

OVERSIGHT OF FINANCIAL MANAGEMENT PRACTICES AT THE DEPARTMENT OF JUSTICE AND THE FEDERAL AVIATION ADMINISTRATION

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HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,  
INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON  
GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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## **OVERSIGHT OF FINANCIAL MANAGEMENT PRACTICES AT THE DEPARTMENT OF JUSTICE AND THE FEDERAL AVIATION ADMINISTRATION**

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**THURSDAY, MARCH 18, 1999**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,  
INFORMATION, AND TECHNOLOGY,  
COMMITTEE ON GOVERNMENT REFORM,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 1:59 p.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Biggert, Ose, Turner, and Maloney.

Staff present: J. Russell George, staff director and chief counsel; Bonnie Heald, director of communications/professional staff member; Mason Alinger, clerk; Kacey Baker, intern; Faith Weiss, minority counsel; and Ellen Rayner, minority chief clerk.

Mr. HORN. A quorum being present, the Subcommittee on Government Management, Information, and Technology, will come to order. Today's hearing is the second in a series of hearings to examine the results of financial statement audits at selected Federal agencies.

In the late 1980's, Congress recognized that one of the root causes of waste in the Federal Government was that financial management leadership, policies, systems, and practices were in a state of disarray. Financial systems and practices were obsolete and ineffective. They failed to provide complete, consistent, reliable, and timely information to congressional decisionmakers or to agency management. In response, Congress passed a series of laws designed to improve financial management practices and to ensure that tax dollars are spent for the purposes that Congress intends.

The Chief Financial Officers Act, enacted in 1990, represented the most comprehensive financial reform legislation of the last four decades. It established a leadership structure for Federal financial management, including the appointment of Chief Financial Officers in the 24 largest Federal departments and independent agencies. In 1994, the Chief Financial Officers Act was amended to require agency-wide audited financial statements covering all agency accounts and associated activities. In addition, the CFO Act, as amended, enables the Office of Management and Budget to require the submission of financial statements by component entities with-

in the agencies. The Federal Aviation Administration within the Department of Transportation is one of those agencies.

Today, we will hear testimony focusing on financial management within the Federal Aviation Administration and within the Department of Justice. After many attempts, neither of these agencies has successfully prepared reliable financial statements. This year, financial audits of these two agencies reveal numerous weaknesses in financial control and in some cases a failure to comply with Federal laws and regulations.

In its fifth attempt to receive a clean opinion on its financial statements, the FAA has failed. Earlier this month, the Department of Transportation's Inspector General reported that FAA cannot keep track of its more than \$11 billion worth of property and equipment. The agency failed to produce support documentation for tax revenues that are collected by the Internal Revenue Service and deposited in the Airport and Airways Trust Fund, and it failed to report accurately on the costs of its programs. This includes the extensive modernization of the Nation's air traffic control system which will ultimately cost more than \$42 billion.

The General Accounting Office, which is the fiscal and program auditing arm of the Congress, recently added the FAA's poor financial management to its list of problem areas that place Federal agencies at high risk of being vulnerable to waste, fraud, and abuse of the taxpayers' money. The GAO reported that these weaknesses could result in the agency being unable to locate mission-critical equipment, such as radar units and other air traffic control equipment, which could exacerbate an emergency.

The GAO also reported that the FAA lack of cost accounting information limits its managers' ability to make effective decisions on the agency's resource needs. It also inhibits managers from maintaining adequate control over major projects, such as the \$42 billion air traffic control and modernization system.

As for the Department of Justice, it also failed to receive a clean opinion on its 1998 financial statement. After three attempts, the Department of Justice's Inspector General has again found that significant weaknesses persist in all of the Department's component agencies, including the Immigration and Naturalization Service, the U.S. Marshal's Service, the Drug Enforcement Administration, and the Asset Forfeiture Fund, to mention but a few.

The Inspector General's audit found that the Department of Justice's computer systems were vulnerable to improper access and that the Department was unable to account properly for seized and forfeited assets. Furthermore, the Department failed to comply with four laws governing financial management within the Federal Government. In an especially troubling situation, one regional office of the Immigration and Naturalization Service illegally earmarked money for unspecified purposes at the end of fiscal year 1998.

Several of the Department's agencies could not reconcile their accounting records within the Department of the Treasury, the Government's bank. The Immigration and Naturalization Service, which I have mentioned, was out of balance by \$76 million. The Drug Enforcement Agency was off by \$38 million, and the Department's Working Capital Fund missed by \$44 million. This issue is

not simply an exercise in bean counting. Accurate financial statements are the keystones to effective financial management in the Federal Government.

The information reported in the financial statements of the Federal Aviation Administration and the Department of Justice plainly do not provide reliable sources of information for decisionmaking by Congress or by the agency itself. In addition, these significant weaknesses in financial control undermine the agency's ability to manage their own operations leaving them vulnerable to fraud, waste, and the abuse of the taxpayers' money.

We will explore these issues in greater detail today. We want to know what the Federal Aviation Administration and the Department of Justice are doing to resolve these deficiencies. We welcome our witnesses, and we look forward to their testimony.

On panel one, the Honorable Michael Bromwich, the Inspector General of the Department of Justice, is accompanied by Ms. Marilyn Kessinger, Director of Financial Statement Audits, Office of the Inspector General, Department of Justice, and Mr. Stephen Colgate, Assistant Attorney General for Administration of the Department of Justice.

If you would rise as we swear in all witnesses, and raise your right hands.

[Witnesses sworn.]

Mr. HORN. We will note for the record that all three have affirmed the oath, and we will begin with the very distinguished Inspector General as the beginning testimony. Mr. Bromwich.

**STATEMENTS OF MICHAEL BROMWICH, INSPECTOR GENERAL, DEPARTMENT OF JUSTICE, ACCOMPANIED BY MARILYN KESSINGER, DIRECTOR, FINANCIAL STATEMENT AUDIT OFFICE; AND STEPHEN COLGATE, ASSISTANT ATTORNEY GENERAL FOR ADMINISTRATION, DEPARTMENT OF JUSTICE**

Mr. BROMWICH. Thank you very much. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before this subcommittee to discuss the Department of Justice's consolidated financial statement audit for fiscal year 1998. Accompanying me today, as you noted, Mr. Chairman, is Marilyn Kessinger who is the Director of our Financial Statement Audit Office, and she is responsible, along with her staff, for coordinating the audits of the consolidated financial statement.

This report represents the third year that the Office of the Inspector General has audited the Department's consolidated financial statement. Due to the Department's decentralized nature, separate audits of nine Department reporting components are first completed and then combined into the consolidated audit report.

We noted improvements at the component level during fiscal year 1998, most notably, a 50 percent decrease in the number of material weaknesses compared to the preceding year; 26 in fiscal year 1997 versus 13 in fiscal year 1998. Other reportable conditions also decreased from 26 in fiscal year 1997 to 18 in fiscal year 1998. No substantial new internal control weaknesses were identified this past fiscal year, and we noted progress in many of the areas that received unfavorable findings during the prior 2 years.

However, this positive news must be tempered by the fact that for the third year in a row the Department received a disclaimer of opinion, in effect, no opinion on its consolidated financial statement, because of an inability to complete the audit due to serious deficiencies noted in the underlying audits.

Four of the nine components—the Assets Forfeiture Funds/Seized Asset Deposit Fund, the Immigration and Naturalization Service, the Office, Boards, and Divisions, and the U.S. Marshal's Service—received disclaimers of opinions on their individual audits in fiscal year 1998.

On the other hand, four components—the FBI, the DEA, the Office of Justice Programs, and the Working Capital Fund—received unqualified or clean opinions on their balance sheets in fiscal year 1998.

The Federal Prison System received a qualified opinion in fiscal year 1998, which means that its financial statements were presented in accordance with applicable accounting standards except for a line item or account.

My written statement and our financial statement audit provides a detailed description of how the Department and each of the components fared in fiscal year 1998. Rather than review this information, Mr. Chairman, I would move that my full written statement be introduced into the record, and I would like to summarize.

Mr. HORN. Let me say, automatically—and I should have said at the beginning—every time a witness first opens their mouth from the first sentence, it is automatically put in the record, and then your remarks or summary, however you want to proceed, follow after to complete that.

Mr. BROMWICH. Terrific; thank you, Mr. Chairman. Rather than review that information, I thought it would be more helpful for me to focus my remarks on the challenges facing the Department for it to improve its financial management and obtain a clean consolidated audit opinion.

First, top Department management must continue to emphasize the importance of these issues and provide necessary support to the component financial staffs. Managers must emphasize long-term correction of problems to improve the Department's financial management, not just short-term fixes that will earn a better audit opinion.

Some components have used contractors extensively to supplement their financial management staff and more quickly implement short-term fixes. This heavy use of contractor support raises two concerns: first, components may become too reliant on contractor assistance and not make the appropriate systemic changes, and, second, the components financial management staffs will not learn from this process if contractors are shouldering the bulk of the responsibility.

This leads to another observation: we see a shortage of adequately trained financial management staff at the Department. While this shortage precipitates the extensive use of contractors, it also has caused many Department components to struggle to meet the deadlines required to ensure a March 1st release of the consolidated audit report. In addition, many Department components



could fail in the future if anything happened to their handful of key financial managers.

Successful implementation of new financial systems is critical to the Department's future of financial management success. The U.S. Marshal's Service encountered numerous difficulties implementing its new system, and this had a significant adverse impact on its audit results in fiscal year 1998.

Finally, Mr. Chairman, your invitation letter to this afternoon's hearing requested that I address financial management practices of three of the Department of Justice's components—DEA, INS, and the Marshal's Service—and I would like to end my oral presentation by referring to the experiences that we had in those three components.

First, with respect to the DEA—the DEA received an unqualified opinion on its balance sheet and a disclaimer on its remaining financial statements. The DEA made significant progress in fiscal year 1998 addressing previously identified weaknesses. For fiscal year 1998, it had four reportable conditions, one of which was considered a material weakness. Implementation of a new core accounting system along with the commitment by senior management was critical in resolving many of DEA's outstanding issues. A particular challenge in fiscal year 1999 for the DEA is the replacement of key finance personnel.

The Immigration Service. For the third straight year, INS received a disclaimer of opinion on its fiscal year 1998 financial statement. INS had nine reportable conditions of which five were considered material weaknesses. Although improvements were made in many areas—for example, INS reduced its material weaknesses from eight to five—weaknesses continue to exist in the overall control environment that prevents INS from producing auditable financial statements.

During fiscal year 1998, INS management began or continued several initiatives to reduce longstanding financial management issues, including a restructuring of its regional accounting operations and resolution of problems in its property subsidiary system. Successful implementation of the new core accounting system scheduled for October 1, 1999, together with development of adequate staffing levels, are critical to improving financial management at INS.

The Marshal's Service. Like INS, the Marshal's Service received its third straight disclaimer of opinion on its fiscal year 1998 financial statements. It had three reportable conditions of which two were considered material weaknesses. The U.S. Marshal's Service was unable to process routine transactions in accordance with standards and provide documents on a timely basis in order to complete the audit.

There were also significant internal control weaknesses over its new financial management system, called STARS, which was implemented in fiscal year 1998. The weaknesses identified in STARS represent the most significant challenge to the Marshal's Service in resolving its outstanding issues.

Mr. Chairman, as I look back on the Department's experiences with consolidated financial audits, results from the first audit in fiscal year 1996 clearly were not encouraging. Regrettably, the re-

sults for fiscal year 1997 were even more disappointing as the reality of the new financial reporting requirements sank in, and the Department enforced the March 1st deadline established by the act. There was also very little time for corrective action to take place between completion of the fiscal year 1996 audit and initiation of the fiscal year 1997 audit.

The Department has made noteworthy progress in fiscal year 1998. However, it faces major challenges with the implementation of new financial systems, increasing financial reporting requirements, and a shrinking of the pool of qualified financial managers.

The success of the consolidated effort is dependent upon the success of individual component audits. Several components have long-standing financial problems that are now just beginning to be addressed after years of neglect. Some of these problems are not easy to correct. The Department needs to concentrate its efforts on the four components that received disclaimers of opinion in fiscal year 1998 while at the same time maintaining the successful results obtained in other components.

Mr. Chairman, I would be happy to answer any questions you might have.

[The prepared statement of Mr. Bromwich follows:]

*Statement of*

Michael R. Bromwich  
Inspector General, U.S. Department of Justice

*before the*

House Committee on Government Reform  
Subcommittee on Government Management,  
Information, and Technology

*concerning*

U.S. Department of Justice  
Annual Financial Statement  
Fiscal Year 1998

March 18, 1999

Mr. Chairman, Congressman Turner, and Members of the Subcommittee on Government Management, Information, and Technology:

I appreciate the opportunity to appear before the Subcommittee to discuss the Department of Justice's Consolidated Annual Financial Statement Audit for FY 1998. Accompanying me today is Marilyn Kessinger, Director of our Financial Statement Audit Office, who is responsible for coordinating the audits of the consolidated financial statements.

This report represents the third year that the Office of the Inspector General (OIG) has audited the Department's consolidated financial statement. Due to the Department's decentralized nature, separate audits of nine Department reporting components are first completed and then combined into the consolidated audit report. Consequently, the consolidated audit opinion is dependent upon the results of the component audits.

We noted improvements at the component level during FY 1998, most notably a 50 percent decrease in the number of material weaknesses<sup>1</sup> compared to the preceding year (26 in FY 1997 versus 13 in FY 1998). Other reportable conditions<sup>2</sup> also decreased from 26 in FY 1997 to 18 in FY 1998. No substantial new internal control weaknesses were identified in FY 1998, and we noted progress in many of the areas that received unfavorable findings during the prior two years.

However, this positive news must be tempered by the fact that for the third year in a row the Department received a "disclaimer of opinion" – in effect, no opinion on its consolidated financial statement – because of an inability to complete the audit due to serious deficiencies noted in the underlying audits. Four of the nine components – the Assets Forfeiture Fund/Seized Asset Deposit Fund, the Immigration and Naturalization Service, the Offices, Boards, and Divisions, and the U.S. Marshals Service – received disclaimers of opinions on their

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1 A "material weakness" is a condition where internal controls are not sufficient to ensure that errors or fraud that are material to the financial statements or performance measures would be detected timely in the normal course of events.

2 "Reportable conditions" are significant deficiencies in internal controls that could adversely affect the organization's ability to meet its internal control objectives. All material weaknesses are reportable conditions. However, only the most serious reportable conditions are material weaknesses.

individual audits in FY 1998. On the other hand, four components – the Federal Bureau of Investigation, the Drug Enforcement Administration, the Office of Justice Programs, and the Working Capital Fund – received unqualified or “clean” opinions on their balance sheets in FY 1998. The Federal Prison System received a qualified opinion in FY 1998, which means that its financial statements were presented in accordance with applicable accounting standards except for a line item or account.

#### I. FY 1998 Audit Results

The following table summarizes the opinions received by the components for FY 1998:

<b>DEPARTMENT OF JUSTICE AUDIT RESULTS: FISCAL YEAR 1998</b>					
<b>Reporting Entity</b>	<b>Balance Sheet</b>	<b>Statement of Net Cost</b>	<b>Statement of Changes in Net Position</b>	<b>Statement of Budgetary Resources</b>	<b>Statement of Financing</b>
Consolidated Department	D	D	D	D	D
Assets Forfeiture Fund and Seized Asset Deposit Fund	D	D	D	D	D
Drug Enforcement Administration	U	D	D	D	D
Federal Bureau of Investigation	U	U	U	U	U
Federal Prison System	Q	Q	Q	Q	Q
Immigration and Naturalization Service	D	D	D	D	D
Offices, Boards and Divisions	D	D	D	D	D
Office of Justice Programs	U	D	D	D	D
U.S. Marshals Service	D	D	D	D	D
Working Capital Fund	U	U	U	U	U

D – Disclaimer of Opinion

Q – Qualified Opinion

U – Unqualified Opinion

The three main areas audited in each component are: 1) financial statements; 2) internal controls (which generates the majority of findings); and 3) compliance testing. With respect to the first issue, auditors looked at five different financial statements for the Department and each component in FY 1998:

- Balance Sheet – presents the financial position or “snapshot” of the component as of a certain date, usually the end of a fiscal year. The balance sheet reports assets, liabilities, and net position.
- Statement of Net Cost – provides results of operations by responsibility segment and major program (similar to an Income Statement).
- Statement of Changes in Net Position – reports the change in net worth during the current reporting period.
- Statement of Budgetary Resources – provides information about budgetary resources and their status for the current reporting period.
- Statement of Financing – ties the Statement of Net Cost to the Statement of Budgetary Resources.

With respect to the consolidated Report on Internal Controls, the second main area reviewed, auditors reported one material weakness and three reportable conditions. The material weakness stemmed from the Department’s failure to record financial transactions in accordance with federal accounting standards (i.e., transactions were not consistently and accurately recorded). This weakness represents a combination of previously identified issues, all of which were caused by a failure to effectively implement proper accounting policies and procedures. Many of these issues are long-standing problems that were not a priority before FY 1996, the first year Department-wide financial statement audits were required by the Government Management Reform Act. All but two components – the Federal Prison System and the Working Capital Fund – had these issues identified in their component reports. As a result of this deficiency, Department managers have not always had reliable financial information available to prepare budgets, report results of operations, and make critical resource decisions. These control weaknesses also leave the Department more susceptible to fraud.

The three reportable conditions for FY 1998 related to improvements needed in reconciling Fund Balance with Treasury accounts – in essence, “balancing the checkbook” – computer security and component financial management systems, and fiscal year-end closing procedures. These same issues were highlighted in last year’s consolidated audit and have yet to be fully corrected. Of particular concern is computer security and the Department’s ability to safeguard critical financial information from unauthorized access.

The audit discovered examples of non-compliance with financial laws and regulations throughout the Department. This deficiency emphasizes that financial controls are not functioning properly and resources are not being effectively managed. Non-compliance with the Federal Financial Management Improvement Act was cited at eight of the nine reporting components – even at components that received an unqualified or qualified opinion. Several components were unable to follow federal accounting standards that are fundamental to fair and accurate financial reporting. Other components are using financial systems that do not meet requirements issued by the Office of Management and Budget.

Two components, the Drug Enforcement Administration and the Immigration and Naturalization Service, failed to pay interest to vendors as required by the Prompt Pay Act. In addition, the Immigration and Naturalization Service was unable to properly allocate cash receipts between two deposit accounts. While these items may appear to be relatively inconsequential, they are symptomatic of controls that do not function as intended, procedures that are not being followed effectively, and a lack of accountability.

A more serious issue of non-compliance with appropriation law was discovered at the Immigration and Naturalization Service where staff was establishing obligations based on anticipated needs and unforeseen costs rather than binding agreements. This serious violation undermines the integrity of financial reporting and was referred to our Investigations Division for review.

As mentioned previously, we noted improvements at the component level during FY 1998 as the number of material weaknesses decreased from 26 to 13 compared to FY 1997 and other reportable conditions decreased from 26 to 18. No substantial new internal control weaknesses were identified in FY 1998.

Since we first started performing consolidated financial statement audits

three years ago, the Department has shown particular improvement in its accounting for property, plant, and equipment. The issue was listed as a material weakness in FY 1996, improved to a reportable condition in FY 1997, and in FY 1998 has dropped off the deficiency list entirely. Only two components – the Immigration and Naturalization Service and Drug Enforcement Administration – have issues remaining in this area.

Another area where the Department significantly improved was reconciliation of Fund Balance with Treasury. For FY 1997, very large differences were noted for the Office of Justice Programs and the Immigration and Naturalization Service. While some issues remain at the Office of Justice Programs, the large unreconciled balance was eliminated using contractors. The Immigration and Naturalization Service also used contractors to begin resolving its large unreconciled balance. The Drug Enforcement Administration showed an increase in clearing account balances for FY 1998, but is currently in the process of hiring contractors to assist them in clearing these issues.

For the first time in three years, computer security was not reported as a material weakness in the Department's consolidated report. However, we continue to have concerns about some of the components' financial systems, at least three of which are in the process of being replaced. Of particular concern is the U.S. Marshals Service's new financial management system implemented during FY 1998 and the Immigration and Naturalization Service's financial management systems. A related issue is the vulnerability of the Department's financial systems to unauthorized access and modification. The Department needs to strengthen its controls in order to prevent penetration by unauthorized users.

## **II. Challenges Facing the Department in FY 1999**

The Department faces many challenges in FY 1999 and beyond for it to continue making progress towards improved financial management and obtain a "clean" consolidated audit opinion. First, top Department management must continue to emphasize the importance of these issues and provide necessary support to the component financial staffs. Managers must emphasize long-term correction of problems to improve the Department's financial management, not just short-term fixes that will earn a better audit opinion. Some components have used contractors extensively to supplement their financial management staff and more quickly implement short-term fixes. This heavy use of contractor support raises two concerns: 1) components may become too reliant on contractor



assistance and not make the appropriate systemic changes; and 2) components' financial management staffs will not learn from this process if contractors are shouldering the bulk of the responsibility.

This leads to another observation: we see a shortage of adequately trained financial management staff at the Department. While this shortage precipitates the extensive use of contractors, it also has caused many Department components to struggle to meet the schedule jointly established by the OIG and the Department's Acting Chief Financial Officer for a March 1 issuance of the consolidated audit report. In addition, many Department components could fail in the future if anything happened to their handful of key financial managers.

Finally, successful implementation of new financial systems is critical to the Department's future financial management success. The U.S. Marshals Service encountered numerous difficulties implementing its new system and this had a significant adverse impact on its audit results in FY 1998. Problems with the Marshals' new financial system also affected the audit of the Assets Forfeiture Fund and Seized Asset Deposit Fund because the audit relies on data from the Marshals' system.

### **III. Summary of Component Audits**

Presented below are brief summaries of the components' audit results for FY 1998, along with challenges facing them in FY 1999:

#### Drug Enforcement Administration

The DEA received an unqualified opinion on its balance sheet and a disclaimer on its remaining financial statements. The DEA made significant progress in FY 1998 addressing previously identified weaknesses. For FY 1998, it had four reportable conditions, one of which was considered a material weakness.

Implementation of a new core accounting system, along with a commitment by senior management, was critical in resolving many of DEA's outstanding issues. DEA used contractors to assist in correcting prior year weaknesses and plans to use contractors to address its one material weakness reported for FY 1998 on reconciling its Fund Balance with the Treasury account. A particular challenge in FY 1999 for the DEA is the replacement of key finance personnel.

#### Immigration and Naturalization Service

For the third straight year, INS received a disclaimer of opinion on its FY 1998 financial statements. INS had nine reportable conditions of which five were considered material weaknesses. Although improvements were made in many areas – INS reduced its material weaknesses from eight to five – weaknesses continue to exist in the overall control environment that prevents INS from producing auditable financial statements. During FY 1998, INS management began or continued several initiatives to reduce long-standing financial management issues including a restructuring of its regional accounting operations, continued implementation of a new core accounting system, and resolution of problems in its property subsidiary system. The successful implementation of the new core accounting system scheduled for October 1, 1999, along with development of adequate staffing levels, are critical to improving financial management at INS.

#### United States Marshals Service

Like INS, the USMS received its third straight disclaimer of opinion on its FY 1998 financial statements. It had three reportable conditions of which two were considered material weaknesses. The USMS was unable to process routine transactions in accordance with standards and provide documents on a timely basis in order to complete the audit. There were also significant internal control weaknesses over its new financial management system, Standardized Tracking Accounting and Reporting System (STARS), which was implemented in FY 1998. The weaknesses identified in STARS represent the most significant challenge to the USMS in resolving its outstanding issues.

#### Assets Forfeiture Fund/Seized Asset Deposit Fund

This component again received a disclaimer of opinion on its FY 1998 financial statements due primarily to an inability to accurately report information on seized and forfeited property. It had three reportable conditions, two of which were considered material weaknesses. The primary challenge facing this component is to improve the quality of data maintained in its Consolidated Asset Tracking System. This will require significant coordination with the many seizing, custodial, and other organizations involved in the asset forfeiture process.

#### Federal Bureau of Investigation

The FBI received an unqualified opinion on its FY 1998 financial statements. It had three reportable conditions and no material weaknesses. While FBI management has demonstrated an ability to respond to the increasing financial reporting requirements, we have concerns over their continued ability to do so on a timely basis because of the amount of responsibility concentrated in a few key individuals.

#### Federal Prison System

The Federal Prison System received a qualified opinion on its FY 1998 financial statements. It only had one reportable condition and no material weaknesses. The Federal Prison System continued to make progress in meeting financial reporting requirements although we note concerns about its ability to produce information promptly. The Federal Prison System has its own reporting complications in that the Federal Prison Industries, Inc., is audited using a different basis of accounting because it more closely resembles a manufacturing concern than a government entity. The Federal Prison System must then consolidate its three reporting entities into a single report, all within the Department's reporting deadlines. The biggest challenge facing the Federal Prison System is implementation of its new accounting system, which is scheduled for October 1999.

#### Offices, Boards and Divisions

This component again received a disclaimer of opinion on its FY 1998 financial statements. It had four reportable conditions, two of which were considered material weaknesses. Previously identified weaknesses in processing transactions continued to exist. Management has taken steps to improve financial reporting, including the establishment of a "FY 1999 Offices, Boards and Divisions Financial Statements Clean Audit Project," with an emphasis on evaluating and correcting weaknesses identified and providing appropriate training to the many entities (approximately 30) that constitute this reporting component.

#### Office of Justice Programs

The OJP received an unqualified opinion on its balance sheet and a disclaimer on its remaining FY 1998 financial statements. It had three reportable conditions of which one was considered a material weakness. The OJP took sufficient corrective action during the year using contractors to resolve prior year material weaknesses on grant accruals and reconciliation of Fund Balance with Treasury. In FY 1999, OJP must continue these efforts and successfully implement a new core accounting system.

#### Working Capital Fund

The Working Capital Fund received an unqualified opinion on its FY 1998 financial statements. It had one reportable condition which related to reconciling accounts with Treasury records and no material weaknesses.

#### **V. Conclusion**

Results from the Department's first consolidated financial audit in FY 1996 were not encouraging. Regrettably, the results for FY 1997 were even more disappointing as the reality of the new financial reporting requirements sank in and the Department enforced the March 1 deadline established by the Act. There was also very little time for corrective action to take place between completion of the FY 1996 audits and initiation of the FY 1997 audits.

The Department has made noteworthy progress in FY 1998. However, it faces major challenges with the implementation of new financial systems, increasing financial reporting requirements, and a shrinking of the pool of qualified financial managers. The success of the consolidated effort is dependent upon the success of individual component audits. Several components have long-standing financial problems that are now just beginning to be addressed after years of neglect. Some of these problems are not easy to correct. The Department needs to concentrate its efforts on the four components that received disclaimers of opinion in FY 1998, while at the same time maintaining the successful results obtained in other components.

The following chart summarizes the opinions received on the Balance Sheet (formerly known as the Statement of Financial Position) and shows how the Department has fared since consolidated reports began being prepared for Department components.

<b>COMPARISON OF BALANCE SHEET RESULTS</b>			
<b>Reporting Entity</b>	<b>FY 1996</b>	<b>FY 1997</b>	<b>FY 1998</b>
Consolidated Department	Disclaimer	Disclaimer	Disclaimer
Assets Forfeiture Fund and Seized Asset Deposit Fund	Unqualified	Disclaimer	Disclaimer
Drug Enforcement Administration	Disclaimer	Disclaimer	Unqualified
Federal Bureau of Investigation	Qualified	Qualified	Unqualified
Federal Prison System	Disclaimer	Qualified	Qualified
Immigration and Naturalization Service	Disclaimer	Disclaimer	Disclaimer
Offices, Boards and Divisions	Disclaimer <sup>1</sup>	Disclaimer	Disclaimer
Office of Justice Programs	Unqualified	Disclaimer	Unqualified
U.S. Marshals Service	Disclaimer <sup>1</sup>	Disclaimer	Disclaimer
Working Capital Fund	Unqualified	Unqualified	Unqualified

<sup>1</sup>In FY 1996, the Offices, Boards and Divisions and the U.S. Marshals Service were a combined reporting entity that together received a disclaimer of opinion.

This concludes my prepared testimony. We would be happy to answer any questions you may have.

Mr. HORN. I thank you. If we might, I would like to finish with the three of you and then have the questions.

Mr. Ose has joined us, and we are delighted to have you here. We are through the first witness, the Inspector General, and we are now starting on—does Ms. Kessinger have anything to add to what Mr. Bromwich said?

All right, Mr. Colgate is the Assistant Attorney General for Administration; go ahead.

Mr. COLGATE. Thank you. Mr. Chairman, I would like to first start off by saying that I endorse the observations that have been made by the Inspector General. I don't think that there is by and large a disagreement between the IG and myself on this, and I think that is important to start off by saying that.

I am pleased to have the opportunity to appear before you today to discuss the status of financial management at the Department of Justice. As the Assistant Attorney General for Administration, I am fully committed to ensuring our financial operations, systems, and internal controls meet and exceed Federal standards. I also recognize the tremendous value in having our financial operations independently reviewed through the audited financial statement process. Excellence in financial management is an established goal in the Department's annual performance plan. The Attorney General and I are committed to obtaining an unqualified Department-wide opinion on our financial statements, and we are making every effort to do that this year, although it is a very sizable task.

At the outset, I recognize we face major financial management challenges. We need to make significant improvements in our business practices, systems, and oversight if we are to meet Government-wide standards, improve accountability, and produce better performance information. As our audit results attest, we have made progress. However, we have not yet attained the degree of precision in our operations that the Federal financial management improvement legislation of the nineties requires.

This afternoon, I would like to discuss our improvement efforts in two primary areas: first, our audit correction action plan in high risk areas, and, second, our systems efforts. While several of the Department's components obtained clean opinions on some or all of the 1998 statements, the auditors could not render an opinion on the consolidated Justice statement for the third year in a row. Clear progress this year was evidenced from the fact that our material weaknesses were reduced from 26 to 13, but we have more work to do.

After 3 years of audits, the Department components with isolated exceptions have been able to effectively resolve our pure accounting weaknesses. The steps taken by the Bureau of Prisons and the FBI to resolve their obligation and property problems are good examples of the success that we have had. Conversely, weaknesses in the business practices and controls are taking much longer to address.

We are making concerted efforts to address our high risk areas. The Drug Enforcement Administration has made major changes in its financial controls to minimize the potential for reoccurrence of the two employee embezzlements. The DEA has had

PriceWaterhouseCoopers verify its new controls, demonstrating DEA's commitment to addressing past weaknesses.

Improvements are also underway at the Immigration Service, although more time is needed to fully address their remaining weaknesses. INS has reorganized into regional finance centers with specialized functions to improve service and has made progress in reconciling its fund's balances.

The Marshal's Service has encountered shortfalls in their budget this year, which are largely a factor of their virtually uncontrollable workload. My senior staff are analyzing the Marshal's Service's budget situation as well as evaluating its efforts to address the accounting and systems weaknesses cited in the audit.

The Assets Forfeiture Fund now has a consolidated national tracking system in place, and the auditors recognize that substantial control improvements were made this past year.

The second area I would like to discuss is the status of our financial systems projects. Although new accounting systems alone will not solve all the weaknesses cited in the audit, improved systems which comply with Federal accounting and security requirements are essential to our success. Installing new systems requires massive and complex multi-year projects. Six of the nine entities or funds which received separate financial audits were impacted by significant system projects during the 1998 audit. Further, all nine will be impacted by major projects or reviews before the 1999 audits are completed.

During the past year, we have completed the move of 100 Bureau of Prisons financial management offices onto the Department's upgraded system. DEA, INS, the Marshals, and the Office of Justice programs continue to refine commercial, off-the-shelf system solutions that have been installed. The majority of components are now operating Y2K compliant commercial packages or have renovated their financial systems. I have recently initiated a comprehensive review of the systems efforts at DEA and the Marshals Service. I anticipate the reviews will reaffirm the progress made in the new systems, address the audit issues, and offer recommendations for most effectively completing the remaining portion of both projects.

In closing, I am encouraged that we have made substantial progress with the audits and that we are seeing some significant progress in our systems efforts. Where we have ongoing problems in underlying business practices and program controls, we have the active involvement of senior management in addressing these problems. Most importantly, I am personally committed, as is the Attorney General, to seeing our finance—our fundamental business practice problems solved through the carefully planned re-engineering of our operations.

Mr. Chairman, this concludes my prepared statement. I would be more than glad to answer any questions that you or other members of the committee may have. Thank you.

[The prepared statement of Mr. Colgate follows:]

Statement of  
Stephen R. Colgate  
Assistant Attorney General  
for Administration  
Before the  
United States House of Representatives  
Committee on Government Reform  
Subcommittee on Government Management,  
Information, and Technology  
March 18, 1999

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear before you today to discuss the status of financial management at the Department of Justice. As the Department's Assistant Attorney General for Administration, I am fully committed to ensuring our financial operations, systems, and internal controls meet and exceed federal standards. I also recognize the tremendous value in having our financial management operations independently reviewed and verified through the audited financial statement process. Excellence in financial management is an established goal in the Department's Annual Performance Plan. The Attorney General and I are committed to obtaining an unqualified Department-wide opinion on our financial statements, and we are making every effort to do that this year, although it is a sizable task.

