Office of Inspector General

Audit Report

Fiscal Year 1998 Financial Statements

Highway Trust Fund

Report Number: FE-1999-079
Date Issued: March 30, 1999

DEPARTMENT OF TRANSPORTATION
UNITED STATES OF AMERICA

Memorandum

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

Subject: INFORMATION: Report on Fiscal Year 1998 Financial Statements, Highway Trust Fund FE-1999-079

Date: March 30, 1999

From: Kenneth M. Mead
Inspector General

Reply To Attn. of: Meche:x61496

To: The Secretary
Thru: The Deputy Secretary

I respectfully submit the Office of Inspector General (OIG) report on the Highway Trust Fund (HTF) Financial Statements for the Fiscal Year (FY) 1998 ended September 30, 1998. 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 Supplemental Information--is the responsibility of the Federal Highway Administration (FHWA), Federal Transit Administration (FTA), National Highway Traffic Safety Administration, and the Federal Railroad Administration (the four Operating Administrations). Our audit was limited to the Financial Statements as of, and for the year ended, September 30, 1998.

While the four Operating Administrations are responsible for financial information, FHWA acts as the principal agent for preparing the HTF Financial Statements. FHWA prepared, for the first time, and we audited the Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing.

This report presents our unqualified opinion on the HTF Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position as of, and for the year ended, September 30, 1998. This report also presents our disclaimer of opinion on the Statement of Budgetary Resources and Statement of Financing. Both of these are new statements required by the Office of Management and Budget.

We encountered major problems with two of the new statements. FHWA was unable to provide records to substantiate material items on the Statement of Budgetary Resources. The Statement of Financing also showed a $10.4 billion difference between the Statement of Budgetary Resources and the Statement of Net Cost. Three examples follow.

- The amount of budgetary authority carried over from prior years for the Federal-Aid Highways program was $13 billion. We analyzed budget authority, congressional limitations, and expenditures back to 1992, but could not substantiate the balance. The beginning balance carried forward in 1992 was $8 billion. According to FHWA, supporting documentation for the $8 billion could go back for years.

- As of September 30, 1998, unliquidated obligations totaling $36.4 billion included obligations that may no longer be needed for project completion. Although initial obligations were supported, unliquidated obligations were not reviewed annually as required by Treasury Manual 98-09. The four Operating Administrations relied on states or grantees to identify unneeded obligations, but they were not doing so. We identified about $562 million in obligations that were no longer needed, some of which were obligated for up to 14 years. For just highway projects, we found over $5.4 billion was obligated for projects that had no activity for at least 1 year, some of which had no activity as far back as 1988.

- Obligations Incurred for the Federal-Aid Highways program totaled $21 billion. While we were able to trace amounts to summary records, we were unable to validate summary amounts to supporting documents. According to the Department's accounting system, there was $146 billion in transactions. This occurred because the Department's accounting system updates transactions but does not eliminate the basic transaction that was adjusted. We could not differentiate between transactions which led to the $21 billion reported, and the adjusted transactions which led to the $146 billion.

Because we were unable to determine the reliability of significant portions of the Statement of Budgetary Resources and Statement of Financing, we are unable to express, and we do not express, an opinion on those two statements.

We also identified a reportable condition concerning the Statement of Net Cost. FHWA identified major programs, but did not allocate overhead cost to each program as required by Federal accounting standards. For example, instead of allocating a portion of the $200 million in salary expenses to each of the major programs, FHWA recorded this entire amount under a miscellaneous account.

We identified three other significant issues. Although these issues are important, they did not affect our audit opinion.

- The four Operating Administrations were not in compliance with the Federal Financial Management Improvement Act of 1996 because the Department's accounting system was not used to prepare the Financial Statements, and the accounting system was not the only source of financial information. Over 100 adjusting and closing entries, totaling $135 billion, were made outside the accounting system to prepare the Financial Statements.

- Federal accounting standards require agencies to have managerial cost accounting systems. The four Operating Administrations use the Department's accounting system, which does not have the capability to produce cost accounting information. A compliant accounting system will not be fully operational until June 2001.

