IMPLEMENTATION OF CONTROLS OVER PAYMENTS TO MARITIME SECURITY PROGRAM CONTRACTORS

Maritime Administration

Report Number: FI-2009-001
Date Issued: October 06, 2008

U.S. Department of Transportation
Office of the Secretary of Transportation
Office of Inspector General

Memorandum

Subject: ACTION: Report on Implementation of Controls Over Payments to Maritime Security Program Contractors, MARAD
Report No. FI-2009-001

Date: October 06, 2008

From: Rebecca C. Leng
Assistant Inspector General for Financial and Information Technology Audits

Reply to Attn. of: JA-20

To: Maritime Administrator

This report provides the results of our review of the Maritime Administration's (MARAD) implementation of controls over payments to Maritime Security Program (MSP) contractors. The objective of this audit was to determine whether payments to MSP contractors were reduced if the minimum operating requirements were not met.

The Maritime Security Act of 1996 established MSP for fiscal years (FY) 1996 through 2005, and the 2003 Act reauthorized the program for FYs 2006 through 2015. The Acts require the Secretary of Transportation, in consultation with the Secretary of Defense, to establish a fleet of active, commercially viable, militarily useful, privately-owned, U.S.-flagged vessels. The fleet's purpose is to aid with national security and defense requirements during times of war or other national emergency. MARAD manages MSP through its Office of Sealift Support.

MSP is currently funded at $156 million per year, increasing to $186 million per year by 2012. Over the next seven years, these payments will total over $1 billion. For more information see Exhibit A.

We conducted this performance audit 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. A detailed description of our audit scope and methodology is presented in Exhibit B.

RESULTS

From FY 2006 through July 2008 there were over 2,000 monthly payments totaling $433 million, of which MARAD reduced 27 payments to MSP contractors by a total of $3,455,095. Based on our control testing and review of the payment reductions, we determined that payments to MSP contractors were properly reduced when the minimum operating requirements were not met and that MARAD's controls are sufficient to ensure that payments to contractors are processed in the correct amounts. However, we have two observations for MARAD's consideration that arose during the course of the audit regarding (1) MARAD's assurance that MSP vessels adhered to cargo preference limitations and (2) MARAD's exclusion of liquid cargo from its application of the cargo preference limitation. Neither of these two issues affects our results because no MSP vessels have carried the cargo in question.

MARAD Procedures Did Not Include Non-Agricultural Cargo In Its Evaluation of the 7,500-Ton Limitation

Per the Maritime Security Act of 2003, vessels are not paid for days engaged in transporting more than 7,500 tons of civilian bulk preference cargo[1] (this limitation does not apply to military cargo). Civilian cargo can be agricultural or non-agricultural. Currently, the MARAD Office of Sealift Support receives certification from the Office of Cargo Preference for MSP vessels carrying agricultural cargo only. Under current procedures, payments to MSP vessels carrying non-agricultural cargo would not be reduced. According to MARAD, no MSP vessels have carried civilian non-agricultural bulk cargo, but agreed that in the future, MARAD could recognize cost savings if vessels are found noncompliant.

During the audit we recommended that MARAD revise the policies and procedures to include certification for MSP vessels that transport *non-agricultural* as well as *agricultural* civilian bulk preference cargo. The Office of Sealift Support agreed with our recommendation and has modified its policies and procedures to include obtaining assurance that all civilian bulk preference cargo has been considered when determining vessel compliance with MSP cargo preference limitations. Further, the Office of Cargo Preference will include MSP vessels carrying *non-agricultural* cargo in its monthly certification. Therefore, we are not making formal recommendations in this report.

---

[1] Bulk cargo means cargo that is loaded and carried in bulk without mark or count (large unpackaged quantities). Cargo Preference is a MARAD-administered Federal program that requires a minimum percentage of Federal oceanborne goods be transported on U.S.-flagged vessels.

MARAD Procedures Do Not Consider Liquid Cargo In Its Evaluation of the 7,500-Ton Limitation

While the Maritime Security Act of 2003 does not make a distinction between dry and liquid cargo, MARAD's Chief Counsel concluded that the 7,500-ton civilian bulk preference cargo limitation does not apply to civilian liquid cargo. MARAD's Counsel did not provide sufficient reasoning why the weight limit would apply to dry bulk cargo but not liquid. We consulted with OIG Counsel who determined that, given the trade meaning and statutory usage of the term "bulk" (which includes liquid cargo), and without a specific exclusion for civilian liquid cargo, the plain language of the Act encompasses civilian liquid cargo when applying the 7,500-ton limitation. It is important to note that according to the Office of Cargo Preference, the only liquid bulk cargo currently being transported is fuel to the Israeli military, which is a military operation and not subject to the 7,500-ton limitation.

