

INACTIVE OBLIGATIONS

Federal Highway Administration

Report Number: FI-2004-039

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Memorandum

**U.S. Department of
Transportation**

Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION**: Report on
Inactive Obligations, FHWA
FI-2004-039

Date: March 31, 2004

From: Alexis M. Stefani 
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for Auditing and Evaluation

Reply to
Attn. of: JA-20:x61496

To: Federal Highway Administrator

This report addresses the results of our audit of inactive obligations at the Federal Highway Administration (FHWA). An “obligation” represents a liability that is created when an agency enters into a binding legal agreement, such as a grant.

The head of each agency is required to certify annually to the Department of the Treasury that obligated amounts are accurate and continue to represent valid liabilities. The success of efforts by FHWA to ensure obligated amounts continue to represent valid liabilities is a critical measure of the effectiveness of its financial management practices. When unneeded obligations for grants are identified, the funds should be deobligated and reapplied to other projects.

In today’s tight budget environment when highway investment needs exceed available resources, allowing unneeded obligations to sit idle on highway projects leaves fewer funds available for expanding and preserving National Highway System infrastructure, increasing mobility, and improving safety, all key FHWA performance goals.¹ Allowing funds to sit idle also affects state resources, because states generally have to contribute a certain percentage of their own funds to secure Federal grants for transportation and safety projects.²

We previously issued two audit reports that identified hundreds of millions of dollars of unneeded funds on FHWA projects. The first report, issued in

¹ FHWA’s FY 2002 Performance and Accountability Report addresses six strategic goals—safety, mobility, productivity (physical infrastructure), human and natural environment, national security, and organizational excellence—and describes FHWA’s progress meeting these goals.

² “The Conditions and Performance Report to Congress, on the 2002 Status of the Nation’s Highways, Bridges, and Transit,” Part II, indicates that even maintaining overall conditions and performance of highways and bridges at current levels through 2020 would require significantly more combined investment than currently experienced by all levels of government.

September 1999, identified unneeded obligations as a significant problem in FHWA, as well as the rest of the Department of Transportation (DOT). Responding to the report, FHWA deobligated \$284 million of funds that were no longer needed and implemented a policy to perform annual reviews of inactive obligations. Two years later, in September 2001, we found \$238 million in idle funds that could be deobligated and put to better use on other projects. In response, FHWA deobligated those funds and issued additional guidance requiring that FHWA Division Office Financial Managers meet with states prior to and during annual reviews of inactive obligations and review state records for a sample of inactive projects to verify whether the obligations were valid. FHWA Headquarters also required that Division Office Financial Managers reemphasize the importance of implementing best practice techniques and temporarily posted the techniques on its web site. FHWA also agreed to incorporate a performance measure to reduce inactive obligations in its Fiscal Year 2003 Performance Plan.

This report assesses the effectiveness of FHWA's corrective actions since our 2001 report addressing inactive obligations.³ Our audit objective was to determine whether FHWA's inactive obligations represent valid financial liabilities or can be used on other projects.

FHWA records show about \$33 billion was obligated for highway grants as of December 31, 2002. We identified about 30,000 obligations, totaling \$3.3 billion, with no activity within 18 months. Consistent with our prior two audits, we defined inactive obligations as those with no activity within 18 months. Our review did not include high priority or other earmarked projects. About \$1.3 billion of the \$3.3 billion was obligated on 484 projects with balances of \$1 million or more. About \$542 million was obligated on 782 projects with balances between \$500,000 and \$1 million. To complete the audit, we visited 10 states, where we reviewed project documentation and discussed project status with responsible state and FHWA officials. We also asked 35 other states to review projects with inactive obligation balances of \$1 million or more. Exhibit A further describes our audit scope and methodology. We performed the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

RESULTS IN BRIEF

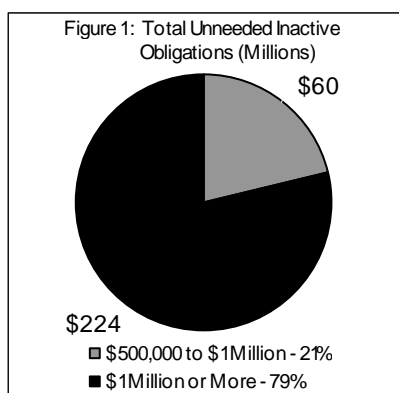
Despite prior audits and FHWA's implementation of policies to identify unneeded obligations, FHWA continues to maintain hundreds of millions of dollars in unneeded obligations. This audit identified \$284 million in unneeded obligations

³ Following this report, we plan to issue reports that address inactive obligations at the Federal Aviation Administration, Federal Transit Administration, and Maritime Administration.

on highway and related transportation grants. The obligations were unneeded primarily because they were associated with canceled, reduced scope, or completed Federal-aid transportation projects. The \$284 million represented 22 percent of the \$1.3 billion reviewed. FHWA and state officials agreed with our findings and are in the process of deobligating unneeded amounts.

Obligations for transportation projects we reviewed were associated with highway construction and improvement; safety; special projects, such as a parking garage; and emergency relief projects. We found transportation projects that had been canceled or completed but their obligated funds were allowed to sit idle for years. For example:

- One canceled project involved a \$28 million obligation to build a large parking garage adjacent to a station at the end of a subway line. Funds were obligated for the project in September 1992. The obligation balance was adjusted to \$25.5 million in August 2000, but no funds were expended for the project. This project was no longer needed because the subway line was being extended by four additional stations. Responding to our visit, the state agreed to deobligate the funds and apply them to other projects.
- One completed project involved a \$4.9 million obligation for highway reconstruction and maintenance, with the last expenditure made in February 2001. The project was completed in May 2002 for about \$2 million. State officials agreed to deobligate the remaining \$2.9 million, releasing it for use on other projects.