- The performance measures presented in the Management Discussion and Analysis did not provide information about cost effectiveness of programs, and did not relate to information in the Statement of Net Cost. Only 3 of 25 performance measures included 1998 performance data, while 16 had old data and 6 measures had no data.

We are making no recommendations in this report. Since problems with the new statements are common to the HTF and other Department of Transportation (DOT) Operating Administrations, recommendations addressing these issues will be made in our report on the DOT Consolidated Financial Statements.

A draft of this report was provided to the FHWA Chief Financial Officer on March 24, 1999. He agreed with the report. We considered his comments in preparing our final report.

We appreciate the cooperation and assistance of the four Operating Administrations 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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FISCAL YEAR 1998 FINANCIAL STATEMENTS

To the Federal Highway Administrator,
Federal Transit Administrator,
National Highway Traffic Safety Administrator, and
Federal Railroad Administrator

The Department of Transportation (DOT), Office of Inspector General (OIG), audited the Highway Trust Fund (HTF) Financial Statements as of, and for the year ended, September 30, 1998. In our opinion, the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position fairly present, in all material respects, the financial position of the HTF and results of operations as of, and for the year ended, September 30, 1998.

FHWA was unable to provide records to substantiate material items on the Statement of Budgetary Resources. The Statement of Financing also showed a $10.4 billion difference between the Statement of Budgetary Resources and the Statement of Net Cost. Because we were unable to determine the reliability of significant portions of the Statement of Budgetary Resources and Statement of Financing, we are unable to express, and we do not express, an opinion on those two statements.

We also are reporting on internal accounting and administrative control systems, and compliance with laws and regulations applicable to the HTF Financial Statements. We performed the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin 98-08, Audit Requirements for Federal Financial Statements, as amended on January 25, 1999.

Our audit objectives for the FY 1998 Financial Statements were to determine whether (1) the principal Financial Statements are presented fairly in accordance with OMB Bulletin 97-01 as amended on November 20, 1998; (2) the four Operating Administrations have an adequate internal accounting and administrative control structure; (3) the four Operating Administrations have complied with laws and regulations which (a) could have a direct and material effect on the Financial Statements or (b) have been specified by OMB; (4) the information and manner of presentation in the Management Discussion and Analysis is materially consistent with the information in the Financial Statements; and (5) the internal control structure ensured the existence and completeness of reported data supporting performance measures.

The financial information included in the Management Discussion and Analysis and Supplemental Information was materially consistent with the Financial Statements. We are including our reports on the internal control structure, and compliance with laws and regulations, in Sections B and C of this report.

A. OPINION ON FINANCIAL STATEMENTS

In our opinion, the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position and associated consolidating statements fairly present, in all material respects, the financial position of the HTF and results of operations as of, and for the year ended, September 30, 1998.

FHWA was unable to provide records to substantiate six material items on the Statement of Budgetary Resources. The sum of these six items totaled $160 billion. The Statement of Financing also showed a $10.4 billion difference between the Statement of Budgetary Resources and the Statement of Net Cost. Because we were unable to determine the reliability of significant portions of the Statement of Budgetary Resources and Statement of Financing, we are unable to express, and we do not express, an opinion on those two statements.

B. REPORT ON INTERNAL CONTROL STRUCTURE

While the purpose of our work was not to express, and we do not express, an opinion on internal controls, we found material internal control weaknesses that contributed to reportable conditions. Our work was limited to applicable internal controls designed to safeguard assets, prepare financial statements, and assure proper execution of budgetary transactions, and would not necessarily disclose all material internal control weaknesses.

MATERIAL WEAKNESSES

The following sections describe material weaknesses we identified and discuss their effect on the Financial Statements and management of HTF operations. The financial statement weaknesses were reported to OMB and Congress as part of the Department's reporting under the Federal Managers' Financial Integrity Act.

Statement of Budgetary Resources

The new Statement of Budgetary Resources provides information about how budgetary resources were made available to the HTF, as well as their status at yearend. FHWA was unable to provide records to substantiate six material items on the Statement of Budgetary Resources. The sum of these six items total $160 billion and includes: Beginning Unobligated Balance ($36.2 billion), Ending Unobligated Balance ($5.4 billion), Adjustments ($20.9 billion), Obligations Incurred ($25.3 billion); Beginning Obligated Balance ($35.7 billion), and Ending Obligated Balance ($36.4 billion). Details on three of the six items follow.