OIG Counsel is working with MARAD's Counsel to resolve the difference. As a result, we are not making any recommendations on this issue.

ACTIONS REQUIRED

Actions taken and planned by MARAD are responsive to our concerns and a formal reply to this report is not required.

We appreciate the courtesies and cooperation of MARAD Office of Sealift Support representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-1407 or Earl Hedges, Program Director, at (410) 962-1729.

#

EXHIBIT A. BACKGROUND

MSP's Maritime Security Fleet includes 60 privately-owned vessels. Current funding levels allot a $2.6-million annual retainer per vessel (increases to $3.1 million by 2012); see Table 1.

Table 1. MSP Funding Levels Established by the Maritime Security Act of 2003

Fiscal Year	*Funding Per Vessel*	*Total Program Funding*
2006	$2.6 million	$156 million
2007	$2.6 million	$156 million
2008	$2.6 million	$156 million
2009	$2.9 million	$174 million
2010	$2.9 million	$174 million
2011	$2.9 million	$174 million
2012	$3.1 million	$186 million
2013	$3.1 million	$186 million
2014	$3.1 million	$186 million
2015	$3.1 million	$186 million
	Total Program Funding	**$1,734,000**

Each vessel operates commercially in one of two ways: between domestic and international ports or between international ports. Each vessel is obligated under a renewable 1-year operating agreement and is required to maintain a U.S. flag presence in international shipping channels. Vessels must comply with operational and program requirements as specified in the operating agreement. For example, each month MSP analysts evaluate vessel operators' payment requests for eligibility based on the following criteria:

1. Did the vessel operate fewer than 320 days in foreign trade during the year? [2]
2. Did the vessel carry more than 7,500 tons of civilian bulk preference cargo at any time during the year?
3. Was the vessel under time-charter[3] to another Federal agency?

---

[2] MSP analysts reduce monthly payments for non-operating or drydock days during the month. At year-end, if the 320-operating-day requirement is met, analysts make a supplemental payment to compensate for the previous reductions.
[3] Time charter is hiring of a vessel for a specific amount of time; the owner still manages the vessel, but the charterer selects the ports and directs the vessel where to go.

If the answer to any of the above questions is “yes,” then the vessel is considered noncompliant and the $2.6-million annual retainer is discounted accordingly, based on the number of days the vessel did not comply.

Exhibit A. Background

EXHIBIT B. SCOPE AND METHODOLOGY

Our audit objective was to determine if payments to MSP contractors were reduced if the minimum operating requirements were not met. Our review focused on vessels entering the MSP from FY 2006 through FY 2008 (74 total), as well as payments made to MSP contractors during the same time frame (totaling $433 million as of July 22, 2008).

We accomplished our objective by (1) meeting with MSP officials to gain an understanding of internal controls, (2) performing tests of controls through judgmental sampling, (3) testing the validity of the Lloyds of London Marine Intelligence Unit database (used to verify vessel operating status), and (4) performing follow-up of prior audit recommendations through inquiry, observation, and obtaining supporting documentation. As part of our testing, we reviewed the 27 payment reductions (see Table 2) to determine if the reductions were justified.

Table 2. Monthly Payment Reductions, October 1, 2005 through July 22, 2008

Fiscal Year	Number of Temporary Reductions	Amount of Temporary Reductions
2006	11	$1,131,721
2007	2	$50,004
2008 as of 7/22/08[a]	11	$1,241,467
Total	**24**	**$2,423,192**
Fiscal Year	**Number of Permanent Reductions**	**Amount of Permanent Reductions**
2006	1	$ 72,373
2007	2	$959,530
2008 as of 7/22/08[a]	N/A	N/A
Total	**3**	**$1,031,903**

[a] The permanence of these payment reductions will be determined by MARAD after September 30, 2008.

Temporary – If non-operating or drydock days are recorded during the month, payment is reduced. At year-end, MARAD determines if annual 320-days-in-operation requirement was met and, if so, issues a supplemental payment.

Permanent – If vessel was under time-charter, transported excess cargo preference, or did not meet annual 320-days-in-operation requirement, no supplemental payment is made.

Our testing took place during June and July 2008 at MARAD Headquarters and local ports on the east coast of the United States. We conducted this performance audit 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.

EXHIBIT C. MAJOR CONTRIBUTORS TO THIS REPORT

Name	Title
Earl Hedges	Program Director
Ingrid Harris	Project Manager
LaKarla Lindsay	Senior Auditor
Stephen Berkeridge	Auditor
Allison Sturges	Analyst
Fritz Swartzbaugh	Associate Counsel
Michael Fruitman	Communications Adviser