



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 2017 and 2016**

**FAA**

Report No. QC2018024

February 12, 2018





## Quality Control Review of the Management Letter for the Federal Aviation Administration's Audited Consolidated Financial Statements for Fiscal Years 2017 and 2016

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*Required by the Chief Financial Officer Act of 1990*

Federal Aviation Administration | QC2018024 | February 12, 2018

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### 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 2017 and 2016. In addition to its audit report on FAA's financial statements, KPMG issued a management letter that discusses 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 nine recommendations in its management letter. FAA concurred with all nine recommendations.

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## Memorandum

Date: February 12, 2018

Subject: INFORMATION: Quality Control Review of the Management Letter for the Federal Aviation Administration's Audited Consolidated Financial Statements for Fiscal Years 2017 and 2016 | Report No. QC2018024

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

To: Acting Federal Aviation Administrator

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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 2017 and 2016. 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 17-03, *Audit Requirements for Federal Financial Statements*. KPMG issued an auditor's report<sup>1</sup> that included a clean (unmodified) opinion on FAA's financial statements.

KPMG also issued, and is responsible for, a management letter dated November 30, 2017 (see attached) identifying seven 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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<sup>1</sup> See *Quality Control Review of the Federal Aviation Administration's Audited Consolidated Financial Statements for Fiscal Years 2017 and 2016* (OIG Report Number QC2018006), November 13, 2017.

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## 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.

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## 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.

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### **Inadequate Documentation of Grant Accrual Lookback Analysis**

Controls over the lookback analysis were not properly implemented and operating effectively to ensure variances larger than +/- 10 percent were sufficiently and accurately explained and that necessary revisions were made to the estimation methodology. While variances larger than +/- 10 percent were analyzed, the analysis did not adequately determine the impact of certain factors to the estimation methodology or result in revisions.

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### **Inaccurate Procurement Expenses**

Controls were not properly implemented and operating effectively to ensure that expense transactions were accurate, valid, and properly posted to the general ledger. Specifically, out of a sample of 69 sample items, 3 were incorrectly recorded. One item was incorrect due to the application of an incorrect overhead rate. Another item was recorded as an expense transaction but should have been recorded as a prepaid asset. The third item was recorded in fiscal year 2017, but a portion of the underlying expenses was related to activities in fiscal years 2015 and 2016.

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### **Items Recorded as Capitalized and Not Properly Supported**

Controls were not implemented properly and operating effectively to ensure that invoices were accurately and appropriately reviewed to determine whether they

were properly expensed or capitalized according to requirements. Specifically, during the period of October 1, 2016 through May 31, 2017, one sample item was not supported by sufficient audit evidence to show that it met capitalization requirements. Another sample item from the period of June 1 through September 30, 2017 was improperly classified as construction in progress (CIP) despite having been flagged in the sub-ledger as a maintenance expense. Management performed a review of the CIP detail and found \$3.4 million in maintenance expenses that were improperly classified as CIP.

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## **Improper Calculation of Accounts Payable Accrual Percentages**

Controls were not implemented properly and operating effectively to ensure the Accounts Payable accrual percentage allocations were accurate in the new Accounts Payable accrual methodology. Specifically, three sample items were incorrectly categorized to fiscal year 2016 instead of fiscal year 2017, resulting in an overstatement of the fiscal year 2016 allocation amount. Two other sample items were incorrectly categorized to fiscal year 2017 instead of fiscal year 2016, resulting in an understatement of the fiscal year 2016 allocation amount.

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## **Restriction of Access to Logistics Center Support System (LCSS)**

Controls were not properly designed and implemented to ensure that LCSS access was restricted to properly authorized users. For a sample of 15 LCSS help desk request tickets, KPMG found no evidence of supervisor review and approval. Additionally, management did not properly maintain copies of eight of the request tickets.

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## **Removal of Terminated and Inactive LCSS Accounts**

Controls were not properly designed and implemented to ensure the timely termination of access to LCSS for inactive and terminated users. Specifically, four LCSS users retained access to the system for between 39 and 207 days after termination. KPMG also identified three users who no longer required access and three accounts inactive for over 60 days that had not been disabled and removed, as required.

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## Periodic Review of Access to LCSS

Controls were not properly designed and implemented to ensure that LCSS user accounts were being reviewed periodically.

