Office of Inspector General
Audit Report

Department of Transportation
FY 1996 Consolidated Financial Statement

Report Number: AD-OT-7-004
Date Issued: April 10, 1997

Memorandum

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

Subject: INFORMATION: Report on the Department of Transportation Fiscal Year 1996 Consolidated Financial Statement Report No. AD-OT-7-004

Date: April 10, 1997

From: Joyce N. Fleischman
Acting Inspector General

Reply To: Attn Of: Stefani: x60500

To: The Secretary
Thru: The Deputy Secretary

As required by the Chief Financial Officers Act of 1990, I respectfully submit the Office of Inspector General's (OIG) report on our audit of the Department of Transportation (DOT) Fiscal Year (FY) 1996 Consolidated Financial Statement as of September 30, 1996. The DOT FY 1996 Consolidated Financial Statement and related notes, Management Overview, and Supplemental Information accompany the report. The DOT Consolidated Financial Statement presents financial information on the Office of the Secretary (OST), United States Coast Guard, Federal Aviation Administration, Federal Highway Administration, Federal Railroad Administration, National Highway Traffic Safety Administration, Federal Transit Administration, Maritime Administration, Research and Special Programs Administration, Bureau of Transportation Statistics, Surface Transportation Board, Saint Lawrence Seaway Development Corporation, and the OIG.

The audit report on the DOT Consolidated Financial Statement is the responsibility of the OIG. All other information, such as the Management Overview, Consolidated Financial Statement and related notes, and Supplemental Information are the responsibility of OST. Our audit, however, was limited to the DOT Consolidated Statement of Financial Position as of September 30, 1996.

If I can answer any questions or be of any further assistance, please call me on x61959 or Alexis M. Stefani on x60500.

Attachment

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U.S. Department of Transportation

Office of Inspector General

Department of Transportation Fiscal Year 1996 Consolidated Financial Statement

Report No.: AD-OT-7-004 ***April 10, 1997***

SYNOPSIS

Objectives

The objectives for our audit of the Department of Transportation (DOT) Fiscal Year (FY) 1996 Consolidated Financial Statement were to determine whether (1) the Consolidated Statement of Financial Position presented fairly, in all material respects, the financial position of DOT programs and activities in accordance with the Office of Management and Budget (OMB) Bulletin No. 94-01; (2) DOT had in place an adequate internal accounting and administrative control structure that provided reasonable assurance of achieving established internal control objectives; (3) DOT had complied with laws and regulations which (a) could have a direct and material effect on the financial statement or (b) have been specified by OMB and/or Office of the Secretary; (4) the information in, and manner of presentation of, the Management Overview and Supplemental Information sections of DOT financial statement package were materially consistent with information in the Consolidated Statement of Financial Position; and (5) DOT had adequate policies and procedures in place to provide reasonable assurance of achieving its internal accounting and administrative control objectives regarding the existence and completeness assertions for performance measures.

Conclusions

We were unable to express an opinion on the Consolidated Statement of Financial Position as of September 30, 1996. We identified 11 material internal control weaknesses, 13 reportable conditions, and 2 instances of noncompliance with applicable laws and regulations associated with the DOT FY 1996 Consolidated Financial Statement. We were unable to validate Property and Equipment and Operating Materials and Supplies reported on the Consolidated Statement of Financial Position valued at $25.8 billion (representing 38 percent of the Department's total assets) due to inadequacies in supporting documentation and unreconciled discrepancies between general ledger balances maintained in the Departmental Accounting and Financial Information System (DAFIS) and subsidiary accounting records. In addition, equipment purchase transactions were inappropriately expensed and should have been capitalized, causing assets to be understated and the invested Capital in the net position section to be materially misstated. As a result of these reconciliation, documentation, and capitalization problems, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the Consolidated Statement of Financial Position as of September 30, 1996.

Furthermore, DOT did not have adequate controls in place to (a) ensure consistency between financial statements and budgetary reports in reporting budget execution results, (b) prevent recording of invalid liabilities, and (c) accrue liabilities for goods and services received at yearend. In addition, we identified problems in recording liabilities not covered by budgetary resources, estimating liabilities for military retired pay and health care costs, calculating intradepartmental elimination entries, and processing DAFIS system change requests.

We identified two instances of noncompliance with laws and regulations directly affecting the Consolidated Statement of Financial Position. They were related to processing of general ledger adjustments and reporting of performance measures. Since we disclaimed an opinion on the Consolidated Statement of Financial Position, we were unable to accomplish our fourth objective of determining the consistency of information in the Management Overview and Supplemental Financial sections with the financial statement.

Monetary Impact

Specific monetary savings were not identified for the material weaknesses and reportable conditions. However, correcting the internal control weaknesses will help ensure accuracy, timeliness, and reliability of the Department's financial statement.

Recommendations

We made 72 recommendations to strengthen internal controls and improve the accuracy of the Department's financial statement.

Management Position

Management officials indicated general concurrence with the recommendations. We have requested a formal response to this report from the Departmental Chief Financial Officer.

U.S. Department of Transportation

Office of Inspector General

Office of Inspector General Comments

We are awaiting management's written comments on the findings and recommendations presented in this report.

SYNOPSIS

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INSPECTOR GENERAL'S REPORT ON THE
DEPARTMENT OF TRANSPORTATION
FISCAL YEAR 1996 CONSOLIDATED FINANCIAL STATEMENT
AS OF SEPTEMBER 30, 1996

To the Secretary:

The Department of Transportation (DOT) Office of Inspector General (OIG) conducted an audit of the DOT Fiscal Year (FY) 1996 Consolidated Financial Statement as of September 30, 1996. The DOT Consolidated Financial Statement is the responsibility of the Office of the Secretary (OST).

The DOT FY 1996 Consolidated Financial Statement presents financial information of OST, United States Coast Guard (USCG), Federal Aviation Administration (FAA), Federal Highway Administration (FHWA), Federal Railroad Administration (FRA), National Highway Traffic Safety Administration (NHTSA), Federal Transit Administration (FTA), Maritime Administration (MARAD), Research and Special Programs Administration (RSPA) including John A. Volpe National Transportation Systems Center (VNTSC), Bureau of Transportation Statistics (BTS), Surface Transportation Board (STB), Saint Lawrence Seaway Development Corporation, and the OIG. The audit was performed in accordance with Government Auditing Standards, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin Number 93-06, “Audit Requirements for Federal Financial Statements.”

The audit objectives were to determine whether (1) the Consolidated Statement of Financial Position presented fairly, in all material respects, the financial position of DOT’s programs and activities in accordance with OMB Bulletin Number 94-01, “Form and Content of Agency Financial Statements;” (2) DOT had in place an adequate internal accounting and administrative control structure that provided reasonable assurance of achieving established internal control objectives; (3) DOT had complied with laws and regulations which (a) could have a direct and material effect on the financial statement or (b) have been specified by OMB and/or OST; (4) the information in, and manner of presentation of, the Management Overview and Supplemental Information sections of DOT financial statement package were materially consistent with information in the Consolidated Statement of Financial Position; and (5) DOT had adequate policies and procedures in place to provide reasonable assurance of achieving its internal accounting and administrative control objectives regarding the existence and completeness assertions for performance measures.

OST prepared the Consolidated Statements of Financial Position and Operations for all DOT programs and activities. In March 1996, DOT requested a waiver from requirements of OMB Bulletin Number 94-01 regarding preparation of the Statement of Cash Flows and the Statement of Budgetary Resources and Actual Expenses. OMB approved the waiver and OST did not prepare these two statements.

The financial statement audit process is intended to foster a collegial and cooperative working relationship between auditors and accounting personnel, and this was accomplished during the audit. Using the results of the audit fieldwork, departmental accounting personnel significantly enhanced the precision and comprehensiveness of the information reported in the FY 1996 Consolidated Financial Statement and accompanying notes. The resulting modifications incorporated into the final version of the DOT FY 1996 Consolidated Financial Statement include $24 billion in line items adjustments and $8 billion in line items reclassifications. We calculated the amounts for the line items adjustments and reclassifications using the value of only one side of each accounting adjustment, i.e., either the debit or credit.

This report presents our disclaimer of opinion on the DOT FY 1996 Consolidated Statement of Financial Position along with our reports on the systems of internal controls and compliance with laws and regulations.

OPINION ON FINANCIAL STATEMENT

In accordance with the Chief Financial Officers (CFO) Act of 1990, the OIG audited the DOT Consolidated Statement of Financial Position as of September 30, 1996. The Consolidated Statement of Financial Position is the responsibility of OST. The OIG's responsibility is to express an opinion on this statement based on the audit.

The auditing standards under which we conducted our work require us to plan and perform the audit to obtain reasonable assurance whether the Consolidated Statement of Financial Position is free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our audit work was limited to the Consolidated Statement of Financial Position because this was the first year that OST prepared a consolidated financial statement covering all programs and activities and we could not validate the beginning balances for assets, liabilities, and net position. We did limited testing of the "Total Expenses" on the Statement of Operations to ensure that assets were not being improperly expensed.

As required by OMB Bulletin Number 94-01, Note 1 to the DOT FY 1996 Consolidated Financial Statement describes the accounting policies used by the Department to prepare the financial statement. Those policies represent a comprehensive basis of accounting other than Generally Accepted Accounting Principles.

Several Operating Administrations (OA) had not reconciled all general ledger balances for material accounts to subsidiary records as of September 30, 1996, and detail records supporting these balances were generally not available to substantiate corresponding amounts reported on the Consolidated Statement of Financial Position. These accounts included Property and Equipment and Operating Materials and Supplies. The lack of records prevented us from applying other auditing procedures to determine whether the balances reported for the corresponding material line items were fairly presented. In addition, our limited testing of expenses found OAs were expensing amounts that should have been capitalized resulting in a material understatement of assets on the Consolidated Statement of Financial Position. As a result of the reconciliation, documentation, and capitalization problems noted above, the scope of our audit work was not sufficient to enable us to express, and we do not express, an opinion on the Consolidated Statement of Financial Position as of September 30, 1996.

CONSISTENCY OF OTHER INFORMATION

Our disclaimer of opinion on the Statement of Financial Position as of September 30, 1996, prevented us from accomplishing our fourth audit objective. We were unable to assess whether the information in the Overview and Supplemental Financial and Management Information sections of the financial statement package was materially consistent with the Statement of Financial Position.

REPORT ON INTERNAL CONTROL STRUCTURE

OMB guidance for implementing the audit provisions of the CFO Act requires the auditors to assess the reporting entity's internal control structure. DOT management personnel are responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control mechanisms, policies, and procedures. The objectives of an internal control structure are to (1) provide management with reasonable, but not absolute, assurance that transactions are properly recorded; (2) permit the preparation of reliable financial reports in accordance with applicable accounting policies; (3) maintain accountability over assets, funds, property, and ensure assets are safeguarded against unauthorized use, loss or disposition; (4) ensure transactions are executed in compliance with laws and regulations; and (5) ensure data supporting reported performance measures are properly recorded.

In planning our audit of the DOT FY 1996 Consolidated Financial Statement, we considered the internal control structure within DOT in order to identify appropriate auditing procedures for the purposes of expressing an opinion on the Consolidated Statement of Financial Position and to determine whether the internal control structure meet DOT internal control objectives. However, the intent of our internal control review was not to provide an opinion on the Department's overall systems of internal controls.

The work we performed included obtaining an understanding of the significant internal control policies and procedures and assessing the level of control risk relevant to all significant activity cycles, classes of transactions, and/or account balances. For those significant internal control policies and procedures found to be properly designed and placed in operation, we performed sufficient tests to assess more fully whether the controls were effective and working as designed.

Some of the Department's internal controls are dependent on automated information systems processing. An independent contractor evaluated the effectiveness of the general controls of the financial systems at the Transportation Administrative Service Center Computer Center in Washington, D.C.; Electronic Data Systems Corporation's computer facility located in Plano, Texas; and USCG's Finance Center in Chesapeake, Virginia. The contractor's evaluation included (a) environmental security software controls, (b) operating system integrity controls, (c) physical security controls, (d) operating system change controls and maintenance, (e) reliability-availability-stability controls, and (f) enterprise-wide security. In addition, another independent contractor conducted a penetration evaluation of the effectiveness of network security controls over access to financial systems within the Integrated Telecommunications Network Environment in DOT. The tests objectives were to determine the level of exposure to financial risk, such as theft of information, embezzlement, availability and/or destruction of data. DOT's Report to the President and Congress for FY 1996 under the Federal Managers' Financial Integrity Act (FMFIA) reported a new material weakness relating to the lack of security controls over access to DOT's Intermodal Data Network.

In addition, we reviewed application controls in the Departmental Accounting and Financial Information System (DAFIS) and selected feeder systems. The evaluation included obtaining an understanding of the significant internal control policies and procedures, and assessing the adequacy of the preventive, detective, and corrective controls over the input, processing, and output of authorized financial data reported to, and processed by, DAFIS and selected feeder systems. The feeder systems were FHWA's Fiscal Management Information System (FMIS), Federal-Aid Payment (PR-20) System, and Federal On-line Xchange (FOX) System (a MARAD-managed system used by FHWA for payment disbursements). Also, we evaluated FTA's Electronic Clearing House Operation (ECHO) System, DAFIS On-line Transaction System (DOTS), and FTA's Grants Management Information System (GMIS).

Our evaluation of the controls for reported performance measures was intended to be limited to controls to ensure the existence and completeness of the information directly relating to DOT. However, OST did not include departmental performance measures as part of the DOT's FY 1996 Consolidated Financial Statement as required by the CFO Act and OMB Bulletin Number 94-01.

Our internal control testing identified 11 deficiencies which we concluded should be considered "material weaknesses" and an additional 13 "reportable conditions" under standards established by the General Accounting Office (GAO), the American Institute of Certified Public Accountants, and OMB Bulletin Number 93-06. We also identified two instances of noncompliance with laws and regulations associated with the DOT FY 1996 Consolidated Financial Statement.

Reportable conditions are matters which have come to our attention involving significant deficiencies in the design or operation of the internal control structure which, in our judgment, could adversely affect the entity's ability to ensure the objectives of the internal control structure are being achieved. A material weakness is a reportable condition where the design or operation of one or more specific internal control mechanisms does not reduce to a relatively low level the risk of material errors or irregularities occurring and not being detected within a reasonable time by employees in the normal course of performing their assigned functions. These deficiencies do not meet the DOT materiality criteria under the FMFIA for reporting to the President and Congress.

Our consideration of DOT's internal control structure would not necessarily identify all matters which should be considered reportable conditions. Accordingly, the 24 deficiencies described below do not necessarily constitute all reportable conditions, including material weaknesses, associated with the internal control structure established for the Department. The more significant problem areas meeting the definition of a material weakness are presented first followed by the reportable conditions.

MATERIAL WEAKNESSES

A. Property and Equipment (P&E)

OAs could not support the $24.4 billion of P&E reported on DOT's draft FY 1996 Consolidated Statement of Financial Position. This occurred because OAs did not (1) maintain accurate subsidiary property records, (2) retain documentation to support the value of P&E, and (3) reconcile subsidiary property records with general ledger P&E asset accounts, and (4) post P&E transactions to the proper general ledger asset accounts. As a result, we were unable to validate the amount of P&E reported on the Consolidated Statement of Financial Position as of September 30, 1996. Unless corrected, this material weakness will have a significant impact on the OIG's ability to render an opinion on future financial statements.

Discussion

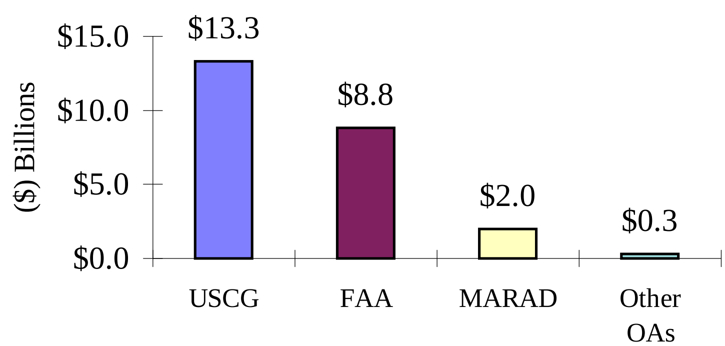
Title 31 United States Code 3512(5)(b) states "The head of each executive agency shall establish and maintain systems of accounting and internal controls that provide (1) complete disclosure of the financial results of the activities of the agency; (2) adequate financial information the agency needs for management purposes; and (3) effective control over, and accountability for, assets for which the agency is responsible."

Statement of Federal Financial Accounting Standards (SFFAS) Number 6, "Accounting for Property, Plant, and Equipment," requires that all property, plant, and equipment be recorded at cost. Cost is defined as all expenses associated with bringing property, plant and equipment to a form and location suitable for its intended use.

DOT Order 4410.4, "Equipment Management and Control," provides overall policy for equipment management. Mandatory procedures are contained in an accompanying handbook which requires equipment to be recorded on an individual basis to include (1) item nomenclature, model number, serial number and manufacturer, (2) acquisition cost, (3) date of acquisition, (4) purchase order or receiving document number, (5) location, and (6) quantity. The order permits records to be established for a group of items or as a system provided the identity of individual accountable components is not lost.

