
Office of Inspector General

Audit Report

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

Federal Aviation Administration

Report Number: QC-2015-037

Date Issued: March 31, 2015





**U.S. Department of
Transportation**

Office of the Secretary
of Transportation
Office of Inspector General

Memorandum

Subject: **ACTION:** Quality Control Review of the
Management Letter for the Audit of Fiscal Years
2014 and 2013 Financial Statements,
Federal Aviation Administration
Report Number: QC-2015-037

Date: March 31, 2015

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, 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 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, which follow, or the related recommendations in its auditor's report:

Financial Reporting and Accounting

1. Improvements Needed in the Property, Plant and Equipment Retirement and Disposal Process
2. Simultaneous Recording of Budgetary and Proprietary Entries

¹ *Quality Control Review of Audited Financial Statements for Fiscal Years 2014 and 2013, Federal Aviation Administration*, OIG Report No. QC-2015-010. OIG's reports are available at www.oig.dot.gov.

3. Improvements Needed in the Evaluation of Policies for Non-Generally Accepted Accounting Principles
4. Improvements Needed in the Financial Statement Review Process
5. Improvements Needed in Review of Manual Journal Vouchers
6. Untimely De-Obligation of Inactive Undelivered Orders and Inadequate Review of Trading Partner Codes
7. Improvements Needed in the Completeness of the Environmental Remediation Liability
8. Grant Monitoring
9. Improper Cut-Off of Construction-in-Progress Accrual and Cash Disbursements
10. Non-Compliance with the Federal Employees' Group Life Insurance Act
11. Improvements Needed in Assessing the Reliability of Underlying Data

Information Technology General and Application Controls

1. Plans of Action and Milestones – Logistics Inventory System (LIS)
2. Password Configurations – LIS and System of Airport Reporting (SOAR)
3. Audit Logging – LIS
4. Periodic Review of Access – LIS
5. Data Center Physical Security – SOAR
6. Removal of Separations – LIS

KPMG made 28 recommendations to strengthen FAA'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.

FAA officials concurred with KPMG's recommendations. The Agency also submitted a detailed action plan to address the findings contained in KPMG's management letter to OIG on January 22, 2015. 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 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

December 19, 2014

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, 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 FAA'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 FAA's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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, 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 significant deficiencies and communicated them in writing to FAA management and those charged with governance within our *Independent Auditors' Report* dated November 7, 2014.

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 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

**Federal Aviation Administration
Management Letter Comments****A. Financial Reporting****Improvements needed in the Property, Plant and Equipment (PP&E) retirement and disposal process - FAA-2014-0001*****Background/Condition***

As of March 31, 2014, we noted that the Federal Aviation Administration (FAA) has made some progress in addressing our recommendations from fiscal year (FY) 2013 related to the PP&E retirement and disposal process. Specifically, we noted that although FAA has determined the specific number of days within which property identified for disposal should be retired and recorded in the general ledger, the policy has yet to be implemented. As of July 30, 2014, the policy is undergoing review by the internal policy board.

During our testing of a sample of ten PP&E disposals and retirements for the period October 1, 2013 through March 31, 2014, we identified four assets that were retired, but not removed from the general ledger timely. Specifically, we noted that three of these assets were not removed from the general ledger three months after the date the asset was sold, disposed, or otherwise removed from the site. The remaining asset was not removed from the general ledger until four years after the date the asset was sold, disposed, or otherwise removed from the site.

As these assets were fully depreciated at the time of disposal, there was no impact on current or prior year depreciation as a result of the time lag between identifying the asset for disposal and recording of the disposal in the general ledger.

Recommendations

We recommend that the 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 general ledger.
- 2) Provide training to the various regions and property owners once the policies and procedures noted in recommendation one above are finalized and implemented.
- 3) Continue to perform alternative procedures to assess the materiality of depreciation expense and loss on retirements for assets that were retired in prior years but have not been recorded in the general ledger until the current year.

Simultaneous recording of budgetary and proprietary entries – FAA-2014-0002***Condition***

During our review of the FAA financial statements for the quarter ended March 31, 2014, and our testing of a sample of manual journal entries for the period of October 1, 2013 through March 31, 2014, we identified two entries in which the corresponding budgetary and proprietary entries were not posted simultaneously in accordance with the associated U.S. Standard General Ledger (USSGL) transaction code. Specifically, we noted the following issues:

Federal Aviation Administration Management Letter Comments

1. FAA did not record the required proprietary entry to reflect the prorated appropriations received under a continuing resolution at the beginning of the fiscal year.
2. FAA did not record the required budgetary entry to reflect the payable related to the nonexpenditure transfer of invested funds from the Airport and Airway Trust Fund (AATF) (69 8103). Until September 30, 2013, the budgetary transactions associated with AATF activities were recorded by the Bureau of Fiscal Service (BFS).

