Office of Inspector General

Audit Report

Fiscal Year 2000
Financial Statements

Federal Aviation Administration

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Memorandum

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

Subject: **ACTION**: Report on Fiscal Year 2000 Financial Statements, FAA
FI-2001-036

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 Federal Aviation Administration (FAA) 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.

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

To assist us, the Department of the Treasury (Treasury) Office of Inspector General audited the schedule of assets and liabilities, and the related schedule of activity for the FAA accounts (referred to as the Corpus account) administered by the Treasury Bureau of Public Debt. The Treasury OIG issued an unqualified opinion on these FY 2000 schedules. The General Accounting Office performed agreed-upon procedures on tax revenue receipts at the Internal Revenue Service and distributions to the Airport and Airway Trust Fund account, and identified no material discrepancies.

This report presents our qualified opinion on the FAA 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.

Last year, although FAA received an unqualified opinion on its FY 1999 Financial Statements, we reported a material internal control weakness in the accounting for FAA property, plant, and equipment. These 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 undertake 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, we recommended that FAA acquire a commercial, off-the-shelf, integrated property management system, and FAA agreed. Results-oriented organizations need good financial systems that automatically generate accurate and reliable financial data. In FAA's case, such a financial system is essential because of the size and complexity of its property accounts.

During FY 2000, FAA tried but was unsuccessful in implementing an integrated property management system to support the FY 2000 FAA Financial Statements. This conversion process was terminated because FAA realized the detailed research and corrective action 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 depreciation expense ($751 million) and the net book value ($11.5 billion) of its property using electronic spreadsheets outside the existing property systems.

Nonfinancial personnel performed the conversion to a new real property system, and FAA did not establish adequate controls over changes being made to financial data. As a result of this conversion process, 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. For example:

> FAA property records showed an air traffic control tower was constructed in 1942 for $18 million and was fully depreciated as of September 30, 1999. During the conversion, FAA added about $900,000 of improvements and nonfinancial personnel changed the acquisition date to 2000 in the property database. As of September 30, 2000, this 58-year old facility was shown on FAA property records as a new building with a net book value of $18.9 million, which overstated net book value by $18 million.

The total amounts associated with these errors could not be substantiated which caused us to issue a qualified opinion on the FY 2000 FAA Financial Statements.

Last year, we also reported that FAA 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, FAA established adequate procedures and produced a fair and reasonable estimate of accrued liabilities and expenses at yearend.

For the FY 2000 FAA Financial Statements, we identified two issues involving compliance with laws and regulations. While these issues are important, they did not affect our audit opinion.

- 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 nine performance measures were based on 1999 rather than 2000 performance data. None of the nine measures was linked to the cost of achieving targeted results.

- FAA 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 FAA Financial Statements. FAA also had a material internal control weakness concerning its property accounts and had not fully implemented a managerial cost accounting system. 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 these two compliance issues are common to FAA and other Department of Transportation (DOT) internal agencies, we will address these issues in our report on the FY 2000 DOT Consolidated Financial Statements.

We are making one recommendation in this report. As we recommended last year, we are again recommending that FAA implement a commercial, off-the-shelf, integrated property management system. To ensure accuracy, FAA also needs to establish tight controls over input data, validate the data, and maintain supporting documents for independent review and validation. As an added measure, FAA should establish a procedure within its property systems that financial information and acquisition dates cannot be changed without approval of the FAA Chief Financial Officer.

A draft of this report was provided to the FAA and DOT Chief Financial Officers on February 28, 2001. They agreed with the report. 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.

Upon receipt and review of the independent accountant's results, we will work closely with FAA to independently review data input into the new property system to ensure accuracy and supportability.

We appreciate the cooperation and assistance of FAA and 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

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Federal Financial Management Improvement Act of 1996; (4) financial information in the Management Discussion and Analysis is materially consistent with the information in the principal FAA 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 FAA 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 FAA Financial Statements. The supplementary and stewardship information also was materially consistent with management representations and the FAA 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 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 depreciation expense ($751 million) and the net book value ($11.5 billion) of its property using electronic spreadsheets outside the existing property systems. These amounts could not be substantiated.

Except for the reported depreciation expense and net book value of property, plant, and equipment, in our opinion, the 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 FAA 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. As a result of these efforts, FAA reported $10.8 billion (total acquisition cost of $15.5 billion less accumulated depreciation of $4.7 billion) as the net book value for property, plant and equipment as of September 30, 1999. Our audit work substantiated the reported amounts, and we issued an unqualified opinion on the FY 1999 FAA Financial Statements.

Although FAA was able to support property amounts for FY 1999, 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 agreed with our recommendation.

FY 2000 Activity

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 its FY 2000 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 could not reconcile the differences and used existing property systems to support the FY 2000 Financial Statements.

In November and December, we statistically tested the acquisition value of FAA real property ($3.3 billion), personal property changes ($535 million), work-in-process ($1 billion) and construction-in-progress ($1.1 billion) at 12 FAA locations and found acquisition values to be substantiated. At that time, FAA had not computed depreciation and net book values for audit testing. Later, FAA calculated depreciation expense ($751 million) and the net book value ($11.5 billion) of its property, plant and equipment in electronic spreadsheets outside the existing property systems. We determined these amounts could not be substantiated for the following reasons.

Real Property

In April 2000, FAA converted from its Real Property Record (RPR) system to a new Real Estate Management System (REMS) to account for its real property. Nonfinancial personnel performed the conversion, and FAA did not establish adequate controls over changes being made to financial data. As a result of this process, the number of real property items went from about 14,000 as of September 30, 1999, to about 18,000 as of September 30, 2000. FAA also reduced accumulated depreciation and increased net book value of real property by $158 million from balances reported as of September 30, 1999. Converting data from one system to another should not have resulted in any changes to the balances as of September 30, 1999.