At the outset, I recognize that the Department faces major financial management challenges. We need to make significant



improvements in our business practices, systems, and oversight if we are to meet government-wide financial standards, improve accountability, and produce better cost and performance information. As our audit results attest, we have made progress. However, we have not yet attained the degree of precision in our operations that the federal financial management improvement legislation and new federal accounting standards of the 1990's require.

This afternoon, I would like to discuss our improvement efforts in two primary areas: first, our audit corrective action plans and high risk areas, and second, our systems efforts.

#### Fiscal Year 1998 Financial Audits

While several of the Department's components obtained clean opinions on some or all of the 1998 statements, the auditors could not render an opinion on the consolidated Justice statements for the third year in a row. Clear progress this year was evident from the fact that our material weaknesses were reduced from 26 to 13, but the disclaimed opinion indicates we have more work to do.

This year, the FBI joined the Working Capital Fund in receiving an unqualified opinion. The Drug Enforcement

Administration and the Office of Justice Programs received clean opinions on their balance sheets, and the Federal Prison system received a qualified opinion, with no material weaknesses noted. All three of those components are well positioned to achieve unqualified opinions on all their statements in 1999.

A range of accounting and internal control issues within the operations and systems at the Immigration and Naturalization Service, the Offices, Boards, and Divisions, and the Marshals Service prevented those organizations from fully substantiating the financial data reported in their statements. The Assets Forfeiture Fund was disclaimed primarily because it could not support its seized and forfeited property values due in large part to inadequate information from the seizing and custodial agencies upon which it depends for its information.

After three years of audits, Department components, with isolated exceptions, have been able to effectively implement timely corrective actions for the "pure accounting" weaknesses. The steps taken by the Bureau of Prisons and the FBI to solve their obligation and property problems are good examples of the success that we have had. Conversely, the weaknesses which are due to fundamental problems in business practices and program controls are taking much longer to address.

The Department has made concerted efforts to address our high risk areas. Senior management at the Drug Enforcement Administration (DEA) has made major changes in its financial controls to minimize the potential for a reoccurrence of the two employee embezzlements discovered in recent years. DEA has had PricewaterhouseCoopers verify its new controls, demonstrating the agency's commitment to address past weaknesses. In conjunction with the Department, DEA is reviewing its budget formulation and execution procedures to ensure that resources are accurately tracked and that the agency complies with all Congressional notification procedures governing the reprogramming of funds.

Improvements are also underway at the Immigration and Naturalization Service (INS), although more time is needed to fully address the remaining weaknesses. INS has reorganized into regional finance centers, each with specialized functions to improve service. This year, INS has also made progress with property inventories and has a contract in place to assist in reconciling its fund balances with Treasury. Currently, the reconciliation difference has been cut in half, and we expect this effort to be completed this year.

The Marshals Service has encountered shortfalls in their budget this year which are largely a factor of a virtually uncontrollable workload. My senior staff are analyzing the

Marshals Service budget situation, as well as evaluating its efforts to address the accounting and systems weaknesses cited in the Inspector General's audit.

The Assets Forfeiture Fund (AFF) statements remain one of our most complex tasks because the accuracy of the data is extensively dependent upon hundreds of custodial and seizing agency offices. The Assets Forfeiture Fund now has a consolidated nationwide tracking system in place, and the auditors have recognized the substantial control improvements that were made this past year. We are continuing to pursue additional corrective actions to move the AFF statements to an unqualified opinion.

Each of the Department's component heads is responsible for submitting detailed corrective action plans that include tangible actions necessary to address the audit weaknesses. These plans will be updated to reflect the outcomes of the recently completed fiscal year 1998 audit reports. The component plans form the basis for the Department's overall corrective action plan that is submitted to the Office of Management and Budget.

For example, across the Offices, Boards, and Divisions (OBD), corrective action teams of senior financial personnel have made nearly 28 trips over the past six weeks to program and

finance offices to offer hands-on analysis of each office's practices and concrete advice on correcting the problems.

The Bureau of Prisons conducted nearly two dozen week long trips with 4 to 5 subject matter experts as it fixed its property valuation problems last year.

The Community Oriented Policing Service (COPS) has a new detailed plan for implementing improvements in its grant administration, and has hired a contractor to implement the corrective actions.

And, at JMD, we are planning staffing changes to better manage the complexity and timeliness of preparing the OBD, Working Capital Fund, and Justice Consolidated Statements, plus assisting in the calculation of the government-wide elimination entries and Treasury transmissions.

I would also like to highlight that the Department of Justice is now employing a strong new approach to focusing senior management attention and resources on audit corrective actions and the need to improve operations. The Department has volunteered to be one of the early agencies which will produce an annual accountability report under the Government Management Reform Act's pilot Accountability Report program. The

accountability report is prepared with the active involvement of the Attorney General and each Department component head. The plan will be used to surface high risk issues, set priorities, and track the progress of our corrective actions. The Attorney General and I fully expect that the accountability report will provide an effective basis for ensuring our corrective actions stay on track.

#### Financial Systems Efforts

The second area I would like to discuss this afternoon is the status of our financial systems projects. Although new accounting systems alone will not solve all the weaknesses cited in the audits, improved systems which comply with federal accounting requirements are essential. We also need to complete our systems efforts in order to address the computer security issues raised in the IG audits.

To give you a sense of the magnitude of the Department's undertaking in terms of systems projects, 6 of the 9 entities or funds which receive separate financial audits were impacted by significant system projects during the 1998 audit season. Further, all 9 will have ongoing major systems projects or reviews underway before the 1999 audits are completed.

During this past year we completed the move of 100 Bureau of Prisons financial management offices onto the Department's upgraded Financial Management Information System known as FMIS2. These offices will move to the FMIS2 reporting system in October. DEA is refining and adding functionality to the Commercial Off-the-Shelf (COTS) system it installed through a cross-servicing arrangement with the Department of the Interior. The Office of Justice Programs implemented a new general ledger earlier this fiscal year and is working to complete its system conversion. Finally, both the Marshals Service and INS are pursuing their Off-The-Shelf systems installations. These are massive and complex multi-year projects.

I have recently initiated comprehensive reviews of the system efforts at DEA and the Marshals Service and will soon begin a review of the INS efforts. I anticipate the DEA review will affirm the progress DEA has made with its new system, identify areas where improvement is needed, and offer recommendations for most effectively completing the remaining portion of the project. It is too early to say what the outcome of the Marshals Service systems review will be, although I expect the review to expand upon the problems with the implementation of the Marshals STARS system which were touched in the IG audit of the Marshals Service, and offer potential options for improvement. I also plan a review of INS's systems project

later this Spring in order to obtain a current assessment of that effort.

To date, we have made good use of our Working Capital Fund Retained Earnings to fund our systems improvement projects. I also want to briefly mention that the majority of components are now operating Y2K compliant COTS or renovated financial systems such as FMIS. INS is expected to be fully operational under its COTS Y2K compliant system in October.

In closing, I am encouraged that we have made substantial and identifiable progress on the weaknesses cited in the audits, and that we are seeing some significant progress in our systems efforts. Where we have ongoing problems in our underlying business practices and program controls, we have the active involvement of senior management in addressing those problems. Most importantly, I am personally committed, as is the Attorney General, to seeing our fundamental business practice problems solved through the carefully planned re-engineering of our operations.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you or the other subcommittee members may have.



Mr. HORN. We thank you for that statement. I note, Mr. Colgate, that you have had some experience in various agencies as a senior civil servant of Budget Officer of Finance, so forth. Who is the Chief Financial Officer for Justice?

Mr. COLGATE. The Department of Justice has not appointed a Chief Financial Officer since the act was enacted because of this dichotomy of having the Assistant Attorney General for Administration being a career civil servant. So, that position has not been filled. I have essentially been performing the functions of the act.

Mr. HORN. Who is the Chief Information Officer in the Department of Justice?

Mr. COLGATE. I serve as the Chief Information Officer at the Department of Justice.

Mr. HORN. Don't you think that part of the problem here is that we have nobody that can work a 7-day week and 18 hours a day to get this job cleaned up, in either case? You are holding three positions.

Mr. COLGATE. I don't think that it is so much of the fact that I am holding the three positions. I think that really the underlying issue is that we are trying to make some major changes in our financial systems at the Department of Justice at the same time trying to engrain within the culture at the Department the importance of an audited financial statement.

I think that I have been very well supported by the staff who works in this area and that we can address these issues. I don't necessarily believe that it is the appointment so much but the order of magnitude of the changes that we have to undertake.

Mr. HORN. Well, don't you think—given the situation in Justice where they are not able to show us a balance sheet, the accountants—don't you think that we ought to have a full-time CFO to concentrate on those problems and a full-time CIO to concentrate on those problems. When you have this kind of a situation, it seems to me you need to take some obvious common sense measures. When Congress passed those laws on a bipartisan basis, they did not think that Assistant Secretaries for Administration or Assistant Attorney Generals would take over those things themselves.

Now, I have had this running war with the Treasury Department which is also screwed up, and the Assistant Secretary for Management has held all the positions, and the result is they can't give the full-time attention that Congress knew 5 years ago in the 103d Democratic Congress when I came in here—they knew, "Hey, we have to spend time on this. We have to have the expert that knows something about finance, something about computing." Now, we didn't think it was all combined in one superhuman, I guess I would say. So, what do you think about that?

Mr. COLGATE. My personal view is that at the Department of Justice, I think the senior management has liked the notion of one-stop shopping. When there is an administrative issue, whether it be financial management or technology issue, instead of going to various different players, that they can hold one person accountable who can coordinate and investigate and get back to them on what corrective action needs to be taken.

I think that we can adequately perform the functions of the underlying statute, whether it be the Clinger-Cohen statute related to

technology or the Chief Financial Officers Act, and I think that is why we have this situation, as you point out, in the Department of Treasury as well as Justice, the senior political leadership want to be able to reach out and hold one person accountable, and that is the tension that is here.

Mr. HORN. And to whom do you report?

Mr. COLGATE. I report to the Deputy Attorney General, but I can assure you that when it comes to management and administrative issues, the Attorney General involves herself personally on these issues.

Mr. HORN. Does the Attorney General know about the situation on these financial statements?

Mr. COLGATE. Yes, she does. As a matter of fact, she has called in all of the heads of the components and has made it really clear to them that she wants this situation straightened out, and she plans to hold additional meetings now that we have the results of the 1998 audit and there has been improvement. We are pleased to see that the Office of Justice programs has moved to a balance sheet clean opinion as well as the Drug Enforcement Administration, but that is not satisfactory—and she holds them personally accountable and meets with them on a periodic basis to address these concerns.

Quite honestly, Mr. Chairman, I am quite glad that we now have a cabinet officer who very much understands from her experience working in Florida of being an individual who was audited when she was State's attorney; who had to go through the laborious task of doing an inventory; who understands and appreciates the importance of audited financial statements. She truly believes that when an organization moves to get a clean, audited financial statement, that you essentially address important internal control situations that but for having this audited financial statement, would just languish.

Mr. HORN. Does she know that she has an option and could appoint a Chief Financial Officer and a Chief Information Officer?

Mr. COLGATE. Yes, she does.

Mr. HORN. And she rejected that approach or what?

Mr. COLGATE. I will give you my observation—I wouldn't want to speak for the Attorney General, but I will give you my observation—I think she likes the notion of what I will jokingly refer to as one-stop shopping.

Mr. HORN. Why would having three people divide that work, get more done, and not have to be a bunch of bureaucrats about it, it seems to me they could work as a team, and you could still get one-stop shopping, because you have to be overworked in this job; same as Mr. Munoz in Treasury when he was there. I know, I have been in an administration; I know the hours people put in, and you have a very distinguished record. I mean, you have the Distinguished Service Award for your administrative programs; you got the Meritorious Executive Distinguished Executive Presidential Rank Award. So, there is no question, you have a lot of ability, but you can have the greatest amount of ability, and if you don't have the time in which to get something done, it eventually becomes the big avalanche. It isn't just a little snowball; it is a big avalanche, and it seems to me you should all rethink and she should rethink and

the Deputy Attorney General should rethink, "How do we get on top of this?" And it should be thought of on an emergency basis, and people should put the horses in there that they need to carry the load.

So, let me move on, but I have very strong feelings on it why certain agencies have problems. You just can't be everywhere every-day on all these issues, and it simply backfires on you, and I think this has backfired. So, we need to give this a little attention, and we need to get somebody as the Chief Information Officer and a Chief Financial Officer, and I think the one-stop service is nonsense, if you can't do it when you have three high-powered people. And if you can't, then there is a problem in building a team.

So, let me go now to the computer security weaknesses and for the fiscal years 1997, 1998, the pervasive computer security weaknesses have been reported at the Department data centers as well as at the FBI's data center. Now, these weaknesses affect the integrity and reliability of the Department's financial information and other program information maintained on those sites. In addition, there are risks of unauthorized access to these systems. Let me ask the Inspector General, what type of computer security testing has been done during this audit?

Mr. BROMWICH. For a detailed response, I would like to turn to Ms. Kessinger to describe that.

Ms. KESSINGER. We hire contractor firms to do the work for us, and we use PriceWaterhouseCoopers to do a general controls review at the Rockville and Dallas data center, and we use KPMG to do a controls review of the data center in the District of Columbia for the FBI, and they do the FISCAM, which is the audit program the GAO prescribes and that is where we get our results from. They also did some applications testing during the last year on various accounting systems throughout the Department. There were improvements this year in the security controls in the Department's data centers, in particular, and we were able to rely upon them and make that conclusion for the first time this year.

Mr. HORN. Do you want to add anything, Inspector General?

Mr. BROMWICH. No, Mr. Chairman.

Mr. HORN. Is the testing that is done actually—does it try to gain unauthorized access to the Department's system when you are testing it yourself?

Ms. KESSINGER. Yes, we do penetration testing at both of the data centers.

Mr. HORN. Do you ever think of going out to a high school and getting one of those little nerds that stays up all night to crack into departmental securities? [Laughter.]

Ms. KESSINGER. Ironically, you know, that is—we do testing from several different perspectives; from an outsider perspective with little or no knowledge of the Department or with some access to a building, for instance, a contractor that is in the FBI building. And with little or no knowledge of the Department, there was some access gained. I don't know that I think the high school student could have done it, but—

Mr. BROMWICH. We use big nerds rather than little nerds, Mr. Chairman.

Mr. HORN. You would be amazed the talents that lie out there beyond the Appalachians.

Could you please elaborate on what the risk is in your judgment now? How secure is secure?

Ms. KESSINGER. I would say that we don't have a humongous risk. I would say we have a risk. We have especially a risk with our own employees and our contractors. There are a lot of contractors in this Department and with people walking around our buildings and that kind of thing, I think it is very, very, very difficult to ever lessen those risks, and we can never do enough in the training, prevention, those kinds of issues, and there has to be almost constant pressure from the top down on those issues, and we need to increase that pressure.

Mr. HORN. Now, do we know how many penetrations have occurred from outside the system and how many have been internal where somebody just wants to sort of snoop around; sees somebody's file?

Ms. KESSINGER. You mean someone other than our auditors?

Mr. HORN. That is correct. Do we have any data on that?

Mr. COLGATE. I could provide to the committee, for the record and I like the notion of what Ms. Kessinger said of the pressure—this is something that the Attorney General is very focused on. We just recently completed our first series of penetration testing within the Department of Justice, and we were very concerned about the results of that penetration testing. It looked at it from outside access as well as the notion of social engineering with our own employees to gain access of these systems. The AG was not satisfied with the results of it, and we have essentially received corrective action plans of every one of the systems that we have tested in the first round—I believe we received them all—and we put the components on notice that we will, this fall, after giving them time to correct the deficiencies that we have identified, we will again conduct a series of tests to ensure that the corrective actions that they have identified have actually been implemented.

As well, Mr. Chairman, we plan to conduct a second round of penetration testing of additional systems within the Department of Justice. We have made the fundamental commitment that computer security is basic business of the Department of Justice, and we will dedicate the necessary resources to ensure that we correct any deficiencies that we can define. We have been, in my personal opinion, too lax in this area, but I think that we have gotten some folks' attention through these recent rounds of penetration testing.

I am pleased that when it comes to the audited financial statement that in 1998 we moved from a material weakness as it relates to our financial systems to a reportable condition. That doesn't mean we let up until we get this absolutely corrected.

Mr. BROMWICH. Mr. Chairman, if I could just add, beyond the computer security testing that we do in the context of the financial statements, my office has a separate computer security office that does this kind of work in the Department, so we are working very hard on these issues across a number of components, and I must say that the management of the Department has been quite responsive to the audits that we have done and is trying to move quickly to address the deficiencies that we have noted.

Mr. HORN. Could you give me a ranking of what are the easiest components of the Department of Justice in terms of penetration?

Mr. BROMWICH. We haven't done them all, so I can't give you a comprehensive one. We have done work in the Rockville data centers and the Dallas data centers; we found some problems there, and those are being addressed, and we are continuing to do work in other components of the Department, but we haven't yet done it throughout the Department so that I could give you a ranking of the sort that you are requesting.

Mr. HORN. Now, is there a way that you would know and the Assistant Attorney General would know when these systems of the different components—because some of them aren't probably comparable; I would suspect you might even have a little inoperability problem—but would you know if there has been penetration, and to whom is that report given if they can tell immediately that the system has been broken into?

Mr. COLGATE. We could provide—we do have a mechanism in which when we are broken into, and we were broken into in a very visible way. It was not too long ago that the Department's Website was broken into by a hacker and pornographic and obscene material was placed in lieu of the Department's Webpage. We do have an incident response system so that when these do become known to us, that we institute it, and I will tell you, Mr. Chairman, we bring in the Federal Bureau of Investigation, and we have brought in other assets to let people know that we are not going to take this lying down. We had a recent, what they determined, denial of service, I would say, within the last 3 months, again, where someone tried to flood our Webpage. We are very sensitive to this. It is the major focus in the Department's budget really from a nationwide perspective in beefing up our capability to deal with what we call cyberattacks and cyberterrorism. We are taking it very, very seriously, and we want folks to know that if you try this, we will investigate.

Mr. BROMWICH. As a routine matter, these would not be reported to us unless it was clear that it was a Department employee who was involved, and then that would be within our investigative jurisdiction.

Mr. HORN. Have you had any Department employees that have been involved?

Mr. BROMWICH. In terms of penetration?

Mr. HORN. Right.

Mr. BROMWICH. Not that I am aware of, no.

Mr. HORN. OK, in terms of being curious about the file.

I am going to ask one more question on this, and yield all the time she wants to Vice Chairman Biggert. I understand that the Immigration and Naturalization Service has been penetrated. What is that situation all about? Is that just eager beaver immigration lawyers or what?

Mr. BROMWICH. I am not aware of it.

Ms. KESSINGER. Our PriceWaterhouseCoopers auditors when they did some testing were able to get into the Immigration network through some—

Mr. HORN. So, it was just through the PriceWaterhouseCoopers camp?

Ms. KESSINGER. Yes, it was just through the testing, yes.

Mr. HORN. So, that is no outside; it is a test you conducted inside?

Ms. KESSINGER. Right, and those results were passed on to the Department, and they are working on them.

Mr. HORN. OK. I now yield to the vice chairman, Mrs. Biggert of Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman. It is my understanding after hearing your testimony that several DEA employees have been involved in two different cases of embezzling DEA funds, and one case involved a single DEA employee who allegedly embezzled more than \$6 million during a 6-year period. The employee allegedly submitted hundreds of false payment vouchers seeking reimbursement for services never performed by a sham corporation he established, and the second case involved collusion among three DEA employees who used DEA funds to purchase various electronic and other equipment valued at approximately \$2.7 million that was diverted for their own use.

And it has been reported that during that period in which the embezzlements occurred, financial management weaknesses and DEA-controlled environment included ineffective segregation of duties, failure to require appropriate approvals, inadequate supporting documentation, inaccurate accounting and control over property and equipment. These financial management weaknesses significantly impaired the organization's ability to prevent or properly detect improper actions by employees, and, Mr. Colgate, what has the DEA done to correct these control problems and to prevent further embezzlements from occurring?

Mr. COLGATE. Your summary was an accurate one of the situation that occurred. We did have a fundamental—in my personal opinion—a fundamental breakdown in the notion of segregation of duties and internal controls that allowed the situation where one employee was able to obligate the funding and essentially control the disbursement of the funding which resulted in this loss.

I am pleased to say that DEA has taken corrective action in addressing these internal control weaknesses. It is my understanding that they brought in an independent accounting firm to look at the revised internal control processes and have implemented those processes.

We have moved DEA, and DEA, I think, in part—Mike, and you have to correct me if I am wrong—one of the reasons why in previous years that they received a disclaimed opinion was because of these very internal control deficiencies that you have outlined. For fiscal year 1998, at least as it relates to the balance sheets, DEA has received a clean opinion.

So, I will say that I am pleased that DEA has taken this very seriously; has reviewed their internal control procedures; has brought in an outside firm to validate those procedures, and I think that we have taken the necessary corrective actions, but I think your summary of the situation was an accurate summary at the time.

Mrs. BIGGERT. Well, maybe to ask, then, of Mr. Bromwich, what did the auditors do to satisfy themselves that these control weaknesses had been addressed?

Mr. BROMWICH. Well, I agree with Mr. Colgate that your summary in looking at the inadequate segregation duties was, in fact, a major cause that led to the \$6 million fraud; that and the fact that it related to covert law enforcement activities which unfortunately is frequently an excuse for violating fundamental rules of financial management. I share Mr. Colgate's view that, in fact, the DEA did attack this problem aggressively; did attack specifically the segregation of duties issues, and did tighten up its financial controls in a way that certainly minimizes the possibility that this kind of fraud will occur again.

Mrs. BIGGERT. Well, it is my understanding that the auditors reported this year that the weaknesses that allowed the embezzlements to occur still exist, and, specifically, that of 153 paid invoices, they tested that 21 of those lacked evidence that DEA ever received the goods or services, and 10 were missing approval for payment. So, I am wondering why—in the light of these recent embezzlements—why the invoice is being paid without documentation of receipt and acceptance?

Ms. KESSINGER. During our testing, it is normal for us to find these kinds of issues and testing of invoices and disbursement. We would normally either look for additional documentation that would support that it was an appropriate payment or that something occurred. We were also covering the period fiscal year 1998, which started back in October 1, 1997, and it is probably a lot of these things that were implemented may not have been implemented at the beginning of the fiscal year and were implemented during the year. The auditors were able to do enough testing to get comfortable really that the numbers were substantially correct.

Mrs. BIGGERT. So, will you continue then to monitor these weaknesses to ensure that this doesn't happen—

Mr. BROMWICH. Yes, absolutely.

Mr. COLGATE. It is my understanding that it is part of the routine review that would occur every year, so that they test it to ensure that there are proper receiving reports, proper invoices that support the payments, because we don't want to ever get ourselves in that situation again.

Mrs. BIGGERT. Well, it seems like you might want to do some special checks on this rather than wait for a whole year to ensure that this hasn't occurred.

Ms. KESSINGER. We will be doing interim testing during the summer, and then we do the substantive testing in the fall, so we are pretty much in there almost on a year-round basis at this point.

Mrs. BIGGERT. OK. Thank you, I yield back my time. Thank you.

Mr. HORN. I thank the gentlewoman. Those are good questions, and you are welcome to do a lot more. I am only going to pick on a few things here, and then we will move along, so if you see—OK, well, I understand that. This is sort of a busy day for everybody.

On the Immigration and Naturalization Service, I guess since there was a problem on their financial aspects, I guess I would say, in 1998, as I understand it, the auditor of INS identified nine significant weaknesses. The auditor then reported "that INS has not established effective controls to ensure that transactions were accurately and completely reported." They went on to say they "could not satisfy themselves as to the extent to which INS financial

statements are affected by this matter.” In addition, the auditor reported that INS could not agree that its accounts with the Treasury were off \$76 million. They couldn’t come up with an accurate listing of who they owed—to whom they owed money. They couldn’t account for the revenue collected from applicants in advance of processing, just to mention a few things. So, I guess I would ask, Mr. Colgate, what actions are you taking to ensure these weaknesses will be corrected in a timely manner?

Mr. COLGATE. I have no dispute with the findings of the auditor. Our biggest concern initially was this whole notion that there wasn’t sufficient reconciliation—I believe you use the term \$77 million—between the INS’ balances and those reflected by the Department of Treasury.

Mr. HORN. That was \$76 million.

Mr. COLGATE. Yes. We are concerned about that, and INS has established a very aggressive corrective action plan. They have brought in an outside firm to help them reconcile the balances where there have been discrepancies. I would say if you asked me a couple of years ago where my greatest concern was within the Department of Justice, I would have to say within the Immigration Service. I would say based on the results of our 1998 audit and the commitment by the Commissioner and the organizational changes of moving to regional financing centers, my personal view is that INS would receive the most improved player award for 1998. I am hopeful that given the level of commitment that INS has demonstrated in 1998, if we can continue that level of commitment in 1999, that we can move to the situation where INS would have a qualified opinion and be able to overcome these deficiencies that have been listed.

The second observation I would offer is that it is very important that we complete moving INS from an antiquated system to the cross-servicing arrangement that it has entered into with the Department of Commerce to move to a new financial management system. With the change in the system and the continued commitment of the Service to get its financial house in order, I think that we can overcome this.

Mr. HORN. Is there suspicion of embezzlement with this \$76 million?

Mr. COLGATE. It is not so much the suspicion of embezzlement, but I would say that we always have to be suspicious until we get our total financial house in order. So, I don’t want to totally disclaim it. I think it is more of a situation of making sure that we accurately reflect the obligations that we incur; that we accurately reflect the receipts that we receive, because when you look at the INS, I believe it is almost a third of its operational expenses are paid for by offsetting collections, so it is very important for us to have sound financial management in an agency that receives almost a third of its funding through receipts.

Mr. HORN. Have we analyzed who is at what financial station that is inputting in these different accounts and examines whether there is a possibility there for embezzlement or fraud?

Mr. COLGATE. I will have to provide that for the record; I don’t know the detailed answer. I would point out, though, that my staff has informed me that INS, since the closing of the 1998 audit, has



been able to completely reconcile, at this point in time, that balance that is in dispute between Treasury and INS, so I think that is a good indication. I will give you those detailed answers that you request.

Mr. HORN. OK, without objection, it will be in the record at this point.

[The information referred to follows:]

**Horn Committee Hearing  
March 18, 1999  
Response to Additional Questions**

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Prepared by Immigration & Naturalization Service  
Office of Financial Management  
May 10, 1999

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**Question 1: Is there a possibility for Embezzlement or Fraud with the \$76 million?**

**Answer:**

The possibility for embezzlement or fraud in the \$76 million is very remote, if not nonexistent. At September 30, 1998, all of the \$76 million differences had been identified except for \$547,000, which had not yet been researched as of September 30, 1998. However, the \$547,000 has now been identified and separated by appropriation and by the responsible Administrative Center. During Fiscal Year 1999, the Administrative Centers have continued researching these differences, and locating the relevant records and documentation to support the adjustments. Headquarters Finance intends to review the work completed at the Administrative Centers, to ensure the differences are properly corrected or cleared.

In addition, certain controls have been established for the INS reconciliation process, designed to prevent embezzlement or fraud. Specifically, the reconciliation process requires that all differences are to be identified by the schedule, batch number, documents, or other identification, so that they can be independently tracked and verified to ensure they have been cleared. To insure the appropriate segregation of duties, those persons assigned to perform the reconciliations, do not obligate funds, disburse, or certify payments.

**Question 2. What is the detail of the \$76 million difference between Treasury and INS' Books?**

**Answer:**

INS has completely reconciled its September 30, 1998, Fund Balances with Treasury. The \$76 million represented the differences between what Treasury reports and what INS's accounting records report. As explained in Question 1, above, all of the \$76 million has been identified, except for the \$547,000. Specifically, the \$76 million difference was comprised of the following:

Justice Management Division transferred \$31 million directly from INS' appropriations instead of processing the payment through the OPAC process. We have discussed this issue with the appropriate officials from the Justice Management Division, and appropriate actions have now been taken to prevent this from happening in the future.

The Office of Justice Programs reimbursed itself for \$3 million in INS grants disbursements directly from INS appropriations. This was done without providing INS with any information or documentation needed for INS to properly record the payments in the accounting records. We have met with officials from Justice Management Division, the Office of Justice Programs, and the INS program office, and developed an improved document and data flow process to correct this issue.

Payroll differences of \$36 million have been identified and are currently being reviewed and analyzed. At the end of Fiscal Year 1998, resources were not available within INS to fully review and correct this difference. Preliminary finding from the current review and analysis indicates that this difference is primarily a timing difference and may have been included in the reconciliation in error. Also, preliminary analysis of the payroll difference for Fiscal Year 1998 indicates that the difference should be about \$1 million. In addition, INS is planning to redo its payroll reconciliations back to Fiscal Year 1997 - the results should provide details of how to correct this error.

Previous to Fiscal Year 1999, INS had five separate accounting offices responsible for reconciling a portion of INS' payroll. This created an extremely difficult environment to perform such reconciliations, as employees were routinely transferred between locations (and accounting offices) throughout the nation. To aid in resolving this issue, INS has centralized the payroll reconciliation effort nationwide in Twin Cities effective the beginning of Fiscal Year 1999.

A \$5.5 million difference stems from the recurring month to month timing differences between Treasury and INS accounting operations. Although short of adequate resources, INS is establishing a centralized process to review and analyze all reconciliations each month to ensure the differences are cleared and the errors are corrected.

The remaining balance of the difference, or \$547,000, is now being researched and will be corrected prior to the end of Fiscal Year 1999.

Mr. HORN. You are saying it is detailed within the \$76 million. Is that what we are talking about? In other words, it is the whole \$76 million, you are saying you are getting reconciliation now?

Mr. COLGATE. It has been pointed out to me—and if I have made a mistake, I will make sure I clarify for the record—but I have been told that the \$76 million that was not reconciled has been, at this point in time, completely reconciled to the Department of Treasury.

Mr. HORN. OK. I will tell you one thing I learned as a chief executive was make sure that person that never takes a vacation takes a vacation, and have someone else sit at their desk and see what kind of weird transactions come through. So, you might want to think about that, rotating people around or something.

Mr. COLGATE. That is a very good point. I think that was a classic example that was in the DEA situation that we were questioned about earlier. Essentially, my recollection was that your new employee who worked at another agency had moved into the accounting operations and was in a similar situation as you described and looked at those invoices and said this doesn't make a lot of sense. I think your observation is a good one.

Mr. HORN. Well, that is what management should be aware of. It doesn't mean all our employees get that way, but sometimes people are under a lot of pressure we don't know about. Sometimes people do weird things when they are under either that kind of either financial pressure on a mortgage or they have a child on drugs and they need treatment or whatever, and all I am saying is there are ways that good auditors know, and I found over 18 years as a CEO, I always kept the auditor afterwards where I could eyeball him and he could eyeball me, and I said, "OK, tell me what you found on I don't know how many other campuses in the State of California, and let me know, and what do you do to do it." And, obviously, making sure that sort of two people have to know about what the financial input and the financial output. It is just watching some things that we think, "Gee, you know, such a dedicated person," and, yes, dedicated, right, to bring their bank accounts up. So, you need to look at that.

In terms of the Community-Oriented Policing Services, otherwise known as COPS, I noticed the Inspector General's Audit Division performs numerous audits each year to determine whether the recipients of the Community-Oriented Policing Services grants are misusing the funds. The audits during the previous year identified over \$35 million of questioned costs and over \$60 million of funds that could be put to better use. In addition, the auditor of the Offices, Board, and Divisions' fiscal year 1998 financial statement identified a weakness in the COPS Program involving inadequate documentation in the grant files. Now, what can you tell us, Inspector General, about that, or Mr. Colgate?

Mr. BROMWICH. Mr. Chairman, we are doing, as you know, a substantial amount of work in the COPS Program. We are right now compiling a summary of all of the work that we have done to date that synthesizes into categories the various problems that we have identified.

In addition to that, we are doing a major internal audit of the administration and management of the COPS Program that is close

to being releasable in draft form within the Department, and I anticipate that that will be released publicly fairly soon.

So, we are visibly engaged in overseeing this particular program.

Mr. HORN. And is that looking at the other end of the grant in the locality and whether they are following—

Mr. BROMWICH. Yes.

Mr. HORN. Is that sort of a random sample or are you looking at that—

Mr. BROMWICH. Not a completely random sample, Mr. Chairman. It began as our following up on specific referrals that were made to us by COPS management. They said, "We think we have problems with X, Y, and Z grant recipients for these reasons." And so we began by looking at those. Since that time, as we have done more of them, we have been selecting for ourselves, approximately 50 percent of the COPS audits that we are doing. So, it is a mix of referrals and self-selected grant audits.

Mr. HORN. Well, I thank you for that information.

