INACTIVE OBLIGATIONS

Maritime Administration

Report Number: FI-2004-099
Date Issued: September 30, 2004

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

Memorandum

Subject: ACTION: Report on Inactive Obligations, Maritime Administration FI-2004-099

Date: September 30, 2004

From: Alexis M. Stefani
Principal Assistant Inspector General for Auditing and Evaluation

Reply to Attn. of: JA-20

To: Maritime Administrator

This report presents the results of our audit of inactive obligations at the Maritime Administration (MARAD). An "obligation" represents a liability that is created when an agency enters into a binding legal agreement, such as a loan guarantee.

The head of each agency is required to certify annually to the Department of the Treasury that obligated amounts are accurate and continue to represent valid liabilities. The success of efforts by MARAD to ensure that obligated amounts continue to represent valid liabilities is a critical measure of the effectiveness of its financial management practices. When unneeded obligations are identified, the funds can be deobligated and reapplied to other projects.

In September 1999, we issued an audit report on the Department of Transportation (DOT) inactive obligations,[1] which included MARAD obligations. We identified unneeded obligations as a significant problem in MARAD, as well as in the rest of DOT. Responding to the report, MARAD deobligated $107 million of funds that were no longer needed and implemented a procedure to perform periodic reviews of inactive obligations.

This report assesses the effectiveness of MARAD's corrective actions since that audit report. Our audit objective was to determine whether MARAD's inactive obligations represent valid financial liabilities or can be used on other projects.

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[1] Office of Inspector General (OIG) Report FE-1999-131, "Inactive Obligations," September 27, 1999. OIG reports can be accessed on our website: www.oig.dot.gov.

We performed the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

MARAD records show that about $321 million was obligated for contracts, cooperative agreements, and loans as of December 31, 2002. We identified 212 obligations totaling $36.2 million that had had no activity within 18 months. To complete this audit, we reviewed loan documentation, cooperative agreements, and contracts and discussed the status of the obligations with responsible MARAD officials. Exhibit A further describes our audit scope and methodology.

Other financial management practices of MARAD have come under close scrutiny. In a March 27, 2003 report,[2] we found MARAD's Title XI Loan Guarantee Program (Title XI) needed more effective oversight of the loan-application process, borrowers, vessels and shipyards constructed under loan guarantees, and foreclosed assets. Under Title XI of the Merchant Marine Act of 1936, as amended, MARAD's Office of Ship Financing guarantees loans to assist private companies (primarily shipbuilders and vessel owners) to obtain financing for ship construction and shipyard modernization projects. We recommended that MARAD improve administration and oversight over all phases of the Title XI loan process. In 2003, Congress appropriated $25 million to MARAD for new Title XI loan guarantees. However, Congress requires us to certify to the House and Senate Committees on Appropriations that MARAD has satisfactorily implemented the recommendations to improve administration and oversight of the Title XI program set forth in our 2003 report. Our follow-up report, "Audit of Title XI Loan Guarantee Program," updates MARAD's efforts in improving the administration and oversight of the Title XI program.[3]

RESULTS IN BRIEF

We found that MARAD had implemented an effective program to monitor and liquidate unneeded inactive obligations except for the obligations related to the Title XI. MARAD made significant progress in reducing the number of inactive obligations since our September 1999 audit report. The number of obligations with no activity for 18 months declined more than 80 percent, from 1,246 in March 1999 to 212 in December 2002.

However, this audit identified $24.4 million in inactive obligations that did not represent valid financial liabilities. Over 99 percent of the unneeded funds ($24 million) were for Title XI loan guarantee obligations. The loan guarantee

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[2] OIG Report Number CR-2003-031, "Audit of Title XI Loan Guarantee Program, Maritime Administration," March 27, 2003.

[3] OIG Report Number CR-2004-095, "Audit of Title XI Loan Guarantee Program, Maritime Administration," September 29, 2004.

obligations were no longer needed because the loans were never made. These unneeded obligations were associated with a bankrupt ship builder and canceled ship financing projects. Once deobligated, these funds can be reapplied to other loan guarantees after Office of Management and Budget approval.

When MARAD approves the loan guarantee application, it issues a Letter Commitment, documenting its agreement to guarantee the loan subject to certain conditions. At that point, MARAD obligates funds to cover the potential cost the Federal Government would incur if the loan applicant defaults. The potential cost to the Government equals the present value of the difference between the Government's payment to a commercial lender and any assets received from the borrower. Once a commercial lender makes the loan, MARAD guarantees payment if the vessel owner defaults.

We reviewed \$20.2 million of loan guarantee obligations and determined that five projects, valued at \$19.6 million, were unneeded. Responding to these findings, MARAD officials agreed that the obligations were no longer needed and deobligated the funds. MARAD officials also reviewed all other outstanding Title XI obligations and deobligated \$4.5 million for another project that had been canceled. The remaining \$363,000 was associated with contracts and interagency agreements not under the Title XI program.

Unneeded Title XI obligations were not identified and deobligated by MARAD because (1) the Title XI obligations did not receive the same monitoring as obligations from other MARAD offices, and (2) the Office of Ship Financing had not established its own process to review all open Letter Commitments to determine if any of the obligations should be canceled.

