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Report to the Chairman, Subcommittee on Regulation, Business Opportunities, and Energy, Committee on Small Business, House of Representatives

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MARITIME ADMINISTRATION

Stronger Management Controls Needed Over Vessels in Title XI Custody

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The Honorable Ron Wyden
Chairman, Subcommittee on Regulation,
Business Opportunities, and Energy
Committee on Small Business
House of Representatives

Dear Mr. Chairman:

In administering the Federal Ship Financing Program, the Maritime Administration (MARAD), within the Department of Transportation (DOT), is responsible for a portfolio of guaranteed loans valued at nearly $2.6 billion. The primary collateral for the guarantees is the privately owned vessels being financed. When a borrower defaults on a loan, MARAD pays off the loan and usually takes custody and eventually title to the vessel. The agency must decide how to maintain and when to sell the vessel—decisions that determine the amount the government recoups on the loss incurred by paying off the loan.

As agreed with your office, we reviewed the adequacy of MARAD's policies and procedures, or management controls, for the custody, maintenance, and sale of vessels acquired by the Federal Ship Financing Program. We also agreed to determine if any problems found are similar to management control problems, previously reported by us and others, in MARAD's National Defense Reserve Fleet (NDRF) program, which maintains government-owned vessels intended to help meet shipping requirements in national emergencies.

Results in Brief

Although the Federal Managers' Financial Integrity Act of 1982 requires executive agencies to develop management controls to ensure that federal programs are managed efficiently and effectively, MARAD has not developed adequate controls for the custody, maintenance, and sale of vessels acquired by its Federal Ship Financing Program (commonly called the title XI program). Specifically, MARAD has not (1) developed detailed formal policies and procedures, including specific criteria, to use in making its decisions about managing and selling vessels; (2) sufficiently documented important information used in making these decisions, such as the rationale for decisions regarding individual vessels; and (3) developed adequate performance indicators to assess these decisions. Consequently, the reasonableness of these decisions cannot be determined. Though

MARAD's management expresses satisfaction with the program's activities in managing and selling vessels, the lack of these management controls (1) precludes the agency from being sure it is achieving its objectives of recouping the maximum amount on the government's losses and acting in the maritime industry's best interest and (2) increases the program's vulnerability to fraud, waste, misappropriation, and mismanagement.

Since 1986, we and DOT's Inspector General have periodically reported on similar problems with management controls in the NDRF program. For example, we recently reported that the program lacks procedures on disposing of vessels and salvaging spare parts and lacks documentation concerning the maintenance and condition of vessels. The similarity of the management control problems in the Federal Ship Financing Program and those previously identified in the NDRF program suggests that MARAD's senior management could do more to convey to program managers the importance of establishing appropriate management controls.

Background

The Federal Ship Financing Program was established by title XI of the Merchant Marine Act of 1936 (Ch. 858, 49 Stat. 1985). To promote the U.S. merchant fleet and encourage domestic shipbuilding, the act, as amended, provides federal guarantees of debt used to finance the purchase or construction of privately owned American-flagged vessels built in U.S. shipyards. If a borrower defaults on a loan, MARAD pays the lender the outstanding balance and usually forecloses, takes title to the vessel or vessels put up as collateral, and attempts to recoup the government's losses by selling the vessel or vessels. MARAD usually stores the vessels in its custody at its NDRF facilities. Currently, the $2.57 billion in loans that the program has guaranteed covers approximately 3,000 vessels and 163 shipowners. There are over 50 vessels in MARAD's custody as a result of defaults totaling approximately $143 million. According to MARAD officials, these vessels have an estimated resale value of $42 million.

Payments to lenders and maintenance and storage costs for vessels in MARAD's custody are paid by the Federal Ship Financing Fund—a revolving fund financed by proceeds from the sale of vessels and from fees paid by borrowers whose loans are guaranteed. Although the fund is self-supporting at this time, in fiscal years 1987 and 1989 MARAD received supplemental appropriations of $1.375 billion and $515 million, respectively, to cover losses by the fund. As of September 30, 1991, the fund had $700 million in cash and investments.

In addition to administering the title XI program, MARAD is responsible for maintaining the government-owned NDRF, which is a fleet of about 230 inactive merchant ships that can be activated to help meet shipping requirements during a national emergency.[1] There are two components to this fleet: (1) a Ready Reserve Force (RRF) consisting of ships routinely maintained so that they could be activated in 5, 10, or 20 days and (2) a less ready component (non-RRF) consisting of vessels receiving less maintenance, so activating them would require a longer time—between 30 and 120 days. In fiscal year 1991, MARAD budgeted about $232 million for this program, approximately one-half of the agency's total budget.

