Office of Inspector General
Audit Report

Fiscal Year 1998
Consolidated Financial Statements

Department of Transportation

Report Number: FE-1999-081
Date Issued: March 30, 1999

DEPARTMENT OF TRANSPORTATION
UNITED STATES OF AMERICA

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

Memorandum

Subject: ACTION: Report on Fiscal Year 1998 Consolidated Financial Statements, Department of Transportation FE-1999-081

Date: March 30, 1999

From: Kenneth M. Mead
Inspector General

Reply To Attn Of: Meche:x61496

To: The Secretary
Thru: The Deputy Secretary

I respectfully submit the Office of Inspector General (OIG) report on the Department of Transportation Consolidated Financial Statements for Fiscal Year (FY) 1998 ended September 30, 1998. This report is required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

The audit report is the responsibility of the OIG. All other information--including the Management Discussion and Analysis, Consolidated Financial Statements, Notes, and Supplemental Information--is the joint responsibility of the Department of Transportation and its Operating Administrations (DOT). Our audit was limited to the Consolidated Financial Statements as of, and for the year ended, September 30, 1998.

Because of their impact on our audit opinion, we focused our efforts this year on the Federal Aviation Administration (FAA) and the U.S. Coast Guard (Coast Guard) actions taken on five previously reported material weaknesses that included real property (land, buildings, and structures), personal property (equipment), work-in-process, accounting for field spares, and inventory valuation. DOT also prepared, for the first time, and we audited the Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Consolidated Statement of Budgetary Resources, and Consolidated Statement of Financing.

During FY 1998, FAA and Coast Guard completed significant corrective actions on property and inventory. FAA revised inventory prices from standard cost to weighted average cost, and performed a "wall to wall" inventory of spare parts at over 800 field units. FAA is establishing a perpetual accounting system for its spare part inventories located throughout the country. Coast Guard verified the existence and acquisition value of its vessels and aircraft. The Coast Guard also completed physical inventories at the Aircraft Repair and Supply Center, 25 airstations, and the Engineering and Logistics Center, and is implementing weighted average inventory pricing at both Centers.

During FY 1998, Coast Guard revised its estimating procedures for retired pay and medical benefits, and adjusted the recorded liability. An independent contractor, under contract with the OIG, concluded the estimating procedures were reasonable and the liability was accurately reported at $20 billion, an increase of $6 billion from last year's estimate.

In November 1997, DOT transferred the computer center operations supporting its financial management systems to the U.S. Department of Agriculture (USDA) National Information Technology Center in Kansas City, Missouri. The USDA OIG initiated a review of the internal control systems during FY 1998. The audit report is being prepared and should be issued in May 1999.

While improvements had been made, we still were unable to substantiate the valuation of property, plant, and equipment reported at $21 billion, because of the continuing property accounting weaknesses in FAA ($11.9 billion) and Coast Guard ($8.7 billion). Improvements are still needed in the accuracy and reliability of real property, personal property, and work-in-process records. The other DOT Operating Administrations accurately accounted for the remaining $363 million.

The acquisition cost of real property (land, buildings, and structures) was reported at $5.3 billion. For 117 FAA real property items with a recorded value of $790 million, we found 41 items recorded at $419 million were not properly valued; 34 items recorded at $141 million could not be supported; and 4 items valued at $50 million should be removed from property records. For example, a critical power system installed in 1992 was reported at $20 million. FAA was only able to provide contracts, purchase orders, payment records, and other support for $3.6 million.

For 221 Coast Guard real property items with a recorded value of $357 million, we found recorded amounts were not fair and reasonable because the Coast Guard (1) used inaccurate data to compute current value, historical cost, and depreciation, and (2) did not provide adequate documentation to support the value of current acquisitions. For example, Coast Guard reported a building at an estimated current replacement cost of $5.5 million, instead of an estimated historical cost of $1.3 million.

The acquisition cost of personal property (equipment) was reported at $9.9 billion. FAA disclosed the reported $4.1 billion acquisition value for its personal property was materially understated in its Financial Statements. The understatement of equipment is the result of years of expensing contract costs, associated with bringing equipment into operational status, that should have been added (capitalized) to the asset value. For example, the voice switching control systems, installed at 23 locations, were recorded at a total cost of $234 million, instead of the true cost of $1.1 billion. Based on an agreement with Coast Guard, we did not audit $871 million of personal property because it had not finalized plans for verifying the value of electronics equipment and small boats.

Work-in-process was reported at $2.9 billion. As property is acquired and buildings are constructed for specific projects, associated costs are charged to, and accumulated in, a work-in-process account until the projects are completed and systems are placed in service. When completed, the project costs should be transferred to the appropriate real or personal property accounts.

