I: Objectives, Scope, and Methodology

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## Objectives

This report responds to your request that we study the internal control environment and selected activities and expenditures of the Academy and its non-appropriated fund instrumentalities (NAFIs), in addition to the oversight and monitoring practices by the Maritime Administration (MARAD), an operating administration of the Department of Transportation. Our specific objectives were to determine whether there (1) were any potentially improper or questionable uses of funds by the Academy, including transactions with its affiliated organizations; (2) was an effective control environment with key controls in place over the Academy's sources and uses of funds, including transactions with its affiliated organizations; and (3) were any actions taken, under way, or planned to improve controls and accountability over the Academy's funds and resources.

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## Scope and Methodology

To address the first two objectives, we analyzed whether the Academy's policies and procedures were adequate to ensure that Academy funds were used as intended and for proper governmental purposes and assessed the Academy's internal controls over its activity and balances against our *Standards for Internal Control in the Federal Government*,<sup>1</sup> Internal Control Management and Evaluation Tool, Guide for Evaluating and Testing Controls Over Sensitive Payments, and Strategies to Manage Improper Payments.<sup>2</sup> Specifically, we

- reviewed laws, regulations, policies, and procedures over Academy operations and activities;

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<sup>1</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999); Under GAO's *Standards for Internal Control in the Federal Government*, agencies should have internal control sufficient to provide reasonable assurance that the objectives of the agency are being achieved and, among other things, should (1) establish and maintain a positive and supportive attitude toward internal control and conscientious management, (2) identify the risks that may impede the achievement of agency objectives, (3) establish effective and efficient control activities that help ensure that management's directives are carried out, (4) ensure that information is recorded and communicated to management and others within the organization that need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities and (5) internal control monitoring should assess the quality of performance over time.

<sup>2</sup>GAO, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001); *Guide for Evaluating and Testing Controls Over Sensitive Payments*, [GAO/AFMD-8.1.2](#) (Washington, D.C.: May 1993); and *Strategies To Manage Improper Payments*, [GAO-02-69B](#) (Washington D.C.: October 2001).

- reviewed the MARAD report and discussed the objectives, scope, and methodology of the internal control review with MARAD officials;
- interviewed selected Department, Department—Office of Inspector General (OIG), MARAD, Academy, and NAFI staff and officials to obtain an understanding of (1) their roles and responsibilities, (2) the internal control environment at the Academy, including the Academy’s organizational structure and relationships to the NAFIs and management’s attitude towards and knowledge of internal controls; (3) the internal controls over selected Academy payments and activities with its affiliated organizations—the 14 NAFIs and 2 foundations; and (4) MARAD and Department practices for overseeing and monitoring the Academy; and
- obtained an understanding of the sources of funding for both the Academy and the NAFIs, including the appropriated funds of the Academy.

We obtained a database of Academy expenses at the transaction level covering fiscal years 2006 and 2007 and

- compared these data to amounts reported for the Academy by MARAD in the Department’s annual performance and accountability reports;
- compared the total amounts—MARAD including the Academy—in the database provided to us with the amounts in the statements of net cost that MARAD submitted to the Department;<sup>3</sup>
- reconciled the MARAD Statement of Net Cost in the database to the Department’s audited financial statements by agreeing the net cost amounts for MARAD including the Academy that were reported in the audited financial statements and separately identified in consolidating statements of net cost schedules for the Department;
- analyzed Academy and NAFI payments, Academy collections of midshipmen fees, and funds from the FCO and GMATS to identify selected payments for further testing; and
- reviewed available documentation supporting selected Academy payment transactions and requested additional support and explanations from Academy and NAFI officials to justify the purpose of these transactions and the sources of funds used.

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<sup>3</sup> The Academy did not prepare separate financial statements for fiscal years 2006 and 2007. To determine the population of payments and obligations, we worked with MARAD to design a data base of such activity for purposes of our audit.

To review the collection of current year's fees from midshipmen and use of those fees for fiscal years 2006 and 2007, as well as prior years' reserve activity for fiscal years 2006 to 2008, we

- analyzed the collection and payment activity reflected in records maintained by the FCO;
- requested and reviewed available support to justify the amounts collected from the midshipmen;
- interviewed Academy and NAFI officials with responsibility for midshipmen fee collections;
- discussed the results of our analysis with Academy and FCO officials and as appropriate requested additional information and explanations from these officials; and
- considered the support and responses we received to assess whether the collection and use of midshipmen fees were questionable.

