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# *Office of Inspector General*

# *Audit Report*

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## **QUALITY CONTROL REVIEW OF THE MANAGEMENT LETTER FOR THE AUDIT OF FISCAL YEARS 2016 AND 2015 FINANCIAL STATEMENTS**

*Federal Aviation Administration*

*Report Number: QC2017026*

*Date Issued: February 7, 2017*





# 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 2016 and 2015 Financial Statements,  
Federal Aviation Administration  
Report Number: QC2017026

Date: February 7, 2017

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) consolidated financial statements as of and for the years ended September 30, 2016, and September 30, 2015. 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's (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.<sup>1</sup>

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. Untimely Review of Manual Journal Vouchers
2. Documentation of Non-Generally Accepted Accounting Principles Policies –  
Accounts Payable Accruals

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<sup>1</sup> *Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2016 and 2015, Federal Aviation Administration*, OIG Report No. QC-2017-011. OIG's reports are available at [www.oig.dot.gov](http://www.oig.dot.gov)

### 3. Items Incorrectly Recorded as Capitalized and Expense

#### **Information Technology General and Application Controls**

##### 1. Data Center Physical Security for a Grants Reporting System

KPMG made 6 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 the OIG to address the findings in KPMG's management letter dated December 23, 2016 (Financial Reporting) and January 23, 2017 (Information Technology). 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.

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

Attachment



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

November 30, 2016

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, 2016, 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 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 FAA's internal control. Accordingly, we do not express an opinion on the effectiveness of 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 FAA management, 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 these in writing to FAA management and those charged with governance in our report on internal control over financial report within our *Independent Auditors' Report*, dated November 10, 2016.

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.

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 be used by anyone other than these specified parties.

Very truly yours,

**KPMG LLP**

## **A. Financial Reporting**

### **Untimely Review of Manual Journal Vouchers – FAA-2016-01**

#### ***Background/Condition***

Certain manual journal vouchers (JVs) are prepared and posted at FAA headquarters. Although FAA policy allows the same individual to prepare and post journal vouchers, the policy requires that all manual JVs be reviewed by an appropriate member of management and by an individual separate from the person who prepares and posts the journal entry. Specifically, FAA's policy states that manual JVs should be reviewed no later than the earliest of (a) ten calendar days after the entry was posted or (b) the date external reports are published for the accounting period in which the entry was posted.

We selected a sample of 30 manual JVs from the population of FAA manual JVs for the period October 1, 2015 through June 30, 2016. Based on our audit procedures, we noted one JV that was prepared on June 15, 2016 but not reviewed until July 19, 2016, 34 calendar days after the JV was posted.

#### ***Recommendation***

We recommend that FAA management revise procedures to ensure manual JVs are reviewed timely and within the timeframes established by the policies.

### **Documentation of Non-GAAP Policies – A/P Accruals – FAA-2016-02**

#### ***Background/Condition***

For non-grant expenses (i.e., any expense not related to a grant agreement or payroll transaction), FAA records the below accruals for goods and services incurred, but not yet paid as of the reporting date:

- On-Hand Invoices Accrual to report invoices received, but not yet processed for payment. The cutoff date to include invoices in the accrual is October 5th.
- Air Traffic Organization (ATO) Accrual to report goods and services incurred on specific large ATO contracts.

FAA has determined that an accrual for the remaining non-grant expense transactions is immaterial to the financial statements.

For the period October 1, 2015 through May 31, 2016, we selected a statistical sample of 88 non-grant expense items. Based on our audit procedures, we noted 4 sample items, totaling \$3.4 million, where the goods or services were incurred in fiscal year (FY) 2015, but the expense was recorded in FY 2016. In addition, these transactions were not included in the on-hand invoice accrual or the ATO accrual.

As a result of the exceptions identified, we selected an additional sample of 20 expense transactions that were not included in the on-hand invoice accrual or the ATO accrual for the period October 1, 2015 through November 30, 2015. Based on our audit procedures, we noted 7 sample items, totaling \$12.7 million, where the goods or services were incurred in FY 2015, but the expense was recorded in FY 2016.

***Recommendation***

We recommend that FAA perform an analysis to determine the materiality of the expense transactions currently not included in the accounts payable accrual. If the amount is determined to be immaterial, we recommend that management develop and implement guidance to document its assessment and recognition decisions, in accordance with Statement of Federal Financing Accounting Concepts (SFFAC) No. 5, as it relates to liabilities for non-grant expense transactions and specifically decisions to not accrue for certain transactions. If the amount is determined to be material, we recommend that management revise its accounts payable policies to include all material payables in the accrual at year-end.

**Items Incorrectly Recorded as Capitalized and Expense – FAA-2016-03**

***Background/Condition***

FAA capitalizes acquisitions for Property, Plant & Equipment (PPE) when the cost equals or exceeds \$100 thousand and the useful life equals or exceeds two years. Transactions not meeting these thresholds are expensed in the fiscal year incurred.

For the period October 1, 2015 through May 31, 2016, we selected a statistical sample of 88 non-grant expense transactions. Based on our audit procedures, we noted 1 item, totaling \$929 thousand that was expensed, but should have been capitalized as construction in progress, in accordance with FAA's capitalization thresholds.

In addition, for the period October 1, 2015 through June 30, 2016, we selected a statistical sample of 22 Construction-in-Progress (CIP) addition transactions. Based on our audit procedures, we noted 1 item, totaling \$41 thousand that was capitalized, but should have been expensed, in accordance with FAA's capitalization thresholds.

***Recommendation***

We recommend that FAA refine its policies and procedures to ensure purchase orders and invoices are reviewed at the appropriate level of precision to ensure that amounts are properly expensed or capitalized.

**B. Information Technology General and Application Controls**

**Data Center Physical Security for a Grants Reporting System – FAA-2016-IT-04**

***Background/Condition***

During the FY 2015 financial statement audit, management was unable to provide a listing of users with physical access to the data center which supports the grants reporting system. Additionally, we were informed that periodic reviews of physical access were not performed.

During the FY 2016 financial statement audit, we inquired of management and were informed that the physical environment had been migrated to an off-site data center. Access to the data center building is under the direct control of the Office of Security and Hazardous Material Safety (ASH).

We requested a Standard of Operating and Procedures (SOP) or formal policies and procedures that detail access controls over the data center. Management provided the Service Level Agreement (SLA) dated September 5, 2012 and a Facility Security Management Plan dated June 13, 2005. Upon our review, we determined that the Facility Security Management Plan documents existing controls over granting and managing physical access to the facility; however the SLA was not appropriately updated to reflect the migration of the grants reporting system application's supporting infrastructure. Additionally, we determined that personnel at the center were not appropriately informed of the physical access controls required to support the application in accordance with the DOT Compendium.

In addition, we requested a listing of all individuals with access to the data center, including the date that access was granted and the specific areas in the data center where individuals were granted access. Management provided 8 separate listings with a total of 425 individuals, but we were unable to validate the appropriateness of how the listings were generated. The listings also did not indicate the date on which access was granted or the specific areas individuals had access to. Lastly, management was unable to provide evidence that a periodic review of the appropriateness of physical access to the data center had been performed.

***Recommendation***

We recommend that FAA management properly document and implement procedures of the following physical access controls: 1) Update policies and procedures over physical access to the data center to be in compliance with the DOT Compendium; 2) maintain accurate and detailed user listings of individuals granted access to the data center; and 3) perform periodic reviews of access rights for existing data center users.