CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEARS 2001 AND 2000

Department of Transportation

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

Memorandum

Subject: INFORMATION: Report on Consolidated Financial Statements for Fiscal Years 2001 and 2000, DOT FI-2002-083

Date: February 27, 2002

From: Kenneth M. Mead
Inspector General

Reply To Attn. of: Meche:x61496

To: The Secretary

I respectfully submit the Office of Inspector General (OIG) report on the Department of Transportation (DOT) Consolidated Financial Statements for Fiscal Years (FY) 2001 and 2000. For the first time starting with FY 2001, the Office of Management and Budget (OMB) requires comparative financial statements to be presented covering 2 years. This report is required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

This report presents our unqualified opinion on the FY 2001 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, 2001; and our qualified opinion on the FY 2000 DOT Consolidated Balance Sheet and Statement of Net Cost as of, and for the year ended, September 30, 2000. The FY 2001 DOT Consolidated Financial Statements show DOT had assets of about $87 billion, liabilities of $42 billion, operating costs of $62 billion, and total budgetary resources of $100 billion.

During FY 2001, high gasoline prices, a slow-down in the economy, and the tragic events of September 11 resulted in a dramatic drop in revenues to the Highway and the Airport and Airway Trust Funds. Although revenues were lower than expected, the amounts collected for FY 2001 were fairly presented in the FY 2001 DOT Consolidated Financial Statements.

Since September 11, expected revenues to the Airport and Airway Trust Fund have dropped by about $2.4 billion, or about 20 percent below original projections. Congress also authorized supplemental appropriations of about $600 million to increase security. These events and actions will result in a substantial draw down of the trust fund's uncommitted balance, which we estimate could drop from $7.3 billion at the beginning of FY 2002 to about $4.3 billion by the end of FY 2002.

For the Highway Trust Fund, the lower revenues in FY 2001 have a direct impact on future obligation authority available to fund state highway projects. For example, based on FY 2001 revenues and FY 2003 projections using the revenue aligned budgetary authority (RABA) provision, the President's FY 2003 budget shows highway funding dropping by about $9 billion, or about 29 percent from the FY 2002 level. Unless legislative action is taken, DOT and the states will need to significantly adjust the planned projects for FY 2003.

We identified two material weaknesses that affect the DOT Consolidated Financial Statements. As required by the Federal Managers' Financial Integrity Act of 1982, both material weaknesses were reported in DOT's FY 2001 annual report to the President and Congress.

- The Federal Aviation Administration (FAA) engaged KPMG LLP to audit its property, plant, and equipment accounts. KPMG recommended that the net book value of FAA property be reduced by $138 million. FAA made the adjustments and KPMG issued an unqualified opinion on FAA property, plant, and equipment as of September 30, 2001. KPMG also cited FAA property accounting as a material weakness and made six recommendations. FAA agreed with the recommendations. As part of our work, we also recommended adjustments of about $184 million to the reported net book value. FAA made these adjustments prior to the KPMG audit.

- DOT has 25 major financial systems. OMB Circular A-130 requires agencies to secure computer systems commensurate with the risk resulting from the loss, misuse, unauthorized access to, or modification of, the systems. We found that only 6 of the 25 major financial application systems have been certified as adequately secured. Unauthorized access to any DOT information system could jeopardize the integrity of financial information systems. DOT also needs to enhance its network security and complete background checks on contractor personnel working on DOT information systems. In separate reports, we made recommendations for improved security and controls.

In addition to the material weaknesses for property accounting and information security, we identified seven FY 2001 issues involving internal control weaknesses and compliance with laws and regulations. While they are important, they did not affect our audit opinion.

- DOT agencies need to do more to determine whether obligations were needed on inactive projects or transactions. During FY 2001, we identified about $293 million of funds that should be used for other essential projects or returned to the U.S. Treasury. DOT agencies agreed with our recommendations. Therefore, we are making no recommendations in this report.

- An interface problem existed between FHWA's grant management system and the DOT accounting system, which underreported valid obligations in the accounting system by about $195 million. FHWA immediately corrected its financial records and adjusted the financial statements accordingly.