We identified numerous improper or questionable activities and uses of funds. However, the results of our work are not generalizable to the population of transactions as a whole because we selected transactions on a nonstatistical basis. We selected transactions that were significant to the Academy or the NAFIs and appeared to have a higher risk of being improper. Consequently, there may be other improper or questionable activities and transactions that our work did not identify. We reviewed the March 9, 2009, report of the Secretary to the President, the Vice President (as President of the Senate), the Speaker of the House, and the Acting Comptroller General to report several violations of the Antideficiency Act that occurred over several years and that the Department estimated totaled as much as \$20 million.

To address our third objective, we obtained relevant documentation on actions taken, under way, or planned, including the MARAD order establishing the Academy's Fiscal Oversight and Administrative Review Board.<sup>4</sup>

During our review, we visited the Academy in Kings Point, New York, and MARAD and Department headquarters in Washington, D.C. We also held teleconferences with Academy officials in New York and MARAD and Department officials in Washington, D.C. We also reviewed prior OIG and

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<sup>4</sup> Maritime Administrative Order 150-3, October 1, 2007.

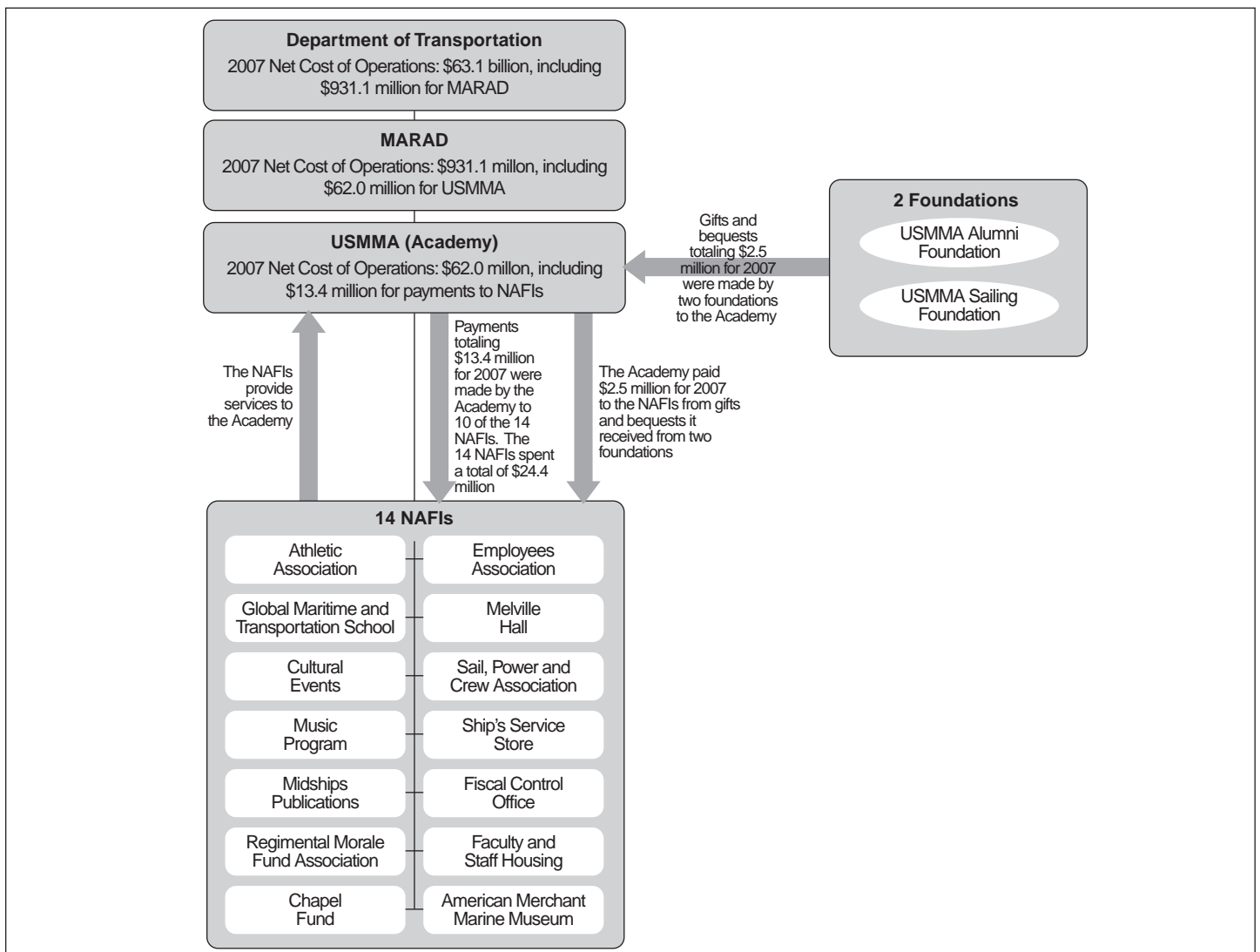
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GAO reports for items of possible relevance to MARAD and Academy activities and internal controls.

