
Office of Inspector General

Audit Report

QUALITY CONTROL REVIEW OF THE MANAGEMENT LETTER FOR THE AUDIT OF FISCAL YEARS 2015 AND 2014 FINANCIAL STATEMENTS

Federal Aviation Administration

Report Number: QC-2016-023

Date Issued: February 25, 2016





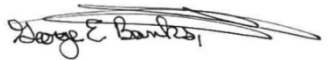
Memorandum

**U.S. Department of
Transportation**

Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION:** Quality Control Review of the
Management Letter for the Audit of Fiscal Years
2015 and 2014 Financial Statements,
Federal Aviation Administration
Report Number: QC-2016-023

Date: February 25, 2016

 for

From: Louis C. King
Assistant Inspector General for Financial and
Information Technology Audits

Reply to
Attn. of: JA-20

To: Federal Aviation Administrator

I am pleased to transmit the attached management letter in connection with the audit of the Federal Aviation Administration's (FAA) financial statements as of and for the years ended September 30, 2015, and September 30, 2014. KPMG LLP of Washington, D.C., completed the audit under contract to the Office of Inspector General (OIG). The contract required that KPMG perform the audit in accordance with generally accepted Government auditing standards and Office of Management and Budget (OMB) Bulletin 15-02, "Audit Requirements for Federal Financial Statements." KPMG issued an auditor's report that included a clean (unmodified) opinion on FAA's financial statements.¹

As part of its audit, KPMG issued, and is responsible for, the attached management letter that identifies internal control matters requiring management attention. KPMG was not required to include these matters or the related recommendations in its auditor's report. The matters are as follows:

Financial Reporting and Accounting

1. Improvements needed in Segregation of Duties over Manual Journal Voucher Process
2. Unfilled Customer Orders with and without Advance

¹ *Quality Control Review of Audited Financial Statements for Fiscal Years 2015 and 2014, Federal Aviation Administration, OIG Report No. QC-2016-007. OIG's reports are available at www.oig.dot.gov.*

3. Improvements needed in the Property, Plant, and Equipment retirement and disposal process
4. Improvements needed in the documentation of the Environmental Remediation Liability
5. Improvements needed in the documentation of the Environmental Cleanup and Decommissioning Liability

Information Technology General and Application Controls

1. Audit Logging for an Inventory System
2. Audit Logging for a Grants Reporting System
3. Data Center Physical Security for a Grants Reporting System
4. Segregation of Duties for an Inventory System
5. Vulnerability Assessment for an Inventory System
6. Password Configurations for Inventory and Grants Reporting Systems
7. Terminated Users for the DOT Financial System

KPMG made 21 recommendations to strengthen FAA's financial, accounting, and system controls. FAA officials concurred with KPMG's recommendations. The Agency also submitted detailed action plans to address the findings in KPMG's management letter to OIG on January 29, 2016 (Information Technology) and February 8, 2016 (Financial Reporting). In accordance with DOT Order 8000.1C, the corrective actions taken in response to the findings are subject to follow up.

We performed a quality control review of KPMG's management letter and related documentation. Our review disclosed no instances in which KPMG did not comply, in all material respects, with generally accepted Government auditing standards.

We appreciate the cooperation and assistance of FAA's representatives and KPMG. If you have any questions, please call me at (202) 366-1407, or George Banks, Program Director, at (410) 962-1729.

Attachment



KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

November 30, 2015

Administrator Federal Aviation Administration
Inspector General, U.S. Department of Transportation

Ladies and Gentlemen:

In planning and performing our audit of the consolidated financial statements of the U.S. Department of Transportation (DOT) Federal Aviation Administration (FAA), as of and for the year ended September 30, 2015, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, we considered FAA's internal control over financial reporting (internal control) as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of FAA's internal control. Accordingly, we do not express an opinion on the effectiveness of FAA's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of FAA management, verbally, as well as through written Notice of Findings and Recommendations (NFRs), are intended to improve internal control or result in other operating efficiencies. The topics covered in Exhibit I are: (A) *Financial Reporting* and (B) *Information Technology General and Application Controls*.