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## Recommendations

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

1. Document their consideration of any factors that could impact the estimate in the current fiscal year when preparing the annual grant accrual estimate.
2. Document their analysis over the lookback review. Management should consider all factors that could result in a variance between the accrual and the lookback calculation, make a determination as to the potential impact in the current year accrual calculation and ensuring the documented factors are accurately described and necessary revisions to the methodology are made.
3. Implement controls at the appropriate level of precision to ensure expense transactions are accurate, valid and properly posted to the general ledger.
4. Develop and implement its policies and procedures to ensure invoices are reviewed at the appropriate level of precision to ensure that amounts are properly expensed or capitalized, and require appropriate level of detail from their contractors in order to effectively distinguish capital transactions from expense transactions.
5. Perform a review of the accounts payable accrual, including the procurement samples used for the percentage allocation, at a level of detail or precision to identify errors in order to prevent a misstatement.
6. Implement policies and procedures for LCSS to ensure LCSS user access is approved prior to the access being granted, and maintain documentation of the approvals, and ensure that user account request tickets are maintained properly.
7. Implement the procedures outlined in the LCSS System Security Plan to ensure that terminated and inactive users are removed appropriately and timely.

8. Implement a process for LCSS to review user access on a periodic basis.
9. Implement policies and procedures for LCSS to ensure that periodic access reviews have a defined timeline, frequency, and provide adequate detail for the reviewer to determine if access is appropriate based on the users' roles and responsibilities.

FAA officials concurred with 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.

**Attachment.**

Independent Auditors' Management Letter



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

November 30, 2017

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, 2017, 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. 17-03, 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 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.

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 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 the 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.

In addition, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies, and communicated these in writing to FAA management and those charged with governance in our report on internal control over financial reporting within our *Independent Auditors' Report*, dated November 9, 2017.

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.

This communication is intended solely for the information and use of management and others within the Department and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

**KPMG LLP**

## **A. Financial Reporting**

### **Inadequate Documentation of Grant Accrual Lookback Analysis – FAA-2017-01**

#### *Background/Condition*

Annually, during the second quarter, the FAA conducts a retrospective review (lookback analysis) over the prior year grant accrual to determine how accurate the estimation methodology was in calculating the prior year estimate and to determine if any adjustments to the methodology are necessary. To perform the lookback analysis, the FAA uses actual grant disbursements from October to January to calculate the amount of grant expenses related to prior year activity, utilizing statistically valid percentages of payments owed but not yet paid to grantees as of September 30. The FAA compares this calculation to the amount booked for the accrual in the prior fiscal year (FY) and develops an analysis to explain any variance larger than +/-10%.

During our testwork, we noted that controls in place over the lookback analysis are not properly implemented and operating effectively to ensure that variances larger than +/- 10% are sufficiently and accurately explained and that necessary revisions to the estimation methodology are made. Specifically we noted that although variances larger than +/- 10% were analyzed, the analysis did not adequately determine the impact of certain factors to the estimation methodology or result in revisions to the estimation methodology.

#### *Recommendation*

We recommend that management:

1. Document their consideration of any factors that could impact the estimate in the current FY when preparing the annual grant accrual estimate.
2. Further document their analysis over the lookback review. Management should consider all factors that could result in a variance between the accrual and the lookback calculation, make a determination as to the potential impact in the current year accrual calculation and ensuring the documented factors are accurately described and necessary revisions to the methodology are made.

### **Inaccurate Procurement Expenses – FAA-2017-03**

#### *Background/Condition*

During our testwork, we noted that controls to ensure that expense transactions are accurate, valid and properly posted to the general ledger were not implemented properly and were not operating effectively. Specifically, we selected a sample of 69 items and noted:

- One item in the amount of \$2,916 was incorrectly recorded due to the application of an incorrect overhead rate.
- One item in the amount of \$701,387 was incorrectly recorded as an expense transaction when it should have been recorded as a prepaid asset.
- One item was recorded in FY 2017, however, a portion of the underlying expenses totaling \$581,993 was related to FY 2015 and 2016 activity.

#### *Recommendation*

We recommend that management implement controls at the appropriate level of precision to ensure expense transactions are accurate, valid and properly posted to the general ledger.

## **Items Recorded as Capitalized and Not Properly Supported – FAA-2017-04**

### *Background/Condition*

The FAA capitalizes acquisitions for PP&E when the expense meets capitalization requirements, the cost equals or exceeds \$100,000 and the useful life equals or exceeds two years. Transactions not meeting these thresholds are expensed in the fiscal year incurred.

During our testwork, we noted that controls to ensure that invoices are accurately and appropriately reviewed were not implemented properly and were not operating effectively. Specifically, one of the 14 sample items for the period October 1, 2016 through May 31, 2017 did not contain sufficient audit evidence to demonstrate that the item met the capitalization requirements.

