
Office of Inspector General

**Management Advisory on
Massachusetts Heavy Industries, Inc.,
Title XI Loan Guarantee**

MARITIME ADMINISTRATION

**Report Number MA-1998-048
Date Issued: December 17, 1997**





**U.S. Department of
Transportation**

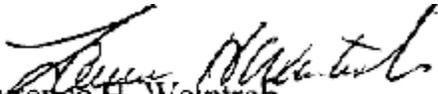
Office of the Secretary
of Transportation

Office of Inspector General

Memorandum

Subject: **ACTION:** Management Advisory on
Massachusetts Heavy Industries, Inc.
Title XI Loan Guarantee
Report Number: MA-1998-048

Date: December 17, 1997

From: 
Lawrence H. Weinrob
Assistant Inspector General for Auditing

Reply to
Attn of:

To: John E. Graykowski
Acting Administrator, Maritime Administration

We reported on the Maritime Administration's (MARAD) processing of Massachusetts Heavy Industries, Inc. (MHI), Title XI loan guarantee application in a Management Advisory Report, Number MA-1998-007, dated November 7, 1997. On December 11, 1997, you provided us a status on the three recommendations contained in that report. We are concerned about the action planned for the following recommendation (recommendation 1 of the report):

Reassess the risk factor rating for MHI's application excluding the related tanker construction project. Based on the results of the reassessment, take appropriate action within the limits of MARAD's legal authority.

MARAD is not planning to reassess the risk factor, prior to closing, based on a legal opinion made by the Office of the Secretary of Transportation's Deputy General Counsel. The legal opinion, dated November 12, 1997, concluded MARAD has no legal authority to reassess the risk factor rating for MHI's application prior to closing. Further, the Commonwealth of Massachusetts is not liable for additional funds if subsequent reassessments identify increased risk. MARAD is responsible for providing additional funds, to cover that risk, from its permanent indefinite appropriation provided for by the Federal Credit Reform Act.

Office of Management and Budget Circular Number A-11, *Preparation and Submission of Budget Estimates*, paragraph 33.11(e)(1)(3), recognizes the need to reassess risks "when a major change in actual versus projected activity is

detected.” The original risk estimate was predicated on a shipbuilding contract, utilizing Title XI loan guarantees, for approximately one sixth of the loan guarantee period. However, this contract has not materialized, and to our knowledge, neither MHI nor MARAD have identified other potential contracts for shipbuilding at MHI. As a result, sources of sufficient income to cover operating expenses and debt service are uncertain. Since the risk would appear to be greater now than when the original calculations were made, we believe MARAD must reassess the risk factor immediately after closing and obtain, from its permanent indefinite appropriation, additional funds necessary to cover additional risk identified by the reassessment. This is necessary since MARAD is precluded from requiring evidence of viable shipbuilding contracts or alternative sources from which revenues can be generated (recommendation 2 of the report) because these requirements were not stipulated in MARAD’s letter commitment.

Our third recommendation required MARAD to ensure MHI fulfills the remaining requirements (13) contained in the letter commitment that were not complete at the time of the report. As of December 11, 1997, MARAD officials indicated that MHI had substantially fulfilled all of these requirements. Other than obtaining legal opinions on MHI’s performance bonds, MARAD needs to finalize documentation and work out minor issues before closing. Our review of MARAD’s final proposed actions regarding the completion of these requirements disclosed there were no substantial deviations from the letter commitment without other compensating controls or justification.

Management Comments

We provided a draft of this report to the Acting Maritime Administrator and discussed the issues with him. He agreed with the issues raised but took exception to our recommendation to reassess risk immediately after closing. He stated MARAD was “. . . sympathetic to MHI’s claim that it is difficult to obtain customers without the modernization going forward and being underway. . . .” The Acting Administrator suggested delaying any reassessment of risk until the last quarter of 1998, thereby giving MHI the opportunity to demonstrate that modernization is underway and that MHI is “aggressively marketing its products.” A copy of the Acting Administrator’s comments is attached.

OIG Response

We understand MHI’s difficulty in obtaining customers before it has the capacity to build ships. However, MARAD agrees that circumstances have changed significantly since the original risk assessment and risk of default appears to have materially increased. In our opinion, due to the change in risk, prudence, applicable regulations and circulars, requires a formal reassessment of risk immediately after closing. If the reassessment demonstrates an increase in risk,

MARAD should recognize this increase when recalculating the aggregate balance of the Credit Reform Financing Account. If MHI obtains firm contracts for work as modernization of the shipyard progresses, or other demonstrated sources of revenue are identified, MARAD should again reassess risk. This reassessment could lead to a conclusion that risk has diminished. MARAD could recognize this change and make the necessary adjustments to its financing reserve fund.

If I can answer any questions or be of further assistance, please feel free to call me on (202) 366-1992.

Attachment

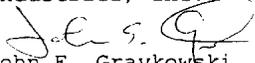
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U.S. Department
of Transportation
**Maritime
Administration**

Memorandum

Subject: Response to Management Advisory
Report on Massachusetts Heavy
Industries, Inc. Date: December 16, 1997

From: 
John E. Graykowski
Acting Maritime Administrator Reply to
Attn of

To: Lawrence H. Weintrob
Assistant Inspector General
for Auditing

I am in receipt of your memorandum regarding certain conclusions and recommendations from the Office of Inspector General (OIG) to the Maritime Administration (MARAD) concerning the completion of the Title XI loan guarantee for Massachusetts Heavy Industries, Inc. (MHI).

While I can concur in recommendation three, without reservation, I do take exception to your comments regarding the need to re-estimate the underlying risk factor "immediately after closing." I do not believe that this would serve any useful purpose, since we all understand at this time that MHI does not have an existing "book of business" for the shipyard. However, we are sympathetic to MHI's claim that it is difficult to obtain customers without the modernization going forward and being underway, and we further understand that MHI contemplates the completion of several contracts in the next few months.

Therefore, I would suggest that we delay any re-estimate of the subsidy rate until the last quarter of 1998, in order to give MHI sufficient time to begin modernization activities and aggressively market its products. If, by that time, no new contracts have been signed, I feel it would be appropriate to perform the necessary adjustments to the subsidy rate. Let me assure you I will do what is necessary to protect the taxpayer from any further risk of default, including using the permanent indefinite authorization under the Federal Credit Reform Act.

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