DOT Order 2700.12, "Financial Management Control of Property," prescribes DOT policies and guidelines to insure uniform and reliable accounting control and reporting of the Department's investment in property. The order states property shall be recorded in the appropriate general ledger P&E asset accounts at the time the OA accepts, acquires, completes construction, or otherwise takes custody. Documentation in support of property transactions shall be maintained so it can easily be associated with the respective transactions. Lastly, the order requires quarterly reconciliations of detailed subsidiary property records with general ledger P&E asset accounts.

DOT's draft FY 1996 Consolidated Statement of Financial Position, dated February 4, 1997, reported a total of $24.4 billion for P&E, of which 99 percent was at three OAs.



To evaluate DOT's assertions related to the valuation, existence and ownership of P&E, we performed substantive testing at USCG, FAA and MARAD. At the remaining OAs, we limited our work to reviewing internal controls and performing analytical reviews of P&E. We were unable to fully evaluate DOT's assertions because (1) subsidiary property records did not contain accurate information on the historical costs of P&E, (2) documentation to support P&E transactions was not retained, (3) general ledger P&E asset accounts were not reconciled with subsidiary property records, and (4) P&E transactions were not posted to the general ledger.

Subsidiary Records. OAs did not maintain accurate information in subsidiary property records. For example:

- At FAA, to determine the accuracy of the subsidiary records supporting real property general ledger account balances, we selected a statistical sample of 277 real property items recorded at $599,878,117 to perform detailed tests. Based on the results of our statistical sample we were able to project, with 95 percent confidence, that the value of real property recorded in the subsidiary records is overstated by about $198 million. Also, subsidiary property records for personal property did not contain the level of detail specified by DOT Order 4410.4. Of the $2.87 billion reported in the subsidiary property records, $2.32 billion involved "rolled-up facility equipment" and associated "installation charges." Additional details are contained in our report on FAA's FY 1996 financial statement.[1]

- At USCG, we tested the accuracy of the subsidiary property records by reviewing 1,251 real property items and 464 personal property items. These items had a reported value of $789.4 million and were located at 30 randomly selected USCG operating units. Based on the results of our review, we concluded the amount sampled was overstated $58.5 million. Furthermore, we identified 81 P&E items, with an estimated value of $8.9 million, that were not recorded in the subsidiary property records. In addition to our sample, we determined USCG incorrectly included $106 million of electronics owned by the Navy in the subsidiary property records. Also, there were over 1,000 electronic transceivers and 150 artifacts, totaling approximately $65 million which were incorrectly included in the subsidiary property records.

Subsidiary property records contained inaccurate information because OAs did not (1) use actual historical cost based upon an invoice or other appropriate documents and (2) update subsidiary records to reflect acquisitions and disposals. Most subsidiary property records at the OAs were developed primarily for property management and budget purposes. These subsidiary property records do not contain the information necessary to satisfy existing financial reporting requirements. To illustrate, USCG has more than 10 separate property systems which do not have the

[1]Report on Federal Aviation Administration Fiscal Year 1996 Financial Statement, Report No. R3-FA-7-004, dated March 27, 1997.

information USCG needs to accurately report P&E. In an attempt to capture information necessary to satisfy financial reporting requirements, several OAs have obtained off-the-shelf property management systems.

Supporting Documentation. OAs did not have documentation to support the valuation, existence and ownership of P&E recorded in subsidiary records. For example:

- FAA did not have documentation to support either the $3.16 billion of personal property or the $3.3 billion of work-in-process reported on the FAA's draft FY 1996 Statement of Financial Position. A detailed discussion of these issues is contained in our report on FAA's FY 1996 financial statement.

- USCG did not have documentation to support the reported value of $8.3 billion for buildings and structures. In addition, DAFIS general ledger accounts only reflected a balance of $968 million or about $7.3 billion less than reported. This large difference occurred because subsidiary property records contained estimated replacement amounts rather than historic costs as required. USCG officials planned to deflate the values to estimate historic costs, however, approximately $1.7 billion of the buildings and structures did not have either the construction or acquisition date necessary to perform the calculation. Also, USCG did not have subsidiary records for the $86 million reported for land on the Consolidated Statement of Financial Position.

- MARAD did not have supporting documentation for P&E reported at $2.0 billion. We reviewed documentation for 25 vessels, with a reported value of $1.07 billion (acquisition costs of $732.3 million and upgrade costs of $336.8 million). MARAD officials did not have any documentation to support the $336.8 million of upgrade costs nor the acquisition cost of $176.5 million for nine vessels. We also reviewed real property items with a value of $4.5 million. MARAD officials could only provide documentation to support $7,814 of real property items reviewed.

We could not substantiate information contained in subsidiary property records because OAs did not retain documentation in accordance with DOT Order 2700.12.

Reconciliations with General Ledger P&E Asset Accounts. Except for OST, OAs were not reconciling subsidiary property records with the associated general ledger P&E asset accounts as required by DOT Order 4410.4. Reconciliations are an important tool to ensure P&E

transactions are properly and accurately posted to both subsidiary property records and general ledger P&E asset accounts. This is especially critical since subsidiary property records are stand-alone systems and do not interface with DAFIS. Had quarterly reconciliations been performed, some errors we discovered would have been identified. For example, USCG P&E was overstated by $195 million because some items were recorded both as systems and as system components in the subsidiary property records. In another example, at MARAD, the general ledger account balance for real property totaled $53.7 million, but the subsidiary real property records totaled only $43.3 million. MARAD officials were unable to explain the difference.

<u>Posting P&E Transactions</u>. MARAD did not post any transactions to DAFIS general ledger P&E asset accounts. The FY 1996 ending balance in DAFIS general ledger P&E asset accounts totaled $1.4 billion, however, the DOT draft Consolidated Statement of Financial Position reflected $2.0 billion or an increase of about $600 million. MARAD accounting officials relied on property managers to provide information from subsidiary property records.

We also determined that FAA improperly expensed at least $325 million of P&E and USCG incorrectly posted $182 million of P&E acquisitions to general ledger operating expense accounts. Details are discussed in Finding C with recommendations for improving posting of P&E transactions. MARAD officials did not determine the value of P&E improperly expensed during FY 1996.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Require OAs to develop and implement a plan with target dates for reconciling general ledger P&E accounts and subsidiary property records for prior years and making appropriate corrections.

2. Explore alternatives, such as acquiring off-the-shelf property management systems, if existing subsidiary property records cannot satisfy financial reporting requirements.

3. Develop procedures for the proper valuation of existing property and equipment when documentation is not available and emphasize to OAs the need to retain documentation, in accordance with DOT Order 2700.12, to support P&E transactions.

4. Require OAs to perform quarterly reconciliations between subsidiary property records and DAFIS general ledger P&E asset accounts.

Management Position

Officials from the CFO's Office of Financial Management (OFM) verbally concurred with our recommendations and stated a need existed for an integrated, systematic process for processing P&E transactions. They agreed to develop a plan, with specific target dates, for reconciling P&E general ledger accounts with respective subsidiary property records, and perform quarterly reconciliations. In addition, DOT's Intermodal Property and Accounting Task Force will continue ongoing work associated with improving management of P&E to include examining the feasibility of acquiring commercial off-the-shelf property systems to satisfy financial reporting requirements. We are awaiting the CFO's response to the final report.

B. Operating Materials and Supplies

Operating materials and supplies reported at $1.4 billion were not adequately supported and could not be substantiated through audit testing. This occurred because physical inventories were not performed, subsidiary records were not adequate to meet accounting and financial reporting needs, and unit prices were unsupported. As a result, we were unable to validate the amount of operating materials and supplies on hand as of September 30, 1996. Unless corrected, this material weakness will have a significant impact on the OIG's ability to render an opinion on future financial statements.

Discussion

SFFAS Number 3, "Accounting for Inventory and Related Property," defines operating materials and supplies as ". . . tangible personal property to be consumed in normal operations. . . ." The standard requires operating materials and supplies be valued on the basis of historical costs. SFFAS Number 3 further requires excess, obsolete and unserviceable operating materials and supplies to be disclosed either as part of the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or shown as a separate line item on the face of the financial statement. It also requires the devaluing of items "held for repair" since these items should not be valued at 100 percent of historical cost.

On December 2, 1996 the Department's CFO issued a policy statement on "Inventory and Related Property," which stated:

> The cutoff date for all unsupported inventory and related property is . . . October 1994. Periodic physical counts of inventory and related materials should be performed on a cyclical basis, assuring that all items are reviewed at least every three years. OAs should develop reasonable estimates to reflect excess, obsolete, and unserviceable inventory for financial statements. Items in nonserviceable condition should be valued at less than 100 percent based on OA-specific criteria and circumstances.

Three OAs reported operating materials and supplies totaling $1.4 billion as of September 30, 1996. The three OAs and the value of operating materials and supplies are: USCG ($875 million), FAA ($432 million), and MARAD ($59 million).

These assets are located at supply control points and field facilities. The supply control points in the USCG include: the Aircraft Repair and Supply Center, Elizabeth City, North Carolina; Engineering Logistics Center formerly Supply Center Baltimore, Baltimore, Maryland; and Supply Center Curtis Bay, Curtis Bay, Maryland. In FAA, the supply control points include the Logistics Center at Mike Monroney Aeronautical Center, Oklahoma City, Oklahoma, and the William J. Hughes Technical Center, Atlantic City, New Jersey. Supply control points in MARAD are located in Chesapeake, Virginia; New Orleans, Louisiana; Nederland, Texas; and Hunters Point, California. Other assets (field spares) are located at facilities unique to each of these OAs including shore facilities and vessels in the USCG, air route traffic control centers in FAA, and vessels in MARAD's Ready Reserve Fleet. On the consolidated statement only USCG reported an amount for field spares.

<u>Physical Inventories</u>. OAs did not conduct sufficient physical inventories of operating materials and supplies at supply control points and field facilities to provide reasonable assurance the quantities recorded in inventory management systems were accurate. For example, FAA had not met the cyclic inventory requirements for the Logistics Center since at least 1990. We were also unable to rely on quantities recorded for field spares by any OA. For example, according to FAA information only 26 percent of the field spares were inventoried nationwide during FY 1996. We performed a physical inventory of operating materials and supplies at the Logistics Center using statistical sampling techniques. The results of the statistical sample showed, at a 95 percent confidence

level, that 20.2 percent of the line items in the inventory system have incorrect on-hand balances. In our opinion, this error rate exceeds the level needed to provide reasonable assurance of the accuracy of the quantities recorded. We found similar error rates between subsidiary records and actual on hand quantities at USCG supply control points. For example, 21.6 percent of high dollar value line items tested at Supply Center Curtis Bay had incorrect on hand balances. The error rate for high dollar value items at Supply Center Baltimore was 26 percent.

Subsidiary Records. Subsidiary records maintained by the OAs for operating materials and supplies are not adequate to meet accounting and financial reporting requirements. Systems in use by the OAs are primarily designed and used for inventory management and budget control and provide limited interface to DAFIS. Unit prices were not recorded at historical cost. In addition, the OAs were unable to reconcile the DAFIS general ledger to the subsidiary records. For example, USCG used inventory management systems unique to each of their supply control points. For the USCG supply control points, the detailed listing of on-hand items totaled $13.4 million less than the amount reported on the Consolidated Statement of Financial Position.

We were unable to validate the amount USCG reported for field spares of $158.9 million because (a) the method used to price the reported field spare was based on current price instead of historical cost, (b) part of the reported value was based on estimates, and (c) over 87,000 records with on-hand quantities did not have a unit price. FAA did not provide an amount for field spares because of inadequacies in their system used to account for field spares and insufficient physical inventories. MARAD could not provide an amount for field spares aboard their fleet of vessels because they had not established a system to capture the cost of field spares.

Unsupported Unit Prices. OAs could not substantiate through invoices or contracts, unit prices of operating materials and supplies where we performed substantive testing. For example, we performed a statistical sample of operating materials and supplies held at the FAA Logistics Center and found 48.4 percent of the depot line items sampled did not have documentation to support the unit prices. Using prices recorded in the FAA's subsidiary record we projected, at a 95 percent confidence level, that $286.3 million of the $591.6 million recorded in the subsidiary was unsupported. USCG could not support unit prices for 566 out of 686 high dollar value line items we tested. MARAD could not provide adequate support for 83 of the 106 items we tested at the Chesapeake warehouse.

We found many of the items tested were purchased before October 1994, the date the Department established for OAs being accountable for retaining documentation to support unit prices. In FAA, our analysis of the 181 unsupported sample line items showed the last receipt date recorded in the subsidiary records for 158 line items (87 percent) was October 1988. At the USCG's Aircraft Repair and Supply Center, 191 of 200 items we tested had no purchases after October 1, 1994. MARAD could not determine the date of acquisition for most spare parts.

The deficiencies of insufficient physical inventories, inadequate subsidiary records to meet accounting and financial reporting requirements, and absence of documentation to support unit prices constitute a material internal control weakness. Also, we are not confident the OAs have identified all excess and obsolete items. This is based on the age of the items tested, the absence of current demands for some of the items, and systems/property being decommissioned. For example, in FAA we identified an exchange and repair item with a unit price of $33,705, which according to the item manager, is part of a system being decommissioned. The item manager further explained that only two of the systems remain active. However, the Logistics Center had an on-hand quantity of 106 of the exchange and repair items totaling $3.6 million as of September 30, 1996. In our opinion, some of the 106 items have the potential to be excess to FAA needs and should be devalued and placed in the disposal process. Although the USCG reduced the value reported for items in need of repair to 75 percent and FAA reduced the value reported for these items to 35 percent, we were unable to verify the validity of the percentages because repair cost data for reparable items were not provided for review. Therefore, we were unable to validate the balances for Operating Material and Supplies in the Consolidated Statement of Financial Position at September 30, 1996.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Require OAs to develop and implement a plan, with target dates, to correct the operating materials and supplies deficiencies identified by the OIG to include:

    (a) Complying with the Department's December 2, 1996, policy guidance on Inventory and Related Property for conducting physical inventories.

(b) Establishing and maintaining adequate subsidiary records for operating materials and supplies (including field spares).

(c) Analyzing repair histories for reparable items, pricing items in need of repair accordingly, and maintaining documentation.

2. Direct OAs to reconcile DAFIS general ledger accounts for operating materials and supplies with subsidiary ledgers prior to preparing the FY 1997 financial statements.

3. Direct OAs to report operating materials and supplies at historical cost and maintain documentation supporting unit prices.

4. Establish a working group with the OAs and OIG to determine the most viable cost effective method to arrive at a dollar amount that would represent the cost of operating materials and supplies on hand that were acquired before October 1, 1994.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. They recognized the need for an integrated system to properly record operating materials and supplies and conduct valid inventories. OFM will require plans with specific target dates to analyze repair histories, conduct physical inventories, and correct the general ledger and subsidiary ledgers as necessary. OFM will reemphasize the need to retain historical records after October 1, 1994. OFM will explore, with the OAs, viable cost effective methods to estimate the value of operating materials and supplies when historical records were not available. One possibility is to expand the charter of DOT's Intermodal Property and Accounting Task Force which is working on a similar problem for P&E. We are awaiting the CFO's response to the final report.

C. Capitalization of Property and Equipment

At least $507 million in property and equipment purchase costs were expensed which should have been capitalized. This occurred because OA procedures did not ensure all costs associated with property and equipment purchases were correctly classified and accounted for as capital costs. However, when OAs attempted to classify property and equipment as capital costs, because of weaknesses in DAFIS, these costs were sometimes expensed. The total amount of the property and equipment capital costs incorrectly expensed is not known. Unless corrected, this material weakness will have an impact on the OIG's ability to render an opinion on future financial statements.

Discussion

SFFAS Number 6 requires all costs incurred to bring property, plant and equipment to a form and location suitable for its intended use to be capitalized. Property and equipment acquisition costs not meeting this criteria should be expensed. Under DOT Order 2700.8A, "Accounting Principles and Standards," the basic cost of property acquired is the cost of the property, transportation, installation, and related costs of obtaining the property in the form and place to be used or managed.

FAA property and equipment is purchased primarily with Facilities and Equipment (F&E) funding, while USCG property and equipment is purchased primarily with Acquisition, Construction, and Improvement (AC&I) funding. During FY 1996, FAA charged

$2.6 billion of F&E transactions to operating expenses and USCG charged $314 million of AC&I transactions to operating expenses.

We reviewed FAA's and USCG's capitalization processes and tested 290 F&E and AC&I transactions expensed during FY 1996. We found FAA expensed at least $325 million and USCG expensed at least $182 million in property and equipment costs which should have been capitalized. We concluded FAA and USCG incorrectly expensed property and equipment acquisition costs because procedures did not distinguish which costs should be capitalized and which should be expensed.

During the audit, USCG decreased operating expenses by $164 million. FAA made no adjustments for the incorrectly expensed capital costs because the total amount which should have been capitalized during FY 1996 had not been determined.

FAA hired a contractor to study its policies and procedures on capitalizing and expensing equipment acquisition costs. We recommended in our report on the FAA FY 1996 financial statement that the procedures developed by the contractor to correct capitalization problems be implemented. USCG procedures do not require all costs (i.e., installation, project management, transportation) incurred to bring property and equipment to a form and location suitable for its intended use to be capitalized.