The process other MARAD offices use to identify unneeded obligations relies on a listing of inactive obligations generated by MARAD's Office of Accounting. The Office of Accounting prepares reports listing inactive obligations and distributes these reports to the respective program offices for review. These reports identify obligations that have had no activity for at least 12 months, but the reports are limited to appropriations with a 1-year authority to obligate funds. Because the Title XI appropriations do not contain the 1-year obligation limitation, Title XI loan guarantee obligations are not included in the reports. As a result, no Title XI inactive obligation reports were provided to the Office of Ship Financing for review.

The Office of Ship Financing also had not established a separate process to review its outstanding obligations prior to our audit. Each Letter Commitment states that if a loan closing has not been held within a specified time, the Letter Commitment may be terminated at the option of the Secretary of Transportation. However, the Office of Ship Financing had not instituted a process to periodically review the status of outstanding loan commitments to determine whether they were still needed. For example,

- MARAD maintained a $10.7 million obligation for 21 months after the loan applicant filed for bankruptcy. In April 1999, MARAD issued a Letter Commitment for the financing of two cruise ships, but the parent company filed for bankruptcy in October 2001. When we discussed the circumstances with MARAD officials in July 2003, they agreed the funds were no longer needed and deobligated the $10.7 million.

- In March 1998, MARAD approved a Title XI Letter Commitment for a $5.0 million obligation to build two barge-mounted power plants. During our review and based on discussions with Office of Ship Financing, MARAD determined the loan would not be made and, therefore, that the obligation was no longer needed. In September 2003, the Letter Commitment was terminated and the funds were deobligated in October.

To reduce unneeded obligations, MARAD needs to ensure more aggressive financial management steps are taken by the Title XI Program Office. We are recommending that the MARAD Administrator direct the Office of Accounting to review justifications for all open Letter Commitment obligations annually and deobligate funds associated with loan commitments that are no longer needed.

On September 29, 2004, MARAD provided written comments (see Appendix) to our September 8, 2004 draft report. The MARAD Administrator agreed that our recommendation can provide a more formalized approach to deobligate funds. He stated he would direct the appropriate offices to develop, within 30 days, the necessary procedures to implement the recommendation.

We consider MARAD's action to be responsive to our recommendation.

FINDING AND RECOMMENDATION

MARAD has implemented an effective financial management program to monitor and liquidate unneeded inactive obligations, except for the Title XI Loan Guarantee Program. This audit identified $24.4 million of unneeded obligations, of which $24 million was for Title XI obligations.

By comparing data presented in our September 1999 audit report to our current report, Table 1 illustrates MARAD's successful continuing efforts to reduce unneeded obligations. The number of inactive obligations with no activity for at least 18 months has declined by more than 80 percent, from 1,246 on March 31, 1999, to 212 on December 31, 2002. During the same period, the amount of unneeded obligations declined by more than 75 percent from $107 million to $24 million. These significant reductions occurred while the total dollar amount of obligations increased by $22 million, or 7 percent.

Table 1. Comparison of Recorded Obligations on March 31, 1999 and December 31, 2002

Date	Total Obligations (Millions)	Number of Inactive Obligations	Unneeded Obligations Deobligated (Millions)
3/31/1999	$299	1,246	$107
12/31/2002	$321	212	$24

Title XI Obligations Were Not Reviewed

Unneeded Title XI obligations were not identified and deobligated by MARAD because (1) the Title XI obligations did not receive the same monitoring as the obligations of other MARAD program offices, and (2) the Office of Ship Financing had not established its own process to review all open Letter Commitments to determine if any of the obligations should be canceled.

The process other MARAD program offices use to identify unneeded obligations relies on a listing of inactive obligations generated by MARAD's Office of Accounting. The Office of Accounting prepares reports listing inactive obligations and distributes these reports to the respective program offices for review. These reports identify obligations with no activity for at least 12 months, but the reports are limited to appropriations with a 1-year authority to obligate funds. Because the Title XI appropriations do not contain the 1-year obligation limitation, their loan guarantee obligations are not included in the reports. As a result, no Title XI inactive obligation reports were provided to the Office of Ship Financing for review.

The Office of Ship Financing had not implemented a process to review its open Letter Commitments and corresponding obligations prior to our audit. We found no open Letter Commitments were canceled and no funds were deobligated during fiscal year (FY) 2001 and FY 2002. Also, no open Letter Commitments were canceled in FY 2003 until our audit began in May 2003. At that time, the Title XI program had 10 outstanding obligations valued at $46.6 million. Its outstanding obligations were reduced by $24 million based on the results of our audit.

Letter Commitments contain specific conditions for loan applicants. When the loan application is approved, a Letter Commitment to guarantee the obligation is issued, stating the requirements necessary for closing the loan. Each Letter Commitment provides that if a loan closing has not been held within a specified time, the Letter Commitment may be terminated at the option of the Secretary of Transportation. Upon loan closing, the loan is issued to the applicant (e.g., vessel owner), and MARAD guarantees payment to a commercial lender in the event of default by the borrower.

