



Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation

Office of Inspector General

Subject: ACTION: Report on Consolidated Financial Statements
for Fiscal Years 2002 and 2001, DOT
FI-2003-018

Date: January 27, 2003

From: Kenneth M. Mead
Inspector General

Reply To
Attn. of: Meche:x61496

To: The Secretary

I respectfully submit the Office of Inspector General (OIG) report on the Department of Transportation (DOT) Consolidated Financial Statements for Fiscal Years (FY) 2002 and 2001. For the first time, the DOT Consolidated Financial Statements include the Transportation Security Administration (TSA), which was established on November 19, 2001. TSA and the U. S. Coast Guard will transfer to the Department of Homeland Security in March 2003. This report is required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

This report presents our unqualified opinion on the DOT Consolidated Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Financing, and the Combined Statement of Budgetary Resources as of, and for the years ended, September 30, 2002, and September 30, 2001. The DOT Consolidated Financial Statements show assets of about \$84 billion, liabilities of \$42 billion, operating costs of \$63 billion, and total budgetary resources of \$105 billion.

The unqualified, or "clean," opinion did not come without extraordinary effort by DOT employees and the auditors. Early in FY 2002, the DOT Chief Financial Officer recognized that the creation of TSA could cause significant challenges for preparing and auditing the DOT Consolidated Financial Statements. In addition to the extra work needed to start up a new agency, DOT also had a major financial management initiative underway at the same time to prepare its larger and more complex agencies to implement the new DOT accounting system, Delphi.

This report identifies significant financial issues that demonstrate the need to fully implement automated systems and internal controls to avoid the extra manual efforts every year to prepare financial statements. However, with the leadership of DOT senior management, especially the DOT Chief Financial Officer and Deputy Chief Financial Officer, the Federal Transit Administrator, and the TSA Chief Financial

Officer, and the hard work by DOT employees to address these issues timely, the clean opinion was attained.

We identified the following material weaknesses affecting the DOT Consolidated Financial Statements.

- Last year, we reported that a headquarters account created by former Federal Transit Administration (FTA) employees existed to hold obligations which were adjusted using inappropriate accounting procedures. This account had a negative \$77 million obligation balance as of September 30, 2001. While addressing this issue during FY 2002, FTA discovered that this account contained the remaining balance of what at one time was a \$562 million overobligation that had occurred 19 years earlier. After a thorough review of its financial records, FTA found that the remaining balance of the FY 1984 overobligation was about \$29 million as of September 30, 2002.

Rather than report the Antideficiency Act violation in FY 1984, former FTA employees engaged in inappropriate actions, such as (1) using funds from other appropriations, some of which had expired for obligation purposes; (2) maintaining records outside the accounting system; and (3) manipulating financial information on reports to Treasury and the Office of Management and Budget (OMB) to prevent detection. Other internal control weaknesses also resulted in adjustments of about \$8 billion to correct the FY 2002 Consolidated Financial Statements. Corrective actions have been taken and are in process.

- DOT has 25 major financial systems. OMB Circular A-130 requires agencies to secure computer systems commensurate with the risk resulting from the loss, misuse, unauthorized access to, or modification of, the systems. Only 10 of the 25 major financial application systems have been certified as adequately secured. Unauthorized access to any DOT information system could jeopardize the integrity of financial information systems. DOT also needs to enhance its network security and complete background checks on contractor personnel working on DOT information systems. In separate reports, we made recommendations to improve computer security and controls.
- Use of cost-reimbursable contracts is more risky for the Government because contractors have little incentive to control costs. The Federal Aviation Administration (FAA) had serious deficiencies in controls over cost-reimbursable contracts. For contracts totaling \$2 billion, FAA did not obtain incurred-cost audits as required. FAA also had a backlog of about 1,400 contracts totaling \$6 billion that were not closed timely. We made recommendations in a separate report to strengthen FAA processes.

- TSA obligated about \$1 billion to contract with 74 private companies already providing passenger security screening services for air carriers. Although TSA contract rates were to be based on actual costs to air carriers, we found six contractors increased billing rates from 58 to 97 percent above those charged to air carriers, and TSA initially was performing virtually no monitoring. We made recommendations for corrective actions in a July 2002 memorandum and in a separate report to be issued in February 2003. TSA has hired independent contractors to audit, administer, and monitor these contracts.
- Under contract with OIG, KPMG LLP (KPMG) found that TSA did not have sufficient personnel or established policies and procedures to ensure accurate reporting of amounts on its financial statements. For example, expenses and liabilities totaling about \$1 billion were understated. TSA corrected its accounting records and reported appropriate amounts in its financial statements.

