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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 2015 AND 2014 FINANCIAL STATEMENTS**

*Department of Transportation*

*Report Number: QC-2016-022*

*Date Issued: February 25, 2016*





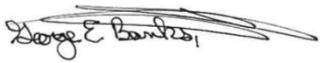
# Memorandum

**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  
2015 and 2014 Financial Statements,  
Department of Transportation  
Report Number: QC-2016-022

Date: February 25, 2016

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

Reply to  
Attn. of: JA-20

To: Assistant Secretary for Budget and Programs/  
Chief Financial Officer

I am pleased to transmit the attached management letter in connection with the audit of the Department of Transportation's (DOT) consolidated financial statements as of and for the years ended September 30, 2015, and September 30, 2014. 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 15-02, "Audit Requirements for Federal Financial Statements." KPMG issued an auditor's report that included a clean (unmodified) opinion on DOT'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:

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<sup>1</sup> *Quality Control Review of Audited Consolidated Financial Statements for Fiscal Years 2015 and 2014, Department of Transportation*, OIG Report No. QC-2016-008. OIG's reports are available at [www.oig.dot.gov](http://www.oig.dot.gov).

## **Financial Reporting and Accounting**

1. Weaknesses in Federal Transit Administration's (FTA's) Grant Accrual Retrospective Review
2. Weaknesses in Federal Railroad Administration's (FRA's) Grant Accrual Retrospective Review
3. Weaknesses in controls over Federal Transit Administration's (FTA's) Undelivered Orders
4. Weaknesses in the controls over Federal Highway Administration's (FHWA's) Undelivered Orders
5. Weaknesses in Management's Documentation of Non-Generally Accepted Accounting Principles Policies

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

1. Weaknesses in DOT's Data Center Access Controls
2. Weaknesses in the Office of the Secretary of Transportation's (OST's) Periodic Review of Privileged Service Accounts
3. DOT's Terminated Users Log

KPMG made eight recommendations to strengthen DOT's financial, accounting, and system controls. DOT officials concurred with KPMG's recommendations. The Department also submitted a detailed action plan to address the findings in KPMG's management letter to OIG on December 29, 2015. 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 DOT'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

November 30, 2015

Secretary and 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 (“Department” or “DOT”), as of and for the year ended September 30, 2015, 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 the Department’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 Department’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Department’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 DOT 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 a material weakness and a significant deficiency and communicated them in writing to DOT management and those charged with governance within our *Independent Auditors’ Report* dated November 12, 2015.

Matters specific to our separate audit of the Federal Aviation Administration (FAA) have been communicated to the Inspector General and the FAA Administrator in a separate letter.

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 Department’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**

**U.S. Department of Transportation  
Management Letter Comments**

**A. Financial Reporting**

**Weaknesses in FTA's Grant Accrual Retrospective Review - DOT-2015-01**

***Background***

When the Federal Transit Administration (FTA) awards a grant, management records a corresponding undelivered order (UDO) for the total amount of the grant award, which is ultimately reduced by the amount of drawdowns on the grant award. Grantees are required to complete a Federal Financial Report (FFR) no later than 30 days after each reporting period.

In order to validate the reasonableness of the grant accrual estimation process, FTA performs a retrospective review over the 3<sup>rd</sup> and 4<sup>th</sup> quarter grant accrual (for the periods ending June 30 and September 30, respectively) by analyzing the Federal share of expenditures reported on each grant project's FFR less cumulative disbursements for the related project. The total is then compared to the estimated grant accrual for that reporting period. FTA investigates differences greater than 10% and, if necessary, adjusts future accrual calculations and/or its methodology. All grantees are required to submit an FFR for the period ending September 30. FTA monitors the submission rate of the grantees' FFR until 90% of the FFRs have been submitted, at which point FTA performs the retrospective review for the period ending September 30.

Per Federal Register Vol. 79 No. 46 Section V, FTA has pre-award authority which allows the grantee to incur expenses prior to the official grant award being obligated. Grantees with pre-award authority are required to submit an FFR and report all expenses incurred on the line Federal share of expenditures. FTA is not obligated to reimburse the grantees for pre-award expenditures until the grant award has been officially approved and obligated by FTA.

***Condition***

FTA did not use the best available data inputs to perform the retrospective review of the September 30, 2014 grant accrual. Specifically, in 14 instances, the Federal share of expenditures reported on the grantees' FFRs exceeded the available UDO balance due to reported pre-award authority expenditures. FTA did not properly limit the amount owed to the grantees to the contractually binding obligation amount (UDO balance).

Additionally, FTA considers only the number of FFRs submitted (i.e., 90%) when assessing whether there is sufficient data to perform the retrospective review. FTA does not consider the relative dollar value or unliquidated balance associated with the grant project when assessing the percentage of FFR submissions. This process has the potential to exclude large balances which could impact the analysis.

***Recommendation***

We recommend that FTA revise its grant accrual retrospective review procedures to ensure that the retrospective review is performed at the appropriate level of precision using relevant and reliable data inputs (including FFR reporting, UDO balances, and grant disbursements) and any resulting material adjustments are properly made to the grant accrual methodology.