In addition, we found that when FAA and USCG correctly classified and accounted for property and equipment acquisition costs as capital costs, these costs were also expensed due to problems associated with DAFIS processing. Accounting personnel did not know about the need to use material asset codes. DAFIS allows users to enter P&E transactions without material asset codes. However, the material asset code determines which general ledger account should be posted. When the material asset code is omitted by the user, DAFIS posts the transaction by default to an expense account.

In December 1996, USCG requested that OFM change DAFIS to ensure property and equipment acquisition costs are correctly classified, accounted for, and charged to the appropriate general ledger accounts. For these transactions, USCG proposed that DAFIS assign a material asset code based on the object class code.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Require OAs to implement the property and equipment capitalization policy provided in SFFAS Number 6 and DOT Order 2700.8A.

2. Strengthen internal controls associated with the posting of property and equipment transactions by: (a) modifying DAFIS to either require users to assign a material asset code or automatically assign a material asset code based on the object class code, (b) ensuring training is provided on using material asset codes to properly post property and equipment transactions, and (c) advising OAs on interim measures to use until DAFIS is corrected.

3. Require OAs to develop and implement a corrective action plan to identify and capture property and equipment acquisition costs incorrectly expensed in prior years to ensure proper presentation of assets on Statements of Financial Position and expenses on Statements of Operations in future years.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. They agreed to explore the feasibility of modifying DAFIS to require the use of a material asset code and planned to require the OAs to provide training on the proper method of posting P&E transactions. OFM also agreed to develop an action plan to implement Recommendation 3. We are awaiting the CFO's response to the final report.

D. Invested Capital

Adequate internal controls were not in place to compute Invested Capital. The OAs (1) reported Invested Capital based upon unreconciled property records;[2] (2) did not include an initial investment in a revolving fund as Invested Capital; and (3) did not properly record pre-credit reform loans in Invested Capital. These problems occurred because the OAs did not follow existing procedures in DAFIS for recording Invested Capital, did not reconcile subsidiary property systems with general ledger account balances, and were not aware of the requirements for recording initial investments in revolving funds or pre-credit reform loans as Invested Capital. As a result, the amount of Invested Capital reported at

[2] We were unable to validate the amount recorded and reported for P&E as discussed in Finding A.

$28 billion on the DOT FY 1996 Consolidated Financial Statement was not reliable or verifiable.

Discussion

OMB Bulletin 94-01 defines Invested Capital as the net investment of the Government in the reporting entity which includes the acquisition cost of capitalized fixed assets financed by appropriations, pre-credit reform loans financed by appropriations, and additional investments in a revolving fund to commence operations or begin a new activity. DOT Order 2700.12 prescribes Departmental policies and guidelines to ensure uniform and reliable accounting controls and reporting of the Department's investment in property which includes capitalized fixed assets. In addition, the order requires each OA to ensure that a reconciliation of detailed subsidiary records to the general ledger control accounts is performed at least quarterly.

Reliable internal controls over P&E directly impact the accurate reporting of Invested Capital on the financial statement. When capitalized P&E is entered into DAFIS, using the correct material asset codes, the capitalized property is reflected in the appropriate general ledger control accounts. The general ledger control accounts generate an automatic entry to Invested Capital, which results in recording Invested Capital in DAFIS.

However, as previously discussed, the OAs did not follow the DAFIS coding system to ensure that Invested Capital, reported at $28 billion, was accurately recorded in *DAFIS and reported on the financial statement.* For example, according to FAA officials, Invested Capital and P&E did not equal because the proper material asset codes were not always used. As a result, Invested Capital was misstated. FAA's draft financial statement reported Invested Capital of $11.2 billion, and P&E and Operating Materials and Supplies, Net of $9.2 billion--a difference of $2 billion.

We found that Invested Capital was reported from data provided by various other property systems without reconciling these systems to the general ledger accounts. Six OAs processed net adjustments, totaling $16.8 billion, at yearend to Invested Capital based on the data provided by the other property systems. Capital investment related subsidiaries records have little or no interface with DAFIS, and no verifications or quarterly reconciliations were performed. For example, the USCG relied totally on data from more than 10 property systems to adjust the Invested Capital from $6.7 billion in FY 1995, to the reported $14.2 billion in FY 1996. Reconciliations were not performed because transactions were not capitalized into

DAFIS property accounts, and individuals had not been assigned the responsibility to perform such reconciliations. As a result, the data in the property systems were not verified and the Invested Capital account was not reliable or verifiable.

FHWA did not include an initial investment in a revolving fund as Invested Capital. Our review of FHWA's draft FY 1996 financial statement showed the initial investment of $280 million in the Right-A-Way revolving fund was not included as Invested Capital. This occurred because FHWA was unaware of the requirement for recording the initial investment of revolving funds as Invested Capital. FHWA made the adjustment to properly reflect Invested Capital on the financial statement.

MARAD did not properly record pre-credit reform loans in Invested Capital. Our review of MARAD's FY 1996 financial statement showed that $24.3 million in pre-credit reform loans were incorrectly recorded in Cumulative Results of Operations. This occurred because MARAD was unaware of the requirements for recording pre-credit reform loans as Invested Capital. This resulted in an understatement of Invested Capital and an overstatement of Cumulative Results of Operations. MARAD made the adjustment of $24.3 million on the financial statement.

Recommendation

We recommend the Departmental CFO ensure training is provided to the OAs on procedures for recording Invested Capital and for identifying and properly recording initial investments in revolving funds and pre-credit reform loans as Invested Capital.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with the finding and recommendation. OFM acknowledged that P&E has been and continues to be a major problem area which affects Invested Capital and agreed that additional training would reemphasize procedures for proper recording. We are awaiting management's response to the final report.

E. Liabilities not Covered by Budgetary Resources

Our reviews of the OAs' draft FY 1996 financial statements showed that total Liabilities not Covered by Budgetary Resources did not equal Future Funding Requirements (FFR) as required. Additionally, we found that three OAs had incorrectly included unobligated unfunded contract authority as Governmental Liabilities and FFR. Although many general ledger accounts are used in the computations, OST had not provided specific guidance to the OAs on how to properly compute these line items. Consequently, the Department adjusted these line items by $12 billion.

Discussion

According to OMB Bulletin 94-01, Liabilities not Covered by Budgetary Resources are liabilities incurred which are not covered by available budgetary resources. OMB Bulletin 94-01 also defines FFR as the line item which reflects liabilities reported in the Statement of Financial Position which are not covered by available budgetary resources. Therefore, FFR should agree with the total Liabilities not Covered by Budgetary Resources. Neither the SFFAS Number 5, "Accounting for Liabilities of the Government, " nor OMB Bulletin 94-01 specifically address how Liabilities not Covered by Budgetary Resources and FFR should be computed. Further, OMB Bulletin 94-01 does not address how unfunded contract authority should be reported on the financial statement. Congress has provided DOT with unfunded contract authority that permits obligations to be made in advance of appropriations to pay these obligations. Unfunded contract authority is classified as unobligated until FAA, FHWA, and FTA enter into grant agreements and obligate the funds.

OMB Bulletin 97-01, "Form and Content of Agency Financial Statements," which is effective for financial statements beginning in FY 1998, excludes FFR as a separate line item. This amount will be included in Cumulative Results of Operations. However, the Liabilities not Covered by Budgetary Resources will remain as a separate and distinct section on the Statement of Financial Position.

On November 12, 1996, the OIG notified OST that FFR amounts reported by the OAs did not comply with OMB Bulletin 94-01 and that the OAs were inconsistent in computing FFR. Our review of the OAs FY 1995 financial statements showed that FFR exceeded total Liabilities not Covered by Budgetary Resources by $35.7 billion. In December 1996, OST notified the OAs that total Liabilities not Covered by Budgetary Resources and FFR should agree and OST would work with the OAs to assure greater conformity in the accounts comprising these two line items. However, OST did not specifically tell the OAs that the unobligated portion of the unfunded contract authority should not be considered as a liability in the two line items or which specific general ledger accounts should be used.

The OAs were to follow OST's FY 1994 yearend supplemental guidance that stated that FFR should equal the sum of the (a) unobligated balances, (b) accrued expenditures unpaid, and (c) undelivered orders, minus (d) fund balance with Treasury, and (e) Unrequisitioned Authorized Appropriations. We found that the OAs used various general ledger accounts in computing liabilities and FFR especially for unobligated balances and accrued expenditures unpaid. The OAs said, and we agreed, that additional guidance was needed to specifically identify which general ledger accounts should be used. This would ensure that all OAs would compute liabilities using a consistent methodology.

In December 1996, our reviews of the OAs draft FY 1996 financial statements showed that total Liabilities not Covered by Budgetary Resources did not equal FFR. Our review disclosed that unobligated unfunded contract authority was included in Governmental Liabilities and FFR. However, as previously stated, OMB Bulletin 94-01 does not address how unfunded contract authority should be reported in the financial statement but OST's FY 1994 yearend supplemental guidance stated that it should be used in the computation of liabilities. We determined that the unobligated balances of unfunded contract authority did not represent a Governmental liability since these amounts, by definition, do not represent an obligation to the Government. Therefore, $12 billion should not be included in total Liabilities not Covered by Budgetary Resources and FFR but discussed in a note to the financial statement. FAA, FHWA, and FTA made these adjustments.

Recommendation

We recommend the Departmental CFO issue revised guidance to the OAs for the FY 1997 Consolidated Financial Statement requiring a consistent method of computing Liabilities not Covered by Budgetary Resources and FFR and instruct the OAs that unobligated unfunded contract authority is not a proper Governmental liability but should be shown as a note to the financial statement.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with the finding and recommendation. These officials indicated that additional guidance would be sent to the OAs for FY 1997 after meeting with the OAs to determine a consistent method for computing FFR and Liabilities not Covered by Budgetary Resources. The guidance would also instruct the OAs that unobligated unfunded contract authority was not a proper

Governmental liability and should be shown as a note to the financial statement. We are awaiting management's response to the final report.

F. **Budget and Financial Statement Reconciliation**

DOT did not have adequate controls in place to (1) ensure the Unexpended Appropriations balance reported on financial statements was consistent with related budgetary reports and (2) resolve discrepancies between budgetary reports and their related general ledger accounts. This occurred because of a lack of management attention and OST guidance for reconciling these balances. As a result, DOT is increasing its risk that inaccuracies exist in Unexpended Appropriations included on the financial statement and in the Unobligated Authority and Undelivered Orders reported to OMB on the "Report on Budget Execution" (SF-133).

Discussion

The goal of both the CFO Act and OMB Circular A-127, "Financial Management Systems," is for agencies to develop and maintain financial management systems which provide complete, reliable, consistent, and timely information for management decision making. OMB Bulletin 94-01 and its replacement 97-01, require Unexpended Appropriations to represent undelivered orders and unobligated authority for the reporting entity's appropriation accounts. The Department of the Treasury also requires agencies to report these balances on SF-133 reports based on general ledger accounts.

Our review found the "gross"[3] Unexpended Appropriations reported on the draft financial statements was $1.891 billion less than the unobligated authority and undelivered orders reported to OMB on the SF-133 for September 30, 1996. Most discrepancies[4] existed in FAA. The other OAs were able to satisfactorily resolve their discrepancies; however, NHTSA, USCG, MARAD, and FRA identified a need to adjust their financial statement and/or SF-133 reports.

[3]In compliance with OST's guidance, OAs did not include the unobligated authority and all undelivered orders for DOT grant programs in the Unexpended Appropriations line item for financial statement reporting. The portion of the obligations in excess of liquidating authority was reported as Liabilities Not Covered by Budgetary Resources. The unobligated authority was included in note disclosure only. Therefore, all these balances had to be combined to form the "gross" Unexpended Appropriations which was then compared to the balances reported on SF-133 for unobligated authority and undelivered orders.

[4] Specifics on FAA differences are presented in our FY 1996 FAA Statement Audit Report. Specifics on the difference for the FHWA, NHTSA, and FTA amounts are contained in our FY 1996 Highway Trust Fund Financial Statement Audit Report, Report No. AS-FH-7-007, dated March 27, 1997.

The discrepancies between the draft financial statement and the SF-133 are shown below.

Unexpended Appropriations
Reported on Draft Financial Statement versus SF-133 Report
($ in millions)

OAs	Draft F/S Balance	SF-133 Balance	Original Difference	Amount Resolved	Final Difference
FAA	$3,697	$5,571	($1,874)	$0	($1,874)
Other OAs	55,934	55,598	336	(353)	(17)
	$59,631	$61,169	($1,538)	($353)	($1,891)

We verified whether both reported balances were supported by corresponding general ledger account balances--i.e., draft financial statement balances supported by proprietary accounts and SF-133 balances supported by budgetary accounts. Management made a significant number of manual adjustments to the proprietary accounts for financial statement reporting. We concluded these adjustments were legitimate. In the budgetary accounts, however, we found abnormal balances (e.g., negative amount of unobligated authority for unexpired appropriations) and material discrepancies from what was reported to OMB on SF-133 reports. The discrepancies between the SF-133 reports and the General Ledger budgetary accounts are shown below.

Unexpended Appropriations
Reported on SF-133 versus Recorded in General Ledger
($ in millions)

OAs	SF-133 Balance	G/L Acc't Balance	Original Difference	Amount Resolved	Final Difference
FAA	$5,571	$14,073	($8,502)	$0	($8,502)
FHWA/FTA/ NHTSA	52,567	60,999	(8,432)	7,609	(823)
MARAD/ USCG/FRA/ OST/RSPA	3,031	5,084	(2,053)	(30)	(2,083)
	$61,169	$80.156	($18,987)	$7.579	($11,408)

These discrepancies occurred because of a lack of management attention and procedures for reconciling the budget execution results between budgetary reports and financial reports. For example, FAA management advised us that they are aware of the existence of incorrect balances in the budgetary accounts and the need to examine the processing used to record fund authority and usage transactions in DAFIS. However, they have not been able to allocate the resources needed to resolve discrepancies. Also, FHWA, FTA, NHTSA, and MARAD management all identified conversion errors--some have been existing since the late 1980's--as a primary contributing factor to their discrepancies.

Until these material discrepancies are resolved and corrective actions taken, management does not have adequate controls in place to assure accurate accounting for budget execution results to OMB. Correcting this control deficiency is becoming very critical to:

- The transmission of Adjusted Trial Balances to the Treasury. For FY 1996, DOT transmitted only proprietary account balances for the compilation of Governmentwide financial statement. However, the transmission of adjusted trial balances for the budgetary accounts is expected for the preparation of Governmentwide "Statement of Budgetary Resources" and "Statement of Financing," which are required for FY 1998.

- The success of future financial statement audits because OMB is placing more emphasis on Unexpended Appropriations. Currently, Federal agencies are required to report Unexpended Appropriations and four other net position line items on the financial statement. Under OMB Bulletin 97-01, effective for FY 1998, the other four line items will be combined into one. The Unexpended Appropriations line item stays intact and will have to be reconciled to unobligated authority and undelivered orders.

- The Department's budget submission process. As indicated by the OST Budget Office, the SF-133 report is a key document used in answering congressional inquiries of DOT's financial status.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Provide departmental guidance for reconciling budget execution results reported on the monthly SF-133 report to both budgetary and proprietary account balances recorded in DAFIS.

2. Require OAs to provide action plans with target dates for completing reconciliations between budgetary reports and financial statements and correcting account balances in DAFIS.

3. Require OAs to adjust current year SF-133 reports submitted to OMB based on the reconciliation results.

Management Response

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. The OFM staff agreed to work with the OAs and OST budget officials to provide guidance for reconciling budget execution results reported on the monthly SF-133 reports to both budgetary and proprietary account balances recorded in DAFIS. Additionally, OFM will obtain action plans from the OAs for completing reconciliations between budgetary reports and financial reports and have the OAs adjust current year SF-133 reports submitted to OMB. We are awaiting management's response to the final report.

G. Actuarial Model for Estimating Liabilities for Military Retired Pay and Health Care Costs

USCG's reported actuarial liability as of September 30, 1996, was not based on standard actuarial practice which calls for a review of pension plan assumptions (economic, demographic, and other) every 3 to 5 years to determine if they are reasonable. In addition, the USCG did not include an actuarial estimate for retiree health care cost. The OIG's actuarial contractor found that five changes should be made to the basic calculation of the USCG actuarial estimate to more accurately determine the Actuarial Accrued Liability (AAL) and the Accumulated Benefit Obligation (ABO). Factoring these changes into a new calculation, the OIG's actuarial contractor calculated that the AAL was overstated by $1.1 billion on the draft consolidated financial statement as of September 30, 1996. However, by not including health care in the USCG actuarial computations we estimated that the AAL was understated by $3.5 billion. As a result, Liabilities not Covered by Budgetary Resources - Pensions and Other Actuarial Liabilities and FFR were understated by $2.4 billion each on the draft Consolidated Statement of Financial Position.