<u>Beginning Unobligated Balance</u>

The unobligated balance reported at $36.2 billion reflects the amount of budget authority carried forward from prior periods which had not been used for projects. To determine if this amount was reasonable, we reviewed the Federal-Aid Highways amount reported at $13 billion.

We analyzed budget authority, congressional limitations, and expenditures back to the beginning of FY 1992, but could not substantiate the balance. The beginning balance carried forward in 1992 was $8 billion. According to FHWA, supporting documentation for the $8 billion could go back for years.

<u>Validity of Ending Obligations</u>

Title 31, United States Code (U.S.C.) Section 1501 states obligations of the United States shall be recorded only when supported by documentary evidence. Title 31, U.S.C. Section 1108 states the head of an agency shall annually submit a certification, supported by records, showing compliance with Section 1501. We found documentary evidence existed to support initial obligations, and obligations were certified annually. However, unliquidated obligations were not reviewed prior to certification. Treasury Financial Manual Bulletin 98-09 states:

> Agencies that have not reviewed their unliquidated obligations during the year must do so before yearend closing. This ensures that those transactions meeting the criteria . . . set forth in 31 U.S.C. 1501 have been properly recorded. Retain work papers and records on verifications to facilitate future audits.

Although the annual certifications were made that obligations totaling $36.4 billion were valid as of September 30, 1998, there was no documentation supporting this certification, and no review was made of unliquidated obligations during the year. Instead, the four Operating Administrations relied on states or grantees to identify obligations that may no longer be needed for project completion and initiate actions to deobligate unneeded funds.

Our audits disclosed states and grantees were not reviewing unliquidated obligations. We identified material amounts of obligations that were no longer needed. To illustrate:

- In December 1997, we estimated there was $500 million in excess obligations on highway projects[1]. Unneeded funds were obligated for as long as 12 years. FHWA agreed to conduct reviews to deobligate funds by the end of calendar year 1998. FHWA had not completed the review, and unneeded funds were still obligated as of September 30, 1998.

- As part of our current audit, we randomly selected 47 FHWA projects in six states with $98 million of obligated balances. We found 12 projects in 3 states had unneeded obligations totaling $5.2 million. For example, one project was completed 8 years ago, and still had $568,000 in unneeded obligations. State officials agreed the funds were no longer needed for project completion, and initiated actions to deobligate funds for use on other projects.

  To identify the magnitude of this issue, we requested FHWA to age their highway projects. Their inquiry against the database found $5.4 billion currently obligated for projects that had no activity for at least 1 year. Included were projects with no activity as far back as 1988. Annual reviews of projects would have readily identified inactive projects, and made unneeded funds available for valid projects.

- We reviewed 67 FTA projects with unliquidated obligations totaling $83 million. We found 45 projects had an estimated $57 million in unneeded obligations[2]. These funds had been obligated for an average of 8 years, and up to 14 years.

<u>Obligations Incurred</u>

Obligations Incurred represents federal funds legally provided to states and grantees from the HTF during FY 1998. The Federal Financial Management Improvement Act requires that an entity's accounting system be able to track summary accounting information to detail transactions.

To determine whether the amount reported as obligations incurred was correct, we obtained detailed supporting records from the Departmental Accounting and Financial

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[1] Unexpended Obligations on Complete and Inactive Highway Projects, FHWA, Report Number TR-1998-045, issued December 11, 1997.

[2] Management of Grant Funds, FTA, Report Number FE-1999-016, issued November 6, 1998.

Information System (DAFIS). We selected for review the FY 1998 Federal-Aid Highways obligations incurred totaling $21 billion.

While we were able to trace reported amounts into summary records, we were unable to validate summary amounts to supporting documents. According to DAFIS, there was $146 billion in transactions. This amount substantially exceeded the $21 billion because each time a state charges a project or adjusts an obligation, DAFIS records the transaction against the Obligations Incurred account. But DAFIS does not eliminate the basic transaction that was adjusted. We could not differentiate between the transactions which led to the $21 billion reported, and the adjusted transactions which led to the $146 billion. FHWA stated it expects to correct this problem in FY 2000.