On January 27, 2001, FAA provided its calculation of accumulated depreciation, net book value, and depreciation expense for real property. We found that during the conversion process FAA inappropriately changed property acquisition dates in its database. As a result, FAA incorrectly calculated depreciation and net book values.

For example, FAA property records showed an air traffic control tower was constructed in 1942 for $18 million and was fully depreciated as of September 30, 1999. During the conversion, FAA added about $900,000 of improvements, and nonfinancial personnel changed the acquisition date to 2000 in the property database. As of September 30, 2000, this 58-year old facility was shown on FAA property records as a new building with a net book value of $18.9 million, which overstated the net book value by $18 million.

To better quantify our results, we expanded our review of real property to include buildings valued at more than $100,000 at 20 FAA enroute centers (216 items totaling $398 million). We found that 58 (27 percent) of the 216 items had incorrect acquisition dates, resulting in a $78 million overstatement of net book value. FAA could not explain why these dates were changed. Based on our sample results, we estimated that 500 real property items had incorrect acquisition dates as of September 30, 2000.

In addition to overstating net book values as a result of inappropriately changing property acquisition dates, FAA also encountered problems computing depreciation using a commercial software program. We found that the software did not properly account for cost changes resulting from improvements and disposals.

For example, a base building and tower was on the property record as one facility with an acquisition value of $15.5 million. During the conversion, the asset was split into two items, one for the tower and one for the base building. While the total cost for the two items remained at $15.5 million, the software program inaccurately computed accumulated depreciation at $31.5 million, or more than double the acquisition value.

Personal Property (Equipment)

On January 13, 2001, FAA presented its calculation of accumulated depreciation, net book value, and depreciation expense for personal property. Our analytical procedures identified problems with acquisition dates and depreciation calculations. For example, a display system replacement was commissioned in 1998 for $41 million. During FY 2000, FAA added a $10 million improvement to the system and changed the acquisition date to 2000. Therefore, as of September 30, 2000, the system is on the property records as a new facility and the net book value is overstated by about $16 million.

FAA agreed that acquisition dates on some property items were changed inappropriately, and that its commercial software program made errors when calculating depreciation.

Recommendation

As in last year's report, we are again recommending that FAA implement a commercial, off-the-shelf, integrated property management system. To ensure accuracy, FAA also needs to establish tight controls over input data, validate the data, and maintain supporting documents for independent review and validation. As an added measure, FAA should establish a procedure within its property systems that financial information and acquisition dates cannot be changed without approval of the FAA Chief Financial Officer.

FAA Chief Financial Officer Comments

FAA essentially agrees with the report. Based on initial findings of the OIG, FAA engaged independent accountants to review and refine real and personal property files and computations. FAA will make the results available within 15 days. Should added steps be needed, FAA is prepared to devote the resources necessary.

OIG Response

Upon receipt and review of the independent accountant's results, we will work closely with FAA to independently review data input into the new property system to ensure accuracy and supportability.

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 FAA 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 two compliance issues.

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. FAA is responsible for establishing and maintaining adequate internal controls. The FY 2000 DOT Performance Plan contained 66 performance measures, of which 9 were in the FY 2000 FAA 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, FAA 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, one FAA measure is to reduce the number of runway incursions to 248 for the FY 2000 goal. FAA did not report FY 2000 cost data for its efforts in this area.

The performance measures presented in the FAA 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 FAA goal is to measure the number of flight segments that aircraft are able to fly outside the air traffic control preferred routes. FAA did not report the FY 2000 cost data for this measure.

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 FAA Financial Statement audit. However, FAA is facing a significant management challenge to ensure that incoming data are accurate and complete.

FAA is relying on third-party organizations, such as commercial airlines and airports, outside the Federal Government for some of its performance data. FAA also used 1999 performance data. Although FAA 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 FAA operational errors are at risk of being underreported because only enroute centers have an automated system that documents when operational errors occur. FAA agreed to take action to improve the reporting of operational errors. 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. The Management Discussion and Analysis overview of the FY 2000 FAA 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 improve the percent of runway pavement in good or fair condition was not addressed.

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.

FAA 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 FAA Financial Statements. FAA also had a material internal control weakness concerning its property accounts and had not fully implemented a managerial cost accounting system. FAA made 393 adjustments, totaling about $7 billion, outside DAFIS to prepare the FY 2000 Financial Statements. These adjustments were recorded in the financial statement module, a tool used to process the adjustments. However, FAA did not use the financial statement module to prepare the financial statements and the adjustments were not recorded in DAFIS.

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 accounts 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 FAA Financial Statements contained no recommendations. However, our report on the FY 1999 DOT Consolidated Financial Statements recommended that the DOT Chief Financial Officer establish procedures requiring DOT internal agencies to accrue liabilities for goods and services received at yearend, and provide additional guidance to DOT internal agencies to use actual cost for estimating environmental cleanup and disposal liabilities. During FY 2000, FAA established adequate procedures and produced a fair and reasonable estimate of accrued liabilities and expenses at FY 2000 yearend.

On February 28, 2000, we reported on FAA property, plant, and equipment. We recommended FAA acquire a commercial, off-the-shelf, integrated property management system that is compatible with the Department's new accounting system. During FY 2000, FAA tried but was unsuccessful in implementing an integrated property management system to support the FY 2000 Financial Statements. FAA plans to have a fully integrated property accounting system by November 12, 2001.

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

Kenneth M. Mead
Inspector General

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.