Our Management Advisory Memorandum, Report No. AD-CG-7-003 transmitted the results of the OIG actuarial contractor to the USCG. The Management Advisory Memorandum contained five recommendations to improve the USCG's actuarial estimates for FY 1997. The five recommendations were for the USCG to (1) review all actuarial assumptions including a comparison of active and retired populations to the Department of Defense (DoD) military active and retired populations, (2) recognize all offsets to retired benefit payments and the liability for former spouses, (3) change the economic and mortality assumptions to those used by DoD, (4) change the salary growth assumptions to better represent the actual promotion and merit increases active duty members receive, and (5) ensure that a valid actuarial estimate for retiree health care is completed for FY 1997.

Our estimate for health care liability used a DoD actuarial report which showed a $210.2 billion actuarial liability for retiree health care programs as of October 1, 1996. Using a ratio of USCG members to DoD members, we estimate the USCG health care liability to be $3.5 billion. Our estimate assumes USCG and DoD have similar retiree health care programs and costs, and reflects the ratio of DoD current active and reserve duty personnel and active and reserve duty retirees to similar classifications in the USCG. We also assumed the ratio of retiree dependents and survivors in DoD and USCG were identical.

The USCG agreed to reflect the $2.4 billion increase in the Pensions and Other Actuarial Liabilities and FFR on the Consolidated Statement of Financial Position and have a note disclosure on how the estimate for health care cost was developed. Our Management Advisory Memorandum has requested the USCG to provide specific target dates on corrective actions planned for the five recommendations. Therefore, we are not making any other recommendations at this time.

H. Intradepartmental Eliminations

Intradepartmental elimination entries were not properly calculated. The draft Consolidated Statement of Financial Position reflected eliminations of $1.2 billion of assets but only $117 million of liabilities, and the Statement of Operations reflected eliminations of $1.4 billion of revenues but only $341 million of expenses. This was primarily caused by the inability of DAFIS to capture intradepartmental transaction balances and amounts for elimination on the consolidated financial statement, and incomplete OST guidance to the OAs on identifying elimination entries. As a result, we were unable to validate that all elimination entries were identified on the Consolidated Statements of Financial Position and Operations.

Discussion

OMB Bulletin 97-01, General Instructions For the Financial Statements, instruction number 9, was effective for FY 1996. It states, " . . . when agencies present disaggregated information for component organizations, the total column for the entity as a whole should reflect consolidated totals net of intra-entity transactions." Statement of Federal Financial Accounting Concepts Number 2, "Entity and Display," dated June 6, 1995, paragraph 77 and SFFAS Number 4, "Managerial Cost Accounting Concepts and Standards For the Federal Government," dated July 31, 1995, paragraph 246, contain similar requirements.

The purpose of elimination entries is to reduce the overstatement of asset, liability, revenue, and expense line items on the consolidated financial statement arising from intradepartmental transactions. Elimination entries are worksheet adjustments recorded to the consolidating financial statement. However, DAFIS did not have accounting codes built into the application programs to capture and report intradepartmental accounting information requiring elimination for consolidated reporting purposes.

OST's instruction on intradepartmental eliminations was contained in "Guidance for Departmental Financial Statement for FY 1996," dated September 17, 1996. The guidance stated:

> Intra-departmental eliminations must be identified to the maximum extent possible. Elimination entries should be provided in a separate column. Eliminated assets should equal eliminated liabilities and net position. Eliminated income and expenses on the Statement of Operations should be carried through to the eliminated net position. The eliminated net position on the Statement of Operations should agree with the eliminated net position indicated on the Statement of Financial Position.

In our opinion, the guidance given to the OAs by OST did not provide adequate detailed, timely instruction or planning for proper accountability and reporting of intradepartmental eliminations.

With this limited guidance, the OAs manually identified, classified, and computed intradepartmental eliminations for submission to OST. Additionally, the OAs did not coordinate their elimination entries with each other. OST used the OAs inputs as submitted and excluded the total amounts from the consolidated financial statement. As a result, material balances were eliminated without a corresponding elimination by another OA.

We found numerous discrepancies with line item elimination entries rolling up into the Departmental combined financial statements. For example, FTA improperly recorded a $1.1 billion elimination entry to Fund Balance with the Treasury without a corresponding elimination entry by another OA. Also, we found at least a $44.9 million discrepancy between intradepartmental uncosted advances reported by VNTSC for elimination and balances reported by other OAs as advances paid to VNTSC. We also found approximately $76.1 million of OST Working Capital Fund payments by the OAs not eliminated and a $2.9 million apparent prior period adjustment eliminated in error by FAA.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Modify DAFIS to provide the capability of identifying intradepartmental accounting data requiring elimination at yearend.

2. Improve the yearend closing process for FY 1997 to provide more timely, clear, and detailed guidance to the OAs for identifying and recording eliminations to the consolidated financial statement. At a minimum, the closing instructions should include detailed examples of reciprocating balances, amounts requiring elimination, and require the OAs to coordinate with each other to determine appropriate amounts for elimination.

3. Improve management oversight and technical review in the future by designing yearend closing schedules for submission by the OAs, requiring complete explanation of amounts eliminated by financial statement line item by OA and assuring only reciprocating transactions are eliminated on the consolidated financial statements.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. They will explore options to modify DAFIS to properly identify intradepartmental eliminations. Until this is accomplished, they will provide more detailed guidance to the OAs to improve the identification and reporting of elimination entries and work with the OAs to design a schedule to ensure reciprocal amounts are identified by the OAs. We are awaiting management's response to the final report.

I. Accounts Payable Liability

About 36 percent of DOT's accounts payable liabilities recorded in the DAFIS subsidiary ledger file were not valid. This occurred because OAs (1) prematurely recorded accounts payable liabilities before goods and services were received and (2) did not reduce the accounts payable liabilities when progress payments were made. As a result, DOT overstated Accounts Payable and understated Unexpended Appropriations balances on the draft Statement of Financial Position by approximately $319.8 million.

Discussion

SFFAS Number 1, "Accounting for Selected Assets and Liabilities," requires agencies to recognize accounts payable liabilities only for ". . . goods and services received from, progress in contract performance made by, and rents due to other entities." Appendix A of this standard distinguishes between recording obligations for budget purposes and recognizing a liability for financial accounting purposes. Under the standard, accounts payable liabilities are to be reduced by the amount of progress payments.

As of September 30, 1996, DOT had 139,806 accounts payable records totaling $882.5 million in one of the key DAFIS subsidiary ledger files--the Open Document File (ODF). We sampled these accounts payable by three groups[5] and found a total of $319.8 million of invalid liabilities. However, we did not find any instances where this improper recording of accounts payable resulted in improper payments to vendors or other entities. Details of the invalid liabilities by OA are shown below.

Accounts Payable Liabilities
($ in millions)

OAs	Total Records	Total Amount	Amount Sampled	Invalid Amount
FAA[6]	83,755	$543.0	$243.0	$293.0
FHWA/FTA/NHTSA[7]	9,922	$43.1	$27.4	$2.4
USCG/MARAD/FRA/ OST/RSPA	46,129	$296.4	$201.1	$24.4
Total	139,806	$882.5	$471.5	$319.8

The accounts payable liabilities were improperly recorded for two reasons. First, contrary to SFFAS Number 1, the OAs were recording accounts payable liabilities and obligations at the same time; regardless of whether goods and services had been received. This practice has been used for years because of the emphasis placed on budgetary accounting versus proprietary accounting in the Federal government. DOT's accounting staff had not been adequately trained to differentiate between the recording of an obligation for budgetary purposes and recording a liability for financial accounting purposes. As a result, DOT not only recorded invalid liabilities on the draft financial statement but also inconsistently recorded like transactions. For example, procurement contracts were recorded as obligations when entered into DAFIS through an automated system interface, but as liabilities and expenses when manually entered by OAs. In addition, approval for

[5]Group 1 - FAA, Group 2 - FHWA, FTA, and NHTSA, and Group 3 - USCG, MARAD, FRA, OST, and VNTSC.

[6]Results are based on a projection from a statistical sample. Further details are discussed in the FAA FY 1996 Financial Statement Audit Report.

[7]Details are discussed in the Highway Trust Fund FY 1996 Financial Statement Audit Report.

Permanent Change of Station (PCS) moves were recorded as obligations by USCG and MARAD, but as liabilities and expenses by FAA and FHWA. The second reason for invalid accounts payable liabilities concerned FAA's progress payments and is detailed in our report on FAA's 1996 financial statement. DOT subsequently adjusted the financial statement to exclude the $319.8 million.

These invalid accounts payable liabilities would have been more timely detected and corrected if the OAs had procedures and controls to better monitor accounts payable. This monitoring can best be achieved through the production of special reports. For example, OAs are not currently required to prepare and review an aging accounts payable report. If such a report were prepared and reviewed, many of the problems associated with the recording of accounts payable would have been identified by the OAs.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Require OAs to provide action plans with target completion dates to review the ODF for valid liabilities and make the necessary adjustments to the accounting records.

2. Provide departmental policy on proper recognition of liabilities with emphasis on the receipt of goods and services.

3. Establish a mechanism to enable OAs to better monitor the validity of accounts payable recording such as the use of an aging report.

Management Position

Officials of the CFO's Office of Financial Management verbally concurred with our recommendations. They agreed to obtain action plans with target dates from the OAs on their review of the ODF for valid liabilities. OFM also agreed to provide departmentwide policy on the proper recognition of liabilities and to establish a mechanism for OAs to better monitor the validity of accounts payable by June 30, 1997. We are awaiting management's response to the final report.

J. Yearend Accrued Liabilities

OAs have not established adequate procedures to accrue liabilities for goods and services received at yearend. This occurred because the current procedures used for estimating yearend accruals did not include uninvoiced or low dollar amount purchases. As a result, DOT understated the Accounts Payable and overstated Unexpended Appropriations line items in the draft Statement of Financial Position by $342.7 million.

Discussion

SFFAS Number 1 requires agencies to recognize a liability for the unpaid amount of the goods to which agencies have accepted the title. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated.

During the audit of the FY 1996 financial statement, all OAs indicated they estimated yearend accrued liabilities for goods and services received in FY 1996 but not yet paid. Through analytical procedures and reviewing supporting documentation, we determined the amount accrued by FHWA, FTA, and NHTSA was reasonable. However, we found other OAs significantly underestimated yearend accrued liabilities as shown below.

Accrued Liabilities
($ in millions)

OAs	Estimated Accrual	Accrued by OAs	Additional Accrual Needed
FHWA/FTA/NHTSA	$617.4	$613.4	$4.0
FAA	$296.0	$133.0	$163.0
USCG/MARAD/ FRA/OST/RSPA	$215.7	$40.0	$175.7
Total	$1,129.1	$786.4	$342.7

For FAA, we statistically sampled disbursements made in October and November 1996, totaling $280 million. Based on test results, we projected that FAA understated its yearend accruals by $163 million. Additional details are contained in our report on FAA's FY 1996 financial statement. For the remaining OAs, we statistically sampled disbursements made in October and November 1996, totaling $144 million, and found $53 million were paid for goods and services delivered in FY 1996. Based on the results, we project, with 95 percent confidence, that $215.7 million (plus or minus $45.8 million) of estimated liabilities and expenses should have been accrued for financial statement reporting. As a result, the remaining OAs understated the Accounts Payable and overstated Unexpended Appropriations line items by about $175.7 million ($215.7 million minus $40 million already accrued by the OAs) on the draft financial statement.

These unrecorded liabilities occurred because procedures used by OAs for estimating yearend accruals were incomplete. FAA estimated yearend accrued liabilities only for goods and services invoiced by yearend but disregarded goods and services that had not been invoiced. The remaining OAs estimated yearend accrued liabilities only for high dollar contract items but disregarded other types of services and deliveries. DOT subsequently adjusted the financial statement by including the $163 million in FAA's portion of the statement and a note disclosure for the need to recognize the additional $175.7 million of liabilities and expenses.[8]

[8]The $175.7 million accrued liabilities were projected based on disbursements made by USCG, MARAD, FTA, OST, and VNTSC. Since the adjustment could not be allocated back to individual OAs, DOT decided to make a note disclosure only.

Recommendation

We recommend the Departmental CFO, in conjunction with the OAs, establish methods to be used for estimating yearend accruals.

Management Position

Officials of the CFO's Office of Financial Management verbally concurred with our recommendation. With the OAs, OFM plans to identify methods to be used for estimating yearend accruals by June 30, 1997. We are awaiting management's response to the final report.

K. DAFIS System Change Requests (SCR)

OFM did not assign resources to DAFIS SCRs which impact the preparation and accuracy of DOT's financial statements. We found two SCRs submitted by OAs to correct material weaknesses in DAFIS processing were not properly evaluated and assigned resources for timely completion. These SCRs would provide the capability to properly process prior period adjustments and assist in reconciling general ledger Work-in-Process (WIP) account balances. These SCRs have not been completed because OFM has issued a moratorium on completing pending SCRs and has effectively closed their SCR evaluation process to additional non-emergency SCRs. As a result, OAs must expend additional resources to track and report direct general ledger adjustments and to manually reconcile WIP accounts without adequate audit trails. The inability of DAFIS to readily process transactions affecting the financial statements reduces the reliability, completeness, and timeliness of financial information and the OIG's ability to perform CFO audits.

Discussion

Both the CFO Act of 1990 and OMB Circular A-127 require agencies to develop and maintain financial management systems which provide complete, reliable, consistent, and timely information for management decisionmaking. Further, OMB Circular A-130, "Management of Federal Information Resources," requires agencies to establish management oversight mechanisms that ensure information systems meet agency mission requirements and to perform periodic reviews of needed changes.

DAFIS lacks the capability to properly record prior year adjustments separately from current year activities. The failure to correct this design deficiency was cited as a material internal control weakness in OIG's audit report on the FY 1993 FAA's Airport and Airway Trust Fund (Report No. AD-FA-4-012). FAA's initial SCR to correct this weakness was accepted by OST in October 1994 but was not assigned any immediate computer programming resources. FAA resubmitted the request in February 1996 as one of their three highest SCR priorities. However, specifications were not developed by FAA and OST removed the SCR from further consideration. As a result, OAs track prior period adjustments offline from DAFIS and rely upon direct general ledger adjustments totaling at least $8.98 billion in FY 1996 as a "work-around" to completion of the SCR. (See Finding Y.)

To correct another material weakness, the prior audit report also recommended an SCR be developed to automate (1) reconciliation of a $1.3 billion discrepancy between detailed job-order cost records and FAA's general ledger WIP account balance and (2) modify the DAFIS Completed Job Orders, WIP, Accrued Cost, and Related Data report (report 32-9F). In 1997, there is still a discrepancy between the WIP general ledger and FAA subsidiary records, and the requirement to automate the analysis process remains valid. The initial SCR to modify the DAFIS 32-9F report was made by FAA in May 1995 and resubmitted in February 1996 as one of FAA's three highest SCR priorities. However, OST did not approve resources for the resubmitted SCR.

In September 1995, OFM determined that the backlog of pending SCRs outstripped available planning and programming resources. OFM asked the OAs to evaluate 217 pending SCRs to determine those which were no longer needed or which had minimal benefit. However, the OAs did not recommend elimination of any SCRs. In January 1996, OST issued a moratorium on completing pending SCRs and requested that each OAs identify their three highest priority SCRs. After receiving these nominations, OFM closed their evaluation process to any additional non-emergency SCRs.

Since then, new SCRs have been identified. For example, OFM did not accept for evaluation a proposed SCR, submitted by FAA in May 1996, that would automate yearend preclosing adjusting entries for various assets and equity accounts. OFM deemed the SCR to be too complicated. Without the proposed SCR, the Non-Operating Changes Balance on the Statement of Operations, and the Net Position Ending Balance are overstated and out of balance with the Total Net Position on the Statement of Financial Position. As a result, FAA must manually adjust the Statement of Operations for each affected appropriation and manually change the adjusted trial balance submitted to the Treasury, totaling $1.4 billion. FAA estimates they expend an additional 120 hours--including overtime--

in tracking and manually processing of over 400 adjustments needed to complete the Statement of Financial Position and Statement of Operations. In our view, these manual adjustments impact the timely completion of financial statements and heighten the risk for material misstatements. Further, no automated audit trail exists for these external adjustments.

According to OFM's FY 1996 DAFIS development workplan, SCRs have the highest priority. However, SCRs only receive 16 percent (9,576 of 57,479 staff hours) of the planned resources. DAFIS enhancements (e.g., development of the Voucher Examination Module) receive 75 percent (42,773 staff hours) of the total resources. Further, this audit report makes recommendations for 12 system changes to DAFIS. In our view, OFM should establish a plan to prioritize SCRs and correct DAFIS weaknesses which materially affect the financial statements.

In February 1997, OFM officials began a re-evaluation of their backlog of pending SCRs. They assured us the SCR to permit processing of prior year adjustments would be addressed. A decision to re-allocate resources to other pending SCRs has not been made.

Recommendations

We recommend the Departmental CFO:

1. Determine from the OAs all DAFIS processing deficiencies which impact financial reporting and warrant submission of SCRs.