In addition, one of the nine sample items for the period June 1 through September 30, 2017 was improperly classified as CIP as of September 30, 2017 despite being flagged as maintenance expense in the project accounting sub-ledger. Management performed an additional review of the CIP detail and noted \$3.4 million of maintenance expenses with a similar flag that should not be included in the CIP balance.

### *Recommendation*

We recommend that management develop and implement its policies and procedures to ensure invoices are reviewed at the appropriate level of precision to ensure that amounts are properly expensed or capitalized. We also recommend that management require appropriate level of detail from their contractors in order to effectively distinguish capital transactions from expense transactions.

## **Improper Calculation of AP Accrual Percentages – FAA-2017-06**

### *Background/Condition*

FAA implemented an Accounts Payable (AP) accrual methodology in FY 2017 to account for all expenses accrued in the fiscal year that are not covered by the on-hand invoice accrual or the Air Traffic Organization (ATO) accrual. Under this methodology, the FAA estimates the accounts payable accrual using a statistical sample of historical information. Specifically, the FAA selected a stratified random sample from the expense population for October and November 2016 and tested these samples to identify the period of performance for each sample. The resulting data for each month is expressed as a percentage which multiplied by the average monthly expenses for the past four fiscal years for October and November to determine the amount accrued.

During our testwork, we noted that controls to ensure the AP accrual percentage allocations are accurate were not implemented properly and were not operating effectively. Specifically we noted:

- Three of 40 sample items tested were incorrectly categorized to FY 2016, however, these items should have been attributed to FY 2017. This resulted in the FY 2016 allocation amount being overstated by \$2.27 million, or 6.5% in October.
- Two of 40 sample items tested were incorrectly categorized to FY 2017, however, these items should have been attributed to FY 2016. This resulted in the FY 2016 allocation amount being understated by \$297 thousand, or 0.4% in November.

As a result of the errors noted above, management performed an additional review of the data used to determine the allocation percentage and revised the allocations accordingly.

### *Recommendation*

We recommend that the FAA perform a review of the AP accrual, including the procurement samples used for the percentage allocation, at a level of detail or precision to identify errors in order to prevent a misstatement.

**B. Information Technology General and Application Controls**  
**Access is restricted to authorized users – LCSS – FAA-2017-IT-03**

*Background/Condition*

During our testwork, we noted that controls are not properly designed and implemented to ensure LCSS access is restricted to properly authorized users. Specifically, we noted that for our selection of 15 LCSS Help Desk (LHD) request tickets, although the tickets adequately describe the user's roles and responsibilities, there was no evidence of review and approval of the related access by the supervisor. In addition, we noted that for our selection of 15 LCSS LHD request tickets, 8 LHD request tickets for operating system users, management was unable to provide the related tickets.

*Recommendation*

We recommend that LCSS implement policies and procedures to ensure LCSS user access is approved prior to the access being granted. In addition, we recommend that LCSS management maintain documentation of the approvals, and ensure that user account request tickets are maintained properly.

**Removal of terminated and inactive accounts – LCSS – FAA-2017-IT-04**

*Background/Condition*

During our testwork, we noted that LCSS controls are not properly designed and implemented to ensure the timely termination of user access for inactive and terminated users. Specifically, we compared a listing of separated employees to the LCSS active user listing as of June 20, 2017 and noted that 4 LCSS application users retained access from between 39 to 207 days after their termination date.

In addition, during our procedures over access to the LCSS development environment, we identified 3 users who no longer required access.

Lastly, we compared the central FAA termination user listing and the LCSS application active user listing, and noted 3 instances where accounts were inactive (without login activity) for a period greater than 60 days without being disabled and removed, as required by DOT compendium and LCSS policy.

*Recommendation*

1. We recommend that the LCSS implement the procedures outlined by the LCSS System Security Plan to ensure that terminated and inactive users are removed appropriately and timely.
2. We recommend that LCSS implement a process to review user access on a periodic basis.

**Periodic review of access – LCSS – 2017-IT-05**

*Background/Condition*

During our testwork, we noted that controls are not properly designed and implemented to ensure privileged and non-privileged LCSS user accounts are being reviewed on a periodic basis. Specifically, we noted that that periodic user access reviews are not currently being performed.

*Recommendation*

We recommend that the LCSS implement policies and procedures to ensure that periodic access reviews have a defined timeline, frequency, and provide adequate detail for the reviewer to determine if access is appropriate based on the user's roles and responsibilities.

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