Inactive Obligations

Federal Highway Administration

Report Number: FI-2001-097
Date Issued: September 24, 2001

Memorandum

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

Subject: **ACTION**: Report on Inactive Obligations, FHWA FI-2001-097

Date: September 24, 2001

From: Alexis M. Stefani
Assistant Inspector General for Auditing

Reply To Attn Of: Meche:x61496

To: Chief Financial Officer
Federal Highway Administration

This report presents our audit results on inactive obligations in the Federal Highway Administration (FHWA). For purposes of this audit, we defined inactive obligations as those recorded obligations that had no activity within 18 months.

Our audit objective was to determine whether inactive obligations represented valid financial liabilities. This audit was performed in conjunction with our Chief Financial Officers Act responsibilities to opine on the Highway Trust Fund Financial Statements for Fiscal Year (FY) 2001.

RESULTS IN BRIEF

FHWA had recorded obligations totaling about $42 billion as of March 31, 2001. We identified about 25,000 obligations, totaling about $2.6 billion, that had no activity within 18 months. In a joint effort with FHWA and State Departments of Transportation (States), we identified in the 10 States reviewed about $238 million of recorded obligations that no longer represented valid financial liabilities.

We found that FHWA was identifying inactive obligations for annual reviews by States as required by Department of Transportation (DOT) policy. However, in most instances, FHWA division financial managers accepted the States' determinations without asking for specific reasons as to why funds were not being used. Consequently, as part of the required annual reviews, FHWA division financial managers should review a sample of inactive projects to verify the need for inactive obligations.

FHWA and the States agreed with our results, and are in the process of closing, or already have closed, unneeded obligations. The $238 million will be used for other valid transportation projects or returned to the United States Treasury General Fund.

BACKGROUND

The General Accounting Office (GAO) Principles of Appropriations Law state an obligation creates a liability on the part of the Government to make a payment at some later time. Title 31, United States Code, Section 1501 (31 U.S.C. 1501) states that obligations of the United States shall be recorded only when supported by documentary evidence. According to 31 U.S.C. 1108, the head of an agency shall submit an annual certification, supported by records, showing compliance with Section 1501.

Agencies are required to review unliquidated obligations prior to certification. The Treasury Financial Management Bulletin 2001-06 states:

> ***Agencies that have not reviewed their unliquidated obligations during the year must do so before yearend closing. This ensures agencies properly record transactions meeting the criteria of valid obligations set forth in 31 U.S.C. 1501.***

In September 1999,[1] we recommended that the DOT Assistant Secretary for Budget and Programs and Chief Financial Officer establish a departmentwide policy requiring annual reviews of inactive obligations.

On December 28, 1999, DOT issued its "Policy for Active Validation of Obligations," requiring that DOT Operating Administrations annually review obligations and expenditures to determine whether obligated amounts that are unexpended do not exceed estimated needs. The Operating Administrations are required to review all unexpended obligations over $5 million; projects with unexpended obligations over $1.5 million and no expenditures for 18 months; and unexpended obligations over $500,000 with no expenditures for 30 months.

SCOPE AND METHODOLOGY

FHWA had recorded obligations of about $42 billion as of March 31, 2001. Using computer inquiries into the Departmental Accounting and Financial Information System, we identified about 25,000 obligations, totaling $2.6 billion, that had no activity for 18 months. We judgmentally selected 10 States with inactive obligations totaling about $670 million to be included in the audit. The chart on the next page shows the 10 States and amounts of inactive obligations we reviewed.

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[1] Report on Inactive Obligations, DOT, Report Number FE-1999-131, September 27, 1999.

We nonstatistically selected 153 inactive obligations from projects with obligated balances of more than $700,000. We requested that FHWA division financial managers provide support to validate the obligated amounts. We also made site visits to FHWA Division and State offices in the 10 States, interviewed program and accounting officials, and reviewed obligating documents, including grant agreements and project files, to evaluate the monitoring of selected projects.

We conducted the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States. Our audit was conducted from May through August 2001.

ANALYSES AND RECOMMENDATIONS

Reviewing Unneeded Obligations

In 10 States, we identified a total of $238 million of recorded obligations that no longer represented valid financial liabilities. The chart below shows our results by State.

Inactive and Unneeded Obligations

State	Inactive Obligations Reviewed (Millions)	Unneeded Obligations (Millions)
California	$319	$132
Connecticut	88	55
Maryland	30	21
Virginia	54	10
Florida	26	7
Massachusetts	36	6
Tennessee	29	3
Rhode Island	11	3
Georgia	40	1
Arizona	37	0
Total	**$670**	**$238**

FHWA identified inactive obligations as of December 31, 2000, and provided these to States for the annual review as required by DOT policy. We found that the FHWA/States reviews could be improved. The examples discussed below show that effective reviews could have identified significant amounts of funds that could have been deobligated and made available for use on other projects.