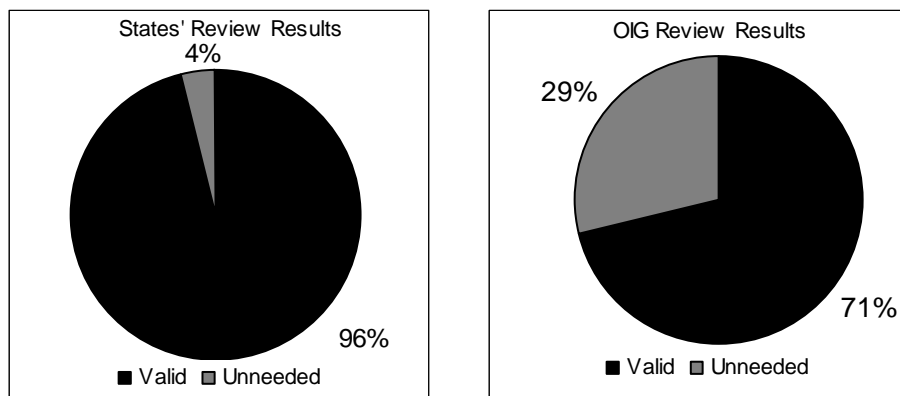


Unneeded obligations associated with these projects can be separated into two categories. As shown in Figure 1, about \$224 million of the \$284 million of unneeded obligations was associated with projects with obligated balances of \$1 million or more. The remaining \$60 million was for projects with obligated balances of \$500,000 to \$1 million.

The results of our reviews of projects with obligation balances of \$1 million or more highlights the limited effectiveness of state reviews and FHWA oversight. FHWA's policy requires states to review these obligations annually to identify unneeded obligations. FHWA Division Office Financial Managers are also

required to monitor the states' results. However, at the 10 states⁴ where we reviewed project documents and discussed project status with responsible officials, we identified a much higher proportion of unneeded obligations (29 percent) than did the 35 states that reviewed the obligations themselves (4 percent), as is shown in Figure 2.⁵

Figure 2. Comparison of Percentage of Unneeded Obligations Identified for Transportation Projects (\$1 Million and More)



Thus additional unneeded obligations probably exist at the states we did not visit. If the proportion of unneeded obligations we identified at the states visited is representative of the amounts available at the states we did not visit, we estimate that an additional \$106 million of unneeded inactive obligations could be deobligated and used on other projects.

FHWA does not currently review inactive projects with obligation balances of less than \$1 million. To determine whether that policy needs to be adjusted, we judgmentally selected a sample of projects below FHWA's threshold to determine whether states were adequately reviewing these inactive obligations. FHWA's records include 782 projects, totaling \$542 million, with obligated balances of between \$500,000 and \$1 million that had been inactive for 18 months or more. Of the 782 projects, we reviewed 220 projects totaling about \$159 million in obligations. We found that obligations for 88 of the 220 projects, totaling \$60 million or about 38 percent of the amount reviewed, were unneeded. Based on these results, FHWA could identify and redeploy significant additional unneeded obligations by amending its policy to begin reviewing inactive obligations at \$500,000. If the proportion of unneeded obligations in our sample is representative of the proportion that exists in other states, we estimate that

⁴ For purposes of this review and in accordance with FHWA practices, we are counting the District of Columbia and Commonwealth of Puerto Rico as states.

⁵ Seven states had no inactive obligations of \$1 million or more.

FHWA could identify an additional \$145 million in unneeded obligations. FHWA can amend its policy to again lower the dollar value threshold as improvements are made in reducing unneeded obligations of \$500,000 or more.

Reasons Unneeded Obligations Are Not Identified

Specific reasons that FHWA Division Offices and the states did not identify unneeded obligations include:

- States performed inadequate reviews of inactive obligations before reporting to FHWA Division Offices that the obligations were still needed. We found that states' reviews were inadequate at 7 of the 10 states we visited.
- States were not adequately monitoring projects managed by local governments. Because the five large states we visited did not receive information about the status of projects managed by local governments, the states were not in a position to know whether inactive obligations were still needed for these projects.
- FHWA Division Office Financial Managers accepted the states' determinations that inactive obligations were still needed without reviewing project documentation to verify the states' determinations. For example, one state merely copied responses from the prior annual review, which the responsible Division Office Financial Manager accepted without any further detailed review.
- FHWA Division Offices encouraged, rather than required, states to implement adequate processes, including using previously identified best practices to review inactive obligations. As a result, none of the 10 states we visited formally adopted the best practices, such as formulating written procedures and deobligating remaining amounts on completed projects awaiting close-out.
- FHWA's policy does not require reviews of projects with inactive obligations under \$1 million. Division Office Financial Managers reviewed only those inactive obligations with unliquidated balances of \$1 million or more. As a result, significant amounts of obligations are not being reviewed.
- FHWA's performance measure does not address implementing processes and procedures to eliminate unneeded inactive obligations. The performance measure is designed to measure the rate of expenditures and does not mention reducing inactive obligations. Additionally, FHWA Division Office Financial Managers' performance standards did not include a requirement that they work

with states to implement processes to reduce amounts of unneeded inactive obligations.

Conclusion and Recommendations

This is the third time in 6 years that we have identified hundreds of millions of dollars of idle funds from inactive transportation projects with unliquidated balances of \$1 million or more. Two prior reports identified \$284 million and \$238 million of unneeded obligations. This report identifies \$224 million with balances of \$1 million or more. Although FHWA committed to strengthen its oversight of inactive obligations in response to the prior reports, clearly its actions have not been effective.

