Memorandum

U.S. Department of Transportation

Office of the Secretary of Transportation

Office of Inspector General

Subject: ACTION: Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2009 and 2008, DOT Report Number: QC-2010-011

Date: November 16, 2009

From: Calvin L. Scovel III, Inspector General

Calvin L. Scovel III

Reply to Attn. of: JA–20

To: The Secretary

I respectfully submit the Office of Inspector General's (OIG) Quality Control Review report on the Department of Transportation's (DOT) audited Consolidated Financial Statements for Fiscal Years (FY) 2009 and 2008.

The audit of DOT's Consolidated Financial Statements as of and for the year ended September 30, 2009, was completed by Clifton Gunderson LLP, of Calverton, Maryland (see Attachment), under contract to OIG. We performed a quality control review of the audit work to ensure that it complied with applicable standards. These standards include the Chief Financial Officers Act, as amended; Generally Accepted Government Auditing Standards; and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended.

Clifton Gunderson concluded that the consolidated financial statements present fairly, in all material respects, the financial position of the U.S. Department of Transportation as of September 30, 2009, and its net costs, changes in net position, and budgetary resources, for the year then ended, in conformity with accounting principles generally accepted in the United States. KPMG LLP, of Washington, D.C., under contract to OIG, audited last year's DOT Consolidated Financial Statements and also expressed an unqualified opinion on those statements.[1]

[1] Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2008 and 2007, Department of Transportation, Report Number QC-2009-009, November 14, 2008. OIG reports and testimony can be found on our Web site at: www.oig.dot.gov.

We congratulate DOT for obtaining clean audit opinions with no material weaknesses for the last 2 years. Your senior leadership team, including the Chief Financial Officer and Modal Administrators, should be commended for its commitment to improving financial management. DOT continued its assessment of internal controls over financial reporting (to comply with OMB Circular 123, Appendix A requirements) and expanded this year's assessment to include the additional controls established in the Operating Administrations that received American Recovery and Reinvestment Act (ARRA) funds. DOT also expanded its review and analysis of financial statement fluctuations, reconciliations between proprietary and budgetary account balances, and testing for improper payments for its four major grants programs—a key control to ensure accountability and transparency for use of Federal funds. While recognizing these improvements, DOT still faces key financial management challenges that require its attention.

Effectively Managing Highway Trust Fund Resources

The Highway Trust Fund (HTF)—primarily funded by motor fuel excise tax revenues—is the primary source for financing highway and mass transit projects. To remain solvent, the HTF required $15 billion in cash infusions from the general fund for the past 2 years (FYs 2008 and 2009). While DOT awaits decisions on future funding, it also needs to ensure effective use of available funds. Yet DOT continues to experience difficulties in releasing (de-obligating) funds that were no longer needed from completed or cancelled projects. Last year, we reported about $300 million of unneeded obligations. This year, Clifton Gunderson reported that about $800 million of obligations were no longer needed and should have been released for other use.[2] In today's budget environment in which highway investment needs exceed available resources, allowing unneeded obligations to sit idle leaves fewer funds available for expanding and preserving the National Highway System infrastructure. DOT needs to closely monitor use of available resources to help maintain the solvency of the HTF and provide the maximum benefit to the economy and the public.

Strengthening Financial Management Oversight and Correcting Anti-deficiency Violations by the Maritime Administration

During this year's audit, Clifton Gunderson reported a significant deficiency in the Maritime Administration's (MARAD) financial management oversight due to erroneous recording of the values of eight ships transferred from the Navy, errors in calculating MARAD's environmental liability, and inaccurate accounting for

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[2] As of September 30, 2009, DOT reported a total of almost $102 billion in outstanding obligations, most of which were associated with HTF obligations.

MARAD ships not in use. DOT needs to work closely with MARAD to ensure these deficiencies are corrected.

Violations of the Anti-deficiency Act were also reported for the U.S. Merchant Marine Academy. Specifically, in March 2009, DOT reported Anti-deficiency Act violations to the President—violations that were initially identified in FY 2007 and totaled as much as $20 million. In August 2009, the Government Accountability Office reported numerous instances of improper and questionable sources and uses of funds by the Academy, including other potential Anti-deficiency Act violations, and made 47 recommendations to improve financial management controls at the Academy. During FY 2010, MARAD needs to determine whether any other Anti-deficiency Act violations exist at the Academy and report confirmed violations. MARAD also needs to continue to correct financial management controls at the Academy.

Improving Financial Reporting and Accounting Controls

Several deficiencies reported by Clifton Gunderson this year were also reported as internal control deficiencies in prior years. First, Clifton Gunderson has noted an over-reliance on the use of journal entries to get the financial statement numbers right. While the use of journal entries is necessary for recording non-routine transactions, such as the accrual of liability estimates, many journal entries could have been avoided by processing normal financial transactions through the Delphi accounting system. During FY 2009, DOT recorded more than 9,000 journal entries with an absolute value of $685 billion. Second, several deficiencies in the Federal Aviation Administration's (FAA) accounting and reporting of Property, Plant, and Equipment remain uncorrected, despite improvements made in FY 2009. For example, properties are still not capitalized in, or retired from, accounting records in a timely manner. Finally, the Federal Highway Administration (FHWA) and the Federal Transmit Administration (FTA) continue to experience difficulties in developing reliable estimates for yearend grant accruals—expenditures incurred but not paid. The actual expenditures exceeded the estimate by more than $600 million in one case. DOT needs to continue strengthening financial controls in these areas to ensure that reliable financial information is available for decision-making.