**U.S. Department of Transportation  
Management Letter Comments**

**Weaknesses in FRA's Grant Accrual Retrospective Review- DOT-2015-02**

***Background***

The Federal Railroad Administration (FRA) provides grants to states, cities, private railroads, and the National Railroad Passenger Corporation (i.e., Amtrak) to help improve the nation's railways. All FRA grantees are required to complete a Federal Financial Report (FFR/SF-425) quarterly and submit it no later than 30 days after quarter-end.

On a quarterly basis, FRA estimates a grant accrual to recognize expenses incurred, but not yet billed to FRA. FRA determines the grant accrual using estimated expense data, at the project level, provided by the grantee. In addition, FRA accrues for all grant invoices that have been received, but not yet processed, at quarter-end.

To validate the reasonableness of the grant accrual estimate, FRA performs a retrospective review over each quarter's estimated grant accrual by analyzing the Federal share of expenditures reported on each grant project's Federal Financial Report (FFR/SF-425) less cumulative disbursements for the related project. FRA compares the retrospective review accrual to the estimated grant accrual recorded for that reporting period. FRA's policy is to investigate variances greater than 10% and, if necessary, adjusts future accrual calculations and/or its methodology.

***Condition***

FRA did not perform an adequate retrospective review over the September 30, 2014 grant accrual. Specifically, in management's analysis:

1. Twenty-four grant awards met FRA's 10% variance threshold requiring investigation; however, FRA did not perform follow-up procedures to investigate these variances.
2. Ten grant awards were not evaluated against FRA's 10% variance threshold as the variance formula denominator (i.e., the September 30, 2014 grant accrual amount) was zero, resulting in an uncalculated percentage change. FRA did not perform follow-up procedures to investigate these variances or document its consideration of these variances.
3. For eight grant awards accrued as of September 30, 2014, FRA determined it was not necessary to perform a retrospective review for items where the accrual amount was calculated using invoices that had been received from the grantee, but not yet processed, as of September 30, 2014; however, FRA did not document its consideration of these items in its policy or in its retrospective review.
4. For five grant awards accrued as of September 30, 2014, FRA did not perform the retrospective review analysis because FRA failed to obtain the FFR/SF-425s from the program manager.
5. Six grant awards resulted in a negative retrospective review accrual because the Federal share of expenditures reported by the grantee on the FFR/SF-425 was less than the cumulative disbursements for the related project. FRA calculated the variance dollar amount and variance percentage using the negative accrual. FRA did not document its consideration of these items in its policy or in their retrospective review.

**U.S. Department of Transportation  
Management Letter Comments**

***Recommendation***

We recommend that FRA revise its grant accrual retrospective review procedures to ensure that the retrospective review is performed at the appropriate level of precision to prevent and/or detect a material misstatement and that all significant variances are researched and documented in order to assess the reasonableness of the grant accrual methodology.

**Weaknesses in Controls over FTA's Undelivered Orders – DOT-2015-03**

***Background***

The FTA Grants A to Z Standard Operating Procedures Document establishes policies and procedures for FTA's review of inactive grant projects. At the beginning of each fiscal year, by October 10<sup>th</sup>, FTA generates the annual grants closeout list as of September 30<sup>th</sup> of the preceding fiscal year. The annual grants closeout list includes inactive grants that should be closed out and de-obligated during the current fiscal year, based on the following criteria:

1. A grant that is 100% disbursed;
2. A grant that was obligated more than three years ago and has had no disbursements within the past 12 months; or,
3. A grant for operating assistance or preventative maintenance that was obligated 12 months or more ago and has had no disbursements within the past 12 months.

The regional offices review and evaluate the status of grants included in the annual grants closeout list to determine if there are valid reasons for excluding any projects from being closed out and de-obligated during the fiscal year. All grants that are not excluded from the annual grants closeout list should be closed out and de-obligated by the end of the fiscal year.

***Condition***

FTA's policy is to generate the annual grants closeout listing as of September 30<sup>th</sup> of the preceding fiscal year and therefore, the listing does not include grants that become inactive during the current fiscal year.

***Recommendation***

We recommend that FTA revise its policies and procedures for monitoring obligations in order to more timely identify and de-obligate stale obligations.

**Weaknesses in Controls over FHWA's Undelivered Orders - DOT-2015-04**

***Background***

The Federal Highway Administration (FHWA) Financial Integrity Review and Evaluation (FIRE) Program, defined by 23 CFR 630 Subpart A, requires the states to review inactive projects with unexpended Federal obligations on a quarterly basis and revise obligated funds, if necessary. Effective December 30, 2013, FHWA management revised its policies and procedures to prioritize the review of projects that have been inactive for the past 12 months with unexpended obligation balances (i.e.

## **U.S. Department of Transportation Management Letter Comments**

undelivered order balances or UDOs) greater than \$150,000. In accordance with FHWA's Supplemental FY 2015 Internal Procedures for the Review, Validation, and Testing of Inactive Obligations, each quarter, the FHWA Office of the Chief Financial Officer (OCFO) prepares and provides the FHWA division offices with a listing of inactive projects for review. The listing is comprised of projects that meet the following criteria:

1. Projects with a UDO balance over \$150,000 that have had no expenditures within the past 12 months
2. Projects with a UDO balance between \$50,000 and \$150,000 that have had no expenditures

The FHWA division offices work with the respective grantees to review and validate all projects included on the listing and revise the obligation balance, if necessary.