Let me just ask Mr. Colgate a couple of closing questions here, because I know you have, I believe, another hearing to go to, Inspector General. So, I would just like to know what percent of your time on the average, let us say over a month, do you spend in your role as Chief Financial Officer? What percent of your time, generally, do you spend in your role as Chief Information Officer? What would you say off the top of your head?

Mr. COLGATE. I would spend, I would say, at least two-thirds of my time related to Chief Financial Officer type of activities. I would say that when it comes to CIO activities, there has been far more delegation to whoever was the Deputy Assistant Attorney General in IRM. I am not going to kid you, my background, as you noted, I mean—I have been Director of Finance staffs and budget officers in three different agencies, and my interest and my love is financial management. So, I would say the majority of my time is spent on financial management issues.

Mr. HORN. OK, and then how much on the Chief Information Officer's role?

Mr. COLGATE. I would say probably—to be quite candid with you, I would say probably—if I was to measure it any one day, I would say 65 percent of my time is spent on CFO or financial management type of activities. I would say that 15 percent of my time is spent on administrative type of issues, whether it be personnel or whatever, and then the smallest portion of my time would be related to CIO type of activities.

Mr. HORN. OK. My last question to you, Mr. Colgate, is the debt collection situation. According to the Department of Justice's fiscal year 2000 summary performance plan, the Department has completed a comprehensive debt management review focusing on the Department's and components' efforts to implement the, if you will, the Horn-Maloney effort in 1996, otherwise known as the Debt Collection Improvement Act which we just happened to get in the Omnibus bill that year, and I guess I would ask you what were the results of this review including the efforts to collect debts referred to from other agencies? Do you have any thoughts on that?

Mr. COLGATE. I don't have—I will provide in detail the results of that review. I know that we are in the process right now of putting

out our Privacy Act notices that we can begin this summer referring debts, the DOJ debts to be serviced by the Department of Treasury, but we have to get this Privacy Act notice out before we can begin that referral process. But, specifically, on the status by appropriation, I would be more than glad to give you that detail by account.

Mr. HORN. If you would, without objection, it will be inserted at this point, and I guess I would ask what improvements are being made as a result of this review, because I am interested in your role in relationship with other departments of the Federal Government where we are also trying to get active, aggressive debt collection?

[The information referred to follows:]

## FY 1992 Through FY 1998

Year	Number of Publications
1992	~15,000
1993	~12,000
1994	~18,000
1995	~15,000
1996	~12,000
1997	~28,000
1998	~25,000

*Since 01/99, DCEd referrals have been received at a rate which will reach 72,000/yr.*

Referrals to DOJ

Agency	Referrals						
	<u>FY 1992</u>	<u>FY 1993</u>	<u>FY 1994</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>	<u>FY 1998</u>
Education	15,142	1,192	125	309	9,430	28,350	25,937
Agriculture	8,311	7,095	5,243	5,492	5,092	4,179	3,252
Small Business Admin	1,579	1,544	1,312	1,203	1,090	909	768
Health & Human Svcs	774	805	1,426	1,407	1,082	934	990
Housing & Urban Dev	1,335	2,319	3,142	3,300	1,038	759	57
Veterans Affairs	1,031	684	474	661	732	444	541



U.S. Department of Justice

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## Department-Wide Debt Management Review

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*June 1998*



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## EXECUTIVE SUMMARY

### Purpose of Review

The Finance Staff and Debt Collection Management (DCM), Justice Management Division (JMD), conducted a Department-wide project to determine compliance with the Debt Collection Improvement Act of 1996 (DCIA) by each component and to review the debt management and debt accounting policies and practices of all the components. The analysis of debt included a review of current receivables as well as delinquent receivables. The Finance Staff, DCM, and components are utilizing the results of this review to implement the provisions of the DCIA and improve debt management and debt accounting practices.

### Method of Review

To initiate the review, the Finance Staff and DCM reviewed the provisions of the DCIA and provided the components with detailed written guidance for use in completing the review. The guidance included a description of the thirteen mandatory and ten optional provisions of the DCIA and was presented to the components for review and response. Full descriptions of the mandatory and optional provisions of the DCIA are located in Section II of this report.

The review guidance also posed specific questions which would provide a comprehensive overview of debt, and debt management and accounting practices of each component. The guidance was designed to reveal any weaknesses in the components' debt management, from recording and reporting the debt at the time of recognition as a receivable to collecting the debt in full or writing the debt off as a bad debt. The components were required to provide milestones for implementing the DCIA and to provide a Corrective Action Report, complete with target dates, for any deficiencies uncovered or reported in this review.

During the review, Finance Staff and DCM made on-site visits to each component to provide advice on the preparation of the review report and to identify any problems in completing the review. The Finance Staff reviewed and discussed with the components the reports submitted and prepared the final review report which included a final Department-wide plan for implementing the DCIA and other debt management improvements.

### Results of Review

The two most significant provisions of the DCIA are cross-servicing of debt and administrative offset. The cross-servicing provisions require Federal agencies to refer debt to Treasury when

the debt becomes more than 180 days delinquent and Treasury will continue efforts to collect this debt. Treasury's efforts will include reporting the debt to credit bureaus, referring the debt to Treasury's administrative offset program (TOP), referring the debt to a private collection agency, and referring the debt to Justice for litigation. The administrative offset provisions require agencies to refer debt more than 180 days delinquent to TOP for offset against Treasury payments to reduce or eliminate debt.

All components have established milestones to comply with the cross-servicing requirements. Most of the referrals for cross-servicing are expected to be from the Immigration and Naturalization Service (INS). Several of the components have a very low volume of debt and may never need to use this program. However, these components will be prepared for cross-servicing by establishing agreements with Treasury.

Exempt from cross-servicing are debts: (1) in litigation or foreclosure; (2) to be disposed of under an asset sales program; (3) at a private collection contractor or a debt collection center; or (4) to be collected under internal offset. Certain other types of debt can be exempted from cross-servicing with Treasury's approval. The Bureau of Prisons' (BOP) request to exempt debts owed by state, local, and other entities for costs of housing inmates is the only request for exemption from cross-servicing received by the Finance Staff.

Referral of delinquent debt to Treasury for administrative offset is one of the services provided by the cross-servicing program. However, debts exempt from cross-servicing are eligible for referral to the administrative offset program. Components with debt that is exempt from cross-servicing will refer debt for administrative offset through DCM, the Department's central processor for referral of debt for administrative offset.

The Secretary of the Treasury has prescribed standards for exempting certain types of payments from administrative offset. These requirements take into consideration whether administrative offset would tend to interfere substantially with or defeat the purposes of the payment certifying agency's program. This is in addition to means-tested programs, which will be exempt when requested by the head of the respective agency, and where certain payments are specifically excluded by statute from any administrative offset program, provided the head of the agency notifies the Secretary of the Treasury of these statutory exclusions. Requests for exemption are being reviewed by the Finance Staff to determine if there is sufficient justification for inclusion in the Department-wide request for exemptions, which will be sent to Treasury. Exemption requests made by the components include: (1) Environment and Natural Resources Division's request to exempt payments for contribution claims by nongovernment, private parties against Federal agencies under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA); and (2) the United States Attorneys' (USA) request to exclude restitution payments made to victims of crime, expedited payments for expenses directly related to litigation (certified invoice procedures), payments to victims of crime through the Office of

Victims of Crime emergency assistance program, payments to threatened witnesses under the Emergency Witness Assistance Program, payments to employees for travel and other expenses, and payments to expert witnesses.

Most of the components will report delinquent debt to consumer credit bureaus, as required by the DCIA, through the cross-servicing program. The only component to indicate that this task will be performed prior to referring the debt for cross-servicing is the CIV. This Division has established a milestone to begin this reporting process.

Another provision of the DCIA is the obtaining of taxpayer identification numbers (TIN) of persons doing business with the agency and informing the person providing the TIN that the TIN could be used for collecting and reporting on any delinquent debt owed to the U.S. Government. The TIN is necessary for the collection of delinquent debt owed to Federal agencies through administrative offset. Most of the components have adequate procedures in place to collect the TINs of persons doing business with the agency. An area that many of the components need to address is the required disclosure of the purpose of obtaining the TINs. Components have set milestones to comply with this provision.

Another important provision of the DCIA is the requirement that Federal payments be made by electronic funds transfer (EFT). All Federal payments (other than payments under the Internal Revenue Code), subject to the authority of the Secretary of the Treasury to grant waivers, will be required to be made by EFT. The Department is working with Treasury to accomplish this goal.

The additional collection authority granted by the DCIA requires that the routine use disclosure provisions under the Privacy Act of 1974 be updated. The Finance Staff provided the components with a sample system of records notice for guidance in updating their routine use disclosures.

The reports from the components identified several deficiencies in debt management practices and debt accounting procedures. The most significant of these involved failure to: charge interest, penalties, and administrative costs; record all receivables in the general ledger; generate a monthly aging report on receivables; and maintain an allowance for doubtful accounts. When a deficiency was identified, the component developed a milestone for correcting the deficiency.

This Executive Summary addresses the more significant of the thirteen mandatory and ten optional provisions of the DCIA. Section IV contains a summary of the status and milestones for implementing all the provisions of the DCIA and correcting deficiencies. Section V contains a summary of the milestones by component. The Finance Staff will follow up on the plans of action with the components to ensure that the goals are achieved.

## I. INTRODUCTION

The Debt Collection Improvement Act of 1996 (DCIA) was passed by Congress to provide additional tools for the Government's effort to collect its delinquent debt. This Department-wide debt management review was initiated by the Finance Staff and Debt Collection Management (DCM), Justice Management Division (JMD), to determine the Department's compliance with the DCIA, and to review the Department's debt management and accounting practices and procedures. The review covers current and delinquent receivables.

To initiate the review, the Finance Staff and DCM reviewed the provisions of the DCIA with the components and provided detailed written guidance to use in completing the review. This guidance was developed to obtain overall debt management and accounting policies and procedures from each component in a consistent format. The guidance included a description of the thirteen mandatory and ten optional provisions of the DCIA. Full descriptions of the mandatory and optional provisions of the DCIA are located in Section II of this report. Each provision was presented to the components for review and response. Some provisions cannot be adequately addressed at this time due to pending Department of the Treasury (Treasury) regulations and/or instructions. Treasury has issued proposed rules on electronic funds transfer (EFT) requirements and taxpayer identifying number (TIN) requirements, and interim rules on the transfer of debts to Treasury for collection and salary offset. The implementation of these and other provisions will be revisited when Treasury's rules and instructions become final.

The review guidance also posed specific questions which would provide a comprehensive overview of the debt practices of each component. The guidance required the components to describe debt; provide data on how each category of debt relates to total component debt; and advise of the distribution of debt among other Federal agencies, and state and local governments. The data are from fiscal year 1996 since the information was requested during fiscal year 1997. The components were also requested to provide information on procedures for establishing debt as a receivable, recording the debt in the general ledger, and reporting the debt on management reports. The guidance was designed to reveal weaknesses in the components' debt management, from recording and reporting the debt at the time of recognition as a receivable to collecting the debt in full or writing it off as a bad debt. Finally, the components were required to provide milestones for implementing the DCIA and to provide a Corrective Action Report, complete with target dates, for any deficiencies uncovered or reported in this review.

This report is based on the components' responses and is presented in six sections. Following this introduction is Section II, which provides the detailed description of the thirteen mandatory and ten optional provisions of the DCIA provided to the components. The reports in Section III



provide descriptions of component debt, results of the component debt management review, component requests for exemption from DCIA provisions, and milestones for corrective action. Section IV presents how the components are addressing each provision of the DCIA. This section also lists the milestones established by the components to improve debt management practices and debt accounting. Section V summarizes by component the corrective actions and milestones developed by each component to comply with the DCIA and to strengthen debt management and debt accounting policies and practices. The DCIA provides for limited exceptions to the administrative offset and cross-servicing programs. The components were requested to provide information about categories of payments which should be excluded from administrative offset and classes of debt that should be exempt from cross-servicing. This information is summarized in Section VI. Written confirmation was provided by each component during May 1998 in regard to the content, milestones, and accomplishments in this report.

The Finance Staff, DCM, and components are utilizing the results of this review to facilitate implementation of the DCIA and to improve debt collection practices and debt accounting procedures. The Finance Staff will follow up with the components on the corrective action plans to ensure that the deficiencies are corrected.

## II. Provisions of the Debt Collection Improvement Act of 1996 (DCIA)

### A. Mandatory Provisions of the DCIA

1. **Cross-Servicing.** Requires debts delinquent for more than 180 days to be referred to Treasury for collection action (cross-servicing). Cross-servicing includes reporting to credit bureaus, administrative offset by Treasury, referral to collection agencies, and referral to Justice for litigation. Major exemptions from cross-servicing are debts: (1) in litigation or foreclosure; (2) to be disposed of under an asset sales program; (3) at a private collection contractor or debt collection center; or (4) to be collected under internal offset. Other classes of debt can be exempted with Treasury's approval. Treasury issued an interim rule, 31 CFR Part 285, Transfer of Debts to Treasury for Collection, that outlines the factors that will be considered in determining whether to exempt a class of debts. The factors are whether an exemption is the best means to protect the government's financial interest, whether the transfer of the debt would interfere with program goals, and if the exemption would be consistent with the purposes of the DCIA.
2. **Administrative Offset.** Requires debts delinquent for more than 180 days to be referred to the Treasury for administrative offset from Treasury payments. The Secretary of the Treasury has prescribed standards for exemption of payments into the Treasury Offset Program (TOP). These requirements take into consideration whether administrative offset would tend to interfere substantially with or defeat the purposes of the payment certifying agency's program. This is in addition to means-tested programs, which will be exempt when requested by the head of the respective agency, and where certain payments are specifically excluded by statute from any administrative offset program, provided the head of the agency notifies the Secretary of the Treasury of this statutory exclusion.
3. **Reporting to Credit Bureaus - Delinquent Debt.** Requires delinquent debt to be reported to consumer reporting agencies or commercial reporting agencies, as appropriate.

4. **Reporting Taxpayer Identification Numbers (TIN).**
  - a. Requires obtaining a TIN from each person doing business with a Federal agency.
  - b. Requires disclosure to a person required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.
  - c. Requires inclusion of TINs on vouchers submitted to disbursing officers.
5. **Administrative Offset by Agency Disbursing Officers.** Requires agency disbursing officers to offset delinquent debt from payments.
6. **Centralized Salary Offset.** Requires participation, at least annually, in a computer match of delinquent debt records to records of Federal employees. The Treasury has published 31 CFR Part 285, Salary Offset; Interim Rule, that establishes procedures for the offset of Federal salary payments.
7. **Barring Federal Assistance to Debtors.** Bars delinquent Federal debtors from obtaining Federal loans, loan insurance, or loan guarantees.
8. **Internal Revenue Service (IRS) Offset.** Amends the IRS disclosure law to permit the Treasury to conduct tax refund offset.
9. **Sale of Debt - After Terminating Collection Action.** After terminating collection action, debts are required to be sold if sale is determined by the Treasury to be in the best interest of the Federal government.
10. **Electronic Funds Transfers (EFT).** All Federal payments, except tax refunds paid by the Internal Revenue Service and subject to the authority of the Secretary of the Treasury to grant waivers, will be required to be by EFT. Treasury has issued 31 CFR Part 208, Management of Federal Agency Disbursements, Proposed Rule, which outlines EFT requirements and provisions for waivers. The Department is aggressively pursuing full implementation of EFT, although it is recognized that obstacles to full implementation exist.
11. **Civil Monetary Penalties.** Requires adjustment of Civil Monetary Penalties for inflation.

12. **Code of Federal Regulations (CFR).** Revise 28 CFR to implement the DCIA. Before collecting a claim by administrative offset, the head of the executive agency must either adopt, without change, regulations on collecting by administrative offset promulgated by the Department of Justice, General Accounting Office or Department of the Treasury, or prescribe regulations on collecting by administrative offset consistent with these regulations.
13. **Compromise of Debt.** Revise the Federal Claims Collection Standards to permanently increase the threshold for referral of debts to the Department of Justice for compromise, suspension, or termination at \$100,000 or higher, as determined by the Attorney General.

#### B. Optional Provisions of the DCIA

1. **Garnishment.** Authorizes garnishing of wages of non-Federal employees through administrative proceedings rather than court order to recover delinquent debts not in repayment status.
2. **Obtaining Consumer Credit Reports.** Authorizes the obtaining of consumer credit reports when acting to collect or compromise a claim, or terminating collection action on a claim.
3. **Contracts to Locate and Recover Financial Assets.** Authorizes agencies to enter into contracts to locate and recover unclaimed financial assets.
4. **Publishing Identity of Delinquent Debtors.** Authorizes publishing or disseminating names of delinquent debtors pursuant to regulations issued by the Treasury.
5. **Reporting to Credit Bureaus - Non-Delinquent Debt.** Authorizes the reporting of nondelinquent debts to credit bureaus.
6. **Sale of Debt - General.** Authorizes agencies to sell debts after the debts are 90 days delinquent.
7. **Charging Cost of Living Adjustments.** Authorizes agencies to increase administrative claims by a cost of living adjustment, in lieu of assessing late payment charges.

8. **Treasury Processing of Form 1099-C.** Allows agencies to submit information for Form 1099-C reporting to the Treasury for the purpose of Treasury filing the Form 1099-C.
9. **Debt Collection Improvement Account.** Establishes the Debt Collection Improvement Account and allows agencies to obtain a portion of collections for improving debt collection activities (gainsharing).
10. **Expansion of Private Counsel.** Provides permanent authority and greater discretion for Justice to use private counsel.

### **III. Reports on Each Component**

## Immigration and Naturalization Service (INS)

### A. Descriptions of Debt

1. **Administrative Fines.** These are fines established when various sections of the Immigration and Nationality Act (INA) are violated. These fines are tracked and adjudicated by the National Fines Office. The following are violations that lead to these inspection fines:
  - Failure of carrier to provide lists of alien and citizen passengers arriving or departing.
  - Failure of carrier to immediately deport alien passengers excluded from admission or entering in violation of the law.
  - Failure of civil aircraft carrying aliens to provide advance notice of intent to land or to arrive at designated ports of entry.
  - Failure of carrier to provide lists of aliens or to report cases of illegal landings.
  - Failure of carrier to detain or deport any alien crewman as required by an immigration officer.
  - Failure of carrier to not employ aliens afflicted with certain disabilities.
  - Failure of carrier to obtain consent of the Attorney General prior to paying off or discharging any alien crewman within the territorial borders of the United States, except an alien lawfully admitted for permanent residence.
  - Bringing into the U.S. alien crewmen on any vessel or aircraft with the intent of evading immigration laws.
  - Failure of carrier to prevent the landing of an alien at a port of entry other than as designated by the Attorney General.

- Bringing in, by a carrier, aliens subject to exclusion on a health-related ground.
  - Bringing in, by a carrier, any alien who does not have a valid passport and an unexpired visa. Failure of a carrier to deport any alien stowaway.
  - **Transit Without Visas (TWOV).** These fines are for violations of Section 238 of the INA. Violations occur if a transportation line allows any alien to land in the United States if that transportation line does not have a contract with the Attorney General for the entry and inspection of any such alien, or allows any alien to land at other than a landing station approved by the Attorney General. The fines resulting from violations are tracked and adjudicated by the National Fines Office.
2. **Breached Surety Bonds.** The surety bond provides assurance that an alien will be delivered to INS for hearings, proceedings, and/or interviews. The insurer underwrites the amount of the bond and agrees to pay the face amount if the bond is breached. The surety is billed upon final breach but may not pay if the obligor has filed an appeal. All appeals are forwarded to the Administrative Appeals Unit, which may take up to two years to process.
  3. **Late Charges.** Interest, penalties, and handling charges are added when applicable to administrative fines, surety bonds, 31 Act billings, and employer sanctions.
  4. **Enforcement Fines and Other Reimbursements.**
    - **274 C Fines.** These are civil penalties imposed for presenting any fraudulent document to INS for the purpose of obtaining a service provided benefit.
    - **Detention & Deportation Costs.** These fees are assessed when a carrier fails or refuses to comply with an order to take on board, guard safely, and transport to a specified destination any alien ordered to be deported.
  5. **Uncollectible Checks.** Ninety-five percent of uncollectible checks are for application fees for INS benefits and are due to closed accounts or insufficient funds. Most clients of INS are aliens who may or may not have social security numbers (SSN) or taxpayer identification numbers (TIN).
  6. **Liquidated Damages.** This fine is imposed when a petitioner, who is most often an employer or sponsor of a temporary alien worker, cannot demonstrate compliance with a petition agreement. The agreement states the conditions under which the petitioner can



continue to employ the alien worker. The petition usually requires the petitioner to notify INS when an alien worker causes a violation of the petition agreement. The National Fines Office tracks and adjudicates these fines.

7. **31 Act Overtime.** These bills are to reimburse INS for the cost of overtime to inspect passengers and crew on vessels and aircraft arriving outside the basic workweek. The amount billed is based on the number and grade of the inspectors and allocated to the number of carriers, prorated by the passenger count, inspected during that shift.
8. **Miscellaneous.** These are primarily Federal Agency receivables and employee debt. Employee debt usually arises when an employee has been found negligent in the loss of Government property. The debt is recognized after all due process has been completed. Employee debt also occurs when a travel advance is not repaid during the normal course of submission of the travel voucher. This category also includes:
  - **Auto Accidents.** These billings arise when an individual, or their insurance company, is determined to be responsible for damages resulting from an accident involving an INS vehicle.
  - **En Route Inspections.** A cruise line is responsible for all travel costs and overtime when the cruise line requests INS inspectors to perform an inspection while the ship is on a voyage.
9. **Employer Sanction Fines.** Sections 274 A & B of the INA do not allow U.S. employers to hire or recruit undocumented aliens. Fines are imposed when these sections are violated.

Categories of Accounts Receivable	Average Per Bill	\$ PERCENT of TOTAL	REMARKS
1. <i>Billings to other Federal Agencies</i>	\$157,647	45.79%	
2. <i>Administrative Fines</i>	\$2,010	17.00%	finest@ \$3,000
3. <i>Bonds</i>	\$3,093	15.00%	bonds@\$2,000-\$5,000
4. <i>Late Charges, interest, penalty, &amp; handling</i>	\$297	12.00%	
5. <i>Enforcement Fines &amp; other reimbursement</i>	\$2,628	8.00%	various
6. <i>Uncollectible Checks</i>	\$387	1.00%	includes uncollectible check fees
7. <i>Liquidated damages</i>	\$212	.44%	
8. <i>31 Act Billing</i>	* \$41	.30%	
9. <i>Miscellaneous</i>	\$4,469	.27%	refunds & not classified/general fund
10. <i>Employer Sanctions</i>	\$698	.02%	sanctions@\$250-\$5,000
<b>TOTAL RECEIVABLES (rounded up) AVERAGE PER COUNT</b>	<b>\$1,405</b>	<b>100.00%</b>	

\*Per 49 U.S.C. 1741(a) billing of private aircraft or vessels cannot exceed \$25.

Percent of total debt owed by another Federal agency. 45.79%

Percent of debt owed by state and local governments. 0%

Description of law enforcement relationship with state and local government. Not applicable.

Advisability of sale of debt. INS will assess potential for sale of debt.

#### **B. Principal Results of the Review**

Cross-servicing will be used by the INS. Except for interest on airline user fees, receivables are recorded to the general ledger and reconciled daily. All required reportable debts are captured on the Report on Receivables Due from the Public. Internal administrative offset is utilized for commercial vendor overpayments and employee debt. Salary offset is utilized for delinquent travel advances and damage to Government property. INS has participated in the IRS Tax Refund Offset Program and refers breached surety bonds and administrative fines to the Department of Justice for litigation. The following debt collection tools are also utilized by the INS: cancellation of airline contracts with delinquent debtors, ceasing to do business for nonpayment of debt, developing a list of bad check writers, and electronic return check processing. Interest, penalties, and administrative costs are charged on delinquent debt.

#### **C. Exemptions Requested by INS**

None.

#### **D. INS Milestones**

Bring Employer Sanction Fines under general ledger control.	Completed October 1997
Implement policies and procedures to obtain TINs from all persons and entities doing business with the INS.	July 1998
Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent	

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amounts arising out of such person's relationship with the Government.	July 1998
Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.	July 1998
Bring interest for late payment of airline user fees under general ledger control.	July 1998
Establish a cross-servicing agreement with Treasury and refer, on a pilot basis, debts delinquent more than 180 days to Treasury for cross-servicing.	August 1998
Refer all debts delinquent more than 180 days to Treasury for cross-servicing.	September 1998

## Bureau of Prisons (BOP)

### A. Descriptions of Debt

1. **Reimbursement Receivables.** Debts owed by state and local governments, and United States territories for housing of prisoners, and amounts owed by the Federal Prison Industries (FPI) for utilities provided by the Bureau of Prisons (BOP). Pursuant to 18 U.S.C. 5003, and the National Capital Revitalization and Self Government Improvement Act of 1997, Section 11201(a), the Director, BOP, is authorized to enter into agreements with state and local governments, and U.S. territories for the purposes of reducing prison overcrowding, housing difficult or high risk state prisoners, and protecting the financial interest of the U.S. Government.
  - a. **Average amount per debt.** \$35,000
  - b. **Percent of all component debt.** 50.1%
  - c. **Percent of debt owed by another Federal agency.** 18%
  - d. **Percent of debt owed by state and local governments.** 82%
  - e. **Description of law enforcement relationship with state and local government.**  
The BOP has a significant law enforcement relationship with State and local governments. The BOP relies on reciprocity agreements with State, local, and territorial governments to meet some of its needs for housing inmates. Reciprocity agreements for inmate housing are but one example of the many cooperative relationships with State, local, and territorial governments that support Justice's law enforcement activities.
  - f. **Advisability of sale of debt.** Not advisable because the BOP needs to control these debts. These debts can involve sensitive reciprocal prisoner exchange cases.
2. **Refund Receivables.** Debts owed by vendors for overpayments and return of merchandise, and reimbursements due from FPI and JMD for services rendered under reimbursable agreements.
  - a. **Average amount per debt.** \$12,000
  - b. **Percent of all component debt.** 48.7%

- c. **Percent of debt owed by another Federal agency.** 93%
  - d. **Percent of debt owed by state and local governments.** 0%
  - e. **Description of law enforcement relationship with state and local government.**  
Not applicable.
  - f. **Advisability of sale of debt.** Yes, for non-Federal debt. The cost involved in collecting these debts may exceed the amount recovered. In some cases, selling the debt is more prudent than using scarce resources to attempt collection with uncertain results.
3. **Employee Debt.** Debts owed by current BOP employees.
- a. **Average amount per debt.** \$1,000
  - b. **Percent of all component debt.** 1.2%
  - c. **Percent of debt owed by another Federal agency.** 0%
  - d. **Percent of debt owed by state and local governments.** 0%
  - e. **Description of law enforcement relationship with state and local government.**  
Not applicable.
  - f. **Advisability of sale of debt.** Not advisable as the BOP can collect these by offset.

#### B. Principal Results of the Review

The BOP has set a milestone to refer delinquent debt to the cross-servicing program. The BOP administratively offsets its payments, and utilizes salary offset and tax refund offset. Inmate Cost of Incarceration Fees are referred internally for litigation and IRS Form 1099-Cs are prepared for write-offs of delinquent debt. The BOP currently reports to credit bureaus debts of former employees being referred to the IRS Offset Program and plans to utilize cross-servicing for reporting all debts to credit bureaus.

The BOP advises that all receivables are under general ledger control, all records of receivables are reconciled to the general ledger at least monthly, and all receivables are reported on the Report on Receivables Due From the Public. An allowance for bad debts was recorded in the

FY1997 financial statements, and system modifications are pending to establish a general ledger account for this purpose. The BOP charges interest on certain debts but does not charge interest, penalties, and administrative costs on all delinquent debts, as required by law. Milestones have been established to address these areas.

### C. Exemptions Requested by BOP

1. **Exemption from Cross-Servicing.** An exemption was requested for debts owed by state, local, and other entities for costs of housing inmates. These billings involve sensitive law enforcement relationships and possible safety arrangements.
2. **Exemptions from Administrative Offset and TINs.** A request was made to exempt payments made on behalf of prisoners from the administrative offset program. This also included a request to exempt requiring TINs on payments made on behalf of prisoners.

### D. BOP Milestones

Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.	July 1998
Charge delinquent debtors interest, penalties, and administrative costs where required by law.	October 1998
Record allowance for bad debt in the general ledger.	October 1998
Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.	October 1998
Establish a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.	November 1998

## Drug Enforcement Administration (DEA)

### A. Descriptions of Debt

1. **Returned Diversion Control Program Checks.** Checks returned for insufficient funds or stop payment, which were used to pay registration fees for the prescribing, dispensing, and manufacturing of controlled substances.
  - a. **Average amount per debt.** \$210
  - b. **Percent of debt owed by another Federal agency.** 0%
  - c. **Percent of debt owed by state and local governments.** 0%
  - d. **Description of law enforcement relationship with state and local government.** Not applicable.
  - e. **Advisability of sale of debt.** Not advisable because DEA can rescind the debtor's license to prescribe controlled substances.
2. **Return of Other Checks.** Checks returned - other than Returned Diversion Control Program Checks.
  - a. **Average amount per debt.** \$234
  - b. **Percent of debt owed by another Federal agency.** 0%
  - c. **Percent of debt owed by state and local governments.** 0%
  - d. **Description of law enforcement relationship with state and local government.** Not applicable.
  - e. **Advisability of sale of debt.** Not advisable.
3. **Duplicate/Erroneous Payments.** Refunds receivable for duplicate/erroneous payments.
  - a. **Average amount per debt.** \$1,621



- b. Percent of debt owed by another Federal agency. 0%
  - c. Percent of debt owed by state and local governments. 0%
  - d. Description of law enforcement relationship with state and local government. Not applicable.
  - e. Advisability of sale of debt. May be advisable for non-Federal employee related debt if there is no significant monetary loss to DEA.
4. Civil Monetary Penalties. Fines and penalties assessed by the courts to those who are in violation of statutes involving controlled substances.

#### B. Principal Results of the Review

Debts will be referred to Treasury for cross-servicing. DEA will use the administrative offset program through the cross-servicing program. Except for debts relating to the Diversion Control Program, delinquent debt is referred for IRS Tax Refund Offset. Debts for the Diversion Control Program are not referred due to lack of TINs. The Diversion Control Program application is being revised to require the TIN and should be finalized by September, 1998. Receivables are under general ledger control and records of receivables are reconciled to the general ledger at least monthly. Delinquent debts are not referred to credit bureaus but will be referred under the Treasury cross-servicing program.

#### C. Exemptions Requested by DEA

No exemptions were requested.

#### D. DEA Milestones

Assess interest, penalties, and administrative costs on delinquent receivables. On October 1, 1997, DEA converted to a new financial management system (Federal Financial System) which calculates interest, penalties, and administrative costs on delinquent receivables.

Milestone complete

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Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.	July 1998
Establish a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.	August 1998
Establish procedures for recording Civil Monetary Penalties (CMP) related to controlled substances in the general ledger and reporting the CMPs on the Report on Receivables Due From the Public.	August 1998
Update the application to collect TINs of all persons participating in the Diversion Control Program.	September 1998

## Federal Bureau of Investigation (FBI)

### A. Descriptions of Debt

1. **Reimbursable Debt.** Debt owed by other Federal agencies pursuant to Economy Act Agreements, including debt owed for investigations and fingerprint identification, and debt owed to the FBI pursuant to the Non-Federal Applicant User Fee program. The Non-Federal Applicant User Fee program provides for the processing of fingerprint identification records for non-Federal law enforcement and non-law enforcement organizations.
  - a. **Average amount per entity.** \$259,327
  - b. **Percent of all component debt.** 98.9%
  - c. **Percent of debt owed by another Federal agency.** 82.3%
  - d. **Percent of debt owed by state and local governments.** 17.7%
  - e. **Description of law enforcement relationship with state and local government.** The FBI provides investigation and identification services to state and local governments.
  - f. **Advisability of sale of debt.** The FBI advises against selling this type of debt. The amount eligible to be sold is insignificant and would not be cost effective to sell.
2. **Miscellaneous Debt.** Debt owed by commercial vendors for credits from goods not being received, defective merchandise, and duplicate payments; by former employees of the FBI; and by current employees of the FBI.
  - a. **Average amount per debt.** \$4,500
  - b. **Percent of all component debt.** 1.1%
  - c. **Percent of debt owed by another Federal agency.** 0%
  - d. **Percent of debt owed by state and local governments.** Less than one percent.

- e. **Description of law enforcement relationship with state and local government.** Periodically, the FBI will inadvertently make a duplicate payment to a state or local Police Department for police officer overtime paid for providing assistance to Joint Task Forces.
- f. **Advisability of sale of debt.** The FBI reports that sale of this type of debt is not advisable. There is a high probability that the FBI will collect this debt without incurring significant administrative costs.

