Office of Inspector General
Audit Report

QUALITY CONTROL REVIEW OF THE MANAGEMENT LETTER FOR THE AUDIT OF FISCAL YEARS 2014 AND 2013 FINANCIAL STATEMENTS

Department of Transportation

Report Number: QC-2015-036

Date Issued: March 31, 2015

Memorandum

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

Subject: **<u>ACTION</u>:** Quality Control Review of the Management Letter for the Audit of Fiscal Years 2014 and 2013 Financial Statements, Department of Transportation
Report Number: QC-2015-036

Date: March 31, 2015

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

Reply to Attn. of: JA-20

To: Assistant Secretary for Budget and Programs/ Chief Financial Officer

I am pleased to transmit the attached management letter in connection with the audit of the Department of Transportation's (DOT) consolidated financial statements as of and for the years ended September 30, 2014, and September 30, 2013. 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 14–02, "Audit Requirements for Federal Financial Statements." KPMG issued an auditor's report that included a clean (unmodified) opinion on DOT'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, which follow, or the related recommendations in its auditor's report:

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[1] *Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2014 and 2013, Department of Transportation*, OIG Report No. QC-2015-011. OIG's reports are available at www.oig.dot.gov.

<u>Financial Reporting and Accounting</u>

1. Weakness in Management's Documentation of Policies for Non-Generally Accepted Accounting Principles
2. Weakness in Financial Statement Preparation and Review
3. Weaknesses in Federal Transit Administration's (FTA) Grant Accrual
4. Weakness in the Subsidy Estimate Review and Approval

<u>Information Technology General and Application Controls</u>

1. Lack of Audit Log Review for Windows Servers - Federal Highway Administration (FHWA)
2. Lack of *Delphi Interface Management System* Periodic Review of Access – FHWA
3. Separated User with Active *Financial Management Information System* (FMIS) Accounts – FHWA
4. Lack of FMIS Periodic Review of Access – FHWA
5. Lack of *Transportation Electronic Award Management* Inactivity Lockout – FTA
6. Separated Users with Active Accounts – FTA

KPMG made 14 recommendations to strengthen DOT's financial, accounting, and system controls. We performed a 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.

DOT officials concurred with KPMG's recommendations. The Department also submitted a detailed action plan to address the findings contained in KPMG's management letter to OIG on December 31, 2014. In accordance with DOT Order 8000.1C, the corrective actions taken in response to the findings are subject to follow up.

We appreciate the cooperation and assistance of DOT'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

December 18, 2014

Secretary and Inspector General
U.S. Department of Transportation

Gentlemen:

In planning and performing our audit of the consolidated financial statements of the U.S. Department of Transportation ("Department" or "DOT"), as of and for the year ended September 30, 2014, 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. 14-02, *Audit Requirements for Federal Financial Statements*, we considered the Department's internal control over financial reporting (internal control) as a basis for designing audit 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 the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department'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 DOT 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*.

In addition, we identified certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies and communicated them in writing to DOT management and those charged with governance within our *Independent Auditors' Report* dated November 14, 2014.

Matters specific to our separate audit of the Federal Aviation Administration (FAA) have been communicated to the Inspector General and the FAA Administrator in a separate letter.

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 the Department'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

Weakness in Management's Documentation of Non-GAAP Policies - DOT-2014-0003

Background

In its annual assessment of accounting policies and procedures, DOT has identified a departure from Generally Accepted Accounting Principles (GAAP) as a result of not recording an estimated liability for goods and services incurred, but not yet invoiced by the grantee or vendor. Specifically, for certain smaller Operating Administration (OA) grant programs, DOT does not record an estimated accrual for invoices not received from the grantee and for all non-grant expenses (i.e., any expense not related to a grant agreement), DOT only records an accounts payable for goods and services incurred for which an invoice has been received from the vendor, but not yet processed by DOT for payment. DOT considers an accrual for these certain exchange transactions to be immaterial to the DOT consolidated financial statements, taken as a whole.

Condition

Based on our review of DOT's non- GAAP policies and procedures, we noted that DOT has determined to not record an estimated liability for certain exchange transactions; however, management has not performed an analysis to determine the impact to the DOT consolidated financial statements.

Recommendation

We recommend that DOT develop and implement guidance to formally document its assessments and recognition decisions, in accordance with Statement of Federal Financial Accounting Concept No. 5, as it relates to liabilities of exchange transactions, specifically those decisions to depart from GAAP based on materiality.

Weakness in Financial Statement Preparation & Review - DOT-2014-0004

Condition

We noted certain material misstatements in the interim DOT consolidated footnote disclosures as of and for the period ended June 30, 2014 that were submitted for audit purposes only and made recommendations to management to correct these errors.

