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*Office of Inspector General*

*Audit Report*

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**Fiscal Year 1997 Financial Statements**

**Highway Trust Fund**

**Report Number: FE-1998-099**

**Date Issued: March 27, 1998**





# Memorandum

U.S. Department of  
Transportation

**Office of the Secretary  
of Transportation**

**Office of Inspector General**

Subject: INFORMATION: Report on Fiscal Year 1997  
Financial Statements, Highway Trust Fund  
Report Number: FE-1998-099

Date: March 27, 1998

From: **Kenneth M. Mead** *K.M.M.*  
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 Highway Trust Fund (HTF) Financial Statements for the Fiscal Year 1997 ended September 30, 1997. 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 Financial Statements, Notes, and Supplemental Information--is the responsibility of the Federal Highway Administration, Federal Transit Administration, National Highway Traffic Safety Administration, and Federal Railroad Administration (the four Operating Administrations). Our audit was limited to the Financial Statements as of, and for the year ended, September 30, 1997.

**The four Operating Administrations properly processed, adjusted, and reported HTF transactions under their control, and did an excellent job of correcting weaknesses identified in our prior Fiscal Year (FY) 1996 report. Except for the Department of Treasury (Treasury) issue discussed in this report, our audit work did not identify any new internal control weaknesses, or compliance issues, related to the FY 1997 Financial Statements. The Treasury issue is beyond the direct control of the four Operating Administrations and the Department of Transportation (DOT).**

In our prior report on the FY 1996 Financial Statements, we issued an unqualified opinion on the HTF's Financial Statements. In that report, we relied on written confirmations from Treasury that the tax revenue and investment balances were accurate. However, revenues were reported differently for FY 1997, so we could not rely on written confirmations. For FY 1997, Treasury reported HTF revenues and investments of \$24.9 billion and \$22.3 billion, respectively.

To independently verify revenues, we asked the General Accounting Office (GAO) to review the Treasury procedures for estimating and certifying revenues for the four DOT trust funds, including the HTF. Accounting standards allow estimates to be used in financial statements so long as management has a reasonable basis for the estimate. GAO hired a contractor to review Treasury's process for estimating FY 1997 revenues. GAO's contractor was unable to complete the review, and terminated its work because information on how the estimates were made was not available.

For the first three quarters of FY 1997, GAO found errors and internal control weaknesses relating to reporting and certifying of total government excise tax revenues which affected the HTF. GAO projected that errors in reporting these revenues were potentially overstated by as much as \$571 million.

We also obtained, from Treasury, the estimated and certified revenues for the HTF. Our comparison of certified revenues to quarterly estimates found variances ranged from an understatement of \$903 million to an overstatement of \$638 million. In the past, a clerical error by Treasury resulted in FY 1994 revenues being understated by \$1.59 billion. Congress had to correct this error in the FY 1997 Emergency Supplemental Appropriations Act. The bill provided \$695 million in additional funding to states, including a shift of \$318 million among the states.

Because the Treasury issue could affect total revenues and investments, we qualified our opinion on the fair and reasonable presentation of the HTF's FY 1997 Financial Statements. **Had it not been for the Treasury issue, we would have issued an unqualified opinion on the Financial Statements.**

It is important that the accounting and certifying of trust fund revenues by Treasury produce a high level of confidence for all parties. With this in mind, our report on DOT's Consolidated Financial Statements will recommend that the Secretaries of Transportation and Treasury, GAO, and the Deputy Controller of the Office of Management and Budget, require audit coverage of the accounting, estimating, certifying, and investing of tax revenues, in accordance with audit standards related to auditing estimates and applying specific agreed-upon auditing procedures.

We appreciate the cooperation and assistance of DOT and the four Operating Administrations' representatives. If we can answer any questions or be of any further assistance, please call me on 61959, or John Meche on 61496.

Attachments

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**SECTION I**  
**AUDIT REPORT**

DEPARTMENT OF TRANSPORTATION  
INSPECTOR GENERAL'S INDEPENDENT REPORT ON THE  
HIGHWAY TRUST FUND  
FISCAL YEAR 1997 FINANCIAL STATEMENTS

To the Federal Highway Administrator,  
Federal Transit Administrator,  
National Highway Traffic Safety Administrator, and  
Federal Railroad Administrator

The Department of Transportation (DOT), Office of Inspector General (OIG), audited the Highway Trust Fund (HTF) Financial Statements as of, and for the year ended, September 30, 1997. We qualified our opinion on the financial statements because internal control weaknesses at Department of Treasury (Treasury) could affect tax revenues and investments reported at \$24.9 billion and \$22.3 billion, respectively. Except for the Treasury issue, the HTF Financial Statements fairly present the financial position and results of operations for Fiscal Year (FY) 1997.