2. Evaluate and prioritize the SCRs identified by OIG and the OAs that impact financial reporting and implement a plan to complete these SCRs.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. They proposed to (1) identify all processing deficiencies which impact the financial statement and warrant a SCR and (2) evaluate and prioritize SCRs identified by the OIG and OAs and institute a plan to complete these SCRs. We are awaiting management's response to the final report.

REPORTABLE CONDITIONS

L. General Controls for DOT Data Centers

A contractor's review confirmed that the general controls environment at the three data centers reviewed provides reasonable assurance that the financial information processed would not be impacted in a material manner. However, the contractor's review identified four reportable conditions at the Transportation Administrative Service Center (TASC) Computer Center; two reportable conditions at FAA's Computer Resources Nucleus; and four reportable conditions at the USCG's Finance Center. The reportable conditions for each data center are summarized below with recommendations for improvements.

<u>Discussion</u>

A contractor determined the effectiveness of the general controls at the principle DOT data centers which process financial information. The data centers reviewed were:

- TASC Computer Center (TCC) located in Washington, D.C. TCC processing includes the USCG's active duty and retired military payroll, the FTA's GMIS, and the FHWA's financial subsystems.

- FAA's Computer Resources Nucleus (CORN) located in Plano, TX. CORN processing includes DAFIS and Consolidated Uniform Payroll System (CUPS).

- USCG's Finance Center (FINCEN) located in Chesapeake, VA. FINCEN accounting functions include the maintenance of a centralized general ledger system of fund, resource, costs, revenue and property accounts. All financial obligations created by USCG units worldwide, with the exception of three inventory control points, are ultimately processed by the Finance Center.

The evaluation of the DOT data centers included environmental security software controls, operating system integrity controls, physical security controls, operating system change control and maintenance, reliability-availability-stability controls, and enterprise-wide security program as of September 30, 1996.

<u>TASC Computer Center</u>

At TCC, the contractor identified reportable conditions addressing control weaknesses relating to the (1) enforcement of computer security policies and procedures, (2) lack of proper independence in the organizational positioning of the Information Security Manager,

(3) use of undocumented authorized command entries in the operating system data set library file, and (4) lack of on-line communication controls to prevent multiple sessions in the same region. Four recommendations were made to improve the controls at this facility.

Computer Security Policies. TCC has not enforced computer security policies and procedures. As a result, some user organizations do not adhere to recommended computer security policies and procedures. For example, the contractor found for FHWA (1) batch entry jobs submitted through TCC's normal network facility do not require security validations, (2) user accounts with no associated passwords were issued to state agencies for batch data submission, and (3) password standards were not enforced as FHWA allowed users to select passwords as small as three characters, permitted some users to have passwords which were not hidden from view, and did not require users to change passwords in accordance with standards. These security weaknesses increases the risk to FHWA application systems, and to a lesser degree all TCC application systems, of unauthorized activities.

Information Security Program Manager. The information security program manager lacks organizational independence. The security manager, who is responsible for implementing security controls which impact system resources, reports to the TCC operations manager, who is tasked with ensuring timely and efficient use of computer resources. This conflict could result in the security environment being compromised to satisfy operational efficiency. Therefore, the security manager should not be positioned under the operations manager.

Operating System Data Sets. Undocumented and unexplained entries were found in a key operating system data set library which controls initialization of the operating system. If the library is not adequately protected, a systems programmer or other knowledgeable person could add program code to bypass password checking and data set protection controls or gain control of the system in an authorized state. These unexplained entries should be removed from the program library and evaluated to determine whether they were used for unauthorized purposes.

On-line Communications Security. The main on-line communications system (Customer Information Control System (CICS)) used for production applications allows multiple sessions in the same CICS region. This condition could allow exposures from unattended terminals or sharing of user logon identifications (ID). Multiple logons to the same CICS region should be prohibited.

FAA's Computer Resources Nucleus

At FAA's CORN, the contractor identified reportable conditions addressing insufficient controls to prevent unauthorized access to (1) system security databases and (2) sensitive and powerful operating system utilities. Three recommendations were made to improve the controls at this facility.

System Security Databases. Security guidelines normally require access to system security databases be limited to authorized personnel only. However, users of the CORN platform have unrestricted "read" access to the main security database. These access privileges allow users to browse the database, enabling them to identify valid logon IDs. This could result in a user copying this information, and executing a password cracking utility against the encrypted passwords in an attempt to identify valid logon ID and password pairs. The global "read" privileges for this database should be revoked.

Operating System Utilities. The review of the Resource Access Control Facility (RACF) implementation indicated that powerful system software utilities are not protected from unauthorized access. Failure to protect these utilities could result in accidental or malicious alteration of data and production programs. Powerful utilities should be identified and restricted to appropriately authorized and trained personnel.

USCG's Finance Center

At FINCEN, the contractor identified reportable conditions addressing control weaknesses relating to (1) users with excessive system privileges, (2) lack of security activity logs, (3) lack of adequate password controls, and (4) lack of formally documented system maintenance procedures. Four recommendations were made to improve the controls at this facility.

User Privileges. An analysis of privileges assigned to key personnel (managers, database administrators, system operators and other critical personnel) indicated that several user accounts have sensitive privileges assigned to them which are incompatible with their normal duties. For example, users had bypass privileges that would allow them to override all safeguards. Approval for, and assignment of, these privileges should be documented to assure adequate separation of duties.

Security Activity Logs. Unauthorized use of FINCEN's minicomputers is not controlled or monitored with security logs, making real-time detection of such access difficult. Further, since accounting and auditing log files are not maintained, the ability to review historical security-related events, such as execution of sensitive commands, is limited. In our view, a mechanism should be in place to provide complete audit trails of activity and detect unauthorized system usage.

Password Controls. According to a review of the encrypted password file, password controls at the FINCEN are inadequate. For example, users are not required to periodically change their password or to use passwords with both alphabetic and numeric characters. Approximately 50 users have not changed their initial password. Effective password controls should be in place to ensure financial data are not compromised through unauthorized access.

System Maintenance Documentation. FINCEN does not have (1) documented system maintenance procedures for either of its two minicomputer systems or (2) written policies and procedures for operating system maintenance or formal logs of completed software alterations. All changes to the operating system should be approved and documented to ensure controlled software maintenance and avoid confusion during system regeneration.

Recommendations

We recommend the Departmental CFO:

1. Require all OAs to follow TCC computer security policies and procedures.

2. Change the information security program manager's reporting responsibilities to ensure that the operation and security management functions are independent.

3. Remove undocumented and unauthorized entries and investigate whether these entries been used for unauthorized purposes.

4. Prohibit multiple logons into the same CICS region.

We recommend the Departmental CFO require that FAA:

5. Remove the global entry providing read access to the security databases.

6. Identify all operating system utilities and implement full RACF protection over these programs.

7. Implement a security monitoring program for these utilities.

We recommend the Departmental CFO require that USCG:

8. Evaluate the access privileges assigned to users and develop a system for written approvals for user privileges.

9. Identify and implement alternate commercial software products which provide improved system audit and accounting functions commensurate with available system resources.

10. Implement password controls which require users to periodically change passwords and use passwords which include both alphabetic and numeric characters.

11. Develop procedures for approving, authorizing, installing, and testing operating system changes. The procedures should document the purpose, responsibilities, sign-offs, test results, dates, and other information needed to maintain a complete history of changes made to the system.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. OFM agreed to initiate corrective action to authorize TCC to enforce security policies and procedures for all user organizations; and to require TCC to change the reporting responsibilities of the security manager, remove and investigate undocumented and unauthorized entries, and prohibit multiple logons into the same CICS regions.

FAA concurred with the Recommendations 5, 6, and 7 and agreed to initiate corrective actions to remove global read access to the security database, implement full RACF protections over all operating system utilities, and implement a security monitoring program.

USCG concurred with the Recommendations 8, 9, 10, and 11 and has initiated corrective actions. USCG officials have completed a review of all user accounts and removed excess privileges. System documentation is being updated to reflect the need for these privileges. USCG has implemented audit software on one of the two minicomputers and is conducting a market search for a commercial package which is not resource-intensive for their smaller machine. USCG also completed actions to implement necessary password controls, centralize system change logs and documentation, and expand their formal security standards to include operating system modifications. Operating system change control is being added to their configuration management plan.

We are awaiting management's response to the final report.

M. Penetration Review of DOT's Integrated Telecommunications Network Environment

Our review of a contractor's penetration study found that the configuration of DOT's Integrated Telecommunications Network Environment (ITNE) prevented the contractor from penetrating mainframe based financial systems. However, the contractor was successful in penetrating numerous other departmental systems in its attempt to gain access to financial systems. The contractor identified eight exposures to the DOT's ITNE in their April 1, 1997, draft report. These exposures represent security problems which could result in the loss or corruption of data or denial of the network services.

Discussion

DOT's ITNE is the Department's extended wide area network (WAN) comprised of the Intermodal Data Network (IDN) and smaller local area networks (LANs) and WANs technologies. IDN is a backbone network connecting hundreds of LANs within the three DOT Headquarters buildings in Washington, D.C. Each OA and other Departmental organizations connect to the IDN as sub-networks. The ITNE supports over 50,000 client workstations, hundreds of servers, and multiple protocols.

A contractor conducted a penetration evaluation of the DOT's ITNE to determine the current effectiveness of network security controls over access to financial systems. The purpose of the network review and penetration testing was to prove the security or vulnerability of DOT financial systems to compromise via access from public networks or internal DOT networks and thus exposure to financial risk, such as theft of information, embezzlement, availability and/or destruction of data. The scope of the contractor's review included seven financial applications hosted at three DOT data centers.

This review was initiated because prior contractor reviews performed for the Department identified weakness in access controls to the IDN. These prior studies did not specifically address access control for the mainframe based financial systems of the Department. The weaknesses identified in the prior studies were significant enough that this condition was reported as a material weakness in the Department's 1996 FMFIA report.

The contractor identified security exposures in the following areas: (1) access to the ITNE, (2) logon IDs and passwords, (3) unprotected devices, (4) security auditing, and (5) host configurations. Because of the potential impact on computer security, the specific findings are not reported in this document.

Recommendation

We recommend the Departmental CFO implement the recommendations contained the contractor's April 1997 report.

Management Position

Officials in the CFO's Office of Financial Management concurred with the intent of the recommendations and will work with the Department's Chief Information Officer to address the contractor's recommendations. We are awaiting management's response to the final report.

N. Applications Computer Security

DOT has not implemented a comprehensive computer security program for DAFIS and major interfacing systems which "feed" financial data to DAFIS. We found applications security deficiencies throughout DOT's financial systems including the lack of (1) computer security planning, (2) computer security training, (3) computer system certifications and accreditations, and (4) password administration. These security deficiencies exist because OST, USCG, FHWA, FTA, and MARAD did not place adequate emphasis on computer security implementation. As a result, the Department has reduced assurance their sensitive financial systems are protected from loss, misuse, and unauthorized access.

Discussion

Federal directives provide guidance for implementing a comprehensive security program for each sensitive system. An effective agency security program includes preparation and implementation of computer security planning including risk analysis, computer security plan, disaster recovery plan, computer security awareness and practices training plan, and system certification and accreditation for each computer system containing sensitive data. The enactment of the Computer Security Act of 1987 (Public Law No. 100-235) established minimum acceptable security practices for systems containing sensitive information. Implementing guidance provided in OMB Circulars, National Institute of Standards and Technology Bulletins, as well as specific DOT guidance, reinforces the Act and provides standards for the cost-effective security and privacy of sensitive computer systems.

We reviewed OST's DAFIS and CUPS; USCG's Personnel Management Information System/Joint Uniform Military Pay System (PMIS/JUMPS), and Retired Pay and Personnel System; FHWA's FMIS, and Federal-Aid Highways Payment Request (PR-20) System; FTA's ECHO System, DOTS, and GMIS; and MARAD's FOX System (a MARAD-managed system used by FHWA for payment disbursements). Computer security deficiencies we identified for FHWA and FTA with recommendations for improvements are presented in the Report on Fiscal Year 1996 Highway Trust Fund. Specific problem areas we identified for OST, USCG, and MARAD are described below.

Computer Security Planning. DOT did not carry out adequate computer security planning. For example, OST did not develop a computer security plan for CUPS. In addition, USCG and MARAD did not develop risk analyses (with the exception of USCG's PMIS/JUMPS), disaster recovery plans, and computer security plans for their systems we reviewed. According to the Computer Security Act, Federal agencies are required to implement a computer security plan for each sensitive system. According to OMB Circular A-130, Appendix III: Security of Federal Automated Information Resources, a risk-based approach establishes adequate security by considering the value of the system or application, threats, vulnerabilities, and the effectiveness of current or proposed safeguards. In addition, managers should plan and test how they will perform their mission and/or recover from the loss (such as a disaster) of existing application support.

OST did not develop a CUPS computer security plan because of efforts to replace CUPS with the new Integrated Personnel and Payroll System (IPPS). However, because the planned replacement system has been terminated, OST now plans to develop a CUPS security plan. USCG agreed to prepare the necessary (1) risk analyses, (2) disaster recovery plans, and (3) computer security plans for their military payroll systems. MARAD officials agree they are responsible for fulfilling a risk analysis, disaster recovery plan, and a computer security plan for FOX as implemented in the MARAD environment, although the Federal Reserve Bank (FRB) provided the FOX software. MARAD is responsible for fulfilling security requirements based on the environment in which it functions. Similar problems exist in FHWA and FTA including inadequate or non-existent (1) computer security planning, (2) computer security training, (3) certification and accreditation, and (4) password administration. FHWA and FTA agreed to improve and/or develop computer security related requirements for FMIS, PR-20, GMIS, DOTS, and ECHO.

Computer Security Training. MARAD had not verified that FHWA-authorized FOX users had been trained in computer security awareness and accepted computer security practices. OMB Circular A-130 requires all sensitive computer system users receive mandatory security training before using or operating sensitive Federal computer systems. MARAD agreed to verify that all FOX users are periodically trained in computer security awareness and accepted computer security practices.

Certification and Accreditation. We found OAs had not taken necessary steps to certify, re-certify, or accredit the systems reviewed. For example, OST and USCG systems--CUPS, PMIS/JUMPS, and the Retired Pay and Personnel System--have not been accredited or certified, while DAFIS has not been re-certified or re-accredited since 1991. Also, MARAD has no assurances FOX has been certified or accredited by FRB. DOT Order H 1350.250, "DOT Information Systems Security Guide," requires certification and accreditation of sensitive Federal computer systems. Security certification is needed to test the system's controls are actually working to provide intended protection, and accreditation is the official determination the system meets all applicable Federal policies, regulations, and standards; and that the installed security safeguards are adequate for the application. OMB Circular A-130, Appendix III requires systems be re-certified and re-accredited at least every 3 years or following major system revisions.

OST, USCG, and MARAD plan to take necessary steps to certify and accredit their sensitive systems. OST plans to proceed with steps necessary to comply with certification and accreditation security requirements. USCG procured a consulting firm to perform a risk assessment and security plan for PMIS/JUMPS. The consultant's Final Certification Reports, dated February 20, 1996, resulted in thirty recommendations required to obtain certification. Sixteen of the thirty recommendations have not been implemented by USCG. The remaining recommendations in the report must be implemented prior to USCG certifying and accrediting its systems or USCG should document a cost/benefit risk analysis showing why they are not implementing the recommendations. MARAD should ensure FRB has completed the certification and accreditation of FOX.

Password Administration. USCG did not establish adequate password controls over the Retired Pay and Personnel System. USCG should upgrade the Retired Pay and Personnel System to improve security controls such as (1) limiting the number of sign-on attempts (currently unlimited), (2) requiring passwords to be at least six characters, including one alpha and numeric character (currently any number), and (3) prohibiting the use of null (blank or spaces) passwords. Also, the Retired Pay and Personnel System allows users to log onto the system without a password. DOT Order H 1350.261, "DOT Mainframe Security Software Standards," provides guidance covering password administration and protection.

USCG agreed to correct password administration weaknesses identified by OIG. USCG will implement procedures to increase controls over password access for the Retired Pay and Personnel System.

Recommendations

We recommend the Departmental CFO:

1. Prepare a computer security plan for CUPS.

2. Obtain certification and accreditation for CUPS and re-certify and re-accredit DAFIS.

3. Require USCG and MARAD to develop and implement a corrective action plan with specific target dates for obtaining risk analyses, disaster recovery plans, computer security plans, and certifications and accreditation's for their systems.

4. Require MARAD to verify all FOX users are periodically trained in computer security awareness and accepted computer security practices.

5. Require USCG to implement procedures to increase controls over password usage for the Retired Pay and Personnel System.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. USCG, FHWA, FTA, and MARAD also concurred with our finding and recommendations. We are awaiting management's response to the final report.

O. DAFIS Batch Controls

Automated internal controls over batch processing within DAFIS should be strengthened. DAFIS does not contain adequate edits to (a) prevent circumvention of batch control totals, (b) prevent unreasonable entries for accounts receivable and recurring charge transactions, (c) identify potential duplicate payments, and (d) ensure budgetary limitations are not exceeded. Further, DAFIS does not comply with core financial system requirements for reprocessing erroneous or deleted transactions and processing transactions from interfacing systems, or process direct reimbursable transactions correctly. As a result, the Department cannot be assured all transactions entered into DAFIS are processed in a timely, complete, and accurate manner.