Our audit procedures are designed primarily to enable us to form an opinion on the consolidated financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of FAA's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

The purpose of this letter is solely to describe comments and recommendations intended to improve internal control or result in other operating efficiencies. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

A. Financial Reporting

Improvements needed in Segregation of Duties over Manual Journal Voucher Process - FAA-2015-01

Background/Condition

Certain manual journal voucher (JVs) are prepared and posted to the general ledger at FAA headquarters (HQ) by staff and management. FAA's policy is to restrict the responsibilities for preparing and posting JVs to select individuals within AFR-300 (the financial statements and reporting division) and AFR-310 (the financial reporting quality assurance branch). However, the DOT financial system is not properly configured to require an individual other than the preparer to post a manual JV. As a result, FAA has instituted a manual process requiring the supervisory review of all manual JVs posted to the general ledger, including the review of relevant supporting documentation.

Specifically, FAA's policy states that each manual JV is required to be reviewed by an appropriate member of management (AFR-300 and AFR-310 managers) and by an individual other than the person who prepares and posts the JV within 10 business days. The review is evidenced by the reviewer's signature on the JV coversheet and is maintained in the JV audit log binder.

Each month, a report is generated, from the DOT financial system where the report requester inputs the period name as a parameter to create a population of all JVs for a given month. The AFR-300 accountant who requests the population then manually reconciles every item in the population to the approved JV coversheets that are maintained in hard copy in the JV audit log. If a manual JV from the DOT financial system report was not properly approved, it should be detected and remedied during this reconciliation process.

During our walkthrough with management over the processing of manual JVs at FAA HQ, we identified inappropriate segregation of duties where the AFR-300 accountant that has access rights to both prepare and post manual JVs to the general ledger is also the individual responsible for ensuring all manual JVs posted to the general ledger, including his own entries, were properly reviewed and approved in accordance with FAA's manual review process noted above.

Recommendations

We recommend that FAA management revise policies and procedures to ensure proper segregation of duties over the processing of manual JVs at FAA HQ.

Unfiled Customer Orders (UCOs) with and without Advance - FAA-2015-02

Background/Condition

A reimbursable agreement is an arrangement whereby FAA agrees to provide goods or services to another agency in return for reimbursement of costs incurred or agrees to reimburse another agency for its costs in providing goods or services to FAA.

UCOs without advance are the total amount of unearned reimbursable agreements/orders accepted without an advance of funds. This account represents the amount of goods and/or services to be furnished to other Federal Government agencies and for any State, local or tribal government and the public, if permitted by law. These budgetary transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely and reliable reports.

Management has monitoring review controls in place over inactive UCOs to identify and de-obligate inactive UCOs.

During the fiscal year (FY) 2015 audit, we selected a statistical sample of seven items from a population of UCOs consisting of three UCOs without advances and four UCOs with advances, as of July 31, 2015. Based on our review, we noted that for one selected UCO without advance, the period of performance had ended; however, the unused obligated balance for this UCO was not properly de-obligated when the project was terminated in December 2012.

Recommendation

We recommend that FAA management emphasize the timely de-obligation of inactive UCOs identified during management's monitoring and review process.

Improvements needed in the Property, Plant, and Equipment (PP&E) retirement and disposal process - FAA-2015-03

Background/Condition

We noted that FAA has made progress in addressing the recommendations from the FY 2014 finding related to the retirement and disposal process for PP&E. Specifically, we noted that FAA has drafted policies and procedures to specify the number of days within which property identified for disposal should be retired and recorded in the general ledger, and management has begun training the various regions and property owners on the new draft policies and procedures. However, a formal policy was not in effect for the entire period under audit. In addition, FAA has developed a year-end accrual process for assets identified for retirement by the various regions and property owners, which have not yet been recorded in the Fixed Asset Module sub-ledgers as of September 30, 2015.

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During the FY 2015 audit, we selected a statistical sample of 33 PP&E retirements for the period October 1, 2014 through September 30, 2015. Based on our review, we identified three assets that were physically disposed of in a prior period, but not retired and removed from the Fixed Asset Module sub-ledger and general ledger until FY 2015. We also noted that these assets were not included in the prior period retired asset accrual.

Recommendations

We recommend that FAA:

1. Finalize the policies and procedures that specify the number of days within which property identified for disposal should be retired and recorded in the fixed asset sub-ledger;
2. Provide training to the various regions and property owners on the new policies and procedures noted in recommendation; and,
3. Continue to perform procedures to assess the amount of assets identified for retirement, by the various regions and property owners, which have not yet been recorded in the general ledger as of September 30th and record an accrual, as needed.