FAA was unable to provide supporting cost documentation to substantiate the $2.1 billion recorded in the work-in-process account. For example, FAA spent $1.2 million on a flight service station during FY 1998, but could only provide transaction histories for costs of $123,000, leaving $1.1 million unsupported. Based on an agreement with Coast Guard, we did not audit its work-in-process account reported at $777 million. Coast Guard is developing a new system for its work-in-process, which will be available in May 1999.

The value of inventory reported at $2.3 billion, particularly Coast Guard inventory reported at $1 billion, could not be substantiated. The Coast Guard inventory currently is valued at various methods, including last acquisition cost and standard prices. The Coast Guard has agreed to value its inventory using moving weighted average pricing. We will test the inventory valuation during FY 1999.

DOT, FAA, and Coast Guard agree property and inventory weaknesses exist, and have initiated plans to correct these material weaknesses by September 30, 1999. We agree with the corrective action plans, and we are closely monitoring resolution of these issues.

We encountered major problems with the new statements required for FY 1998. Operating costs of more than $41 billion were not properly presented on the Consolidated Statement of Net Cost. Material items on the Consolidated Statement of Budgetary Resources could not be substantiated. The reconciliation performed by the Statement of Financing identified reconciling/unexplained differences totaling $11.6 billion between the Consolidated Statement of Budgetary Resources and the Consolidated Statement of Net Cost. Four examples follow.

- DOT distributed its operating costs into three components on the Statement of Net Cost; Surface Transportation ($26.4 billion), Air Transportation ($9.1 billion), and Maritime Transportation ($5.4 billion). This presentation combined programs and activities with many separate and distinct goals, and did not link program costs to performance measures.

- The Highway Trust Fund beginning unobligated balance ($36.2 billion) represents the amount of budget authority carried forward from prior periods, which had not been used for highway projects. We reviewed the Federal-Aid Highways portion reported at $13 billion. We analyzed budget authority, congressional limitations, and expenditures since the beginning of FY 1992, but could not substantiate the balance. Similarly, we could not verify the beginning unobligated balance of $7.2 billion for FAA. Supporting documentation for these amounts could date back for years.

- The four DOT Operating Administrations responsible for the Highway Trust Fund did not review unliquidated obligations prior to certification. We identified about $562 million in obligations that were no longer needed, some of which were obligated for up to 14 years. For just highway projects, we found over $5.4 billion was obligated for projects that had no activity for at least 1 year, some of which had no activity as far back as 1988.

- During FY 1998, we participated in a review of unliquidated obligations with the Maritime Administration, and identified $87 million in unneeded obligations which were deobligated. These funds had been obligated from 1 to 11 years.

Because we could not determine the reliability of significant portions of the Consolidated Financial Statements, we are unable to express, and we do not express, an opinion on DOT's Consolidated Financial Statements as of, and for the year ended, September 30, 1998.

We identified three other significant issues. Although these issues are important, they would not prevent DOT from receiving an unqualified audit opinion.

- DOT was not in compliance with the Federal Financial Management Improvement Act of 1996 because the Department's accounting system was not used to prepare the Consolidated Financial Statements and the accounting system was not the only source of financial information. DOT made over 2,200 closing and adjusting entries, totaling over $220 billion, outside the accounting system to prepare the Consolidated Financial Statements.

- The Department's accounting system does not perform cost accounting, and the Department did not have the cost accounting data that are needed to effectively evaluate performance against strategic goals and outcomes. The new Departmental accounting system, currently expected to be fully operational by June 2001, will address these issues.

- The performance measures in the Management Discussion and Analysis did not provide information about the cost effectiveness of DOT programs, and did not relate to information presented in the Statement of Net Cost. Only 5 of the 32 performance measures included FY 1998 performance data.

To address the internal control weaknesses and compliance issues, we are making five new recommendations. Our report on the FY 1997 Consolidated Financial Statements contained four recommendations, and disclosed efforts were in process to complete corrective actions on 33 prior recommendations. During FY 1998, DOT took action to implement corrective actions on 13 recommendations. Efforts still are underway on 24 prior recommendations.

A draft of this report was provided to the Chief Financial Officer on March 24, 1999. He agreed with the recommendations. We considered his comments in preparing this report.

We appreciate the cooperation and assistance of DOT representatives. If we can answer questions or be of any further assistance, please feel free to call me at (202) 366-1959, or John Meche at (202) 366-1496.