Discussion

OMB Circular A-123, “Management Accountability and Control,” GAO’s “Standards for Internal Controls in the Federal Government,” and the Joint Financial Management Improvement Program’s (JFMIP) “Federal Financial Management System Requirements--Core Financial System Requirements,” describe internal control objectives, standards and system requirements. General management control standards require systems to ensure obligations and costs comply with applicable law, and assets are safeguarded against waste, loss, unauthorized use, and misappropriation. To meet these standards, internal controls techniques should provide for separation of key duties and responsibilities, and prompt and accurate transaction processing.

System Edits

System edits are an automated way to determine whether transaction records contain reliable, proper, authorized, and valid data elements. Screen format edits, for example, guide data entry personnel in supplying proper data in the proper location. Table edits determine whether data elements contain valid codes. We identified four areas where DAFIS system edits could be improved.

Batch Control Totals. Batch control totals are a key detective control for accurate and complete data entry in a batch processing system. For these controls to be effective, users must manually compute and enter batch control totals into the batch header record before entering any individual transactions. After all transactions are entered, the system calculates the total number and aggregate dollar amount of the transactions entered and compares these totals to the amounts in the header record. If a discrepancy exists, the batch will not be processed. However, we observed that data entry personnel did not always follow written procedures. Users could circumvent this control by entering dummy control totals, allowing the system to display the batch totals, and then re-entering the amounts computed by the system into the header record. To allow batch controls to function as intended, DAFIS should mask the calculated amounts from the user.

Reasonableness Tests. Although DAFIS transactions are edited against various tables as they are entered, our test deck transactions determined that additional reasonableness tests could reduce the potential for errors. We found reasonableness edit checks are not applied to dollar amounts entered into the recurring charge master file or to interest rate, penalty, or administrative charges applied to accounts receivable transactions.

Reasonableness edits can supplement manual oversight of transaction processing to prevent erroneous payments. For example, in September 1995, a $55.2 billion recurring charge payment transaction erroneously entered into DAFIS was not detected by the USCG data entry clerk or the certifying official. However, the payment transaction was halted by the Treasury and FAA officials, who questioned the size of the proposed payment. The USCG admitted their certification review process had failed and that a smaller payment error probably would not have been detected. In our view, the size of the amount field for recurring charges (13 characters) should either be reduced or the system should provide a compensating control--such as a warning to the user--when amounts entered exceed certain limits.

Similarly, our tests showed there are no edits which restrict interest rate, penalty, and administrative charges applied to accounts receivable transactions. Through a special query, we identified 897 records totaling $970,000 which contained excessive interest or penalty rate charges (e.g. 90.0 percent instead of 9.0 percent), or excessive administrative charges (e.g., $120 per month rather than $12 per month). Although we did not test for abnormally low amounts, we observed an instance where the rates were significantly understated (e.g., the penalty rate was 0.006 percent and the administrative charge was only $.10). These erroneous records misstate the related receivables, revenues and expenses on departmental financial statements.

A key preventative control is adequate written procedures. We determined that the DAFIS user guide does not describe how to enter interest, penalty, and administrative charge rates for all types of receivables. To ensure the accuracy of recording accounts receivable and related revenue and expense accounts, adequate system edits and written procedures are necessary.

Duplicate Payments. Detective edit checks for disbursement transactions could be strengthened to reduce the potential for duplicate payments. The existing edit compares new transactions to existing transactions on the batch control file, warehouse file, and paid schedule file and provides a warning message of a potential duplicate payment for those transactions with the same vendor type, vendor number, and invoice customer account number. However, the edit check does not include the amount field (a key data element), and the warning flag issued can be easily overridden by the data entry clerk without management review.

According to the DAFIS user guide, the invoice customer account number is a free format data element which ". . .identifies vendor information (invoice, contract number, etc.)." Thus, users can enter anything they want into this field, including the same information for different payment transactions. We frequently saw that the same customer account number or contract number was used to make different payments. This weakens the utility of potential duplicate payments reports which are provided to agency managers. Further, the users do not make effective use of these reports because they contains too many valid transactions.

To reduce the potential for inadvertent duplicate payments and increase the utility of existing management oversight reports, transaction edits comparing vendor type, vendor number, and invoice customer account number should also include the dollar amount. Further, data entry personnel should enter unique information in the invoice customer account number. Finally, supervisory personnel should approve system overrides for transactions flagged as potential duplicate payments.

Budgetary Limitations. Fund authority transactions lack sufficient controls to prevent budgetary limitations from being exceeded. According to our test deck analysis, DAFIS does not have detective controls to prevent the recording of (1) budgetary rescissions in excess of the appropriation balance, (2) apportionments in excess of the appropriation balance, or (3) contract liquidating authority in excess of contracting authority without liquidating appropriation. In our view, DAFIS should either preclude these transactions outright or provide an appropriate warning message to ensure the OAs do not exceed their respective legal budgetary authority.

Core Financial System Requirements

DAFIS does not fully comply with core financial system requirements to (1) use error files to control the reprocessing of erroneous or deleted transactions and (2) provide the same data validation and segregation of duties controls for the processing of interface transactions as for on-line transactions.

Erroneous or Deleted Transactions. According to JFMIP's Core Financial System Requirements, financial systems must provide control over the reprocessing of all erroneous transactions through the use of error files and/or suspense accounts. DAFIS currently holds batches with erroneous records in the batch control file. However, input records deleted by the data entry clerk prior to batch completion, certifier-initiated stop pay transactions, and unprocessed batches (containing unbalanced header and detail records or uncorrected edit errors) at month-end are deleted from the system. The user is required to re-enter these transactions. To ensure proper management oversight and minimize the opportunity for additional reprocessing errors, these transactions should be captured in a suspense file.

Interface Systems. According to Core Financial System Requirements, all transactions from interfacing systems must be subject to the same core financial system edits, validations, and error correction procedures as on-line transactions. This precaution reduces the likelihood of incorrect processing or abnormal program terminations.

We found that certain data validations and segregation of duties which were enforced in on-line batch data entry processes were absent in the generic interface batch entry processes. For example, DAFIS editing programs expect each record in a batch will contain the same agency code. For on-line data entry, this provision is enforced through system security privileges. However, our test deck analysis indicates that generic interface batches containing transactions with two different, but valid agency codes, will not process correctly. Specifically, DAFIS initially validates the agency code in each record in the batch. Later in the processing cycle, the record with a differing agency code will be deleted from the batch and written to a new batch file which is not accessible or visible to the user. The user may then re-balance the original batch without knowledge that a transaction has been deleted, thus creating an exposure that a transaction could be lost and not recorded in DAFIS. To ensure these transactions are properly validated and recorded, DAFIS should capture these transactions in a user-accessible file or reject the entire batch.

Our test deck analysis also confirmed on-line batch entry controls preclude certifying officials from certifying disbursement batches which they entered into DAFIS. However, the generic interface batch entry system does not have a corresponding control. Generic interface batch records do not identify the individual who created the batch. This creates an exposure that a payment batch could be submitted and certified by the same individual. The generic interface batch process should identify the individual who created the batch and preclude this individual from certifying the batch.

Direct Reimbursable Transactions. Our test deck analysis disclosed that certain transactions for direct reimbursable agreements (containing limitation code 6) do not post general ledger accounts correctly. As part of the reimbursable process, DAFIS automatically generates an accounts receivable when an expenditure is made for services or goods provided under the reimbursable agreement. However, our tests for intragovernmental agreements showed DAFIS improperly posts the receivable to a public instead of a governmental account. Further, when we entered a stop payment to reverse the erroneous transaction, DAFIS did not reverse the accounts originally posted. Instead, governmental accounts which should have been originally posted were reversed. Accordingly, intragovernmental accounts receivable and revenue accounts were understated and public accounts receivable and revenue accounts were overstated. In FHWA, this system error resulted in an invalid credit balance in governmental accounts receivable and an overstatement of public accounts receivable totaling $33.4 million and $38.6 million, respectively. Agency accounting officials made appropriate corrective adjustments.

Actions Taken. In response to the lack of edits restricting application of interest, penalty, and administrative charges, FAA officials administering DAFIS were reluctant to modify the existing accounts receivable module because the USCG is testing a replacement module from a commercial vendor. They agreed to notify agency accounting officials of the erroneous records containing excessive rates. In our view, since a replacement accounts receivable module is being field-tested, no immediate change to the existing system is needed. However, OST should ensure the replacement system includes a corresponding control. Further, until the new system is in place, OST should periodically review the existing accounts receivable records to identify erroneous records and initiate corrective actions.

FAA officials indicated they would initiate an emergency system change request to correct the direct reimbursable general ledger postings and would defer to OFM officials for guidance on any additional system modifications. OFM officials indicated the cost of implementing additional edits must be balanced against risks, existing manual compensating controls, and a large backlog of other system change requests.

Recommendations

We recommend the Departmental CFO authorize and implement DAFIS system changes to:

1. Mask batch control totals from data entry personnel.

2. Reduce the size of the amount field for recurring charges transactions to a more reasonably expected payment amount or provide a warning to the user requiring a confirmation when payment amounts exceed certain limits.

3. Modify controls over potential duplicate payments by requiring: (a) transaction edits which include a comparison of the amount field, (b) entry of unique invoice customer account numbers, and (c) supervisory approval of system overrides of transactions flagged as potential duplicate payments.

4. Establish controls to prevent the recording of, or provide appropriate warning for: (a) budgetary rescissions in excess of the appropriation balance, (b) apportionments in excess of the appropriation balance, and (c) contract liquidating authority in excess of contracting authority without liquidating appropriation.

5. Establish an error or suspense file for all stop payments, deleted transactions, and batches purged immediately prior to month-end processing.

6. Establish controls in the generic interface batch process to capture transactions with agency code discrepancies in a user-accessible file or reject the entire batch.

7. Establish controls in the generic interface batch process to identify the individual who created the batch and preclude this individual from certifying the batch.

To improve controls over accounts receivable transactions, we recommend the Departmental CFO:

8. Issue a user guide amendment to fully describe how to enter interest, penalty, and administrative charges for all receivable types.

9. Ensure controls over interest, penalties, and administrative charges are functional in the proposed accounts receivable replacement module.

10. Periodically review the existing DAFIS accounts receivable file to detect erroneous records and initiate corrective action.

Management Position

Officials in the CFO's Office of Financial Management generally concurred with our recommendations. For Recommendation 1, as an alternative to an immediate system change to mask the batch totals, OFM proposed to re-emphasize the need for data entry personnel to follow existing written procedures for batch preparation and entry. For Recommendation 2, OFM proposed an alternative corrective action to limit the dollar value field for recurring charge transactions. OFM agreed to implement Recommendations 3a and 3b but disagreed with the need to implement Recommendation 3c. OFM believes that with the new edits and revised data entry procedures, existing compensation controls would reduce the need to implement supervisory approvals. For Recommendation 5, OFM agreed to establish a error or suspense file for stop pay transactions and month-end batch purges but indicated additional analysis would be needed before including deleted transactions in a suspense file. OFM agreed to implement the remaining recommendations. We are awaiting the CFO's response on the recommendations.

P. Payroll Systems Change Control

OST did not have a formal software maintenance change control policy to ensure software changes were completed on CUPS. The lack of a formal maintenance policy was due in part to the anticipated replacement of CUPS, which may now be significantly delayed. The System Change Proposal (SCP) procedures for military pay systems in the USCG were not effective. Our review of the USCG Human Resources Services and Information Center's (HRSIC) log of changes to military and retired pay systems showed that target completion dates were not routinely established and inactive proposals were not closed. Without a formal change control policy for civilian payroll, DOT can not assure that changes to CUPS are adequately implemented and the integrity of the application software is maintained. In addition, the lack of target completion dates or close out of inactive SCPs, could affect USCG's management of payroll system changes.

Discussion

Under DOT Order 1350.2, "Departmental Information Management Manual (DIRMM)," it is the Department's policy to ensure software will follow the principles, standards, and guidelines of the Federal Information Process (FIPS) Publications and other Federal guidelines. FIPS Publication 106, "Guidelines on Software Maintenance," contains techniques, procedures, and methodologies to use throughout the life cycle of a software system. Software can become non-functional or faulty due to changes in the environment in which it must operate, the size or sophistication of the user community, the amount of data it must process, or damage to code which is the result of other maintenance efforts on other parts of the system. The software maintenance manager is responsible for keeping the application systems running and to facilitate communication between management, users, and maintainers. The software maintenance manager should ensure all system change requests are formally submitted, reviewed, assigned a priority, and scheduled.

In October 1995, responsibility for CUPS shifted from FAA to OST. OST had not established a formal maintenance policy because of anticipated replacement of the existing civilian personnel and payroll systems with the Integrated Personnel and Payroll System (IPPS). However, the IPPS project was terminated before completion and CUPS continued to function as the Department's civilian payroll system. OST recognizes that CUPS will be the payroll system for at least 2 years and drafted a change control policy in November 1996. However, as of February 1997, the policy was not issued.

HRSIC did not properly maintain a log of all changes made to military and retired pay systems. Of the 112 SCPs listed, we found 105 SCPs were active and 7 SCPs were complete and should be deleted from the log. A review of the 105 active SCPs showed 63 SCPs (60 percent) did not have project completion dates which were critical to ensuring timely completion of SCPs. The HRSIC should revise their SCP log to contain sufficient information to manage the timely completion of SCPs to military and retired pay systems.

HRSIC agreed the SCP Log would be a more useful by deleting completed SCPs, adding SCPs approval dates, and developing target completion dates. HRSIC has started deleting completed SCP from the log and adding SCP approval dates.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Issue a formal software maintenance policy for making changes to CUPS.

2. Require the USCG to provide an implementation plan with target dates to develop procedures to establish target completion dates for SCPs and delete completed SCPs from the log.

<u>Management Position</u>

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. OST will issue formalized software maintenance policy for making changes to CUPS. USCG also concurred with our finding and recommendations and is initiating corrective actions. We are awaiting management's response to the final report.

Q. <u>Separation of Duties Over Pay Systems</u>

DOT does not have adequate separation of duties for IPPS, JUMPS, and the USCG Retired Pay and Personnel System. We found (1) DOT employees paid through IPPS can approve their own time and attendance (T&A) report, including premium pay and leave; and non supervisory employees can approve other T&A reports; (2) USCG Payment Approving Officials (PAOs) at the Personnel Reporting Units (PERSRUs) can enter and approve their own pay, leave, and benefit transactions; and (3) a USCG Retired Pay and Personnel System computer programmer could (a) develop and implement program changes, (b) control access to files, and (c) make changes to the files. These internal control weaknesses exist in IPPS largely because managers were not aware of departmental policies prohibiting self-approval, and DOT Order 2730.10, "Time and Attendance Reporting for IPPS," does not clearly define who should be an authorizing official. The separation of duties weakness for the JUMPS and the Retired Pay and Personnel System exist primarily due to staffing limitations. As a result, management does not have reasonable assurance that the financial information to process pay, leave, and benefits is complete, accurately recorded, properly authorized, and approved.

Discussion

According to GAO Title 6, "Pay, Leave, and Allowances," responsibilities for duties and functions should be sufficiently segregated to provide appropriate internal controls to minimize opportunities for carrying out unauthorized or otherwise irregular acts. Under GAO Title 6, all T&A reports and related supporting documents are to be reviewed and approved by an authorized official, the employees' supervisor or other equivalent officials. However, the head of an agency may authorize particular individuals to approve their own T&A data in certain situations. Such exceptions are intended to apply when it is not feasible to have the T&A data approved by a supervisor. These exceptions include but are not necessarily limited to Senior Executives and employees working alone at a remote site for long periods. In these situations, an official authorized by the agency head must grant advance authority in writing, and agencies must ensure that effective controls are in place.

We found inadequate separation of duties over IPPS. DOT employees paid through IPPS can approve their own T&A reports, including premium pay and leave. Also, non-supervisory employees can approve time and attendance of others.

We found nine OAs on the automated time collection system are allowing significant numbers of self-approvals of T&As. However, MARAD has only one Senior Executive who self-approves and RSPA has no self-approvers. Of the OAs allowing self-approval, 721 employees in grade 15 and below can approve their own T&A record. These employees, including 44 in grade 7 or below, did not receive advanced written authority. We also identified 241 non-supervisory employees in grade 14 and below that can approve T&A reports for other employees. This includes 54 employees in grade 7 or below.

The USCG does not have adequate separation of duties for JUMPS. PAOs at the PERSRUs were able to enter and approve their own pay, leave, and benefit transactions contrary to GAO Title 6. The USCG has 159 PAOs at 48 PERSRUs who were able to enter and approve their own pay transactions. Self-approval of pay transaction should be prohibited.

The primary objective of T&A systems is to ensure that the hours worked, hours in pay status, and hours absent are properly reported. Without adequate separation of duties, management does not have reasonable assurance that the financial information to process pay, leave, and benefits is complete, accurately recorded, properly authorized, and approved.

