

**Before the Subcommittee on Oversight, Investigations, and Emergency
Management, Committee on Transportation and Infrastructure**

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**Financial Data Quality in the
U.S. Department of Transportation**

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Madam Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify today concerning the Department of Transportation's (DOT) financial data and its financial systems.

On March 30, 1999, we issued our audit report on DOT's Fiscal Year (FY) 1998 Consolidated Financial Statements. We could not determine the reliability of significant portions of these financial statements. Consequently, we did not express an opinion on the fair and reasonable presentation of DOT's financial statements. This is commonly called a disclaimer of opinion.

Our testimony today addresses these issues:

- the current status of DOT's financial statement information, and
- challenges ahead to improve the quality of DOT's financial data.

Current Status

The Chief Financial Officers (CFO) Act of 1990 requires each Federal agency to prepare an annual financial statement that must be audited by the agency Inspector General, or an independent external auditor. We have been doing the audits in DOT. In the past 3 years, we made over 100 recommendations to improve financial management and accounting practices within DOT and its Operating Administrations.

DOT must produce fair and accurate financial statements as a first step to establish accountability for its assets, improve financial credibility for its budget requests, collect accurate data to support sound management decisions, and establish a basis for user fees. To do this, DOT needs basic financial tools, including a reliable cost accounting system and good financial data.

The primary material weakness that has prevented DOT from getting an unqualified, "clean," audit opinion relates to its property and equipment accounts, which total about \$21 billion. Most of DOT's property and equipment are owned by the Federal Aviation Administration (FAA) and the U.S. Coast Guard. Much of this property was acquired years ago when the Federal Government was not overly concerned with accounting for its property acquisition costs. Because of the age of some assets, the supporting records cannot be found, or involve labor intensive processes to conduct searches for records and documents.

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We are working closely with FAA and the Coast Guard to resolve property and equipment valuations. In a joint effort with FAA during FY 1999, we determined FAA's equipment account was understated by about \$4.5 billion. FAA is adjusting its property records accordingly. In January 1999, we reported the Coast Guard overstated its valuation of buildings and structures by about \$800 million. The Coast Guard agreed and we are working together to resolve this issue.

Another obstacle pertains to DOT's financial systems. DOT's accounting system does not produce all the financial and budgetary information for preparing its financial statements. As a result, it is necessary to make billions of dollars of closing and audit adjustments outside the accounting system to present DOT's financial condition. The Consolidated Financial Statements also are prepared manually from the Operating Administrations' individual financial statements.

On May 26, 1998, the President announced the goal to have an unqualified audit opinion on the Federal Government's Financial Statements for FY 1999. DOT immediately began operating with a sense of urgency. During FY 1999, DOT and its Operating Administrations made significant progress toward resolving the material weaknesses and improving the accuracy of the financial data. For example:

- innovative methods were used to value older property and equipment,
- massive efforts were made to retrieve documentation supporting values for recent property and equipment acquisitions,
- commercial software packages were purchased to help support property accounts, and
- unneeded obligations were reduced by about \$672 million.

Challenges Ahead

DOT agrees it has material weaknesses affecting its accounting and financial data, and is working very hard to correct them. To resolve long-standing issues with property and equipment valuations, FAA and Coast Guard established "task forces" under the direct leadership of their Chief Financial Officers. Target dates were established for accomplishment of the work, and the results are being closely monitored by the FAA Administrator and the Commandant of the Coast Guard.

As a result, DOT has taken significant actions to fix the material weaknesses identified in the FY 1998 audit. However, we cannot form an opinion on the FY 1999 financial statements until we complete our detailed testing of account

balances as of September 30, 1999. Our testing of FAA and Coast Guard property is encouraging.

As DOT moves into the next millenium, it needs to develop accurate and reliable information to report on the efficiency and effectiveness of its operations. To comply with the Government Performance and Results Act, DOT must be able to link cost information to performance measures, provide information on the cost effectiveness of its major programs, and ensure that performance measures are based on current performance and financial data. DOT's financial systems do not produce the required data.