## B. Principal Results of the Review

The FBI will refer delinquent debts to the Treasury for cross-servicing on an as-needed basis. The administrative offset program will be accessed through the cross-servicing program. Salary offset is used to pay delinquent employee debt and payroll debt. All debts are under general ledger control and reconciled monthly to the general ledger. Appropriate accounts receivable aging reports are provided for payroll, employee, and miscellaneous debt. Interest, penalties, and administrative costs were not charged on delinquent debts, except employee debt paid in installments. Milestones were established and procedures implemented to correct this area. Form 1099-Cs are prepared internally for debt written-off.

## C. FBI Exemptions Requested

The FBI seeks an exemption from administrative offset for payments and the TIN requirement for investigative expenses of a confidential nature. These payments include, but are not limited to, cooperative witnesses, informant payments, etc.

## D. FBI Milestones

The following milestones were completed by October 1997:

- Provide management with appropriate aging reports for all debt.
- Charge interest, penalties, and administrative costs on all delinquent debt, except miscellaneous debt.
- Implement a plan for preparing 1099-Cs for payroll debt written-off.
- Establish policies and procedures to strengthen internal controls over employee debt.

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- Record miscellaneous debt as an accounts receivable in the general ledger.

Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.

Completed  
February 1998

Develop procedures to charge interest, penalties, and administrative costs on all delinquent miscellaneous debts.

Completed  
February 1998

Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.

July 1998

Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.

August 1998

## Federal Prison Industries (FPI)

### A. Descriptions of Debt

**Reimbursement Receivables.** Debt arising from sale of products to other government agencies, defective raw material from vendors, subcontract sales to the public, and sale of scrap to the public. Nearly all of the debt owed FPI (99.4%) is generated from sales to other government agencies and is excluded from the DCIA. At the end of FY 1997, non-federal debt accounted for only \$380,000 (.6%) of the \$63,000,000 total debt due FPI.

Non-federal debt includes the following:

Defective Raw Material from Vendors - Vendors are billed back for raw materials sold to FPI that failed to meet specifications. The vendor generally resolves the debt by replacing the substandard material. Defective raw material comprises approximately 65% of non-federal debt.

Subcontract Sales - FPI is authorized to sell goods to private industries in support of contracts they may have with the Federal Government. Subcontract sales comprise approximately 25% of non-federal debt.

Scrap Sales - Scrap is generated from FPI's production process and occasionally disposed of through sales to the public. Debts generated by scrap sales comprise approximately 10% of non-federal debt.

The following data is for all debt.

- a. **Average amount per debt.** \$26,800
- b. **Percent of all component debt.** 100%
- c. **Percent of debt owed by another Federal agency.** 99.4%
- d. **Percent of debt owed by state and local governments.** None
- e. **Description of law enforcement relationship with state and local government.**  
N/A

- f. **Advisability of sale of debt.** FPI recommends not selling non-federal debt because the administrative cost would exceed the benefit.

#### B. Principal Results of the Review

FPI will use the cross-servicing program beginning by August 1998. FPI uses salary offset to collect debt from employees and uses tax refund offset to collect from employees who have retired or resigned from the government. An aging report is provided monthly and is maintained by each business office. Receivables are under general ledger control and records of receivables are reconciled to the general ledger accounts at least monthly. Receivables are reported on the Accounts Receivable Due from the Public report. A Corrective Action Plan has been developed to address the failure to assess interest, penalties, and administrative costs.

#### C. Exemptions Requested by FPI

None

#### D. FPI Milestones

Draft and issue instructions for assessing interest, penalties, and administrative costs to delinquent receivables due, including procedures for calculating amounts, notifying debtors, etc., and inform all financial officers of these requirements.

Completed  
April 1998

Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.

July 1998

Establish a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.

August 1998

Complete developing a centralized vendor master list where TINs can be stored. FPI is in the process of creating and maintaining a centralized vendor master list where TINs can be stored without inmates having access to the information.

August 1998

Develop written procedures for collecting and maintaining  
TINs of persons, including other than vendors, doing  
business with FPI in the central vendor master list.

August 1998



## Office of Justice Programs (OJP)

### A. Descriptions of Debt

1. **Grants.** The OJP provides grants to scholars, practitioners, and State and local governments for research and technical assistance in carrying out the function of making the Nation's justice system more efficient and effective in preventing and controlling crime. Debt arises when a grantee submits a request, and receives payment, for a cost that is later disallowed. OJP, as financial services provider to the Community Oriented Policing Services, will be servicing grant related debt of that organization.
2. **Refund Receivable.** Refund receivables arise from vendor overpayments and duplicate payments.
3. **Employee Debt.** Debts owed by current employees.

### B. Principal Results of the Review

OJP will use the cross-servicing and administrative offset programs to collect delinquent debt which may arise. OJP advises that an audit tracking system is in place which tracks grant audit cost findings to resolution. If, during audit resolution, a cost is disallowed and the final finding is that the grantee owes monies to OJP, repayment is immediate (normally offset against a current grant). If an audit finding involves repayment in installments, OJP has a mechanism in place to record the debt as a receivable. As of the date of its report, OJP had no debt in that status. OJP reports virtually no debt from overpayments and refunds. The OJP Audited Financial Statement for FY 1996 did not advise of any reportable weakness in receivables.

### C. OJP Exemptions Requested

OJP did not request any exemptions from administrative offset.

**D. OJP Milestones**

Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.

July 1998

Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.

August 1998

## U.S. Marshals Service (USMS)

*The USMS did not provide a written response as requested. The information presented on the USMS was gathered during telephone conversations and was confirmed by the Chief, Office of Finance, USMS.*

### A. Descriptions of Debt

No description of debt was provided by the USMS.

### B. Principal Results of the Review

The USMS advised verbally that most of the provisions of the DCIA are not applicable, that the only delinquent debts are travel advances, and there is no material debt delinquent more than 180 days. The USMS did not provide details on its debt.

### C. USMS Exemptions Requested

No exemptions were requested.

### D. USMS Milestones

Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.

Completed  
March 1998

Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.

July 1998

Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.

August 1998

## Antitrust Division (ATR)

### A. Description of Debt

The Antitrust Division assesses civil penalties and damages, and criminal fines. Since it currently collects and reports only civil penalties and damages, only information on these debts is provided in this report. Criminal fines are referred to the appropriate U.S. Attorney for collection.

1. **Notification of Acquisition Penalties.** Penalties assessed for failure to file notice of acquisition to enable the Federal Trade Commission and the Department of Justice to: (1) determine if the acquisition may violate antitrust laws and (2) prescribe rules and other action relative to the acquisition. These penalties are also assessed for failure to abide by the prescribed waiting period for acquisition after filing such notice.
  - a. **Average amount per debt.** Not available. The amount of each debt ranges from \$10,000 to \$5,000,000.
  - b. **Percent of all component debt.** Both Notification of Acquisition Penalties and Civil Penalties Assessed in Criminal Cases (described in 2 below) are 100% of the program debt collected by ATR.
  - c. **Percent of debt owed by another Federal agency.** 0%
  - d. **Percent of debt owed by state and local governments.** 0%
  - e. **Description of law enforcement relationship with state and local government.** Not applicable.
  - f. **Advisability of sale of debt.** Not applicable.
2. **Civil Penalties Assessed in a Criminal Case.** Civil damages assessed relating to violation of criminal law.
  - a. **Average amount per debt.** Not available. Damages assessed vary.
  - b. **Percent of all component debt.** Both Notification of Acquisition Penalties (described in 1 above) and Civil Penalties Assessed in Criminal Cases are 100% of the program debt collected by ATR.

- c. Percent of debt owed by another Federal agency. 0%
- d. Percent of debt owed by state and local governments. 0%
- e. Description of law enforcement relationship with state and local government.  
Not applicable.
- f. Advisability of sale of debt. Not applicable.

#### B. Principal Results of the Review

The Antitrust Division will use cross-servicing as required to collect delinquent debt and to access the administrative offset program. The ATR essentially has no delinquent debt because payments are usually made immediately. The ATR's program receivables are not recorded in the general ledger or reported on the Report on Receivables Due From the Public. The Finance Staff has established milestones to correct these deficiencies.

#### C. Exemptions Requested by the Antitrust Division

No exemptions were requested.

#### D. Antitrust Division Milestones

Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.

July 1998

Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.

August 1998

**E. Finance Staff, JMD, Milestones**

Record Notification of Acquisition Penalties and Civil Penalties Assessed in Criminal Cases in the general ledger and report these debts on the Report on Receivables Due from the Public. While these debts are deposited to miscellaneous receipts, they should be reported as a nonentity asset.

October 1998

## Civil Division (CIV)

### A. Descriptions of Debt

**Debts Referred by Federal Agencies.** Debts that CIV litigates on behalf of referring Federal agencies include claims in which the Federal agency is a party, defaulted loans and other debts from creditor Federal agencies, civil and criminal penalties imposed in regulatory cases, and disputes over tariff assessments. Since these are not debts of the Department, CIV is not responsible for many of the usual debt collection activities such as referring debts to collection agencies, selling debt, referring debt to Treasury for cross-servicing, and writing off debts.

### B. Principal Results of the Review

CIV will refer delinquent debts to the Treasury for administrative offset through Debt Collection Management, JMD. IRS Tax Refund Offset is utilized. Monthly reports are issued to management on the status of the ten largest debts. CIV will report delinquent debt to credit bureaus as a service to the referring Federal agencies.

### C. Civil Division Exemptions Requested

No exemptions were requested.

### D. Civil Division Milestones

Refer debts through Debt Collection Management (DCM), JMD, to the Department of Treasury for administrative offset.	July 1998
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Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.	July 1998
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Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.	July 1998
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Provide reports and updates to credit bureaus on debt that is delinquent.

July 1998



## Civil Rights Division (CRT)

### A. Descriptions of Debt

**Civil Monetary Penalties and Discrimination Cases.** These are penalties that are collected by the Division's Housing and Civil Enforcement, Disability Rights, and Office of Special Counsel for Unfair Employment Practices program areas. The vast majority of collections in the CRT are for judgments to be paid directly to aggrieved parties. The majority of civil penalties are for fines assessed for violations of laws governing fair housing, mortgage lending, insurance redlining, the American with Disabilities Act, and the Immigration Reform and Control Act. The volume of the delinquencies for these debts is small. As of the date of CRT's report, one civil monetary penalty was delinquent. In the last eight years, the Division has experienced only one case where the civil penalty was not paid. After exhausting in-house efforts, this debt was referred out for collection to the U.S. Attorneys office. As of the date of CRT's report, all of the pending civil penalty judgments relate to cases which were on appeal and there was no delinquent debt owed.

### B. Principal Results of the Review

Delinquent Civil Monetary Penalties and Discrimination Cases are referred to Treasury for administrative offset by Debt Collection Management, JMD, and are sent to the U.S. Attorneys for enforcement. These debts are not recorded in the accounting system's general ledger and are not reported in the Report on Receivables Due from the Public. A milestone has been established by the Finance Staff to correct this deficiency.

### C. Exemptions Requested

No exemptions were requested.

### D. Civil Rights Division Milestones

Develop a procedure to provide disclosures to persons required to furnish a TIN or intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.

August 1998

**E. Finance Staff, JMD, Milestones**

Record Civil Monetary Penalties and Discrimination  
Cases in the general ledger and report these debts on  
the Report on Receivables Due from the Public.

October 1998

## Criminal Division (CRM)

### A. Descriptions of Debt

1. **Fines Assessed by the Court.** Fines assessed by the court in cases won by CRM. The CRM has no collection and reporting responsibility for these debts. The record keeping for these debts is maintained by the Administrative Office of the U.S. Courts. Litigation, when necessary, is undertaken by the U.S. Attorneys to enforce the court's judgment.
2. **Foreign Agent Registration Act Fees.** Agents of foreign principals are required to register with the Department. Registrants, foreign principals, and the general public are also charged for information searches. Registration does not occur if the required fee is not paid in full or if the check does not clear. As a result, no debts arise under this program.
3. **Gambling Device Registration Fees.** Registration fees paid before a gambling device enters the interstate or foreign commerce. Registration does not occur if there is no payment or the check does not clear. As a result, no debts arise under this program.

### B. Principal Results of the Review

The CRM will not be using the cross-servicing or administrative offset programs because the Division has no responsibility for collecting or recording debt.

### C. Exemptions Requested

The Division did not request any exemptions.

### D. Criminal Division Milestones

Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.

Completed  
April 1998

## Offices, Boards & Divisions (OBD)

### Administrative Debt Collection Activity (Non-administrative debt collection activity is reported under the OBDs responsible for the debt program)

#### A. Descriptions of Debt

**Refunds Receivable.** Refunds receivable represents amounts due from other than Federal entities for payments made in error, overpayments, return of merchandise, employee debt, etc., and which are recorded as a reduction of expenditures.

- a. **Average amount per debt.** \$900
- b. **Percent of all component debt.** 100%
- c. **Percent of debt owed by another Federal Agency.** 60%
- d. **Percent of debt owed by state and local governments.** 0%
- e. **Description of law enforcement relationship with state and local government.**  
Not applicable.
- f. **Advisability of sale of debt.** Not advisable because of the very low amount and volume.

#### B. Principal Results of the Review

Delinquent debt will be referred for cross-servicing. Salary offset is utilized for employee debt after due process is given. An accounts receivable aging report is not prepared.

**C. OBD Exemptions Requested**

The Environment & Natural Resources Division requested that payments for contribution claims by private parties against Federal agencies under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) be exempt from administrative offset.

**D. Finance Staff, JMD, Milestones**

Implement policies and procedures to obtain TINs from all persons and entities doing business with the OBDs.	August 1998
Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.	August 1998
Develop a procedure requiring TINs be reported on payment vouchers submitted for payment.	August 1998
Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.	August 1998
Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.	September 1998
Establish procedures to record receivables to the general ledger and perform quarterly reconciliations of receivables to the general ledger.	September 1998
Prepare an accounts receivable aging report on a monthly basis using the following categories: 1-30, 31-60, 61-90, 91-180, 181-365 days, 1-2 years, 2-6 years, 6-10 years and over 10 years.	December 1998

## U.S. Attorneys (USAs)

### A. Descriptions of Debt

**Debts Referred by Federal Agencies.** The USAs are responsible for litigation to collect both criminal and civil debts referred to the Department by other Federal agencies. Since these are not debts of the Department, the USAs are not responsible for many of the usual debt collection activities of a creditor organization such as: referring debts to collection agencies, selling debt, referring debt to the Treasury for cross-servicing, and writing-off debt. If the debtor cannot be located, the debt has been paid, or the debt is uncollectible, the debt is returned to the referring agency for write-off or other appropriate action.

### B. Principal Results of the Review

Delinquent civil judgment debts are currently being submitted for administrative offset. Debts referred to the USAs for litigation are not eligible for cross-servicing. In some cases, debtors' wages and real and personal property are garnished and offsets are undertaken.

Due to the statutory transfer of the receipting function for criminal debts from the USAs to the U.S. Courts, the Administrative Office of the United States Courts (AOUSC) is responsible for processing and tracking payments on criminal debts. The USAs do not have the most current payment and balance information on these debts and, accordingly, cannot meet the certification and updating requirements for participation in administrative offset. As the official record keeper, AOUSC is the entity required to submit criminal debts for administrative offset. Justice is coordinating the transfer of the record keeping function to the AOUSC. The AOUSC has contracted for a requirements analysis for the management of criminal debt data at the district court level.

### C. USA Exemptions Requested

1. **Requests for Exemptions from Administrative Offset.** Exemptions from administrative offset were requested for the following types of payments:
  - a. Restitution payments made to victims of crime
  - b. Payments made under certified invoice procedures

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- c. Payments made to victims through the Office of Victims of Crime emergency assistance program.
  - d. Payments made to threatened witnesses under the Emergency Witness Assistance Program.
  - e. Payments made to employees for travel and other expenses incurred to perform their jobs.
  - f. Payments to expert witnesses for services provided in support of litigation.
2. **Request for Exemption from Submitting Debts for Administrative Offset.** A two-year exemption for criminal debts was requested due to a change in recordkeeping responsibilities from the USAs to the AOUSC.
  3. **Request for Exemption from TINs.** An exemption was requested from the requirement to identify TINs on payments for refunds to defendants.

*The Finance Staff, JMD, will review these requests to determine which ones should be included in the Department's request to Treasury for exemption from administrative offset.*

**D. USAs Milestones**

Submit the remainder of debt through DCM to Treasury for administrative offset on a routine basis.

Completed  
July 1997

Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.

July 1998

Update a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.

July 1998

## U.S. Trustees (UST)

### A. Descriptions of Debt

**Quarterly Fees.** The UST's debts are quarterly fees charged to those filing a petition under Chapter 11 of the Bankruptcy Code. The quarterly fees are based on disbursements from the date the petition is filed until the case is converted, dismissed, or closed by the court. The minimum fee is \$250 per quarter and the maximum fee is \$10,000 per quarter. The fees are estimated quarterly and adjusted to the actual amount when disbursement reports are received.

- a. **Average amount per debt.** A manual data base cleanup is underway. Until completed, this information is not available.
- b. **Percent of all component debt.** 100%
- c. **Percent of debt owed by another Federal agency.** 0%
- d. **Percent of debt owed by state and local governments.** 0%
- e. **Description of law enforcement relationship with state and local government.** Not applicable.
- f. **Advisability of sale of debt.** Not advisable because the chance of collecting these debts is very small. In many instances, the debtor entity no longer exists or the asset is nonexistent.

### B. Principal Results of the Review

The cross-servicing and administrative offset programs will be used by the USTs, where appropriate. Debts are not recorded to the general ledger and are not reported on the Receivables Due From the Public Report. Receivables are not aged; interest, penalties, and administrative costs are not charged to delinquent debt; and an allowance for uncollectible accounts is not established. In most cases, debts are not referred for litigation.



**C. U.S. Trustees Exemptions Requested**

The USTs considered requesting an exemption from administrative offset for payments to fact and expert witnesses. UST chose to offer this witness payment exemption as a suggestion rather than an exemption request.

**D. U.S. Trustees Milestones**

Review and correct the accounts in the accounts receivable data base.	Completed May 1998
Develop and implement policies and procedures to obtain TINs from all persons and entities doing business with the UST.	September 1998
Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.	September 1998
Develop and implement procedures to refer additional delinquent debt to the U.S. Attorneys for litigation. Only two regions have referred debt.	September 1998
Implement accounts receivable aging.	January 1999
Establish an allowance for uncollectible accounts.	January 1999
Transfer cases dismissed and closed by the Bankruptcy Court to Treasury for cross-servicing.	March 1999
Charge delinquent debtors interest, penalties, and administrative costs where required by law.	April 1999

**E. Barriers to Collection**

The United States Trustee Program (the Program) collects fees in a unique environment. It receives quarterly fees from chapter 11 debtors while they are under Bankruptcy Court protection. This limits the Program's ability to enforce collection of the fees. Chapter 11 quarterly fees, which constitute approximately sixty percent of the UST Program's annual funding, are set by statute and are based on quarterly disbursement levels of the debtor. Open chapter 11 bankruptcy cases are protected from collection efforts by an automatic stay. Since the fees accrue every quarter while the case is pending before the bankruptcy court, the total amount owed in a case is not determined until the case is closed or dismissed by the court. These effectively prohibit the Program from referring these debts for cross-servicing and administrative offset until the case has been finally adjudicated.

When quarterly fees become delinquent during the pendency of a case, the U.S. Trustee files a motion with the bankruptcy court requesting that the debtor be compelled to pay the fees owed or that the case be dismissed or converted to a chapter 7 liquidation for non-payment of fees. In some cases, the debtor will pay overdue fees to avoid dismissal or conversion. The Program also objects to bankruptcy court approval of a debtor's plan of reorganization if the quarterly fees are not paid in full. The success of such motions, however, varies from court to court and judicial district to judicial district. When the UST Program has encountered judicial resistance to quarterly fees, it has actively pursued its rights through appellate litigation.

**F. Additional Action Required by U.S. Trustees**

- The U.S. Trustees have been informed by the Internal Revenue Service that Form 1099-C procedures do not apply to bankruptcy cases and are waiting for written confirmation.

**G. Finance Staff, JMD, Milestones**

Record the quarterly fee receivables in the general ledger.	October 1998
Report the quarterly fee receivables on the Report on Receivables Due From the Public.	October 1998

#### IV. Department-Wide Plans for Implementing the DCIA and Other Debt Management Improvements

##### A. Milestones and Plans for Implementing Mandatory Provisions of the DCIA

###### 1. Cross-Servicing.

Bureau of Prisons	November 1998
Drug Enforcement Administration	August 1998
Federal Bureau of Investigation	August 1998
Federal Prison Industries	August 1998
Immigration and Naturalization Service	August 1998 (pilot program)
Office of Justice Programs	August 1998
United States Marshals Service	August 1998
Antitrust Division	August 1998
Civil Division	Exempt (debts in litigation)
Civil Rights Division	Exempt (debts in litigation)
Criminal Division	No Debt Responsibility
Offices, Boards, and Divisions (Finance Staff) - Administrative Debt	September 1998
United States Attorneys	Exempt (debts in litigation)
United States Trustees	March 1999

###### 2. Administrative Offset.

Bureau of Prisons	Through Cross-Servicing
Drug Enforcement Administration	Through Cross-Servicing
Federal Bureau of Investigation	Through Cross-Servicing
Federal Prison Industries	Through Cross-Servicing
Immigration and Naturalization Service	Through Cross-Servicing
Office of Justice Programs	Through Cross-Servicing
United States Marshals Service	Through Cross-Servicing
Antitrust Division	Through Cross-Servicing
Civil Division	July 1998
Civil Rights Division	January 1998
Criminal Division	No Debt Responsibility
Offices, Boards, and Divisions - Administrative Debt	Through Cross-Servicing

United States Attorneys	July 1997
United States Trustees	Through Cross-Servicing

**3. Reporting to Credit Bureaus - Delinquent Debt.**

Bureau of Prisons	Through Cross-Servicing
Drug Enforcement Administration	Through Cross-Servicing
Federal Bureau of Investigation	Through Cross-Servicing
Federal Prison Industries	Through Cross-Servicing
Immigration and Naturalization Service	Through Cross-Servicing
Office of Justice Programs	Through Cross-Servicing
United States Marshals Service	Through Cross-Servicing
Antitrust Division	Through Cross-Servicing
Civil Division	July 1998
Civil Rights Division	Response Pending
Criminal Division	No Debt Responsibility
Offices, Boards, and Divisions -	
Administrative Debt	Through Cross-Servicing
United States Attorneys	Exempt (referring agencies responsible)
United States Trustees	Through Cross-Servicing

**4. Reporting Taxpayer Identification Numbers (TIN).****a. Obtain a TIN from each person doing business with a Federal agency.**

Bureau of Prisons	Procedures in Place
Drug Enforcement Administration	Procedures in Place
Federal Bureau of Investigation	Procedures in Place
Federal Prison Industries	August 1998
Immigration and Naturalization Service	July 1998
Office of Justice Programs	Procedures in Place
United States Marshals Service	Procedures in Place
Antitrust Division	Procedures in Place
Civil Division	Procedures in Place
Civil Rights Division	Procedures in Place
Criminal Division	Procedures in Place
Offices, Boards, and Divisions (Finance Staff) -	
Administrative Debt	August 1998
United States Attorneys	Procedures in Place
United States Trustees	September 1998

**b. Disclosure to a person required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government.**

Bureau of Prisons	July 1998
Drug Enforcement Administration	Procedures in Place
Federal Bureau of Investigation	Procedures in Place
Federal Prison Industries	Procedures in Place
Immigration and Naturalization Service	July 1998
Office of Justice Programs	Procedures in Place
United States Marshals Service	Procedures in Place
Antitrust Division	July 1998
Civil Division	July 1998
Civil Rights Division	August 1998
Criminal Division	Procedures in Place
Offices, Boards, and Divisions (Finance Staff) - Administrative Debt	August 1998
United States Attorneys	July 1998
United States Trustees	September 1998

**c. Inclusion of TINs on vouchers submitted to disbursing officers.**

Bureau of Prisons	Procedures in Place
Drug Enforcement Administration	Procedures in Place
Federal Bureau of Investigation	Procedures in Place
Federal Prison Industries	August 1998
Immigration and Naturalization Service	Procedures in Place
Office of Justice Programs	Procedures in Place
United States Marshals Service	Procedures in Place
Antitrust Division	Procedures in Place
Civil Division	Procedures in Place
Civil Rights Division	Procedures in Place
Criminal Division	Procedures in Place
Offices, Boards, and Divisions (Finance Staff) - Administrative Debt	August 1998
United States Attorneys	Procedures in Place
United States Trustees	Procedures in Place

**5. Administrative Offset by Agency Disbursing Officers.**

Since the data base will be maintained by Treasury, instructions from Treasury are required to access the data base before this provision can be fully implemented.

**6. Centralized Salary Offset.**

Treasury has published 31 CFR Part 285, Salary Offset; Interim Rule, that establishes procedures for the offset of Federal salary payments through the Treasury Offset Program. Treasury has requested the National Finance Center (NFC), which processes all Department salary payments except for the FBI, to participate in the centralized salary offset program. NFC will withhold a portion of salary payments when notified by Treasury of any matches with a delinquent Federal debt in Treasury's file. The FBI is waiting for instructions from Treasury before being able to participate in this program.

**7. Barring Federal Assistance to Debtors.**

Not applicable to the Department since the Department does not have these programs.

**8. Internal Revenue Service (IRS) Offset.**

Full merger of the Tax Refund Offset Program with the Treasury Offset Program is being delayed. Debt Collection Management, JMD, is advising components on interim procedures for the Tax Refund Offset Program.

**9. Sale of Debt - After Terminating Collection Action.**

Before this provision can be implemented, guidance is required from Treasury on sales that are in the best interests of the United States.

**10. Electronic Funds Transfers (EFT).**

By January 2, 1999, all Federal payments, except tax refunds paid by the Internal Revenue Service, must be by EFT. Treasury issued 31 CFR Part 208, Management of Federal Agency Disbursements, Proposed Rule, which outlines EFT requirements and provisions for waivers. The components addressed the criteria, developed milestones for compliance, and have plans in place to implement EFT.

**11. Civil Monetary Penalties.**

The process of adjusting for inflation the Civil Monetary Penalties assessed or enforced by the Justice Department has been delayed due to additional coordination and consultation between Justice Department components, and between the Department and the Office of Government Ethics. The Office of Policy Development (OPD) anticipates publishing by August 1998, the Final Rule adjusting for inflation the Department's penalties other than those immigration-related penalties within the jurisdiction of the Executive Office for Immigration Review (EOIR). This Final Rule will include revisions to the proposed rule relating to penalties under the jurisdiction of the ATR, CIV, CRT, USA, and INS. EOIR submitted to the Office of Legal Counsel in April 1998 a draft rule amending its Office of the Chief Administrative Hearing Officer regulations, a portion of which will also adjust the immigration-related civil penalties within EOIR's jurisdiction.

**12. Code of Federal Regulations (CFR).**

Revise 28 CFR, Part 11-Debt Collection.

Joint draft prepared by Finance  
Staff and Debt Collection Management,  
JMD, for concurrence and signature.

August 1998

Publication in the CFR.

September 1998

**13. Compromise of Debt.**

Included in 31 CFR Chapter IX and Parts 900,  
901, 902, 903, and 904, Federal Claims  
Collection Standards; Proposed Rule.

Issued  
December 1997

**B. Plans for Implementing Optional Provisions of the DCIA****1. Garnishments.**

Treasury has published 31 CFR Part 285, Administrative Wage Garnishment; Final Rule, implementing the administrative wage garnishment provisions contained in the DCIA. This rule establishes the procedures for Federal agencies to administratively

garnish up to 15% of the disposable pay of a debtor to satisfy a delinquent nontax debt owed to the United States. This rule was effective June 5, 1998.

**2. Obtaining Consumer Credit Reports.**

The application of this debt management tool was evaluated by each of the components. Only the U.S. Attorneys indicated they use this tool. All other components indicated that they are not likely to use this authority because they will not benefit from the credit evaluations.

**3. Contracts to Locate and Recover Financial Assets.**

The components evaluated this provision and only the Civil Division and U.S. Attorneys indicated that they would use these contracts when they believed financial assets were available.

**4. Publishing Identity of Delinquent Debtors.**

Pending issuance of regulations by Treasury.

**5. Reporting to Credit Bureaus - Non-Delinquent Debt.**

The application of this debt management tool was evaluated by each of the components. Non-delinquent debt will not be reported to the credit bureaus as a normal course of business.

**6. Sale of Debt - General.**

The provisions of the DCIA that authorize sales of debts are specifically directed to "loans, notes and guarantees, and other collateralized debts." Section 31001 (p)(4)(A). Justice has no debts that meet these criteria, and the Office of Management and Budget has been notified that the Department will not be submitting reports on the availability of property for such sales.

**7. Charging Cost of Living Adjustments.**

The benefit of applying cost of living adjustments in lieu of assessing late payment charges was evaluated by the components. Except for INS, this provision will not be used because the components charge interest, penalties, and administrative costs. INS will apply cost of living adjustments on administrative fines imposed for violations of the Immigration and Nationality Act.



**8. Treasury Processing of Form 1099-C.**

DEA was the only component to advise that Form 1099-Cs would be processed by Treasury.

**9. Debt Collection Improvement Account.**

The Department will not participate in gainsharing.

**10. Extension and Expansion of Private Counsel.**

The DCIA provides the Attorney General with permanent authority and greater flexibility to use the Department's Private Counsel Program. Currently, there are twelve U.S. Attorneys' Offices (USAO) participating in this program. The program is expected to be expanded during FY 98 when a new automated system is installed that will enable expansion.

Private counsel handle secured debt cases (foreclosures) in six districts, unsecured debt cases (debt collection cases) in five districts, and both foreclosures and debt collection cases in the remaining district. Five of the six districts where foreclosure cases are handled by private counsel will expand their use of the program to include debt collection cases. The sixth district that uses private counsel for foreclosure cases will renew use of private counsel for debt collection cases when concerns of the Judiciary and USAO are successfully addressed. The five districts that handle unsecured debts are in nonjudicial foreclosure jurisdictions where private counsel is not needed for foreclosure litigation.

Any district will be considered for the foreclosure litigation program if statistics and contacts indicate it will receive at least 40 foreclosure referrals a year. Any district will be considered for the debt collection litigation program if at least 200 debt collection cases were referred to the USAO in the current or preceding year and this level of referrals is likely to continue.

**C. Other Plans Related to Implementation of the DCIA**

Request waivers from administrative offset of certain types of payments and from cross-servicing for certain types of debt.

July 1998

**D. Other Plans Related to Debt Management Improvements**

## 1. DOJ Orders.

Develop plans for revising and issuing DOJ  
Orders on debt (These plans to be coordinated  
with the revision of the CFR, described in A12). September 1998

## 2. Component Corrective Action in Debt Management and Debt Accounting.

## a. Develop procedures and begin charging interest, penalties, and administrative costs on all delinquent debtors.

Bureau of Prisons	October 1998
Federal Bureau of Investigation	Completed
	February 1998
Federal Prison Industries	Completed
	April 1998
United States Trustees	April 1999

## b. Establish and maintain an allowance for doubtful accounts in the general ledger.

Bureau of Prisons	October 1998
United States Trustees	January 1999

## c. Issue monthly aging reports on debts on a 1-30, 31-60, 61-90, 91-180, 181-365 days, 1-2, 2-6, 6-10, and over 10 years format.

Offices, Boards, and Divisions (Finance Staff) - Administrative Debt	December 1998
United States Trustees	January 1999

## d. Record all receivables under general ledger control.

Immigration and Naturalization Service (Interest on airline user fees)	July 1998
Offices, Boards, and Divisions (Finance Staff) - Administrative Debt (Refunds receivable)	September 1998
Finance Staff (Penalties assessed for failure to provide proper notification of acquisition and	October 1998

civil penalties assessed in criminal cases in Antitrust proceedings; civil monetary penalties and penalties assessed in discrimination cases in Civil Rights proceedings; and quarterly fees charged in Chapter 11 cases and payable to the U.S. Trustees)

e. Report debt on the Report on Receivables Due From the Public.