### ***Condition***

Of a statistical sample of 104 FHWA items from the population of stale grant UDOs as of March 31, 2015 we noted that seven met FHWA's inactive criteria at the project level<sup>1</sup> and were properly included on the listing of inactive projects distributed to the FHWA division offices for review. For one of these seven items, the FHWA division office identified the item for de-obligation as the project was completed; however, the UDO balance of \$1 million was not properly de-obligated timely.

### ***Recommendation***

We recommend that FHWA continue to emphasize the timely de-obligation of all stale obligations identified through the revised Supplemental Internal Procedures for the Review, Validation, and Testing of Inactive Obligations.

## **Weaknesses in Management's Documentation of Non-GAAP Policies - DOT-2015-06**

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

In its annual assessment of accounting policies and procedures, DOT has identified a departure from Generally Accepted Accounting Principles (GAAP) to not record an estimated liability for goods and services incurred, but not yet invoiced by the grantee or vendor. Specifically, for certain smaller Operating Administration (OA) grant programs, DOT does not record an estimated accrual for invoices not received from the grantee. In addition, for all non-grant expenses (i.e. any expense not related to a grant agreement), DOT only records an accounts payable for goods and services incurred for which an invoice has been received from the vendor, but not yet processed by DOT for payment. DOT deems an accrual for these certain exchange transactions to be immaterial to the DOT consolidated financial

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<sup>1</sup> FHWA analyzes obligations at the project level to determine whether it meets the inactive criteria. A project can have multiple program elements, which are recorded in the general ledger with unique purchase order numbers. We evaluate whether an obligation is stale, which we define as any obligation that has had no activity in the past 12 months, and select our sample at the purchase order level. Therefore, some of the UDO items selected in our sample of stale UDOs are not included in FHWA's inactive listing as they are purchase orders on projects with multiple purchase orders, and there has been recent activity on one of the other purchase orders and therefore overall, the project is active.

**U.S. Department of Transportation  
Management Letter Comments**

statements taken as a whole; however, management has not performed an analysis to determine the impact to the DOT consolidated financial statements.

***Recommendation***

We recommend that DOT develop and implement guidance to formally document its assessments and recognition decisions, in accordance with SFFAC No. 5, as it relates to liabilities of exchange transactions, specifically those decisions to depart from GAAP based on materiality.

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

**Weaknesses in DOT Data Center Access Controls - DOT-2015-OST-IT-01**

***Background/ Condition***

During our review of the physical security of the data center that hosts all the in-scope applications for FHWA and FTA, we selected a sample of 8 individuals who had been granted access to the data center for the period October 1, 2014 through March 1, 2015. We noted that for 6 of the 8 individuals selected, documentation approving the individual's access to the DOT Data Center was not properly retained.

***Recommendation***

We recommend that the IT Shared Services enhance data center procedures to ensure all access requests and approvals are retained in accordance with applicable DOT policies.

**Weaknesses in OST's Periodic Review of Privileged Service Accounts - DOT-2015-OST-IT-02**

***Background/ Condition***

FTA manages its federal grants in the Transportation Electronic Award and Management System (TEAM) and the Electronic Clearing House Operation System (ECHO-Web). Server administrator access to TEAM and ECHO-Web is managed by the Office of the Secretary (OST) and specifically, the DOT IT Shared Services (ITSS). ITSS is responsible for reviewing privileged service accounts for continued appropriateness for all OAs.

While performing procedures over the ITSS review of server administrator access, we noted IT Shared Services does not periodically review privileged service accounts with access to in scope FTA servers for continued appropriateness. These service accounts are user accounts that are created explicitly to provide a security context for services running on Microsoft Windows Servers and are used for server operations such as backups, vulnerability scanning, patching, and mail services.

***Recommendation***

We recommend that OST management enhance account review processes and procedures to ensure that privileged service accounts are periodically reviewed for continued appropriateness, based on the principle of least privileged.

**U.S. Department of Transportation  
Management Letter Comments**

**DOT Terminated Users Log – DOT-2015-OST-IT-03**

***Background/ Condition***

DOT uses Delphi, an Oracle Federal Financial software, as its agency wide financial management and accounting system of record. Delphi users have the ability to search, browse, maintain, share, classify, register and standardize financially administered items through a web based application and access is controlled by the Delphi system owners.

We obtained a listing of DOT employees who separated from DOT, compared the listing to the Delphi active user listing, and noted 24 separated employees whose access to Delphi had not been removed.

We inspected the Delphi user audit report and noted that the users did not access Delphi after their termination date.

***Recommendation***

We recommend that DOT management develop and implement policies and procedures, including increasing the level of precision of the quarterly review of Delphi access, to remove application access for separated employees and contractors immediately upon termination or when it is determined that a user's access is no longer required.