

January 2, 2002

The Honorable Joseph I. Lieberman  
Chairman  
Committee on Governmental Affairs  
United States Senate  
Washington, DC 20510

Dear Mr. Chairman:

We are providing this information in response to your letter of June 26, 2001, regarding the Department of Transportation (DOT) internal controls and plans for reducing improper payments. You asked that the Office of Inspector General (OIG) provide an assessment of DOT's efforts specified in the Committee's letter, and any thoughts OIG may have on the General Accounting Office (GAO) executive guide, "Strategies to Manage Improper Payments."

OIG reviewed GAO's guide and found it to be an excellent document to help agencies manage payments and reduce improper payments. Our comments were delayed awaiting DOT's response to the Committee's request. DOT has not yet responded. Accordingly, our comments are based on our audit and investigative work.

We share the Committee's view that administration of government funds is an essential public trust and that improper payments represent wasteful spending. With the huge increases in DOT funding in recent years due to passage of the Transportation Equity Act for the 21<sup>st</sup> Century (TEA-21), the Wendall H. Ford Aviation Investment and Reform Act for the 21<sup>st</sup> Century (AIR-21), and most recently, the Aviation and Transportation Security Act, there is a compelling need for DOT to provide better oversight and accountability of Federal payments.

OIG, as part of its work plans, reviews and tests the adequacy of internal controls for major DOT programs based on our assessments of risks. We also provide significant coverage of financial operations while conducting annual audits of DOT financial statements. However, program and financial statement audits are no substitute for good management controls and oversight.

Our work in DOT has identified improper payments, weaknesses in internal controls, poor management of agency programs, and outright fraud by program participants and agency employees. The following are four examples:

- We identified improper payments of about \$150 million for workers compensation insurance on the Central Artery Owner-Controlled Insurance Plan. The overpayments resulted because payments were computed using more employees than were employed by the Central Artery. Overpayments had been retained by the Massachusetts Highway Department.
- DOT itself issues more than \$3 billion of cost-reimbursable contracts annually. These contracts represent high risk because contractors have no incentive to control costs. We found limited DOT oversight, and in many cases DOT was simply paying costs that were billed by contractors. After we transferred the responsibility for requesting contract audits to DOT internal agencies, independent audits of DOT contracts by the Defense Contract Audit Agency (DCAA) dropped from 280 in 1996 to 68 in 1999. We recommended that DOT increase oversight of these high-risk contracts, and request more audits by DCAA. Congress also instructed DOT to take corrective actions. DOT agreed this is necessary to improve accountability and reduce improper payments.

In 2001, the total number of contract audits increased to 169; however, only 21 percent of these audits were related to cost incurred on the contracts. The other contract audits were for establishing contract prices, evaluating contractor systems or determining compliance with specific contract requirements. DCAA reports that on average its audits of contracts question about two percent of billed costs. For DOT, that could amount to about \$60 million in potential improper payments annually. DOT needs to improve oversight of contracts by obtaining more independent audits of cost incurred by contractors. Until then, we have no assurance that DOT improper payments do not exceed the estimated two percent level.

- On January 17, 2001, a Midwestern steel company agreed to pay the United States and the State of Louisiana \$30 million to settle criminal charges resulting from the selling of unapproved steel pipe for drainage culverts.
- Our audit of Fiscal Year (FY) 1999 financial statements identified \$1.6 million in duplicate payments. These improper payments occurred due to insufficient oversight and monitoring by the Federal Highway Administration (FHWA) of a new financial system that the State of Georgia prematurely implemented. FHWA and the State of Georgia took immediate corrective action, and the State refunded the improper payments.

During FY 2000 and FY 2001, OIG issued 121 reports with 315 recommendations to improve management oversight, strengthen internal controls, establish accountability, and recoup improper payments. These reports identified about \$62 million of questioned costs and \$2.5 billion of funds that could be put to better use. Our investigations resolved during these same 2 years resulted in \$168 million in fines, restitutions, judgments, and monetary recoveries.

Notwithstanding our significant audit and investigative work, we have no reasonable basis to quantify the total amount of improper payments made by DOT. The amounts found by audits and investigations should be low compared to amounts that should be identified from appropriate oversight by DOT program officials. However, DOT itself could not quantify improper payments made by its internal agencies, and has never reported or disclosed any amount for improper payments in its annual financial statements. At our request, DOT asked its agencies for this information, which DOT is collecting and analyzing.

Congress and the Office of Management and Budget (OMB) have recognized the need for better oversight and accountability within DOT, and DOT has agreed it must do more. One major initiative that is needed to improve internal controls over financial operations is the implementation of new automated financial systems that meet core financial system requirements of the Joint Financial Management Improvement Program.<sup>1</sup> DOT has significant efforts underway, and this is a step in the right direction.

DOT does not have a departmentwide plan to address improper payments. Therefore, we can not provide any assessment as requested by the Committee. At the core of any plan to identify and reduce improper payments is the need for intensive management oversight of agency programs and payments. While we have noticed improvements in DOT oversight, much more needs to be done.

In our opinion, DOT should develop a departmentwide plan to identify, track, and report its progress on reducing improper payments by establishing performance goals in its performance plan. As part of this action, we would suggest that identifying and reducing improper payments also should be included in the annual performance agreements between the Secretary of Transportation and senior DOT officials. A very meaningful and useful step could be to measure the increase of contract cost audits obtained from DCAA. We are providing this letter for DOT's consideration in responding to the Committee's request.

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<sup>1</sup> JFMIP is a joint cooperative undertaking of OMB, GAO, the Department of the Treasury, and the Office of Personnel Management, working in cooperation with each other and with operating agencies to improve financial management practices throughout the Federal Government.

We will continue to monitor financial operations for improper payments. If we can answer any questions or be of further assistance, please feel free to contact me at (202) 366-1959, or my Deputy, Todd J. Zinser, at (202) 366-6767. An identical letter was sent to Senator Fred Thompson, Ranking Member of the Committee.

Sincerely,

A handwritten signature in black ink, appearing to read "Kenneth M. Mead". The signature is written in a cursive style with a large initial "K" and "M".

Kenneth M. Mead  
Inspector General