To correct this longstanding problem, the FHWA Administrator needs to ensure that more aggressive steps are taken. We recommend that the FHWA Administrator:

1. Immediately direct Division Office Financial Managers to review inactive obligations at the 35 states we did not visit that had projects with inactive obligations over \$1 million to identify unneeded obligations. The reviews should include reviews of documentation and discussions with responsible state officials to determine the status of projects, and results should be reported to the Administrator by September 30, 2004.
2. Establish and implement policies and procedures that require Division Office Financial Managers annually to (1) work directly with state officials to identify unneeded obligations, and (2) ensure that all states implement an effective process based on already identified best practices to identify and deobligate unneeded funds.
3. Establish and implement policies and procedures that require that the Manager, Federal-aid Financial Management Division, periodically review the effectiveness of state office and Division Office practices to identify unneeded obligations and report the results to the Administrator.
4. Include a performance goal and measure specifically to reduce unneeded obligations in FHWA's Performance Plan. For example, a measure could be the number of states that have implemented effective processes to identify unneeded obligations.
5. Hold Division Office Administrators and Financial Managers accountable by including in their performance standards a requirement that they should work with state officials to identify unneeded inactive obligations and ensure that the state implements effective processes to identify unneeded obligations.

6. Revise the FHWA policy for reviewing inactive obligations by lowering the dollar value to \$500,000. FHWA should consider including a requirement to further lower the dollar value as the unneeded inactive obligations being identified decrease.
7. Immediately direct Division Office Financial Managers to review inactive obligations at the 43 states we did not visit that had projects with inactive obligations between \$500,000 and \$1 million to identify unneeded obligations. The reviews should include reviews of documentation and discussions with responsible state officials to determine the status of projects, and results should be reported to the Administrator by September 30, 2004.

Management Comments and Office of Inspector General Analysis

In its March 29, 2004 response to the draft report, FHWA stated that dealing with inactive obligations has been an emphasis area for the past few years. However, the continued existence of hundreds of millions of dollars of idle obligations identified in this report suggests otherwise. In fact, this is the third time in 6 years that we have identified (1) deficiencies in FHWA's process to free-up idle funds and (2) hundreds of millions of dollars of unneeded obligations. Prior agreements by FHWA to correct the problem have not succeeded because it has not made a commitment to aggressively tackle the problem. Until it does so, little improvement can be expected.

FHWA also did not clearly agree or disagree with any of the recommendations. To illustrate, responding to the first recommendation—that FHWA immediately direct Division Office Financial Managers to review inactive obligations at the 35 states we did not visit—FHWA commented that the states had already performed an annual review of the projects and reported the results to the OIG. The recommendation, however, is directed to FHWA Division Office Financial Managers, not the states.

This report also clearly demonstrates the need for active FHWA involvement. Figure 2 on page 4 of the report compares the results of the states' reviews (4 percent of inactive obligations identified as unneeded) to the results of more in-depth OIG reviews (29 percent identified as unneeded). If the proportion of unneeded obligations at the states we visited is representative of the amounts available at the states we did not visit, we estimate that an additional \$106 million in idle funds could be freed and used more productively on other projects.

As for the other recommendations, FHWA basically said that it would *consider* them as it develops a new financial oversight policy. In our opinion, this response is too general and vague for us to conclude that FHWA's actions will be responsive to our recommendations. Therefore, we are requesting that the Administrator provide more details on the specific actions FHWA will take to implement the recommendations and the timeframes for implementation. For example, FHWA should describe methods, such as use of a standard review guide or checklist of recommended procedures and best practices, that it plans to use to improve the annual reviews performed by states.

FINDINGS AND RECOMMENDATIONS

In 1999 and 2001, we reported that hundreds of millions of dollars in unneeded obligations existed in FHWA's accounting records. In response to those reports, FHWA acknowledged the need to strengthen its funds management efforts and took corrective actions to address the problem. Those actions included (1) creating an agencywide report from its Fiscal Management Information System (FMIS), titled the FMIS Q22A Report, to identify obligations of \$1 million and greater, (2) requiring FHWA Division Office and state officials to perform annual reviews of projects based on the report, and (3) establishing a performance measure for inclusion in the FHWA Performance Plan.

Despite these efforts, a significant amount of unneeded obligations still exists, indicating that more aggressive steps are needed. We reviewed \$1.3 billion of inactive obligations and identified \$284 million that no longer represented valid financial liabilities and that should be freed up to be used for other Federal-aid highway projects.

Unneeded obligations for highway projects can be separated into two parts. About \$224 million of the \$284 million of unneeded obligations were for projects with unobligated balances of \$1 million or more. The remaining \$60 million was for projects with unobligated balances between \$500,000 and \$1 million. We reviewed projects with inactive obligations between \$500,000 and \$1 million to determine whether FHWA can identify additional unneeded funds by reviewing projects with smaller balances.

Several deficiencies contributed to the problem of not identifying those inactive obligations that should be put to better use. First, 7 of 10 states performed inadequate or only cursory annual reviews of inactive projects, and 5 large states did not adequately monitor projects managed by local governments. Second, FHWA Division Office Financial Managers accepted states' determinations that inactive obligations were needed without reviewing project documentation and encouraged but did not require states to implement an effective process, including use of identified best practices when reviewing inactive obligations. Third, FHWA only reviewed inactive projects with unliquidated obligations of \$1 million or more. Fourth, FHWA does not have a performance measure that adequately addresses reducing unneeded obligations.

Federal-aid Transportation Projects

We performed an in-depth review of \$1.3 billion of inactive obligations and determined that an additional \$284 million, or 22 percent of the amount reviewed for transportation projects, were unneeded obligations that could be freed up to be

used on transportation projects at the states. We found \$224 million unneeded for projects with inactive balances of \$1 million or more and \$60 million unneeded for projects with inactive balances between \$500,000 and \$1 million.

Projects with Inactive Obligations of \$1 Million or More

We found \$207 million of unneeded obligations on projects with balances of \$1 million or more at states visited. Table 1 summarizes the results of our reviews for the states we visited.