MARAD and all other executive agencies are required by the Federal Managers' Financial Integrity Act (P.L. 97-255) to develop and implement management controls (also known as internal controls) in compliance with the Comptroller General's guidelines in GAO's Standards for Internal Controls in the Federal Government, commonly referred to as the "Green Book." In general, management controls are the combination of policies and procedures program managers use to provide reasonable assurance that program objectives are efficiently achieved with full accountability for the resources made available. The ultimate responsibility for ensuring that management controls are developed and implemented rests with an agency's senior management.

Management Controls Over Title XI Vessels Are Weak

MARAD has not instituted adequate management controls over the custody, maintenance, and sale of vessels acquired as a result of defaults. Specifically, it lacks detailed formal policies and procedures for making decisions about managing and selling individual vessels, has not sufficiently documented its rationale for making these decisions, and has not developed adequate performance indicators to assess these decisions. Management controls such as these reduce a program's vulnerability to fraud, waste, misappropriation, and mismanagement. While MARAD officials believe the segment of the program concerning the management and sale of vessels is achieving its objectives, without these management controls this cannot be confirmed, and the Congress, agency officials, and others interested in the operation of the title XI program cannot be assured that it is efficiently accomplishing all of its objectives.

As required by the Federal Managers' Financial Integrity Act, MARAD regularly assesses the title XI program's vulnerability to fraud, waste, misappropriation, and mismanagement. For fiscal year 1991, MARAD

[1]The NDRF was established by the Merchant Ship Sales Act of 1946 (Ch. 82, 60 Stat. 41).

assessed the vulnerability of the overall program as "medium." It did not, however, choose to report separately on the management and sale of vessels acquired as a result of defaults on loans.

Formal Policies and Procedures for Making Decisions Do Not Exist

MARAD does not have detailed formal policies and procedures to provide guidance for decisions concerning the custody, maintenance, and sale of vessels acquired when borrowers default on loans. Without such guidance, MARAD cannot be sure that these decisions are achieving the program's objectives in managing and selling vessels. However, MARAD officials believe that their system of review, requiring that decisions be approved by a number of officials, adequately ensures the program's success.

The title XI program's primary objective in taking custody, maintaining, and then selling vessels is to recoup, to the extent possible, the government's losses on defaults. When a borrower defaults, MARAD usually takes custody of and eventually title to the vessel.[2] Once MARAD takes custody, it must decide how long it expects to retain the vessel and how much it should spend on preservation and other custodial expenses, such as insurance. After MARAD takes title, it must decide when and for what price to sell the vessel. These decisions involve thousands to millions of dollars. For example, in fiscal years 1983 through 1991, MARAD sold over 2,000 vessels for a total of more than $937 million and spent approximately $65 million on preservation and custodial expenses. The annual cost of storing and maintaining a vessel can range from $2,500 to $1 million, depending on the type of vessel.

Program officials said that they make decisions concerning the management and sale of vessels informally on the basis of conversations with ship brokers, information from trade journals, and MARAD field offices' recommendations concerning preservation methods. Decisions are then approved or disapproved by officials in the chain of command. However, without well-defined formal policies and procedures to provide guidance on making these decisions, agency officials cannot be sure that their actions are minimizing, to the extent possible, the government's losses on defaults. Well-defined procedures specifying, for example, the process and criteria to use in determining when and for what price to sell a vessel would help provide assurances that decisions are consistent and are based on the appropriate information. Moreover, formal policies and procedures

[2]MARAD takes custody of the vessel before it has title in order to protect the vessel's value in anticipation of the foreclosure sale. Legal proceedings can prevent the foreclosure sale from taking place for up to 5 years after the default.

would help ensure that a smooth transition occurs if there are changes in personnel.

Besides recovering losses on defaults, the title XI program has a second objective in managing and selling vessels, which stems from MARAD's overall mission to foster the development and encourage the maintenance of the U.S. maritime industry. In particular, in operating the title XI program, MARAD tries to avoid harming weak sectors of the shipping industry by not introducing additional capacity through the sale of vessels. For example, when MARAD obtained a large number of supply boats used to transport equipment to oil rigs, the agency decided to hold for later sale those vessels that were in better condition and to sell the other vessels with the restriction that they be used for different purposes, such as fishing. Thus, MARAD avoided doing economic harm to owners of supply boats remaining in use in the oil business. This second objective, however, conflicts with the first objective when it results in MARAD's recouping less through the sale of the vessels because the agency received a lower sale price and/or incurred additional custodial expenses. Nevertheless, MARAD has no detailed formal procedures for weighing the trade-offs when the objectives conflict to ensure that its actions optimally benefit both the government and the industry. For example, the agency does not have procedures or criteria for determining what reduction in the sale price of vessels is acceptable when its objectives are in conflict. Instead, program officials said these decisions are made informally case by case.