Statement of Financing

The Statement of Financing is a reconciliation of the budgetary information in the Statement of Budgetary Resources and the operating expense information in the Statement of Net Cost. The Statement of Financing also includes information about other financing sources from the Statement of Changes in Net Position. The reconciliation ensures there is a proper relationship between financial and budgetary accounts in the entity's financial management system. The Statement of Financing uses data from the three other financial statements and contains no original data.

We traced amounts reported in the Statement of Financing to the corresponding amounts in other statements. While the amounts were presented in accordance with appropriate Treasury guidance, the Statement of Financing was out of balance by $10.4 billion. The difference resulted from following Treasury guidance requiring the HTF net transfers in the Statement of Net Position also to be in the Statement of Financing. To present a reconciled Statement of Financing, the $10.4 billion was reported as reconciling differences. FHWA is addressing the issue of reporting trust fund transfers with Treasury and OMB.

REPORTABLE CONDITION

Statement of Net Cost

According to the Managerial 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 programs and activities. According to OMB Bulletin 97-01, an entity should report performance measures that provide information about the cost effectiveness of major programs and should link these costs to programs featured in the Statement of Net Cost. Agencies are required to report full costs, including overhead, to program areas. As discussed separately in this report, the four Operating Administrations did not link performance measures to the major programs.

DAFIS does not perform cost accounting, and the Department's Financial Statements Module does not produce the Statement of Net Cost. While the Statement of Net Cost identified major programs, FHWA did not allocate overhead costs to these programs. For example, FHWA had about $200 million in salary expense. Instead of allocating a portion of these costs to each of the major programs, FHWA recorded the costs under Miscellaneous Programs and Administration.

C. REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Our objective was not to express, and we do not express, an opinion on overall compliance with laws and regulations. Our work was limited to selected provisions of laws and regulations, and would not necessarily disclose all material noncompliances.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 requires auditors to report whether agencies' financial management systems comply substantially with federal accounting standards, financial systems requirements, the government's standard general ledger at the transaction level, and Federal Financial Management Systems Requirements issued by the Joint Financial Management Improvement Program. The four Operating Administrations are in noncompliance because (1) $160 billion on the new statements could not be substantiated, (2) DAFIS was not used for preparation of the financial statements, and (3) a managerial cost accounting system had not been implemented.

DAFIS was not the only source of financial information used to prepare the HTF Financial Statements. OMB implementation guidance states that to be in substantial compliance with the Federal Financial Management Systems Requirements, the "agency core financial system, supported by other systems containing the detail data summarized in the core financial system, is the source of information used in the preparation of the annual financial statements. . . ." Because the core accounting system did not contain the most current financial information, FHWA made over 100 adjustments, totaling $135 billion, outside DAFIS to prepare the Financial Statements.

These adjustments were recorded in the financial statement module, a tool used to generate the Financial Statements. These adjustments, at a minimum, should be recorded in DAFIS at a summary level. However, FHWA could not record these adjustments in DAFIS because FY 1998 records were closed within 5 days after yearend.

Federal Financial Accounting Standards Number 4 requires Federal departments to have the capability in place, beginning in FY 1998, to meet requirements of managerial cost accounting standards. Cost accounting is needed in the Federal Government to provide reliable and timely information on the full cost of Federal programs. The four Operating Administrations use DAFIS which does not have the capability to produce cost accounting information. The Department is in process of replacing DAFIS, but the replacement system will not be fully operational until June 2001.

Annual Obligational Certifications

Title 31, U.S.C. Section 1501 states obligations of the United States shall be recorded only when supported by documentary evidence. Title 31, U.S.C. Section 1108 states the head of an agency shall annually submit a certification, supported by records, showing compliance with Section 1501. However, as presented in our discussion of the Statement of Budgetary Resources, there were no records showing unliquidated obligations were reviewed prior to certification.