We also identified the following key issues involving internal control weaknesses and compliance with laws and regulations. While they are important, they did not affect our audit opinion.

- Last year, we reported significant deficiencies in accounting for FAA property. Under contract with OIG, KPMG found that FAA did not adhere to established policies and procedures concerning property reporting during FY 2002, and made recommendations for improvement in a separate report. FAA needs to integrate its property system with DOT's new accounting system, Delphi. FAA plans to integrate its property and financial systems by October 2003.
- FAA overstated its legal liabilities by about \$514 million. FAA corrected its estimate and adjusted its financial statements. KPMG made recommendations in a separate report to improve communication and coordination within FAA.
- Delphi has been implemented in 10 of DOT's smaller agencies, but the computer system lacked basic system controls and contained nine high vulnerabilities in system security. DOT also needs better plans to continue operations in case of system failure or catastrophic events. DOT is working to resolve these issues.
- An interface deficiency existed between the Federal Highway Administration (FHWA) grants management system and the existing DOT accounting system, which underreported valid obligations by about \$388 million. FHWA plans to resolve this interface deficiency during the Delphi implementation process.
- DOT was not in compliance with the Federal Financial Management Improvement Act of 1996 because the DOT accounting system did not (1) provide the data necessary for preparing the DOT Consolidated Financial

Statements, (2) comply with the U.S. Government standard general ledger, and (3) comply with requirements for implementing managerial cost accounting standards. DOT also needs to enhance computer security. DOT plans to have compliant and secure financial systems by September 2004.

- DOT spent about \$37 million obtained from Treasury miscellaneous receipts accounts between FYs 1998 and 2001, rather than using appropriated funds. DOT had no authority to spend Treasury's money. When the transactions were corrected during FY 2002, FHWA and the Office of the Secretary prior year appropriations were overobligated by about \$5 million. We recommended corrective actions in a separate report.
- DOT did not confirm about \$1.9 billion of intragovernmental balances with its trading partners. The General Accounting Office (GAO) reported this area as one impediment to an opinion on the Financial Report of the United States Government. The unreconciled difference among Federal entities for FY 2001 was \$21 billion. Although our audit tests did not identify significant differences, DOT needs to do its part to resolve this Governmentwide issue.
- The performance measures presented in the Management Discussion and Analysis did not provide information about the cost-effectiveness of programs nor relate to the Statement of Net Cost. Of the 64 performance measures, 14 were based on FY 2001 rather than FY 2002 performance data. None of the measures was linked to the cost of achieving targeted results.
- DOT distributed its operating costs into four components on the Consolidated Statement of Net Cost: Surface, Air, Maritime, and Cross-Cutting Transportation Programs. This presentation inappropriately combined agencies and programs with separate and distinct goals.

This report includes one new recommendation to confirm intragovernmental balances. DOT and its agencies have ongoing corrective actions to address these internal control and compliance issues. A draft of this report was provided to the DOT Chief Financial Officer on January 24, 2003. She agreed with the report.

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

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DEPARTMENT OF TRANSPORTATION
INSPECTOR GENERAL'S INDEPENDENT AUDIT REPORT
ON THE DEPARTMENT OF TRANSPORTATION
CONSOLIDATED FINANCIAL STATEMENTS
FOR FISCAL YEARS 2002 AND 2001

To the Secretary

The Department of Transportation (DOT), Office of Inspector General (OIG), audited the DOT Consolidated Financial Statements and accompanying notes as of, and for the years ended, September 30, 2002, and September 30, 2001. In our audit of the DOT Consolidated Financial Statements for Fiscal Years (FY) 2002 and 2001, we found:

- the financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles;
- five material internal control weaknesses concerning DOT's financial, accounting, and information security programs; and reportable conditions concerning property, liabilities, obligations, and performance measures;
- noncompliance with the Federal Financial Management Improvement Act of 1996 (FFMIA) regarding: (1) DOT's accounting system, (2) financial system interfaces, (3) computer security over financial information systems, (4) managerial cost accounting standards, and (5) overobligation of funds;
- financial information in the Management Discussion and Analysis was materially consistent with the financial statements, except 14 of 64 performance measures were based on FY 2001 rather than FY 2002 performance data; and
- supplementary and stewardship information was consistent with management representations and the financial statements.