Activities Not Sufficiently Documented

MARAD does not have records of key information supporting its decisions regarding the custody, maintenance, and sale of individual vessels. For example, between fiscal years 1983 and 1987, MARAD acquired title to over 150 supply vessels because of defaults totaling more than $340 million. The condition of these vessels ranged from very poor to very good. Although officials decided to preserve the vessels that were in better condition for long-term custody and sell the others into alternative markets such as fishing, little documentation is available to support the decisions made on specific vessels. For example, the information collected from ship brokers and trade journals and its use in making decisions concerning vessels are not documented.

Additionally, some information that MARAD collects and that could be used to justify decisions is not maintained in a format usable for this purpose. For example, although virtually all custodial expenses on vessels acquired through defaults are recorded for accounting purposes, MARAD's accounting system does not break down these custodial expenses for individual vessels. This information could be used in evaluating decisions to sell vessels and would provide greater accountability for the $65 million spent for the preservation and custodial care of title XI vessels in fiscal years 1983 through 1991.

GAO's Standards for Internal Controls in the Federal Government specifically requires that significant events and related information be documented so that managers, auditors, and others analyzing a program's operations can trace the events. MARAD officials said that support to justify their decisions is not documented because personnel with a need to know participated in the decisions or were informed of them. However, without documentation, not only can reasons for decisions by MARAD officials not be substantiated, but others are hampered in their efforts to identify and correct inefficiencies in the program.

Adequate Performance Indicators Have Not Been Developed

MARAD does not have procedures to assess its performance in managing and selling vessels or in determining the appropriateness of its decisions. In large part, MARAD is precluded from measuring its performance because, as discussed earlier, it lacks detailed formal policies and procedures and adequate documentation concerning important decisions. Nevertheless, program officials told us that they have not developed performance indicators because senior management is involved with the program, is satisfied with its performance, and has confidence in the staff's expertise. Program officials also maintain that systematically assessing the program's performance would be difficult because some factors affecting performance, such as market influences on the shipping industry, are outside of MARAD's control.

While we acknowledge that market conditions, such as the demand for certain types of vessels, are beyond MARAD's control and can influence the program's results, MARAD could still develop useful indicators. These indicators could help program officials determine how well the program is recouping the government's losses and, in particular, could measure the program's success regarding those factors within MARAD's control. Performance indicators would force MARAD to be more accountable in linking its activities and resources to its objectives. For example, at present, MARAD can show what it sold an individual vessel for as a percentage of the amount it paid out for the default. If the custodial expenses for the vessel were included in computing this percentage, this measure could be used as an indicator of the extent to which the program has recouped the government's losses on the vessel. Including custodial expenses for individual vessels would also help MARAD officials determine the effect of custodial care on the net amount the government recoups. MARAD could use this information, coupled with other performance indicators, to help determine if the program can be improved.

Performance indicators could also help MARAD determine if it is harming weak sectors of the industry through the sale of vessels. For example, MARAD could use information such as the percentage of fully employed vessels in a sector to help determine the impact that the agency's actions are having on that sector. Without performance indicators, MARAD cannot be assured that the program is achieving its objectives in managing and selling vessels and cannot adequately account for the resources used to achieve those objectives.

Similar Management Control Problems Found in Another MARAD Program

Since 1986, we and DOT's Inspector General have periodically issued reports revealing management control problems in the NDRF program that are similar to those we found in the title XI program. Although MARAD officials stated that they have corrected or are correcting the NDRF program's problems identified in these reports, the repeated occurrence of these problems suggests that not enough emphasis has been placed on developing management controls such as formal policies and procedures and adequate documentation.

For example, in our October 1991 report, we found that MARAD did not have formal written criteria for determining if vessels in the NDRF should be disposed of to make room for better suited vessels, nor did MARAD have written policies or procedures for salvaging equipment and parts from ships before they were sold for scrap.[3] At the time of the report, MARAD officials indicated that in selecting individual ships for disposal they considered the ships' military usefulness (as specified by the Navy), condition, and tonnage. Regarding parts removal, MARAD officials agreed that there were no written procedures for stripping ships. One official noted that the agency authorized the removal of valuables and some equipment and components common to other vessels in the fleet before the ships were sold for scrap. However, we found no evidence of a systematic approach for salvaging parts.