USCG does not have adequate separation of duties for the Retired Pay and Personnel System. A programmer stationed in Topeka, Kansas can establish and delete users of the Retired Pay and Personnel System. This individual also manages, develops, and implements programming changes, has access to Retired Pay and Personnel System files, and can change the retired and annuitant master files. Furthermore, this programmer had access to change user passwords which should only be performed by the security administrator. In our opinion, this lack of separation of duties is significant and some of these current functions should be reassigned to others.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Reemphasize to the OAs the need to eliminate the practice of employees approving their own T&As unless they have advanced written authority.

2. Revise DOT Order 2730.10 to incorporate GAO Title 6 requirements for authorizing approving officials.

3. Require USCG to provide an action plan with target dates to prohibit PAOs from entering and approving their own transactions at PERSRUs, and analyze duties performed by the Retirement Pay and Personnel System programmer and reassign functions as necessary to achieve proper separation of duties.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. OFM is responsible for IPPS and is currently assessing the appropriate action necessary to correct the separation of duties weakness. USCG agreed with our finding and recommendations. USCG officials agree to prohibit PAOs from inputting and approving their own transactions and to evaluate the functions performed by their programmer and reassign work as necessary. We are awaiting management's response to the final report.

R. Retired and Military Pay Edits

USCG's controls over the retired and military pay systems were not adequate. Our testing showed (1) information on deceased recipients was not processed timely, (2) existing controls to prevent payment of deceased individuals were ineffective, and (3) certain relational and automated pay status edits in USCG's military pay system were not effective. If paid, erroneous overpayments would improperly reduce cash accounts and require the establishment of accounts receivable to the Government.

Discussion

Under OMB Bulletin 90-08, "Guidance for Preparation of Security Plan for Federal Systems that Contain Sensitive Information," sensitive systems should include data integrity controls used to protect data from accidental or malicious alternation or destruction. OMB Circular A-130 establishes policy for the management of Federal information resources. According to this circular, technical security controls (e.g., test to filter invalid entries) should be built into each application.

HRSIC used information furnished by DoD to stop pay on deceased retirees and annuitants (the retiree's beneficiary). Bimonthly, HRSIC received from DoD's Defense Manpower Data Center a copy of the monthly "Social Security Administration's Death File" (SSA Death File). Our review showed HRSIC was not receiving the SSA Death File timely. For instance, the Death File received in January 1997 was for October 1996. In addition, HRSIC took almost 2 months to process the Death File received in January.

The edit process within the retired system was not adequate. Our testing of edits within the Retired Pay and Personnel System showed the automated edit process was not effective. For example, during our testing, we entered a recent death date on a retired member and an annuitant, and found that the system still generated pay for those individuals. After discussing these issues with HRSIC, they established an edit to inform the user that a date of death was entered, and the retiree or annuitant must be placed in a non-pay status.

Relational and automated pay status edits within the military pay system were also not effective. During our testing of the military pay system, we established unusual pay status on members and no warning was given. For example, we (1) initiated flight pay on a Yeoman assigned to an administrative unit, a duty station at which flight pay would be highly unlikely; (2) changed a member's unit without placing the member on travel status or processing a permanent change of station order; and (3) changed a member from an administrative unit to a vessel and initiated Career Sea Pay. In all three cases, pay was made with no edit warning of a potential improper payment.

HRSIC should implement edits to identify and "flag" unusual pay entitlements. HRSIC stated they would evaluate opportunities to use relational edits for unusual payments in the military pay systems depending on cost versus benefit analysis.

Recommendations

We recommend the Departmental CFO:

1. Require USCG to provide an implementation plan with target dates to ensure the SSA Death File is received and processed on a timely basis.

2. Require USCG to provide an action plan with target dates to implement relational and automated edits to warn HRSIC of unusual pay status.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. USCG agreed to review administrative procedures to obtain quicker Death File matches. USCG will do an analysis to determine the cost effectiveness of implementing edits for the pay system. We are awaiting management's response to the final report.

S. Capital Leases

OAs did not properly identify, account for, and report capital leases. This occurred because neither OST nor the OAs issued procedures for identifying and accounting for capital leases. As a result, capital leases reported at $103.9 million may have been understated on the FY 1996 DOT Consolidated Financial Statement.

Discussion

OMB Bulletin Number 94-01 and SFFAS Number 6 define capital leases as leases that transfer substantially all the benefits and risks of ownership to the lessee. A lease should be classified as a capital lease if, at its inception, one or more of the following four criteria is met.

- The lease transfers ownership of the property to the leasee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

We reviewed a total of 161 operating leases entered into by six OAs: FAA, USCG, MARAD, FHWA, NHTSA, and FRA. We found 36 of these leases potentially met the criteria to be classified as capital leases. The potential capital leases were entered into by FAA, USCG, MARAD, and NHTSA and represented annual payments of $4,881,994.

We were unable to determine whether the 36 leases were capital leases because the lease files did not include the estimated economic life or the fair value of the properties at the inception of the lease as required by SFFAS Number 6. However, if any of these operating leases are capital leases, then assets and liabilities reported on the FY 1996 DOT Consolidated Financial Statement will be understated and will not accurately reflect the Department's capital lease commitments.

According to OST officials, DOT Order 2700.8A contains no specific reference to capital and operating leases. In addition, the OAs had not issued procedures to identify, account for, and report capital leases. In our Supplementary Report of Internal Control Systems and Compliance Related to the Airport & Airway Trust Fund Portion of FAA's FY 1993 Financial Statement (Report No. AD-FA-5-005), issued March 29, 1995, we found capital leases may have been inappropriately expensed, and recommended FAA Order 2700.31, "Uniform Accounting System Operations Manual," be revised to properly distinguish between capital and operating leases. The Department should emphasize to the OAs the importance of identifying, accounting for, and reporting capital leases by issuing Departmentwide procedures. This will ensure future financial statements more accurately reflect the Department's assets, liabilities, and expenses.

Recommendations

We recommend the Departmental CFO:

1. Revise DOT Order 2700.8A to incorporate procedures to identify, account for, and report capital leases.

2. Require the OAs to (a) determine fair value and economic life (at the time of inception) for the 36 potential capital leases included in our sample, (b) review their records to determine if any additional leases should be classified as capital leases, and (c) make the necessary adjustments to their financial records.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. OFM acknowledged the DOT order should incorporate procedures related to capital leases and the OAs should review current leases and make necessary adjustments to their records. We are awaiting management's response to the final report.

T. Accounting and Reporting of DOL Chargeback Costs

OAs did not properly account and report their portion of the Department of Labor (DOL) chargeback costs related to the Federal Employee Compensation Act (FECA). Costs already incurred were not recorded in DAFIS quarterly and reported in the consolidated financial statement. As a result, Liabilities not Covered by Budgetary Resources-Other Intragovernmental Liabilities and FFR were each understated by $36.2 million on the draft Consolidated Statement of Financial Position.

Discussion

OMB's memorandum to Chief Financial Officers of Executive Departments and Agencies Subject to the CFO Act, dated December 23, 1994, stated liabilities and related expenses associated with FECA should be recognized in general purpose financial reports when they are incurred (accrual basis) regardless of whether they are covered by available budgetary resources. This guidance conforms to SFFAS Number 1 requirement of recognizing assets, liabilities, revenues, and expenses when an event occurs even if funds have not been provided for payment. However, OST's guidance on accounting for DOL chargeback costs did not require the recording of these costs for the quarterly period ended September 30th of each fiscal year.

The understatements by OA is shown in the following table.

UNRECORDED DOL CHARGEBACK COSTS

Operating Administration	FY 1995 Expense	FY 1996 Expense	Total
OST		$ 40,448	$ 40,448
FHWA		293,102	293,102
NHTSA		47,893	47,893
FRA		330,014	330,014
FTA		13,495	13,495
FAA		18,359,251	18,359,251
USCG	$ 8,007,640	6,391,621	14,399,261
MARAD	1,446,272	1,362,129	2,808,401
IG		(44,113)	(44,113)
RSPA		(1,939)	(1,939)
Consolidated	$9,453,912	$26,791,901	$36,245,813

The Consolidated Statement of Financial Position should have reflected the total FECA chargeback costs of $36.2 million as Liabilities not Covered by Budgetary Resources-Other Governmental Liabilities and Future Funding Requirements. Also, the FY 1995 expense of $9.4 million should have reduced the Cumulative Results of Operations on the Consolidated Statement of Financial Position. Finally, the draft consolidated financial statement should have reflected an additional $26.8 million in Program and Operating Expense. The OAs have agreed to make the adjustments.

Recommendation

We recommend the Departmental CFO issue procedures to OAs to ensure FECA costs are identified, recognized, and recorded in DAFIS on a quarterly full accrual basis to ensure they are properly reported in the consolidated financial statement.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with the finding and recommendation. This office will develop guidance for the OAs to properly record FECA on a quarterly basis. We are awaiting management's response to the final report.

U. Post Employment Benefits

USCG did not properly account for post employment benefits associated with the costs for PCS moves for military service members when the members separate from service. This occurred because USCG personnel were not aware that Financial Accounting Standards Board (FASB) Statement Number 112 requires costs associated with post employment benefits to be expensed and a liability recorded when the benefit is actually earned. Instead, USCG personnel incorrectly delayed reporting these PCS costs as expenses until the costs were paid. As a result, Liabilities not Covered by Budgetary Resources and FFR on the draft DOT Consolidated Statement of Financial Position were understated by an estimated $56.9 million. In addition, Non Operating Changes on the draft DOT Consolidated Statement of Operations were understated by an estimated $56.9 million.

Discussion

FASB Statement 112, "Employers' Accounting for Post Employment Benefits," specifies generally accepted accounting principles for post employment benefits. Under Joint Federal Travel Regulations, paragraph U5125-A, a military service member, upon separation or retirement, is entitled to be reimbursed for a PCS move from their current duty station to their enlistment location (home of record) or any other location provided the cost does not exceed the cost the Government would have incurred to move the service member to the home of record. Statement 112 requires that the cost of deferred (post employment) compensation be recorded as an expense and a liability in the reporting period that the benefit is earned. SFFAS Number 5, effective with the reporting period beginning after September 30, 1996, states expenses and associated liabilities for post employment benefits should be recognized at the time a future outflow is probable and measurable based on events occurring on or before the respective reporting period. SFFAS Number 5 further states any part of the expense unpaid at the end of the period constitutes a liability.

USCG did not recognize the expense or establish a liability for end-of-service PCS moves during the period in which military service members earned these post employment benefits. Instead, USCG recognized the expenses in the period the costs for the PCS moves were paid. Using USCG's reported "Military Full-Time Equivalent-Active Duty Military Personnel Workforce," budget estimates for FY 1996 and responses to an OIG questionnaire on PCS costs, we determined USCG at September 30, 1996, had a liability of approximately $62.6 million for the PCS moves of military service members upon separation. We reduced the actual numbers of officers and enlisted personnel at the end of FY 1996 because USCG Academy graduates and new recruits during the past 4 years would have only earned a percentage of the post employment benefit.

OIG Estimate of Post Employment Benefits for PCS Costs

Category	**No. of Personnel**	**Average Cost**	**Unfunded Amount**
Officers	**5,495**	**$3,275**	**$17,996,125**
Warrant Officers	**1,537**	**3,275**	**5,033,675**
Enlisted	**21,336**	**1,855**	**39,578,280**
			$62,608,080

USCG officials agreed that a portion of the estimated PCS cost should be expensed and reflected as a liability. Therefore, USCG officials posted an expense and a corresponding liability of $5.7 million. USCG officials did not agree that the full amount should be recognized because, in their view, acceptance of the service members' request for separation or retirement represents the event leading to the recognition of the expense and associated liability. We disagree because the military service member, under the Joint Federal Travel Regulations, is entitled to the end-of-service PCS and, therefore, the full amount should be recognized. As a result, Liabilities not Covered by Budgetary Resources-Other Governmental Liabilities and FFR on the draft DOT Consolidated Statement of Financial Position were understated by an estimated $56.9 million. In addition, Non Operating Changes on the draft DOT Consolidated Statement of Operations were understated by an estimated $56.9 million. We did not determine if other OAs had employees entitled to post employment benefits.

Recommendation

We recommend the Departmental CFO develop and provide guidance for reporting post employment benefits associated with military PCS as an expense when the future outflow is probable and measurable based on events occurring on or before the reporting period.

Management Position

Officials from the CFO's Office of Financial Management verbally agreed to work with USCG officials to seek a clarification of the guidance specified in SFFAS Number 5 regarding the treatment of military PCS costs as post employment benefits. If appropriate, a plan for implementing the requirements in SFFAS Number 5, to include a methodology for estimating the post employment benefits, will be completed 60 days after obtaining the clarification. We are awaiting management's response to the final report.

V. Federal Workforce Restructuring Act of 1994

OAs did not correctly account for costs associated with implementation of the Federal Workforce Restructuring Act of 1994. OST guidance did not address the proper financial reporting of these costs and accounting personnel in the OAs were not aware of the requirement to recognize these costs as expenses or to establish a liability during the proper period. As a result, OAs did not reflect estimated costs of $33.8 million as expenses or establish a corresponding liability in FY 1995. Instead, the OAs incorrectly reported a portion of the costs as expenses during FY 1996 when the costs were actually paid. For the FY 1996 DOT Consolidated Financial Statement, Program or Operating Expenses on the Statement of Operations were overstated by about $19.4 million and Liabilities not Covered by Budgetary Resources on the Statement of Financial Position were understated by an estimated $14.4 million expected to be paid in FYs 1997 and 1998.

Discussion

FASB Statement Number 74, "Accounting for Special Termination Benefits Paid to Employees," requires employers to recognize special termination benefits as a liability and an expense at the time employees accept the offer and the amount can be reasonably estimated. SFFAS Number 4 states that other post employment benefits should be reported as an expense for the period during which a future outflow is probable and measurable on the basis of events occurring on or before the reporting period. SFFAS Number 5 states special termination benefits (such as specially authorized separation incentive programs) are considered other post employment benefits and should be recognized as such.

The Federal Workforce Restructuring Act of 1994 (Public Law No. 103-226) permits the heads of Federal agencies to offer incentive payments up to $25,000 to encourage employees to retire or resign from their Federal positions. To be eligible for the incentive payment, employees had to retire or resign by April 1, 1995. However, agency heads were permitted to delay the retirement or resignation until March 31, 1997, to ensure the performance of the agency's mission. The Restructuring Act also required each agency to make two types of special payments to the Treasury for credit to the Civil Service Retirement and Disability Trust Fund. First, Federal agencies are required to make a one-time payment equivalent to 9 percent of the final salary for each employee who retired early and received an incentive payment. Second, Federal agencies are required to make four annual payments, FY 1995 through FY 1998, of $80 for each of these employees onboard as of March 31 of each year.

Recording Payments. During FY 1995, DOT approved deferred incentive payments for 721 employees with 275 employees having a separation date during FY 1996. The remaining 446 employees are scheduled to separate during FY 1997. Using an average incentive payment of $24,000 per employee, we estimated incentive payments of $17.3 million would be paid to employees during FYs 1996 and 1997. None of the incentive payments were recorded as expenses during FY 1995 as required. Instead, the incentive payments were recorded as an expense when paid. As a result, Program or Operating Expenses on the FY 1996 DOT Consolidated Statement of Operations was overstated by $6.6 million and the FY 1997 DOT Consolidated Statement of Operations will be overstated by $10.7 million. In addition, the estimated $10.7 million for incentive payments to be paid in FY 1997 was not recorded as Liabilities not Covered by Budgetary Resources on the FY 1996 Consolidated Statement of Financial Position.

Of the 721 employees approved to receive a deferred incentive payment, 330 employees elected to retired early during FYs 1996 or 1997. These early retirements with an incentive payment created a liability equivalent to 9 percent of the employee's final base pay. Using an average salary of $50,000, we determined an expense of $1.5 million with a corresponding liability should have been recorded in FY 1995. During FY 1996, OPM billed and DOT paid $76,924 for 15 employees. This was incorrectly recorded as a FY 1996 expense. The remaining $1.4 million will be paid during FY 1997 and accordingly represents a Liability not Covered by Budgetary Resources on the FY 1996 Statement of Financial Position.

DOT made or will make four annual payments per year for FYs 1995 through 1998, based on the criteria in the Restructuring Act. As required, DOT paid $5.0 million in FYs 1995 and 1996. The

FY 1995 payment was properly reflected as an expense. During FY 1996, FAA recorded the annual payments for FYs 1997 and 1998, estimated at $7.8 million, as a FY 1996 expense and liability. As a result, Program or Operating Expense on the Consolidated FY 1996 Statement of Operations was overstated by $12.8 million (FAA's liability of $7.8 million and the FY 1996 annual payment totaling $5.0 million). For the remaining OAs, annual payments to be made in FYs 1997 and 1998 estimated at $2.3 million, were not recorded resulting in understatement of Liabilities Not Covered by Budgetary Resources on the Consolidated Statement of Financial Position.

OST Guidance. On May 26, 1994, OMB issued a supplement to Bulletin 94-04 which stated ". . . an obligation for the payment of the buyout is incurred when the agreement is signed." OST's Office of Budget issued a memorandum, dated July 22, 1994, to notify OAs of the OMB guidance. Subsequently, on March 29, 1995, the Office of Budget informed the OAs that OMB determined that the buyout obligations occurs at the time Standard Form 52, Personnel Action Request, is signed. However, OST's guidance did not address the financial reporting requirements for the costs associated with the Restructuring Act and accounting personnel in the OAs were not aware of the requirement to record the costs as expenses in FY 1995.