Attachments

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DEPARTMENT OF TRANSPORTATION
INSPECTOR GENERAL'S INDEPENDENT REPORT ON
FISCAL YEAR 1998 CONSOLIDATED FINANCIAL STATEMENTS

To the Secretary

The Department of Transportation (DOT), Office of Inspector General (OIG) audited the DOT Consolidated Financial Statements as of, and for the year ended, September 30, 1998. We were unable to express an opinion on the Consolidated Financial Statements because we could not substantiate property, plant, and equipment reported at $21 billion, and inventory reported at $2.3 billion on the Consolidated Balance Sheet. Operating costs of more than $41 billion were not properly presented on the Consolidated Statement of Net Cost. Material items on the Consolidated Statement of Budgetary Resources could not be substantiated. Finally, the reconciliation in the Consolidated Statement of Financing between the Consolidated Statement of Budgetary Resources and the Consolidated Statement of Net Cost identified reconciling/unexplained differences totaling $11.6 billion.

We also are reporting on internal accounting and administrative control systems, and compliance with laws and regulations as applicable to DOT's FY 1998 Consolidated Financial Statements. We performed the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin 98-08, Audit Requirements for Federal Financial Statements, as amended on January 25, 1999.

Our audit objectives for the FY 1998 Consolidated Financial Statements were to determine whether (1) the principal Financial Statements are presented fairly in accordance with OMB Bulletin 97-01 as amended on November 20, 1998; (2) DOT has an adequate internal accounting and administrative control structure; (3) DOT has complied with laws and regulations which (a) could have a direct and material effect on the Financial Statements, or (b) have been specified by OMB; (4) the information and manner of presentation in the Management Discussion and Analysis is materially consistent with the information in the Financial Statements; and (5) the internal control structure ensured the existence and completeness of reported data supporting performance measures.

This report presents our disclaimer of opinion on DOT's Consolidated Financial Statements as of, and for the year ended, September 30, 1998. The financial information in the Management Discussion and Analysis and Supplemental Information was materially consistent with the Consolidated Financial Statements. We are including our reports on the internal control structure, and compliance with laws and regulations, in Sections B and C of this report.

A. DISCLAIMER OF OPINION ON FINANCIAL STATEMENTS

Property, plant, and equipment, reported at $21 billion on the Consolidated Balance Sheet, could not be substantiated. More specifically, the Coast Guard and Federal Aviation Administration (FAA) real property (land, buildings, and structures), personal property (equipment), and work-in-process reported at $20.6 billion could not be substantiated. We were able to determine that FAA personal property was significantly understated. Inventory reported at $2.3 billion, particularly the Coast Guard inventory reported at $1 billion, could not be substantiated.

Operating costs of more than $41 billion were not properly presented on the Consolidated Statement of Net Cost. DOT distributed its operating costs into three components, Surface Transportation ($26.4 billion), Air Transportation ($9.1 billion), and Maritime Transportation ($5.4 billion). This presentation combined programs and activities with many separate and distinct goals, and did not link program costs to the 32 performance measures presented in the Management Discussion and Analysis.

We were unable to substantiate material items on the Statement of Budgetary Resources such as Beginning Unobligated Balance ($47.6 billion), Obligations Incurred ($46.1 billion), and Ending Obligated Balance ($48.6 billion). The reconciliation in the Statement of Financing identified reconciling/unexplained differences totaling $11.6 billion, and these differences were not adequately disclosed.

Because we could not determine the reliability of significant portions of the Consolidated Financial Statements, we are unable to express, and we do not express, an opinion on the DOT Consolidated Financial Statements as of, and for the year ended, September 30, 1998.

B. REPORT ON INTERNAL CONTROL STRUCTURE

While the purpose of our work was not to express, and we do not express, an opinion on internal controls, we found material internal control weaknesses that contributed to reportable conditions. Our work was limited to applicable internal controls designed to safeguard assets, prepare financial statements, and assure proper execution of budgetary transactions, and would not necessarily disclose all material internal control weaknesses.

MATERIAL WEAKNESSES

The following sections describe material weaknesses we identified, and their effect on the Consolidated Financial Statements and management of DOT operations. The financial statement weaknesses were reported to OMB and Congress as part of DOT's reporting under the Federal Managers' Financial Integrity Act.

Consolidated Balance Sheet

Property, Plant, and Equipment

We were unable to substantiate the acquisition value of property, plant, and equipment reported at $21 billion, because of the continuing property accounting weaknesses in FAA ($11.9 billion) and Coast Guard ($8.7 billion).

Real Property

The acquisition cost of real property (land, buildings, and structures) was reported at $5.3 billion. FAA reported real property at a total value of $2.5 billion. The FAA Real Property Record System included property that was not valued correctly or whose stated value was not supported. For 117 items with a recorded value of $790 million, we found 41 items recorded at $419 million were not properly valued; 34 items recorded at $141 million could not be supported; and 4 items valued at $50 million should be removed from property records.

For example, a critical power system installed in 1992 was reported at $20 million. FAA was only able to provide contracts, purchase orders, payment records, and other support for $3.6 million. In another example, a building demolished over 10 years ago was still on FAA's records at $1 million.