**Table 1. Inactive Obligations for Transportation Projects
With Balances of \$1 Million or More,
As of December 31, 2002**

Item	States Visited	Inactive Obligations Reviewed (Millions)	Unneeded Obligations	
			Millions	Number of Projects
1	California	\$229	\$113	18
2	District of Columbia	25	25	1
3	Georgia	64	17	5
4	Hawaii	26	4	3
5	Maryland	17	5	3
6	New Jersey	14	4	3
7	New York	84	6	3
8	Pennsylvania	82	7	3
9	Texas	78	4	1
10	Virginia	87	22	13
	Total	\$706	\$207	53

The following examples show the types of projects we identified with obligations that should have been deobligated and made available for use on other projects.

- In one state, about \$28 million was obligated in September 1992 to construct a large parking garage adjacent to a subway station. The obligation balance was reduced to \$25.5 million in August 2000. The project was cancelled when a decision was made to add four stations to the subway line, three of which were to have significant parking facilities. As a result of our recommendation, the state is in the process of deobligating the \$25.5 million for use on other projects.

- In one state, about \$17.6 million of emergency relief funds was obligated to open roads that were damaged by flooding and mudslides. The last expenditure for the project was in December 1999. As a result of our recommendation, state and FHWA officials agreed that the unexpended balance of about \$7.8 million would be deobligated and used on other emergency relief projects.
- Planned right-of-way acquisitions totaling about \$34.2 million for five construction projects in one state were funded separately from the related construction projects. Although the right-of-way acquisitions were completed by December 2000, remaining unused amounts of about \$8.6 million were never deobligated. State officials agreed to deobligate the remaining amount and use the funds on other projects.
- A \$1.8 million project to perform preliminary engineering for the reconstruction of a highway was withdrawn because the state did not program adequate funds to complete the project. Funds were obligated for the project in December 1997, but nothing was expended. The state agreed to deobligate the \$1.8 million, as well as about \$6 million for four other projects for similar reasons. Deobligated amounts will be used on other highway projects.
- In one state, about \$4.9 million was obligated for a highway reconstruction and maintenance project. The project was completed in May 2002 for about \$2 million. As a result of our recommendation, state officials agreed to deobligate the remaining \$2.9 million for use on other projects.
- In one state, \$3.7 million was obligated in April 1999 for roadway reconstruction, but no expenditures were made because approvals were not obtained from the public utility. State officials advised us that the project will be withdrawn and that funds will be deobligated and used for other projects.

In addition to states visited, 35 states not visited performed their own reviews and identified an additional \$17 million in unneeded obligations on projects with balances of \$1 million or more.

Projects with Inactive Obligations of Under \$1 Million

As of December 31, 2002, FHWA had 782 projects, totaling \$542 million, with obligation balances between \$500,000 and \$1 million. We reviewed 220 of these projects at 9 of the 10 states visited, with a total of about \$159 million in obligations, to determine whether states were adequately reviewing inactive obligations below FHWA's review threshold. We found that obligations for 88 of

the 220 projects, totaling \$60 million or about 38 percent of the amount reviewed, were unneeded, as is shown in Table 2.

Table 2. Inactive Obligations for Transportation Projects Between \$500,000 and \$1 Million As of December 31, 2002

#	States*	Inactive Obligations Reviewed From \$500,000 to \$1 Million (Millions)	Unneeded Obligations (Millions)
1	District of Columbia	\$7	\$6
2	Georgia	10	8
3	Hawaii	20	12
4	Maryland	12	5
5	New Jersey	5	1
6	New York	35	2
7	Pennsylvania	29	9
8	Texas	19	5
9	Virginia	22	12
	Total	\$159	\$60

* We reviewed inactive obligations between \$500,000 and \$1 million at 9 of the 10 states we visited. The exception, California, had a significant number of projects with inactive obligations of \$1 million or more. Due to the time required to review these projects, we did not review inactive obligations from \$500,000 to \$1 million during our field visit.

The following examples show the types of projects with obligations that should have been deobligated and made available for use on other projects.

- Construction work on an interchange project was completed and a final voucher was submitted in September 1992. However, the remaining funds of about \$658,000 were never deobligated. According to FHWA's and states' best practice techniques, the obligated amount in excess of the amount billed in the final voucher should have been deobligated. State officials agreed to deobligate the entire amount.
- A local government was responsible for managing a project for bridge inspections. Although \$506,000 was obligated in July 1999 to complete the inspections, nothing was expended. State officials agreed to deobligate the entire amount.

- In one state, about \$1,000,000 was obligated in June 1997 for widening a section of an interstate highway. The last expenditure was in June 2001, and the total expended for the project was about \$142,000. State officials agreed to deobligate the remaining \$858,000 for use on other projects.

If the proportion of unneeded obligations we identified is representative of the total amount of inactive obligations for the remaining projects with balances between \$500,000 and \$1 million, we estimate that about \$145 million in additional unneeded obligations could be deobligated and used to fund other projects.

Additional Unneeded Obligations Probably Exist

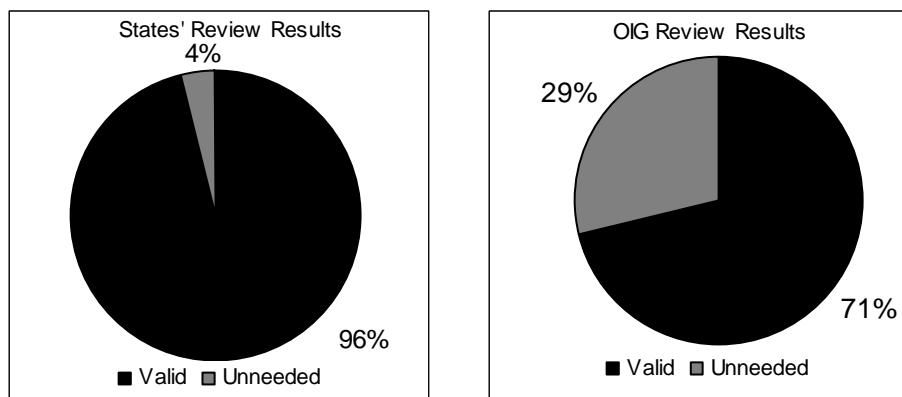
Relying on the states to identify unneeded obligations without adequate oversight was not effective. We identified a much higher amount of unneeded obligations at the 10 states we visited compared to the states we did not visit.