We performed our work in accordance with U.S. generally accepted government auditing standards and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. The following sections discuss these conclusions. Our audit objectives, scope, and methodology are discussed in Exhibit A. We believe that our audit provides a reasonable basis for our opinion.

A. UNQUALIFIED OPINION ON FINANCIAL STATEMENTS

In our opinion, the DOT Consolidated Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Financing, and the Combined Statement of Budgetary Resources, including accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the DOT assets, liabilities, and net position; net costs; changes in net position; budgetary resources; and reconciliation of net costs to budgetary obligations as of September 30, 2002, and September 30, 2001.

Under contract with OIG, KPMG LLP (KPMG) audited the financial statements of the Federal Aviation Administration (FAA) and Transportation Security Administration (TSA) as of and for the period ended September 30, 2002. KPMG rendered unqualified opinions on the FAA and TSA financial statements.

B. CONSIDERATION OF INTERNAL CONTROLS

In planning and performing our audit, we considered DOT's internal controls over financial reporting and compliance with laws and regulations. We do not express an opinion on internal controls and compliance because the purpose of our work was to determine our procedures for auditing the financial statements and to comply with OMB Bulletin 01-02 audit guidance, not to express an opinion on internal controls.

For the controls we tested, we found five material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level, the risk that errors, fraud, or noncompliance that would be material to the financial statements, may occur and not be detected promptly by employees in the normal course of performing their duties. Our internal control work would not necessarily disclose all material weaknesses or reportable conditions.

Our work also identified the need to improve internal controls over financial reporting and compliance in four other areas. These reportable weaknesses in internal controls, although not considered material weaknesses, represent significant deficiencies in the design and operation of internal controls, which could adversely affect the DOT Consolidated Financial Statements.

Material Weaknesses

The following sections describe the material weaknesses that we identified. On December 26, 2002, as required by the Federal Managers' Financial Integrity Act of 1982, the Secretary of Transportation reported four of the five material weaknesses to

the President and Congress. The other material weakness concerning TSA financial management was identified after the 2002 report was issued.

Federal Transit Administration (FTA) Financial Management

Last year, we reported that a headquarters account created by former FTA employees existed to hold obligations which were adjusted using inappropriate accounting procedures. This account had a negative \$77 million obligation balance as of September 30, 2001. While addressing this issue during FY 2002, FTA discovered that this account contained the remaining balance of what at one time was a \$562 million overobligation that had occurred 19 years earlier.

Rather than report the Antideficiency Act violation in FY 1984, former FTA employees engaged in inappropriate actions, such as (1) using funds from other appropriations, some of which had expired for obligation purposes, (2) maintaining records outside the accounting system, and (3) manipulating financial information on reports to OMB and Treasury to prevent detection. After a thorough review of its financial records, FTA found that the remaining balance of the FY 1984 overobligation was about \$29 million as of September 30, 2002. This labor-intensive effort identified a material internal control weakness involving many areas of FTA financial practices as the following examples indicate.

- Adjustments totaling about \$8 billion were needed to correct the FY 2002 Consolidated Financial Statements.
- Interface deficiencies between the new DOT accounting system (Delphi) and FTA's financial feeder systems (TEAM and ECHO) prevented FTA from electronically processing transactions. For example, about \$350 million in ECHO payments had to be manually processed into Delphi.
- In June 2002, when FTA implemented Delphi, significant obligation and expense transactions were not electronically transferred to Delphi. For example, when FTA manually processed transactions, about \$64 million in valid obligations were not entered into Delphi.

FTA corrected its financial records and provided accurate amounts for the financial statements. In a separate report, we recommended that FTA report a violation of the Antideficiency Act that occurred in FY 1984 and ensure that new policies and procedures are implemented. FTA is in the process of reporting the Antideficiency Act violation to OMB and Congress and implementing new internal control policies and procedures.