The Coast Guard reported real property valued at $2.6 billion. The Coast Guard recorded estimated cost for real property acquisitions prior to October 1, 1994, based on a model calculation, and actual cost for all other acquisitions. For 221 items with a recorded value of $357 million, we found recorded amounts were not fair and reasonable because the Coast Guard (1) used inaccurate data to compute current value, historical cost, and depreciation, and (2) did not provide adequate documentation to support the value of current acquisitions. This occurred because Coast Guard had not established an effective quality control process to ensure that reliable and accurate data were used.

For example, Coast Guard reported a building at an estimated current replacement cost of $5.5 million, instead of an estimated historical cost of $1.3 million. In another example, the estimated replacement value of an 18,000 square foot building was overstated by $2.2 million because the building size was inaccurately recorded at 30,000 square feet.

Personal Property

The acquisition cost of personal property (equipment) was reported at $9.9 billion. FAA disclosed the reported $4.1 billion acquisition value for its personal property was materially understated in its Financial Statements. The understatement of equipment is the result of years of expensing contract costs, associated with bringing equipment into operational status, that should have been added (capitalized) to the asset value. We have preliminarily identified that the value for five of the most costly equipment systems, currently in operation, needs to be increased by at least $1 billion. For example, the voice switching control systems, installed at 23 locations, were recorded at a total cost of $234 million, instead of the true cost of $1.1 billion. The exact amount of the undervaluation for the five systems, and other less expensive systems, is unknown at this time.

Coast Guard personal property was reported at $5.4 billion. Coast Guard verified the existence and acquisition value of its vessels and aircraft reported at $4.5 billion during FY 1998. Based on an agreement with Coast Guard, we did not audit the remaining personal property reported at $871 million because Coast Guard had not finalized its plans for verifying the value of electronics equipment and small boats.

Work-in-Process

Work-in-process was reported at $2.9 billion. As property is acquired and buildings are constructed for specific projects, associated costs are charged to, and accumulated in, a work-in-process account until the projects are completed and systems are placed in service. When completed, the project costs should be transferred to the appropriate real or personal property accounts.

FAA was unable to provide supporting cost documentation to substantiate the $2.1 billion recorded in the work-in-process account. We statistically sampled 185 FAA projects from 7,345 active work-in-process projects with accumulated costs estimated at $887 million. We were unable to obtain transaction histories on 34 percent of the projects. Without transaction histories, recorded amounts cannot be traced to supporting documentation, such as invoices or contracts. For example, FAA spent $1.2 million on a flight service station during FY 1998. FAA could only provide transaction histories for costs of $123,000, leaving $1.1 million unsupported.

FAA project costs are considered backlog if not removed from the work-in-process account within 6 months after project completion. FAA estimated its backlog at $1.3 billion as of September 30, 1998. Depreciation of assets begins only when completed projects are transferred to the appropriate asset account (real or personal property). For example, FAA completed construction of an air navigation facility in

1995 at a cost of $746,000. As of December 31, 1998, the facility remained in the work-in-process account. Consequently, the backlog in the work-in-process account causes an understatement of depreciation expenses on the Statement of Net Cost. For a sample of 251 backlog FAA projects, we found unrecorded depreciation was at least $62 million.

Coast Guard reported $777 million for its work-in-process. Based on an agreement with Coast Guard, we did not audit the Coast Guard account in FY 1998. Coast Guard is developing a new system for its work-in-process, which will be available in May 1999.

Corrective Action Plans on Property

Elimination of these material weaknesses in its property accounts is essential if DOT is to obtain an unqualified opinion on its FY 1999 Financial Statements. DOT agrees the material weaknesses exist, and has initiated corrective actions. Plans were developed by FAA and Coast Guard, and approved by the DOT Chief Financial Officer, to correct the real property, personal property, and work-in-process weaknesses by September 30, 1999. We agree with the corrective action plans, and we are closely monitoring the work to ensure resolution of issues with property, plant, and equipment. Since DOT has corrective actions underway, we are making no new recommendations.

Inventory

The value of inventory reported at $2.3 billion, particularly Coast Guard inventory reported at $1 billion, could not be substantiated. Statement of Federal Financial Accounting Standards Number 3, Accounting for Inventory and Related Property, requires inventory to be valued at either historical cost, or latest acquisition cost. The Coast Guard inventory currently is valued at various methods, including last acquisition cost and standard prices. The Coast Guard has agreed to value its inventory at the Aircraft Repair and Supply Center and the Engineering Logistics Center using moving weighted average pricing. We will test the inventory valuation during FY 1999.