Recommendation

We recommend the Departmental CFO issue detailed instructions to the OAs on how to correctly report the costs associated with the Restructuring Act on the FY 1997 financial statements.

Management Position

Officials from the CFO's Office of Financial Management verbally concurred with our recommendation and indicated detailed instructions for the correct reporting of costs associated with the Restructuring Act will be included in DOT's annual yearend closing instructions. We are awaiting management's response to the final report.

W. Contingent Liabilities for Legal Claims

The DOT financial statement did not properly recognize a contingent liability for legal claims. FAA correctly recognized $303.7 million on the statements and in a note disclosure for contingencies that would be payable from the Treasury Judgment Fund for asserted and unasserted claims. In FY 1996, $11.6 million was paid from the

Judgment Fund in expenses for legal claims for DOT. However, from the list of judgment cases provided by the Treasury, it appeared that the cases listed would involve several other OAs. Since the Treasury only tracked payments by department, amounts for each OA could not be determined. The FY 1997 financial statement should disclose all DOT contingent liabilities to be paid by the Judgment Fund.

Discussion

OMB Bulletin 94-01 requires disclosure of estimated losses for commitments and contingencies. The Federal Accounting Standards Advisory Board, in the October 1996 Board meeting, addressed how Federal entities should report the costs and liabilities arising from legal claims to be paid by the Treasury Judgment Fund. These expenses are to be recognized as an other financing source according to the November 1996 issue of "FASAB News," the newsletter of the Federal Accounting Standards Advisory Board.

The Federal Accounting Standards Advisory Board, at their October 1996 Board meeting, approved a summarized interpretation for issuance on accounting for Treasury Judgment Fund transactions. The Judgment Fund, with a permanent indefinite appropriation, was established in the 1950's by Congress to pay, in whole or in part, the court judgments and settlement agreements negotiated by the Justice Department on behalf of Federal agencies, as well as certain types of administrative awards. The interpretation states that, in accordance with SFFAS Number 5, a contingent liability should be recognized when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. If the agency's management, as advised by the Justice Department, determines that a legal claim will end in a loss and the loss is estimable, the agency would recognize an expense and liability for the full cost of the expected loss, regardless of who is actually paying the judgment amount. The expense and liability would be adjusted as necessary, based on any changes in the estimated loss.

The newsletter goes on to say, "Once the claim is either settled or a court judgment is assessed against the federal entity and the fund is to pay the loss amount, the liability should be removed from the financial statements of the entity that incurred the liability and an 'other financing source' amount (which represents the amount to be paid by the Judgment Fund) would be recognized."

We found no evidence that contingent liabilities for any OA had been entered in the General Ledger Account #29BX "Contingent

Liabilities" in DAFIS. FAA was the only OA to recognize a liability of $303.7 million that would be payable from the Judgment Fund. However, $11.6 million was paid by the Treasury for all OAs in DOT.

Although the amount paid by the Judgment Fund is not material to this financial statement, procedures to recognize future payments should be established for FY 1997. OAs should also be reminded that contingencies that are probable and estimable should be included in the accounting records and in the financial statements.

Recommendations

We recommend the Departmental CFO:

1. Work with the Treasury to identify Judgment Fund payments by OA within the DOT.

2. Issue guidance to the OAs for the FY 1997 Consolidated Financial Statement concerning the recognition of (a) contingencies that are probable and estimable in the financial statement and in the accounting records and (b) costs paid by the Treasury Judgment Fund as an "other financing source" in the financial statement and accounting records.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with the finding and recommendations. OST received a copy of the list of payments provided by the Treasury and agreed to work with the Treasury to identify the payments by each OA. Also, OST agreed to issue guidance to the OAs for FY 1997 concerning the recognition of contingent liabilities for legal claims. We are awaiting management's response to the final report.

X. Canceled Appropriations

DOT did not have adequate controls over assets and liabilities deleted from canceled appropriation accounts. This occurred because OAs did not comply with departmental guidance in reviewing canceled appropriations before yearend. As a result, over $100 million of assets and liabilities were deleted from the Department's official accounting records without proper management review during FYs 1995 and 1996.

Discussion

According to the Treasury Financial Manual Bulletin No. 96-03 “Yearend Closing,” fixed-year appropriations, once expired, will remain available for liquidation purpose for 5 years. At the end of the fifth year, these appropriation accounts shall be closed and any remaining balance in the account shall be canceled. Accordingly, OST in its yearend closing instructions, dated July 30, 1996, required OAs to reclassify or deobligate remaining balances in these appropriations before yearend. Any remaining balances would be deleted by DAFIS during yearend closing.

Our review indicated DAFIS deleted a total of $48 million of assets[9] and liabilities during FY 1995, and $52 million of assets and liabilities during FY 1996 yearend closing. The totals by line item follow.

Assets-	-Receivables from Public	$89,000
	-Other Assets	3,960,000
	-Advances to Other Agencies	1,393,000
	-Unresolved Cash Reconciliation	1,527,000
	-Property	83,146,000
Liabilities		9,958,000
	Total Deleted Assets and Liabilities	$100,073,000

The property, totaling $83 million, deleted from DAFIS was added back to the Department’s financial statement through yearend manual adjustments. The other assets totaling $7 million and liabilities of almost $10 million were written off. Although not material to the Department’s financial statements, these assets and liabilities should not have been deleted from official accounting records without proper review and approval. This occurred because (1) OAs were not complying with departmental yearend closing instructions to reclassify remaining balances in canceled appropriations and (2) the Department did not have a mechanism for identifying noncompliance for followup actions.

Recommendations

We recommend the Departmental CFO:

1. Reemphasize to the OAs the importance of compliance with yearend closing instructions for reclassifying asset and liability balances in expired appropriations before cancellation.

[9] This does not include fund balance with the Treasury and unrequisitioned cash since these assets are returned to the Treasury upon cancellation of expired appropriations.

2. Develop a management exception report listing assets and liabilities deleted from canceled appropriations for OST management review and followup.

Management Position

Officials of the CFO's Office of Financial Management verbally concurred with our recommendations. The CFO staff plans to reemphasize to the OAs the importance of reclassifying asset and liability balances in expired appropriations before cancellation and develop an exception report listing assets and liabilities deleted from canceled appropriations for their own review and followup by June 30, 1997. We are awaiting management's response to the final report.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

OMB guidance for implementing the audit provisions of the CFO Act requires auditors to assess the reporting entity's compliance with applicable laws and regulations. Compliance with laws and regulations applicable to the DOT is the responsibility of DOT management.

As part of obtaining reasonable assurance about whether the DOT Consolidated Statement of Financial Position was free of material misstatements, we tested compliance with the laws and regulations directly affecting the financial statement and certain other laws and regulations designated by OMB and OST General Counsel. Our objective was not to provide an opinion on overall compliance with these provisions.

Material instances of noncompliance are failures to follow requirements or violations of prohibitions contained in laws or regulations which cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the principal statements or the sensitivity of the matters would cause them to be perceived as significant by others.

Except as described below and discussed in the internal control weaknesses, the results of our tests of compliance indicted with respect to those items tested, DOT complied in all material respects with the provisions of the laws and regulations directly affecting the DOT Consolidated Statement of Financial Position as of September 30, 1996.

Y. **General Ledger Adjustments**

Adjustments can be made to the general ledger file that bypass normal approval, edit, and file management processes. During FY 1996, FAA's Accounting Functional Division processed 53 general ledger adjustment requests totaling about $9.6 billion to correct DAFIS general ledger account balances. These adjustments, generally made because DAFIS lacks the capability to properly process prior period adjustments separate from current year activities, were recorded directly into the general ledger file as an adjustment of the beginning balance without updating any subsidiary files and without an adequate audit trail. The bypassing of normal DAFIS edits and the lack of a clear audit trail create an exposure for reporting an incomplete or inaccurate representation on the Department's financial statements.

Discussion

According to OMB Circular A-127, the design, development, operation, and maintenance of agency financial management systems shall conform to the functional requirements contained in the Federal Financial Management System Requirements for Core Financial System Requirements issued by JFMIP. Included in the Core Financial System Requirements guidance, issued in September 1995, are general ledger processing requirements to:

- Use standard transactions to control transaction editing, posting to appropriate general ledger accounts, and updating of other information maintained in the system.

- At yearend, provide for the capability to post to the current year by month, as well as to the prior year, regardless of when yearend closing occurs. For example, a user should be able to post to the previous fiscal year, while also posting transactions to the new year.

- Provide an adequate audit trail for transactions critical to providing support for balances maintained by the core financial system. For example, audit trails should allow for the detection and systematic correction of errors as they arise. Such audit trails should be able to trace transactions from the source documents, original input, and other systems through the core system. Further, transaction processing should subject all transactions to system edits, validations, and error correction procedures.

OAs requested general ledger adjustments to correct the effects of accounting errors, incorrect or incomplete manual and automated yearend closing entries, computer program errors, and to account for transactions processed outside of DAFIS such as inventory. These non-routine general ledger adjustments can have a significant impact on the Department's consolidated financial statement. For example, in FY 1996 FRA requested over $6.76 billion in adjustments primarily to reclassify equity accounts. FWHA requested adjustments totaling $466 million because the agency had not manually closed the accounts at yearend or instructed OST to include rescission accounts in the automated yearend closing process. Total requested adjustments for FY 1996 are shown below.

		Amount Adjusted (in millions)				
Agency	No. of Requests	Total	Accounting Errors	Year-End Closing Problems	Activities Outside of DAFIS	Computer Program Errors/ Other
FRA	3	$6,756.8	$6,756.6			$ 0.2
MARAD	2	1,064.6	1,064.3			0.3
FHWA	7	572.9	100.8	$471.9		0.2
FAA	18	474.0	102.2	369.4		2.4
USCG	10	409.2	0.1		$406.2	2.9
OST	8	194.8	2.5	18.9		173.4
NHTSA	2	69.1	69.1			
Other	3	33.4	31.0			2.4
Totals	53	$9,574.8	$8,126.6	$860.2	$406.2	$181.8

Since the general ledger file does not contain a data element for adjustments, FAA personnel at the Mike Monroney Aeronautical Center (MMAC) use a special software routine to adjust general ledger beginning balances. A "snapshot" of the before and after general ledger account balance, along with the input transaction, is written to a MMAC database file, but this file is not accessible to users or OST personnel. These adjustments are not processed through any edit routines and do not update the transaction history file (batch control file) or any subsidiary files, such as the ODF. Since these adjustments are not recorded in the batch control file, DAFIS's Management Information Reporting System, which provides details on general ledger balances, is also not updated. Further, existing query programs available to DAFIS users will not show evidence of the adjustment.

To control the use of these adjustments, OST orally instructed the OAs' accounting representatives in FY 1995 to submit all requests for adjustments to general ledger beginning balances to OFM for approval. However, our review found that of the 32 requests made by OAs to change beginning balances, 19 requests, almost 60 percent, valued at about $1 billion were submitted directly to FAA officials without OFM approval.

The extensive use of non-routine general ledger adjustments represents a significant control weakness as they bypass normal edit and validation procedures, lack an adequate audit trail, and do not update subsidiary records. Therefore, in our view, these deficiencies represent a material nonconformance with JFMIP requirements for use of standardized transactions and transaction control. Although the adjustment requests were reviewed by MMAC system accountants--and we did not detect any adjustments not authorized by OA accounting officials--an exposure exists where invalid or incomplete data could be processed or valid data deleted without an audit trail. Accordingly, erroneous adjustments could go undetected during normal day-to-day operations or financial audit review. Since implementing prior-year adjustment capability in DAFIS requires detailed analysis, we recommend OST management take immediate steps to strengthen controls over current operations and develop a plan to comply with JFMIP requirements.

<u>Recommendations</u>

We recommend the Departmental CFO:

1. Provide immediate actions to strengthen controls over the use of non-routine general ledger adjustments by:

    a. Reducing the need for adjustments by performing an extensive review of the yearend closing processes--both manual and automated--and initiate steps to automate all appropriate account closings.

    b. Emphasizing the need to record manual closing entries on a timely basis.

    c. Providing written guidance on needed approvals of all adjustments.

2. Implement a plan, including target completion dates, to comply with JFMIP requirements for use of standardized transactions and transaction control by:

    a. Adding a data element for prior period adjustments to the general ledger file.

b. Incorporating into DAFIS an edit which prohibits changes to general ledger beginning balances.

c. Requiring that general ledger adjustments be processed through editing programs.

d. Establishing a subsidiary file, accessible to authorized users, to record all general ledger adjustments.

e. Modifying on-line inquiry routines and general ledger reports to show the amount of adjustments to the beginning balances.

Management Position

Officials in the CFO's Office of Financial Management verbally concurred with our recommendations. For Recommendation 1, OFM promised to review the yearend closing process, emphasize to the OAs the need to record manual closing entries, and provide written guidance on needed approvals for making general ledger adjustments. While concurring with Recommendation 2, they will determine the level-of-effort and costs of making changes to DAFIS implementing any changes. When evaluating the level-of-effort and costs of making changes to DAFIS, we request OST to consider the (1) impact of deficiencies in DAFIS on preparing future financial statements and (2) costs of manual controls which will be necessary to provide adequate audit trails. We are awaiting management's response to the final report.

Z. Performance Measures

In the overview for the DOT Consolidated Financial Statement for FY 1996, OST included information on performance measures for each OA. However, the OAs' performance measures did not always have goals and trends included as required by the OMB Bulletins. As a result, information regarding the measurement of DOT's effectiveness in accomplishing its mission was not disclosed, thereby reducing the usefulness of the financial statements.

Discussion

The CFO Act of 1990 states that an agency Chief Financial Officer is required to develop and maintain an integrated agency accounting and financial system, including financial reporting and internal controls which, among other things, provides for the systematic measurement of performance. Additionally, OMB Bulletin 94-01 states each annual financial statement should include a narrative overview of the reporting entity which includes information on whether and how the mission of the reporting entity is being accomplished and should include measures of program performances. Requirements set forth by OMB Bulletin 94-01 are further supplemented by OMB Bulletin 97-01. It states performance measures should relate to purposes and goals, and be consistent with measures previously included in budget documents and other materials related to the Government Performance and Results Act (GPRA).

The bulletins state that the measures should present outputs and outcomes, include positive and negative results, explain the significance of trends, and provide goals and comparisons of results to benchmarks. However, our review of the information provided on each OA's performance measures showed that only the measures for the USCG met all the OMB requirements. Generally the other OAs measures did not include goals or information on the significance of trends.

OST did not include departmentwide performance measures in the overview. OST officials indicated they are developing departmentwide goals and measures to reflect a high-level, crosscutting view across DOT. They also identified the following outcome areas as the basis for developing departmental performance measures: Mobility; National Security/National Defense; Safety; Environmental Protection; and Technological Progress. In future statements, OST's intent is that the performance goals supporting each of the outcome areas will be clearly stated and include high level goals with target performance levels and specific measures.

In our audit of the Highway Trust Fund (HTF) FY 1996 Financial Statement, we reported that FHWA's eight performance measures for fiscal services did not meet OMB requirements. The other HTF performance measures met requirements. We also reported that FAA's FY 1996 financial statement did not include performance measures, as described by OMB Bulletins, and was not consistent with FAA's GPRA implementation efforts. FAA recognizes the need to integrate the GPRA performance measures into its annual report and will do so once the measures are refined and supported by auditable and verifiable data.

Recommendations

We recommend the Departmental CFO:

1. Provide the OAs with guidelines to ensure consistency with OMB requirements in reporting performance measures in the stand-alone FAA and HTF financial statements as well as in the consolidated financial statement.

2. Ensure that the performance measures included in the FY 1997 Consolidated Financial Statement provide sufficient information by which the results of the OA programs and departmentwide efforts can be systematically measured.

Management Position

We are awaiting management's response to the final report.

PRIOR AUDIT COVERAGE

OMB Bulletin 93-06 requires disclosure of the status of known but uncorrected significant internal control findings (and associated recommendations) from prior audits that affect the objectives of the current audit. Since 1991, the OIG has issued 30 audit reports on financial statements prepared by the OAs within the Department. These audit reports identified numerous problems associated with these financial statements and included recommendations for corrective action. The status of the recommended corrective actions contained in prior audit reports was evaluated during this audit of the consolidated financial statement. The previous recommendations were either resolved, immaterial to the consolidated financial statement based on the amount of dollars associated with the control weakness, or addressed in the body of this report as current deficiencies warranting further corrective actions.

This report is intended to inform Congress, OMB, and those with management responsibility for DOT. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Joyce N. Fleischman
Acting Inspector General

Exhibit

LISTING OF AUDIT FINDINGS

SECTION II

Contains the consolidated financial statement and related notes
(information can be scanned)

SECTION III

Supplemental Information Includes the Following:

Message from the Chief Financial Officer

Management Overview

Combining Statements of Financial Position and Operations

For further information, please contact Chris Kent of OST on (202) 366-5622