Recommendations

We recommend that the FAA:

- 1) Complete a more detailed review of manual journal entries to verify the entry was made in accordance with the appropriate USSGL transaction code.
- 2) Identify all procedures previously provided by the BFS to account for the activities of the AATF, and incorporate those procedures into the FAA's financial reporting process.

Improvements needed in the evaluation of non-GAAP policies – FAA-2014-0003

Background/Condition

In Notice of Finding and Recommendation (NFR) FAA-2013-004, we recommended that FAA develop and implement a process to formally identify, assess, and document the impact of errors, misclassifications, and departures from generally accepted accounting principles (GAAP) in the financial statements and accompanying notes. Subsequently, we issued NFR FAA-2013-0007 because the FAA did not perform an assessment to determine the impact of a change in estimated useful lives for existing Internal Use Software assets with remaining net book value as of March 1, 2013 on the financial statements, and did not document its decision as a non-GAAP policy.

Though the FAA implemented certain corrective actions during FY 2014 to address our prior year recommendations, we continued to note that improvement is still needed in the evaluation of non-GAAP policies. Specifically, we reviewed the fixed asset subsidiary ledger as of April 30, 2014 and identified 480 assets that were not retired but were reported at a historical asset cost of \$0, instead of the actual cost as required by GAAP. An assessment of the impact to the financial statements had not been performed, nor had the FAA documented its decision as a non-GAAP policy as of May 2014.

Recommendation

We continue to recommend that the FAA develop and implement a process to formally identify, assess, and document the impact of errors, misclassifications, and departures from GAAP in the financial statements and accompanying notes, including an assessment as to whether the errors are material in relation to the financial statements as a whole, both in current and future periods. The assessment should be reviewed by an appropriate level of management.

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Management Letter Comments****Improvements needed in the financial statement review process – FAA-2014-0005*****Condition***

During our interim testing as of and for the period ended June 30, 2014, we noted improvement was needed in the FAA's consolidated financial statement preparation and review process. Specifically, through our review of the FAA's interim consolidated financial statements and notes as of and for the period ended June 30, 2014, we noted an error within the Consolidated Statement of Changes in Net Position, and misclassifications and errors in the notes to the financial statements within the following disclosures:

1. Fund Balance with Treasury;
2. Funds from Dedicated Collections; and
3. Reconciliation of Net Cost of Operations to Budget.

In addition, during our testing of 25 projects to assess the accuracy of the FAA's methodology for classifying transactions by strategic priority within the Net Cost by Program and Other Statement of Net Cost Disclosures note, we identified one project that was not classified to the appropriate strategic priority.

Recommendation

We recommend that the FAA develop and implement monitoring controls to ensure costs and revenues are mapped to the appropriate strategic priority.

Improvements needed in review of manual journal vouchers – FAA-2014-0006***Condition***

During our testing of a sample of nine manual journal vouchers prepared by the FAA headquarters and recorded in the Delphi general ledger between July 1, 2014 and August 31, 2014, we identified the following deficiencies:

1. One instance whereby the journal voucher was not reviewed prior to posting in the general ledger.
2. Two instances where the journal voucher was not reviewed by all required second-level reviewers or the second level review was not performed timely.

Recommendations

We recommend that the FAA:

- 1) Enhance policies and procedures related to the review of journal vouchers to include a requirement that the initial review of journal vouchers occur before the journal voucher is posted to the general ledger.
- 2) Revise policies and procedures to clarify or remove the second-level review requirement.

**Federal Aviation Administration
Management Letter Comments****Untimely de-obligation of inactive undelivered orders and inadequate review of trading partner codes – FAA-2014-0007*****Background/Condition***

During our testing of a sample of 88 undelivered orders (UDOs) as of July 31, 2014, we noted the following exceptions:

1. One UDO was inactive for a period of more than 365 days. Per discussion with the FAA management, the contract had ended and the remaining balance should have been de-obligated prior to July 31, 2014.
2. One UDO was not associated with a proper trading partner code in the general ledger.