DOT Information Security Program

In September 2002, we issued our second annual report on DOT's Information Security Program as required by the Government Information Security Reform Act. We found that DOT's Chief Information Officer lacked authority to enforce DOT security guidance and weaknesses existed in management controls, network security, system security, infrastructure-critical systems and asset protection, and E-government and personnel security.

Specifically, we found unsecured network connections to contractors and unauthorized telephone line (dial-up) computer connections; no system security certification and accreditation reviews on 78 percent (438 out of 561) of mission-critical systems, including 15 of the 25 major financial systems; 79 high vulnerabilities on DOT's web sites; and no background checks on 24 percent of the contractor personnel we reviewed. Unauthorized access to any DOT information system could jeopardize the integrity of financial information systems. We made recommendations in separate reports to improve computer security and controls.

FAA Oversight of Cost-Reimbursable Contracts

FAA's oversight of its cost-reimbursable contracts, as required by acquisition regulations, was deficient, lacked accountability, and did not adequately protect FAA from fraud, waste, and abuse. This vulnerability was significant because FAA awarded about 800 cost-reimbursable contracts totaling \$3.4 billion in FY 2001. For example, we found that cost-reimbursable contracts totaling \$2 billion did not have the required incurred-cost audits, and about 1,400 contracts totaling \$6 billion were not closed timely. In a separate report, we recommended that FAA ensure contract audits are obtained and establish better policies and procedures to enhance oversight of its contract management functions.

TSA Security Screening Contracts

In February 2002, TSA assumed responsibility for passenger security screening at the Nation's airports. To do this, TSA contracted at an estimated cost of \$1 billion with 74 private companies that already were on site providing passenger security screening services for air carriers. Of the 74 contractors, 13 accounted for about 93 percent of the total passenger screening costs. Although contract rates for TSA were to be based on actual costs incurred providing screening services for air carriers, we found that 6 of the 13 contractors increased billing rates from 58 to 97 percent above those charged to air carriers and TSA initially was performing virtually no monitoring of these contracts. We made recommendations for corrective action in a July 2002 memorandum and in a separate report to be issued in February 2003. TSA has hired independent contractors to audit, administer, and monitor these contracts.

TSA Financial Management

On November 19, 2001, the President signed the Aviation and Transportation Security Act that created TSA. From the first day of its existence, DOT and TSA were faced with many significant challenges and short statutory milestones. Getting organized and building a financial management organization with only a few Federal employees was very challenging for TSA.

Under contract with OIG, KPMG found that TSA did not have sufficient personnel or established policies and procedures to ensure accurate reporting of amounts on its financial statements concerning (1) expenses and liabilities of about \$1 billion; (2) purchase orders and other obligations of \$322 million; (3) equipment purchases of \$309 million; and (4) accounts receivable from air carriers and passenger fees of \$157 million. TSA corrected its accounting records and reported appropriate amounts on its financial statements. KPMG made recommendations in a separate report to improve TSA financial management.

Reportable Conditions

Internal control weaknesses existed because of (1) the lack of an integrated property and accounting system in FAA; (2) inadequate coordination concerning reporting procedures for FAA legal liabilities; (3) computer security weaknesses in Delphi; and (4) an interface deficiency between FHWA's grants management system and DOT's existing accounting system, DAFIS.

FAA Property, Plant, and Equipment

Last year, we reported significant deficiencies in accounting for FAA property, plant, and equipment. Under contract with OIG, KPMG audited the FY 2002 FAA financial statements and reported that FAA did not adhere to established policies and procedures to ensure its property accounts were properly reported. In a separate report, KPMG made recommendations to improve property accounting; reconcile the property system and DAFIS throughout the year, record property additions and disposals, and capitalize labor and travel costs. FAA still needs to integrate its property accounting system with Delphi. FAA plans to integrate the two systems by October 2003.

FAA Legal Liabilities

FAA overstated its legal liabilities by about \$514 million. This occurred because the FAA Chief Counsel, when preparing the estimate, incorrectly included cases deemed to be *reasonably possible* of loss with those deemed to be *probable* of loss. FAA also incorrectly included cases where the likelihood of loss was deemed to be *remote*.

KPMG made recommendations in a separate report to improve communication and coordination within FAA.