DOT, as well as the rest of the Federal Government, was required by Federal Financial Accounting Standards to have the capability to perform managerial cost accounting beginning in FY 1998. DOT recognizes its current accounting system does not meet today's needs, and is developing a replacement system with a cost accounting module. FAA also is developing a separate cost accounting system.

DOT recognizes the limitations of its financial systems and is taking extraordinary efforts to resolve the material weaknesses. However, until its financial systems are replaced for the long term and accountability is established for keeping financial data current and accurate, there is a risk that DOT's accounts could revert back to containing inaccurate financial information.

The good news is that the Secretary of Transportation has the personal commitment of the DOT Chief Financial Officer that the job will get done. DOT is well on its way to getting a new accounting system and FAA is developing a cost accounting system. Both new systems are currently scheduled to be fully operational within 2 years.

Background

The Chief Financial Officers Act of 1990 requires an annual financial report pertaining to an agency's overall financial position, results of operations, and budgetary information. Financial statements must be audited to provide an independent opinion on the fair and reasonable presentation of the financial statements.

Professional accounting standards provide for four types of audit opinions:

- ◆ Unqualified “Clean” – The financial statements meet accounting standards and the material dollar amounts are supported.
- ◆ Qualified – The financial statements generally meet standards, but some dollar amounts cannot be supported.
- ◆ Disclaimer – The financial statements may or may not meet accounting standards, and material dollar amounts cannot be supported. Basically, the auditor cannot determine if the dollar amounts are correct or not.
- ◆ Adverse – The financial statements contain significant dollar amounts that are incorrect, but management refuses to make changes.

Status of Financial Information

DOT prepared its first Consolidated Financial Statements for FY 1996, and we issued our audit report on April 10, 1997. We were unable to express an opinion. We identified 11 material internal control weaknesses, 13 reportable conditions, and 2 instances of noncompliance with applicable laws and regulations. We made 77 recommendations for corrective action. Although we still disclaimed an opinion on DOT's FY 1997 and FY 1998 financial statements, significant progress has been made.

Issues which caused the disclaimer of opinion for FY 1998 are discussed in the following paragraphs. DOT's primary problem relates to its property and equipment reported at an acquisition value of \$21 billion. The major components include real property (land, buildings, and structures), personal property (equipment), and work-in-process. Most of DOT's property and equipment are owned by FAA or the Coast Guard. Another problem concerns support for financial data in the new financial statements required for the first time in FY 1998.

Property and Equipment

Real Property - For FY 1998, neither FAA nor the Coast Guard could provide documentation to support acquisition costs for real property reported at \$5.3 billion. Subsequently, FAA and Coast Guard were able to reasonably estimate the acquisition cost, based on a model calculation, for property acquired before October 1, 1994. During FY 1999, we verified that the model results were reasonable. Most work with the model is complete and supportable values are being recorded in the accounting records.

For property acquired since October 1, 1994, the DOT Operating Administrations were required to provide documentation, including contracts, purchase orders, credit card receipts, and other miscellaneous documents to support acquisition values. Our testing of this documentation is finding that recorded amounts are adequately supported.

Personal Property – The major weakness in FY 1998 was that FAA had significantly understated the acquisition value of its personal property. This understatement occurred because FAA did not routinely record its equipment purchases in its property records. In a joint effort with FAA, using appropriation data, budget information, and other financial records, we were able to determine that FAA had understated its equipment value by about \$4.5 billion. FAA's records are being adjusted accordingly.

Work-in-Process – As property is acquired and buildings are constructed for specific projects, associated costs are charged to, and accumulated in a work-in-process account until the projects are completed and systems are placed in service. When completed, the project costs should be transferred to the

appropriate real or personal property accounts and then depreciated over their expected life.

FAA had two problems with its work-in-process. FAA did not transfer costs from work-in-process for completed projects, or have documentation supporting the account balances for active work-in-process projects. During FY 1999, FAA corrected the first problem by transferring about \$1.6 billion in completed projects to the appropriate accounts. FAA currently is in the process of documenting costs that will remain in work-in-process as of September 30, 1999. Upon completion, we will review the documentation supporting current costs for active work-in-process projects.