We conducted this performance audit from June 2008 to August 2009 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 findings and conclusions based on our audit objectives.

# Appendix II: Department of Transportation, MARAD, Academy, and Affiliated Organization Relationships

The following presents the organizational environment in which the Academy operates and illustrates the nature and amount of some of the activity that occurred during fiscal year 2007 between the Academy and its affiliated organizations.



Source: GAO.



# Appendix III: Academy Expenses by Category, Fiscal Years 2006 and 2007

	2006	
	Payments to NAFIs	Total expenses
Compensation and benefits	( \$ 0.4)	\$ 24,429.7
Travel and transportation	48.7	987.2
<b>Operating expenses:</b>		
Operations and maintenance, utilities, other	1,454.4	12,723.6
Other contractual services	6,059.0	13,399.4
<b>Total operating expenses</b>	<b>7,513.5</b>	<b>26,123.0</b>
Equipment, depreciation		2,079.3
Gifts and bequests	2,053.6	2,062.4
<b>Total expenses</b>	<b>\$ 9,615.4</b>	<b>\$ 55,681.6</b>
	2007	
	Payments to NAFIs	Total expenses
Compensation and benefits	\$ 38.1	\$ 26,074.1
Travel and transportation	3.4	888.9
<b>Operating expenses:</b>		
Operations and maintenance, utilities, other	1,547.8	12,867.4
Other contractual services	9,339.0	16,025.5
<b>Total operating expenses</b>	<b>10,886.8</b>	<b>28,892.9</b>
Equipment, depreciation		3,686.6
Gifts and bequests	2,477.0	2,482.7
<b>Total expenses</b>	<b>\$ 13,405.3</b>	<b>\$ 62,025.2</b>

Source: GAO analysis of MARAD's unaudited data for the Academy.

Note: Total expenses per this table represent the Academy's expenses that were included by MARAD as gross expenses in its statement of net cost for fiscal years 2006 and 2007. Expenses for both fiscal years include amounts funded by annual appropriations and multi-year appropriations.

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# Appendix IV: The Antideficiency Act

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The ADA is one of the major laws in the statutory scheme by which the Congress exercises its constitutional control of the public purse.<sup>1</sup> The ADA contains both affirmative requirements and specific prohibitions, as highlighted below. The ADA:

- Prohibits the incurring of obligations or the making of expenditures in advance or in excess of an appropriation. For example, an agency officer may not award a contract that obligates the agency to pay for goods and services before the Congress makes an appropriation for the cost of such a contract or that exceeds the appropriations available.
- Requires the apportionment of appropriated funds and other budgetary resources for all executive branch agencies. An apportionment may divide amounts available for obligation by specific time periods (usually quarters), activities, projects, objects, or a combination thereof. OMB, on delegation from the President, apportions funds for executive agencies.
- Requires a system of administrative controls within each agency, established by regulation, that is designed to (1) prevent obligations and expenditures in excess of apportionments or reapportionments; (2) fix responsibility for any such obligations or expenditures; and (3) establish the levels at which the agency may administratively subdivide apportionments, if it chooses to do so.
- Prohibits the incurring of obligations or the making of expenditures in excess of amounts apportioned by OMB or amounts of an agency's subdivision of apportionments (i.e., "allotments").
- Prohibits the acceptance of voluntary services or the employment of personal services, except where authorized by law.<sup>2</sup>

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<sup>1</sup> "No money shall be drawn from the Treasury, but in Consequence of Appropriations made by law." U.S. Const. art. I, § 9, cl. 7.

<sup>2</sup> The prohibition against the employment of unauthorized personal services covers contracts with individuals who have an employment relationship with the federal agency. 30 Op. Atty. Gen. 51 (1913). The purpose of this prohibition is to preclude agencies from "coercing" Congress into making additional appropriations to cover the cost of the additional services. *Id.* The federal procurement regulations also contain a general prohibition against the making of contracts for personal services. FAR § 37.104(b). In this context, as explained in a Comptroller General decision,

- Specifies potential penalties for violations of its prohibitions, such as suspension from duty without pay or removal from office. In addition, an officer or employee convicted of willfully and knowingly violating the prohibitions may be fined not more than \$5,000, imprisoned for not more than 2 years, or both.
- Requires that for violations of the act's prohibitions, the relevant agency report immediately to the President and to the Congress all relevant facts and a statement of actions taken with a copy to the Comptroller General of the United States.