Delphi Computer System Controls

Our ongoing review of Delphi¹ identified that the system security functions need to ensure access to Delphi only by authorized personnel. We found that Delphi lacked basic system controls, such as (1) passwords not properly configured to prevent guessing; (2) no systematic way to identify and remove user accounts for terminated employees; and (3) programmers given access to production systems. Using a commercial scanning tool, we also identified nine high vulnerabilities in Delphi's security system. Access to the Delphi computer room also was not adequately secured. These deficiencies occurred partially because Delphi operates on a stand-alone server, and security responsibilities that are normally provided by a central security function, as was provided for DAFIS, must now be performed by Delphi managers.

DOT also needs a better plan for Delphi to continue operations in case of system failure or catastrophic events such as tornadoes. We will make specific recommendations in a separate report to be issued later. DOT agreed with our findings and corrective actions already are underway.

FHWA's Grants Management System

Last year, we identified an electronic interface deficiency between FHWA's Fiscal Management Information System (FMIS) and DAFIS, and recommended corrective action. FMIS records initial obligations for Federal-aid grants to states. However, when FMIS interfaces with DAFIS, all obligations are not electronically transferred into DAFIS. This occurs due to problems resulting from upgrades and changes that were made to the FMIS system. FHWA also did not reconcile obligated balances between FMIS and DAFIS. As of September 30, 2002, valid obligations of about \$388 million were understated. FHWA plans to resolve this interface deficiency during the Delphi implementation process.

C. COMPLIANCE WITH LAWS AND REGULATIONS

Our objective was not to express, and we do not express, an opinion on compliance with laws and regulations. Our work was limited to selected provisions of laws and regulations that would be reportable under U.S. generally accepted government auditing standards or under OMB guidance. Our work disclosed the following instances of noncompliance with FFMIA and other laws and regulations.

¹ For security reasons, specifics concerning the weaknesses and vulnerabilities we identified and our audit procedures are not discussed in this report, but were provided to DOT managers during the audit.

Federal Financial Management Improvement Act of 1996

Under FFMIA, we are required to report whether or not DOT financial management systems substantially comply with: (1) Federal financial management system requirements, (2) applicable Federal accounting standards, and (3) the U.S. Government standard general ledger at the transaction level. On January 4, 2001, OMB issued *Revised Implementation Guidance for the Federal Financial Management Improvement Act*, including factors for determining compliance and auditor reporting responsibilities. To meet the FFMIA audit requirement, we performed tests of compliance with the three FFMIA section 803(a) requirements and the revised OMB guidance, including financial management systems; the standard general ledger; and accounting standards.

DOT did not meet FFMIA requirements for financial management systems because: (1) DOT's accounting system, DAFIS, cannot produce auditable financial statements; (2) interface deficiencies exist between DAFIS and FMIS and between Delphi and FTA's financial feeder systems; (3) DAFIS does not contain all of the U.S. Government standard general ledger accounts; (4) DOT has not implemented managerial cost accounting standards; and (5) five material weaknesses existed concerning DOT's financial, accounting, and information security programs.

Financial Management System Requirements

DOT's major agencies use DAFIS, which cannot produce financial statements based on the information included within the system. For example, DOT made about 860 adjustments, totaling \$51 billion, outside DAFIS to prepare the financial statements. These adjustments were recorded in a financial statement module, a tool used to process the adjustments. However, all DOT agencies did not use the financial statement module to prepare the financial statements and adjustments were not recorded in DAFIS. For example, the Coast Guard and Maritime Administration (MARAD) did not use the financial statement module.

Ten of DOT's agencies use the new accounting system, Delphi. Although Delphi is being used, the system is under development and does not yet fully meet all FFMIA requirements for financial management systems. For example, none of the 10 DOT agencies on Delphi used the full capabilities in Delphi to prepare their FY 2002 financial statements. Delphi is being evaluated as to compliance with FFMIA as part of its implementation. As discussed in Section B, the Delphi computer system contains vulnerabilities and security control weaknesses. DOT plans to have all agencies on Delphi by October 2003.