Recommendations

We recommend that the FAA:

- 1) Continue to emphasize the timely de-obligation of inactive UDOs through training and communication to the various lines of business.
- 2) Continue to perform quarterly obligation reviews to monitor the validity of inactive UDOs.
- 3) Correct the set-up of the vendor trading-partner code in the vendor table.

Improvements needed in the completeness of the Environmental Remediation liability – FAA-2014-0008***Background/Condition***

The FAA environmental cleanup (ECU) Program requires an ECU Program Criteria Checklist (checklist) to be prepared each time a potential new contaminated site is identified. The checklist is reviewed by ECU Program personnel for inclusion in the Environmental Remediation (ER) liability.

During our testing of a sample of 15 new sites that were included in the ER liability for FY 2014, we identified the following deficiencies related to four sites:

1. Two sites that were identified in FY 2013 were not included in the ER liability until FY 2014, as FAA suspended the review of new sites to prepare the FY 2013 Environmental Site Cleanup Report (ESCR).
2. Checklists associated with four new sites, including the two sites noted above, were not reviewed by ECU Program managers between 36 and 126 days after the checklists were submitted.

At our request, management also provided a listing of the ten new site checklists submitted for review during the ESCR preparation period for the FY 2014 liability. We noted that these ten sites were not included in the FY 2014 ESCR.

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Recommendations

We recommend that the FAA:

- 1) Develop and implement policies and procedures to accumulate a listing of new sites identified during the ESCR preparation period and to assess the impact of the new sites to the ER liability.
- 2) Develop and implement policies and procedures to specify the number of days within which the checklists related to new sites should be reviewed.

Grant monitoring – FAA-2014-0009

Background/Condition

FAA assigns each sponsor (i.e grantee) a grant payment risk level of nominal, moderate or elevated. A sponsor's grant payment risk level pertains to the risk that the sponsor will improperly use federal funds; not submit grant payments in accordance with established policies and procedures; and/or violate other terms of the grant agreement. A grant payment risk level of nominal is assigned to those sponsors that pose a minimal risk of improper use of grant funds.

During our testing of 20 grant disbursements for the period April 1, 2014 through September 30, 2014, we identified one disbursement to a sponsor with a nominal risk rating that was initially unsupported. Specifically, the invoice summary was not uploaded in the FAA's eInvoicing application to support the related payment.

Recommendation

We recommend that the FAA enhance their policies and procedures to include the nature and extent of monitoring procedures to be performed by the Regional Office/Airport District Office during their quarterly review of payments made by sponsors with a nominal risk level.

Improper cut-off of Construction-in-Progress (CIP) Accrual and cash disbursements – FAA-2014-0010

Condition

During the FY 2014 audit, we noted two exceptions related to the completeness of the FAA's Accounts Payable (AP) accruals as of and for the period ending September 30, 2014. Specifically, we noted the following issues:

1. One invoice related to property, plant, and equipment received and approved for payment in FY 2014 was not included in the CIP On-Hand Invoice accrual.
2. One invoice related to services provided and approved for payment in FY 2014 was not included in the non-CIP On-Hand Invoices accrual.

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Management Letter Comments*****Recommendation***

We recommend that the FAA enhance monitoring procedures to ensure that expenses are recorded in the proper period and accruals are complete.

Non-compliance with the Federal Employees' Group Life Insurance Act (FEGLI) – FAA-2014-0011***Condition***

During the FY 2014 audit, we selected a sample of 32 employees to test the FAA's compliance with the FEGLI. As a result of the procedures performed, we identified one exception whereby an employee's life insurance election on Form 2817 (Life Insurance Election Form), submitted by the employee, was incorrectly recorded in the employee's SF50 (Notification of Personnel Action).

Recommendation

We recommend that the FAA Enterprise Services Center enhance its monitoring controls to ensure that someone other than the Human Resource Specialist who prepares the SF50 (Notification of Personnel Action) review the SF50 (Notification of Personnel Action) to verify the information from the employee election form is properly recorded.

Improvements needed in assessing the reliability of underlying data – FAA-2014-0012***Background/Condition***

At the end of each fiscal year, the FAA is required to estimate an accrual for liabilities associated with sick leave based on current employee pay rates, unused sick leave balance, and bargaining unit contractual provisions.

