

***Fiscal Year 2000
Consolidated Financial Statements***

Department of Transportation

Report Number: FI-2001-037

Date Issued: March 1, 2001



Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation

Office of Inspector General

Subject: **INFORMATION**: Report on Fiscal Year 2000
Consolidated Financial Statements, DOT
FI-2001-037

Date: March 1, 2001

From: Kenneth M. Mead

Inspector General

Reply To

Attn. of: Meche:x61496

To: The Secretary

I respectfully submit the Office of Inspector General (OIG) report on the Department of Transportation (DOT) Consolidated Financial Statements for the Fiscal Year (FY) 2000 that ended September 30, 2000. This report is required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

Last year, DOT received an unqualified opinion on its FY 1999 Consolidated Financial Statements. In separate reports this year, the Highway Trust Fund and the Saint Lawrence Seaway Development Corporation again received unqualified opinions. Except for the Federal Aviation Administration (FAA), we did not identify material issues with any of the other DOT internal agencies.

This report presents our qualified opinion on the DOT Consolidated Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing as of, and for the year ended, September 30, 2000. The DOT Consolidated Financial Statements show DOT and its internal agencies had assets of about \$85 billion, liabilities of \$32 billion, operating costs of \$47 billion, and total budget authority of \$56 billion.

DOT received a qualified opinion on the FY 2000 Consolidated Financial Statements because of a material internal control weakness in the accounting for property, plant, and equipment at FAA. The FAA accounts include about \$17 billion of assets and keep track of property supporting air traffic control modernizations and other major property investments. To obtain an unqualified opinion in FY 1999, FAA had to take extraordinary, expensive, and labor-intensive efforts. In our report last year, we cautioned that such efforts were not sustainable for the long term. Accordingly, in a separate report last year, we recommended that FAA acquire a commercial, off-the-shelf, integrated property management system. Both the FAA and DOT Chief Financial Officers agreed.

During FY 2000, FAA tried but was unsuccessful in implementing an integrated property management system. This conversion process was not completed because FAA realized the detailed research and corrective actions necessary to resolve a \$479 million difference between the old and new systems could not be accomplished in time for the financial statement audit. The balances in both systems should have been equal. Consequently, FAA calculated the net book value of its property (\$11.5 billion of the \$16.2 billion total for DOT) using electronic spreadsheets outside the existing property systems.

Nonfinancial personnel at FAA performed the conversion to a new property system, and FAA did not establish adequate controls over changes being made to financial data. As a result of this conversion, among other things, the number of real property items went from 14,000 to 18,000, and increased the net book value of real property by \$158 million. Converting data from one system to another should not have resulted in any changes to the recorded balance. Material errors were made during the conversion. We issued a separate report to FAA with a recommendation for corrective action. The total amounts associated with the errors could not be substantiated which caused us to issue a qualified opinion on the FY 2000 FAA Financial Statements and the DOT Consolidated Financial Statements.

Last year, we also reported that DOT had not established procedures to fully accrue liabilities and expenses at yearend and to use actual costs for estimating environmental and disposal liabilities. During FY 2000, DOT established adequate procedures and produced a fair and reasonable estimate of accrued liabilities and expenses at FY 2000 yearend.

For the FY 2000 DOT Consolidated Financial Statements, we identified four additional areas involving weaknesses in internal controls and compliance with laws and regulations. While these issues are important, they did not affect our audit opinion.

- DOT has about 20 major financial systems. OMB Circular A-130 requires agencies to secure computer systems commensurate with the risk resulting from the loss, misuse, unauthorized access to, or modification of, the systems. OIG found that improved security and controls were needed in DOT data centers and computer networks, and major financial application systems need to be accredited and certified. In separate reports, we made recommendations for improved security and controls. During FY 2000, DOT resolved a material internal control weakness concerning the security controls of the Department's Intermodal Data Network.
- The performance measures presented in the Management Discussion and Analysis did not provide information about the cost-effectiveness of programs nor relate to the Statement of Net Cost. The 41 performance measures were based on 1999 rather than 2000 performance data. None of the measures was linked to the cost of achieving targeted results.