Finance Staff

October 1998

(Penalties assessed for failure to provide proper notification of acquisition and civil penalties assessed in criminal cases in Antitrust proceedings; civil monetary penalties and penalties assessed in discrimination cases in Civil Rights proceedings; and quarterly fees charged in Chapter 11 cases and payable to the U.S. Trustees)

## V. Summary of Component Plans For Implementing the DCIA and Other Debt Management Improvements

### A. Immigration and Naturalization Service

- |   |                           |
|---|---------------------------|
| 1. Bring Employer Sanction Fines under general ledger control.  | Completed<br>October 1997 |
| 2. Implement policies and procedures to obtain TINs from all persons and entities doing business with INS.  | July 1998                 |
| 3. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. | July 1998                 |
| 4. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.   | July 1998                 |
| 5. Bring interest for late payment of airline user fees under general ledger control.   | July 1998                 |
| 6. Establish a cross-servicing agreement with Treasury and refer, on a pilot basis, debts delinquent more than 180 days to Treasury for cross-servicing.  | August 1998               |
| 7. Refer all debts delinquent more than 180 days to Treasury for cross-servicing.   | September 1998            |

### B. Bureau of Prisons

- |   |           |
|---|-----------|
| 1. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. | July 1998 |
|---|-----------|

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- |   |               |
|---|---------------|
| 2. Charge delinquent debtors interest, penalties, and administrative costs where required by law.   | October 1998  |
| 3. Record allowance for bad debt in the general ledger.   | October 1998  |
| 4. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA. | October 1998  |
| 5. Establish a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.   | November 1998 |

**C. Drug Enforcement Administration**

- |  |                |
|--|----------------|
| 1. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.                      | July 1998      |
| 2. Establish a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.  | August 1998    |
| 3. Establish procedures for recording Civil Monetary Penalties (CMP) related to controlled substances in the general ledger and reporting the CMPs on the Report on Receivables Due From the Public. | August 1998    |
| 4. Update the application to collect TINs of all persons participating in the Diversion Control Program.   | September 1998 |

**D. Federal Bureau of Investigation**

- |   |                            |
|---|----------------------------|
| 1. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. | Completed<br>February 1998 |
|---|----------------------------|

Department-Wide Debt Management Review	June 1998
2. Develop procedures to charge interest, penalties, and administrative costs on all delinquent debts.	Completed February 1998
3. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.	July 1998
4. Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.	August 1998
<b>E. Federal Prison Industries</b>	
1. Draft and issue instructions for assessing interest, penalties, and administrative costs to delinquent receivables due, including procedures for calculating amounts, notifying debtors, etc., and inform all financial officers of these requirements.	Completed April 1998
2. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.	July 1998
3. Establish a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing.	August 1998
4. Complete developing a centralized vendor master list where TINs can be stored. FPI is in the process of creating and maintaining a centralized vendor master list where TINs can be stored without inmates having access to the information.	August 1998
5. Develop written procedures for collecting and maintaining TINs of persons, including other than vendors, doing business with FPI in the central vendor master list.	August 1998
Department of Justice	55

**F. Office of Justice Programs**

1. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA. July 1998
2. Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing. August 1998

**G. United States Marshals Service**

1. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. Completed March 1998
2. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA. July 1998
3. Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing. August 1998

**H. Antitrust Division**

1. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. July 1998
2. Develop a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing. August 1998

**Department-Wide Debt Management Review****June 1998****I. Civil Division**

1. Refer debts through Debt Collection Management, JMD, to the Department of Treasury for administrative offset. July 1998
2. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. July 1998
3. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA. July 1998
4. Provide reports and updates to credit bureaus on debt that is delinquent. July 1998

**J. Civil Rights Division**

1. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. August 1998

**K. Criminal Division**

1. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. Completed April 1998

**L. United States Attorneys**

1. Submit the remainder of debt through Debt Collection Management to Treasury for administrative offset on a routine basis. Completed July 1997



- |   |           |
|---|-----------|
| 2. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. | July 1998 |
| 3. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA.   | July 1998 |

**M. United States Trustees**

- |   |                |
|---|----------------|
| 1. Develop and implement policies and procedures to obtain TINs from all persons and entities doing business with the UST.  | September 1998 |
| 2. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. | September 1998 |
| 3. Develop a plan, with an estimated completion date, to consider referring additional delinquent debt to the U.S. Attorneys for litigation. Only two regions have referred debt.   | September 1998 |
| 4. Implement accounts receivable aging.   | January 1999   |
| 5. Establish an allowance for uncollectible accounts.   | January 1999   |
| 6. Transfer cases dismissed and closed by the Bankruptcy Court to Treasury for cross-servicing.   | March 1999     |
| 7. Charge delinquent debtors interest, penalties, and administrative costs where required by law.   | April 1999     |

**N. Offices, Boards, and Divisions - Administrative Debt**  
(Finance Staff, JMD, is responsible for corrective action)

1. Implement policies and procedures to obtain TINs from all persons and entities doing business with the OBDs. August 1998
2. Develop a procedure to provide disclosures to persons required to furnish a TIN of the intent to use the TIN for purposes of collection and reporting on any delinquent amounts arising out of such person's relationship with the Government. August 1998
3. Develop a procedure requiring TINs be reported on all payment vouchers submitted for payment. August 1998
4. Publish a system of records notice disclosing the possible uses of information maintained in the system for debt collection purposes, including uses authorized by the DCIA. August 1998
5. Establish a cross-servicing agreement with Treasury and refer debts delinquent more than 180 days to Treasury for cross-servicing. September 1998
6. Establish procedures to record receivables to the general ledger and perform quarterly reconciliations of receivables to the general ledger. September 1998
7. Prepare an accounts receivable aging report on a monthly basis using the following categories: 1-30, 31-60, 61-90, 91-180, 181-365 days, 1-2, 2-6, 6-10, and over 10 years. December 1998

**O. Finance Staff - Non-Administrative Debt**

1. Record the following in the general ledger. October 1998
  - a. Penalties assessed for failure to provide proper notification of acquisition and civil penalties assessed in criminal cases in Antitrust proceedings.

- b. Civil monetary penalties and penalties assessed in discrimination cases in Civil Rights proceedings.
- c. Quarterly fees charged in Chapter 11 cases and payable to the U.S. Trustees.

2. Report the following on the Report on Receivables Due From the Public:

October 1998

- a. Penalties assessed for failure to provide proper notification of acquisition and civil penalties assessed in criminal cases in Antitrust proceedings.
- b. Civil monetary penalties and penalties assessed in discrimination cases in Civil Rights proceedings.
- c. Quarterly fees charged in Chapter 11 cases and payable to the U.S. Trustees.

## **VI. Summary of Exemptions Requested from DCIA Provisions**

Various requests for exemptions from provisions of the DCIA were submitted by the components. The requests are summarized below by category .

### **A. Cross-Servicing**

The BOP requests an exemption for debts owed by state and local entities for costs of housing inmates to protect critical law enforcement relationships.

### **B. Administrative Offset**

1. The BOP requested an exemption for payments made on behalf of prisoners.
2. The FBI requested an exemption for payments for investigative expenses of a confidential nature, including, but not limited to, payments to cooperative witnesses and informants.
3. A request was made by the OBDs to exempt payments for contribution claims by private parties against Federal agencies under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).
4. The USAs submitted the following exemption requests:
  - a. Restitution payments to victims of crime.
  - b. Payments made under certified invoice procedures.
  - c. Payments to victims through the Office of Victims of Crime emergency assistance program.
  - d. Payments to threatened witnesses under the Emergency Witness Assistance Program.
  - e. Payments to employees for travel and other expenses incurred in performing their jobs.
  - f. Payments to expert witnesses for services provided in support of litigation.

**C. Taxpayer Identification Numbers (TIN)**

There currently is no provision for waivers from the TIN requirements. However, each agency is to develop a plan implementing the TIN requirement. The concerns raised by the components will be able to be addressed in developing the implementing plans.

1. The BOP requested a waiver for payments made on behalf of prisoners.
2. The FBI requested a waiver for payments to informants, which include cooperative witnesses, informant payments, etc.
3. The USAs requested a waiver for refunds to defendants.

Mr. COLGATE. We are in the process, Mr. Chairman, of implementing a new system so that we can significantly improve the management of the Government's debt and the ability to not only improve its management but its referral out to either private counsel or Assistant U.S. Attorneys to collect. I have been very pleased at the levels of debt referrals, in particular, in the Department of Education, we have received a significant increase in the number of student loan cases that have been turned over from the Department of Education to the Department of Justice for collection. That is really good news for the taxpayer, because to the extent that we can aggressively go after those using private counsel, in many instances, you can essentially return those loan balances to provide additional loans to new college students.

I will be more than glad to give you a list over the last 3 years of increases in our civil debt collection, and we can give it to you by client agency is my recollection. In summary, we are making some system improvements. I am pleased to see client agencies like Education increase their referrals to us. I think we have made important strides here, but there is more work to do.

Mr. HORN. Well, I am glad to hear that and any guidance you can give us on that, we will be holding extensive hearings on the debt collection in other agencies, and I am glad to hear that you see a real change with some of the Departments. We will be going over with the ranking Democrat as well as some on the majority that have not been able to get here because of markups and other things, some of the other questions that we might not have in the record, and we would be most grateful if both the Inspector General and the Assistant Attorney General would give us a reply, and we will put the question and the answers, at this point, in the record, without objection.

[The information referred to follows:]

# APPENDIX



## BUDGET OF THE UNITED STATES GOVERNMENT

*Fiscal Year 2000*

authority and will continue to be made available as set forth in the Memorandum of Understanding between the Federal Deposit Insurance Corporation and the Department of Justice, dated October 2, 1998, and may not be paid from amounts provided in this Act.

SEC. 114. Section 151 of the Foreign Relations Authorization Act, fiscal years 1990 and 1991 (5 U.S.C. 5928 note), is amended by inserting "or Federal Bureau of Investigation" after "Department of Justice".

SEC. 115. Section 122 of the Department of Justice Appropriations Act, 1998, is amended in subsection (a) by striking "3-year" and inserting "5-year" and in subsection (f) by striking "2000" and inserting "2002".

SEC. 116. (a) For fiscal year 2000, and thereafter, whenever the Federal Bureau of Investigation (FBI) participates in a cooperative project with a foreign country on a cost-sharing basis, any funds received by the FBI from that foreign country to meet that country's share of the project may be credited to any appropriation or appropriations available to the FBI for the purposes served by the project and shall remain available for expenditure until the close of the fiscal year next following the date of such receipt, as determined by the Director of the FBI.

(b) Funds credited pursuant to subsection (a) shall be available for the following:

(1) payments to contractors and other suppliers (including the FBI and other participants acting as suppliers) for necessary articles and services;

(2) payments for—

(A) one or more participants (other than the FBI) to share with the FBI the cost of research and development, testing, and evaluation, or joint production (including follow-on support) of articles or services;

(B) the FBI and another participant concurrently to produce in the United States and the country of such other participant an article or service jointly developed in a cooperative project; or

(C) the FBI to procure articles or services from another participant in the cooperative project.

SEC. 117. Notwithstanding 50 U.S.C. App. 1989b et seq. and in addition to any funds previously appropriated for this purpose, the Attorney General may make available from any funds available to the Department of Justice not more than \$3,000,000 for the purpose of paying restitution to individuals (1) who are eligible for restitution under the Civil Liberties Act of 1988 (50 U.S.C. App. 1989b et seq.) and who have filed timely claims for restitution, or (2) who are found eligible under the settlement agreement in the case of Carmen Mechiuki et al. v. United States (case No. 97-294C, United States Court of Federal Claims) and filed timely claims covered by the agreement.

SEC. 118. Section 507 of Title 28, United States Code, is amended by adding a new subsection (c) as follows:

"(c) Notwithstanding the provisions of Title 31, section 901, the Assistant Attorney General for Administration shall be the Chief Financial Officer of the Department of Justice."

SEC. 119. Funds made available in this or any other Act hereafter, for the United States Marshals Service may be used to acquire subsistence and medical care for persons in the custody of the United States Marshals Service at fair and reasonable prices. Without specific authorization from the Attorney General, the expenses incurred in the provision of such care shall not exceed the costs and expenses charged in the provision of similar health-care services paid pursuant to Medicare and Medicaid.

SEC. 120. Section 1404B of the Victims of Crime Act of 1984 (42 U.S.C. 10603b) is amended to read as follows:

#### "SEC. 1404B. COMPENSATION AND ASSISTANCE TO VICTIMS OF TERRORISM OR MASS VIOLENCE

"The Director may make supplemental grants, as provided in either section 1402(d)(4)(B) or 1404, to States for eligible crime victim compensation and assistance programs, and to units of local government, nonprofit organizations, instrumentalities of the Federal Government, and necessary for-profit organizations, to provide emergency relief including compensation, assistance, crisis response efforts, training, and technical assistance) for the benefit of—

"(1) victims of a terrorist act or mass violence occurring within the United States (as defined in section 2340 of title 18, United States Code); or

"(2) individuals—

"(A) who are—

"(i) United States citizens; or

"(ii) officers or employees of the Federal Government; and

"(B) who—

"(i) while outside of the United States (as defined in section 2340 of title 18, United States Code) are victims of a terrorist act or mass violence; and

"(ii) are not eligible for compensation under title VIII of the Omnibus Diplomatic Security and Antiterrorism Act of 1986."

SEC. 121. Section 286(d) of the Immigration and Nationality Act (8 U.S.C. 1356) is amended by striking "shall charge and collect \$6" and inserting "shall charge and collect \$8".

SEC. 122. Section 298 of the Immigration and Nationality Act (8 U.S.C. 1358) is amended by striking paragraph (c) and inserting in its place: "The Attorney General is authorized to charge and collect \$3 per individual for the immigration inspection or preinspection of each commercial vessel passenger whose journey originated in Mexico, Canada, the United States of America, a territory or possession of the United States, or any adjacent island: Provided, That this section shall not apply to immigration inspection at designated ports-of-entry of passengers arriving by Great Lakes international ferries or Great Lakes vessels on the Great Lakes and connecting waterways, when operating on a regular schedule."

SEC. 123. The Director of the Federal Bureau of Investigation is authorized to carry out a 3-year demonstration project showing the viability for the defensive arming of select non-agent personnel: Provided, That the Director may authorize to carry firearms without additional compensation not more than 50 non-agent investigative specialists assigned to Special Surveillance Groups that provide surveillance support to investigations of counterterrorism and counterintelligence activities: Provided further, That personnel designated under this authority shall meet selection criteria established by the Director and shall successfully complete training for firearms proficiency, defensive tactics, and deadly force policy prior to the issuance of firearms: Provided further, That personnel designated under this authority shall not be deemed law enforcement officers under Title 5, United States Code, for pay, retirement, or position classification purposes: Provided further, That the Director shall submit to the Committees on Appropriations, the Judiciary, and Intelligence of both the House and the Senate, no later than April 30, 2002, a report on the viability of the defensive arming demonstration project along with recommendations for permanent authority or discontinuance of the demonstration project. (Department of Justice Appropriations Act, 1998, as included in Public Law 105-277, section 101(b).)

<sup>1</sup>The Administration proposes to delete this provision and will work with the Congress to address this issue.



Mr. HORN. So, that is all I think we are going to do today on the Department of Justice. So, you are free to leave, but in answering the questions, you are still under the oath that you took to tell the truth and nothing but the truth. So, thank you very much for coming.

Mr. BROMWICH. Thank you, Mr. Chairman. I want to again express my appreciation for your being flexible in terms of the order of panels this afternoon.

Mr. HORN. Glad to try to be flexible.

OK, we are now ready on panel two, and that is the Federal Aviation Administration.

[Pause.]

Mr. HORN. All right, if the four witnesses and anybody who is their assistant who might be talking, I would just have you all stand and be sworn in at once.

[Witnesses sworn.]

Mr. HORN. All right, 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12—you almost equal the Pentagon—[laughter]—have affirmed to the oath, and they are free to talk into the record.

So, let us start just down the order on the agenda and the lineup we have in the first part of the panel. Ms. Linda Calbom is the Director, Resources Community and Economic Development Accounting and Financial Management from the General Accounting Office. Thank you for coming and being lead witness.

**STATEMENTS OF LINDA CALBOM, DIRECTOR, RCED ACCOUNTING AND FINANCIAL MANAGEMENT, GENERAL ACCOUNTING OFFICE; JOHN MECHE, DEPUTY ASSISTANT INSPECTOR GENERAL, FINANCIAL, ECONOMIC, AND INFORMATION TECHNOLOGY, DEPARTMENT OF TRANSPORTATION; DAVID KLEINBERG, DEPUTY CHIEF FINANCIAL OFFICER, DEPARTMENT OF TRANSPORTATION; AND CARL SCHELLENBERG, CHIEF FINANCIAL OFFICER, FEDERAL AVIATION ADMINISTRATION**

Ms. CALBOM. Thank you, Mr. Chairman. I am pleased to be here today to discuss financial management issues at the Federal Aviation Administration. As you know, in January 1999, GAO designated FAA financial management as a high-risk area because of serious and longstanding accounting and financial reporting weaknesses. These weaknesses render FAA vulnerable to waste, fraud, and abuse; undermine its ability to manage its operations, and limit the reliability of financial information provided to the Congress and taxpaying public.

Since 1994, the Department of Transportation's IG has undertaken audits of FAA's financial statements and has consistently been unable to determine whether the financial information is reliable. This pattern of negative financial results continues today with the IG's recent financial audit report, a disclaimer of opinion on FAA's fiscal year 1998 financial statements, and I know Mr. Meche will talk a little bit more about that.

Four fundamental problems must be resolved before FAA can achieve the most basic level of financial accountability. First, the agency must resolve the serious problems related to accounting for property, plant, and equipment, and institute systems, procedures,

and controls to ensure that accountability is maintained on an ongoing basis. Since 1994, the IG has consistently reported that these assets are being inappropriately expensed or otherwise unaccounted for, and current estimates are that the asset balance may be understated by as much as \$5 billion to \$10 billion.

During the audit of the fiscal year 1998 financial statements, the IG specifically identified \$1 billion of equipment that was not recorded on the books as well as numerous other errors and weaknesses in FAA's process for keeping track of property and equipment.

The second issue FAA must address is to complete its improvements to its inventory accounting system, particularly related to spare parts at thousands of field locations around the country. FAA does not currently have a reliable system in place to track and control these field spare parts on a continuous basis.

The agency's lack of accountability for property and equipment and inventory impairs its ability to efficiently and effectively manage operations that use these assets and expose the agency to waste, fraud, and abuse. For example, lack of physical controls over inventory and equipment could result in the costly, unnecessary acquisition of assets already on-hand, shortages of critical parts, delays in ordering needed assets or undetected theft or loss.

The third basic problem FAA must address is to implement a cost accounting system capable of reliably accumulating full project cost information. The lack of cost accounting information impairs FAA's ability to make effective decisions about resource needs; to adequately monitor and control major projects such as the \$42 billion air traffic control modernization project that you mentioned, Mr. Chairman, and to identify and avoid waste. The lack of cost accounting information also limits the ability of FAA management and other decisionmakers to develop a system of user fees based on the cost of services provided. And, finally, it limits the agency's ability to meaningfully evaluate performance measures in terms of efficiency and cost effectiveness.

And the fourth issue FAA must address is its other financial reporting weaknesses that preclude it from preparing meaningful financial statements. Audited financial statements, as you were mentioning as well, are designed to provide a public report of how taxpayer money provided to a given agency was spent and when linked to performance measures what the taxpayer got for their money. However, as evidenced by the numerous problems in preparing the basic financial statements that were reported by the IG, FAA lacks this fundamental level of accountability.

FAA's senior management has indicated that they recognize the urgency of addressing their financial management deficiencies, and they are working diligently toward correcting them. However, they are still far from financial accountability. Until the agency is able to correct its basic accounting deficiencies and produce a complete set of auditable financial statements, it will continue to be negligent in its duty to the taxpaying public to be a responsible steward for the billions of dollars it is provided annually to carry out its mission.

That concludes my statement, Mr. Chairman.

[The prepared statement of Ms. Calbom follows:]

**GAO**

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United States General Accounting Office

**Testimony**

Before the Subcommittee on Government Management,  
Information, and Technology, Committee on Government  
Reform, House of Representatives

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For Release on Delivery  
Expected at  
2:00 p.m.  
Thursday,  
March 18, 1999

**FEDERAL AVIATION  
ADMINISTRATION**

**Financial Management Issues**

Statement of Linda M. Calborn  
Director, Resources, Community, and Economic Development  
Accounting and Financial Management Issues  
Accounting and Information Management Division



Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss financial management issues at the Federal Aviation Administration (FAA). In January 1999, we designated FAA financial management as a high-risk area because of serious and long-standing accounting and financial reporting weaknesses. These weaknesses render FAA vulnerable to waste, fraud, and abuse; undermine its ability to manage operations; and limit the reliability of financial information provided to the Congress. Beginning with fiscal year 1994, the Department of Transportation's Office of the Inspector General (OIG) has audited FAA's financial statements and has consistently been unable to determine whether the financial information is reliable. This pattern of negative financial audit results continues today with the OIG's recent financial audit report—a disclaimer of opinion<sup>1</sup>—on FAA's fiscal year 1998 financial statements.<sup>2</sup> The OIG was unable to substantiate billions of dollars in major assets, or determine the accuracy of the reported \$9 billion of costs for FAA's programs.

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<sup>1</sup>A disclaimer of opinion means that the auditor is unable to form an opinion on the financial statements. A disclaimer results when a pervasive material uncertainty exists, or there is a significant restriction on the scope of the audit.

<sup>2</sup>Report on Fiscal Year 1998 Financial Statements, Federal Aviation Administration  
Department of Transportation Office of Inspector General, (FE-1999-070) dated March 8, 1999.

My testimony today will

- provide a brief history of FAA's financial management weaknesses;
- discuss the identified fundamental problems which FAA must resolve in order to achieve financial accountability; and
- highlight corrective measures the agency has under way.

#### HISTORY OF FINANCIAL MANAGEMENT WEAKNESSES

Beginning with fiscal year 1994, the first year that the OIG performed an audit of FAA's financial statements, significant problems with FAA's accounting for billions of dollars of inventory and property, plant, and equipment (PP&E) were disclosed, including the agency's failure to properly capitalize the costs of major assets. Because of the pervasive uncertainties surrounding these major assets, the OIG could not determine the reliability of the fiscal year 1994 financial statements and issued a disclaimer of opinion on those statements.<sup>3</sup> Similar results occurred for fiscal years 1995 through 1997.

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<sup>3</sup>The OIG report specifically disclaimed on the Statement of Financial Position and stated that its audit work was limited to that statement because the balances for inventory and PP&E could not be validated, and those balances materially impacted the other statements

Again in fiscal year 1998, the IG was unable to express an opinion on the reliability of FAA's financial statements, citing as a primary reason the inability to verify PP&E reported at a cost of \$11.9 billion. The OIG reported, as it had for fiscal year 1994, that PP&E was significantly understated due to FAA's improper expensing of capital assets. Additionally, the OIG reported other significant accounting and reporting issues related to the reliability of FAA's financial statements and the records that support those statements.

We have previously reported that problems in accounting for PP&E and inventory affect FAA's ability to efficiently and effectively manage programs that use these assets and expose the agency to waste, fraud, and abuse.<sup>4</sup> Recently, we reported that FAA needs to improve its accountability over its field spares inventory.<sup>5</sup>

Many problems in the PP&E and inventory accounts result from the lack of a reliable system for accumulating project cost accounting information. The lack of cost accounting information limits FAA's ability to make effective decisions about resource needs and adequately control major projects, such as its multibillion-dollar air traffic control (ATC)

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presented.

Financial Management: Federal Aviation Administration Lacked Accountability for Major Assets (GAO/AIMD-98-62, February 18, 1998).

Financial Management: Briefing on the Federal Aviation Administration's Inventory Accountability (GAO/AIMD-99-98R, March 3, 1998).

modernization program. This mission-critical capital investment program, aimed at modernizing FAA's aging ATC infrastructure, was begun in 1981 to combat the strain on the current ATC system, which has experienced sustained growth and aging equipment.

The modernization program currently consists of over 200 separate projects estimated to cost over \$42 billion through fiscal year 2004. It includes acquisition of new radar and automated data processing, navigation, and communications equipment, as well as new computer software, facilities, and support equipment. As these items are placed in service, FAA is required to capitalize them and report them as property and equipment assets in its financial statements. However, as the OIG reports have shown, FAA for years has erroneously expensed many of these investments to current operations, thereby losing track of the specific cost of individual assets and the accumulated cost of major projects.

#### FUNDAMENTAL PROBLEMS NEED RESOLUTION

Four fundamental problems must be resolved before FAA can achieve the most basic level of financial accountability.

- First, FAA must resolve the basic problems related to accounting for property, plant, and equipment, and institute systems, procedures, and controls to ensure that accountability is maintained on an ongoing basis.
- Second, FAA must complete its improvements to its inventory accounting system, particularly those related to field spares.
- Third, FAA must implement a cost accounting system capable of reliably accumulating full project cost information.
- And, finally, FAA must address its other financial reporting issues that preclude it from preparing meaningful financial statements.

I will now discuss each of these issues in a little more detail.

#### Property, Plant, and Equipment Accountability Is Deficient

During fiscal years 1982 through 1998, FAA spent approximately \$26 billion on capital improvement programs; however, as of September 30, 1998, the agency had reported less than \$12 billion in gross property, plant, and equipment asset costs—a difference of \$14 billion. Although some portion of the \$14 billion was undoubtedly properly charged to expense accounts, a significant portion was improperly expensed. Since fiscal year 1994,



the IG has consistently reported that assets are being inappropriately expensed or otherwise unaccounted for.<sup>6</sup> During the audit of the fiscal year 1998 financial statements, the OIG specifically identified \$1 billion in assets that were not recorded on the balance sheet. More recently the IG testified that the total understatement for all equipment "could be as much as \$10 billion."<sup>7</sup>

The OIG's audit report on the fiscal year 1998 financial statements identified numerous errors and weakness in FAA's process for keeping track of amounts related to PP&E. Specifically, the OIG found that:

- The reported \$2.1 billion in the "work- in- process" account, which is supposed to be used to accumulate the costs of projects under development, could not be substantiated because FAA did not have an effective process to accumulate and document these

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<sup>6</sup>Some of these capital improvement program costs relate to terminated or cancelled programs that should not currently be reported as assets. However, because the costs related to these programs were never fully captured, it is impossible to tell how much of the \$14 billion relates to terminated projects. Other costs relate to the acquisition of spare parts, which are reported in a different asset category--inventory--which totaled less than \$1 billion as of September 30, 1998. Further, some costs may be appropriate expenses because they are for services unrelated to property acquisition.

<sup>7</sup>This statement was made by the Honorable Kenneth M. Mead, Inspector General of the U.S. Department of Transportation before the Subcommittee on Transportation and related agencies, House Committee on Appropriations, on March 9, 1999 in his testimony Federal Aviation Administration: Financing and Cost Control.

costs, nor to eventually record them in the appropriate PP&E accounts. For example, FAA was unable to provide supporting documentation for 34 percent of the \$887 million in work-in-process items selected for testing, including a flight service station with recorded costs of \$1.2 million, of which FAA could only provide information for costs of \$123,000.

- The work-in-process account included an estimated \$1.3 billion that related to projects that had been completed for at least 6 months. These completed project costs should have been moved to the appropriate property and equipment accounts, with related depreciation expense being charged to operations. Unrecorded depreciation expense related to these projects amounted to at least \$62 million.
- Real property (land, buildings, and structures), reported at \$2.5 billion, included significant amounts of items that were not properly valued, or had no support for the values assigned. Additionally, a number of real property items were identified that were not recorded at all, while others that were recorded did not currently exist. For example, FAA was only able to provide supporting records for \$3.6 million of the \$20 million recorded for a power supply system installed in 1992. In another example, FAA's records included \$1 million for a building that had been demolished over 10 years ago.

- Personal property (equipment), reported at \$4.1 billion, was understated by at least \$1 billion due to FAA's long-standing practice of expensing rather than capitalizing material portions of major equipment systems. For example, voice switching control systems with an estimated cost of \$1.1 billion were recorded on the books at a total cost of \$234 million.

These deficiencies affect FAA's ability to properly manage these assets, thus giving rise to potential operational inefficiencies. For example, mission-critical equipment, such as radar and other air-traffic-control equipment, may be difficult to locate when needed, which could exacerbate an emergency situation. Also, asset theft could go undetected, and funds could be spent unnecessarily to acquire equipment that is already on hand. Problems in accounting for property and equipment also affect FAA's ability to properly maintain these assets, including estimating maintenance and deferred maintenance funding needs, and impair long-range planning for future facilities and equipment needs.

#### Inventory Accountability Has Improved But Uncertainties Remain

Problems similar to those just discussed for PP&E have also plagued FAA's inventory accounting, although the amounts involved have not been as significant. FAA inventory,

reported at almost \$820 million as of September 30, 1998, primarily consists of spare parts located at the FAA Logistics Center in Oklahoma City and at about 34,000 field locations (referred to as field spares).

The Logistics Center is the central warehouse for operating materials and supplies and uses an automated inventory system, which continuously updates the reported quantities on hand as parts are received and issued to the field.<sup>5</sup> Although some ongoing minor issues remain, the accounting for inventory quantities on hand at the Logistics Center has improved significantly over the last year, and as of September 30, 1998, inventory quantities were reasonably stated in the accounting records.<sup>6</sup>

However, the accuracy of FAA's accounting for field spares quantities remains uncertain. Field spares are mission-critical parts that support the National Airspace System and are maintained at locations near the facilities they support. As of September 30, 1998, the reported value of field spares inventory was \$338 million. Based on our analysis of the OIG's field spares inventory workpapers, we were unable to satisfy ourselves about the accuracy of reported field spares inventory quantities. In addition, FAA did not have a

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<sup>5</sup>This system, commonly referred to as a perpetual inventory system, updates inventory quantities at various points in time, depending on the situation at hand. Updates may be performed immediately, daily, or on some other periodic basis.

reliable system in place to track and control field spares on a continuous basis. In its review of fiscal year 1998 field spares inventory, the OIG tested data for 14 sites with a recorded value of \$14 million, and found numerous errors in inventory record keeping. For example:

- At one site, FAA had not recorded \$106,000 of communication equipment spares for newly commissioned systems.
- At another site, 11 items valued at over \$39,000 that support new systems were not included in the records, while 21 items valued at about \$67,000 could not be located.
- At a third site, numerous errors resulting from inaccurate or incomplete record keeping totaled \$380,000.

The lack of physical controls over field spares increases the risk that theft or loss could go undetected. Additionally, inaccurate information about field spares could result in shortages of critical parts or unnecessary ordering of parts already on hand. The latter situation may lead to excess or obsolete stock requiring storage, control, and other activities that consume operating resources.

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<sup>a</sup>Neither the OIG nor we validated the reported inventory values as of September 30, 1998.

Cost Accounting Implementation Delays Have Pervasive Effects

The inadequacy of FAA's cost accounting system has been identified by GAO,<sup>10</sup> the OIG, and others as a weakness that prevents the agency from having reliable and timely information about the full cost of program activities. The objective of a cost accounting system is to provide this information by accumulating basic financial cost data, such as contractor invoices and agency labor and overhead costs, and allocating these costs, by category, to the applicable program activities. Although FAA originally expected that a cost accounting system would be fully implemented by October 1, 1998, this objective was not met. It subsequently revised this goal to implementation of a partially operational system by December 31, 1998, and a fully operational system by March 31, 1999. FAA now projects partial implementation in June 1999 and full systems implementation by March 31, 2001.<sup>11</sup>

The lack of reliable and timely information about the costs of program activities limits the ability of FAA management and other decisionmakers to use past costs to help estimate

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<sup>10</sup> Air Traffic Control: Improved Cost Information Needed to Make Billion Dollar Modernization Investment Decisions (GAO/AIMD-97-20, January 22, 1997).

<sup>11</sup> Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Standards, (SFFAS No. 4), effective in fiscal year 1998, requires agencies to accumulate and report the full costs of their activities. FAA officials told us that the cost accounting system they are implementing goes well beyond the requirements of SFFAS No. 4 and that they believe they will be in compliance with SFFAS No. 4 for fiscal year 1999.

future costs in preparing and reviewing budgets, to control and reduce costs, and to identify and avoid waste. For example, without reliable cost information, FAA and other decisionmakers may not be able to effectively

- compare, during the budgeting process, expected costs with expected benefits, identify activities that add value, and make fully informed decisions about whether to expend resources for activities that are not cost effective;
- compare and identify the causes of cost changes over time;
- identify and reduce excess capacity costs (the cost to maintain a level of service that may not be needed), if any;
- choose among alternative actions such as whether to perform a project in-house or contract it out, to accept or reject a proposal, or to continue or eliminate a product or service; and
- compare costs of similar activities and find causes for cost differences, if any.

The lack of reliable cost information also limits the ability of FAA management and other decisionmakers to establish fees for services based on the cost of the services provided. The Federal Aviation Reauthorization Act of 1996 (Public Law 104-264) directed FAA to establish user fees not to exceed \$100 million for selected services, including aircraft

overflight, and to directly relate these fees to the costs of providing the service rendered. A recent federal court decision, which resulted in FAA refunding \$12 million in fees already collected, reemphasized that these fees must be based on cost.<sup>12</sup>

#### Reporting Weaknesses Undermine the Usefulness of Financial Statements

Audited financial statements are designed to provide a public report of how taxpayer money provided to a given agency was spent. This information can then be linked with performance measures such that taxpayers can be apprised of what they received for their money. Further linkage of this information to budgetary accounts could also provide some level of assurance over the amounts reported in the budget as actual expenditures, which are considered in determining budgeted amounts for future years. However, until basic accountability over the amounts reported in the financial statements is achieved, none of these benefits can be realized. FAA lacks this basic accountability.

In addition to the accounting and reporting weaknesses already discussed, the OIG's audit disclosed the following deficiencies in the fiscal year 1998 financial statements.