- The Federal Transit Administration (FTA) used inappropriate accounting procedures for adjusting obligations on projects. As of September 30, 2001, an FTA headquarters account had a negative $77 million obligation balance because FTA used that account to adjust inactive projects rather than recording the transactions against individual projects. FTA is working to resolve this issue.

- DOT was not in compliance with the Federal Financial Management Improvement Act of 1996 because the DOT accounting system did not provide the data necessary for preparing the DOT Consolidated Financial Statements, did not comply with the U.S. Government standard general ledger, and did not comply with requirements for implementing managerial cost accounting standards. DOT also needs to enhance security over financial information systems, and plans to have these financial systems certified for adequate security by May 2003.

- DOT's new Delphi accounting system, which is being developed to address compliance problems with the existing system, has been implemented in seven of DOT's smaller agencies. During FY 2001, we identified serious deficiencies that warranted immediate attention and delay of the Delphi implementation schedule for DOT's larger and more complex agencies. DOT is working hard to resolve these problems with Delphi and plans to have a compliant accounting system fully operational by January 2003. FAA also plans to have a fully operational cost accounting system early in calendar year 2003.

- 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 FY 2001 performance measures were presented based on FY 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 inappropriately combined agencies and programs with separate and distinct goals, and did not link program cost to performance measures.

DOT and its agencies have ongoing corrective actions to address all of these internal control and compliance issues. This report includes one new recommendation concerning FTA accounting procedures for inactive projects.

A draft of this report was provided to the DOT and FTA Chief Financial Officers on February 25, 2002. They agreed with the report.

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

Attachments

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DEPARTMENT OF TRANSPORTATION
INSPECTOR GENERAL'S INDEPENDENT AUDIT REPORT
ON THE DEPARTMENT OF TRANSPORTATION
CONSOLIDATED FINANCIAL STATEMENTS
FOR FISCAL YEARS 2001 AND 2000

To the Secretary

The Department of Transportation (DOT), Office of Inspector General (OIG), audited the DOT Consolidated Financial Statements and accompanying notes as of, and for the years ended, September 30, 2001, and September 30, 2000. In our audit of the DOT Consolidated Financial Statements for Fiscal Years (FY) 2001 and 2000, we found:

- the FY 2001 financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles;

- except for the net book value of property, plant, and equipment, the FY 2000 financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles;

- two material weaknesses in internal controls concerning the Federal Aviation Administration (FAA) property, plant, and equipment accounts, and DOT's Information Security Program, and we identified reportable conditions concerning recorded obligations and performance measures;

- noncompliance with the Federal Financial Management Improvement Act of 1996 (FFMIA) regarding: (1) DOT's accounting system, (2) financial system interfaces, (3) security over financial information systems, and (4) managerial cost accounting standards;

- financial information in the Management Discussion and Analysis was materially consistent with the DOT Consolidated Financial Statements, except performance measures were based on FY 2000 rather than FY 2001 performance data; and

- supplementary and stewardship information was consistent with management representations and the DOT Consolidated Financial Statements.

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

A. OPINION ON FINANCIAL STATEMENTS

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, including accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the DOT assets, liabilities, and net position; net costs; changes in net position; budgetary resources; and reconciliation of net costs to budgetary obligations as of September 30, 2001, and for the year then ended.

We expressed a qualified opinion on the FY 2000 DOT Consolidated Financial Statements because FAA was unsuccessful in implementing an integrated property accounting system, and calculated the net book value of its property, plant, and equipment using electronic spreadsheets outside the existing property system, which could not be substantiated. Except for the reported net book value, in our opinion, the Consolidated Balance Sheet and Statement of Net Cost, including accompanying notes, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles as of September 30, 2000, and for the year then ended. During FY 2001, FAA reduced the net book value of property, plant, and equipment by $322 million, but did not restate the FY 2000 Consolidated Balance Sheet and Statement of Net Cost.

B. CONSIDERATION OF INTERNAL CONTROLS

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

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

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

Material Weaknesses

The following sections describe material weaknesses concerning FAA's property, plant, and equipment, and DOT's Information Security Program. On January 11, 2002, as required by the Federal Managers' Financial Integrity Act of 1982, the Secretary of Transportation reported these material weaknesses to the President and Congress.