Disclosing Transportation Investments

During the past 5 years, DOT has invested more than $239 billion in surface and air transportation projects nationwide. These investments include projects related to the National Highway and Interstate Systems, state and local transit and rail systems, and airport planning and development at public use airports. DOT also provided other forms of financial assistance such as loan guarantees for shipping companies. Some investments have resulted in special financial interests. For example, in October 2009, DOT disclosed that the Federal Railroad Administration has owned all preferred stock and a major portion of the equities in Amtrak since the 1980s.[3] As a result of this disclosure, DOT had to perform a special evaluation to determine how this financial interest should be addressed in DOT's Consolidated Financial Statements. DOT determined that Amtrak was not a reporting entity that needed to be consolidated into DOT's financial statements and a disclosure in the financial statements would suffice. However, to prevent recurrence of similar incidents, DOT needs to work with the Operating Administrations to fully disclose financial investments in outside entities, and changes to related legislation, so that these investments could be properly reflected in the DOT's Consolidated Financial Statements.

Strengthening Oversight of Grantee Operations

Both the President and Congress have emphasized the need for full accountability, efficiency, and transparency in the allocation and expenditure of ARRA funds. In June 2009, we issued an ARRA Advisory on the sampling methodology used for testing improper payments.[4] During FY 2009, DOT significantly expanded the FY 2009 improper payment testing for all four major grants programs—the FHWA Federal-aid Highway Program, the FTA Formula Grants Program, the FTA Capital Investment Grants Program, and the FAA Airport Improvement Program. In FY 2008, DOT tested payments totaling $59.6 million; in FY 2009 DOT tested payments totaling $663 million—more than a 10-fold increase—and identified significant improper payments in FHWA's Federal-aid Highway program. Most of these improper payments were due to insufficient supporting documentation provided by grantees. Requiring grantees to provide adequate support for use of Federal funds is essential to ensure accountability and provide for transparency. During FY 2010, DOT should implement corrective actions to minimize improper payments to grantees and expand improper payment testing to other high-risk programs such as the high-speed rail program.

The Single Audit Act requires state and local entities (grantees) expending more than $500,000 of Federal funds to conduct a single audit in accordance with OMB Circular A-133. In addition to rendering an opinion on the grantee's financial statements, Single Audits test whether the grantee complied with grant

[3] This financial investment was specified in the Amtrak Improvement Act of 1981 (Public Law 97-35) and the Amtrak Reform and Accountability Act of 1997 (Public Law 105-134). While former departmental officials, including OIG, had knowledge of the legislation, there is no process to ensure special congressional decisions are properly disclosed for inclusion in DOT financial statements.

[4] ARRA Advisory – Sampling of Improper Payments in Major DOT Grants Programs, Department of Transportation, Advisory Number AA-2009-002, June 22, 2009. OIG reports and testimony can be found on our Web site at: www.oig.dot.gov.

requirements in spending Federal funds. An analysis of the FY 2008 Single Audits for 51 FHWA grantees (49 states, the Government of Guam, and the Puerto Rico Highways and Transportation Authority) showed that 29 of the 51 grantees had not complied with at least one Highway Planning and Construction grant requirement; while 8 of the 29 had significant noncompliance.[5] For example, 10 states had not complied with allowable costs principle requirements in calculating the Federal share of costs, 9 states had not complied with Davis-Bacon Act labor rate requirements, and 8 states had not complied with cash management requirements. DOT has taken steps to improve the Single Audit resolution process to help ensure responsible use of regular grant and ARRA funds. However, sustained management attention is needed to ensure timely correction of Single Audit findings by DOT grantees.

Clifton Gunderson FY 2009 Audit Report

Clifton Gunderson reported five internal control significant deficiencies and one instance of potential or known noncompliance with laws and regulations:

Significant Deficiencies

1. Financial Accounting, Reporting and Analysis
2. Undelivered Orders
3. Grant Accruals
4. Financial Management Oversight by MARAD
5. Information Technology Controls over Financial Systems and Applications

Noncompliance with Laws and Regulations

1. Antideficiency Act

Clifton Gunderson made 22 recommendations to strengthen financial, accounting, and system controls for remediation; we agree with all and, therefore, are making no additional recommendations. DOT officials concurred with the significant deficiencies, and potential or known instances of noncompliance, and committed to submitting to OIG a detailed action plan to address the findings contained in the audit report no later than December 31, 2009. In accordance with DOT Order 8000.1C, the corrective actions taken in response to the findings are subject to follow up. Please provide us with actual amounts de-obligated as a result of actions taken in response to the "Undelivered Orders" significant deficiency by June 30, 2010.

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[5] The eight received qualified opinions from the auditors for their overall compliance with FHWA grant requirements.

Our review disclosed no instances where Clifton Gunderson did not comply, in all material respects, with applicable auditing standards.

We appreciate the cooperation and assistance of DOT and Clifton Gunderson representatives. If we can answer any questions, please call me at (202) 366-1959; Ann Calvaresi-Barr, Principal Assistant Inspector General for Auditing and Evaluation, at (202) 366-1427; or Rebecca Leng, Assistant Inspector General for Financial and Information Technology Audits, at (202) 366-1407.

Attachment

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