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<sup>12</sup> Asiana Airlines, et al., Petitioners v. Federal Aviation Administration and Barry Valentine,



- The Statement of Net Cost<sup>13</sup> could not be substantiated because it could not be determined if expenses were charged to appropriate accounts, whether total expenses charged to the accounts were accurately accumulated, and whether administrative overhead expenses were accurately included.
- Material items included in the Statement of Budgetary Resources,<sup>14</sup> including the \$7.2 billion reported unobligated balance, could not be substantiated.
- A difference of \$877 million between the Statement of Budgetary Resources and the Statement of Net Cost could not be explained.
- FAA's accounting system was not able to generate the required financial statements, and the agency made 349 adjustments to its accounting records, totaling \$51 billion, in the process of manually preparing the statements.

These conditions, which are indicative of the inability of FAA's systems to support financial management and to efficiently prepare reliable, auditable financial statements, along with the other significant record keeping deficiencies discussed above, mean that FAA faces significant challenges in order to meet its goal of a clean audit opinion for fiscal year 1999.

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Acting Administrator, 134 F. 39 393 (D.C. Cir. January 30, 1998).

<sup>13</sup>The Statement of Net Cost presents the cost of major lines of business, which are intended to relate to FAA's performance measures.

<sup>14</sup>The Statement of Budgetary Resources shows what budgetary resources were available to spend during the year, how much was spent, and how much remained obligated and

CORRECTIVE MEASURES ARE UNDER WAY

FAA senior management has indicated that they recognize the urgency of correcting their financial management deficiencies and have recently taken steps to address them, including the following.

- A comprehensive effort is being undertaken to identify all major PP&E assets and to develop accurate, supportable historical cost information for those assets.
- The agency is in the process of establishing a perpetual inventory system for its field spares and plans to conduct a 100 percent field spares physical inventory for fiscal year 1999.
- Efforts continue to develop a cost accounting system that is capable of accumulating the full cost of program activities on a timely basis. As previously discussed, FAA expects to have this system partially in place in June 1999 with a fully operational system expected to be in place in 2001.

While these actions are a step in the right direction, FAA is still far from achieving financial accountability. Until the agency is able to correct its basic accounting deficiencies and

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unobligated at year end.

produce a complete set of auditable financial statements, it will not fulfill its responsibility to the taxpaying public to be a responsible steward for the billions of dollars it is provided annually to carry out its mission.

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Mr. Chairman, this concludes my statement. I would be happy to answer any questions that you or the Members of the Subcommittee may have.

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Mr. HORN. Thank you very much. We will now move on to John L. Meche, the Deputy Assistant Inspector General for Financial, Economic, and Information Technology for the Department of Transportation. Welcome.

Mr. MECHE. Thank you. Good afternoon, Mr. Chairman. Thank you for inviting the Inspector General's Office to testify on FAA's financial management. In the interest of time, I will summarize my prepared statement. I will cover three topics: FAA's current financial status, actions to develop a cost accounting system, and challenges ahead for FAA.

Seven years ago, we began auditing the FAA financial statements. To be frank, the books and records at that time were in very poor shape. Since then, FAA has done lots of work; and made many improvements. Unfortunately, some issues identified years ago still haunt FAA. About 3 months ago, we briefed FAA on the results of our audit for fiscal year 1998. We informed FAA that it would not get a clean opinion this year, and that fiscal year 1999 was already in jeopardy. At that time, FAA decided it had to tackle these tough issues. FAA's toughest challenge is the property and equipment accounts which totaled about \$12 billion. Much of this is old stuff, and the records do not exist or cannot be easily found. FAA has put together a task force involving headquarters and its regional employees. We and GAO are working with FAA to find acceptable solutions, and, Mr. Chairman, it is working.

For example, FAA's voice switching control systems, installed in 23 locations, were on the books at \$234 million. By using budget information and national contracts, the FAA was able to document its true cost as \$1.1 billion. The difference becomes really important if FAA is to recoup its full cost from user fees.

Turning to cost accounting, FAA had set out to develop a system by October 1, 1998, but the project has not gone smoothly. FAA recently acknowledged it could not implement the cost accounting system by its milestone of March 31, 1999 and has revised the schedule. As of today, FAA plans to have a fully operational cost accounting system by the end of fiscal year 2001. The FAA needs cost accounting for management purposes, but it is vital to establishing user fees if and when they are authorized.

The FAA must address one other issue. The cost accounting system gets its source data from the Department's accounting system. During the past 7 years, including this year, we identified significant financial control deficiencies within the existing system. Without a clean audit opinion on its financial statements, the FAA cost accounting system, even if flawlessly designed, will not produce defensible cost-based data. The Department plans to replace the accounting system by June 2001.

The FAA and the rest of the Federal Government is moving to measuring performance as required by the Government Performance and Results Act. This will require financial systems that can link cost information to performance data, and provide information on cost effectiveness of FAA's major programs. Unfortunately, FAA's current financial systems do not produce the data it will need.

In conclusion, FAA is making an extraordinary effort to fix the books by the end of fiscal year 1999. But, Mr. Chairman, that is

not good enough. Unless FAA fixes the financial systems for the long term, FAA's books are likely to revert to their current inaccurate position.

FAA is facing difficult financial conditions. To control and monitor its costs, FAA needs basic financial tools, including a reliable cost accounting system and good financial data. It will take leadership, dedication, commitment, and very hard work to solve these financial issues. FAA now has the team in place and has the support of the Department's Chief Financial Officer. We in the IG's Office stand ready to assist the FAA Administrator and her Chief Financial Officer in any way we can to make this a success for FAA, DOT, and the Federal Government.

Mr. Chairman, that concludes my oral comments. I will be pleased to answer any questions.

[The prepared statement of Mr. Meche follows:]

**Before the Subcommittee on Government Management, Information, and  
Technology, House Committee on Government Reform**

**U.S. House of Representatives**

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For Release on Delivery  
expected at  
2:00 p.m. EST  
Thursday  
March 18, 1999  
Report Number: FE-1999-073

## **Financial Management at the Federal Aviation Administration**

**Statement of John L. Meche  
Deputy Assistant Inspector General for  
Financial, Economic, and Information Technology  
U.S. Department of Transportation**



Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify today concerning the Federal Aviation Administration (FAA) financial systems and its financial statements.

Ten days ago, we issued our audit report on FAA's Fiscal Year (FY) 1998 Financial Statements. The report is attached to this statement. We reported that we could not determine the reliability of significant portions of FAA's Financial Statements. Consequently, we could not express an opinion on the fair and reasonable presentation of FAA's Financial Statements. This is commonly called a disclaimer of opinion.

Our testimony today will address three areas related to FAA financial systems and statements:

- Current status of financial conditions,
- Actions to develop a cost accounting system, and
- Challenges ahead for FAA.

#### 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. In the Department of Transportation (DOT), the Office of Inspector General audits FAA's Financial Statements. During the past 7 years, we have issued 12 audit reports with over 100 recommendations to improve FAA's financial management and accounting practices.

FAA faces significant risks in funding all agency requirements since its operating costs are increasing. We recently testified that FAA is facing a funding shortfall in FY 1999, and improvements in financial management are needed to mitigate this shortfall. To control its cost, FAA will need basic financial tools, including a reliable cost accounting system and good financial data.

FAA 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, if and when they are implemented. Until recently, FAA has been slow to implement our recommendations and initiate corrective actions. Consequently, it has never received an unqualified ("clean") audit opinion.

With the announcement by the President of the goal to have an unqualified audit opinion on the Federal Government's Financial Statements for FY 1999, we have seen a dramatic change at FAA, and it is now operating with a sense of urgency. Within the past 3 months, FAA has obtained the commitment of its Administrator, and senior DOT and FAA officials to get the job done.

The primary material weakness preventing FAA from getting a clean audit opinion relates to its property and equipment accounts, which total about \$12 billion. This accounts for nearly half of FAA's assets. Much of this property was acquired years ago when the Federal Government was not overly concerned with accounting for its 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, many times only to come up short. We also have found specific instances where FAA's equipment account is significantly understated. For example, FAA's voice switching control systems, installed at 23 locations, were recorded at a total cost of \$234 million, instead of the true cost of \$1.1 billion.

Another material weakness pertains to the requirement that an agency's financial systems be the source of information used in preparing annual financial statements. FAA uses DOT's accounting system, but that system does not produce all the financial and budgetary information for preparing the FAA Financial Statements. Therefore, it becomes necessary for FAA to make billions of dollars of adjustments to amounts generated by the accounting system to present its financial condition. DOT and FAA recognize the accounting system does not meet today's needs. DOT is developing a replacement system that currently is planned to be fully operational by June 2001.

### **Cost Accounting**

The FAA Reauthorization Act of 1996 required FAA to implement a cost accounting system. The Act also established the National Civil Aviation Review Commission to provide advice on aviation operations. The Commission called for strong financial controls, including a reliable cost accounting system by October 1998, so that FAA could manage its resources in a businesslike manner, and allocate its cost correctly and fairly as the basis for a cost-based user fee system. FAA set out to develop a cost accounting system by October 1, 1998, but the development project did not go as smoothly as planned.

We reviewed the FAA cost accounting system during its first phase of development. On August 10, 1998, our report identified four areas, potentially involving billions of dollars, that FAA needed to address before its cost accounting system would accurately account for FAA's full cost of operations.



FAA had not established a systematic method to identify and reflect (1) the cost of accounting adjustments, (2) cost for all development projects, (3) cost incurred by other agencies for air traffic services, and (4) the correct labor cost charged to appropriate projects. FAA had not yet decided how to allocate its costs. We also found its implementation schedule was overly aggressive, contained conflicting tasks, and omitted responsibilities and resource needs. We recommended FAA revise its milestones.

In January 1999, FAA acknowledged its existing implementation schedule was unattainable. As of today, the current plan reflects a phased implementation of the cost accounting system, with the segment of Air Traffic Services supporting overflight user fees to be implemented by June 1999, the rest of Air Traffic Services by December 1999, and a fully operational system by the end of FY 2001. The current schedule could impact FAA's ability to realize the \$1.5 billion in user fees proposed in its FY 2000 budget.

### **Challenges Ahead**

FAA agrees it has material weaknesses affecting its accounting and financial information, and is working hard to correct them. To resolve its long-standing issues with property and equipment valuations, FAA has established a "task force" under the direct leadership of the Chief Financial Officer. To be successful for FY 1999, these accounts must be cleaned up, and supporting records found by September 30, 1999. This is an enormous task at this late stage. For example, in the next 6 months, FAA must document and transfer over \$1 billion of costs for 16,000 completed job orders. At the same time, FAA also must focus on long-term solutions.

The FAA cost accounting system being developed gets its source data from the Department's existing accounting system. Without a clean audit opinion on the FAA Financial Statements, the FAA cost accounting system, even if properly designed, will not produce cost-based data that are defensible. Realistic user fees cannot be established with inaccurate or unsupportable costs.

The FAA, as well as the rest of the Federal Government, is moving into a new era of measuring performance, as required by the Government Performance and Results Act. To accomplish this will require financial systems that can link cost information to performance measures, and provide information on the cost effectiveness of FAA's major programs. While this is a great idea, FAA's current financial systems do not produce the required data.

With the extraordinary effort that FAA is making, it is possible that these material weaknesses can be substantially corrected by the end of FY 1999. However, this

alone is not good enough. Unless the financial systems are fixed, FAA's accounts are likely to revert back to their current inaccurate position. Not only would this result in future disclaimed opinions, it also could prevent FAA from establishing and collecting defensible user fees.

### **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.

### **Current Status of Financial Condition**

Our audit opinion on FAA's FY 1998 Financial Statements was a disclaimer. Material issues which caused that opinion are discussed in the following paragraphs. FAA's primary problem relates to its property and equipment accounts. For FY 1998, we could not substantiate the acquisition value of property and equipment reported at about \$12 billion.

#### **Property, Plant, and Equipment**

This item represents nearly half of FAA assets. The major components include real property (land, buildings, and structures), personal property (equipment), and work-in-process.

**Real Property** - The FAA Real Property Records System includes property that is not valued correctly or whose stated value is not supported by verifiable documentation. We sampled 117 items with a recorded value of \$790 million and found:

- 41 items, recorded at \$419 million, were not properly valued,
- 34 items, recorded at \$141 million, could not be supported, and
- 4 items, valued at \$50 million, should be removed from property records.

For example, a power system installed in 1992 was reported at \$20 million. FAA was only able to provide contracts, purchase orders, payment records, and other support for \$3.6 million. In another example, a building demolished over 10 years ago was still on FAA's records at \$1 million.

**Personal Property** - FAA recognizes the reported \$4.1 billion acquisition value for its equipment is materially understated. This understatement is the result of years of expensing contract costs associated with bringing equipment into operational status, that should have been added (capitalized) to the asset value. We have preliminarily identified that the value for five of the most costly equipment systems, currently in operation, should be increased by over \$1 billion. Our current estimate is that FAA equipment should be valued at about \$10 billion. Unless FAA establishes supportable values for its substantial property investments, it will be unable to accurately compute annual operating costs associated with use of the property, and recoup its full cost through user fees.

**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 placed in service. When completed, the project costs should be transferred to the appropriate real or personal property accounts. Project costs are considered backlog if not removed from the work-in-process account within 6 months after project completion.

FAA has two major problems with work-in-process. FAA does not have reasonably available documentation to support the account balance, and has not transferred the costs out for completed projects.

We reviewed 185 projects from 7,345 active projects in the work-in-process account, and found 34 percent did not have transaction histories. Without transaction histories, recorded amounts cannot be traced to supporting documentation, such as invoices or contracts. For example, FAA spent

\$1.2 million on a flight service station during FY 1998. FAA could only provide transaction histories for costs of \$123,000, leaving \$1.1 million unsupported.

FAA estimates there was \$1.3 billion of completed projects in backlog as of September 30, 1998. For example, FAA completed construction of an air navigation facility in 1995 at a cost of \$746,000. As of December 31, 1998, the facility remained in the work-in-process account. This backlog not only results in the improper classification of amounts in the property accounts, but also results in an understatement of annual operating costs, associated with the use of property, on the Statement of Net Cost.

#### **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, Statement of Budgetary Resources, and Statement of Financing. The Statement of Net Cost should report the true cost to operate major government programs. FAA identified six major programs. The presentation of the Statement of Net Cost was a giant step towards development of cost accounting information that relates to operational data supporting performance measures. However, because of delays in implementation, FAA was unable to prepare the Statement of Net Cost for FY 1998 from its cost accounting system. Instead, FAA used a combination of analyses of FY 1998 expense transactions and manual distributions of administrative overhead expenses. Although operating costs were distributed among the six lines of business, the statement did not present operating costs for major programs and activities within each line of business.

The Statement of Net Cost included an accumulation of expenses for each line of business using an analysis of over one million expense transactions charged to about 9,000 cost centers by the FAA cost accounting system, which was still under development. Administrative overhead expenses were manually distributed to the six lines of business. After we questioned the basis for distribution of these costs, FAA manually re-distributed nearly \$1.3 billion, increasing costs for Air Traffic Services and reducing costs for the five other lines of business by \$647 million. Consequently, we did not determine if expense transactions were charged to correct cost centers, and whether total expenses charged to cost centers were accurately accumulated.

The Statement of Budgetary Resources shows the amount of resources provided and the status of those resources. We were unable to trace the amounts on the Statement of Budgetary Resources to FAA's accounting system because the accounting system does not have all general ledger accounts required by the

Department of Treasury. As a result, we were not able to substantiate material items, such as Unobligated Balance of \$7.2 billion. This amount represents total budget authority carried forward from prior years which had not been used. Supporting documentation for this could date back for years.

The Statement of Financing is a reconciliation of the budgetary information in the Statement of Budgetary Resources and the financial information in the Statement of Net Cost. There was an \$877 million unreconciled difference between the Statement of Budgetary Resources and the Statement of Net Cost.

The problems we encountered with the new statements point out the need for better accounting practices and for developing state-of-the-art financial systems.

### **Cost Accounting System**

The Federal Aviation Reauthorization Act of 1996 required FAA to establish a cost accounting system, and gave FAA the authority to collect user fees for flights that neither take off nor land in the United States, referred to as overflights. FAA immediately began development of its cost accounting system. Although the cost accounting system was not developed or implemented during FY 1997, FAA began collecting for overflight services. The airline industry challenged the user fee in court. On January 30, 1998, a Federal court ruled that (1) FAA's methodology for calculating overflight fees, which was developed independently from the cost accounting system, was not cost based, and (2) FAA's allocation of fixed and common costs, using a value-oriented methodology, violated the Act. The Federal court voided FAA's overflight fee schedule in its entirety. This action required FAA to accelerate the development and implementation of its cost accounting system.

We reviewed the FAA cost accounting system during its first phase of development. On August 10, 1998, our report identified four areas, potentially involving billions of dollars, that FAA needed to address before its cost accounting system would accurately account for FAA's full cost of operations. FAA had not established a systematic method to identify and reflect (1) the cost of accounting adjustments, (2) cost for all development projects, (3) cost incurred by other agencies for air traffic services, and (4) the correct labor cost charged to appropriate projects. FAA also had not decided how to allocate its costs.

FAA initially planned for its cost accounting system to be fully implemented by October 1, 1998. We found this schedule was overly aggressive, contained conflicting tasks, and omitted responsibilities and resource needs. During our audit, FAA revised its implementation plan into two stages; an initial operational

cost accounting system by December 31, 1998, and a fully operational system by March 31, 1999. We reported this timeframe was very ambitious and recommended FAA revise its milestones.

In January 1999, FAA acknowledged its existing implementation schedule was unattainable. The current plan reflects a phased implementation of the cost accounting system, with the segment of Air Traffic Services supporting overflight user fees to be implemented by June 1999, the rest of Air Traffic Services by December 1999, and a fully operational cost accounting system for the entire agency by the end of FY 2001.

While many decisions need to be made regarding the future funding of FAA, user fees may be a major source. FAA has proposed in its FY 2000 budget to collect \$1.5 billion in user fees, and proposes ultimately to be primarily funded by user fees. Regardless of funding sources, FAA needs an accurate and reliable cost accounting system for management information and performance measurement purposes.

### **Challenges Facing FAA**

To correct the material weaknesses, FAA must obtain support for the acquisition value of about \$12 billion of property and equipment. Since records are not centrally located, the retrieval of this information is a massive undertaking. For real property, FAA is using a model to support the value for over 700 older buildings and structures, and obtaining contracts, purchase orders, and invoices to support current costs. FAA is analyzing major system equipment costs to allocate these costs to individual assets in its personal property records. For work-in-progress, FAA is developing central files to document costs, and also is accelerating the transfer of over \$1 billion for 16,000 job orders associated with completed projects that are still in the work-in-process account.

FAA needs to develop alternative means to prepare its financial statements, until DOT's new accounting system and FAA's cost accounting system are completed. Consequently, FAA must look to short-term solutions for preparing its financial statements because the Department's new accounting system will not be operational until June 2001 and FAA's cost accounting system will not be fully implemented until the end of FY 2001.

Finally, as FAA 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, FAA must be able to link cost accounting 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.

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

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

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*Office of Inspector General*  
***Audit Report***

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*Fiscal Year 1998*  
*Financial Statements*

*Federal Aviation Administration*

*Report Number: FE-1999-070*  
*Date Issued: March 8, 1999*







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

## Memorandum

Subject: **INFORMATION:** Report on Fiscal Year 1998  
Financial Statements, Federal Aviation Administration  
FE-1999-070

Date: March 8, 1999

From: Kenneth M. Mead  
Inspector General *K.M. Mead*

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 Federal Aviation Administration (FAA) 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 FAA. Our audit was limited to the Financial Statements as of, and for the year ended, September 30, 1998.

Our efforts this year focused on actions taken on five previously reported material weaknesses that included real property (land, buildings, and structures), personal property (equipment), work-in-process, accounting for field spares, and inventory valuation. FAA also 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.

During FY 1998, FAA completed significant corrective actions on its inventory. FAA revised inventory prices from standard cost to weighted average cost and performed a "wall to wall" inventory of spare parts at over 800 field units. As a result, FAA improved the accountability and overall management of its spare part inventories located throughout the country. FAA is establishing a perpetual accounting system for the field spares to correct its control weaknesses.

Real property, personal property, and work-in-process, reported at \$11.9 billion, still could not be substantiated. We were unable to substantiate the acquisition cost of

real property reported at \$2.5 billion. For 117 real property items valued at \$790 million, we found 41 items recorded at \$419 million were not properly valued; 34 items recorded at \$141 million could not be supported; and 4 items valued at \$50 million should be removed from property records. For example, a critical power system installed in 1992 was reported at \$20 million. FAA was only able to provide contracts, purchase orders, payment records, and other support for \$3.6 million. We also identified a building that was demolished over 10 years ago was still on FAA's records at \$1 million.

A comparison of contracts for new equipment to personal property records showed FAA's equipment account was understated by at least \$1 billion. The understatement of these assets primarily resulted from improper expensing of capital costs. For example, the voice switching control systems installed at 23 locations were recorded at \$234 million, instead of the true cost of \$1.1 billion. Unless FAA establishes supportable values for its substantial property investments, it will be unable to accurately compute depreciation and recoup its full cost through user fees.

FAA was unable to provide supporting cost documentation to substantiate the \$2.1 billion recorded in the work-in-process account. 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 projects are completed and systems are placed in service. FAA estimates there was \$1.3 billion of completed projects in backlog as of September 30, 1998. For example, FAA completed construction of an air navigation facility in 1995 at a cost of \$746,000. As of December 31, 1998, the facility remained in the work-in-process account. This backlog causes an understatement of depreciation expenses.

We also reviewed 185 projects from 7,345 active projects in the work-in-process account, and found 34 percent did not have transaction histories. Without transaction histories, recorded amounts cannot be traced to supporting documentation, such as invoices or contracts. For example, FAA spent \$1.2 million on a flight service station during FY 1998. FAA could only provide transaction histories for costs of \$123,000, leaving \$1.1 million unsupported. As a result, we were unable to substantiate the accumulated costs for active projects.

FAA agrees property weaknesses exist, and initiated plans to correct these material weaknesses by September 30, 1999. We agree with FAA's corrective action plans, and we are closely monitoring resolution of the property issues.

We encountered problems with the new statements required for FY 1998. The presentation of the Statement of Net Cost by each FAA line of business was a giant step towards development of cost accounting information that would relate to

operational data supporting performance measures. However, the Statement of Net Cost could not be substantiated because of delays in implementation of the cost accounting system which led to the late completion of the statement. Since the system was in the development stage, we did not determine if expense transactions were charged to correct cost centers, whether total expenses charged to costs centers were accurately accumulated to the six lines of business, and whether administrative overhead expenses were accurately distributed.

We also could not substantiate material items on the Statement of Budgetary Resources and Statement of Changes in Net Position. The Statement of Financing showed an \$877 million unexplained difference between the Statement of Budgetary Resources and Statement of Net Cost.

Correction of these material weaknesses will improve FAA's accountability and financial credibility, and provide accurate financial data to support budget requests, management decisions, and user fees.

FAA also is required to include excise tax revenues (revenues) in its Financial Statements. However, the Department of Treasury (Treasury) has control over collecting and reporting of revenues for the Airport and Airway Trust Fund. Last year, we asked the General Accounting Office (GAO) to review Treasury procedures for estimating and certifying revenues. GAO found errors and internal control weaknesses related to reporting and certifying total government excise tax revenues, and estimated these revenues were potentially overstated by as much as \$571 million.

For FY 1998, we again asked GAO to review the Treasury's Office of Tax Analysis (OTA) estimating process and the Internal Revenue Service (IRS) quarterly certification process. GAO concluded internal control weaknesses still exist. Major weaknesses included IRS written procedures for certifying revenues and timely processing of tax returns. We again found significant variances between OTA estimates and IRS-certified revenues. For the five quarters ended June 1998, variances between estimated and actual revenues ranged from an understatement of \$598 million to an overstatement of \$276 million. This Treasury issue is totally outside the control of FAA and the Department of Transportation (DOT).

Because we could not determine the reliability of significant portions of the Financial Statements, we are unable to express, and we do not express, an opinion (commonly called a disclaimer of opinion) on the FAA Financial Statements as of, and for the year ended, September 30, 1998.

We identified three other significant issues. Although these issues are important, they would not necessarily prevent FAA from receiving an unqualified audit opinion.

- The National Civil Aviation Review Commission called for strong financial controls, including a reliable cost accounting system by October 1998, so that FAA could manage its resources in a businesslike manner, and allocate its cost correctly and fairly as the basis for a cost-based user fee system. FAA still lacks the detailed and reliable cost data to accurately distribute its cost. The FAA cost accounting system was scheduled to be operational by October 1, 1998, but will not be fully implemented until March 31, 2001. Consequently, FAA may not be able to realize the \$1.5 billion in user fees proposed in its FY 2000 budget.
- FAA was 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. FAA made 349 closing and adjusting entries, totaling \$51 billion, outside the accounting system to prepare the Financial Statements.
- The performance measures presented in the Management Discussion and Analysis did not provide information about the cost effectiveness of FAA programs, and did not relate to the information presented in the Statement of Net Cost. Only two of the nine performance measures included FY 1998 performance data.

Our report on the FY 1997 FAA Financial Statements disclosed efforts were in process to complete corrective action on 21 prior recommendations. We are not making new recommendations this year because efforts are still underway on 17 recommendations. Since problems with the new statements and trust fund revenues are common to FAA and other 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 FAA Assistant Administrator for Financial Services on February 24, 1999. We considered his comments in preparing this report. He agreed with the issues, and said FAA expects to have all corrective actions completed by September 30, 1999.

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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**DEPARTMENT OF TRANSPORTATION  
INSPECTOR GENERAL'S INDEPENDENT REPORT ON  
FEDERAL AVIATION ADMINISTRATION  
FISCAL YEAR 1998 FINANCIAL STATEMENTS**

To the Federal Aviation Administrator

The Department of Transportation (DOT), Office of Inspector General (OIG), audited the Federal Aviation Administration (FAA) Financial Statements as of, and for the year ended, September 30, 1998. We were unable to express an opinion on the Financial Statements because we could not substantiate the acquisition value for property, plant, and equipment reported at \$11.9 billion. The Statement of Net Cost could not be substantiated because of delays in the implementation of the cost accounting system which led to the late completion of the statement. We also could not substantiate material items on the Statement of Budgetary Resources and Statement of Changes in Net Position. The Statement of Financing showed there was an \$877 million unexplained difference between the Statement of Budgetary Resources and the Statement of Net Cost.

We also are reporting on internal accounting and administrative control systems, and compliance with laws and regulations, as applicable to the FAA 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) FAA has an adequate internal accounting and administrative control structure; (3) FAA has 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.

This report presents our disclaimer of opinion on the FAA Financial Statements as of, and for the year ended, September 30, 1998. The financial information 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. DISCLAIMER OF OPINION ON FINANCIAL STATEMENTS**

Property, plant, and equipment, reported at \$11.9 billion on the Balance Sheet, could not be substantiated. We were able to determine that personal property (equipment) is significantly understated. The Statement of Net Cost could not be substantiated because of delays in the implementation of the cost accounting system which led to the late completion of the statement. Consequently, we did not determine if expense transactions were charged to correct cost centers, whether total expenses charged to costs centers were accurately accumulated, and whether administrative overhead expenses were accurately distributed. The understatement of equipment, and the backlog in the work-in-process account, cause an understatement of depreciation expense on the Statement of Net Cost.

We also could not substantiate material items on the Statement of Budgetary Resources such as Unobligated Balance (\$7.2 billion), and Statement of Changes in Net Position such as Increase (Decrease) in Unexpended Appropriations (\$380 million). We again found significant variances between the Department of Treasury estimated and certified excise tax revenues for the Airport and Airway Trust Fund. The Statement of Financing showed there was an \$877 million unexplained difference between the Statement of Budgetary Resources and the Statement of Net Cost.

Because we could not determine the reliability of significant portions of the Financial Statements, we are unable to express, and we do not express, an opinion on the FAA Financial Statements as of, and for the year ended, September 30, 1998.

#### **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 would not necessarily disclose all material internal control weaknesses.

#### **MATERIAL WEAKNESSES**

The following sections describe material weaknesses we identified, and their effect on the Financial Statements and management of FAA 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.

#### **Accounting for Property, Plant, and Equipment**

##### **Real Property**

We were unable to substantiate the acquisition cost of real property (land, buildings, and structures) reported at \$2.5 billion. Improvements continue to be needed in the accuracy and reliability of real property records. The FAA Real Property Record System includes property that is not valued correctly or whose stated value is not supported. We also found unrecorded property during our site visits. As of April 30, 1998, real property records contained 11,132 property items, recorded at \$25,000 or greater. We sampled 117 items with a recorded value of \$790 million and found:

- 41 items, recorded at \$419 million, were not properly valued,
- 34 items, recorded at \$141 million, could not be supported, and
- 4 items, valued at \$50 million, should be removed from property records.

For example, a critical power system installed in 1992 was reported at \$20 million. FAA was only able to provide contracts, purchase orders, payment records, and other support for \$3.6 million. In another example, a building demolished over 10 years ago was still on FAA's records at \$1 million.

We also identified 52 items, owned by FAA, that were not recorded in the Real Property Record System. FAA could not provide documentation to support the value of these items.

##### **Personal Property**

FAA recognizes the reported \$4.1 billion acquisition value for its personal property (equipment) is materially understated as disclosed in Note 9 to its Financial Statements. The understatement of equipment is the result of years of expensing contract costs, associated with bringing equipment into operational status, that should have been added (capitalized) to the asset value. We have preliminarily identified that the value for five of the most costly equipment systems, currently in operation, needs to be increased by at least \$1 billion. For example, the voice switching control systems installed at 23 locations were recorded at a total cost of \$234 million, instead of the true cost of \$1.1 billion.



Unless FAA establishes supportable values for its substantial property investments, it will be unable to accurately compute depreciation and recoup its full cost through user fees. The exact amount of the undervaluation for the five systems, and other less expensive systems, is unknown at this time. As a result, personal property and its related accumulated depreciation are understated on the Balance Sheet, and depreciation expense is understated on the Statement of Net Cost.

#### **Work-in-Process**

FAA was unable to provide supporting cost documentation to substantiate the \$2.1 billion recorded in the work-in-process account. 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. Project costs are considered backlog if not removed from the work-in-process account within 6 months after project completion. FAA estimates there was \$1.3 billion in backlog as of September 30, 1998.

We statistically sampled 185 projects from 7,345 active work-in-process projects with accumulated costs estimated at \$887 million. We were unable to obtain transaction histories on 34 percent of the projects. Without transaction histories, recorded amounts cannot be traced to supporting documentation, such as invoices or contracts. For example, FAA spent \$1.2 million on a flight service station during FY 1998. FAA could only provide transaction histories for costs of \$123,000, leaving \$1.1 million unsupported. As a result, we were unable to substantiate the accumulated costs for active projects.

The remaining \$1.3 billion of accumulated project costs, determined by FAA as backlog, also could materially affect the Financial Statements. Depreciation of assets begins only when completed projects are transferred to the appropriate asset account (real or personal property). For example, FAA completed construction of an air navigation facility in 1995 at a cost of \$746,000. As of December 31, 1998, the facility remained in the work-in-process account. Consequently, the backlog in the work-in-process account causes an understatement of depreciation expenses on the Statement of Net Cost. For a sample of 251 backlog projects, we found unrecorded depreciation was at least \$62 million.

The Departmental Accounting and Financial Information System (DAFIS) does not provide detailed information and audit trails to trace transactions to source documents to support the work-in-process balance. Instead, FAA relies on a cost report that has two major deficiencies. The report captures costs which are

expensed, and therefore should not be recorded in the work-in-process account. The report also contains costs associated with completed work that should be recorded in the personal or real property accounts. In our report on the FY 1996 Financial Statements, we recommended the cost report be reconciled to summary account records, or a new database be created to support the work-in-process balance. FAA elected to reconcile the cost report to the work-in-process balance. Over the past 2 years, FAA has been unable to demonstrate that the cost report can be reconciled to the work-in-process balance. FAA has agreed to improve the work-in-process database.

#### **Capitalization Process**

FAA does not have an effective process for accumulating costs for acquiring property, and eventually recording these costs in the appropriate real and personal property accounts. This process is commonly referred to as the capitalization process. The most recent study of the capitalization process was conducted by an independent public accounting firm under contract to FAA. The study found FAA Regional Offices were not performing timely closeout of facilities and equipment projects, leaving projects open and accumulated costs in regional work-in-process accounts. The study included 89 recommendations. FAA has implemented some recommendations, but has no comprehensive plan in place to monitor corrective actions taken, to evaluate the impact on the capitalization process, or to evaluate other recommendations to automate this labor-intensive process. FAA has agreed to form a process improvement team to streamline capitalization procedures.

#### **Corrective Action Plans on Property**

Elimination of these material weaknesses in its property accounts is essential if FAA is to obtain an unqualified opinion on its FY 1999 Financial Statements. FAA agrees the material weaknesses exist, and has initiated corrective actions. Plans are developed to correct the real property, personal property, and work-in-process weaknesses by September 30, 1999. We agree with the corrective action plans, and we are closely monitoring the work to ensure resolution of issues with property, plant, and equipment.