Accounting for FAA Property, Plant, and Equipment

Our report on the FY 2000 DOT Consolidated Financial Statements expressed a qualified opinion because FAA was unsuccessful in implementing an integrated property accounting system. As a result, FAA calculated the net book value of its property, plant, and equipment using electronic spreadsheets outside the existing property system, and these amounts could not be substantiated.

After issuing our FY 2000 report, we initiated a review of FAA personal property (equipment) balances as of September 30, 2000. We found the net book value was overstated. FAA immediately developed a corrective action plan to validate these inaccurate accounts. As a result, FAA reduced the net book value of its personal property by $184 million.

FAA then engaged KPMG LLP to audit its property, plant, and equipment accounts. KPMG recommended that the net book value of FAA property be reduced by $138 million. FAA made the adjustments, and KPMG issued an unqualified opinion on property, plant, and equipment as of September 30, 2001. KPMG also cited a material weakness in accounting for property, plant, and equipment and made six recommendations. FAA agreed with the recommendations. FAA is developing an integrated property accounting system and plans to have this completed by November 2002.

DOT Information Security Program

In September 2001, we issued our first annual computer security report on DOT's Information Security Program, as required by the Government Information Security Reform Act. We identified system security, network security, and personnel security weaknesses that were particularly critical to the integrity of DOT financial systems.

- System Security: 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. We identified the general lack of an adequate process for accreditation and certification of information systems—a key management tool to evaluate whether systems are adequately secured. Only 6 of DOT's 25 major financial systems (24 percent) have been certified as adequately secured. DOT plans to have these systems reviewed and certified for adequate security by May 2003.

- Network Security: DOT needs to strengthen its network security. DOT employees, contractors, grantees, industry associations, and the public can access DOT computers through various network entry points. For example, the public can access DOT web sites from the Internet. Business associates also can access DOT computers through direct network connections. While DOT has made good progress in preventing unauthorized access by Internet users, we found DOT has weak controls over direct network connections with business associates. Unauthorized access to any DOT information system could jeopardize the integrity of financial information systems. DOT plans to complete corrective actions by August 2002.

- Personnel Security: Background checks are needed for individuals authorized to access computer systems on DOT's private networks. DOT has about 18,000 contractor personnel working on its information systems. FAA is responsible for the majority of these contractors. While FAA reported that it has completed background checks on 85 percent of its contractor personnel, the other DOT agencies reported completion of background checks on only 25 percent of their contractor personnel.

Because recommendations were made in separate reports and corrective actions are ongoing, we are making no additional recommendations in this report.

Reportable Conditions

Internal control weaknesses existed because of (1) insufficient reviews by DOT agencies to identify inactive obligations that were no longer needed; (2) an interface deficiency between FHWA's grant management system and DOT's accounting system, and (3) inappropriate accounting procedures for Federal Transit Administration (FTA) inactive projects.

Inactive Obligations

During FY 2001, we reviewed inactive obligations that had no activity within 18 months. We identified about $293 million of obligations that were no longer needed. These funds can be used for other valid transportation needs or returned to the U.S. Treasury General Fund. DOT agencies agreed with our recommendations. Therefore, we are making no recommendations in this report.

FHWA's Grants Management System

FHWA's Fiscal Management Information System (FMIS) records initial obligations for Federal-aid grants to states. However, when FMIS interfaces with the Departmental Accounting and Financial Information System (DAFIS), all obligations were not electronically transferred and recorded in DAFIS. This occurred due to information technology application control problems resulting from upgrades and changes that were made to the FMIS system in FY 2001. FHWA also did not reconcile obligated balances between FMIS and DAFIS. As a result, valid obligations totaling about $195 million were understated in DAFIS as of September 30, 2001. FHWA immediately corrected the appropriate amounts in its financial records and on the FY 2001 Consolidated Statement of Budgetary Resources. Because recommendations were made in a separate report, no recommendations are made in this report.

Adjusting Obligations for FTA Inactive Projects

FTA reported a negative obligation balance of about $77 million in one account as of September 30, 2001. FTA established a headquarters account to hold amounts associated with negative obligations from inactive projects. Adjustments were made to that account rather than recording transactions against individual projects. Although FTA has not made significant use of the account recently, FTA increased the negative obligation balance by about $4 million in FY 2001. The total obligations and expenditures are properly reported, but individual project balances are not accurately recorded.