Statement of Net Cost

The Statement of Net Cost is one of the new financial statements required by OMB Bulletin 97-01 for FY 1998. According to the Managerial Cost Accounting Implementation Guide, issued by the Joint Financial Management Improvement Program, the Statement of Net Cost is pertinent to reporting performance results, and provides financial information that can be related to outputs and outcomes of an entity's major programs and activities. According to OMB Bulletin 97-01, an entity should report performance measures that provide information about the cost effectiveness of programs, and should be linked to the programs featured in the Statement of Net Cost.

The Departmental Accounting and Financial Information System (DAFIS) does not perform cost accounting and the Department's Financial Statement Module does not produce the Statement of Net Cost. Because of the inability of DAFIS to generate cost accounting data, in July 1998, the Department issued guidance for preparing FY 1998 Financial Statements that required each Operating Administration to submit its operating cost in total, without identifying and allocating costs to major programs.

The Department prepared the Consolidated Statement of Net Cost that distributed $41 billion of operating costs into three components; Surface Transportation ($26.4 billion), Air Transportation ($9.1 billion), and Maritime Transportation ($5.4 billion). This presentation combined Operating Administrations and programs with many separate and distinct goals, and did not link program costs to the 32 performance measures presented in the Management Discussion and Analysis. (See discussion on Performance Data).

For example, the Maritime Transportation Costs category combined separate and distinct programs in Coast Guard and the Maritime Administration (MARAD), such as maintaining MARAD's Ready Reserve Fleet, with Coast Guard's Search and Rescue, Drug Interdiction, and civilian Boating Safety costs. DOT attempted to disclose operating costs by major program in a footnote, but full program costs were not displayed. For example, under Maritime Transportation Costs, DOT reported Coast Guard Operating Expenses of $2.8 billion as a major program cost. However, these costs represented total operating and maintenance costs that should have been allocated among the major Coast Guard programs.

The DOT Strategic Plan and the FY 1999 Performance Plan identify these five strategic goals: (1) Safety, (2) Mobility, (3) Economic Growth and Trade, (4) Human and Natural Environment, and (5) National Security. Success in each of these strategic goals will be measured by performance under various outcome goals. For example, eight specific outcome goals are presented for Safety, including reducing the number of transportation-related deaths, and reducing the dollar loss from high-consequence, reportable transportation incidents. The Statement of Net Cost, as currently presented, does not link cost with performance. DOT needs to develop cost accounting data that are needed to effectively evaluate performance against these goals and outcomes.

To improve financial management, DOT initiated a project to replace DAFIS as its core accounting system. The new system is being designed to produce financial statements, as well as cost accounting information. However, it will not be fully operational until June 2001. As discussed earlier, property accounting weaknesses continue to exist in

FAA and Coast Guard that impact the Statement of Net Cost. Until property issues are resolved, the depreciation expense will not be accurately reported.

Recommendations 1 and 2

We recommend the Chief Financial Officer:

- Identify the major programs to be presented in the FY 1999 Consolidated Statement of Net Cost, consistent with the goals and outcomes presented in the DOT Strategic and Performance Plans.

- Require the Operating Administrations to allocate operating costs among the programs presented, and report operating costs for these programs on the FY 1999 Consolidated Statement of Net Cost.

Statement of Budgetary Resources

The new Statement of Budgetary Resources provides information about how budgetary resources were made available to DOT as well as their status at yearend. We were unable to substantiate six material items including Beginning Unobligated Balance ($47.6 billion), Obligations Incurred ($46.1 billion), and Ending Obligated Balance ($48.6 billion).

Beginning Unobligated Balance

We could not verify the beginning unobligated balance of $47.6 billion. For example, the Highway Trust Fund beginning unobligated balance represents the amount of budget authority carried forward from prior periods, which had not been used for highway projects. To determine if this amount was reasonable, we reviewed the Federal-Aid Highways portion reported at $13 billion. We analyzed budget authority, congressional limitations, and expenditures since the beginning of FY 1992, but could not substantiate the balance. The beginning balance carried forward in 1992 was $8 billion. According to Federal Highway Administration (FHWA) representatives, supporting documentation for the remaining $8 billion could date back for years. Similarly, we could not verify the beginning unobligated balance of $7.2 billion for FAA.

Obligations Incurred

We were unable to obtain detailed supporting records from DAFIS to determine whether obligations incurred were accurately reported at $46.1 billion. For example, the following footnote disclosure was included in the FAA Financial Statements:

> In an effort to accurately reflect the status of budgetary resources, FAA compiled data from the SF-132, Appointment and Reapportionment Schedule, and the SF-133, Report on Budget Execution, to prepare the Statement of Budgetary Resources. Some of the budgetary account balances from the (DAFIS) general ledger were not accurate or were incomplete because the processes to record specific transactions were not available in the accounting system.