#### **Cost Accounting Information**

The Statement of Net Cost is one of the new Financial Statements required by OMB Bulletin 97-01 for FY 1998. 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 programs, and should be linked to the programs featured in the Statement of Net Cost.

The Federal Aviation Reauthorization Act of 1996 required FAA to establish a cost accounting system. The FAA cost accounting system was to be fully operational by October 1, 1998. However, as of March 1, 1999, the FAA cost accounting system is not expected to be fully operational for all lines of business until March 31, 2001.

FAA decided to present the Statement of Net Cost by its six lines of business. This was a giant step towards development of cost accounting information that relates to operational data supporting performance measures. However, the Statement of Net Cost could not be substantiated because of delays in implementation of the cost accounting system which led to late completion of the statement.

DAFIS does not perform cost accounting, the Department's Financial Statements Module does not produce the Statement of Net Cost, and the FAA cost accounting system was not operational. Although operating costs were distributed among the six lines of business, the statement did not present operating cost for major programs and activities under each line of business. Therefore, the Statement of Net Cost did not relate to the performance measures presented in the Management Discussion and Analysis.

The Statement of Net Cost included an accumulation of expenses for each line of business using an analysis of over one million expense transactions charged to about 9,000 cost centers by the FAA cost accounting system, which was still under development. Consequently, we did not determine if expense transactions were charged to correct cost centers, and whether total expenses charged to cost centers were accurately accumulated to the six lines of business.

Administrative overhead expenses were manually distributed to the six lines of business. After we questioned the basis for distribution of these costs, FAA manually re-distributed nearly \$1.3 billion, increasing costs for Air Traffic Services and reducing costs for the five other lines of business by \$647 million. We did not determine if the administrative overhead expenses were accurately distributed to the lines of business because of the unavailability of the cost accounting system to test distribution of costs.

Using statistical sampling techniques, we estimated FAA overstated current year expenses for airport grants by \$146 million. This overstatement represented prior year grant expenses that were not presented to FAA for payment until FY 1998. For example, on May 20, 1998, the City and County of Denver requested reimbursement of expenses totaling \$30 million for the Denver International Airport, for January 1992 through December 1995. While these expenses were for prior periods, they were reported on the Statement of Net Cost as expenses of FY 1998. Since the statement is to show cost components for the current reporting period, these expenses were distorting costs for the Airports line of business. FAA was aware of this problem and made the correct adjustment. Unless FAA establishes a process to estimate and report grant expenses at yearend, the Statement of Net Cost will continue to misstate current costs for Airports.

As discussed earlier, FAA continues to have property accounting weaknesses that impact the Statement of Net Cost. The understatement of equipment, and the backlog in work-in-process, cause an understatement of depreciation expense on the Statement of Net Cost.

#### **Budgetary Accounting Information**

Three of the new statements for FY 1998 are dependent on budgetary accounting information. The Statement of Budgetary Resources provides information about how budgetary resources were made available, as well as their status at yearend. The Statement of Changes in Net Position reports the beginning net position, the items which caused net position to change, ending net position, and reports on appropriations used as a financing source. 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 reconciliation ensures there is a proper relationship between financial and budgetary accounts in the entity's financial management system.

FAA made the following disclosure in Footnote 24, Statement of Budgetary Resources Disclosures.

In an effort to accurately reflect the status of budgetary resources, FAA compiled data from the SF-132, Apportionment and Reapportionment Schedule, and the SF-133, Report on Budget Execution, to prepare the Statement of Budgetary Resources. Some of the budgetary account balances from the (DAFIS) general ledger were not accurate or were incomplete because the processes to record specific transactions were not available in the accounting system.

Consequently, the Department's accounting system was not the source of the budgetary accounting information reported in the Financial Statements.

We could not substantiate material items on the Statement of Budgetary Resources, such as Unobligated Balance (\$7.2 billion), and Statement of Changes in Net Position, such as Increase (Decrease) in Unexpended Appropriations (\$380 million). The Statement of Financing showed there was an \$877 million unexplained difference between the Statement of Budgetary Resources and the Statement of Net Cost. FAA stated this discrepancy was identified during the reconciliation of the two statements, but could not provide any other information. Therefore, FAA was unable to determine if there was a proper relationship between its financial and budgetary records.

FAA is aware of these budgetary accounting issues, and has hired an independent contractor to assist in correcting them. We support this effort and will work with FAA and the contractor to correct this weakness.

#### **Excise Tax Revenues**

FAA is required to include excise tax revenues (revenues) in its Financial Statements. However, the Department of Treasury (Treasury) has control over collecting and reporting of revenues for FAA. The Internal Revenue Service (IRS) collects revenues and makes daily deposits into the General Fund of the United States (General Fund). Upon receipt, IRS cannot differentiate between revenues for the Airport and Airway Trust Fund (AATF) and other government trust funds. IRS places these funds in a "holding" account until tax returns are filed, usually several months later. IRS then uses tax returns to certify the amount of revenues that should have been distributed to the AATF.

Congress, recognizing that trust funds cannot wait months for revenues, directed the Secretary of the Treasury to make monthly transfers, based on estimated revenues, from the General Fund to the appropriate trust funds. Within Treasury, the Office of Tax Analysis (OTA) makes these monthly estimates, and the Bureau of Public Debt transfers estimated amounts to the AATF. Estimates are adjusted later based on actual tax returns.

Last year, we asked GAO to review the Treasury procedures for estimating and certifying revenues. The GAO contractor was unable to complete the review of the estimating process, and terminated its work because information on how estimates were made was not available. GAO also found errors and internal control weaknesses related to reporting and certifying of total government excise

tax revenues, and estimated these revenues were potentially overstated by as much as \$571 million.

For FY 1998, we again asked GAO to review the OTA estimating process and the IRS quarterly certification process. GAO concluded internal control weaknesses still exist. Major weaknesses included IRS written procedures for certifying revenues and timely processing of tax returns.

We again found significant variances between OTA estimates and IRS-certified revenues. For the five quarters ended June 1998, variances between estimated and actual revenues ranged from an understatement of \$598 million to an overstatement of \$276 million. Details follow:

Quarter Ending	OTA Estimate (Thousands)	IRS Certification (Thousands)	Difference (Thousands)
June 1997	\$1,433,442	\$1,533,890	\$(100,448)
September 1997	1,829,463	1,722,851	106,612
December 1997	2,016,322	1,980,573	35,749
March 1998	1,778,504	1,502,650	275,854
June 1998	2,212,434	2,810,497	(598,063)

During this year's audit, GAO found internal control weaknesses. For example, the December 1997 certification was understated by \$57 million because IRS omitted collections for aviation gas from its certification. IRS subsequently made adjustments and corrected the error in December 1998.

In the past, the transfer of revenues, based on estimates, to the AATF exceeded aviation tax revenues. On January 1, 1996, legislation authorizing collection of aviation taxes lapsed. The Small Business Job Protection Act of 1996 reinstated the aviation taxes from August 27 to December 31, 1996. Revenues were transferred to the AATF during this period, although airlines were not making deposits. Excess transfers totaled \$1.2 billion. Legislation was needed to avoid a shortfall in the AATF, and allow the trust fund to retain the \$1.2 billion.

Considering the internal control weaknesses, and the Treasury's past performance, one additional area causes concern. The AATF receives about nine percent of excise tax revenues collected by IRS. As of September 30, 1998, the IRS "holding" account has a \$9.2 billion balance awaiting the receipt of tax returns. If tax returns are not filed or otherwise matched to receipts, the money remains in the General Fund. We were concerned that this "holding" account might contain revenues for the AATF. At our request, GAO asked IRS to age this account. As of February 26, 1999, IRS had not responded.

OTA also has noticed a consistent residual amount of about \$1 billion annually in the "holding" account with no liability to trust funds. This "holding" account could contain revenues for the AATF.

### **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 would not necessarily disclose all material noncompliance.

#### **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. FAA continues to be in noncompliance because (1) property, plant, and equipment amounts presented on the Balance Sheet were inaccurate and not supported by financial records, (2) DAFIS was not used for preparation of the Financial Statements, and (3) a cost accounting system had not been implemented.

Acquisition value of property and equipment could not be substantiated. For example, FAA was unable to provide supporting cost documentation to substantiate the \$2.1 billion recorded in the work-in-process account. Personal property reported at \$4.1 billion was materially understated. We also were unable to substantiate real property reported at \$2.5 billion.

DAFIS was not the only source of financial information used to prepare the FAA 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 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, FAA made 349 closing and adjusting entries, totaling \$51 billion, outside DAFIS to prepare the Financial Statements. The 349 entries 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 the summary level. However, FAA could not record these adjustments in DAFIS because FY 1998 records were closed within 5 days after yearend. DAFIS also did not account for Appropriations Used activity and was not in compliance with

the Standard General Ledger. These issues will be addressed in the new Departmental accounting system currently expected to be fully operational by June 2001.

Federal Financial Accounting Standards Number 4 requires all Federal departments to have the capability in place, beginning in FY 1998, to meet requirements of the 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 National Civil Aviation Review Commission called for strong financial controls, including a reliable cost accounting system for FAA by October 1998, so that FAA could manage its resources in a businesslike manner, and allocate its cost correctly and fairly as the basis for a cost-based user fee system. FAA still lacks the detailed and reliable cost data to accurately distribute operating cost. The FAA cost accounting system was scheduled to be operational by October 1, 1998, but will not be implemented in all lines of business until March 31, 2001. Consequently, FAA may not be able to realize the \$1.5 billion in user fees proposed in its FY 2000 budget.

#### **Performance Data**

Under OMB Bulletin 98-08, our responsibility was to obtain an understanding of internal controls relating to the existence and completion of performance data. The nine performance measures presented by FAA in the Management Discussion and Analysis were consistent with the measures under development by FAA as part of its implementation of the Government Performance and Results Act. The performance measures also complied with requirements of OMB Bulletin 97-01 to report performance measures consistent with goals and objectives in the agency's strategic plan.

OMB Bulletin 97-01 also requires entities to strive to develop performance measures that provide information about cost effectiveness of programs, and link to the programs presented in the Statement of Net Cost. However, as we reported in our finding on Cost Accounting Information, FAA did not accumulate or report costs by major program under each line of business, or provide information about the cost effectiveness of FAA programs. Furthermore, the performance measures did not relate to the information presented in the Statement of Net Cost. The cost accounting information, needed to link the performance measures with the Statement of Net Cost and provide information on cost effectiveness of FAA's programs, was not available because the FAA cost accounting system was still under development.



The performance measures also were not based on current performance data. While only two of the nine performance measures were based on FY 1998 operational data, five were based on 1997 data, one was based on 1996 data, and one was based on 1995 data. For example, FAA presented a performance goal of reducing the number of residents exposed to significant aircraft noise by 60 percent. However, statistics were only presented through 1995, so current performance could not be evaluated. Five of the nine measures relied on data from sources outside the Department. Consequently, we could not determine if the data were complete.

As part of our Financial Statement audit, we did not test the validity or accuracy of the 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. Without timely and complete data, FAA will be unable to compare performance results with current year financial data.

#### **D. PRIOR AUDIT COVERAGE**

The OIG has issued audit reports on the FAA Financial Statements for the past 6 years. The FYs 1992 and 1993 audits were limited to the Airport and Airway Trust Fund. The subsequent audits included all FAA funding and activities, but were limited to the Statements of Financial Position (Balance Sheet). The FY 1996 audit report included 35 recommendations to strengthen internal controls and establish the correctness of financial statement balances. The FY 1997 audit report stated efforts were still in process to complete corrective action on 21 recommendations. Efforts are still underway to complete action on 17 of our prior recommendations.

Since our report on the FY 1997 Financial Statements was issued, we issued five financial-related audit reports, three of which related to FAA inventory issues. The reports on inventory were:

Replenishing Logistics Center Inventory, Report Number FE-1998-136, dated May 15, 1998.

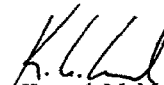
Valuation of Logistics Center Inventory, Report Number FE-1998-202, dated September 10, 1998.

Inventory of Field Spare Parts, Report Number FE-1998-209, dated September 29, 1998.

On July 6, 1998, in Report Number FE-1998-167, we reported that while FAA established automated fund control systems to track reprogramming of appropriated funding, FAA (1) exceeded Congressionally established internal reprogramming thresholds in FY 1997 for three budget line items by \$8.7 million, (2) processed reprogramming actions in FYs 1997 and 1998 that resulted in "assessments," (3) charged at least \$2 million to the wrong appropriation during FYs 1997 and 1998, and (4) permitted employees to work during FY 1998 on a program that did not receive FY 1998 funding.

On August 10, 1998, in Report Number FE-1998-186, we reported FAA needed to address four system design issues, potentially involving billions of dollars of transactions, in the development of its cost accounting system. We reported that FAA had not decided how to allocate facilities and equipment costs to operating facilities throughout FAA. We also reported that much work needed to be done to meet the very ambitious goal of having a fully operational cost accounting system by March 31, 1999.

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

  
Kenneth M. Mead  
Inspector General

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Mr. HORN. We will defer the questions till we have everybody's statement before us.

Now, I don't know who is to talk first, but in the line, Mr. Kleinberg is the Deputy Chief Financial Officer, but Mr. Schellenberg is the Chief Financial Officer. So, who is first?

Mr. KLEINBERG. I will speak first. I am from the Department of Transportation; Mr. Schellenberg is from——

Mr. HORN. Mr. Kleinberg is going into the Valley of Death, I guess, and you are on the horse right behind him. [Laughter.]

Mr. KLEINBERG. Mr. Chairman and members of the subcommittee, thank you for the opportunity to speak before the subcommittee and to testify on FAA's improvements in financial management and the Department's actions to encourage and support FAA's efforts.

We are pleased with the improvements that FAA has been making in financial management over the past years and especially their recent stepped up efforts. The audited financial statement process has been of great benefit in improving financial management throughout the Department. It has brought greater discipline and focused the financial management activities.

The material weaknesses identified by the DOT Inspector General have directed DOT organizations to areas that can benefit from financial management improvements. FAA has been preparing financial statements for audit for the past few years. Material weaknesses have been identified in the areas of property, plant, equipment, and inventory. Corrective action plans for these areas have been developed. Some actions have been completed; others remain in the process of being executed. These corrective action plans have extended over multiple years and have involved numerous FAA offices. FAA has mobilized both financial and program officials from headquarters, regional, and field offices to assure the needed financial improvements are implemented.

These financial management improvements must be accomplished while at the same time not compromising vital programmatic activities. Although the task has involved adding new responsibilities and priorities to many FAA offices, FAA has been making excellent progress in eliminating material weaknesses through the execution of these corrective action plans. The FAA Administrator, the DOT Chief Financial Officer, the DOT Inspector General frequently review FAA's progress in achieving these corrective actions. They support FAA's endeavors and believe that they are on a reasonable course to achieve a clean opinion.

The Secretary, the FAA Administrator, and the Chief Financial Officer are committed to meeting the President's goal of a clean audit opinion for the Department for fiscal year 1999. To accomplish this goal, FAA must also receive a clean audit opinion in their fiscal year 1999 statement. In line with this important goal, FAA's corrective action plans are scheduled to be completed in fiscal year 1999. FAA's organizations are currently ahead of schedule in completing their required goals and milestones. This should allow ample time for the General Accounting Office and the DOT Inspector General to review FAA activities and to render a clean audit opinion for fiscal year 1999.

We believe the FAA's actions demonstrate their full commitment to improving financial management. They are taking the necessary steps to demonstrate to the General Accounting Office and the DOT Inspector General that their financial statement is deserving of a clean audit opinion. A clean audit opinion for FAA will assure the Congress and the American public that FAA resources are being managed wisely and in the public's best interest.

I will be pleased to respond to your questions after the cycle is over.

[The prepared statement of Mr. Kleinberg follows:]

STATEMENT OF DAVID K. KLEINBERG  
DEPUTY CHIEF FINANCIAL OFFICER  
DEPARTMENT OF TRANSPORTATION  
BEFORE THE HOUSE COMMITTEE ON GOVERNMENT REFORM  
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,  
INFORMATION AND TECHNOLOGY  
CONCERNING FAA'S FINANCIAL MANAGEMENT  
MARCH 18, 1999

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the Subcommittee to testify on FAA's improvements in financial management and the Department's actions to encourage and support FAA's efforts.

We are very pleased with the improvements that FAA has been making in financial management over the past few years. The audited financial statement process has been of great benefit in improving financial management throughout the Department. It has brought greater discipline and focus to financial management activities. The material weaknesses

identified by the DOT Inspector General have directed DOT organizations to the areas that can benefit from financial management improvements.

FAA has been preparing financial statements for audit for the past few years. Material weaknesses have been identified in the areas of property, plant, and equipment and inventory. Corrective action plans for these areas have been developed. Some actions have been completed, while others remain in the process of being executed.

These corrective action plans have extended over multiple years and have involved numerous FAA offices. FAA has mobilized both financial and program officials, from headquarters to regional field offices, to assure that the needed financial improvements are implemented. These financial management improvements must be accomplished while at the same time not compromising vital programmatic activities.

Although the task has involved adding new responsibilities and priorities for many FAA offices, FAA has been making excellent progress in eliminating material weaknesses through the execution of the corrective action plans. The FAA Administrator, the DOT Chief Financial Officer and

the DOT Inspector General frequently review FAA's progress in achieving corrective actions. They support FAA's endeavors and believe that they are on a reasonable course to achieve a clean opinion.

The Secretary and the Chief Financial Officer are committed to meeting the President's goal of a clean audit opinion for the Department for FY 1999. To accomplish this goal, FAA must also receive a clean audit opinion on their FY 1999 stand-alone financial statement.

In line with this important goal, FAA's corrective action plans are scheduled to be completed in FY 1999. FAA organizations are currently ahead of schedule in completing their required goals and milestones. This should allow ample time for the General Accounting Office and the DOT Inspector General to review FAA activities and to render a clean audit opinion for FY 1999.

We believe that FAA's actions have demonstrated their full commitment to improving financial management. They are taking the necessary steps to demonstrate to the General Accounting Office and the DOT Inspector General that their financial statement is deserving of a clean audit opinion.

A clean audit opinion for FAA will assure Congress and the American public that FAA resources are being managed wisely and in the public's best interests.

I would be pleased to respond to any questions you have at this time.



Mr. HORN. Thank you very much. Mr. Schellenberg, the Chief Financial Officer of the Federal Aviation Administration.

Mr. SCHELLENBERG. Thank you very much, Mr. Chairman. It is a pleasure to be here to explain what the FAA is attempting to do to resolve both of these major issues. I want you to know one of our agency's top priorities is to enhance FAA's financial credibility and integrity as quickly and effectively as possible.

Recently, the General Accounting Office put FAA on its high-risk list for financial management for two key reasons: the agency's failure to receive a clean audit opinion on its financial statements, and the lack of a fully implemented cost accounting system. We are fully committed to taking those actions necessary to give the DOT Inspector General the basis on which they can provide us a clean audit opinion.

Getting such an audit opinion is important to us not only as a part of the goal to achieve a governmentwide unqualified audit but also to assure the public that the assets entrusted to the FAA are properly managed and accounted for. To ensure success in this effort, we are working cooperatively with the Office of Inspector General and the General Accounting Office to identify and rectify those financial discrepancies that are holding the agency back from receiving a clean audit opinion.

Together, we have identified three critical areas that the FAA must address that had previously been overlooked for years. First, reduce the FAA's work in process account which has been overstated as completed facilities and facilities and equipment were not transferred to the appropriate fixed-asset accounts at appropriate times. Second, the need to adequately document the agency's assets at sites throughout the country, and, third, the need to adjust accounts for personal property, such as radars and switching systems, to properly reflect their full costs.

Let me emphasize at this point that the deficiencies that we have described in those three circumstances relate to the appropriate accounting process not the agency's ability to locate those assets. In other words, it is not a loss of assets, it is a question of an appropriate accounting treatment.

As the agency's Chief Financial Officer, I am leading the FAA's monumental effort to tackle these problem areas. Together with the Office of Inspector General, we have set goals and targets for FAA employees at headquarters and each of the regions to complete this work. Led by each regional administrator, dedicated teams have been formed throughout the regions to undertake this work according to established goals and processes.

For example, early in fiscal year 1998, the agency convened a field spare parts inventory conference to coordinate the physical inventory with the regional liaisons at over 800 sites. This analysis resulted in the FAA changing the methodology it uses to price the agency's inventory to more accurately reflect the cost of that inventory. Since then, both GAO and OIG have sampled the inventory and found no material discrepancies for the line items sampled. Another full wall-to-wall inventory is planned for later this year.

In order to correct other financial statement deficiencies, we will work with the Department and the IG to develop and implement changes to our existing accounting systems; to capture the new

standard general ledger accounts, and change or convert existing records to meet new reporting standards. We have also accelerated our efforts with regard to developing a process improvement plan. This plan when completed will identify all changes in requirements needed to ensure that the FAA has in place the correct automated systems, procedures, and resources necessary to ensure the continued integrity of our financial systems for the future. I share Mr. Meche's concern that we institute processes so that we don't have to play catchup again in the future, and that not only do we get a clean audit opinion, we keep a clean audit opinion.

The deadlines we have set for ourselves will enable the task to be completed with ample time remaining for the Office of Inspector General to issue a clean audit opinion in fiscal year 1999. We are pleased to be able to report that as of mid-March, each region and center and their respective lines of business is ahead of the goals for accomplishing these tasks, and we anticipate having this work fully completed on time.

The second reason why FAA was put on the GAO high-risk list was the lack of a fully implemented cost accounting system. It should be noted, however, that the FAA is one of the first Federal agencies to take steps to establish a full cost accounting system based on generally accepted government accounting principles. We have not just embarked on a traditional cost accounting system but one that incorporates non-financial with financial transactions in order to allocate and determine the full cost of FAA's services. So, it is a combination of performance measurement as well as the financial data so that we can have, in fact, the kind of information Mr. Meche referenced earlier. Knowing these costs will allow us to track our performance and make informed management decisions both which will help the agency better control its costs.

FAA commenced this effort 2½ years ago and will deliver the first phase of the cost accounting system to support the air traffic service organization by the fourth quarter of 1999. Thereafter, other lines of business will be added in phases so that the cost accounting system will be fully implemented throughout the agency by the end of fiscal year 2001.

In our discussions with private companies that have implemented similar cost accounting systems. We determined our 5-year completion target falls well within the range of best business practices. Although the FAA has been held at fault for not having delivered a complete cost accounting system. We believe that the FAA should also be given the credit for having taken these pioneering steps.

Let me summarize by saying that the FAA is undertaking serious, comprehensive steps to regain our financial credibility and integrity. We are cooperating fully with the Office of Inspector General and the General Accounting Office on an ongoing basis to achieve these goals and to avoid any future problems. We have every confidence we will meet these goals of achieving a clean audit opinion and implementing the first phases of our cost accounting system in fiscal year 1999.

And if I may be permitted a personal comment when the Administrator appointed me to this position during the middle of the summer, it was made crystal clear to me by her and later by the

Chief Financial Officer of the Department that these two functions, that delivering a clean financial statement and a cost accounting system were the two major priorities that I needed to proceed with. Let me assure you I am directly focused on doing exactly those things. When I found that we were not proceeding in both of those areas with the speed and with the diligence that was necessary, we stepped in; we reorganized; we took steps; we instituted new processes; we made accountability; we made overtures to the OIG and the GAO to work constructively to resolve issues in advance. I think we are on track at this point, and I look forward to the fact that we will be able to achieve that statement of cleanliness this fiscal year. Thank you.

[The prepared statement of Mr. Schellenberg follows:]

STATEMENT OF CARL B. SCHELLENBERG  
CHIEF FINANCIAL OFFICER  
FEDERAL AVIATION ADMINISTRATION  
BEFORE THE HOUSE COMMITTEE ON GOVERNMENT REFORM  
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,  
INFORMATION AND TECHNOLOGY  
CONCERNING FAA'S FINANCIAL MANAGEMENT  
MARCH 18, 1999

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the Subcommittee to testify on FAA's financial management and the actions the agency is undertaking to better manage our costs and develop a more efficient operation.

One of our top agency priorities is to enhance the FAA's financial credibility and integrity as quickly and effectively as possible. Recently, the General Accounting Office put FAA on its high-risk list for financial management for two key reasons: the agency's failure to receive a clean audit opinion on its financial statements and our lack of a fully implemented cost accounting system.

We are fully committed to taking those actions necessary to give the DOT Inspector General the basis on which to provide us with a clean audit

opinion. Getting such an audit opinion is important to us not only as part of the goal to achieve a Government-wide unqualified audit, but also to assure the public that the assets entrusted to the FAA are properly managed and accounted for.

To ensure success in this effort, we are working cooperatively with the Office of Inspector General and the General Accounting Office to identify and rectify those financial discrepancies that are holding the agency back from receiving a clean audit opinion. Together, we have identified three critical areas that FAA must address that had previously been overlooked for years:

- Reduce the FAA's Work-In-Process account, which has been overstated as completed facilities and equipment were not transferred to the appropriate fixed asset accounts;
- The need to adequately document the agency's assets at sites throughout the country;
- The need to adjust accounts for personal property, such as radars and switching systems, to properly reflect their full cost.

As Chief Financial Officer, I am leading the FAA's monumental effort to tackle these problem areas. Together with the Office of Inspector General, we have set goals and targets for FAA employees in headquarters and in each of the regions to complete this work. Led by the regional administrators, dedicated teams have been formed throughout the regions to undertake this work according to established goals and processes.

For example, early in FY 1998 the agency convened a field spare part inventory conference to coordinate the physical inventory with the regional liaisons at over 800 sites. This analysis resulted in the FAA changing the methodology it uses to price the agency's inventory to more accurately reflect the cost of that inventory. Since then, both GAO and the OIG have sampled the inventory and found no material discrepancies for the line items sampled. Another full inventory is planned for later this year.

In order to correct other Financial Statement deficiencies, we will work with the Department and the OIG to develop and implement changes to our existing accounting system to capture the new standard general ledger accounts and change or convert existing records to meet the new reporting standards. We have also accelerated our efforts with regard to developing a

“Process Improvement Plan”. This plan, when completed, will identify all changes/requirements needed to ensure that the FAA has in place the correct automated systems, procedures and resources necessary to ensure the continued integrity of our financial systems for the future.

The deadlines we have set for ourselves will enable the tasks to be completed with ample time remaining for the Office of Inspector General to issue a clean audit opinion for FY1999. We are pleased to be able to report that as of mid-March each region, center, and their respective lines of business is ahead of its goals for accomplishing these tasks and we anticipate having this work fully completed on time.

The second key reason why the FAA was put on GAO’s high-risk list was the lack of a fully implemented cost accounting system. However, it should be noted that the FAA is, if not the first – then one of the first - Federal agencies to take the steps to establish a full cost accounting system based on generally accepted government accounting principles. We have not just embarked on a traditional cost accounting system, but one that incorporates non-financial with financial transactions in order to allocate and determine the full cost of FAA’s services. Knowing these costs will allow us to track

performance and make more informed management decisions, both of which will help the agency better control its costs.

FAA commenced this effort two and a half years ago and will deliver the first phase of the cost accounting system to support the Air Traffic Services organization by the fourth quarter of FY 1999. Thereafter, other lines of business will be added in phases so that the cost accounting system will be fully implemented throughout the agency by the end of FY 2001. In our discussions with private companies who have implemented similar cost accounting systems, our five-year completion target falls within the range of best business practices. Although the FAA has been held at fault for not having delivered a complete cost accounting system, we believe that the FAA should also be given credit for having taken these pioneering steps.

Let me summarize by stating that the FAA is undertaking serious, comprehensive steps to regain our financial credibility and integrity. We are cooperating fully with the Office of Inspector General and the General Accounting Office on an on-going basis to achieve these goals and to avoid any future problems. We have every confidence that we will meet our goals



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of achieving a clean audit opinion and implementing the first phases of our cost accounting system in FY 1999.

I would be pleased to respond to any questions you have at this time.

Mr. HORN. Well, we wish you well on that point. Just so I get the relationship of reporting correct in my mind, Mr. Schellenberg, you report to whom in the Federal Aviation Administration?

Mr. SCHELLENBERG. I report to the Administrator, Mrs. Garvey.

Mr. HORN. OK, and to whom does the Chief Information Officer report?

Mr. SCHELLENBERG. The Chief Information Officer who is a new gentleman that has just joined us also reports to Mrs. Garvey.

Mr. HORN. OK, and so you have full responsibility for being the Chief Financial Officer.

Mr. SCHELLENBERG. That is correct.

Mr. HORN. All right. Who is the Assistant Administrator for Management or whatever that position is called?

Mr. SCHELLENBERG. Well, we no longer have an Assistant Administrator for Management, sir. What happened is that we have Assistant Administrator for Financial Services, and I am that person. We have an Assistant Administrator for Human Resource Management, and that is Ms. Glenda Tate. And we have an Assistant Administrator and Chief Financial Officer, and that is Mr. Daniel Meehan. I have some slight administrative duties.

Mr. HORN. Wait a minute right there. You are the Assistant Administrator for Financial Services.

Mr. SCHELLENBERG. And Chief Financial Officer.

Mr. HORN. And you are also Chief Financial Officer, but you just named that other person Chief Financial Officer.

Mr. SCHELLENBERG. Oh, I am sorry. The other person I named was the Chief Information Officer; I probably misspoke.

Mr. HORN. OK, yes.

Mr. SCHELLENBERG. And that is Mr. Daniel Meehan.

Mr. HORN. OK, so your role as Assistant Administrator for Financial Services, did that precede your coming to the agency? I mean, has that position been around for a long time?

Mr. SCHELLENBERG. No, no, that was just created. I have been in the agency for a long time, but I was appointed to that position, and it was created for the first time last summer.

Mr. HORN. OK, so you are not really doing anything other than the Chief Financial Officer operation.

Mr. SCHELLENBERG. That is correct.

Mr. HORN. OK, that is what I wanted to get straight, because I wondered if you were reporting to an Assistant Administrator for Financial Services, because the role should report to Mrs. Garvey, the Administrator. Good, OK.

Now, we welcome Mr. Turner, and we are just finished the testimony, and we are into questions now, and if you would like to say anything at this point, you are certainly welcome.

Mr. TURNER. You go right ahead.

Mr. HORN. OK. Well, let me ask the General Accounting Office, Mrs. Calbom, is it true that the items mentioned are missing or there was a mention that these items were not missing? What is the finding of the General Accounting Office?

Ms. CALBOM. You are talking about the property and equipment items?

Mr. HORN. Right.

Ms. CALBOM. I think what has been happening is over the years as equipment is purchased it is being charged through to the expense accounts, so it just flows through operations, and it is not then being tracked on an ongoing basis. And what the IG is finding is they are trying to go back—actually. The agency, with the IG looking right behind them as they go, is trying to go back and reconstruct the records, so they can figure out which assets should have been put on the books and kept on the books, so they can track those assets on an ongoing basis. So, I think that is mostly what they are finding. They are also finding situations, I know there was at least one situation that is in the IG's audit report, where there was a structure on the books for \$1 million, and the structure had been demolished 10 years ago. So, it is a lot of sloppy bookkeeping is what it is.

Mr. HORN. And that is to be done by the Federal Aviation Administration or is to be done by the Department of Transportation?

Ms. CALBOM. The cleaning up?

Mr. HORN. Well, the keeping of what data when and where.

Ms. CALBOM. Oh, it is FAA's job to be doing that.

Mr. HORN. OK, so each service agency, whatever they are called, within the Department of Transportation has their responsibility.

Ms. CALBOM. Yes, it is fairly autonomous, and FAA, as you know, then prepares its own consolidated financial statements which are subjected to an independent audit.

Mr. HORN. Interesting. OK, let us take a look at some of the property, plant, and equipment just to review it. You say FAA spent \$26 billion on its Capital Improvement Program. Now, those are the ones related to the Airport Improvement Fund, I assume; the special trust fund that is set aside? Or is that general fund money beyond the trust fund? Like a third runway at Los Angeles International; a lot of that would come out of the trust fund.

Ms. CALBOM. Correct me if I am wrong, but I believe a lot of that relates to the Air Traffic Control Modernization Program.

Mr. HORN. OK. So, that is in terms of facilities for the FAA to do its job itself, OK.

Ms. CALBOM. Correct.

Mr. HORN. All right. And then we noted that they reported less than \$12 billion in gross property, plant, and equipment asset costs. Is that correct?

Ms. CALBOM. Yes, I believe it was right around \$12 billion that is on the books, and when we say gross, we mean before depreciation is considered.

Mr. HORN. Well, then comes the obvious question: If you have spent approximately \$26 billion on capital year improvement during fiscal years 1982 through 1998 and the financial statements reported less than \$12 billion in gross property, plant, and equipment asset costs, the question is where is the remaining \$14 billion?

Ms. CALBOM. Right.

Mr. HORN. So, where is it?

