QUALITY CONTROL REVIEW OF CONSOLIDATED FINANCIAL STATEMENTS FOR FY 2008 AND FY 2007

Department of Transportation

Report Number: QC-2009-009
Date Issued: November 14, 2008

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 2008 and 2007, DOT
Report Number: QC-2009-009

Date: November 14, 2008

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) 2008 and 2007.

The audit of DOT's Consolidated Financial Statements as of and for the year ended September 30, 2008, was completed by KPMG LLP, of Washington, D.C. (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 Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended.

KPMG 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, 2008, and its net costs, changes in net position, and budgetary resources, for the year then ended, in conformity with U.S. generally accepted accounting principles. OIG audited last year's DOT consolidated financial statements, and we also expressed an unqualified opinion on those statements.[1]

We congratulate the Department for reaching a significant milestone this year. The DOT consolidated financial statements have been audited since FY 1996, and DOT this year received the best outcome yet - an unqualified (clean) audit opinion

[1] Report on Consolidated Financial Statements for FY 2007 and FY 2006, Department of Transportation, Report Number FI-2008-011, November 13, 2007.

with no internal control material weaknesses. This signals to the public that the Department is maintaining a mature and reliable financial environment to account for its available financial resources of nearly $134 billion.

This would not have occurred without your emphasis and personal commitment to improving financial management practices, along with that of your senior leadership team, including the departmental Chief Financial Officer and the Acting Federal Aviation Administrator. This commitment enabled the Department to sustain clean audit opinions in the last 2 years and make significant progress toward improving a long-standing concern associated with the Federal Aviation Administration's (FAA) Property, Plant, and Equipment Account.

The Department must, however, remain vigilant in sustaining good financial management operations to ensure effective use of financial resources in an environment of uncertain financial markets, volatile fuel prices, rising deficits, and a softening economy. This environment presents a special challenge to the Highway Trust Fund and Aviation Trust Fund revenue receipts, which financed more than 70 percent of DOT's operating costs. The following summarizes the key financial management challenges that the Department continues to face.

Improving Financial Reporting

The Department needs to sustain clean audit opinions with no material weaknesses, continue enhancing its financial management oversight, and improve the quality of its financial information throughout the year. Several of the significant deficiencies reported by KPMG - use of journal entries, analysis of proprietary and budgetary account relationships, calculating grant accruals, eliminating intradepartmental activity, and implementing managerial cost accounting capabilities - have been reported as internal control deficiencies for several years, especially for the DOT Operating Administrations funded by the Highway Trust Fund. DOT needs to continue working to correct these internal control deficiencies to ensure that financial records accurately reflect operational results to support management decisions in today's tight financial environment. Correcting these long-standing deficiencies will also bring DOT into full compliance with Federal Financial Management Improvement Act (FFMIA) requirements.

Implementing New CIP Processes

The Department needs to ensure that FAA remains vigilant and continues to implement new policies and procedures in accounting for Property, Plant, and Equipment, especially Construction in Progress (CIP) transactions. The significant deficiency associated with accounting for FAA Property, Plant, and

Equipment, including the CIP account, was reported as a material weakness in the last three consecutive years and resulted in a qualified opinion on the DOT consolidated financial statements in FY 2006. Similarly, DOT slipped to a qualified opinion in FY 2000 because of a material weakness in accounting for FAA Property, Plant, and Equipment. On both occasions, DOT and FAA had to execute expensive corrective action plans to improve accounting for Property, Plant, and Equipment, and to get back to an unqualified audit opinion.

Effectively Managing the Highway Trust Fund Resources

The Highway Trust Fund (HTF) is the primary source for financing highway construction projects; it experienced a solvency problem during FY 2008. In August, the Department worked closely with Congress to have $8 billion transferred from the General Fund to help alleviate fund shortages. While the Department is researching alternative funding sources, it also needs to ensure effective use of available funds. As of September 30, 2008, DOT reported a total of $80 billion in outstanding obligations, most of which were associated with HTF-related grants. KPMG estimated that about $300 million of these obligations were no longer needed and should have been released (de-obligated) for other use. 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 National Highway System infrastructure.

KPMG FY 2008 Audit Report

KPMG reported seven internal control significant deficiencies, none of which were believed to be material weaknesses, and four instances of potential or known noncompliance with laws and regulations:

Significant Deficiencies

1. Journal Entries and Account Relationships
2. Property, Plant, and Equipment, including the Construction in Progress Account
3. Grant Accruals
4. Exchange Revenue
5. Financial Reporting
6. Undelivered Orders
7. Information Technology Controls over Financial Systems and Applications

Noncompliance with Laws and Regulations

1. Antideficiency Act
2. Federal Financial Management Improvement Act of 1996
3. Federal Managers' Financial Integrity Act of 1982
4. Improper Payments Information Act of 2002

KPMG made 25 recommendations for corrective action; 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 developing a detailed action plan to address the findings contained in the report no later than December 29, 2008. 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, 2009.

In our opinion, the audit work performed by KPMG complied with applicable standards.

We appreciate the cooperation and assistance of DOT and KPMG representatives. If we can answer any questions, please call me at (202) 366-1959; David Dobbs, 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

#