- DOT distributed its operating costs into four components on the Consolidated Statement of Net Cost: Surface, Air, Maritime, and Cross-Cutting Transportation Programs. This presentation combined programs and activities with separate and distinct goals, and did not link program cost to performance measures.
- DOT was not in compliance with the Federal Financial Management Improvement Act of 1996 because the Department's accounting system did not comply with the United States Government standard general ledger and did not provide the data necessary for preparing the DOT Consolidated Financial Statements. DOT also had not implemented a managerial cost accounting system. The material internal control weakness concerning FAA's property accounts also represents a material weakness for DOT.

DOT's new accounting system (Delphi), which is being developed to address the compliance problems with the existing accounting system, has been implemented in three of DOT's smaller internal agencies. Delphi is being evaluated as to compliance with existing governmental standards as part of its implementation. The Department plans to have a compliant accounting system fully operational by December 31, 2001. FAA plans to have a fully operational cost accounting system by September 30, 2002.

Because DOT and FAA have ongoing corrective actions to address these internal control weaknesses and compliance issues, we are making no additional recommendations to the DOT Chief Financial Officer.

Concerning the FAA property issue, the FAA Chief Financial Officer stated that FAA engaged independent accountants to review and refine real and personal property files and computations, and these results will be available in 15 days. The FAA Chief Financial Officer stated that should added steps be needed, FAA is prepared to devote the resources necessary.

A draft of this report was provided to the DOT Chief Financial Officer on March 1, 2001. He agreed with the report and stated that he would direct that specific action plans, including who is accountable and target dates for corrective actions, be developed that will resolve the property issues at FAA. Upon receipt of the FAA action plan, the DOT Chief Financial Officer will give specific direction and appropriate guidance to FAA to ensure corrective actions are taken and these actions will effectively solve the problem with property accountability at FAA.

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

Attachments

TABLE OF CONTENTS

TRANSMITTAL MEMORANDUM

**SECTION I: INDEPENDENT AUDIT REPORT ON THE
DEPARTMENT OF TRANSPORTATION
CONSOLIDATED FINANCIAL STATEMENTS I-1**

A. Qualified Opinion on Consolidated Financial Statements I-2

B. Report on Internal Controls I-2

C. Report on Compliance with Laws and Regulations I-3

D. Prior Audit Coverage..... I-8

EXHIBIT: Financial-Related Reports I-9

SECTION II: FINANCIAL STATEMENTS

Consolidated Balance Sheet II-1

Consolidated Statement of Net Cost II-3

Consolidated Statement of Changes in Net Position..... II-4

Consolidated Statement of Budgetary Resources II-5

Consolidated Statement of Financing..... II-6

Notes to the Financial Statements II-8

SECTION III: SUPPLEMENTARY INFORMATION

Management Discussion and Analysis..... III-1

Major Program Performance III-37

Financial Management Performance Highlights..... III-85

Supplementary and Stewardship Information III-93

Consolidating Financial Statements III-120

DEPARTMENT OF TRANSPORTATION
INSPECTOR GENERAL'S INDEPENDENT AUDIT REPORT
ON THE DEPARTMENT OF TRANSPORTATION
FISCAL YEAR 2000 CONSOLIDATED FINANCIAL STATEMENTS

To the Secretary

The Department of Transportation (DOT), Office of Inspector General (OIG), audited the DOT Consolidated Financial Statements as of, and for the year ended, September 30, 2000, and issued a qualified opinion. Except for net book value of property, plant, and equipment (\$16.2 billion), in our opinion, the Consolidated Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing were fairly presented, in all material respects, in conformance with Generally Accepted Accounting Principles.

The audit report is the responsibility of the OIG. All other information--including the Financial Statements, Notes, Management Discussion and Analysis, and Supplementary and Stewardship Information--is the joint responsibility of DOT and its internal agencies.