Ms. CALBOM. That is the question that is being pursued right now by FAA officials as well as—as I was saying, the IG has been looking at what they are coming up with, and they are trying to go back and reconstruct the records and determine which of those funds that were spent really should have been assets that are cap-

itized on the books. There is certainly some of the property that was properly expensed, and certainly there is some of it that relates to projects that were abandoned or written off.

Mr. HORN. Has anybody checked those projects to see if they were ever built?

Ms. CALBOM. Well, I think as far as the funds that they are identifying that relate to assets that should be capitalized—and Mr. Meche can probably answer this better—but I believe that they are going out and taking a look at those assets and ensuring that, in fact, they are there.

As far as the funds that relate to the scrapped projects, so to speak, that is money that was spent that isn't providing any long-term benefit.

Mr. HORN. Well, we ought to be check to see if the structure is there. I am not being humorous about it, but the Subcommittee on Appropriations, independent offices, HUD, so forth, went checking in New Orleans to see where the buildings were that the Department of Housing and Urban Development had been granting money to them over time, and they found a lot of buildings that never even were erected, but somebody got the money. So, we ought to check that.

Mr. MECHE. Mr. Chairman.

Mr. HORN. Yes.

Mr. MECHE. We know where most of that money has gone. We are, in fact, in the process of rebuilding the records. There was about \$5 billion—and that is a very rough estimate right now, because we are looking to the future—there is about \$5 billion of that difference that was, in fact, expensed off the records, and we are rebuilding those records right now with FAA to be able to get that amount. There is another at least \$2 billion, maybe \$3 billion that we know. For example, the money for the AAS system that was spent, but it never came into production. So we know right now where a lot of that money is.

Mr. HORN. Well, you have me down to presumably \$5 billion or if you muddled a couple of things there, I am not quite sure what the net balance is, but I asked where is the remaining \$14 billion, and I think you said, "Well, we certainly have about \$5 billion we think we know." And, obviously, then, what has happened to the \$9 billion?

Mr. MECHE. That is correct, sir, and we are reconciling that number down, and what we are finding so far is the kinds of situations that I described. It is where FAA has not put the system in place because it just never got off the ground, but yet the money was spent. So, that is part of the money that you are looking at, as well as expensing it and not capitalizing it on the records. That is what the situation is with the \$5 billion we know about right now.

Mr. SCHELLENBERG. Mr. Chairman, maybe I can help a little bit also.

Mr. HORN. Please.

Mr. SCHELLENBERG. What we are really talking about is the appropriate status on the records, not the location of the assets. For example, it could be a question of where the FAA had charged an asset to an inappropriate account. In such a case, we are going

back and correctly capitalizing the asset while placing it where it properly belongs in our financial statements records.

Mr. HORN. Well, let us take that item and example. Who signs off on that particular asset item so that there is some senior management responsibility? Would that be you signing off on it or your predecessor?

Mr. SCHELLENBERG. The actual decision to expense a particular item?

Mr. HORN. Yes, right.

Mr. SCHELLENBERG. It would be handled by the offices, particularly on a regional basis, that were in charge of doing the accounting for that particular project. As a practical matter, I can't find any proper justification for expensing what should have been capitalized; it should have been capitalized.

Mr. HORN. Do those papers still exist with somebody's signature on it? Did somebody assume responsibility, and did they not then just input it properly or improperly at the headquarters level?

Mr. SCHELLENBERG. It was a combination of two pieces: expensing it improperly and leaving it for too long in a work in process kind of account. What we are doing in the one case is the catch-up work to take things out of work in process that have been completed long ago and putting those now in appropriate asset accounts. Next we go back and recalculate and redetermine the appropriate figure to put on the capital account and the appropriate figures to actually expense. When we have finished this work in the June timeframe, we will have an accurate statement of what is legitimate work in process, what is legitimate expense, and what is legitimately assigned to those capital asset accounts. We are putting those figures where they should have been all along.

Mr. HORN. Sure. Do we have any sort of feeling as to how many thousands items there are here? Are we talking hundreds of items or what?

Mr. SCHELLENBERG. We are talking thousands of items. We are working on the most significant items. We are ensuring that current assets are appropriately accounted for. We are working collectively and quite cooperatively with the Inspector General and the GAO to ensure that we identify and characterize the most material parts of inventory, so that everything is appropriately accounted for. So, it is literally thousands of job orders that have to be appropriately characterized.

Mr. HORN. Now, in your judgment as Chief Financial Officer, do you think that the FAA has the appropriate system and equipment to do this job?

Mr. SCHELLENBERG. I think we have in place the appropriate equipment and systems to do the catch-up. I do not yet think we have in place the appropriate systems to keep current. We have some groups that will develop those systems so that if you ask me that question in 2 months, I feel confident I will be able to tell you at that point, we have the systems that will let us stay current. So, we are working on one; one I think is in place.

Mr. HORN. Now, in terms of just the equipment—let us not talk about property for a minute or big structures—do you have a system now that you feel will keep track of the billions of dollars in equipment that FAA purchases?

Mr. SCHELLENBERG. Yes.

Mr. HORN. So, you think you are OK on that one?

Mr. SCHELLENBERG. I think we will be OK.

Mr. HORN. Have you evaluated the FAA's plans to correct their records for items that have not been recorded in the past, and, if so, do you think this effort will be successful?

Mr. SCHELLENBERG. Yes, we have taken a look at that, and I think it will be successful.

Mr. HORN. OK. Let us see, I think we have enough on that. If we haven't, we will send you a few questions after the hearing.

Let us talk a little bit about air traffic control modernization. I served on the Aviation Subcommittee when I first came here and had a few views as I went out and looked at that thing, and it turns out I was right, and the FAA was right to cut it off at \$4 billion. I would just like to know why they didn't cut it off at about \$4 million, \$40 million or \$400 million? The IRS went to \$4 billion also. I don't know if they were cloned so that FAA and IRS—you got different letters, but it didn't sound like a clone, but they end up with the same \$4 billion, and I guess nobody gets their attention until a few billion are spent in Government.

Now, the General Accounting Office testimony indicates that the \$42 billion Modernization Program is expected to continue through fiscal year 2004. This is a significant program, and I believe its expected costs will be an additional \$16 billion over the next 6 years for such things as radar navigation, communications equipment, as well as computer software. When we buy this additional equipment, I am concerned whether or not you will be able to account for it properly. What do you think?

Mr. SCHELLENBERG. I am concerned about that too. That is exactly why I convened this group to get together to design the kind of system that will let us keep current and make sure that as those items are acquired, they are appropriately characterized in the accounts and that we are current with the process.

Mr. HORN. Well, I guess I will ask the obvious, because it seems to me there must be some corporations in America that have related things to deal with in terms of categories and that maybe you could get it off the shelf or have you looked at that? Or has the Chief Information Officer looked at that? Or is the person too new to look at it?

Mr. SCHELLENBERG. Well, I don't. I will defer to Mr. Kleinberg on that issue, if I may, please.

Mr. KLEINBERG. We have looked at it in the sense that we have adopted an Oracle financial package that we are putting in the Department that will be in place in 2001. That handles, obviously—

Mr. HORN. And you have already tested this Oracle system to see if it does for you what you want it to do?

Mr. KLEINBERG. We tested it in the first stage; the second stage of a more refined testing starts next month and will be completed by the middle of June at which time we get into what we call the final build stage. By Oracle's own management view, they think we are chasing them rather than them chasing us at this stage, and we hope that continues. So, we think that that is the type of package that is supplying chain management although if all the other types of software at the private sector do use similar type things,

it will be available to us and subtle enough to handle all of these problems.

Mr. HORN. So, you are not the alpha site, you are the beta site.

Mr. KLEINBERG. No, actually, we are beyond the beta site in the sense that this is proven by about 5,000 corporations already.

Mr. HORN. Good. Well, we will extend the alphabet a little bit. [Laughter.]

No, I am glad that you let somebody wear themselves out in making sure it works.

Mr. KLEINBERG. Exactly.

Mr. HORN. It makes sense.

OK, inventory. I understand from the testimony here that a lot of progress has made in the ability to keep track of inventory located in your warehouse, as I understand it, in Oklahoma City. However, there still seems to be problems keeping track of parts located in the field. This seems especially critical since those parts are scattered around 30,000 locations throughout the country. You might have some overseas also; I know you keep some people overseas. FAA, I would have the question is, what are you doing to ensure that you have a system in place that can keep track of these parts on an ongoing basis? I guess, Mr. Schellenberg, that all was headed in your direction.

Mr. SCHELLENBERG. I rather expected it was. We have been doing a number of things on our field spares. We have conducted physical inventories to ensure the present location of all those items. We did one last year; we will do another one this year. We are also in the process of developing the perpetual inventory system to keep better track of those field spare items. Again, the question associated with those field spares is often the fact that you need a critical part in another facility and sometimes the issue has been that it has been more pressing for our folks to restore that facility—get it there, get the equipment running—than it has been to do the paperwork. What we need to do in the new system is to make it simple enough, quick enough, and easy enough that inventory tracking steps happen quickly, easily, and currently, so that we have an accurate and complete status that is up to date at the moment.

Mr. HORN. Yes, having heard the question and the answer, I would like to know from the Inspector General and from the General Accounting Office, do you think they are on the right track or are there real problems here?

Mr. MECHE. Mr. Chairman, I think they are on the right track. We recommended to FAA about 5 years ago that they establish a perpetual record system for these field spares. It wasn't until about 6 months when Mr. Schellenberg came on board that we brought this to his attention. We showed him what the results were and convinced him that it was time for FAA to establish perpetual records, and he has moved out on that. As soon as the FAA gets those spares into inventory—there is going to be a physical inventory—we will test it, and assuming that there is no problem with the accountability, we will be OK with it.

Mr. HORN. Ms. Calbom, for GAO, what is your reaction?

Ms. CALBOM. I guess we still have some concerns about the field spares inventory at this point. As stated in my testimony, when we

took a look at some of the test counts that the IG did in the field—we, ourselves, did not do test counts in the field; we did them at the big warehouse but not in the field—we were just concerned that at all the sites the IG staff went to there were a number of problems that were discovered, and we really felt like probably the count process may not have been a good process. It is real hard tell if they truly had a good handle on what was out there.

I am happy to hear that they are going to do another complete count for the fiscal year 1999 audit, and then the IG will go in and take a look at those, and we will be following up on that as well. And I do agree with Mr. Meche that they are beginning to implement a perpetual inventory system which is something where they can keep track of the ins and outs, and so, at any given point in time, they know what they have at different locations, and I think that is really essential for this type of operation, because, like you say, it is scattered all over the country. And when you have spare parts like this, I mean, some of them are really critical, it is important if you have modifications or other things like that, it is very important from an operational standpoint, to know where those are so that they can be updated if need be.

Mr. HORN. Well, let us put it this way, thousands of American firms that assemble things or manufacture have adopted the so-called Japanese inventory system where your parts are fed into when you need them in some way, obviously by computing the stocks down to a certain level. Is there any possibility that the kind of parts FAA needs and has in that huge warehouse in Oklahoma City where that can be directly sent to people in the field by the person that is making them? And I don't know if you have looked at that or that would save you warehouse space or what, but it is something you might think about.

Mr. SCHELLENBERG. We have done much of that, Mr. Chairman. Let me also point out that at most of these field facilities it is not a question of manufacturing something that you have anticipated demand for, it is often a question of a part failure that needs to be replaced very quickly in order to preserve their safety. So that we try to anticipate; we try to stock these facilities with the required number, but there will often come times when it doesn't happen exactly the way you planned. What we want to do is to have economic quantities, but we also need to have the ability to respond very rapidly. So, we are doing what you are suggesting; it is a difficult balance to take at times.

Mr. HORN. Give me an idea of what the FAA needs in parts. Is this for radar or what?

Mr. SCHELLENBERG. This could be the major tube for a radar. It could be major components of air ground—

Mr. HORN. Tube for radar? You mean, we are not still using vacuum tubes, right? LAX was until recently, I think.

Mr. SCHELLENBERG. The tube is the major thing that generates the radar signal, the clystron, on many of our things. It could be air ground communications equipment; it could be something that is a part of a navigational aid. So, when these things cease working, we need to get them back up and operating as soon as possible. So, it is a question of anticipating what parts are going to fail, and that is not always an easy process.



Mr. HORN. Well, I am glad you are taking a look at it. Do you know in your current inventory different parts are there in that Oklahoma City warehouse?

Mr. SCHELLENBERG. I don't have the number at my fingertips; we will be happy to provide it.

[The information referred to follows:]

The total inventory of items at the Logistics Center in Oklahoma City is 84,143 items.

Mr. HORN. The Air Force, I found, over the years, has so many spare parts it is unbelievable, and a lot of them are planes they no longer order, so when you have a master sergeant that knows what they are doing there, why, they can usually clean up that inventory.

Mr. SCHELLENBERG. We are doing an interesting thing, Mr. Chairman, that you might be interested in. We are now operating our logistic center as a franchise fund. The individual facilities that now need to have parts are being charged for those parts, so that they now have financial accountability. This has increased their awareness of economic quantities to have on hand, so it is working a very positive effect.

Mr. HORN. And routine maintenance to be preventive maintenance to help extend life.

Mr. SCHELLENBERG. Yes.

Mr. HORN. Well, that makes sense, and I congratulate you on that.

Financial reporting. It has been mentioned that there are significant errors in the 1998 financial statement, including problems with statements of budgetary resources and net costs. In addition, FAA's financial statements, themselves, say that "some of the budgetary balances from the general ledger were not accurate or were incomplete in the accounting system." I guess I would ask the Inspector General, what do you mean in your report when you say that \$7.2 billion unobligated balance in the statement of budgetary resources could not be substantiated?

Mr. MECHE. Mr. Chairman, this is the first year that we have had to audit these new statements. What we have found in this particular example you are talking about is that this is a cumulative figure that has built up over years. For auditors to come in for the first time—I mean, for auditors to validate that number, they have to be able to track it back to every single dollar that it is involved, and when you are dealing with transactions that have been occurring over 15 to 20 years, it is just not possible to do. That is what we ran into with these new statements.

Mr. HORN. What you are saying is there is no way we can ever check this?

Mr. MECHE. I believe that is probably correct. We have tried to do some of that work this year, and we have been able to get to some of the dollars, but certainly not anywhere near the total amount, because it just keeps going further and further back in time.

Mr. HORN. What is the General Accounting Office's view and what is the FAA's view on this?

Ms. CALBOM. Well, as you know, Mr. Chairman, the purpose of adding these new statements is really so you can get, No. 1, a com-

plete picture of what is going on. I mean, you have your statement of budgetary resources that kind of tracks things on a budgetary basis; you have your statement of net cost which then says, OK, how is the money spent specifically. If we can do detailed audits on our statement of net cost and then tie that into the statement of budgetary resources and our budget accounts, ultimately, then we can get some comfort on the validity of the numbers that are reported in the budget accounts.

Unfortunately, what has happened with FAA—and there are other agencies where this has occurred as well—they have not maintained good documentation—because they never had to before; no one ever checked—of the budgetary accounts. This is the first year we have subjected some of those to audits, and it is a similar situation, as you have heard time and time again in the various testimonies on the other agencies, when we first started subjecting them to the audit of just the balance sheet and the operating statement, nobody had the records. They are starting to get the records now; put them together. Same thing on this statement of budgetary resources; they are finally realizing, “OK, we have to keep records of this as well.” Until we are able to do that, we are not going to have the full package; the last part of the package being the performance reporting, that we can provide that full set of accountability that really needs to be provided.

Mr. MECHE. And, Mr. Chairman, one other point on that: when FAA tried to prepare that statement this year, they had to go totally outside their accounting system. The accounting system does not have that information—that is the point that you pulled out of our report. One of the issues for the future that we talked about is having a financial system that incorporated all of the requirements so the system itself, automatically, internally, checks and balances itself to where you keep these things under control as you go along.

Mr. HORN. Well, this leads, obviously, to a few questions on cost accounting and if we think it is reasonable at this point. The fiscal year 2000 budget that was submitted to us in Congress includes \$7.5 billion in user fees to be collected during the 5-years beginning October 1, 1999, the beginning of the new fiscal year 2000. It is only about 6 months away. These are described as cost-based user fees, and the Inspector General and the General Accounting Office testimony state that one of your major problems in FAA is the lack of a cost accounting system and that this is the key to your ability to establish cost-based user fees. So, I would ask Mr. Schellenberg as Chief Financial Officer of the FAA, where do you stand in terms of implementation of a cost accounting system?

Mr. SCHELLENBERG. As far as the cost accounting system is concerned, we will deliver during the third quarter of fiscal year 1999 the first major phase of the cost accounting system. This will constitute the cost information, the fully allocated cost information, that will involve that portion of the air traffic system involving the en route and oceanic air traffic operations.

This will allow for two things. This will allow for the issuance of an interim final rule on those fees that are currently authorized; that is a limited slice known as the overflight fee, and that will be able to be issued before the end of this fiscal year. We will then

also have in place the costing information necessary to support the President's fiscal year 2000 budget at the \$1.5 billion level. Should there be enabling legislation that would allow us to go ahead, the cost accounting information will be prepared for that. We will then institute the balance of the cost accounting system delivered also in phases.

We will complete the first phase being the remainder of the air traffic system. We will then take the other agency elements such as the regulatory process, space transportation, those pieces, culminating in the last piece being delivered in fiscal year 2001. So that according to our present schedule, which I have good confidence in, we will proceed to have in place the necessary cost accounting pieces to support those charges should they be authorized as contained in the President's budget.

Mr. HORN. Well, I am delighted to hear that, Mr. Schellenberg. I would just simply Mr. Meche, has the Inspector General reviewed the FAA cost accounting system designs and plans, and, if so, do you have any comments or concerns about the planned system?

Mr. MECHE. We have, Mr. Chairman. We made an initial review of the system last year and issued a report in August 1998. We identified four major issues with the development of that system. We pointed those out to FAA, and they are considering them in the schedule that they are doing right now to address those concerns. So, yes, we have looked at that. We have not looked at anything associated with the piece that is being developed right now that is going to support the overflight fees. We are waiting for FAA to have that piece in place, and as soon as it is we will audit it to see that the amounts are cost-based and that they are valid and legitimate costs going into accounts.

Mr. HORN. Tell me how the overflight fees work? I am just not that familiar with it.

Mr. SCHELLENBERG. We have the authority to impose a fee on aircraft that fly through U.S. air space but neither takeoff nor land within the United States. So, that to an extent that someone is flying through our air space, the premise is that they are not otherwise paying taxes for their operation in air space. We capture through our air traffic system their presence, and we will impose a cost-based fee for that operation with U.S. air space.

Mr. HORN. Is this because they are utilizing the information that your radar service is providing?

Mr. SCHELLENBERG. We are providing them air traffic control services within the United States, and since they neither takeoff nor land here, there is no basis for otherwise charging them.

Mr. HORN. Can you give me a few examples of which airlines do this that don't land here; don't take off here, and overfly us?

Mr. SCHELLENBERG. Well, there have been a number of airlines, Canadian airlines were that way for a long time.

Mr. HORN. Just go directly to Mexico, let us say, out of Toronto.

Mr. SCHELLENBERG. Right, or come from Pacific destinations and fly through U.S. air space and land in another country; any number of those.

Mr. HORN. Fascinating. You guys in FAA ought to be the tax collectors for the country if you have figured out how you can tax people going over the air. [Laughter.]

Mr. SCHELLENBERG. Well, we have had our problems.

Mr. HORN. I learn something new everyday; that is why we hold these hearings. That is my factoid to do something with tonight.

Anyhow, your testimony laid out a number of other areas where cost accounting was important. Could you elaborate a little bit on that; I am fascinated?

Mr. SCHELLENBERG. Essentially, we view that there are two fundamental reasons for having cost accounting: one, you talked about, the necessary piece to support user fees, but really more and more important than that is the fact that the FAA needs to know how much it costs to deliver its services, so that we can effectively manage this agency in the most effective and efficient way. Until we have that in place, we are making choices often based on assumption rather than hard data.

So, what we are trying to pull together is unassailable information that says it costs you this much to do your services. If you begin to compare one facility to another and we see the cost of operation in one is significantly different from the other, I think you recognize this, as we do, that the powerful impact that that can have on encouraging better operation that is more efficient.

So, that, on the one hand, just having the information and knowing what your costs are will have a salutary effect on the agency. When we couple that information as we will with the performance information and how well we are delivering our services, then it becomes more powerful yet, and then I think we have the technique that the GPRA anticipated. We would balance those two pieces and I think greatly improve how we serve the public and at the cost that it takes to do that.

Mr. HORN. Well, that leads to another question which I would like to have your opinion on it. You have a goal, obviously, and it is commendable, to receive a clean opinion on your 1999 financial statements on September 30th, and I would be curious how you plan to accomplish this given the various serious problems that the auditors, the General Accounting Office, the Inspector General have all said that FAA has, and I guess the question, to me, at least, is in the year 2000, that budget has been prepared, recommended by the President, were you there in time to get some input from the role of the Chief Financial Office in FAA, and if you need any personnel resources in order to get the job done or did you come into the system too late to get your ore into the boat and see what they would do with it?

Mr. SCHELLENBERG. I came right in the middle of that process, and I think we have appropriately participated in an effective way.

Mr. HORN. OK, so you are not short on resources?

Mr. SCHELLENBERG. No, sir.

Mr. HORN. Or did you recommend—well, let me ask you this: did any of your recommendations get cut at either the Administrator's level—this is the kind of thing OMB can't punish you over; once we ask it, you have to give us the truth. [Laughter.]

And we don't listen to them anyway. But the question is obvious, did the Administrator cut your request back? Did the Secretary of Transportation cut it back? Did OMB cut it back? Who killed Cock Robin in brief? Cock Robin is probably regulated by FAA somewhere. [Laughter.]

It flies, doesn't it? Or was he a little boy?

Mr. SCHELLENBERG. You always have me in that wonderful box. I can tell you, I am a good bureaucrat, and like any other bureaucrat, we would like to have more money that we can get. But what I can tell you is this: that where it has come to the question both in fiscal year 1999, plans for 2000, so far as the Administrator is concerned in providing and finding the dollars necessary to pursue these two critical initiatives. She has always been in the position of ensuring that we find the dollars to do so, so that I am convinced, whether it be a part of the 2000 process or whether it be a part of how we execute the budgets that we have, that we will find the dollars to make this happen.

Mr. HORN. Well, I will let that one pass. [Laughter.]

So, just let us know under oath if you have to, and if you have anything else to say, we will put in the record where the whole world can see it. [Laughter.]

Environmental clean-up liability. I also sit beside—my other assignment is on Transportation and Infrastructure. I sit on that subcommittee, and we are very interested in this. Mr. Boehlert is pursuing some very good strategies on this, but the amount estimated for future clean-up of environmental waste, including fuel storage tanks, has increased dramatically since last year. The estimate increased by over \$2.2 billion; that is an increase of over 237 percent. The obvious question to you, Mr. Schellenberg, is what has caused this huge increase and was something missed in prior years?

Mr. SCHELLENBERG. Mr. Chairman, unfortunately, that is something that I have little direct knowledge of. I will be happy to do some research for you and provide the information.

[The information referred to follows:]

The FAA reported, in Environmental and Disposal Liabilities, \$1 billion in FY97 and \$3.2 billion in FY98, an increase of \$2.2 billion. Most of this increase, \$1.5 billion, is the result of our greater recognition of, and our improved ability to estimate, the costs associated with the decommissioning of radars and navigational aids as Global Positioning Satellite (GPS) is implemented. As these facilities are decommissioned, it is incumbent that the FAA restores the land to its original condition. The remaining additional costs are associated with added costs for the replacement of fuel storage tanks; cleaning up and preventing releases of hazardous materials; and complying with OSHA and environmental mandates.

Mr. HORN. Well, is this an FAA responsibility or is this is a Department of Transportation responsibility with all of your various components, Mr. Kleinberg?

Mr. KLEINBERG. Each organization determines its liabilities associated with all of those types of operational activities as they take place throughout facilities that they either have or have abandoned in some cases, and they usually go through an analysis of that and get the lawyers in to figure out what the upper levels are. So, we can, if you want, assemble it through the Department, Department-wide if you would like, but it generally comes—we will assemble it from the component agencies of the Department.

Mr. HORN. But this figure is really tied, is it, to the FAA, this \$2.2 billion?

Mr. KLEINBERG. Yes.

Mr. HORN. And, so you have a bigger—few more billion, and I assume the railroad—

Mr. KLEINBERG. The Coast Guard, actually, has many, many facilities that they took over from Defense that have clean-up problems, Governor's Island being one.

Mr. HORN. Yes, I have held hearings there, and you are right on that, and I can see where Coast Guard would have it no different than the Navy in reality which, by the way, I guess we authorized you two new Coast Guard cutters yesterday, because the Navy wouldn't give them to you, and that really ticked me off. I voted for it, but I told Secretary Perry when we were both in Panama together, he was looking at the military stuff and three of us were looking at the drug situation, and I said we need some platforms in the Puerto Rico to Panama area and up the west side of Mexico where we could track these drug planes which are just—they just sort of spit in your eye as they go over you, and they dump this stuff about 20 feet off the Puerto Rican sands or in Puerto Rico right under our noses.

So, we were all ticked off, and we did unload on General McCafrey that as far as we are concerned they ought to start checking everybody from Puerto Rico that lands anywhere in the mainland United States, because there is no question drugs are being brought in, and they were just helpless to follow the radar thing and a few Navy ships that nobody's using, keep a couple in the Persian Gulf, and give us help is my attitude here. So, anyhow you have two cutters coming out of us, assuming the appropriations came, and I am sure you are going to give a good case for that.

I think the Coast Guard does a superb job. I didn't like you moving the 11th Coast Guard District from Long Beach, CA up to Alameda, but I think you do a superb job.

Mr. KLEINBERG. Thank you.

Mr. HORN. Anyhow, so what has caused this thing now? Is this strictly FAA property or is it things they have funded through the Airport Improvement Fund that you get stuck with in terms of environmental waste?

Mr. KLEINBERG. I am informed that it is FAA property, sir.

Mr. HORN. FAA property, OK. Do you think that is pretty accurate, Mr. Meche.

Mr. MECHE. Yes, sir, that is correct.

Mr. HORN. I guess some might have said this questionable number impact the fiscal year 1999. You have the estimate for the fiscal year 2000. Are we even worse off now or will something be done between now and September 30?

Mr. SCHELLENBERG. I am informed we book the estimate each year, and there is no anticipation that it would go down by 2000.

Mr. HORN. OK. Mr. Meche, did the Inspector General look at this number and see if it made sense?

Mr. MECHE. We have not looked at that number, Mr. Chairman.

Mr. HORN. OK, and I would like to know if you do look at it, will it possibly affect next year's opinion?

Mr. MECHE. I can certainly tell you we will look at it.

[The information referred to follows:]

Per your request of April 19, the information below is an insert to the transcript of the March 18, 1999 hearing entitled "Oversight of Financial Management Practices at the Department of Justice and the Federal Aviation Administration."

**Line 2248**

[The information follows:]

In FY 1998, FAA reported \$3.2 billion in Environmental and Disposal Liabilities on its financial statements in these categories:

Environmental Remediation	\$ 828,900,000
OSHA & Environmental Compliance	512,200,000
Decommissioning Cleanup	1,900,000,000
Air Traffic Control at Closed DOD Bases	3,200,000
<b>Total Environmental and Disposal Liabilities</b>	<b>\$3,244,300,000</b>

We met with FAA officials and discussed how they identify cleanup responsibilities and costs. For cleanup costs, regional engineers identify properties as prescribed by the Federal Facilities Compliance Act, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Resource Conservation & Recovery Act of 1976, the Clean Water Act, as well as all state and local environmental regulations.

The FAA Office of System Architecture and Investment Analysis (ASD) sets the schedule for decommissioning current properties. As systems are identified for decommissioning, ASD estimates the cost as it relates to environmental laws and regulations.

As part of our FY 1999 financial statements audit, we are reviewing how FAA identifies current and future cleanup sites. We will determine if the inventory of cleanup sites is complete, and determine whether cost estimates are reasonable.

Mr. HORN. OK. We found with the Department of Defense, their environmental waste group, it just takes forever to get anything done. We will all be in Medicare 20 times over, I think, before they get something done, and then all these bases that have been closed sit there, and you can't put them into economic development or anything else.

OK. GAO on the importance of financial statements. What the Inspector General has said they reported numerous areas in FAA's financial statements and several areas reported that they were unable to complete their audit due to a lack of records, similar reasons where we have discussed some of that, but I guess I would ask the General Accounting Office to explain to us for the record what it means, the ramifications, if FAA is unable to prepare reliable financial statements that can be audited?

Ms. CALBOM. You know, Mr. Chairman, the financial statements really are the public report card that an agency gives the taxpayers. It is similar to what any publicly held company reports to its shareholders. Shareholders are able to quickly look at what they got for their money, because company's report earnings per share; I mean, profit is the name of the game. As far as Government agencies, what taxpayers get for their money is outputs and outcomes, and there is an overall reporting scheme that the Federal Accounting Standards developed, and I was touching on it a little bit earlier.

Basically, we have our budgetary statements now that are supposed to reconcile your budget activity for the year. Then you have your basic financial statements that tell you, "OK, what did I spend that money on that I received? What are the investments the taxpayer made? What are the balances on the books related to those investments today?" And then you have your performance reporting which is a fairly new concept in Government, but it is a very important one, because that is the piece where you say, "All right, what did I get, and how much did it cost me?" And when you get all those pieces together, then the taxpayer can start to say, and, more importantly, the Congress who is overseeing these activities, "All right, was it worth it to me to receive that outcome for this much money? We budgeted this amount to this agency; here is how they spent it; here is what they got. Was it really worth it, and should we be shifting priorities?" Across Government, we are far away from being able to do that, but you have to take things one step at a time, and the step that I think we are all here today focusing on that is critical to the whole process is getting these financial statements. That middle link has to be a good solid link or you will never get the rest of it.

Mr. HORN. I agree with every word you said, Ms. Calbom. Your eloquence is right on the spot and headed in the right direction. There is no question that once Congress passed the Results Act, as we call the Performance Act—and we have strategic plans now going, and a lot of Federal agencies didn't have the slightest idea what we were talking about on the strategic plan, and yet every one of us that has been in local government or on the local Chamber of Commerce or running a university or whatever it is or a corporation that has stock on the New York Stock Exchange and so forth, all of those in the last 20 years have developed strategic



plans. What is our mission? And just as you say so very well, how do we measure what we are accomplishing?

And we will be looking at Australia and New Zealand that we have given quite a platform to here 2 years ago when we started in on that. They are the only two countries in the world with results-oriented governments. The only place in the United States I know it exists in government is Oregon. The State of Oregon has gone out and it isn't easy, as you know, to relate financial data to measurement of satisfaction of the clientele, but let us face it, we have trillions of dollars down the line that things are going to cost, and we have to figure out what do we do best with the most reasonable amount of money to please the taxpayers, which we are all here to serve, both in the executive branch and the legislative branch.

So, I think that we are on the right track, especially when you can use the user fees, because I don't know how many people will take you into court if you didn't have a data base to back it up. I have seen it happen on the Airport Trust Funds all over the place, but I think you are on the right track, and I want to thank you all for testifying here today.

It is obvious that we still have a great deal to go on financial accounting, but it is absolutely necessary. I think you obviously agree with that, and we certainly agree with you agreeing with that.

If both Justice and Federal Aviation were corporations, they would be struggling to stay in business given the financial reports. Publicly held corporations have to accurately report their finances to stockholders, to boards of directors. Public agencies have to be held to the same high standard for their stockholders, namely, the taxpayers of the country, and I am glad to see the interest that both the General Accounting Office, the Inspector General, the Department of Transportation, and the Federal Aviation Administration has in this, and I am glad you joined the team, Mr. Schellenberg, because I am impressed with what you had to say and get on top of this situation.

It is not easy; we all know it, but it is going to take a couple of years to turn this thing around, and that is true everywhere. All we can do is work steadily at it, and I wish you well, and I hope next year about this time you will have a lot more to say or you won't even be up here. [Laughter.]

Mr. SCHELLENBERG. I will opt for the second one.

Mr. HORN. So, merry holidays, Merry Christmas. Thank you very much for coming.

Mr. SCHELLENBERG. Thank you.

Mr. KLEINBERG. Thank you.

Mr. MECHE. Thank you.

Ms. CALBOM. Thank you, Mr. Chairman.

Mr. HORN. I am going to thank the staff that prepared this fine hearing, and we can start with J. Russell George, the staff director and chief counsel—he is off on other business; Bonnie Heald, I see in the corner back there, director of communications, professional staff member for the Subcommittee on Government Management, Information, and Technology, and the right arm on this hearing happens to be the left arm, Larry Malenich who is the GAO detailee; Mason Alinger, over there in the corner, principal staff as-

sistant and clerk, and Kacey Baker, an intern, was here, but she helped on this; Faith Weiss, for the minority; Ellen Rayner, the chief clerk for the minority and our two court reporters, Kristine Mattis—is it, have I got that right? And Carl Huang. I thank you all, and, with that, this hearing is adjourned.

[Whereupon, at 4:10 p.m., the subcommittee was adjourned.]