Recommendation

We recommend that DOT:

1) Automate footnotes, where applicable, to ensure consistency across the Department;
2) Provide training and instruction, where necessary, to the OAs to ensure the financial reporting guidance is implemented consistently department-wide and to ensure the OAs understand the requirements of each line item on the financial statements and footnotes;
3) Revise the financial reporting package review checklist to incorporate the financial reporting instruction in order to determine that the financial statements were consistently prepared; and,
4) Implement an independent review of the DOT consolidated financial statements to ensure the financial statements are properly consolidated and that the financial reporting guidance has been consistently applied.

Weaknesses in FTA's Grant Accrual – DOT-2014-0005

Background

When the Federal Transit Administration (FTA) awards a grant, it records a corresponding undelivered order (UDO) for the total amount of the grant award, which is ultimately reduced by the amount of draw downs on the grant award. Grantees are required to complete a Federal Financial Report (FFR) no later than 30 days after each reporting period. On a monthly basis, FTA estimates a grant accrual to recognize expenses incurred but not yet billed to FTA.

In addition, FTA performs a retrospective review over the 3rd and 4th quarter grant accrual (for the periods ending June 30 and September 30, respectively) to validate the reasonableness of the quarterly estimate compared to subsequent grantee reporting. FTA performs this review by analyzing the Federal share of expenditures reported on the grant project's FFR less cumulative disbursements for the project. Cumulative disbursements are obtained from FTA's grant disbursement system, the Electronic Clearing House Operations System (ECHO-Web). The quarterly grant accruals for each project are summed and the total is then compared to the estimated grant accrual for that reporting period. For variances greater than 10 percent, FTA investigates the differences and, if necessary, adjusts future accrual calculations and/or methodology.

Per Federal Register Vol. 79 No. 46 Section V, FTA has pre-award authority which allows the grantee to incur expenses prior to the official grant award being obligated. Grantees with pre-award authority are required to submit an FFR and report all expenses incurred on the line Federal share of expenditures. However, FTA is not obligated to reimburse the grantees for these pre-award expenditures until the grant award has been officially approved and obligated by FTA.

Conditions

<u>Condition 1:</u>

FTA did not use the best available data to perform its retrospective review over the June 30, 2014 grant accrual. FTA calculated a variance of $396 million between the retrospective grant accrual and the grant accrual per the methodology. However, the Federal share of expenditures, which can exceed the available UDO balance as a result of reported pre-award authority expenditures, was not limited to the contractually binding obligation of FTA (UDO balance).

The error in FTA's calculation resulted in the retrospective review grant accrual, as of June 30, 2014, being overstated by $287 million.

<u>Condition 2:</u>

For the 4th quarter grant accrual (September 30, 2014), FTA performed its calculation in accordance with the methodology. However, FTA also recorded a $197 million on-top adjustment to account for the 3rd quarter variance. FTA calculated the adjustment as the difference in 3rd quarter grant accrual (June 30, 2014) variance less subsequent disbursements for the period of July 1 – September 30, 2014 (representing unbilled expenses reported by the grantee as of June 30, 2014).

However, as noted in condition 1, FTA's variance was incorrectly calculated and should not have been used as a basis to record an adjustment in the September 30, 2014 consolidated financial statements.

Recommendation

We recommend that FTA revise its grant accrual retrospective review to ensure that the retrospective review is performed with the appropriate level of precision and all data inputs (FFR reporting, UDO balances, grant disbursements) are reasonable and based on relevant and reliable data in order to ensure that all adjustments to the grant accrual or methodology are properly calculated and supported.

Weakness in the Subsidy Estimate Review & Approval - DOT-2014-0008

Condition

The Federal Highway Administration (FHWA) manages the Transportation Infrastructure Finance and Innovation Act (TIFIA) program which provides direct loans in accordance with the Federal Credit Reform Act. On an annual basis, FHWA re-estimates the subsidy for each loan by preparing cash flow projections based on a schedule of principal and interest payments, the probability of default and any recoveries if default occurs. The cash flow projections are input into the Office of Management and Budget's Credit Subsidy Calculator (CSC II), which performs the interest rate and technical re-estimates. These re-estimates are then recorded as an accrual in the consolidated financial statements.

During FY2014, we selected four loans for the review and evaluation of the subsidy calculation and the valuation of the subsidy re-estimates. During our review of the input assumptions and related functionality of the cash flow models, we noted that for one loan selected, the principal and interest payment amounts utilized in the cash flow model did not agree to the original loan agreement.

During the review of the DOT consolidated financial statements as of September 30, 2014, DOT calculated the interest rate estimates but did not separately disclose the interest rate and technical re-estimate in their footnote disclosure.

Recommendation

We recommend that FHWA:

1) Review the inputs into the cash flow model to ensure that the inputs are complete and accurate and agree to the underlying supporting documentation; and,

2) Review the consolidated financial statements and footnote disclosures to ensure that they are prepared in accordance with the applicable accounting standards and contain all required disclosures.