Similar conditions existed for the Highway Trust Fund. We reviewed the $21 billion Federal-Aid-Highways obligations incurred. While we were able to trace reported amounts into summary records, we were unable to validate summary accounts to supporting documents. According to DAFIS, there was $146 billion in obligation transactions. This amount substantially exceeded the $21 billion because each time a state charges a project or adjusts an obligation, DAFIS records the transaction against the obligations incurred account. However, DAFIS does not eliminate the basic transaction that was adjusted. We could not differentiate between the transactions supporting the $21 billion reported, and the transactions supporting the $146 billion reported in DAFIS. FHWA expects this problem will be corrected in FY 2000.

<u>Ending Obligated Balance</u>

Title 31, United States Code (U.S.C.) Section 1501 states obligations of the United States shall be recorded only when supported by documentary evidence. Title 31, U.S.C. Section 1108 states the head of an agency shall annually submit a certification, supported by records, showing compliance with Section 1501. For the Highway Trust Fund, we found documentary evidence existed to support initial obligations, and obligations were certified annually. However, the four DOT Operating Administrations responsible for the Highway Trust Fund did not review unliquidated obligations prior to certification. Treasury Financial Manual Bulletin 98-09 states:

> Agencies that have not reviewed their unliquidated obligations during the year must do so before yearend closing. This ensures that those transactions meeting the criteria . . . set forth in 31 U.S.C. 1501 have been properly recorded. Retain work papers and records on verifications to facilitate future audits.

Although the annual certifications were made that obligations were valid as of September 30, 1998, there was no documentation supporting this certification, and no review was made of unliquidated obligations during the year. The four Operating Administrations relied on states or grantees to identify unneeded obligations, but they were not doing so.

In December 1997, we estimated there was $500 million in unneeded obligations on highway projects, some of which were obligated for as long as 12 years. FHWA representatives agreed to conduct reviews to deobligate funds by the end of calendar year 1998. FHWA had not completed the review, and unneeded funds were still obligated as of September 30, 1998.

We requested FHWA to age their highway projects. Their inquiry against the database found more than $5.4 billion currently obligated for projects that had no activity for at least a year.

- As part of our current audit, we randomly selected 47 FHWA projects in six states with obligated balances of $98 million. We found 12 projects in 3 states had unneeded obligations totaling $5.2 million. For example, one project was completed 8 years ago and still had $568,000 in unneeded obligations. State officials agreed, and initiated actions to deobligate funds for use on other projects.

- We reviewed 67 FTA projects with unliquidated obligations totaling $83 million. We found 45 projects had an estimated $57 million in unneeded obligations. These funds had been obligated for an average of 8 years, and up to 14 years.

During FY 1998, we also participated in a review of unliquidated obligations with MARAD. Based on our statistical sample, we projected that at least $81 million was unneeded obligations. MARAD performed a complete review, and deobligated $87 million in unneeded obligations as of September 30, 1998. These funds had been obligated from 1 year to 11 years.

Recommendations 3 and 4

We recommend the Chief Financial Officer:

- Require the Operating Administrations to research and verify the beginning and ending unobligated balances before the FY 1999 Consolidated Statement of Budgetary Resources is prepared, and retain supporting documentation.

- Require the Operating Administrations to review outstanding obligations, at least during the annual certification process, and document their actions to close completed grants and contracts.

Statement of Financing

The Statement of Financing is a reconciliation of the budgetary information in the Statement of Budgetary Resources and the operating expense information in the Statement of Net Cost. The Statement of Financing also includes information about other financing sources from the Statement of Changes in Net Position. The reconciliation ensures there is a proper relationship between the financial and budgetary accounts in the entity's financial management system. The Statement of Financing uses data from the three other financial statements and contains no original data.

We traced amounts reported in the Statement of Financing to the corresponding amounts in other statements. The Highway Trust Fund, FAA, and Coast Guard presented amounts in accordance with appropriate Treasury guidance. However, the reconciliation performed by the Statement of Financing identified reconciling/unexplained differences totaling $11.6 billion. As a result, DOT was unable to determine if there was a proper relationship between its financial and budgetary records.

The Highway Trust Fund Statement of Financing reported a $10.4 billion reconciling difference between the two statements. FHWA officials indicated this discrepancy resulted from including trust fund transfers on the Statement of Financing. The FAA Statement of Financing reported an $877 million reconciling difference. FAA officials indicated this discrepancy was identified during the reconciliation of the two statements, but could not provide any other information. Coast Guard also had a $296 million reconciling difference, because the Aquatic Resources Trust Fund and Oil Spill Liability Trust Fund transfers were included on the Statement of Financing.

The Consolidated Statement of Financing did not adequately disclose these reconciling differences. The Highway Trust Fund and Coast Guard differences were reported as Intra-Departmental Transfers, and the FAA difference was reported as Other Miscellaneous Resources. The Department did not include a footnote disclosure explaining the reconciling differences. Consequently, readers of the Consolidated Financial Statements would not recognize DOT was unable to reconcile its financial and budgetary records.