- In FY 1985, about $54 million was obligated to construct a freeway. The project was never started because the U.S. Army Corps of Engineers withheld approval. FHWA asked the State to provide a feasible plan for advancing the project or face a possible withdrawal of funds. On July 17, 2001, the State responded that it will submit a plan for using the funds on alternate projects.

- In FY 1993, about $120 million of credit authority was obligated to provide annual financing as needed to maintain a toll road. Federal funds could not be used unless annual expenses exceeded tolls collected. The State collected sufficient tolls to cover expenses and none of the Federal funds had been used for the 4 years ended July 2001. FHWA deobligated $48 million on September 21, 2001.

- Right-of-way portions for nine construction projects in one State were funded separately from the construction projects. Although the right-of-way projects were completed from 2 to 9 years ago, unneeded funds were not deobligated. After our review, the State deobligated $17 million and reprogrammed the excess funds to other projects.

- One project to relocate utility services had been completed about 2 years ago. The State agreed to deobligate $2.6 million.

- The State canceled the construction of a ramp for an Interstate highway project in September 1998. However, FHWA never closed the project. FHWA officials agreed to deobligate $2.5 million in excess funds.

Monitoring Inactive Projects

FHWA was performing annual reviews of inactive obligations. However, we found that in most instances FHWA division financial managers were accepting States' responses without asking for explanations as to why obligations remained open on projects with no activity. However, when we asked for support that these inactive obligations still were needed, States began to deobligate funds. This shows that, to be effective, FHWA needs to independently verify the needs for inactive obligations. FHWA and States agreed that $238 million should be deobligated for the inactive obligations that we questioned.

Using Best Practices

FHWA and States were not applying recommended best practices. FHWA and States prepared a joint report[2] describing best practices such as: (1) forming joint teams to meet regularly and review funding needs on inactive projects; (2) entering agreements to deobligate unneeded funds on completed projects awaiting determination of final costs; (3) assigning people part-time or full-time to review inactive projects; and (4) establishing written guidelines for managing inactive projects.

We found only 1 of the 10 States we visited was applying these best practices techniques. For this State, we found that all recorded obligations were valid.

Establishing Performance Measure

The Government Performance and Results Act of 1993 requires that agencies establish strategic goals. To improve the effectiveness of programs and internal management, agencies are to establish performance goals and related measures to achieve these strategic goals.

FHWA's FY 2002 Performance Plan includes a performance goal to improve delivery of Federal-aid and Federal Lands Highway programs, and establishes a performance measure addressing timely delivery of Federal funds to the States. This is a worthy measure. However, another performance measure for reducing the percentage of inactive obligations would further enhance efficient use of these limited funds. Deobligating funds that are no longer needed would allow reprogramming for use on other highway projects.

Efficient use of funds on inactive and invalid projects has been a continuing problem. For example, this is our third audit report addressing this issue since December 1997 (see Exhibit). Our two previous reports identified a total of $316 million of unneeded obligations. States continue to hold funds on projects where Federal funds are no longer required. Establishing a performance measure to reduce the percentage of inactive funds by eliminating invalid obligations will encourage FHWA and States to use more effective practices when managing Federal funds.

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[2] FHWA Report "National Quality Financial Management Initiatives, Project Funds Management, March 1999.

Recommendations

We recommend that the FHWA Chief Financial Officer in coordination with the Chief, Federal-aid Financial Management Division:

1. Provide guidance requiring that FHWA division financial managers meet with States prior to and during annual reviews of inactive obligations. The guidance should require that FHWA review available state records for a sample of inactive projects to independently verify the need for inactive obligations.

2. Reemphasize to FHWA division financial managers and States the importance of implementing best practices techniques when reviewing projects with inactive obligation balances. As part of this action, FHWA could post the best practices to the FHWA web site.

3. Develop and include a performance measure in the FHWA Performance Plan for reducing inactive obligations.

MANAGEMENT RESPONSE

A draft of this report was provided to the FHWA Chief Financial Officer and the Chief, Federal-aid Financial Management Division on September 6, 2001. FHWA concurred with the three recommendations and agreed to take these actions.

Recommendations 1 and 2. FHWA will provide additional guidance to the division offices by December 31, 2001, which is prior to the next annual review. The guidance will emphasize the importance of implementing best practice techniques. The information will be placed on the FHWA web site.