We also are reporting on internal controls and compliance with laws and regulations applicable to the Fiscal Year (FY) 2000 DOT Consolidated Financial Statements. We performed the audit in accordance with Government Auditing Standards as prescribed by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin 01-02, Audit Requirements for Federal Financial Statements. We examined the validity of financial transactions and interviewed DOT financial management officials. We examined, on a test basis, evidence supporting the amounts and disclosures in the DOT Consolidated Financial Statements. We assessed the accounting principles and estimates used by management. We evaluated the overall presentation of the FY 2000 DOT Consolidated Financial Statements.

Our audit objectives for the FY 2000 DOT Consolidated Financial Statements were to determine whether: (1) principal DOT Consolidated Financial Statements are presented fairly, in all material respects, in conformance with Generally Accepted Accounting Principles; (2) DOT has adequate internal controls over financial reporting, including the safeguarding of assets; (3) DOT has complied with laws and regulations that could have a direct and material effect on the DOT Consolidated Financial Statements or have been specified by OMB, including the Federal Financial Management Improvement Act of 1996; (4) financial information in the Management Discussion and Analysis is materially consistent with the information in the DOT Consolidated Financial Statements; (5) internal controls ensured the existence and completeness of reported data supporting performance measures; and (6) supplementary and

stewardship information is consistent with management representations and the DOT Consolidated Financial Statements.

Except for performance measures, which were based on 1999 performance data (Part C of this report), the financial information in the Management Discussion and Analysis was materially consistent with the FY 2000 DOT Consolidated Financial Statements. The DOT supplementary and stewardship information also was materially consistent with management representations and the DOT Consolidated Financial Statements.

We are including our reports on internal controls and compliance with laws and regulations in Parts B and C of this report.

A. QUALIFIED OPINION ON CONSOLIDATED FINANCIAL STATEMENTS

Last year, we reported a material internal control weakness in the accounting for FAA property, plant, and equipment. During FY 2000, FAA tried but was unsuccessful in implementing an integrated property management system to support the FY 2000 FAA Financial Statements. Consequently, FAA calculated the net book value of its property (\$11.5 billion of the \$16.2 billion total for DOT) using electronic spreadsheets outside the existing property systems. This amount could not be substantiated.

Except for net book value of property, plant, and equipment, in our opinion, the DOT Consolidated Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing as of, and for the year ended, September 30, 2000, were fairly presented, in all material respects, in conformance with Generally Accepted Accounting Principles.

B. REPORT ON INTERNAL CONTROLS

Our objective was not to express, and we do not express, an opinion on internal controls. Our work was limited to applicable internal controls designed to ensure reliable financial reporting, including the safeguarding of assets. We obtained an understanding of the internal controls, determined whether the controls had been placed in operation, assessed control risk relevant to the assertions embodied in the financial statements, and performed tests of controls to determine our auditing procedures for the purpose of expressing our opinion on the FY 2000 DOT Consolidated Financial Statements.

Because of inherent limitations in internal controls, misstatements and losses may occur and not be detected. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. We identified one material internal control weakness.

MATERIAL WEAKNESS

The following section describes a material internal control weakness concerning FAA's property, plant, and equipment. The Department reported this material weakness to the President and Congress on December 27, 2000, under the requirements of the Federal Managers' Financial Integrity Act of 1982.

Property, Plant, and Equipment

During FY 1999, FAA made extraordinary and labor-intensive efforts to overcome accounting and financial system weaknesses with its property accounts. Although FAA was able to support property amounts for its FY 1999 Financial Statements, we reported the deficiencies in the existing property systems as a material internal control weakness, and recommended that FAA acquire a commercial, off-the-shelf, integrated property management system that would be compatible with the Department's new accounting system. FAA and DOT Chief Financial Officers agreed with our recommendation.

