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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

OCTOBER 30, 1985

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The Honorable Elizabeth Hanford Dole
The Secretary of Transportation

Dear Madam Secretary:

Subject: Department of Transportation: Implementing the Federal Managers' Financial Integrity Act (GAO/RCED-86-35)

As part of our management review at the Department of Transportation (DOT), we assessed the agency's second-year efforts to evaluate its internal control and accounting systems for purposes of reporting under the Federal Managers' Financial Integrity Act (FMFIA) of 1982, [31 U.S.C. 3512(b) and (c)]. The act is aimed at strengthening management controls and accounting systems, thus helping to detect and deter fraud, waste, abuse, and mismanagement in federal agencies.

We are in the process of completing our management review and will be providing you with a draft of our report for your official review and comment as well as arranging a meeting to brief you on the results of our work in detail. We are issuing this letter report to provide you with a summary of the results of our FIA work and to present our views so that they can be considered in preparing DOT's third-year report to the President and the Congress on the status of internal controls and accounting systems as required by FMFIA.

In summary, we found that while DOT has made considerable progress in implementing FMFIA, an adequate basis does not yet exist for reporting that, taken as a whole, the Department complied with the act's requirement to provide reasonable assurance that its objectives had been met. Your 1984 FMFIA report states that numerous internal control weaknesses were reported, many weaknesses remain to be corrected, and some accounting systems were not in conformance with the Comptroller General's principles, standards, and related requirements. In addition, DOT's Inspector General pointed out a number of

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improvements needed in the internal control evaluation process in his July 3, 1985, report.

THE ACT's REQUIREMENTS

Section 2 of FMFIA requires the heads of federal agencies to annually report to the President and the Congress on the status of their agencies' internal controls. The report must state whether the agency's controls fully comply with the act's requirements which are to establish controls in accordance with the Comptroller General's standards and to provide reasonable assurance that (1) obligations and costs comply with law, (2) assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures are properly recorded and accounted for. The Office of Management and Budget (OMB) issued internal control guidelines in December 1982 for agencies to use in evaluating and reporting on their internal controls. Section 4 of the act requires agencies to report annually on whether their accounting systems conform to the Comptroller General's principles, standards, and related requirements, hereafter referred to as the Comptroller General's requirements.

DOT INITIATIVES TO IMPROVE INTERNAL CONTROLS AND ACCOUNTING SYSTEMS

Since our last report,[1] DOT continued to make progress in implementing FMFIA. During 1984 DOT reported that its offices and administrations either amended or issued new internal control directives and operating instructions and began drafting a comprehensive internal control guidebook. Other DOT 1984 FMFIA initiatives included establishing a centralized tracking system, developing and distributing a definition of material weakness, and defining the Office of Inspector General's role.

DOT also has several initiatives underway to improve financial management. These initiatives range from small improvements, such as system documentation, to a major effort to develop a department accounting system.

DOT's BASIS FOR REPORTING ON THE STATUS OF INTERNAL CONTROLS IS INADEQUATE

On December 31, 1984, you reported that DOT's internal control systems were evaluated in accordance with FMFIA

[1] Transportation's First-Year Implementation of the Federal Managers' Financial Integrity Act (GAO/RCED-84-141, July 13, 1984).

requirements and stated that your evaluations complied with the the act's requirements to provide reasonable assurance that its objectives had been met. The conclusion was based on a variety of evaluations which included vulnerability assessments, internal control reviews, and assurances from DOT officials.

Although DOT has made progress in implementing FMFIA and the number of evaluations it performed, we believe that the basis DOT used for reporting on the status of internal controls was inadequate. In determining whether an agency has an adequate basis for providing reasonable assurance, an agency head must consider four factors collectively: (1) the significance of the weaknesses disclosed by the agency, (2) the status of corrective actions, (3) the comprehensiveness of the internal control evaluation work performed, and (4) whether accounting systems conform with the Comptroller General's requirements.

Material weaknesses remain

DOT reported progress in correcting its 1983 material internal control weaknesses and planned actions for correcting the 1983 and 1984 weaknesses. In spite of DOT's progress, a number of corrective actions still remain to be taken before the material weaknesses are corrected.

DOT's 1983 annual report identified two DOT-wide material weaknesses, both of which were in the automated data processing (ADP) area, and dealt with (1) inventories of security-sensitive ADP uses and applications and (2) risk analyses of computer facilities. In 1983 DOT also reported 15 organization-specific material weaknesses in its various administrations, such as UMTA's automated grant management system. Although some corrective actions have been taken, the 2 DOT-wide and 10 of the 15 organization-specific material weaknesses were listed again in DOT's 1984 annual report and still require corrective action.