Interface deficiencies exist between DAFIS and FMIS, and between Delphi and FTA's financial feeder systems. The Joint Financial Management Improvement Program

(JFMIP) *Core Financial System Requirements* and *Grant Financial System Requirements* and OMB guidance require that, to be compliant with FFMIA, integrated financial management systems must maintain data accuracy between the core financial system and feeder systems. As discussed in Section B, an interface deficiency between DAFIS and FMIS resulted in recorded obligations in DAFIS being understated by \$388 million. Interface deficiencies between Delphi and FTA's financial feeder systems prevented FTA from electronically processing transactions. DOT plans to resolve these deficiencies during the Delphi implementation process.

United States Government Standard General Ledger

DAFIS does not comply with the U.S. Government standard general ledger (SGL) at the transaction level because it does not contain all of the SGL accounts. As a result, about 860 adjustments, totaling \$51 billion, were made outside DAFIS to prepare the financial statements. Delphi is compliant with the SGL, and DOT plans to have Delphi fully operational in all agencies by October 2003.

Federal Cost Accounting Standards

DOT agencies, except FAA and Coast Guard, are just beginning to identify planning requirements for implementation of cost accounting systems. The Statement of Federal Financial Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Standards*, requires that beginning in FY 1998, each reporting entity should provide reliable and regular reporting of full costs of their activities and outputs. DAFIS does not have the capability to capture full costs, including direct and indirect costs assigned to DOT programs. DOT's goal is to be compliant with cost accounting standards by September 2004.

During FY 2002, DOT demonstrated its commitment to implementing cost accounting standards by appointing a full-time cost accounting project manager and forming a steering group with representatives from each DOT agency to coordinate the Departmentwide implementation of cost accounting standards. These are positive steps, but extensive efforts will be needed to complete implementation by September 2004.

FAA made progress by implementing its cost accounting system in its Air Traffic Services and Commercial Space Transportation lines of business. FAA also is working on developing a labor distribution system. However, FAA still needs to improve the system and develop the cost accounting system for its other three lines of business. FAA plans to complete its cost accounting system implementation by September 2003.

As discussed in Section B, material weaknesses exist concerning (1) FTA financial management; (2) computer security; (3) FAA oversight of cost-reimbursable contracts; (4) TSA security screener contracts; and (5) TSA financial management.

On December 26, 2002, as required by the Federal Managers' Financial Integrity Act of 1982, the Secretary of Transportation reported four of the five material weaknesses in DOT's 2002 report, and also reported that DOT was taking remedial and progressive actions in these areas that will bring DOT into substantial compliance with FFMIA when its actions are successfully implemented. The other material weakness concerning TSA financial management was identified after the 2002 report was issued.

Antideficiency Act Violations

Title 31, United States Code, Section 1341(a) provides that an officer or employee of the U.S. Government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation. As discussed in Section B, a \$562 million overobligation occurred in FY 1984, and FTA still needs about \$29 million to pay the remaining overobligation balance.

DOT also spent about \$37 million obtained from Treasury miscellaneous receipts accounts between FYs 1998 and 2001, rather than using appropriated funds. DOT had no authority to spend Treasury's money. When the transactions were corrected during FY 2002, FHWA and Office of the Secretary prior year appropriations were overobligated by about \$5 million. We made recommendations in a separate report. DOT is in the process of reporting both Antideficiency Act violations.

Intragovernmental Balances

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, requires that reporting entities reconcile intragovernmental asset, liability, and revenue amounts by confirming balances with their trading partners. Some DOT agencies only partially confirmed or reconciled their intragovernmental balances, but most did not. However, our testing found no material differences. Notwithstanding, DOT intragovernmental asset, liability, and revenue amounts of about \$1.9 billion were not confirmed or reconciled with trading partners.

Confirming and reconciling these balances is important to the Financial Report of the United States Government. Last year, GAO reported that one impediment to an opinion on the Government Consolidated Financial Statements that must be overcome is the Government's inability to account for billions of dollars of transactions among Federal entities. GAO attributed part of this problem to agencies not reconciling balances with their trading partners. The unreconciled difference among Federal entities for FY 2001 was about \$21 billion.

Recommendation. We recommend that the DOT Chief Financial Officer establish a special reporting procedure to verify that DOT agencies confirm and reconcile intragovernmental balances with trading partners.