At states visited, we reviewed documents of projects with inactive obligations of \$1 million or more and discussed each project's status with responsible officials. We determined that 29 percent of the obligation balances reviewed were unneeded (\$207 million unneeded of \$706 million reviewed). This was after the states had completed their annual reviews of inactive obligations.

We requested that 35 other states review their projects and provide us the results of their reviews. We did not ask the remaining seven states to review their projects because they had no inactive obligations of \$1 million or more. The 35 states that performed the reviews themselves identified only 4 percent of the obligation balances as unneeded (\$17 million unneeded of \$419 million reviewed).

Differences in amounts deobligated for transportation projects depending on whether states or the DOT-OIG conducted the reviews are shown in Figure 3.

Figure 3. Comparison of Percentage of Unneeded Obligations Identified for Transportation Projects (\$1 Million and More)



The analysis shows that there may be significantly more funds that should be deobligated at states that conducted their own reviews. If the proportion of unneeded obligations we identified at states we visited applied to states not visited, we estimate that an additional \$106 million of unneeded inactive obligations could be deobligated and used on other projects.

Reasons Unneeded Inactive Obligations Were Not Identified

Several reasons contributed to the problem of not identifying those inactive obligations that could be put to better use. First, 7 of 10 states performed inadequate annual reviews of inactive projects, and 5 large states did not adequately monitor projects managed by local governments. Second, FHWA Division Office Financial Managers accepted states' determinations that inactive obligations were needed without reviewing project documentation and encouraged but did not require states to use identified best practices when reviewing inactive obligations. Third, FHWA only reviewed inactive projects with unliquidated obligations of \$1 million or more. Fourth, FHWA does not have a performance measure that adequately addresses reducing unneeded obligations.

Adequacy of States' Reviews of Inactive Obligations

The states are required to perform funds management activities, including reviewing projects with inactive obligations and promptly releasing unneeded obligation amounts. However, at 7 of 10 states visited we found that the states' reviews were not adequately performed. Hundreds of millions of dollars of unneeded inactive obligations were not being identified and deobligated. Reviews were not thorough enough, and the states were not implementing the best practices for reviewing inactive obligations. Additionally, states lacked documenting evidence to demonstrate that detailed reviews were being performed. Based on the results of our more thorough procedures, officials at the 10 states we visited

deobligated about \$207 million, 29 percent of the total reviewed, for projects with inactive obligation balances of \$1 million or more.

We found examples where officials merely copied the prior year's response when responding to the annual review. Also, officials responsible for reviews at some states did not have documentation to support their determinations and ultimately reversed their decisions after we requested and began reviewing the documentation.

As part of the annual project funds management review, FHWA required the states to use the FMIS Q22A report and provide them results of their review of projects with no billing activity for the past year and an unexpended balance of \$1 million or more as of December 31, 2002. The reviews performed by the 52 states⁶ covered 604 projects totaling \$1.7 billion in unexpended balances. The 52 states identified approximately \$146 million or 9 percent of unneeded obligations that could be released and reapplied to other projects. About \$62 million of the unneeded obligations identified by states were deobligated before we started our review.

Our review procedures included reviewing supporting documentation and questioning state managers regarding the necessity of the obligation balances for the projects reviewed. We also questioned officials responsible for projects to determine whether obligations were still needed for projects that were never started or which had not had any expenditure for years. As a result, state officials and project managers agreed that unneeded obligations existed and began deobligating unneeded balances.

Projects Managed by Local Governments

Five states with large urban areas did not perform adequate oversight of projects managed by local governments. Projects, such as implementing the use of traffic signals or installing walkways, were managed by local government officials, who were ultimately responsible for determining the necessity of inactive obligations for these projects. States are required to oversee the local projects to ensure that funds are managed efficiently, but officials at five states visited had difficulty tracking and determining the status of the local projects.

For example, during our August 2003 visit, the New Jersey FHWA Division Office Financial Manager and state officials were unable to provide us with the status of and supporting documentation for 13 projects totaling \$18 million managed by the local governments. Twelve of the thirteen projects,

⁶ For purposes of this review and in accordance with FHWA practices, we are counting the District of Columbia and Commonwealth of Puerto Rico as states.

totaling \$15.3 million, were obligated between 1997 and 2001, but nothing was expended. The New Jersey Division Office eventually provided us a response indicating that the funds were still needed for all of the projects.

In addition to New Jersey, FHWA Division Office and state financial managers in California, New York, Pennsylvania, and Maryland also had difficulty tracking the status of projects managed by local officials. States and FHWA Division Office Financial Managers should periodically visit local governments or otherwise obtain supporting documentation from local officials for use in their annual reviews.

Adequacy of FHWA Division Offices' Reviews of Inactive Obligations

The processes used by FHWA Division Office Financial Managers to review states' determinations on the necessity of inactive obligations were not sufficient in 6 of 10 states visited. When performing their annual reviews, FHWA Division Office Financial Managers did not work closely with state officials reviewing inactive obligations and frequently accepted states' determinations without verifying whether inactive obligations were still needed. Supporting documentation was not being reviewed and key state officials, such as Federal-aid managers, project managers, engineers, and budget and accounting officials, were not sufficiently questioned regarding the status of the projects. For example, although many of the projects were either completed or canceled, the Division Office Financial Managers did not challenge the states' conclusions that funds were still needed.