During FY 2000, FAA began implementing its new integrated property management system to consolidate property assets, compute depreciation, and maintain a record of asset changes. Using the new system, FAA input the substantiated property balances as of September 30, 1999, and provided the output as support for the amount to be reported in the FY 2000 FAA Financial Statements. Although the beginning balances in the new system should have equaled the substantiated balance as of September 30, 1999, the balances were off by \$479 million. FAA terminated the conversion process and used existing property systems to support the FY 2000 FAA Financial Statements.

In November and December 2000, we statistically tested the acquisition value of FAA real property, personal property changes, and construction-in-progress and found acquisition values to be substantiated. At that time, FAA had not computed net book values for audit testing. Later, FAA calculated the net book value (\$11.5 billion) of its property, plant and equipment using electronic spreadsheets outside the existing property systems. We determined this amount could not be substantiated. This issue was addressed in a separate report to FAA. Therefore, we are making no recommendations in this report.

C. REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Our objective was not to express, and we do not express, an opinion on compliance with laws and regulations. Our work was limited to selected provisions of laws and regulations that would have a direct and material effect on the FY 2000 DOT Consolidated Financial Statements, or have been specified by OMB, including the

Federal Financial Management Improvement Act of 1996, and would not necessarily disclose all material noncompliances. We identified four compliance issues.

Computer Security Controls

OMB Circular A-130 requires agencies to secure computer systems commensurate with the risk resulting from the loss, misuse, unauthorized access to, or modification of, the systems. This requirement applies to both general support systems, such as data centers or network systems, and major application systems.

DOT has about 20 major financial systems that operate at multiple data centers with the support of 3 major computer networks. In response to OIG audits, DOT has improved security and controls in its data centers and computer networks. However, for major application systems, OIG reviews identified a general lack of system accreditation/certification process—a key management tool to evaluate whether systems are adequately secured for operation. Audit reports with recommendations for corrective actions are listed in the Exhibit to this report.

During FY 2000, DOT corrected a material internal control weakness concerning the security controls of the Department's Intermodal Data Network. DOT also has been focusing on having new and replacement financial systems accredited and certified. For example, the departmental accounting replacement system, called Delphi, was accredited during FY 2000. Both the Federal Transit Administration and Federal Highway Administration plan to have their grants management replacement systems accredited during FY 2001.

DOT has issued a new requirement that systems which interface with Delphi have to be accredited and certified in advance. OIG will continue evaluating computer security and controls in key financial systems through ongoing financial statement audits. Because corrective actions are ongoing, we are making no additional recommendations in this report.

Performance Data

Under OMB Bulletin 01-02, our responsibility is to obtain an understanding of internal controls relating to the existence and completeness of performance data. DOT and its internal agencies are responsible for establishing and maintaining adequate internal controls. The FY 2000 DOT Performance Plan contained 66 performance measures, of which 41 were in the FY 2000 DOT Consolidated Financial Statements. The presentation complied with the requirements of OMB Bulletin 97-01 and related technical amendments to report performance measures consistent with goals and objectives from agencies' strategic plans.

Linking to the Statement of Net Cost and Measuring Cost-Effectiveness

OMB Bulletin 97-01 and related technical amendments state:

Entities should strive to develop and report objective measures that . . . provide information about the cost effectiveness of programs. The reported measures . . . should be linked to the programs featured in the Statement of Net Cost To further enhance the usefulness of the information, agencies should include an explanation of what needs to be done and what is planned . . . to improve financial or program performance.

As we reported last year, DOT still did not have systems in place to allocate costs by major program. Consequently, the performance measures could not be linked to the Statement of Net Cost. For example, the Federal Railroad Administration's goal to reduce rail grade crossing accidents is not linked to the Statement of Net Cost.

The performance measures presented in the DOT Consolidated Financial Statements also did not provide information about cost-effectiveness. None of the measures was linked to the cost of achieving targeted results, or to the Statement of Net Cost. For example, one Coast Guard goal is to reduce the amount of oil spill by maritime sources. DOT did not report the FY 2000 cost data for its efforts in this area.