Improvements needed in the documentation of the Environmental Remediation (ER) Liability - FAA-2015-04

Background/Condition

FAA records an ER liability for costs necessary to bring known contaminated sites into compliance with applicable environmental standards. FAA estimates the liability using various methods including Remedial Action Cost Engineering and Requirements (RACER) and actual costs.

William J. Hughes Technical Center

The William J. Hughes Technical Center (the Center) in Atlantic City, a designated Environmental Protection Agency (EPA) superfund site, represents approximately 45% of the estimated ER liability. The liability at the Center is determined using a combination of RACER estimates and actual costs. Based on our review of the Center's liability, we noted that the following assumptions were not adequately supported or revalidated on a regular basis.

- Operations & Maintenance (O&M) and Long Term Monitoring (LTM) costs are estimated as current annual expenses projected out for 30 years. In FY 1999, the Superfund Cleanup Program Manager determined that the use of 30 years was the appropriate rate based on professional experience and the extent/nature of the contamination.

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- An estimated cost for rehabilitation and technology changes at the Central Treatment Plant (CTP) is calculated as 60% of the original construction cost of the CTP. In FY 2006, the Superfund Cleanup Program Manager determined that 60% of the original construction cost was appropriate.
- Natural Resource Damage Mitigation (NRDM) costs are costs required by the U.S. Fish and Wildlife Service to seek compensation for natural resources injured or destroyed when areas are contaminated with hazardous substances. The exact NRDM cost is unknown; however, in FY 2006, management estimated the costs to be approximately \$1.04 million.

Overhead and Project Management Costs

The total ER liability includes estimated amounts for overhead and project management costs for the Service Areas and FAA HQ. For the FY 2015 liability, the Service Areas overhead and project management costs were an average 15% of the total estimated technical liability. The FAA HQ project management costs were estimated as 20% of the total technical liability. Per the *FAA ATC Facilities EOSH Services Environmental Cleanup Program (ECU) Standard Procedures for Environmental Cleanup program cost estimation data June 2013*, FAA estimated the project management percentage to be approximately 17% based on a study conducted by the Department of Defense. FAA has not performed an analysis to validate this number based on actual FAA costs.

Recommendations

We recommend that FAA strengthen policies and procedures over the ER liability to include requirement to:

1. Revalidate all key data inputs and assumptions on an annual basis; and,
2. Document the key assumptions applied in the calculation of the liability.

Improvements needed in the documentation of the Environmental Cleanup and Decommissioning (EC&D) Liability - FAA-2015-05

Background/Condition

FAA records an EC&D liability for costs that will occur to cleanup and dispose of hazardous materials when operations cease and the asset is decommissioned. The Office of Investment Planning and Analysis prepares the Cost Basis of Estimate (BOE) report to calculate the EC&D liability. The costs included in the EC&D liability are: Environmental Due Diligence Audits (EDDA), Abatement, Hazmat, and Oversight and Project Support.

Based on our review of the FY 2015 BOE report, we noted that the following assumptions were not adequately supported or revalidated on a regular basis:

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- EDDA cost factors for facility types Localizer (LOC), Outer Marker (OM), Tactical Air Navigation Collocated with a VOR (TACR), Remote Transmitter/Receiver (RTR), and Medium Intensity Approach Lighting System with Runway Alignment (MALSR) were last updated by the Air Traffic Control (ATC) Facilities Technical Operations subject matter expert in FY 2012.
- The Oversight and Project Support cost factor is estimated at approximately 20% of the EC&D liability. In FY 2014, the ATC Facilities Technical Operations subject matter expert estimated the oversight and project support to be 20% but did not maintain documentation to support the assumption.

In addition, beginning in FY 2014 and continuing in FY 2015, FAA updated the cost factors for the top five facility types, by percentage, of the total EC&D liability and the top five facility types by number of facilities decommissioned using the inflation factors from the OMB FY 2016 Budget, Table 1.1.9 Economic Assumption report. Based on our review of the FY 2015 BOE report, we noted that the cost factors were inadvertently inflated twice.

Recommendations

We recommend that FAA strengthen policies and procedures over the estimation of the EC&D liability to include requirements to:

1. Revalidate all key data inputs and assumptions on an annual basis;
2. Document the key assumptions applied in the calculation of the liability; and,
3. Review the reasonableness of the formulas and calculations in the estimate.