Performance Data

Under OMB Bulletin 01-02, our responsibility is to obtain an understanding of internal controls relating to existence and completeness of performance data. DOT agencies are responsible for establishing and maintaining adequate internal controls. The FY 2002 DOT Performance and Accountability Report contains 39 primary and 25 supplementary performance measures which were in the FY 2002 DOT Consolidated Financial Statements. The overall presentation complied with requirements of OMB Bulletin 01-09 to report performance measures consistent with goals and objectives from agencies' strategic and performance plans.

Linking to Statement of Net Cost and Measuring Cost-Effectiveness

According to OMB Bulletin 01-09:

Entities should strive to develop and report objective measures that . . . provide information about the efficiency and cost effectiveness of programs. The discussion of performance . . . should be clearly linked to cost categories . . . 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.

DOT does not have systems in place to allocate costs by major program and the performance measures presented in the financial statements did not provide information about cost-effectiveness. Consequently, none of the performance measures was linked to the cost of achieving targeted results or to the Statement of Net Cost.

DAFIS does not have the capability to accurately identify program costs. DOT is in the process of replacing DAFIS, and plans to have Delphi in full operation by October 2003. FAA also is developing a separate cost accounting system, which FAA expects will be fully operational by September 30, 2003.

Assessing Internal Controls

We performed various procedures to assess internal controls relating to performance data. While our work disclosed no material internal control weaknesses, we were not required to, and we did not, test the validity or accuracy of performance data as part of the DOT Consolidated Financial Statement audit. However, DOT is facing a significant challenge to ensure the incoming data are accurate and complete.

DOT relies on third-party organizations outside the Federal Government, such as states; grantees; transit authorities; commercial airlines; and airports, for some of its

performance data. States, for example, report on a calendar-year basis, and DOT did not receive some FY 2002 performance information in time to incorporate it into the DOT Consolidated Financial Statements. Of the 64 performance measures, 14 were based on FY 2001 rather than FY 2002 performance data.

Reporting of Planned Actions

To enhance the usefulness of performance information, OMB Bulletin 01-09 encourages entities to include an explanation of what is planned to improve financial or program performance. The Management Discussion and Analysis overview includes general comments on how to improve performance; however, specific plans to improve financial performance were not included.

Statement of Net Cost Presentation

According to the Cost Accounting Implementation Guide issued by JFMIP, 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. OMB Bulletin 01-09 requires an entity to report performance measures that can be clearly linked to cost categories in the Statement of Net Cost.

In September 2002, DOT issued guidance for preparing the FY 2002 DOT Consolidated Financial Statements that established the major program areas on the DOT Consolidated Statement of Net Cost would be Surface, Air, Maritime, and Cross-Cutting Transportation Programs. This presentation inappropriately combines DOT agencies and programs with separate and distinct goals.

For example, the Maritime Transportation category combined separate and distinct programs in Coast Guard and MARAD, such as the cost for maintaining MARAD's Ready Reserve Fleet were combined with Coast Guard's Search and Rescue, Drug Interdiction, and Recreational Boating Safety. Under Maritime Transportation Costs, DOT reported Coast Guard operating expenses of \$3.8 billion as a major program cost. However, these costs represented total operating and maintenance costs that should have been allocated among Coast Guard programs.

To improve financial management, DOT has initiated a project to replace DAFIS. Delphi is being designed to produce financial statements, as well as cost accounting information. Delphi is scheduled to be fully operational by October 2003.

D. CONSISTENCY OF OTHER INFORMATION

Management's Discussion and Analysis, required supplementary information (including stewardship information), and other accompanying information contain a wide range of data, some of which are not directly related to the financial statements. We are not required to, and we do not, express an opinion on this information. We compared this information for consistency with the DOT Consolidated Financial Statements and discussed the methods of measurement and presentation with DOT officials. Based on this work, except for FY 2002 performance measures that were based on FY 2001 performance data (Part C of this report), we found no material inconsistencies with the DOT Consolidated Financial Statements nor nonconformance with OMB guidance.

E. PRIOR AUDIT COVERAGE

Our report on the DOT Consolidated Financial Statements for FYs 2001 and 2000 expressed an unqualified opinion and made one recommendation that FTA discontinue use of the headquarters account and eliminate the negative obligation balance before transferring to Delphi. As discussed in Section B, FTA took corrective actions. In March 1998, we also recommended that DOT ensure DAFIS, or its replacement, is the primary source of information for preparing financial statements. This item remains open until Delphi is fully implemented and demonstrates it can provide the information needed to prepare the DOT Consolidated Financial Statements.