During our testing of the employee sick leave accrual as of September 30, 2014, we noted the following instances whereby key inputs and assumptions used in the calculation of the estimates were not complete and/or accurate. Specifically, we noted that:

1. Management did not include all relevant bargaining units when accounting for the sick leave buyback provision of employee bargaining agreements.
2. Based on the FAA's estimation methodology, 592 employees were incorrectly included in the accrual as of September 30, 2014.
3. Management did not fully research and define their position on the accounting treatment of the sick leave buyback provision in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*.

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Recommendations

We recommend that the FAA:

- 1) Design and implement procedures to validate the completeness and accuracy of key inputs provided by other organizations within the FAA, including a periodic review of the key assumptions.
- 2) Fully research and document their conclusions on the proper treatment of the sick leave buyback provisions in accordance with SFFAS No. 5.

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B. Information Technology General and Application Controls

Plan of Action and Milestones (POA&Ms) – LIS – DOT-2014-FAA-IT-0001

Condition

KPMG obtained a listing of POA&Ms for the Logistics Inventory System (LIS) dated May 7, 2014 and noted it was incomplete. Specifically, the LIS POA&M did not include two weaknesses that were identified in August 2013 related to multi-factor authentication and password complexity that were reported by management in a signed a risk acceptance.

Recommendation

We recommend that the FAA ensure that all security weaknesses identified during reviews performed by or on behalf of the agency, including Government Accountability Office audits, financial audits, system status reports, and critical infrastructure vulnerability assessments are included in the Cyber Security Assessment Manager POA&M tracker for LIS.

Password configurations – LIS and SOAR – DOT-2014-FAA-IT-0002

Condition

During our testing of general information technology controls for the LIS mainframe and the System of Airport Reporting (SOAR) application, we determined that the password complexity configurations did not meet Department of Transportation (DOT) minimum password requirements of at least 12 characters, including a combination of letters, numbers, and special characters. Specifically, we noted the following:

1. The LIS mainframe and SOAR application currently have a minimum password length of eight characters; and
2. LIS passwords do not require any special characters.

Recommendations

We recommend that the FAA:

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

Audit logging – LIS – DOT-2014-FAA-IT-0003

Condition

During our testing of general information technology controls over the LIS mainframe, we noted the protection audit logs defined in the System Security Plan (SSP) do not report on inappropriate or unusual system activity. We were informed LIS security audit logging and monitoring is performed

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by the Information System Security Officer at the National Information Technology Center, which is maintained by the United States Department of Agriculture.

Recommendation

We recommend that the FAA update the LIS SSP to reflect the current security audit log mechanisms in place, and develop and implement procedures requiring periodic reviews of LIS audit logs. The procedures should include the items being reviewed and the frequency within which the reviews should occur.

Periodic review of access – LIS – DOT-2014-FAA-IT-0004***Condition***

During our testing of controls related to LIS, we noted that periodic reviews of privileged LIS accounts are performed on an annual basis, which does not meet the DOT requirement to review privileged accounts semi-annually. Additionally, the latest review from October 2013 did not include any approval(s).

Recommendation

We recommend that the FAA perform semi-annual reviews of all privileged user accounts, and their associated access levels, in accordance with the DOT Cyber Security Compendium, and include documented approval(s).

Data center physical security – SOAR – DOT-2014-FAA-IT-0005***Condition***

In order to determine if physical access controls over the FOB10B data center that houses the SOAR application were properly designed, implemented and operating effectively during fiscal year (FY) 2014, we selected two users that were granted physical access to the data center in the current fiscal year, and requested evidence of access approval. Evidence of access approval could not be provided for either individual. Additionally, we were informed that a periodic review of existing users with physical access to the FOB10B data center was not performed.

Recommendations

We recommend that the FAA develop and implement procedures for:

- 1) granting physical access to the data center;
- 2) retaining authorizing documents for those individuals that are granted access; and
- 3) performing periodic reviews of access rights for existing data center users.

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Removal of separations – LIS – DOT-2014-FAA-IT-0006

Condition

In order to determine if access controls for the LIS application were properly designed, implemented and operating effectively during FY 2014, we obtained a listing of DOT employees and contractors who separated from DOT between October 1, 2013 and March 31, 2014, and compared it to a list of active LIS users as of April 11, 2014. As a result of our procedures, we identified one user that separated on February 9, 2014 who had an active LIS user account 38 days after their date of separation. The account was not disabled until March 19, 2014. We noted that the account was not accessed after the employee's separation date.

Recommendation

We recommend that the FAA develop and implement procedures that require the timely notification of LIS administrator(s) when LIS users are terminated and/or it is determined that a user's access to LIS is no longer required.