The Departmental Accounting and Financial Information System (DAFIS) does not have the capability to track program costs. However, DOT is in the process of replacing DAFIS, and plans to have the new accounting system fully operational by December 31, 2001. FAA also is developing a separate cost accounting system, which is expected to be fully operational by September 30, 2002.

Assessing Internal Controls

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

DOT is relying on third-party organizations, such as states; grantees; transit authorities; commercial airlines; and airports, outside the Federal Government for some of its performance data. DOT also used 1999 performance data. States, for example, report on a calendar-year basis, and this information usually is received by DOT too late to incorporate into its FY 2000 Consolidated Financial Statements. Although DOT had some FY 2000 data, the Department instructed all DOT agencies to present 1999 data for consistency across DOT.

Although not part of the Financial Statement audits, the OIG performed audits in FYs 1999 and 2000 addressing performance measures and data. OIG will continue to address performance measures as part of program audits. For example, OIG conducted a performance audit and found that Coast Guard performance data used were inaccurate to measure its performance toward reducing recreational boating fatalities. The Coast Guard agreed to improve the data accuracy. Furthermore, the Department is continuing its efforts to further enhance the quality of all performance data.

Reporting of Planned Actions

To enhance the usefulness of performance information, OMB Bulletin 97-01 and related technical amendments encourage entities to include an explanation of what is planned to improve financial or program performance. As we reported last year, the Management Discussion and Analysis overview of the FY 2000 DOT Consolidated Financial Statements included general comments on how to improve performance; however, specific plans to improve financial performance through performance measures were not included. For example, the financial needs for the planned action to reduce the rate of liquid hazardous materials spilled were not addressed.

Statement of Net Cost Presentation

According to the Cost Accounting Implementation Guide, issued by the Joint Financial Management Improvement Program, the Statement of Net Cost is pertinent to reporting performance results, and provides financial information that can be related to outputs and outcomes of an entity's major programs and activities. OMB Bulletin 97-01 and related technical amendments state an entity should report performance measures that can be linked to the programs featured in the Statement of Net Cost.

In our report on the FY 1998 DOT Consolidated Financial Statements, we recommended that the DOT Chief Financial Officer identify the major programs to be presented in the DOT Consolidated Statement of Net Cost and require the DOT internal agencies to allocate operating costs among these programs.

In its initial planning to implement our recommendation, DOT found DAFIS could not allocate operating costs among DOT's major programs. So, in August 2000, the Department issued guidance for preparing the FY 2000 DOT Consolidated Financial Statements that again established the major program areas on the DOT Consolidated Statement of Net Cost would be Surface, Air, Maritime, and Cross-Cutting Transportation Programs. This presentation combined DOT internal agencies and programs with separate and distinct goals, and did not link program costs to the 41 performance measures.

For example, the Maritime Transportation category combined separate and distinct programs in Coast Guard and the Maritime Administration (MARAD), such as

maintaining MARAD's Ready Reserve Fleet, with Coast Guard's Search and Rescue, Drug Interdiction, and Recreational Boating Safety costs. DOT attempted to disclose operating costs by major program in a footnote, but full program costs were not displayed. For example, under Maritime Transportation Costs, DOT reported Coast Guard Operating Expenses of \$3 billion as a major program cost. However, these costs represented total operating and maintenance costs that should have been allocated among the major Coast Guard programs.

To improve financial management, DOT has initiated a project to replace DAFIS. The new system is being designed to produce financial statements, as well as cost accounting information. The new financial system is scheduled to be fully operational by December 31, 2001. Because ongoing actions will address this compliance issue, we are making no additional recommendations.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires auditors to report whether the agencies' financial management systems comply substantially with the requirements of Federal financial management systems, Federal accounting standards, and the United States Government standard general ledger at the transaction level. On January 4, 2001, OMB issued revised guidance to be used for determining compliance with FFMIA for financial reports and audits of the FY 2000 Financial Statements. The OMB guidance states that progress toward resolving deficiencies should not be construed as compliant with FFMIA.

