FEDERAL ELECTION COMMISSION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT

Audit of the Federal Election Commission's Fiscal Year 2005 Financial Statements

November 2005
ASSIGNMENT OIG-05-01

FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

Office of Inspector General

MEMORANDUM

TO: The Commission

FROM: Inspector General

SUBJECT: Audit of the Federal Election Commission's Fiscal Year 2005 Financial Statements

DATE: November 10, 2005

This letter transmits the final audit report of the Federal Election Commission's (FEC) fiscal year (FY) 2005 financial statements. In accordance with the Accountability of Tax Dollars Act of 2002, the FEC prepared financial statements in accordance with Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, as amended, and subjected them to audit.

The Chief Financial Officers Act of 1990 (Public Law 101-576, commonly referred to as the "CFO Act"), as amended, requires the FEC Office of Inspector General (OIG), or an independent external auditor as determined by the Inspector General, to audit the agency financial statements. Under a contract monitored by the OIG, Clifton Gunderson LLP (CG-LLP), an independent certified public accounting firm, performed the audit of the FEC's FY 2005 financial statements.

The OIG commends the FEC for the accomplishment of completing the fiscal year 2005 on time this year. The Inspector General acknowledges the significant challenge of meeting the accelerated due date of the annual financial statement audit required by OMB.

<u>Audit Process</u>

CG-LLP conducted the audit 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 OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended. The results of the financial statement audit are detailed in three reports: report on compliance with laws and regulations; report on internal control; and the opinion on the financial statements.

Report on Compliance with Laws and Regulations

FEC management is responsible for complying with laws and regulations applicable to the agency. To obtain reasonable assurance about whether FEC's financial statements are free of material misstatements, CG-LLP performed tests of compliance with certain provisions of laws and regulations, non-compliance with which could have a direct and material effect on the determination of financial statement amounts, and certain laws and regulations specified in OMB Bulletin No. 01-02, such as the Anti-Deficiency Act and the Prompt Payment Act.

The results of CG-LLP's tests of compliance with laws and regulations described in the audit report disclosed no instances of noncompliance with the laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Report on Internal Control

CG-LLP's planning and performance of the audit included consideration of the FEC's internal control over financial reporting. The CG-LLP auditors obtained an understanding of the FEC's internal control; determined whether internal controls had been placed in operation; assessed control risk; and performed tests of controls in order to determine auditing procedures for the purpose of expressing an opinion on the financial statements. The auditors limited their internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and consequently CG-LLP did not provide an opinion on internal control.

Internal control as it relates to the financial statements, is a process, affected by agency's management and other personnel, designed to provide reasonable assurance of the following: (1) transactions are properly recorded, processed, and summarized to permit preparation of the financial statements and assets are safeguarded against loss from unauthorized acquisition, use or disposition; (2) transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations identified by OMB; and (3) transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

In performing the testing of internal control necessary to achieve the objectives in OMB Bulletin No. 01-02, the auditors identified matters relating to significant deficiencies in the design or operation of FEC's internal control. The testing of internal control identified both reportable conditions and material weaknesses. The American Institute of Certified Public Accountants (AICPA) categorizes reportable conditions as matters relating to significant deficiencies in the design or operation of the internal control, which in the judgment of the auditor, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

CG-LLP identified material weaknesses in the areas of:

- Cost Accounting System and Processes
- Administrative Fines, Civil Penalties and Miscellaneous Receipts
- General Property and Equipment
- Information Technology

CG-LLP identified reportable conditions, not considered to be material weaknesses, which include the following:

- Financial Reporting
- Payroll

Opinion on the Financial Statements

CG-LLP audited the balance sheets of the FEC as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. In the report dated November 7, 2005, CG-LLP issued a qualified opinion on the FEC's financial statements.

In fiscal year 2005, the FEC was late in providing cost information to support the allocation of program costs reported on the statement of net cost. As a result, adequate time did not remain to obtain sufficient competent evidential matter and apply auditing procedures necessary to conduct the audit in accordance with the standards and OMB audit guidance mentioned above.

In the independent auditor's opinion, except for the effects of such adjustments to the fiscal year 2005 statement of net cost, if any, as might have been necessary had the auditors been able to perform adequate audit procedures on the program costs referred to in the preceding paragraph, the financial statements and related notes referred to above were presented fairly, in all material respects, the financial position of the FEC as of September 30, 2005 and 2004, and its net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations, and custodial activity for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The audit included an examination, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also included assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall principal statements' presentation.

Audit Follow-up

The report on internal control contains numerous recommendations to address weaknesses found by the auditors. Management was provided a draft copy of the audit report for comment and CG-LLP reviewed management's comments. Although CG-LLP stands by the report and the weaknesses detailed, the OIG and CG-LLP intend to work with management through the follow-up and audit process to ensure the weaknesses are addressed satisfactorily. In accordance with OMB Circular No. A-50, *Audit Followup*, revised, and based on an agreement with the Offices of the Staff Director and General Counsel, the Staff Director or designee shall develop an action plan for corrective action of the recommendations. The action plan is to set forth specific action planned to implement the recommendations and the schedule for implementation.