At one state we visited, the FHWA Division Office Financial Manager said he relied totally on the state Federal-aid manager and accepted whatever the state decided to do. To adequately review projects, Division Office Financial Managers should perform a detailed review of supporting documentation and question key state and local officials.

Establishing Effective Processes and Using Best Practices

FHWA Division Offices and state departments of transportation we visited did not formally institute FHWA-identified best practices, such as formulating written procedures for managing inactive projects and deobligating remaining amounts for completed projects awaiting close-out. When FHWA Division Financial Managers did ensure that that states implemented effective processes, we found a lower percentages of unneeded inactive obligations.

For example, the FHWA Financial Manager at the Texas Division Office ensured effective processes were used for reviewing obligations. The FHWA Texas Division Office Financial Manager met regularly with state officials to determine

the status of projects. The Financial Manager also requested written documentation from the state on the status of projects managed at various state district offices. These practices helped the FHWA Financial Manager and state officials better identify completed and canceled projects and track projects managed at the local level. The FHWA Division Office Financial Manager also ensured that the state implemented other best practices including reducing obligated balances on completed projects waiting final vouchers or audits. As a result, we found a low percentage of unneeded inactive obligations in Texas.

In response to earlier OIG findings on inactive obligations, FHWA and the states identified best practices in a March 1999 report. The best practices included techniques such as: (1) formalizing states' procedures for managing inactive projects and closing completed projects, (2) entering agreements to close projects and deobligate funds before final audits are completed, (3) forming joint FHWA and state teams to meet regularly and review funding needs on inactive projects, (4) establishing policies that separate financial requirements from engineering and other nonfinancial requirements that prevent closing completed projects, and (5) including clauses in contracts to require that final vouchers be submitted within a specified time after the work is completed.

In its latest Project Funds Management Process Improvement Review, dated December 2002, FHWA concluded that recommended best practices were not consistently applied and cited the need to implement best practices for managing inactive obligations. However, FHWA still has not required Division Offices and the states to implement best practices.

Until the FHWA Division Offices and state departments of transportation formally implement and consistently apply the best practices for managing inactive obligations, significant amounts of inactive obligations will continue to exist.

Using Performance Measures and Performance Management Techniques

FHWA financial managers need to be held accountable for ensuring that the level of unneeded obligation is kept to a lower amount. Our September 2001 report included a recommendation to "develop and include a performance measure in the FHWA Performance Plan for reducing inactive obligations." Although FHWA incorporated a performance measure addressing funds management in its FY 2003 Performance Plan, the performance measure does not mention reducing unneeded inactive obligations. Additionally, FHWA Division Office Financial Managers performance standards do not require that their performance be measured in part based on ensuring that unneeded inactive obligations are being identified by state officials.

FHWA incorporated a performance measure in its FY 2003 Performance Plan to “reduce the annual amount of Federal-aid funds obligated, but not expended, by 10 percent from the previous year.” That measure should encourage states to start work, incur expenditures, and complete projects sooner. However, it does not focus on eliminating unneeded inactive obligations. Accordingly, we are repeating our recommendation that FHWA implement a performance measure to specifically address reducing unneeded inactive obligations. For example, a performance measure could be to measure the number of states that have implemented effective processes to identify unneeded obligations.

To ensure that FHWA’s performance goals are met, FHWA should require that FHWA Division Office Financial Managers’ performance standards include a requirement that they work with state officials to identify unneeded obligations and ensure that the state implements effective processes to reduce unneeded inactive obligations, including using identified best practices.

RECOMMENDATIONS

We recommend that the FHWA Administrator:

1. Immediately direct Division Office Financial Managers to review inactive obligations at the 35 states we did not visit that had projects with inactive obligations of \$1 million or more to identify unneeded obligations. The reviews should include reviews of documentation and discussions with responsible state officials to determine the status of projects, and results should be reported to the Administrator by September 30, 2004.
2. Establish and implement policies and procedures that require Division Office Financial Managers annually to (1) work directly with state officials to identify unneeded obligations, and (2) ensure that all states implement an effective process based on already identified best practices to identify and deobligate unneeded funds.
3. Establish and implement policies and procedures that require that the Manager, Federal-aid Financial Management Division, periodically review the effectiveness of state office and Division Office practices to identify unneeded obligations and report the results to the Administrator.
4. Include a performance goal and measure specifically to reduce unneeded obligations in FHWA’s Performance Plan. For example, a measure could be the number of states that have implemented effective processes to identify unneeded obligations.

5. Hold Division Office Administrators and Financial Managers accountable by including in their performance standards a requirement that they should work with state officials to identify unneeded inactive obligations and ensure that the state implements effective processes to identify unneeded obligations.
6. Revise the policy for reviewing inactive obligations by lowering the dollar value threshold to \$500,000 and by including a requirement to further lower the dollar value as the unneeded inactive obligations being identified decrease.
7. Immediately direct Division Office Financial Managers to review inactive obligations at the 43 states we did not visit that had projects with inactive obligations between \$500,000 and \$1 million to identify unneeded obligations. The reviews should include reviews of documentation and discussions with responsible state officials to determine the status of projects, and results should be reported to the Administrator by September 30, 2004.

MANAGEMENT COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In its March 29, 2004 response to the draft report, FHWA stated that dealing with inactive obligations has been an emphasis area for the past few years. (FHWA's comments are reproduced in the Appendix.) However, the continued existence of hundreds of millions of dollars of idle obligations identified in this report suggests otherwise. In fact, this is the third time in 6 years that we have identified (1) deficiencies in FHWA's process to free-up idle funds and (2) hundreds of millions of dollars of unneeded obligations. Prior agreements by FHWA to correct the problem have not succeeded because it has not made a commitment to aggressively tackle the problem. Until it does so, little improvement can be expected.