Performance Data

Under OMB Bulletin 98-08, our responsibility was to obtain an understanding of internal controls relating to the existence and completeness of performance data. The four Operating Administrations' FY 1999 Performance Plans contained 127 performance measures, of which 25 were included in the FY 1998 HTF Financial Statements. The presentation complied with requirements of OMB Bulletin 97-01 to report performance measures consistent with goals and objectives from agencies' strategic plans.

OMB Bulletin 97-01 also states:

> . . . 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.

We found performance measures did not provide information about cost effectiveness, FY 1998 financial data could not be linked to performance, and planned actions were not always reported.

Measuring Cost Effectiveness

The four Operating Administrations did not have systems in place to allocate costs by major program. Therefore, the performance measures could not be linked to the Statement of Net Cost. The FY 1998 Financial Statements also did not include any performance measures that related to financial operations or cost effectiveness. We found none of the measures was linked to the cost of achieving targeted results, or to the Statement of Net Cost.

For example, one FHWA goal is to improve the condition of bridges so that, in 10 years, less than 25 percent are classified as deficient. However, FHWA did not report the FY 1998 cost data for improving deficient bridges.

In developing its strategic and annual performance plans, DOT directed the Operating Administrations to implement outcome-based measures (actual effects of the program). The four Operating Administrations did not focus on measuring outputs (targeted results) or allocating cost to measure benefits. For example, the Financial Statements contain a performance measure assessing progress to reduce the percentage of alcohol-related fatalities from 40.9 percent in 1996, to 36 percent in 1999. The Management Discussion and Analysis did not describe the program, its cost, or the effectiveness of dollars spent. Such a relationship between costs and program performance should be presented in the FY 1999 Financial Statements.

DOT's current accounting system (DAFIS) does not have the capability to track program costs, or allocate payroll costs to programs. DOT is in process of replacing its accounting system, but it will not be fully operational until June 2001. In the interim, the four Operating Administrations need to develop allocation techniques to capture costs that relate to performance measures.

Completeness and Timeliness of Performance Data

To comply with OMB Bulletin 97-01, current year performance data must be reported to compare with current year financial data. The FY 1998 Financial Statements included 1998 performance data for 3 of 25 measures, 1997 data for 4, 1996 data for 10, 1995 data for 2, and 6 measures had no data. For example, FHWA had no data on the measure "To increase user satisfaction with the Nation's highway system to meet their needs." FHWA is in process of gathering the necessary data for this and two other measures. FHWA could not state when it expects to have sufficient data to report on these three measures:

- Reducing highway-related delays at border crossings by 30 percent in 10 years.
- Reducing life cycle costs on highways by 25 percent in 10 years.
- Increasing the use of accelerated contracting mechanisms for emergency repairs.

Without timely and complete data, performance results cannot be compared to current year financial data. As part of our Financial Statements audit, we did not test the validity or accuracy of performance data. This will be accomplished as part of selected program audits during FY 1999. The Department is in process of implementing a comprehensive system to control the quality of performance data.

Reporting of Planned Actions

The Management Discussion and Analysis included planned actions to improve performance for 16 of 25 measures. For example, planned actions were reported to reduce the rate of fatalities on highways, but how to improve pavement quality of the National Highway System was not addressed. In its FY 2000 Performance Plan, DOT reported three initiatives designed to improve pavement quality. The FY 2000 Performance Plan also describes six initiatives to reduce highway fatality and injury rates, and six other initiatives to reduce alcohol-related highway fatalities. This available information should be incorporated in the HTF Financial Statements.

D. PRIOR AUDIT COVERAGE

Our report on the FY 1997 HTF Financial Statements contained no recommendations. However, five recommendations from our FY 1996 report relating to automated data processing controls and safeguards have not been fully implemented. One recommendation to establish controls to detect duplicate payments was to be completed by March 31, 1998, but is still in process. Three recommendations to (1) perform required tests/reviews to obtain certification and accreditation of computer systems, (2) improve password control procedures, and (3) establish automated procedures to preclude payments in excess of obligated amounts, are to be completed by December 1999. No target completion date had been established to prepare security and disaster recovery plans, which must be completed before system certification and accreditation.

This report is intended for the information of the four Operating Administrations and DOT. However, this report is a matter of public record, and its distribution is not limited.

Kenneth M. Mead
Inspector General