DOT was not in compliance with FFMIA because DAFIS did not comply with the standard general ledger and did not provide the data necessary for preparing the DOT Consolidated Financial Statements. FAA also had a material internal control weakness concerning its property accounts and DOT, including FAA, had not fully implemented a managerial cost accounting system. DOT made more than 700 adjustments, totaling about \$20 billion, outside DAFIS to prepare the FY 2000 Consolidated Financial Statements. These adjustments were recorded in the financial statement module, a tool used to process the adjustments. However, most DOT internal agencies did not use the financial statement module to prepare the financial statements and the adjustments were not recorded in DAFIS.

The Department began implementation of a new accounting system, called Delphi, as a pilot program in the Federal Railroad Administration (FRA) in April 2000. Delphi has been implemented in three of DOT's smaller internal agencies. Delphi is being evaluated as to compliance with governmental standards as part of its implementation. We are completing a separate audit on the implementation of Delphi and plan to issue our report in April 2001. The Department plans to have a compliant accounting system fully operational by December 31, 2001. FAA also plans to have a compliant cost accounting system by September 30, 2002.

On December 27, 2000, as required by the Federal Managers' Financial Integrity Act of 1982, the Secretary of Transportation reported that FAA had a material weakness concerning its property account and that the Department was taking remedial and progressive actions to bring the Department into substantial compliance with FFMIA.

D. PRIOR AUDIT COVERAGE

Our report on the FY 1999 DOT Consolidated Financial Statements contained three recommendations. All recommendations were resolved during FY 2000. In March 1998, we recommended that DOT ensure DAFIS, or its replacement, is the primary source of information for preparing financial statements. This remains an open issue until DOT's new accounting system is implemented and demonstrates it can provide information needed to prepare the DOT Consolidated Financial Statements.

Since we issued our report on the FY 1999 DOT Consolidated Financial Statements, a total of 15 reports were issued that relate to the FY 2000 DOT Consolidated Financial Statements. The list of reports is the Exhibit to this report.

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



Kenneth M. Mead
Inspector General

FINANCIAL-RELATED REPORTS

<u>TITLE</u>	<u>REPORT NUMBER</u>	<u>DATE ISSUED</u>
Fiscal Year 2000 Financial Statements, FAA	FI-2001-036	March 1, 2001
Status Assessment of Cost Accounting System and Practices, FAA	FI-2001-015	February 28, 2001
Fiscal Year 2000 Financial Statements, Highway Trust Fund	FI-2001-035	February 27, 2001
Actuarial Estimates for Retired Pay and Medical Benefits, USCG	FI-2001-033	February 23, 2001
Quality Control Review of FY 2000 Audited Financial Statements, St. Lawrence Seaway Development Corporation	QC-2001-021	February 7, 2001
Major Management Challenges and Program Risks, DOT	GAO-01-253	January, 2001
Closeout and Payment Processes for Cost-Reimbursable Contracts, DOT	FI-2001-018	January 23, 2001
Top Ten Management Challenges, DOT	PT-2001-017	January 18, 2001
Design of the Cost Accounting System for Research and Acquisitions, FAA	FI-2001-013	December 18, 2000
Third Party Draft Payment System, DOT	FI-2001-001	October 3, 2000
Inactive Obligations on Contracts, DOT	FI-2000-125	September 25, 2000
Headquarters Computer Network Security, DOT	FI-2000-124	September 25, 2000
Interim Report on Computer Security, DOT	FI-2000-108	July 13, 2000
Computer Security Controls of Financial Management System, FTA	FE-2000-098	May 23, 2000
Use of Funds for the Year 2000 Computer Program, DOT	FE-2000-080	April 11, 2000

If you would like to view, or obtain copies of, SECTION II – FINANCIAL STATEMENTS, or SECTION III – SUPPLEMENTARY INFORMATION, of this report, please call 202-366-1496.