According to Department of Treasury officials, other Federal agencies have had similar problems reconciling their financial and budgetary records and preparing the Statement of Financing. Treasury is currently reviewing its reconciliation guidance.

C. REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Our objective was not to express, and we do not express, an opinion on overall compliance with laws and regulations. Our work was limited to selected provisions of laws and regulations, and would not necessarily disclose all material noncompliance.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 requires auditors to report whether agencies' financial management systems comply substantially with federal accounting standards, financial systems requirements, the government's standard general ledger at the transaction level, and Federal Financial Management Systems Requirements issued by the Joint Financial Management Improvement Program. DOT continues to be in noncompliance because (1) property, plant, and equipment, and inventory amounts presented on the Balance Sheet were inaccurate and not supported by financial records, (2) DAFIS was not used for preparation of the Financial Statements, and (3) the cost accounting data needed to effectively evaluate performance against performance goals and outcomes was not available.

Acquisition value of property, plant, and equipment could not be substantiated. For example, we were unable to substantiate the acquisition cost of real property reported at $5.3 billion, and personal property reported at $9.9 billion. DOT was unable to provide supporting cost documentation to substantiate the $2.9 billion recorded in the work-in-process account. Similarly, the value of inventory reported at $2.3 billion could not be substantiated.

DAFIS was not the only source of financial information used to prepare the Consolidated Financial Statements. OMB implementation guidance states that to be in substantial compliance with the Federal Financial Management Systems Requirements, the "agency core financial system, supported by other systems containing the detail data summarized in the core financial system, is the source of information used in the preparation of the annual financial statements. . . ." Because the core accounting system did not contain the most current financial information, DOT made more than 2,200 closing and adjusting entries, totaling $220 billion, outside DAFIS to prepare the Consolidated Financial Statements. These adjustments, at a minimum, should be recorded in DAFIS at the summary level. However, DOT could not record these adjustments in DAFIS because FY 1998 records were closed within 5 days after yearend. These issues will be addressed in the new Departmental accounting system currently expected to be fully operational by June 2001.

Federal Financial Accounting Standards Number 4 requires all Federal departments to have the capability in place, beginning in FY 1998, to meet requirements of the managerial cost accounting standards. Cost accounting is needed in the Federal Government to provide reliable and timely information on the full cost of Federal programs. However, DAFIS does not perform cost accounting and the Department's Financial Statement Module does not produce the Statement of Net Cost. The Department prepared a Consolidated Statement of Net Cost that distributed $41 billion of operating costs into three components and combined Operating Administrations and programs with many separate and distinct goals, and did not link program costs to performance measures.

Annual Certification of Obligations

Title 31, United States Code (U.S.C.) Section 1501 states obligations of the United States shall be recorded only when supported by documentary evidence. Title 31, U.S.C. Section 1108 states the head of an agency shall annually submit a certification, supported by records, showing compliance with Section 1501. However, as presented in our discussion on the Consolidated Statement of Budgetary Resources, unliquidated obligations were not reviewed prior to certification.

Performance Data

Under OMB Bulletin 98-08, our responsibility was to obtain an understanding of internal controls relating to the existence and completeness of performance data. DOT's FY 1999 Performance Plan contained 70 performance measures, of which 32 were included in the FY 1998 Consolidated Financial Statements. The presentation complied with requirements of OMB Bulletin 97-01 to report performance measures consistent with goals and objectives from the Department's strategic plan.

OMB Bulletin 97-01 also states:

> . . . entities should strive to develop and report objective measures that…provide information about the cost effectiveness of programs. The reported measures should be…linked to the programs featured in the Statement of Net Cost…To further enhance the usefulness of the information, agencies should include an explanation of what needs to be done and what is planned . . . to improve financial or program performance.

We found performance measures did not provide information about cost effectiveness, FY 1998 financial data could not be linked to performance, and planned actions were not always reported.

Measuring Cost Effectiveness

DOT did not have systems in place to allocate costs by major programs. Therefore, the performance measures could not be linked to the Statement of Net Cost. The FY 1998 Consolidated Financial Statements also did not include any performance measures that related to financial operations or cost effectiveness. We found none of the measures was linked to the cost of achieving targeted results, or to the Statement of Net Cost.

For example, one goal is to reduce the rate of rail-related fatalities per million train miles. However, DOT did not have a system in place to link the cost of this program to the goal. Consequently, DOT did not report the FY 1998 cost data for reducing the rate of rail-related fatalities.