Recommendation. We recommend that the FTA Chief Financial Officer discontinue use of the headquarters account and eliminate the negative obligation balance before transitioning to Delphi.

C. COMPLIANCE WITH LAWS AND REGULATIONS

Our objective was not to express, and we do not express, an opinion on compliance with laws and regulations. Our work was limited to selected provisions of laws and regulations that would be reportable under U.S. generally accepted government auditing standards or under OMB audit guidance. Our work disclosed instances in which DOT did not comply with FFMIA. We also found noncompliance with laws and regulations for reporting obligations and performance measures; and combining separate and distinct major programs on the Consolidated Statement of Net Cost.

Federal Financial Management Improvement Act of 1996

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

DOT did not meet FFMIA requirements for financial management systems because: (1) DOT's accounting system, DAFIS, cannot produce auditable financial statements; (2) an interface deficiency exists between DAFIS and FMIS; (3) DAFIS does not use the U.S. Government standard general ledger; (4) DOT has not implemented managerial cost accounting standards; and (5) material weaknesses exist for FAA property accounting and DOT information security.

Financial Management System Requirements

DOT's major agencies use DAFIS, which cannot produce financial statements based on the information included within the system. For example, DOT made about 850 adjustments, totaling about $41 billion, outside DAFIS to prepare the financial statements. These adjustments were recorded in a financial statement module, a tool used to process the adjustments. However, all DOT agencies did not use the financial statement module to prepare the financial statements and the adjustments were not recorded in DAFIS. For example, the Maritime Administration (MARAD) maintained most of the financial information it used for its financial statements outside DAFIS and also did not use the financial statement module. DOT plans to transition MARAD to the new Delphi accounting system in April 2002, which should resolve this issue.

Seven of DOT's smaller agencies use Delphi. Although Delphi is being used, the system is under development and does not yet fully meet all FFMIA requirements for financial management systems. Delphi is being evaluated as to compliance with FFMIA as part of its implementation. During FY 2001, we identified serious deficiencies that warranted immediate attention and delay of the Delphi implementation schedule for DOT's larger and more complex agencies. For example, key deficiencies involved Delphi's capability to account for recovery of prior-year funds automatically, and to adjust obligations electronically recorded from other financial systems. DOT plans to restart the implementation schedule in April 2002 and have all agencies on

Delphi by January 2003. Because recommendations were made in a separate report, no recommendations are made in this report.

An interface deficiency exists between DAFIS and FMIS. The Joint Financial Management Improvement Program (JFMIP) *Core Financial System Requirements* and *Grant Financial System Requirements* and OMB guidance require that, to be compliant with FFMIA, integrated financial management systems must maintain data accuracy between the core financial system and feeder systems. As discussed in Section B, an electronic interface deficiency between DAFIS and the FMIS feeder system resulted in recorded obligations in DAFIS being understated by about $195 million. FHWA is working to solve this problem.

United States Government Standard General Ledger

DAFIS does not comply with the U.S. Government standard general ledger (SGL) at the transaction level because it does not use all of the SGL accounts. As a result, about 850 adjustments, totaling $41 billion, were made outside DAFIS to prepare the financial statements. Delphi is compliant with the SGL, and DOT plans to have Delphi fully operational by January 2003.

Federal Cost Accounting Standards

DOT agencies, except FAA and Coast Guard, have not made progress implementing managerial cost accounting systems or using cost accounting practices to identify the costs of DOT programs. Statement of Federal Financial Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Standards,* require that beginning in FY 1998, each reporting entity should accumulate and report the costs of its activities on a regular basis. Costs may be accumulated either through the use of cost accounting systems or cost finding techniques. DAFIS does not have the capability to capture the full costs, including the direct and indirect costs assigned to DOT programs. DOT plans to address this issue as part of implementing Delphi.

FAA has made good progress and has implemented a cost accounting system in its first and largest line of business, Air Traffic Services, and is working on developing an adequate labor distribution system. However, FAA still needs to complete the cost accounting system for its other four lines of business.