We also are reporting on the internal accounting and administrative control systems, and compliance with laws and regulations for the Federal Highway Administration, Federal Transit Administration, National Highway Traffic Safety Administration, and Federal Railroad Administration (the four Operating Administrations), as applicable to the HTF Financial Statements. The audit was performed in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin 93-06, Audit Requirements for Federal Financial Statements.

The objectives for our audit of the HTF's FY 1997 Financial Statements were to determine whether (1) the financial statements present fairly the financial position and results of operations of the HTF in accordance with OMB Bulletins 94-01 and 97-01; (2) the four Operating Administrations have an adequate internal accounting and administrative control structure; (3) the four Operating Administrations have 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 Supplemental Information section are materially consistent with information in the financial statements; and (5) supporting data for performance measures existed and were properly reported.

This report presents our qualified opinion on the HTF Financial Statements as of, and for the year ended, September 30, 1997. The financial information included in the Supplemental Information section was materially consistent with the financial statements, except for the Consolidating Statement of Budgetary Resources. This statement was prepared based on budgetary accounting requirements which

significantly differ from accounting policies used to prepare the financial statements as described in Note 1.

The performance measures included in the Supplemental Information section were not financial-related. Therefore, we limited our work to determining if the reported performance measures met the requirements contained in OMB Bulletins and the Government Performance and Results Act, and were consistent with the DOT Strategic Plan. The reported performance measures complied with these requirements, and were consistent with DOT's Strategic Plan.

We also are including our reports on the internal control structure, and compliance with laws and regulations, in Sections B and C of this report.

#### A. QUALIFIED OPINION ON FINANCIAL STATEMENTS

In accordance with the Chief Financial Officers (CFO) Act of 1990, as amended by the Government Management Reform Act of 1994, the OIG audited the HTF Financial Statements (Consolidating Balance Sheet and Consolidating Statement of Operations) as of, and for the year ended, September 30, 1997. The financial statements of the HTF are the responsibility of the four Operating Administrations. The OIG's responsibility is to express an opinion on the fairness and reasonableness of the financial statements based on our audit.

As required by OMB Bulletins 94-01 and 97-01, Note 1 to the Financial Statements describes the accounting policies used by the four Operating Administrations to prepare these financial statements. These policies represent generally accepted accounting principles for the Federal Government.

The Federal Highway Administration is required to include, in the HTF Financial Statements, the related financial transactions recorded by the four Operating Administrations and Department of Treasury's (Treasury) investments and excise tax revenues (revenues). The Federal Highway Administration has no control over the collecting and reporting of revenues for the HTF. The overall process Treasury used to estimate and make the initial distribution of revenues, and the Internal Revenue Service's (IRS) certification process had not been audited. Treasury collects and distributes revenues into government trust funds, including the HTF. Revenues are received daily, while supporting information on how revenues should be distributed (tax returns) is usually submitted quarterly.

Treasury uses economic models to estimate and make the initial distribution of revenues to the various trust funds. Subsequently, the IRS, a component of Treasury, uses tax returns to certify the amount that should have been transferred to the trust

fund, and Treasury makes the appropriate adjustment. Typically, adjustments lag 6 to 9 months behind the distributions made from estimates.

By comparing certified revenues to estimates for eight quarters (September 1995 to June 1997), we found variances ranged from an understatement of \$903 million to an overstatement of \$638 million. We also found, in the past, a clerical error by Treasury resulted in FY 1994 revenues being understated by \$1.59 billion. Congress had to correct this error in the FY 1997 Emergency Supplemental Appropriations Act. The bill provided \$695 million in additional funding to states, including a shift of \$318 million among the states.

Limited tests on the IRS certification process for revenues also identified significant internal control weaknesses. For the first three quarters of FY 1997, total excise tax revenues could be overstated by as much as \$571 million.

Concerning a qualified opinion, the American Institute of Certified Public Accountants' Statements on Auditing Standards describes it this way: "Certain circumstances may require a qualified opinion." A qualified opinion is appropriate when the auditor could not determine the fair and reasonable presentation of one or two line items contained in the financial statements. In our opinion, except for the effect Treasury estimates and certifications could have on revenues and investments, HTF's FY 1997 Financial Statements fairly present the financial position and results of operations as of, and for the year ended, September 30, 1997.