Coast Guard did not record its financial data in a work-in-process account during FY 1998. For FY 1999, Coast Guard purchased a commercial software package to record all property transactions. To establish the amounts to be recorded, Coast Guard reviewed 10 years of Congressional appropriation history to account for all projects funded by its Acquisition, Construction and Improvement appropriation. The Coast Guard now has a work-in-process account which we will audit for accuracy and supportability.

New Financial Statements

The Office of Management and Budget required Federal agencies to prepare additional financial statements for the first time in FY 1998, including the Statement of Net Cost and Statement of Budgetary Resources. We encountered problems with the new statements, which demonstrated the need for better accounting practices, more accurate financial data, and state-of-the-art financial management systems.

Statement of Net Cost - Because its financial systems could not generate cost data by major programs, DOT had to report its operating costs in three components on the Statement of Net Cost; Surface Transportation, Air Transportation, and Maritime Transportation. This presentation combined programs and activities with many separate and distinct goals, and did not link program costs as required to the performance measures. For example, DOT reported Coast Guard operating expenses of \$2.8 billion as a major program cost. However, these costs represented total operating and maintenance costs that should have been allocated among the major Coast Guard programs.

Statement of Budgetary Resources - The Statement of Budgetary Resources shows the amount of resources provided and the status of those resources. The Highway Trust Fund beginning unobligated balance (\$36.2 billion) represents the amount of budgetary authority carried forward from prior periods, but we could not substantiate the balance because supporting documents go back for years.

There also was no documentation supporting certifications that recorded obligations were valid, and no reviews were made of unliquidated obligations. To overcome this, we performed a review of inactive obligations during FY 1999. We identified about 63,000 obligations, totaling \$5.1 billion, that had no activity within 18 months. In a joint review with the DOT Operating Administrations, we identified about \$672 million of recorded obligations that were no longer valid.

Challenges Facing DOT

DOT agrees it has material weaknesses affecting its accounting and financial data, and is working very hard to correct them. To resolve long-standing issues with property and equipment valuations, FAA and Coast Guard established "task forces" under the direct leadership of their Chief Financial Officers, with close

monitoring by the FAA Administrator and the Commandant of the Coast Guard. DOT has taken corrective actions on the material weaknesses from the FY 1998 audit. However, we cannot form an opinion on the FY 1999 financial statements until we complete our detailed testing of account balances as of September 30, 1999.

As DOT moves into the next millenium, it needs to develop accurate and reliable information to report on the efficiency and effectiveness of its operations. To comply with the Government Performance and Results Act, DOT must be able to link cost information to performance measures, provide information on the cost effectiveness of its major programs, and ensure that performance measures are based on current performance and financial data. For example, DOT presented a performance goal of reducing the percentage of deficient bridges on the National Highway System. However, the cost of attaining this goal was not linked to the performance measure. Further, only 5 of the 32 performance measures in the FY 1998 Consolidated Financial Statements were supported with current performance data. DOT needs financial systems that produce the required data in a timely and usable manner.

DOT recognizes the limitations of its financial systems and is taking extraordinary efforts to resolve the material weaknesses. However, until its financial systems are replaced and accountability is established for keeping financial data current and accurate, there is a risk that DOT's accounts could revert back to containing inaccurate financial information. DOT is well on its way to getting a new accounting system and FAA is developing a cost accounting system. DOT's new accounting system is on schedule, and is planned to be fully operational by the end of FY 2001.

FAA originally planned for its cost accounting system to be fully implemented by October 1, 1998, but delays have occurred. Our audit work also identified accounting issues which FAA is in the process of resolving. For example, FAA does not account for its labor cost by type of service. FAA assigned labor cost to specific air traffic services based on a 2 or 3 day manual summary of labor data. This information came from only two of the four locations where the work occurred. The limited information was not representative of FAA's total operations. FAA is developing a new plan for assigning labor costs. The estimated delivery date for a fully operational cost accounting system for FAA is currently planned for September 30, 2001.

In conclusion, we are working closely with the Department's Chief Financial Officer to resolve these financial issues. DOT and Operating Administration officials have been extremely cooperative. We will continue to monitor the issues discussed in this statement, and advise the Department's Chief Financial Officer of progress and problems.

Madam Chairman, this concludes our statement. I would be pleased to answer any questions.

