February 8, 2008

LYNN MALCOLM
VICE PRESIDENT, CONTROLLER

SUBJECT: Audit Report – Fiscal Year 2007 Postal Service Financial Statements Audit – Washington, D.C., Headquarters (Report Number FT-AR-08-006)

This report presents the results of our audit of selected financial activities and accounting records at U.S. Postal Service Headquarters for the fiscal year (FY) ended September 30, 2007 (Project Number 07BM007FT000). The Postal Reorganization Act of 1970, as amended, requires annual audits of the Postal Service's financial statements. We conducted this audit in support of the independent public accounting (IPA) firm's overall audit opinion on the Postal Service's financial statements. Please refer to Appendix A for additional information about this audit.

Overall Audit Conclusion

- Financial accounting policies and procedures provided for an adequate internal control structure and conformed with accounting principles generally accepted in the U.S.
- Accounting transactions at headquarters[1] affecting general ledger account balances were stated in accordance with accounting principles generally accepted in the U.S.
- General ledger account balances conformed to the general classification of accounts on a basis consistent with that of the previous year.
- The Postal Service complied with laws and regulations that have a direct and material effect on the financial statements.
- No adjustments were proposed.
- A control deficiency regarding manual journal voucher (JV) processing was identified. This item was not significant to the financial statements and did not affect the overall adequacy of internal controls.

[1] The U.S. Postal Service Office of Inspector General (OIG) and IPA coordinate testing and review of significant headquarters accounts and manual journal vouchers.

Manual Journal Voucher Processing

- Management did not always maintain adequate controls over JV preparation, approval, and review.

- Of 382 manual JVs reviewed, we found 18 JVs, with entries totaling approximately $1.3 billion, had one or more internal control deficiencies. Refer to Appendix B for manual JV details.

TIMEFRAME OF JV					INTERNAL CONTROL ISSUE
Qtr 1	**Qtr 2**	**Qtr 3**	**Qtr 4**	**Total**	
		1		1	Preparer not identified
	1		1	2	No evidence of approval
1	6		1	8	No evidence of review
	1		4	5	Some or all support missing
			1	1	No evidence of final approval, input into JEV,[2] or posting to the general ledger (GL)
	1			1	JV amount differed from support by $100

- **Criteria:**
  - Handbook F-20, *General Ledger Accounting and Financial Reporting System*, dated December 2004.
  - Corporate Financial Reporting (CFR) internal control procedures over JV processing.
  - Postal Accountability and Enhancement Act of 2006, Section 204, Subchapter IV, Section 3654(a)(3).
- **Cause:**
  - Human error and inadequate oversight.

[2] The Journal Entry Vehicle (JEV) application provides a method for entering JVs into the General Ledger Accounting and Financial Reporting System. The application allows users to create, save, edit, and approve or reject manual journal vouchers.

- **Effect:**
  - When internal controls over manual JV processing are not in place, there is increased risk of misstated financial information in the general ledger. Refer to Appendix C for our detailed analysis of this issue.

We recommend the Vice President, Controller:

1. Direct the Manager, Corporate Accounting, to reiterate journal voucher internal control procedures to all applicable personnel.

Management's Comments

Management concurred with our recommendation and planned to reiterate JV internal controls procedures to all applicable personnel by the end of January 2008. Management's comments, in their entirety, are included in Appendix D.

Evaluation of Management's Comments

Management's comments are responsive to the recommendation, and the action planned should correct the issue identified.

Observations

We observed the following issues during our JV review that were not material to the overall financial statements and do not affect the overall adequacy of internal controls over JV processing. However, we presented them to management to further enhance the JV entry process.

<u>Inconsistent Evidence of Approval for 14 Journal Vouchers that were Prepared and Approved by Another Office</u>

We noted 14 instances where JVs were prepared and approved by personnel from another office. Although these JVs were authorized to be prepared and approved by that office, we found no evidence of CFR official approval prior to input into the JEV. CFR officials stated since the JVs were entered by CFR, this indicated their approval. However, they agreed that to comply with applicable portions of the Sarbanes-Oxley (SOX) Act of 2002, they should approve all JVs prior to input into the JEV.

<u>"Approver" and "Entered By" was the Same Official</u>

We noted two instances where the "approver" and "entered by" were the same CFR official. Although Postal Service policy does not indicate they must be different officials, we believe there should be a segregation of duties since the steps are in consecutive order and no single official should have control over two or more consecutive steps of the JV entry process. Since these JVs were subsequently reviewed by another individual, we are not offering a recommendation at this time.

<u>JV Amounts Differed from Control Sheets</u>

We noted two instances where the dollar amounts on the JVs differed from the control sheets. Specifically, [redacted], dated February 2007, differed by $294,000; and [redacted], dated September 2007, differed by $48,441,276. CFR attributed the differences to typographical errors on the control sheets. Since the JV amounts were entered correctly into the general ledger, we are not offering a recommendation at this time.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information, please contact Lorie Nelson, Director, Financial Reporting, or me at (703) 248-2100.