DOT and FAA plan on being compliant with managerial cost accounting standards early in calendar year 2003. Because recommendations were made in separate reports and corrective actions are ongoing, we are making no recommendations in this report.

Accounting for FAA Property, Plant, and Equipment

To be compliant with FFMIA, integrated financial management systems must maintain data accuracy between the core financial systems and feeder systems. As discussed in Section B, FAA has a material weakness concerning property accounting and is taking corrective actions.

Security for Financial Information Systems

OMB Circular A-130 requires agencies to secure computer systems commensurate with the risk resulting from loss, misuse, unauthorized access to, or modification of, the systems. As discussed in Section B, DOT has a material weakness concerning information security and is taking corrective actions.

On January 11, 2002, as required by the Federal Managers' Financial Integrity Act of 1982, the Secretary of Transportation reported the material weaknesses in FAA property and DOT's Information Security Program in DOT's FY 2001 annual report, and also reported that DOT was taking remedial and progressive actions in these areas that will bring DOT into substantial compliance with FFMIA when its actions are successfully implemented.

Inactive Obligations

Title 31, United States Code, Section 1501 and Treasury Financial Management Bulletin 2001-06 state that obligations must be supported and that agencies only report valid obligations. As discussed in Section B, about $293 million of unneeded obligations were recorded in financial records. DOT agencies are taking corrective actions.

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 agencies are responsible for establishing and maintaining adequate internal controls. The FY 2001 DOT Performance Plan contained 71 performance measures, of which 32 were in the FY 2001 DOT Consolidated Financial Statements. The overall presentation complied with the requirements of OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, to report performance measures consistent with goals and objectives from agencies' strategic and performance plans.

Linking to Statement of Net Cost and Measuring Cost-Effectiveness

According to OMB Bulletin 01-09:

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

As we reported last year, DOT still does not have the systems in place to allocate costs by major program. Consequently, the performance measures could not be linked to the Consolidated Statement of Net Cost. For example, the Federal Railroad Administration goal to reduce rail-related fatalities is not linked to the Consolidated 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 Consolidated Statement of Net Cost. For example, one Research and Special Programs Administration goal is to reduce the number of natural gas pipeline failures. DOT did not report the FY 2001 cost data for efforts in this area.

DAFIS does not have the capability to accurately identify program costs. DOT is in the process of replacing DAFIS, and plans to have its Delphi accounting system in full operation by January 2003. FAA also is developing a separate cost accounting system, which is expected to be fully operational early in calendar year 2003.

Assessing Internal Controls

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

DOT is relying on third-party organizations outside the Federal Government, such as states; grantees; transit authorities; commercial airlines; and airports, for some of its performance data. DOT also used 2000 performance data. States, for example, report on a calendar-year basis, and DOT did not receive the FY 2001 performance information in time to incorporate it in the DOT Consolidated Financial Statements.

Although DOT has some FY 2001 data, DOT instructed all agencies to present FY 2000 data, for consistency across DOT. We found that the performance data for 11 performance measures in the DOT Consolidated Financial Statements were different from the data on the same performance measures in the Highway Trust Fund and FAA Financial Statements. These differences were not material.

Although not part of the financial statement audits, the OIG performed audits in FY 2001 addressing selected performance measures and data. OIG will continue to address performance measures as part of program and financial audits. For example, we conducted an audit of FHWA inactive obligations and found that about $238 million of recorded obligations no longer were needed. In a separate report, we recommended that FHWA develop a performance measure to track and reduce inactive obligations. FHWA agreed.

Reporting of Planned Actions

To enhance the usefulness of performance information, OMB Bulletin 01-09 encourages entities to include an explanation of what is planned to improve financial or program performance. As we reported last year, the Management Discussion and Analysis overview of the DOT Consolidated Financial Statements includes general comments on how to improve performance; however, specific plans to improve financial performance through performance measures were not included. For example, planned action to reduce the number of recreational boating fatalities was 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 01-09 requires an entity to report performance measures that can be clearly linked to cost categories 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 DOT 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 September 2001, DOT issued guidance for preparing the FY 2001 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 inappropriately combined DOT agencies and programs with separate and distinct goals, and did not link program costs to the 32 performance measures.