Since we issued our report on the DOT Consolidated Financial Statements for FYs 2001 and 2000, a total of 10 reports were issued related to the DOT Consolidated Financial Statements. The list of reports is in Exhibit B.

This report is intended for information and use by DOT, OMB, GAO, and Congress. This report is a matter of public record, and its distribution is not limited.



Kenneth M. Mead
Inspector General

EXHIBIT A. OBJECTIVES, SCOPE, AND METHODOLOGY

Our audit objectives for the DOT Consolidated Financial Statements for FYs 2002 and 2001 were to determine whether: (1) principal DOT Consolidated Financial Statements and accompanying notes are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; (2) DOT has adequate internal controls over financial reporting, including safeguarding assets; (3) DOT has complied with laws and regulations that could have a direct and material effect on the DOT Consolidated Financial Statements or that have been specified by OMB, including FFMIA; (4) financial information in the Management Discussion and Analysis is materially consistent with the information in the principal DOT Consolidated Financial Statements; (5) internal controls ensured the existence and completeness of reported data supporting performance measures; and (6) supplementary and stewardship information is consistent with management representations and the DOT Consolidated Financial Statements.

DOT is responsible for (1) preparing the DOT Consolidated Financial Statements for FYs 2002 and 2001 in conformity with U.S. generally accepted accounting principles; (2) establishing, maintaining, and assessing internal controls to provide reasonable assurance that broad control objectives of the Federal Managers' Financial Integrity Act are met; (3) ensuring that DOT financial management systems substantially comply with FFMIA requirements; and (4) complying with applicable laws and regulations.

OIG is responsible for obtaining reasonable assurance about whether (1) the DOT Consolidated Financial Statements for FYs 2002 and 2001 are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles and (2) management maintained effective internal controls. The objectives of these controls are:

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Compliance with laws and regulations: Transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and Governmentwide policies identified by OMB audit guidance.

OIG also is responsible for (1) obtaining sufficient understanding of internal controls over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing, and

(3) performing limited procedures with respect to certain other information appearing in the DOT Consolidated Financial Statements for FYs 2002 and 2001.

To fulfill these responsibilities, we examined the amounts and disclosures in the financial statements; assessed accounting principles and estimates; evaluated internal controls; observed physical inventories; and evaluated the presentation of the financial statements. We reviewed the work of KPMG on the FAA and TSA financial statements to determine whether the work was performed in accordance with U.S. generally accepted government auditing standards. We also examined the validity of financial transactions and interviewed financial management officials.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal controls, misstatements due to error or fraud, losses or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

We did not test compliance with all laws and regulations applicable to DOT. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the DOT Consolidated Financial Statements for FY 2002 ended September 30, 2002, and FY 2001 ended September 30, 2001. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes. We also caution that our internal control testing may not be sufficient for other purposes.

We performed our work in accordance with U.S. generally accepted government auditing standards and OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

EXHIBIT B. FINANCIAL-RELATED REPORTS

<u>TITLE</u>	<u>REPORT NUMBER</u>	<u>DATE ISSUED</u>
Quality Control Review of Fiscal Years 2002 and 2001 Financial Statements, FAA`	QC-2003-017	January 27, 2003
Quality Control Review of Fiscal Year 2002 Financial Statements, TSA	QC-2003-016	January 27, 2003
Financial Statements for Fiscal Years 2002 and 2001, Highway Trust Fund	FI-2003-015	January 24, 2003
Actuarial Estimates for Retired Pay and Medical Benefits, USCG	FI-2003-014	January 22, 2003
Terminal Service Cost Accounting Practices, FAA	FI-2003-013	January 21, 2003
Top Management Challenges, DOT	PT-2003-012	January 21, 2003
Information Security Program, DOT	FI-2002-115	September 27, 2002
Vessel Documentation User Fees, USCG	FI-2002-110	September 18, 2002
Spending Money from Treasury Miscellaneous Receipts Accounts, DOT	FI-2002-108	September 12, 2002
Oversight of Cost-Reimbursable Contracts, FAA	FI-2002-092	May 8, 2002