



Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation

Office of Inspector General

Subject: INFORMATION: Quality Control Review
of Audited Financial Statements
for Fiscal Year 2002, FAA
QC-2003-017

Date: January 27, 2003

From: Kenneth M. Mead
Inspector General

Reply To

Attn Of: Meche:x61496

To: The Secretary
Federal Aviation Administrator

The audit of the Federal Aviation Administration (FAA) Financial Statements as of and for the year ended September 30, 2002, was completed by KPMG LLP (KPMG) of Washington, D.C. We performed a quality control review of the audit work to determine compliance with applicable standards. These standards include the Chief Financial Officers Act, *Government Auditing Standards*, and Office of Management and Budget Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

The KPMG audit report rendered an unqualified opinion on the FAA financial statements. The report included one material internal control weakness, six reportable internal control conditions, and one material noncompliance with accounting laws and regulations. KPMG made 14 recommendations for corrective actions (see Attachment). We agree with the KPMG recommendations. We are requesting that, within 15 days, FAA specify actions taken and planned, along with estimated completion dates for planned actions.

In our opinion, the audit work performed by KPMG complied with applicable standards. Therefore, we are not making any additional recommendations.

We appreciate the cooperation and assistance of FAA and KPMG representatives. If we can answer any questions, please call me at (202) 366-1959, or John Meche at (202) 366-1496.

Attachment

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**KPMG RECOMMENDATIONS ON ITS AUDIT
OF FAA FINANCIAL STATEMENTS**

Recommendation 1

Develop a communication and coordination plan to ensure timely, complete, accurate information regarding legal matters is routinely provided and reviewed. The information must be sufficiently complete to allow FAA to properly state legal liabilities in the financial statements and the notes thereto, in compliance with applicable accounting standards.

Recommendation 2

Since FAA will be converting to DOT's new accounting system in the near future, FAA should establish compensating controls to detect and correct financial reporting and accounting reconciliation discrepancies. In conjunction with this effort, FAA should routinely reconcile and resolve budgetary and proprietary account differences, and perform account and subledger analyses and reconciliations on other key accounts throughout the year, in order to produce reliable interim financial reports and reduce the number of post-closing adjustments at year-end. FAA also should assess the financial reporting impact related to weaknesses in its process for closing-out cost reimbursable contracts.

Recommendation 3

To improve the reliability, relevance and timeliness of information regarding environmental remediation, FAA should:

- Establish a process to provide periodic reporting for environmental liabilities;
- Develop and report estimates in current year dollars;
- Consider a risk-based evaluation of uninspected facilities to determine if any environmental remediation exists. This evaluation should focus on those facilities that are similar in function and design as other facilities in which FAA has determined contamination exists;
- Develop guidance for Environmental Site and Cleanup Report preparation and documentation requirements; and
- Improve documentation and quantification of planning assumptions.

Recommendation 4

Regarding the environmental cleanup and decommissioning estimate, FAA should:

- Establish a process to provide quarterly reporting for environmental liabilities;
- Improve the planning assumption documentation to include information on the contaminate type and quantity;
- Develop cost estimating models for each facility type; and
- Establish a cost/schedule baseline estimate for the environmental cleanup and decommissioning scope of work.

Recommendation 5

Implement procedures to ensure that field spare quantities are adequately recorded and tracked.

Recommendation 6

Evaluate the accounting methodology used by the Franchise Fund to account for returned field spares to ensure that the financial statements properly reflect depreciation and do not include adjustments for changes in value (other than depreciation expense) once the field spare is issued by the Franchise Fund.

Recommendation 7

Develop and implement formal periodic financial reporting processes to reconcile the property recorded in IFAS to the general ledger, and record additions and disposals in a timely manner.

Recommendation 8

Ensure that there is appropriate staffing to complete and review these periodic month-end reporting procedures, and that regional offices fully cooperate in providing information in a timely manner.

Recommendation 9

Prepare a roll-forward of fixed assets on a regular basis, at least quarterly, as a high level review of the property activity and help ensure that all transactions have been properly coded and recorded.

Recommendation 10

Improve FAA policy regarding accounting for construction-in-progress and ensure a timely matching of depreciation expense with assets placed in-service.

Recommendation 11

In conjunction with the Assistant Administrator for Regions and Center, reemphasize the need to follow procedures related to recording property disposals timely and ensuring labor, travel and other costs necessary to put an asset in place are correctly capitalized.

Recommendation 12

Improve information technology controls over third-party systems and applications by:

- Monitoring the progress of the FAA organizations responsible for implementing the specific recommendations previously provided;
- In conjunction with the DOT OIG, request that the USDA OIG complete its review of the FAA operations at NITC sooner; and
- In conjunction with DOT, request FTA to have an independent review performed, preferably in accordance with SAS 70, and prepare a report on controls placed in operation and tests of operating effectiveness related to the ECHO system.

Recommendation 13

Monitor the progress of those who are responsible for implementation of the specific recommendations associated with LIS.

Recommendation 14

Work aggressively to implement the new DOT accounting system.