B. Information Technology General and Application Controls

FHWA Lack of Audit Log Review for Windows Servers - DOT-2014-FHWA-IT-0001

Background/ Condition

FHWA manages its federal grants in the following systems: User Profile and Access Control System (UPACS), Rapid Approval and State Payment System (RASPS), Financial Management Information System (FMIS) and the Delphi Interface Management System (DIMS).

Management is responsible for the review of the audit logs from the ArcSight application daily. We selected a sample of 15 days throughout FY2014 and requested the FHWA audit log review forms. The FHWA Oracle database, UNIX server, and Windows servers support UPACS, RASPS, FMIS, and DIMS. Based on our review of these items, we noted the following:

- There was no evidence of management's review of the Oracle Database for the selected day of October 11, 2013;
- There was no evidence of management's review of the UNIX Operating system audit log for the selected days of October 28, 2013 and February 19, 2014; and,
- There was no evidence of management's review of the Windows Operating system audit logs for the selected day of February 19, 2014.

Recommendation

We recommend that FHWA continue to take appropriate measures to ensure the audit logs are reviewed timely and documentation of the review is maintained.

FHWA Lack of DIMS Periodic Review of Access - DOT-2014-FHWA-IT-0002

Background/ Condition

During our review of user access controls over DIMS, we noted that one DIMS user out of eleven users with the "UPDATE" role retained access to the application when access was no longer necessary to accomplish their assigned tasks. Although there is a monthly review of DIMS users' access, the review does not operate at a level of precision necessary to ensure that an active employee has the "least privileged" access necessary to perform their assigned tasks. Therefore, this user's inappropriate access was not identified and removed during the June 2014 monthly review.

Recommendation

We recommend that FHWA management increase the level of precision of the monthly user access review process to evaluate user access based on "least privileged" necessary to perform their assigned tasks.

FHWA Separated User with Active FMIS Accounts – DOT-2014-FHWA-IT-0003

Background/ Condition

For Division or State DOT users that no longer require access to FMIS (i.e. employment terminated, change in job responsibilities, etc.), an individual in a FHWA Division who is assigned the role of the FMIS System Sponsor is required to notify the FMIS System Owners who then removes the user from the application. In addition, FHWA receives notification from FHWA Office of Human Resources (HR) of separated FHWA employees and upon this notification, removes the accounts from UPACS, the application that controls access to FMIS. This process should occur upon termination or at the point in time when such access is no longer required.

We obtained a listing of DOT employees and FHWA contractors who separated from DOT/FHWA between October 1, 2013 and August 21, 2014 and compared the listing to an active user listing generated for FMIS on August 13, 2014. Our review identified six separated employees (one FAA, one FTA, and four FHWA employees) that were classified as "active" on the FMIS user listings.

The users in question retained access to FMIS between 30 and 90 days after separation.

We noted that none of the users signed into the application after their respective separation dates

Recommendation

We recommend that FHWA strengthen its controls for removing access of separated employees and contractors to ensure that access is removed immediately upon termination or at the point in time when access is no longer required, and ensure that other DOT components are aware of the requirement to immediately notify FHWA of separations.

FHWA Lack of FMIS Periodic Review of Access – DOT-2014- FHWA-IT-0004

Background/Condition

FHWA has 52 divisional offices that utilize FMIS to award and manage Federal grants. During our review of the monthly FMIS user review, we noted that the system owner reviews the user listing to determine if users still require access, but does not confirm the appropriateness of specific access rights. In addition, divisional offices do not review their FMIS user listing to determine if user's access remains appropriate.

Recommendation

We recommend that FHWA management increase the precision of the FMIS user access review to include a review performed at the division level over the appropriateness of user access and access rights.

FTA Lack of TEAM Inactivity Lockout – DOT-2014-FTA-IT-0002

Background/ Condition

FTA manages its federal grants in the Transportation Electronic Award and Management System (TEAM). As noted in the previous two audits, the system configuration settings for TEAM are not configured to force an account lockout after an inactivity period of 30 minutes or to require users to re-authenticate after such period of inactivity.

Recommendation

We recommend that FTA implement re-authentication requirements, in accordance with the DOT Cyber Security Compendium, in the grant management systems utilized by FTA.

FTA Separated Users with Active Accounts – DOT-2014-FTA-IT-0004

Background/ Condition

We obtained a listing of DOT employees and FTA contractors who separated from DOT/FTA between October 1, 2013 and March 14, 2014 and compared the listing to an active user listing for TEAM on March 26, 2014. Our review identified one separated user who was terminated on February 28, 2014, but was classified as active on the TEAM user listing as of March 26, 2014 (26 days after termination).

We noted that the user account was disabled on May 15, 2014 as part of the automated account disabling procedures after 90 days of inactivity. We also noted that the user did not login to the TEAM application after termination from DOT/FTA on February 28, 2014.

Recommendation

We recommend that FTA implement procedures to remove application access for separated employees and contractors immediately upon termination.