## **B. REPORT ON INTERNAL CONTROL STRUCTURE**

OMB guidance for implementing the audit provisions of the CFO Act requires the auditors to assess the reporting entity's internal control structure. The four Operating Administrations' management are responsible for establishing and maintaining an internal control structure. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that (1) transactions are properly recorded and accounted for, to permit preparation of reliable financial reports in accordance with applicable accounting policies; (2) funds, property, and other assets are safeguarded against unauthorized use, loss, or disposition; (3) transactions are executed in compliance with laws and regulations; and (4) data supporting reported performance measures existed and were properly recorded.

In planning our financial statement audit, we considered the internal control structures of the four Operating Administrations to identify appropriate auditing procedures for the purpose of expressing an opinion on the financial statements, and to determine whether the internal control structures met the HTF internal control objectives. Our work included understanding the significant internal control policies and procedures,

and assessing control risk of significant activity cycles, classes of transactions, and account balances. For significant internal control policies and procedures that were properly designed and placed in operation, we performed sufficient tests to assess whether the controls were effective and working as designed. However, the intent of our internal control review was not to provide an opinion on the overall system of internal controls within the four Operating Administrations.

Our internal control testing during this audit identified one issue, but that issue was beyond the control of the four Operating Administrations and DOT.

### Trust Fund Excise Tax Revenues

The Federal Highway Administration is required to include excise tax revenues (revenues) in the HTF Financial Statements. The Federal Highway Administration and DOT have no control over the collecting and reporting of revenues for the HTF. Treasury collects and distributes the revenues into government trust funds, including the HTF. Revenues are received daily, while supporting information on how the revenues should be distributed (tax returns) is usually submitted quarterly. Therefore, Treasury estimates the revenues and makes an initial distribution to the various trust funds.

Subsequently, the IRS, a component of Treasury, uses tax returns to certify the amount that should have been distributed to the trust funds, and Treasury makes the appropriate adjustment. Typically, adjustments lag 6 to 9 months behind the distribution made from estimates.

OMB Bulletin 93-06 and Government Auditing Standards require the OIG to determine whether FY 1997 revenues and investments, reported at \$24.9 billion and \$22.3 billion, respectively, are fair and reasonable. Treasury OIG and GAO have the authority to conduct audits of Treasury activities. Treasury OIG hired an independent public accounting firm to audit the accounting transactions for distribution and investment of the revenues. However, the contract audits did not include coverage of procedures for estimating or certifying revenues distributed to the individual trust funds.

Weaknesses existed with Treasury's estimates of trust fund revenues. GAO hired a contractor to evaluate Treasury's process for estimating FY 1997 revenues. Accounting standards allow estimates to be used in financial statements if management has a reasonable basis. Treasury was unable to provide a basis for its estimate. Accordingly, GAO's contractor was unable to complete the review, and terminated its work because Treasury did not (1) maintain documentation supporting the estimates, (2) document internal controls, and (3) make key personnel available to explain the process. Since GAO was not able to evaluate Treasury's estimates, we

obtained information, from Treasury, to compare revenues, certified by IRS, to quarterly estimates for eight quarters (September 1995 through June 1997). For the HTF, our comparison found variances between estimates and IRS-certified revenues ranged from an understatement of \$903 million to an overstatement of \$638 million. We also found, in the past, a clerical error by Treasury understated the tax receipts reported on the FY 1994 HTF Income Statement by \$1.59 billion, and the over reporting of those same receipts on the FY 1995 Income Statement. Correcting the error, to record tax receipts in the appropriate year, required Congress to enact an FY 1997 Emergency Supplemental Appropriations Act to provide \$695 million in additional funding to states, including a shift of \$318 million among the states.

Weaknesses also existed with Treasury's certification of revenues. GAO performed specific audit procedures to evaluate the process for certifying revenues. This work identified significant internal control weaknesses, and errors, in Treasury's certification process. GAO estimated the errors resulted in FY 1997 Governmentwide excise tax revenues being potentially overstated by as much as \$571 million, but was not able to quantify the impact on the HTF.