[3] Strategic Sealift: Part of the National Defense Reserve Fleet Is No Longer Needed (GAO/NSIAD-92-03, Oct. 7, 1991).

We also pointed out in our October 1991 report that MARAD lacked current documentation on non-RRF ships' condition, though this documentation would aid in making decisions about activating or scrapping the vessels, and had not established a requirement to periodically review the fleet to assess individual ships' condition. We concluded that MARAD did not have important information available to make decisions on which ships should be activated first in an emergency or, conversely, which ships should be scrapped first.

In another example, in our August 1986 report, we found problems with MARAD's documentation of test activations to measure the readiness of RRF vessels.[4] We noted that reports, prepared by the Navy and MARAD, evaluating the test activations varied in format and content and often provided little detailed information on the type of problems experienced, their causes, and their solutions. We also found that MARAD lacked (1) a system to ensure that problems identified in the reports were corrected and (2) formal procedures to disseminate such information to prevent the problems from recurring.

Similarly, in 1991, DOT's Inspector General identified incidents in which fleet personnel failed to document which of the required components on RRF vessels had been tested.[5] The personnel instead relied on their recollection to ensure that components were tested. The Inspector General also noted that some reports of mechanical deficiencies on RRF vessels lacked sufficient information, such as the location and description of the deficiencies, for the ship managers to develop adequate repair specifications.

Conclusions

Without detailed formal policies and procedures, appropriate documentation, and adequate performance indicators, title XI program managers cannot be sure that their activities in managing and selling vessels are as efficient and effective as possible. While MARAD officials believe that these activities are being conducted properly, no one can independently confirm this because of the lack of these basic management controls. Furthermore, these management controls are required by the Federal Managers' Financial Integrity Act to help reduce a program's vulnerability to fraud, waste, misappropriation, and mismanagement. Ultimately, the responsibility for strong management controls rests with

[4] Navy Sealift: Observations on the Navy's Ready Reserve Force (GAO/NSIAD-86-168, Aug. 18, 1986).

[5] Report of the Audit of Maintenance of the Ready Reserve Force Maritime Administration (AV-MA-1-012, Feb. 4, 1991).

top management. The similarity of the problems in the title XI program and previously identified problems in the NDRF program suggests that senior management could do more to ensure that management controls are consistently a high priority for program managers.

Recommendations

To help ensure that the title XI program is administered efficiently and effectively and provides reasonable assurance that government resources are protected against fraud, waste, misappropriation, and mismanagement, we recommend that the Secretary of Transportation direct the Administrator of MARAD to take the following actions:

- Develop detailed formal policies and procedures to guide decision-making regarding the custody, maintenance, and sale of title XI vessels.
- Identify and document significant information and program activities concerning decisions affecting the custody, maintenance, and sale of individual vessels.
- Develop indicators to allow MARAD officials and others to better monitor the program's performance.

Agency Comments

We discussed the facts and recommendations contained in this report with the Deputy Administrator, the Associate Administrator for Administration, the Deputy Associate Administrator for Maritime Aids, and other MARAD headquarters and DOT officials. We made changes as appropriate. The Deputy Administrator generally agreed with our recommendations but disagreed with our portrayal of senior management as not sufficiently committed to emphasizing management controls. He maintained that senior management is committed to encouraging strong management controls and cited MARAD's responsiveness to GAO's and the Inspector General's recommendations. However, we believe it is important for MARAD's senior management to cultivate an atmosphere in which strong management controls are developed and implemented before weaknesses are identified by others. As requested, we did not obtain written agency comments on a draft of this report.

Scope and Methodology

To determine what management controls MARAD has established and what type of information the agency has maintained, we interviewed (1) personnel from MARAD headquarters in Washington, D.C., who are responsible for the custody, maintenance, and sale of title XI vessels and (2) personnel from NDRF field offices responsible for the fleet's storage facility in Beaumont, Texas, where many vessels in the title XI program's custody are stored. We also reviewed the statutory requirements for the title XI program and program documents and reports. Additionally, we reviewed previous reports by GAO and DOT's Inspector General regarding the NDRF program. We conducted our review from October 1991 to March 1992 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send a copy to the Secretary of Transportation, the Administrator of MARAD, and other interested parties. We will also make copies available to others on request.

This work was performed under the direction of Kenneth M. Mead, Director, Transportation Issues, who can be reached at (202) 275-1000. Other major contributors to this report are listed in appendix I.

Sincerely yours,

J. Dexter Peach

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Assistant Comptroller General

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