John E. Cihota
Deputy Assistant Inspector General
for Financial Accountability

Attachments

cc: H. Glen Walker
Stephen J. Nickerson
Vincent H. DeVito, Jr.
Katherine S. Banks

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

U.S. Postal Service Headquarters Finance establishes accounting policies and provides guidelines for recording and reporting Postal Service financial transactions. Internal control and reporting systems have been created to ensure management and the public receive meaningful financial information in accordance with generally accepted accounting principles. We conducted this audit in support of the IPA's overall audit opinion on the Postal Service's financial statements.

We will issue separate financial statements audit reports for the Eagan, San Mateo, and St. Louis Information Technology and Accounting Service Centers (IT/ASCs). Further, in addition to the overall opinion on the Postal Service's financial statements, the Board of Governors' IPA, contracted to express an opinion on the financial statements, will issue separate reports on the Postal Service's internal controls and compliance with laws and regulations. The OIG will also issue a separate report for the audit of the FY 2007 information system controls at the Eagan, Minnesota; San Mateo, California; and St. Louis, Missouri, IT/ASCs; and the Raleigh, North Carolina, Information Technology Service Center.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the audit were to determine whether:

- The financial accounting policies and procedures provide for an adequate internal control structure and comply with accounting principles generally accepted in the U.S.

- Accounting transactions at headquarters impacting the general ledger account balances for assets, liabilities, equity, income, and expenses of the Postal Service are fairly stated in accordance with accounting principles generally accepted in the U.S.

- General ledger account balances conform to the general classification of accounts of the Postal Service on a basis consistent with that of the previous year.

- The Postal Service complies with laws and regulations that have a material and direct effect on the financial statements as a whole.

To accomplish our objectives, we conducted fieldwork from March through November 2007. We have a memorandum of understanding with the IPA regarding responsibilities for the testing and review of internal controls and transactions, and noted headquarters accounts and processes. Specifically, the IPA and OIG coordinate testing and review of significant headquarters accounts (e.g., Cash, Investments, Workers Compensation, and Unemployment Liability), manual JVs,[3] and laws and regulations. Further, we verified the Board of Governors' travel and miscellaneous expenses totaling about $92,500 and external professional fees totaling approximately $1,300; and tested and accepted officers' travel and representation expenses totaling about $880,000. We will issue separate reports for our audits of the FY 2007 Board of Governors' travel and miscellaneous expenses and the FY 2007 officers' travel and representation expenses.

We conducted this audit from March 2007 through February 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform our work to obtain sufficient audit evidence to limit the audit risk to a low level that is, in our professional judgment, appropriate for supporting the overall audit opinion on the financial statements. Those standards also require considering the results of previous engagements and following up on known significant findings and recommendations that directly relate to the objectives of the audit. An audit also includes obtaining a sufficient understanding of internal control to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed. We supported the IPA in obtaining reasonable assurance about whether the financial statements are free of material misstatement (whether caused by error or fraud). Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with generally accepted government auditing standards may not detect a material misstatement. However, the IPA and the OIG are responsible for ensuring that appropriate Postal Service officials are aware of any significant deficiencies that come to our attention. We discussed our observations and conclusions with management officials on December 5, 2007, and included their comments where appropriate.

We relied on computer-generated data from several Postal Service financial systems, including the eTravel system, Chase Insight, Workers' Compensation Master File, and Accounting Data Mart. We performed specific internal control and transaction tests on these systems' data, to include tracing selected financial information to supporting source records. For example, we reconciled the number of claimants and dollar amounts on the Workers' Compensation Master File against Department of Labor payment records.

[3] Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit*, requires auditors to perform certain tasks to address the risk of management override of internal control. To address such situations, SAS No. 99 requires auditors to test the appropriateness of journal entries recorded in the general ledger and other adjustments.

PRIOR AUDIT COVERAGE

Report Title	Report Number	Final Report Date	Results
Fiscal Year 2006 Postal Service Financial Statements Audit –Washington, D.C., Headquarters	FT-AR-07-004	December 7, 2006	There were no reportable conditions.

APPENDIX B: MANUAL JOURNAL VOUCHER DETAILS

Journal Voucher #		Month	JV Amount
Preparer not identified			
1	[redacted]	Apr 2007	$1,643,114
No evidence of approval			
1	[redacted]	Mar 2007	$ 559,600
2	[redacted]	Aug 2007	12,599,108
			$13,158,708
No evidence of review			
1	[redacted]	Dec 2006	$138,217,700
2	[redacted]	Jan 2007	4,299,959
3	[redacted]	Jan 2007	2,279,956
4	[redacted]	Feb 2007	1,750,000
5	[redacted]	Feb 2007	427,059,920
6	[redacted]	Mar 2007	3,870,016
7	[redacted]	Mar 2007	3,900,000
8	[redacted]	Jul 2007	1,500,000
			$582,877,553
Some or all support missing			
1	[redacted] *	Mar 2007	N/A
2	[redacted]	Jul 2007	$17,460,903
3	[redacted]	Aug 2007	4,800,000
4	[redacted] **	Sep 2007	N/A
5	[redacted]	Sep 2007	248,300,000
			$270,560,903
No evidence of final approval, input into JEV, or posting to GL			
1	[redacted]	Jul 2007	$33,186,500
JV amount differed from support			
1	[redacted]	Mar 2007	$369,306,393
18			$1,270,733,171

* JV contains more than one issue, but dollar amounts are only counted once.
** Dollar amount is included within JV [redacted] dated September 2007.