For example, the Maritime Transportation category combined separate and distinct programs in Coast Guard and MARAD, such as maintaining MARAD's Ready Reserve Fleet, with Coast Guard's Search and Rescue, Drug Interdiction, and Recreational Boating Safety costs. Under Maritime Transportation Costs, DOT reported Coast Guard operating expenses of $3.2 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 Delphi accounting system is being designed to produce financial statements, as well as cost accounting information. Delphi is scheduled to be fully operational by January 2003. Because ongoing actions will address this issue, we are making no additional recommendations in this report.

D. CONSISTENCY OF OTHER INFORMATION

Management's Discussion and Analysis, required supplementary information (including stewardship information), and other accompanying information contain a wide range of data, some of which are not directly related to the financial statements. We are not required to, and we do not, express an opinion on this information. We compared this information for consistency with the DOT Consolidated Financial Statements and discussed the methods of measurement and presentation with DOT officials. Based on this work, except for the presentation of FY 2000 performance data in the FY 2001 DOT Consolidated Financial Statements (Part C of this report), we found no material inconsistencies with the DOT Consolidated Financial Statements or nonconformance with OMB guidance.

E. PRIOR AUDIT COVERAGE

Our report on the FY 2000 DOT Consolidated Financial Statements expressed a qualified opinion because FAA was unsuccessful in implementing an integrated property accounting system; calculated the net book value of its property, plant, and equipment using electronic spreadsheets outside the existing property system; and these amounts could not be substantiated. Because recommendations had been made in a separate report to FAA, we made no recommendations in the audit report on the FY 2000 DOT Consolidated Financial Statements.

In March 1998, we recommended that DOT ensure DAFIS, or its replacement, is the primary source of information for preparing financial statements. This item remains open until Delphi is fully implemented and demonstrates it can provide the information needed to prepare the DOT Consolidated Financial Statements.

Since we issued our report on the FY 2000 DOT Consolidated Financial Statements, 13 reports were issued related to the DOT Consolidated Financial Statements. The list of reports is in Exhibit B to this report.

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

Kenneth M. Mead
Inspector General

Exhibit A. Objectives, Scope, and Methodology

Our audit objectives for the DOT Consolidated Financial Statements for FYs 2001 and 2000 were to determine whether: (1) principal DOT Consolidated Financial Statements and accompanying notes are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; (2) DOT has adequate internal controls over financial reporting, including safeguarding assets; (3) DOT has complied with laws and regulations that could have a direct and material effect on the DOT Consolidated Financial Statements or that have been specified by OMB, including FFMIA; (4) financial information in the Management Discussion and Analysis is materially consistent with the information in the principal DOT Consolidated Financial Statements; (5) internal controls ensured the existence and completeness of reported data supporting performance measures; and (6) supplementary and stewardship information is consistent with management representations and the DOT Consolidated Financial Statements.

DOT is responsible for (1) preparing the DOT Consolidated Financial Statements for FYs 2001 and 2000 in conformity with U.S. generally accepted accounting principles; (2) establishing, maintaining, and assessing internal controls to provide reasonable assurance that broad control objectives of the Federal Managers' Financial Integrity Act are met; (3) ensuring that DOT financial management systems substantially comply with FFMIA requirements; and (4) complying with applicable laws and regulations.

OIG is responsible for obtaining reasonable assurance about whether (1) the DOT Consolidated Financial Statements for FYs 2001 and 2000 are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles and (2) management maintained effective internal controls. The objectives of these controls are:

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

- Compliance with laws and regulations: Transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and Governmentwide policies identified by OMB audit guidance.

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

(3) performing limited procedures with respect to certain other information appearing in the DOT Consolidated Financial Statements for FYs 2001 and 2000.

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

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

We did not test compliance with all laws and regulations applicable to DOT. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the DOT Consolidated Financial Statements for FY 2001 ended September 30, 2001, and FY 2000 ended September 30, 2000. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes. We also caution that our internal control testing may not be sufficient for other purposes.

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

Due to the volume of information contained in this document, please call 202-366-1496 to obtain a copy of the attachments to this report.