U.S. DEPARTMENT OF TRANSPORTATION

OFFICE OF INSPECTOR GENERAL

Quality Control Review of the Management Letter for the Federal Aviation Administration's Audited Consolidated Financial Statements for Fiscal Years 2018 and 2017

FAA

Report No. QC2019025

March 26, 2019

Quality Control Review of the Management Letter for the Federal Aviation Administration's Audited Consolidated Financial Statements for Fiscal Years 2018 and 2017

Required by the Chief Financial Officer Act of 1990

Federal Aviation Administration | QC2019025 | March 26, 2019

What We Looked At

This report presents the results of our quality control review (QCR) of KPMG LLP's management letter related to the audit it conducted, under contract with us, of the Federal Aviation Administration's (FAA) consolidated financial statements for fiscal years 2018 and 2017. In addition to its audit report on FAA's financial statements, KPMG issued a management letter that discusses four internal control matters that it was not required to include in its audit report.

What We Found

Our QCR of KPMG's management letter disclosed no instances in which KPMG did not comply, in all material respects, with generally accepted Government auditing standards.

Recommendations

KPMG made four recommendations in its management letter. FAA concurred with all four recommendations.

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U.S. DEPARTMENT OF TRANSPORTATION
OFFICE OF INSPECTOR GENERAL

Memorandum

Date: March 26, 2019

Subject: INFORMATION: Quality Control Review of the Management Letter for the Federal Aviation Administration's Audited Consolidated Financial Statements for Fiscal Years 2018 and 2017 | Report No. QC2019025

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

To: Federal Aviation Administrator

I am pleased to transmit the attached management letter related to the audit of the Federal Aviation Administration's (FAA) consolidated financial statements for fiscal years 2018 and 2017. KPMG LLP of Washington, D.C., completed the audit under contract with us. The contract required that KPMG perform the audit in accordance with generally accepted Government auditing standards and Office of Management and Budget's Bulletin 19-01, *Audit Requirements for Federal Financial Statements*. KPMG issued an auditor's report[1] that included a clean (unmodified) opinion on FAA's financial statements.

KPMG also issued, and is responsible for, a management letter dated November 30, 2018 (see attachment), identifying four internal control matters that require FAA management's attention. KPMG was not required to include these matters or the related recommendations in its auditors' report.

We appreciate the cooperation and assistance of FAA's representatives and KPMG. If you have any questions, please contact me at (202) 366-1407, or George Banks, Program Director, at (202) 420-1116.

Attachment

cc: The Secretary
DOT Audit Liaison, M-1
FAA Audit Liaison, AAE-100

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[1] See *Quality Control Review of the Independent Auditor's Report on the Federal Aviation Administration's Audited Consolidated Financial Statements for Fiscal Years 2018 and 2017* (OIG Report No. QC2019006), November 14, 2018.

Our QCR

We performed a QCR 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.

Summary of KPMG's Management Letter

In its management letter, KPMG reported the following matters involving FAA's internal control that require management's attention.

Weaknesses in the Design and Implementation of Controls Related to the Calculation of Accounts Payable Accrual

The accounts payable accrual methodology, pertaining to certain expenses, estimated accounts payables using a statistical sample of historical data. However, controls did not ensure that the sampled items were representative of the population. For fiscal year 2018, FAA selected a stratified, random sample from the expense population for the period October through November 2017, and tested the samples. The resulting data for the period was expressed as a percentage that was then multiplied by the average monthly expenses for the past 4 fiscal years for the same period to determine the estimated amount to accrue. During its recalculation of the accrual calculation, KPMG found certain transactions that should have been excluded from the population when calculating both the average monthly expenses and the accrual percentage because they were not representative of the expense population.