The requirements of the ADA and the enforcement of its proscriptions are reinforced by, among other laws, the Recording Statute, 31 U.S.C. § 1501(a), which requires agencies to record obligations in their accounting systems, and the 1982 law commonly known as the Federal Managers' Financial Integrity Act of 1982, 31 U.S.C. § 3512(c), (d), which requires executive agencies to implement and maintain effective internal controls. Federal agencies use "obligational accounting" to ensure compliance with the ADA and other fiscal laws. Obligational accounting involves the accounting systems, processes, and people involved in collecting financial information necessary to control, monitor, and report on all funds made available to federal agencies by legislation—including both permanent, indefinite appropriations and appropriations enacted in annual and supplemental appropriations laws that may be available for 1 or multiple fiscal years. Executive branch agencies use obligational accounting, sometimes referred to as budgetary accounting, to report on the execution of the budget.<sup>3</sup>

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"[a] personal services contract is one that, by its express terms or as administered, makes the contractor personnel appear, in effect, government employees. FAR §§ 37.101, 37.104(a). The government is normally required to obtain its employees by direct hire under competitive appointment or other procedures required by the civil service laws. FAR § 37.104(a). Obtaining personal services by contract, rather than by direct hire, circumvents those laws unless Congress has specifically authorized acquisition of the services by contract. Id. Agencies may not award personal services contracts unless specifically authorized by statute to do so. FAR § 37.104(b)." *Matter of: Encore Management, Inc.*, B-278903.2, Feb. 12, 1999.

<sup>3</sup>The Department must also implement and maintain proprietary (or financial) accounting to record financial information that is summarized in financial statements prepared in accordance with U.S. generally accepted accounting principles and audited on an annual basis. The Department's audited financial statements include a Statement of Budgetary Resources that presents information on the status of appropriations. For a description of the different methods for tracking funds in the federal government, see app. III of GAO, *A Glossary of Terms Used in the Federal Budget Process*, [GAO-05-734SP](#) (Washington, D.C.: September 2005).

# Appendix V: Comments from the Department of Transportation



**U.S. Department of  
Transportation**  
Office of the Secretary  
of Transportation

Assistant Secretary  
for Administration

1200 New Jersey Avenue, SE  
Washington, DC 20590

JUL 16 2009

Ms. Jeanette Franzel  
Managing Director  
Financial Management and Assurance  
U.S. Government Accountability Office  
441 G Street N.W.  
Washington, DC 20548

Dear Ms. Franzel:

The United States Merchant Marine Academy provides a vital service to the Nation by supplying many of the highly trained and skilled people necessary to sustain American flag shipping in support of the Nation, both in war and in peace. Given the Academy's vital service, the Department was especially concerned when a 2008 Maritime Administration (MARAD) report brought to light the significant internal control issues at the Academy. MARAD shared this report with Congress while continuing to identify the full nature and extent of the issues and implement solutions. As described below, substantial actions are underway at the Academy. For example, the Secretary has appointed a blue ribbon panel to provide outside expertise to help ensure that the Academy makes sound investments in its future. Actions are also underway to ensure the Academy has the financial internal controls necessary to continue fulfilling its duties and responsibilities to the Nation in sustaining a capable American flag fleet.

#### **MARAD Took Immediate Action to Address Key Issues**

MARAD took swift and appropriate actions to address the serious internal control deficiencies at the Academy. These actions started at the top, as MARAD appointed a new Superintendent for the Academy in November 2008. In order to ensure appropriate oversight for the use of funds, MARAD established and filled a new position of Assistant Chief Financial Officer (CFO) for Academy Operations, who reports directly to MARAD's CFO. This official offers the onsite financial expertise previously lacking, and with the reporting relationship to the MARAD CFO, maintains a high level of independence in managing the Academy's financial affairs. This reporting relationship also provides for the quick and effective flow of information directly to MARAD management and helps to ensure that funds are derived from appropriate sources. Management awareness and information flow are further enhanced by the establishment of the Fiscal Oversight Board, comprised of senior

MARAD headquarters officials, to assist the Superintendent and his staff in implementing corrective measures. Further, the level of oversight and interaction has significantly increased with the appointment of dedicated legal counsel and direct headquarters administration of human resources and procurement functions.