In developing its strategic and annual performance plans, DOT emphasized outcome-based measures (actual effects of the program). DOT did not focus on measuring outputs (targeted results) or allocating cost to measure benefits. For example, the Consolidated Financial Statements contain a performance measure assessing progress to reduce the fatal accident rate for commercial air carriers. While a narrative describing FAA's efforts to carry out its aviation safety program was included, the cost to achieve program goals was not reported, nor did the performance measure assess the effectiveness of dollars spent. Such a relationship between cost and program performance should be presented in the FY 1999 Consolidated Financial Statements.

DOT's current accounting system (DAFIS) does not have the capability to track program costs, or allocate payroll costs to programs. DOT is in process of replacing its accounting system, but it will not be fully operational until June 2001. In the interim, DOT needs to develop allocation techniques to capture costs that relate to performance measures.

Completeness and Timeliness of Performance Data

To comply with OMB Bulletin 97-01, current year performance data must be reported to compare with current year financial data. The FY 1998 Consolidated Financial Statements included 1998 performance data for 5 of 32 measures, 1997 data for 10, 1996 data for 11, 1995 data for 5, and 1994 data for 1 measure. For example, DOT presented a performance goal of making the national fixed-route bus system compliant with the American with Disabilities Act by the year 2003. DOT reported 63 percent of fleet buses were compliant in 1996, but did not show 1997 or 1998 compliance data. We identified six performance measures in the Highway Trust Fund Financial Statements that had no performance data. These measures were not used in the Consolidated Financial Statements.

Without timely and complete data, performance results cannot be compared to current year financial data. As part of our audit of the Consolidated Financial Statements, we did not test the validity or accuracy of performance data. This will be accomplished as part of selected program audits during FY 1999. The Department is in process of implementing a comprehensive system to control the quality of performance data.

Reporting of Planned Actions

The Management Discussion and Analysis reported planned actions to improve performance for 16 of 32 measures. For example, DOT reported planned actions to reduce the rate of air travel delays, but how to restrain the flow of undocumented migrants entering the United States was not addressed. In its Performance Plan, DOT reported two initiatives designed to restrain the flow of undocumented migrants. The Performance Plan also describes five initiatives to reduce recreation boating fatalities, and four other initiatives to save mariners and property in imminent danger. This available information should be incorporated in the Consolidated Financial Statements.

Recommendation 5:

We recommend the Chief Financial Officer, in coordination with the Operating Administrations, identify the performance measures that will be included in the FY 1999 Consolidated Financial Statements, develop cost allocation techniques to ensure the selected performance measures are related to the programs detailed in the Statement of Net Cost, and report actions to improve performance.

D. PRIOR AUDIT COVERAGE

DOT prepared its first Consolidated Financial Statements for FY 1996. The OIG's audit report on the FY 1996 Consolidated Financial Statements contained 11 material internal control weaknesses, 15 reportable conditions, and 77 recommendations to strengthen internal controls and establish the correctness of financial statement balances. The FY 1997 audit report stated efforts were still in process to complete action on 33 recommendations and included 4 new recommendations. Efforts are still underway to complete corrective actions on 24 prior recommendations.

Since we issued our report on DOT's FY 1997 Consolidated Financial Statements, we issued 15 reports related to the audit of the FY 1998 Consolidated Financial Statements (see exhibit).

This report is intended for the information of DOT management. However, this report is a matter of public record, and its distribution is not limited.

Kenneth M. Mead
Inspector General

FINANCIAL-RELATED AUDIT REPORTS

TITLE	REPORT NUMBER	DATE ISSUED
Formal Reprogramming of Facilities and Equipment Appropriation, FAA	FE-1998-132	May 7, 1998
Replenishing Logistics Center Inventory, FAA	FE-1998-136	May 15, 1998
Actuarial Estimates for Retired Pay and Health Care Cost, USCG	FE-1998-151	June 2, 1998
Federal Agencies' Centralized Trial-Balance System Data, FY 1997	FE-1998-164	June 30, 1998
Control of Appropriations, FAA	FE-1998-167	July 6, 1998
Implementation of Cost Accounting System, FAA	FE-1998-186	August 10, 1998
Valuation of Logistics Center Inventory, FAA	FE-1998-202	September 10, 1998
Inventory of Field Spare Parts, FAA	FE-1998-209	September 29, 1998
Management of Grant Funds, FTA	FE-1999-016	November 6, 1998
Real Property, USCG	FE-1999-051	January 27, 1999
FY 1998 Financial Statements, FAA	FE-1999-070	March 8, 1999
Valuation of Vessels and Aircraft, USCG	FE-1999-075	March 24, 1999
Actuarial Estimates for Retired Pay and Medical Benefits, USCG	FE-1999-076	March 24, 1999
Quality Control Review of FY 1998 Saint Lawrence Seaway Development Corporation Financial Statements	QC-1999-078	March 29, 1999
FY 1998 Financial Statements, Highway Trust Fund	FE-1999-079	March 30, 1999