B. Information Technology General and Application Controls

Audit logging for an Inventory System - DOT-2015-FAA-IT-01

Background/Condition

During our testing of general information technology controls over the inventory Enterprise Architecture and Solutions Environment (EASE) mainframe, we noted security audit logging and monitoring is performed by the Information System Security Officer (ISSO) at the National Information Technology Center (NITC), which is maintained by the U.S. Department of Agriculture (USDA). We noted that FAA management does not have a documented procedure to review and approve audit log and security violation reports transmitted to FAA by NITC. We were informed that ad hoc reviews of audit log and security violation reports are performed; however, these reviews are not independently conducted or documented by FAA.

Recommendations

We recommend that FAA develop and implement procedures requiring periodic independent reviews of audit logs. The procedures should require reviews to be documented, include the items being reviewed, and the frequency within which the reviews should occur.

Audit Logging for a Grants Reporting System - DOT-2015-FAA-IT-02

Background/Condition

During our testing of general information technology controls, we noted the operation relies on two privileged database accounts, both of which are active; however, there is no periodic review in place over security audit logs for these accounts or any other database activity.

Recommendation

We recommend that FAA management develop and implement procedures requiring periodic reviews of audit logs for all platforms, including the database. The procedures should include the items being reviewed and the frequency within which the reviews should occur. Lastly, the System Security Plan (SSP) should be updated to reflect the new implementations.

Data Center Physical Security for a Grants Reporting System - DOT-2015-FAA-IT-03

Background/Condition

In order to determine if physical access controls over the data center were properly designed, implemented, and operating effectively during FY 2015, we requested a listing of users with physical access to the data center and it could not be provided. Additionally, we were informed that a periodic review of existing users with physical access to the data center is not performed.

Recommendation

We recommend that FAA management completes the implementation of procedures for:

1. Granting physical access to the data center;
2. Retaining authorizing documents and maintaining user listings of individuals that are granted access; and,
3. Performing periodic reviews of access rights for existing data center users.

Additionally, we recommend that FAA management complete the relocation of the system, as soon as possible, to a secure data center with strong physical access controls.

Segregation of Duties for an Inventory System - DOT-2015-FAA-IT-04

Condition

During our testing of general information technology controls over the mainframe, we compared a system-generated list of developers to a system-generated list of Production Systems and Technical Support (PSTS) staff and noted two listed developers are on the PSTS staff, which have the ability to modify production libraries and datasets.

Recommendation

We recommend that FAA update the SSP and relevant policies and procedures to ensure segregation of duties is maintained throughout the change management process. If restricting developers' access to production libraries and datasets is not technically feasible or not operationally practical, FAA should identify a compensating control, such as independently conducting and documenting a periodic review of audit logs to identify inappropriate and unauthorized changes implemented outside of the formal change management process.

Vulnerability Assessment for an Inventory System - DOT-2015-FAA-IT-05

Condition

During our testing of general information technology controls, we noted that a high vulnerability, identified during our June 2015 observation during security scans, remained on the system beyond the 90 day remediation timeframe.

Recommendation

We recommend that FAA management apply system patches for weaknesses identified in monthly vulnerability scans to strengthen patch management controls in the system environment.

Password Configurations for Inventory and Grants Reporting Systems - DOT-2015-FAA-IT-06

Condition

During our testing of general information technology controls for the mainframe and application, we determined that the password complexity configurations did not meet DOT minimum password requirements of at least 12 characters, including a combination of letters, numbers, and special characters. Specifically, we noted that mainframe and application passwords had a minimum password length of 8 characters. Additionally, the passwords for both systems do not require complexity.

Upon notification of the finding, FAA configured passwords to require a minimum length of 12 characters with complexity requirements in accordance with the DOT Cyber Security Compendium.

Recommendation

We recommend that FAA:

1. Strengthen password complexity configurations for both systems, in accordance with the DOT Cyber Security Compendium; or,
2. Obtain a waiver from the DOT Chief Information Officer to relieve FAA of the implementation requirements within the DOT Cyber Security Compendium.

Terminated Users for the DOT Financial System - FAA-IT-07

Background/Condition

FAA uses commercially available Federal Financial software, as its financial management and accounting system of record. System users have the ability to search, browse, maintain, share, classify, register, and standardize financially administered items through a web based application and access is controlled by the system owners.

We obtained a listing of FAA employees who separated from FAA, compared the listing to the DOT Financial System active user listing, and noted 19 separated employees whose access had not been removed.

Recommendation

We recommend that FAA management develop and implement policies and procedures, including increasing the level of precision of the quarterly review of user access, to remove application access for separated employees and contractors immediately upon termination or when determined that a user's access is no longer required.