Weaknesses in the Completeness of the Environmental Cleanup and Decommissioning Facility Quantities Report

FAA's facilities quantities report provided data needed to compute FAA's environmental cleanup and decommissioning (EC&D) liabilities. However, controls were not properly implemented and operating effectively to ensure the report's completeness. Of the 25 facilities sampled, 1 facility was converted from a Tactical Air Navigation (TACR) facility to a Distance Measuring Equipment Remaining (DMER) facility but was not added to the EC&D facility quantities report under its new designation, even though it had been removed from the report as a TACR facility type. This error resulted in the report's lacking a complete list of facilities requiring future cleanup. Upon further investigation, management identified 28 additional facilities that had been converted to the DMER facility type and improperly excluded from the EC&D facility quantities report.

Inaccurate Asset Useful Life and Depreciation Expense

Management intended to adjust the useful life of all En Route Automation Modernization (ERAM) assets to 10 years. However, controls were not operating effectively to ensure these adjustments were made. Specifically, one asset related to ERAM equipment was recorded with a useful life of 20 years. Since useful life is used to compute depreciation, the depreciation expense for this asset was not correct.

Weaknesses in the Timely Capitalization of Internal Use Software in Development

Certain internal use software is capitalized when it meets baseline requirements. Once capitalized, FAA should begin recording depreciation for the asset. However, controls were not in place to ensure that applicable software that met the baseline requirements were capitalized or depreciated. For example, in fiscal year 2016, FAA made the Logistics Center Support System the inventory system of record for the majority of its inventory classes. However, management did not capitalize any portion of the system and did not begin depreciating the asset as required.

Recommendations

To strengthen FAA's financial, accounting, and system controls, KPMG recommended that FAA:

1. Perform a review of the accounts payable accrual, including the procurement samples selected and their fiscal year allocation, at a level of precision to identify errors in order to prevent a potential misstatement.

2. Develop and implement policies and procedures to ensure that all assets that meet the criteria for the EC&D liability are included in the facility quantities report and that any converted assets are properly removed and re-included in the report under the new facility contraction.

3. Develop and implement policies and procedures to ensure that all assets are recorded with the appropriate useful life based on the asset dictionary.

4. Develop and implement policies and procedures to ensure accurate accounting for internal use software assets in accordance with SFFAS 10.

FAA concurred with all four of KPMG's recommendations and provided a detailed action plan to address the findings in the management letter. In accordance with DOT Order 8000.1C, the corrective actions taken in response to the findings are subject to follow up.

Exhibit. List of Acronyms

DEMR	Distance Measuring Equipment Remaining
DOT	U.S. Department of Transportation
EC&D	environmental cleanup and decommissioning
FAA	Federal Aviation Administration
OIG	Office of Inspector General
QCR	quality control review
SFFAS	Statements of Federal Financial Accounting Standards
TACR	Tactical Air Navigation

Attachment.

Independent Auditors' Management Letter

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

November 30, 2018

Acting 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 2018, in accordance with auditing standards generally accepted in the United States of America and 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. 19-01, Audit Requirements for Federal Financial Statements, we considered 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 FAA's internal control. Accordingly, we do not express an opinion on the effectiveness of FAA's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses and/or significant deficiencies and therefore, material weaknesses and/or significant deficiencies may exist that were not identified. In accordance with *Government Auditing Standards*, we issued our report dated November 9, 2018 on our consideration of the FAA's internal control over financial reporting in which we communicated certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. During our audit, we identified the following financial reporting deficiencies in internal control that are presented in Exhibit I for your consideration.

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

This purpose of this letter is solely to describe the deficiencies in internal control identified during our audit. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

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

Exhibit I

A. Financial Reporting

Weaknesses in the Design and Implementation of Controls Related to the Calculation of the Accounts Payable Accrual – (NFR FAA-2018-02)

Background/Condition

FAA implemented an Accounts Payable (AP) accrual/methodology in fiscal year (FY) 2017 to account for all expenses in the fiscal year that are not covered by the on-hand invoice accrual, PRISM Mod Accrual, or the Air Traffic Organization (ATO) accrual. Consistent with the methodology, FAA estimates the AP accrual using a statistical sample of historical information. Specifically, FAA selected a stratified, random sample from the expense population for the period October through November 2017 and tested these samples to identify the period of performance for each sample. The resulting data for the period is expressed as a percentage, which is multiplied by the average monthly expenses for the past four fiscal years for the same period to determine the estimated amount to accrue. During our recalculation of the accrual calculation, we noted certain transactions that should have be excluded from the population when calculating both, the average monthly expenses and the accrual percentage, as they were not representative of the expense population.