It is important that the accounting and certifying of trust fund revenues by Treasury produce a high level of confidence for all parties. With this in mind, our report on DOT's Consolidated Financial Statements will recommend that the Secretaries of Transportation and Treasury, GAO, and OMB's Deputy Controller, require appropriate audit coverage of the accounting, estimating, certifying, and investing of tax revenues by Treasury. The American Institute of Certified Public Accountants' Statements on Auditing Standards (SAS) provides specific guidance for adequate audit coverage. These standards include SAS 57, Auditing Accounting Estimates, SAS 70, Reports on the Processing of Transactions by Service Organizations, and SAS 75, Engagements to Apply Agreed-Upon Procedures.

Our consideration of the four Operating Administrations' internal control structures would not necessarily identify all matters which should be considered reportable conditions.

### C. REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

OMB guidance implementing the audit provisions of the CFO Act, as amended by the Government Management Reform Act, requires auditors to assess the reporting entity's compliance with applicable laws and regulations. Compliance with laws and regulations is the responsibility of the four Operating Administrations.

To obtain reasonable assurance on whether the HTF Financial Statements were free of material misstatements, we tested compliance with the laws and regulations directly affecting the financial statements and certain other laws and regulations designated by

OMB. Our objective was not to provide an opinion on overall compliance with these provisions.

The Federal Financial Management Improvement Act (FFMIA) of 1996, Title 31, U.S. Code, Section 3512, established certain financial management system requirements in statute that had already been established by policies, and established requirements for auditors to report on compliance. Accordingly, under FFMIA, we are required to report whether the entity's financial management systems substantially comply with the Federal Financial Management Systems Requirements, Federal Accounting Standards, and U.S. Standard General Ledger at the transaction level. To meet these requirements, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997.

The four Operating Administrations had completed the assessments, required by OMB, of automated data processing systems under their control for the Year 2000 computer problem. However, the four Operating Administrations use the Departmental Accounting and Financial Information System (DAFIS), and the Federal Highway and Federal Transit Administrations' grant management systems operate on the Transportation Computer Center mainframe computer.

As of February 13, 1998, DOT reported to OMB that DAFIS and the Transportation Computer Center systems were not yet assessed. DAFIS also did not contain the most current financial information because adjustments made in preparing the financial statements were not processed in DAFIS. DAFIS noncompliance and Year 2000 issues will be included in our report on DOT's Consolidated Financial Statements. Except for these issues, the four Operating Administrations complied, in all material respects, with the provisions of the laws and regulations directly affecting the HTF Financial Statements.

#### D. CONSISTENCY OF INFORMATION

The Federal Highway Administration prepared a Consolidating Balance Sheet and Consolidating Statement of Operations for the HTF programs and activities. The Consolidating Statement of Operations was prepared in accordance with the requirements of OMB Bulletin 94-01. Effective for FY 1998, Federal agencies must prepare financial statements in accordance with OMB Bulletin 97-01. OMB Bulletin 97-01 makes widespread changes to the form and content of government financial statements.

To facilitate the transition and be better prepared to implement these changes, DOT required preparation of the Consolidating Balance Sheet and the Consolidating Statement of Budgetary Resources according to OMB Bulletin 97-01. The

Consolidating Statement of Budgetary Resources is shown as supplemental information, and is not part of the principal statements. The financial information included in the Supplemental Information section was materially consistent with the financial statements, except for the Consolidating Statement of Budgetary Resources. This statement was prepared based on budgetary accounting requirements which significantly differ from accounting policies used to prepare the financial statements as described in Note 1. This issue will be addressed in our report on DOT's Consolidated Financial Statements. We will work with the four Operating Administrations, DOT, and OMB to resolve these inconsistencies before the FY 1998 Financial Statements are prepared.

E. PRIOR AUDIT COVERAGE

The OIG issued audit reports on the HTF Financial Statements for FYs 1992, 1993, 1994, 1995, and 1996. All recommendations in these reports have been implemented, except for five recommendations in our FY 1996 report related to automated data processing controls and safeguards. One of the five recommendations to establish controls to detect duplicate payments is to be completed by March 31, 1998. Three recommendations to (1) perform required tests/reviews to obtain certification and accreditation of computer systems, (2) improve password control procedures, and (3) establish automated procedures to preclude payments in excess of obligated amounts, are to be completed by December 1999. No target completion date had been established to prepare security and disaster recovery plans which must be completed before system certification and accreditation.

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

  
Kenneth M. Mead  
Inspector General

**Sections II and III are available from:**

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(202) 366-6872**