Recommendation 3. FHWA will develop a performance measure relating to inactive obligations by December 31, 2001, for inclusion in the FHWA Performance Plan.

The complete text of management comments is in the Appendix to this report. We considered FHWA comments in preparing this report.

OFFICE OF INSPECTOR GENERAL COMMENTS

Actions taken and planned by FHWA are reasonable.

We appreciate the courtesies and cooperation of FHWA and State representatives. If you have questions, please call me at (202) 366-1964 or John Meche at (202) 366-1496.

PRIOR AUDIT COVERAGE

OIG Audit Report Number: FE-1999-131, *Inactive Obligations*, *DOT*, September 27, 1999.

OIG concluded there was $672 million of recorded obligations that no longer represented valid DOT financial liabilities as of March 31, 1999. About $284 million was inactive FHWA obligations. Annual reviews of obligations were not being performed. We recommended annual reviews of obligations. FHWA is now performing annual reviews of inactive obligations.

OIG Audit Report Number: TR-1998-045, *Management Advisory on Unexpended Obligations on Complete and Inactive Highway Projects, December 11, 1997.*

FHWA and States kept excess funds obligated for as long as 12 years on 43 of 80 projects audited. The excess funds totaled $32 million of the $119 million audited. FHWA did not accurately account for inactive projects or have plans and procedures for identifying, monitoring, and closing complete and inactive projects. We recommended formal procedures for managing funds on inactive projects. As a result, FHWA initiated a joint review with state representatives to identify appropriate actions. Identified best practices were recommended to FHWA Divisions and States as suggested procedures for their consideration.

U.S. Department of Transportation
Federal Highway Administration

Memorandum

Subject: **Information**: Draft Report on Inactive Obligations, FHWA

Date: September 20, 2001

From: Michael J. Vecchiett
Director of Administration

Reply to Attn. of: HABF-40

To: John L. Meche, Deputy Assistant Inspector General for Financial, Information Technology, and Departmentwide Programs, (JA-20)

Thank you for providing us with a copy of the draft report on your audit of Inactive Obligations. This has been an emphasis area within the Federal Highway Administration (FHWA) during the past few years. As you stated in the draft report, FHWA performs an annual review of inactive obligations and has established a performance measure relating to unobligated balances. As a result, there has been significant improvement in reducing excess obligations.

We believe it is noteworthy to recognize actions taken by some of the FHWA division offices and States included in this review. For example, the Florida Department of Transportation has a full-time central office position monitoring inactive obligations along with six Federal-aid Coordinators at the district offices. Recognizing that many projects are administered by local governments, the California Department of Transportation sent letters to each county relating to inactive obligations. The FHWA Connecticut Division Office has initiated actions to encourage the State to advance a large project that has been slow to develop.

You offered three recommendations in the draft report. We concur in each and agree to take the following actions:

1. Provide guidance requiring that FHWA division financial managers meet with States prior to and during annual reviews of inactive obligations. The guidance should require that FHWA review available State records for a sample of inactive projects to independently verify the need for inactive obligations.

   We will provide additional guidance to the division offices by December 31, 2001, which is prior to the next annual review.

2. Reemphasize to FHWA division financial managers and States the importance of implementing best practices techniques when reviewing projects with inactive obligation balances. As part of this action, FHWA could post the best practices to the FHWA web site.

When we issue the additional guidance, we will also emphasize the importance of implementing best practice techniques. The information will be placed on the web site.

3. Develop and include a performance measure in the FHWA Performance Plan for reducing inactive obligations.

We will develop a performance measure relating to inactive obligations by December 31, 2001, for inclusion in the FHWA Performance Plan.

We have two comments relating to the draft report that we believe should be clarified in the final report.

- Several projects included in your review were identified as line of credit projects. One of the examples stated that $48 million should be deobligated and the funds returned to the Treasury General Fund. We believe it would be appropriate in your report to recognize that an obligation of credit authority is fundamentally different from an obligation of contract authority. First, since none of the lines of credit has been activated, there actually are no funds that can be returned to Treasury. Second, these lines of credit were statutorily authorized for specific projects in Southern California and are not available for use on any other project. It would seem appropriate to make a clear distinction between these two types of authority for reporting purposes. The FHWA plans to disclose these differences in our financial statements.

- The draft report states that FHWA agreed to withdraw $54 million obligated to construct a freeway. To clarify this issue, FHWA has asked the State to provide a feasible plan for advancing this project or face a possible withdrawal of the funds.

We appreciate the opportunity to comment on your draft report. If you or your staff have any questions, please contact Max Inman, Chief, Federal-aid Financial Management Division at (202) 366-2853.