APPENDIX C: MANUAL JOURNAL VOUCHER PROCESSING

We found the internal controls over manual JVs processed by CFR were generally adequate and served a legitimate business purpose. However, CFR did not always comply with controls over manual JV preparation, approval and review. Specifically, of 382 manual JVs reviewed, 18 JVs, with entries totaling about $1.3 billion, had one or more internal control deficiencies.

The General Ledger Accounting and Financial Reporting System includes a process for entering manual accounting journal entries into the Oracle General Ledger (OGL). The manual JV process begins with the need to capture financial information in the general ledger, or the occurrence of a business activity.

CFR personnel prepare both manual recurring[4] and non-recurring[5] journal entries. CFR uses Postal Service Form 82411, *Journal Entry Vehicle* (JEV), to track all manual JVs processed. The JEV forms are in an Excel spreadsheet format and include a description of the journal entry, preparer, JV number, dollar amount, and date prepared and entered into the OGL. For FY 2006, CFR prepared 504 manual JVs with entries totaling approximately $31 billion, and for FY 2007, 539 manual JVs with entries totaling approximately $48 billion.

Handbook F-20, Chapters 2 and 5, covers manual JV processing. In addition, CFR supplements Handbook F-20 with additional informal procedures as follows:

1. Personnel prepare JVs with documentation justifying the entry and supporting the finance numbers, account numbers, and dollar amounts. The preparer initials the JV form as “Prepared By.”

2. A different individual reviews and approves the JV and accompanying documentation. This individual initials the JV form as “Approved By.”

3. An individual then determines whether the JV has proper approval, enters it into the JEV, saves the data entry, and initials the JV form as “Entered By.”

4. An individual different from the one entering the JV into the JEV, reviews the data entry and, if approved, initials the JV form as “Reviewed By.”

5. Upon approval, the individual that entered the JV into the JEV electronically submits the JEV data to a senior accountant for final review and preparation for posting into the OGL. The individual then writes the letter “S” on the JV.

[4] Recurring journal entries have the same accounts and/or amounts, and recur from month to month. At headquarters, these entries range from JV numbers [redacted] through [redacted]

[5] Non-recurring journal entries are initiated by CFR to reverse journals, month-end accruals, and reclassification entries. At headquarters, these entries range from JV numbers [redacted] through [redacted].

6. The senior accountant performs an overall final review of the JV and its input into JEV. Upon completion, the senior accountant moves the JEV entry for posting into the OGL. The senior accountant then writes "M" on the JV.

7. Eagan IT/ASC personnel post the JEV entry into the OGL.

8. The individual from headquarters (step 3 above) reviews the OGL the next day to verify the JV entries were posted to the general ledger and are accurately reflected in Accounting Data Mart. The individual documents this verification with a notation of "POSTED" on the JV.

The Postal Service is required by the Postal Accountability and Enhancement Act, passed in December 2006, to comply with applicable portions of SOX. Accordingly, the Postal Service must be able to detect and prevent misstatements in a timely manner and be assured that internal control procedures are maintained and designed to ensure material information is disclosed. When internal controls over manual JV processing are not in place, there is increased risk of misstated financial information in the general ledger.

APPENDIX D. MANAGEMENT'S COMMENTS

LYNN MALCOLM
VICE PRESIDENT, CONTROLLER

UNITED STATES POSTAL SERVICE

January 9, 2008

LUCINE M. WILLIS

SUBJECT: Fiscal Year 2007 Postal Service Financial Statements Audit—Washington, DC Headquarters (Report Number FT-AR-08-DRAFT)

Thank you for the opportunity to review and comment upon the draft audit report issued December 19, 2007. We are pleased to note that the financial accounting procedures employed at the headquarters location are adequate and that the accounting transactions recorded at headquarters were stated in accordance with generally accepted accounting principles.

The control deficiency noted in your report regarding manual journal voucher processing was, to a certain extent, a result of the difficulty of maintaining adequate staffing levels in the headquarters accounting function, and the challenging timelines for performing monthly and quarterly close procedures. We are making efforts to address the staffing issues and improve oversight.

We concur with your recommendation that the Manager, Corporate Accounting, should reiterate to all applicable personnel, journal voucher internal control procedures. This will be done by the end of January, 2008. We anticipate that, as staffing shortfalls are resolved, the level of compliance with journal voucher control procedures will improve as well.

Lynn Malcolm

Lynn Malcolm
Vice President, Controller

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