Recommendation

We recommend that management perform a review of the AP accrual, including the procurement samples selected and their fiscal year allocation, at a level of precision to identify errors in order to prevent a potential misstatement.

Weaknesses in the Completeness of the EC&D Facility Quantities Report – (NFR FAA-2018-04)

Background/Condition

The FAA has title to various real property and other assets for use in its operations. Prior to October 1, 1998, these assets may have been constructed with environmental contaminants, such as lead-based paint and asbestos, etc. FAA records an estimated environmental cleanup and decommissioning (EC&D) liability for the estimated costs to remove, contain, and/or dispose of the hazardous materials when the assets are decommissioned. The EC&D liability is estimated by multiplying the number of assets by an average cost of disposal. The number of facilities used in this calculation is obtained from the Facility Quantities Report, which captures FAA's Property, Plant, & Equipment (PP&E) detailed records of capital and expensed assets that meet the criteria to be included in the liability. A facility is comprised of at least one or more co-located assets. The average cost of disposal is calculated using actual invoices and contracts for assets currently being decommissioned and cost studies, where applicable.

The facility quantities report is updated on a quarterly basis to include any changes to the underlying asset detail that occur through FAA’s normal course of business. This includes changes such as, assets disposals, location changes, or facility conversions. A facility conversion occurs when the primary piece of equipment, such as an antenna, is removed or replaced by another type of primary equipment. The other underlying assets, such as buildings and support equipment are not replaced, but now support the new equipment, therefore, the assets detail records are updated to reflect the accurate facility type that the asset supports after the conversion.

During our audit of the completeness of the EC&D facility quantities report, we identified one facility that was converted from a Tactical Air Navigation (TACR) to a Distance Measuring Equipment Remaining (DMER). Although the TACR facility was properly removed from the EC&D facility quantities report, the DMER facility was not properly added to the report. Upon further investigation, management subsequently identified 28 additional facilities which were converted to the DMER facility type that were improperly excluded from the EC&D facility quantities report.

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

Recommendation

We recommend that management develop and implement policies and procedures to ensure that all assets that meet the criteria for the EC&D liability are included in the facility quantities report and that any converted assets are properly removed and re-included in the report under the new facility contraction.

Inaccurate Asset Useful Life and Depreciation Expense – (NFR FAA-2018-05)

Background/Condition

During our audit of Plant, Property and Equipment and the related accounts, we identified one asset related to ERAM equipment with a recorded useful life of 20 years; however, during the year, management intended that all ERAM assets have a useful life adjustment to 10 years.

Recommendation

We recommend that management develop and implement policies and procedures to ensure that all assets are recorded with the appropriate useful life based on the asset dictionary.

Weaknesses in the Timely Capitalization of Internal Use Software in Development – (NFR FAA-2018-06)

Background/Condition

When management begins a project, they can elect to establish the project as either a phased project or a program baseline project. For a phased project, multiple capitalization milestones are determined, and project costs are capitalized in phases, as the project reaches established milestones of completion. For a program baseline project, no costs are capitalized until the project meets the full acquisition program baseline. The Logistics Center Support System (LCSS) projects were established program baseline projects.

During our audit of Plant, Property and Equipment and the related accounts, we noted that although the LCSS system was placed into use in FY16 as the inventory system of record for the majority of FAA's inventory classes, management had not capitalized any portion of the system and had not begun depreciating the asset.

Recommendation

We recommend that management develop and implement policies and procedures to ensure accurate accounting for internal use software assets in accordance with SFFAS 10.

U.S. DOT OIG

Fraud & Safety Hotline

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Our Mission

OIG conducts audits and investigations on behalf of the American public to improve the performance and integrity of DOT's programs to ensure a safe, efficient, and effective national transportation system.

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U.S. Department of Transportation
1200 New Jersey Ave SE
Washington, DC 20590