FHWA also did not clearly agree or disagree with any of the recommendations. To illustrate, responding to the first recommendation—that FHWA immediately direct Division Office Financial Managers to review inactive obligations at the 35 states we did not visit—FHWA commented that the states had already performed an annual review of the projects and reported the results to the OIG. The recommendation, however, is directed to FHWA Division Office Financial Managers, not the states.

This report also clearly demonstrates the need for active FHWA involvement. Figure 2 on page 4 of the report compares the results of the states' reviews (4 percent of inactive obligations identified as unneeded) to the results of more in-depth OIG reviews (29 percent identified as unneeded). If the proportion of unneeded obligations at the states we visited is representative of the amounts

available at the states we did not visit, we estimate that an additional \$106 million in idle funds could be freed and used more productively on other projects.

As for the other recommendations, FHWA basically said that it would *consider* them as it develops a new financial oversight policy. In our opinion, this response is too general and vague for us to conclude that FHWA's actions will be responsive to our recommendations. Therefore, we are requesting that the Administrator provide more details on the specific actions FHWA will take to implement the recommendations and the timeframes for implementation. For example, FHWA should describe methods, such as use of a standard review guide or checklist of recommended procedures and best practices, that it plans to use to improve the annual reviews performed by states.

ACTION REQUIRED

In accordance with Department of Transportation Order 8000.1C, we request that you provide a response within 30 days to this report that clearly indicates whether you agree or disagree with each of the recommendations. If you agree with a recommendation, please provide details on the actions and methods that you plan to use to implement the recommendation and provide a time table for implementing the recommendation. If you do not concur, please provide your rationale. You may provide alternative courses of action that you believe would resolve the issues presented in this report.

We appreciate the courtesies and cooperation of Federal Highway Administration representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-1992 or Ted Alves, Assistant Inspector General for Financial and Information Technology Audits, at (202) 366-1496.

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EXHIBIT A. SCOPE & METHODOLOGY

FHWA had recorded grant obligations of about \$33 billion as of December 31, 2002. The bulk of the \$30 billion distributed each year is apportioned to the states to fund investments in highway infrastructure and safety programs. Using computer queries of the Departmental Accounting and Financial Information System (DAFIS), we identified 29,896 obligations, totaling \$3.3 billion, which had had no activity for 18 months. Of the \$3.3 billion, \$1.3 billion represented 484 projects with balances of \$1 million or more, and \$542 million represented 782 projects with balances between \$500,000 and \$1 million.

The objective of this audit was to determine if FHWA's inactive obligations represented valid financial liabilities or could be used on other projects. We did not include high priority or earmark projects in our review. To determine whether inactive obligations recorded in FHWA accounting records represented valid financial liabilities, we reviewed inactive obligations of \$1 million or more. To assess the impact of revising FHWA's policy to include reviews of inactive obligations of less than \$1 million, we also reviewed inactive obligations between \$500,000 and \$1 million.

We judgmentally selected 10 states for our site visits: California, New York, Pennsylvania, New Jersey, Hawaii, Virginia, Texas, Georgia, Maryland, and the District of Columbia. These states were selected based on dollar amounts and the number of inactive obligations projects. For the 10 states visited, we reviewed 253 projects with inactive obligation balances of about \$706 million, which represented projects with inactive obligations of \$1 million or more. At the 35 states not visited with inactive obligations of \$1 million or more, we asked state officials to review 172 projects, totaling about \$419 million. In total, \$1.125 billion of inactive obligations of \$1 million or more at 10 states visited and 35 states not visited were included in this review.

In addition, for 9 of the 10 states visited, we judgmentally selected 220 projects, totaling about \$159 million, from projects with obligated balances between \$500,000 and \$1 million for inclusion in our audit. California had a significant number of projects with inactive obligations greater than \$1 million and due to the time required to review these projects, we did not review its inactive obligations of between \$500,000 and \$1 million during our field visit.

At the states visited, we requested that FHWA Division Office Financial Managers provide support to validate the obligated amounts. We also visited state offices,

Exhibit A. Scope & Methodology

interviewed project fund managers and program and accounting officials, and reviewed obligating documents, including project files, to evaluate the monitoring of selected projects and the use of best practices. At the 35 states not visited, we sent information to the Financial Managers of the FHWA Division Offices requesting that states provide the status of projects with inactive obligations balances of \$1 million or more.

We relied on automated information in DAFIS (the Departments' prior accounting system) as the primary source for identifying our universes of inactive obligations. We relied on information from Delphi, DOT's new financial management system, to identify the status of obligation balances. We also relied on obligation and expenditure information in FMIS. Although significant general and security control weaknesses exist for each of these systems, we were able to substantiate the accuracy of the data by comparing the information to data maintained at the states or to supporting obligating records maintained by FHWA.

We conducted the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States. Our audit was conducted from April 2003 through March 2004. There was no indication of the existence or occurrence of fraud related to whether the inactive obligations reviewed represented valid liabilities.

EXHIBIT B. PRIOR AUDIT COVERAGE

OIG AUDIT REPORT NUMBER FE-2001-097, “INACTIVE OBLIGATIONS, FEDERAL HIGHWAY ADMINISTRATION,” SEPTEMBER 24, 2001

Our audit identified \$2.6 billion of FHWA’s obligations that had been inactive for 18 months as of March 31, 2001. Of the total inactive obligation amount, we reviewed \$670 million and identified \$238 million that no longer represented valid financial liabilities that could either be used for valid transportation projects or be returned to the United States Treasury General Fund. We recommended FHWA (1) provide guidance requiring that FHWA Division Office Financial Managers meet with states before and during annual reviews of inactive obligations and review available state records for a sample of inactive projects, (2) reemphasize to FHWA Division Office Financial Managers and the states the importance of implementing best practices when reviewing projects with inactive obligation balances, and (3) develop and include a performance measure in the FHWA Performance Plan for reducing inactive obligations.