DOT's 1984 annual report also identified a new DOT-wide material weakness in addition to the two uncorrected DOT-wide weaknesses that were reported in 1983. The weakness deals with the inefficient use and disposal of property. Because of this weakness, equipment is susceptible to misplacement, underutilization, and loss. The report also identified three new organization-specific material weaknesses.

Improvements needed in evaluation process

Our review also disclosed that further improvements are needed in DOT's system for evaluating the effectiveness of its internal controls. Specifically, further improvements are needed in segmenting the agencies into assessable units to permit meaningful analysis, providing additional guidance and training for staff conducting vulnerability assessments and internal control reviews, and providing more accurate information in the annual assurance letters.

The need for further improvements in these areas should not be viewed as a lack of concern or commitment by DOT staff to attaining the act's objectives but rather as necessary steps in the evaluation of a sound internal control evaluation process.

<u>Some accounting systems do not conform</u>

In its second annual report, DOT stated that the Urban Mass Transit Administration's (UMTA's) and the Coast Guard's accounting systems did not conform with the Comptroller General's requirements. For example, the report stated that UMTA's systems provided inaccurate reports, lacked property accountability in some instances, and lacked adequate internal controls. DOT also stated that 11 accounting systems were in general conformance with the Comptroller General's requirements although each system had one or more principal areas of nonconformance.

DOT reported that the Federal Aviation Administration's (FAA's) and the Transportation Systems Center's (TSC's) systems were in general conformance. The report did include four areas of nonconformance for FAA's system. We believe, however, that DOT did not have a sufficient basis for its report because

--no testing of systems in operation was performed at two of the three FAA locations we visited at the time they prepared their FIA reports and TSC only performed minimal testing;

--FAA regional offices only considered Inspector General (IG) reports applicable to their own accounting operations and did not consider IG reports on accounting operations at other regional offices because they did not have access to the other audit reports (some of these IG reports contained findings and recommendations applicable to all regional offices);

--internal control weaknesses, which we believe were material, were identified in a FAA accounting system review and reported to FAA headquarters for FIA purposes. However, because of a lack of coordination between FAA headquarters personnel, these weaknesses were not included in either the section 2 or section 4 sections of the Secretary's annual report; and

--neither FAA nor TSC tested invalid transactions which would have strengthened their evaluation process.

Conversely, although the Federal Highway Administration (FHWA) did not test its accounting systems for invalid transactions, we found that it performed significant amounts of work for its section 4 report at the locations we visited. For example, FHWA custom designed a system review program for each of its 55 divisions to use. The IG also noted that FHWA performed conscientious and thorough evaluations at the two regions they reviewed. However, the IG found several problems with specific principles and standards which FHWA will need to review.

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We recognize that management judgment is involved in reaching a conclusion that the internal control systems, taken as a whole, provide reasonable assurance that the act's requirements have been met. However, we believe that unless an agency's key accounting systems and internal controls over major programs and functions are adequately evaluated and tested, and until the material weaknesses in the systems are substantially corrected, the agency does not have an adequate basis to conclude that it has reasonable assurance under the act. Evaluations and corrective actions needed to address the act's requirements may take several years to complete. An agency may be making good progress toward that goal, yet not have progressed to the point where reasonable assurance can be provided.

We further recognize that you may have reached your judgment in accordance with guidelines disseminated by OMB. In our report on first-year implementation of FMFIA (GAO/OGC-84-3), we recommended that OMB clarify and revise its guidance on what should be contained in the year-end reporting statement. The House Committee on Government Operations, in its August 2, 1984, report on first-year implementation of the act, also recommended that OMB revise its guidance concerning annual reporting. The Committee suggested that it would be more practical for some agencies to report that they ". . . have reasonable assurance except. . ." and identify areas where they do not have assurance. However, OMB took no action on these recommendations. This issue will be discussed further in our overall report on second-year implementation of the act which is to be issued later this year.

We discussed our findings with directly responsible program officials and their views were incorporated in the report where appropriate. We did not request official agency comments on a

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draft of this report. As previously noted, however, we will be providing you with a draft of our management review report for your official review and comment as well as briefing you on the details of our work. Our work was performed in accordance with generally accepted government auditing standards.

We would be happy to meet with you or your staff to discuss the results of our work in further detail. We appreciate the cooperation extended to our staff during our work and look forward to the same cooperation in subsequent reviews.

Sincerely yours,

J. Dexter Peach
Director