**Longer Term Actions Underway to Improve the Academy's Internal Controls**

MARAD and the Academy are developing approaches and procedures to rectify the issues identified in the GAO draft report. We appreciate the draft report's recognition of many of the actions underway and plan to provide a full accounting of the specific actions taken and planned in response to the recommendations in the final report. However, it would be useful to highlight some of these actions now.

MARAD is working with officials at the Academy to strengthen the school's internal controls environment. This includes the full conversion of the Academy to the Department's accounting system of record, Delphi, and implementation of the associated funds control and budget mechanisms that are part of that system. The school also has reformed its relationships with two important donor organizations, the Alumni Foundation and the Sailing Foundation, to maintain the appropriate level of independence between the school and these organizations. Complementing these reforms, procedures for accepting gifts from these foundations and other donors have been updated to provide a greater level of legal oversight and improved accounting for these funds.

MARAD has taken several important steps to address issues related to Midshipmen Fees. First, the CFO has taken custody of Midshipmen Fee bank accounts and has frozen accounts holding prior year excess collections in anticipation of returning this money to former students. Further, special administrative procedures were instituted by the CFO during the 2008/2009 Academic Year, which ensured that fee revenue was only spent for authorized purposes. As a result of these efforts, the 2008/2009 Academic Year ended with an excess balance in the Midshipmen Fee account, which will be refunded to students after final accounting for midshipmen expenses is reconciled for the school year. At the direction of the Acting Deputy Maritime Administrator, the Academy revisited the entire schedule of Midshipmen Fees for the 2009/2010 Academic Year. Based on this thorough review, a new, significantly reduced fee schedule was approved in May and was reflected in bills sent to all students in June. In addition, MARAD will examine Midshipmen Fee collections for prior years not reviewed by GAO to assess whether it is possible to determine if similar issues existed for those years. Finally the President's 2010 Budget proposes a critical reform in the management of these funds. Rather than collecting and accounting for this money in commercial bank accounts, MARAD is seeking statutory authority to collect these fees into the Treasury and access these funds through a permanent appropriation that restricts spending to the authorized and specific purposes of the fees. This change will greatly enhance accountability for these funds and provide a high degree of transparency, as these transactions will now be part of the agency's official accounting records.

MARAD also is committed to reforming the Academy's non-appropriated fund instrumentalities (NAFI) structure to significantly reduce the potential for the kinds of

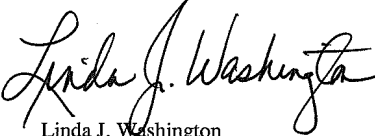
irregularities arising from interactions between the Academy and its NAFIs. These changes will ensure independent NAFIs through non-Government management, accountability, and revenue stream while significantly reducing the number of NAFIs and narrowing their focus to traditional morale, welfare and recreation activities. In addition, these reforms will address many of the outstanding internal control weaknesses identified in GAO's report, particularly with respect to the school's Athletics program and Waterfront Activities.

**MARAD Preparing Comprehensive Strategy for Corrective Action**

As indicated above, the Academy and MARAD have initiated many corrective actions to address the full range of internal control weaknesses identified in the GAO draft report. We are now carefully reviewing the full extent of the GAO report's recommendations and will provide a detailed response to each recommendation upon issuance of the final report. MARAD will produce a comprehensive strategy and corrective action plan to address the internal control weaknesses and ensure effective internal control procedures govern all aspects of the Academy's activities. This will be conducted as part of an overall, systematic management review of the Academy.

Management at the Academy, MARAD and the Department take very seriously the findings and recommendations in the GAO draft report and intend to ensure that effective action is taken in each area. Specific and focused attention will be applied to ensure that appropriate actions are implemented to address the issues identified by the GAO and strengthen the Academy. This will enable the Academy to move forward and take its place as the premier institution in maritime education and a source of continuing pride for the school's alumni, this Department, and the Nation.

Sincerely,



Linda J. Washington

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# Appendix VI: GAO Contact and Staff Acknowledgments

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## GAO Contact

Jeanette M. Franzel, (202) 512-2600 or franzelj@gao.gov

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## Acknowledgments

In addition to the contact named above, staff members who made key contributions to this report include Robert Owens, Assistant Director; Lisa Brownson; F. Abe Dymond, Assistant General Counsel; Tony Eason; Frederick Evans; Tiffany Epperson; Jehan-Abdel-Gawad; Thomas Hackney; Paul Kinney; Scott McNulty; and Meg Mills.

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