MARAD's Title XI loan guarantee obligations remained open because loan closings never occurred and the loans were not made. For example, MARAD approved the Western Power, USA, LLC and Astro Offshore Corporation projects for over 5 years before confirming in September 2003 these loans would not be issued. Table 2 shows a listing of unneeded inactive obligations we identified.

Table 2. Unneeded Inactive Guarantee Loan Projects

Company	Project	MARAD Approval Date	Unneeded Obligations Deobligated (Millions)
Project America II, Inc.	Cruise ship	04/08/99	$10.7
Western Power, U.S.A., LLC	Two power barges	03/19/98	5.0
Kvaerner Shipholding, Inc.	Container ship	04/13/01	2.0
Torch Deepwater, Inc.	Multi-purpose support vessel	04/08/99	1.0
Astro Offshore Corporation	Platform supply vessel	09/18/98	0.9
Total			**$19.6**

RECOMMENDATION

We recommend that the MARAD Administrator direct the Office of Accounting to review justifications for all open Letter Commitment obligations annually and deobligate funds associated with loan commitments that are no longer needed.

MANAGEMENT COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In his September 29, 2004 written comments (see Appendix), the MARAD Administrator agreed that our recommendation can provide a more formalized approach to deobligate funds. He stated he would direct the appropriate offices to develop, within 30 days, the necessary procedures to implement the recommendation. He also indicated that this recommendation will complement the ongoing efforts to improve the administration of the Title XI program.

ACTION REQUIRED

The actions taken and planned by MARAD are reasonable. Therefore, we consider the recommendation resolved subject to follow-up requirements in Department of Transportation Order 8000.1C. We would appreciate receiving a copy of the procedures when they are completed.

We appreciate the courtesies and cooperation of Maritime Administration representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-1992 or Theodore Alves, Assistant Inspector General for Financial and Information Technology Audits, at (202) 366-1496.

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EXHIBIT A. SCOPE AND METHODOLOGY

MARAD records show that about $321 million was obligated for contracts, cooperative agreements, and loans as of December 31, 2002. To determine the validity of inactive obligations and consistent with our prior audits, we identified obligations with no activity for 18 months and tested MARAD's compliance with the DOT policy for validating obligations. Using computer inquiries of the Departmental Accounting and Financial Information System, we identified 212 inactive obligations totaling $36.2 million with no activity for at least 18 months.

The objective of this audit was to determine if MARAD's inactive obligations represented valid financial liabilities. For our review, we selected from the Departmental Accounting and Financial Information System report inactive obligations of $50,000 and over, which totaled $35.5 million. To complete this audit, we interviewed MARAD program officials and legal counsel and reviewed loan documentation, cooperative agreements, and contracts.

We performed the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States and included such tests as we considered necessary to provide reasonable assurance of detecting abuse or illegal acts. Our audit was conducted at MARAD Headquarters in Washington, DC, from May 2003 to March 2004.

EXHIBIT B. MAJOR CONTRIBUTORS TO THIS REPORT

THE FOLLOWING INDIVIDUALS CONTRIBUTED TO THIS REPORT.

Name	Title
Ron Brown	Project Manager
Mark Rielly	Senior Auditor
Brian Greene	Auditor

Exhibit B. Major Contributors to This Report

APPENDIX. MANAGEMENT COMMENTS

Memorandum

U.S. Department
of Transportation

**Maritime
Administration**

Subject: Draft Report on Audit of Inactive Obligation

Date: September 29, 2004

From: Captain William G. Schubert
Maritime Administrator

Reply to
Attn. Of:

To: Theodore Alves
Assistant Inspector General
for Financial and Information Technology Audits

The Maritime Administration (MARAD) has reviewed your draft report on the results of your audit of inactive obligations at MARAD. Your audit contained one recommendation as follows: "We recommend that the MARAD Administrator direct the Office of Accounting to review justifications for all open Letter Commitment obligations annually and de-obligate funds associated with loan commitments that are no longer needed." We believe this recommendation can provide a more formalized approach to de-obligate funds with regard to the Title XI program. Therefore, I will direct the appropriate offices to develop within 30 days the necessary procedures to implement the recommendation. These procedures will be utilized commencing with the balances at the end of FY 2004. As you know, MARAD has been involved in a comprehensive effort to improve the administration of the Title XI program. Implementation of your recommendation is complementary to these ongoing efforts of MARAD.

As a matter of information we would like to point out that at the present time there is only one outstanding Title XI commitment for which a closing has not occurred. This is with respect to the Vane Line Bunkering (Vane) project approved on July 27, 2004. MARAD is in the final stages of document negotiation and a closing in the next several weeks is anticipated. Additionally, the Letter Commitment gave MARAD the option of terminating its approval if a closing were not held within six months of approval. Since the optional termination date is still several months away and a closing is anticipated in the near future it is appropriate that the Vane Letter Commitment remain outstanding at this time. Thus, we believe it is important to note that at present all appropriate de-obligations of Title XI funds have taken place.