OIG AUDIT REPORT NUMBER FE-1999-131, “INACTIVE OBLIGATIONS, DOT,” SEPTEMBER 27, 1999

DOT and its Operating Administrations had recorded obligations totaling \$51.2 billion as of March 31, 1999. Based on computer inquiries, we identified about 63,000 obligations, totaling \$5.1 billion, with no activity within 18 months. In a joint effort with the Operating Administrations, we identified \$672 million of recorded obligations that no longer represented valid DOT financial liabilities and could be used for other needs or returned to the U.S. Treasury.

About \$36 billion in recorded obligations belonged to FHWA. Of those, about \$3.2 billion had been inactive for 18 months as of March 31, 1999. We identified about \$284 million of inactive obligations at FHWA that no longer represented valid financial liabilities. We recommended that DOT establish a policy requiring that annual reviews of inactive obligations be performed.

**OIG AUDIT REPORT NUMBER TR-1998-045, “MANAGEMENT
ADVISORY ON UNEXPENDED OBLIGATIONS ON COMPLETE
AND INACTIVE HIGHWAY PROJECTS,” DECEMBER 11, 1997**

As of December 31, 1996, FHWA had \$4 billion of unexpended obligations with no activity for 12 or more months that were associated with completed projects. We conducted a review of unexpended obligations in four states that accounted for \$1.2 billion of the \$4 billion of unexpended balances. We found that FHWA and the states kept excess funds obligated for as long as 12 years on 43 of the 80 projects audited. These excess funds totaled \$32 million of \$118.8 million audited at the four states. We recommended, and the FHWA Administrator agreed, that FHWA develop plans and procedures, including performance goals, for managing excess funds on complete and inactive highway projects.

EXHIBIT C. MAJOR CONTRIBUTORS TO THIS REPORT

THE FOLLOWING INDIVIDUALS CONTRIBUTED TO THIS REPORT.


<u>Name</u>	<u>Title</u>
Ted Alves	Assistant Inspector General for Financial and Information Technology Audits
Terrence Letko	Program Director
Michael Ralph	Project Manager
Leonard Meade	Project Manager
Linda Toms	Senior Auditor
Clarence Fujimoto	Senior Auditor
Sharon Ayers	Senior Auditor
LaKarla Lindsay	Senior Auditor
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Jelilat Ojodu	Auditor
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William Savage	Computer Specialist
Shirley Murphy	Editor
Kathleen Huycke	Editor



U.S. Department
of Transportation
**Federal Highway
Administration**

Memorandum

Subject: **INFORMATION:** FHWA Comments on Draft Report
on Inactive Obligations Project No. 04F3001F000 Date: March 29, 2004

From: Mary E. Peters
Administrator  Reply Refer To: HABF-20

To: Theodore Alves
Assistant Inspector General for Financial and
Information Technology Audits (JA-20)

Thank you for the opportunity to provide comments on your draft audit report regarding Inactive Obligations. This has been an emphasis area within the Federal Highway Administration (FHWA) during the past few years. Following are our comments on the specific audit recommendations:

- 1. Immediately direct Division Office Financial Managers to review inactive obligations at the 35 States we did not visit that had projects with inactive obligations of \$1 million or more to identify unneeded obligations.**

The 35 States that were not visited by the OIG did perform an annual review of projects with inactive obligations of \$1 million. This information was provided to the Office of Budget and Finance and your office was also provided a spreadsheet that included this information listed by State and amount of funds identified for de-obligation.

- 2. Establish and implement policies and procedures that require Division Office Financial Managers annually to: (1) work directly with State officials to identify unneeded obligations, and (2) ensure that all States implement an effective process based on already identified best practices to identify and de-obligate unneeded funds.**

In response to the findings of the FY 2003 Financial Statement audit, we have established a team of Division, Resource Center, and Headquarters personnel to develop a financial oversight policy and review program, which includes specific review requirements. The issue of inactive projects will be included in the policy and review program. We expect that the team will develop a new financial oversight policy by the end of the fiscal year.

3. **Establish and implement policies and procedures that require that the Manager, Federal-aid Financial Management Division, periodically review the effectiveness of State Office and Division Office practices to identify unneeded obligations and report the results to the Administrator.**

This aspect will be addressed as part of the new financial oversight policy.

4. **Include a performance goal and measure specifically to reduce unneeded obligations in FHWA's Performance Plan. For example, a measure could be the number of States that implemented effective processes to identify unneeded obligations.**

This aspect will be considered as part of the new financial oversight policy.

5. **Hold Division Office Administrators and Financial Managers accountable by including in their performance standards a requirement that they should work with State officials to identify unneeded inactive obligations and ensure that the State implements effective processes to identify unneeded obligations.**

This aspect will be considered as part of the new financial oversight policy.

6. **Revise the policy for reviewing inactive obligations by lowering the dollar value threshold to \$500,000 and by including a requirement to further lower the dollar value as the unneeded inactive obligations being identified decreases.**

This aspect will be considered as part of the new financial oversight policy.

7. **Immediately direct Division Office Financial Managers to review inactive obligations at the 43 States we did not visit that had projects with inactive obligations between \$500,000 and \$1 million to identify unneeded obligations.**

As mentioned in response to item #1 above, all Divisions have completed their current review at the \$1 million threshold. After establishment of the new financial oversight policy and review program, Division offices will conduct their annual review based on the thresholds established in the policy.

If you or your staff has any questions, please contact Sandra L. Weisman, Director, Office of Budget and Finance at (202) 366-0622.