OIG Evaluation of Clifton Gunderson LLP's Audit Performance

In connection with the OIG's contract with CG-LLP, the OIG reviewed CG-LLP's reports and related documentation and inquired of its representatives. Specifically, we performed the following: (1) reviewed CG-LLP's approach and planning of the audit; (2) evaluated the qualifications and independence of the auditors; (3) monitored the work of the auditors throughout the audit; (4) examined audit documents and audit reports to ensure compliance with *Government Auditing Standards* and OMB Bulletin No. 01-02; and (5) performed other procedures we deemed necessary.

The OIG's review of CG-LLP's work, as differentiated from an audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States, was not intended to enable us to express an opinion on the FEC's financial statements; provide conclusions about the effectiveness of internal control; or reach conclusions on whether FEC's management substantially complied with laws and regulations related to the audit. CG-LLP is responsible for the opinion and conclusions reached in the attached reports dated November 7, 2005. The OIG review disclosed no instances where CG-LLP did not comply, in all material respects, with *Government Auditing Standards*.

If you should have any questions, please contact my office on (202) 694-1015. We appreciate the courtesies and cooperation extended to Clifton Gunderson LLP and the OIG staff during the conduct of the audit.

Lynne A. McFarland

Lynne A. McFarland
Inspector General

Attachments

Cc: Acting Staff Director
Chief Financial Officer and Deputy Staff Director for Management
Accounting Officer
Information Technology Director

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Clifton
Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Inspector General of the
Federal Election Commission

We have audited the balance sheets of the Federal Election Commission (FEC) as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. These financial statements are the responsibility of FEC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audits 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. 01-02, *Audit Requirements for Federal Financial Statements,* as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements' presentation. We believe our audits provide a reasonable basis for our opinion.

In fiscal year 2005, the FEC was late in providing cost information to support the allocation of program costs reported on the statement of net cost. As a result, adequate time did not remain to obtain sufficient competent evidential matter and apply auditing procedures necessary to conduct the audit in accordance with the standards and OMB audit guidance mentioned above.

In our opinion, except for the effects of such adjustments to the fiscal year 2005 statement of net cost, if any, as might have been necessary had we been able to perform adequate audit procedures on the program costs referred to in the preceding paragraph, the financial statements and related notes referred to above present fairly, in all material respects, the financial position of the FEC as of September 30, 2005 and 2004, and its net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations, and custodial activity for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 7, 2005 on our consideration of FEC's internal control over financial reporting, and on our tests of FEC's compliance with certain provisions of laws and regulations. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management Discussion and Analysis, required supplementary information, and other accompanying information contain a wide range of data, some of which is not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with the FEC officials. Based on this limited work, we found no material inconsistencies with the financial statements or nonconformance with OMB guidance.

Clifton Gunderson LLP

Calverton, Maryland
November 7, 2005

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control

To the Inspector General of the
Federal Election Commission

We have audited the financial statements of the Federal Election Commission (FEC) as of and for the year ended September 30, 2005, and have issued our report dated November 7, 2005. In our report, our opinion was qualified for the effects of adjustments, if any, as might have been necessary had we been able to perform adequate audit procedures on the cost information supporting the allocation of program costs reported on the statement of net cost. Except as described above, we conducted our audit 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. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered FEC's internal control over financial reporting by obtaining an understanding of FEC's internal control; determined whether internal controls had been placed in operation; assessed control risk; and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act (FMFIA) (31 U.S.C. 3512), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

and not be detected. However, we noted certain matters discussed in the following paragraphs involving the internal control and its operation that we consider to be reportable conditions and material weaknesses.

Finally, with respect to internal control related to performance measures reported in FEC's Performance and Accountability Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

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FEC attained a major achievement by having its financial statements audited for the first time in fiscal year 2004. FEC continues to design and implement internal controls to strengthen its financial reporting processes. Also, early in the second half of fiscal year 2005, FEC hired a Deputy Staff Director for Management/Chief Financial Officer, a position which was not filled for over a year. In fiscal year 2005, however, certain controls were still being designed, not yet implemented, not fully implemented or not consistently implemented throughout the year.

MATERIAL WEAKNESSES

I. Cost Accounting System and Processes

The weaknesses identified below collectively resulted in a material weakness in FEC's cost accounting system and processes.

A. Cost Allocation Methodology (Repeat Finding)

FEC does not have a cost accounting system that is integrated with the general ledger (GL) system. The current cost accounting system is not adequate to produce the cost data for the Statement of Net Cost (SNC) in an efficient manner. Moreover, the lack of documented procedures and the heavy reliance on a single person to carry out this process impaired FEC's ability to generate timely information especially after the person became unavailable. Consequently, FEC was not able to provide the documentation for cost allocation timely and we were not able to apply auditing procedures to satisfy ourselves with the program costs reported on the SNC.

The cost data presented on the SNC is compiled from three systems' raw data, which is then gathered and analyzed using an elaborate, complex, and manually intensive process. Raw data used in the allocation of costs, such as FTE hours, is sometimes based on estimates due to the timing of the availability of the data.

FEC summarizes employee hours in a spreadsheet based on an office's program numbers, which is generated by a system. The program numbers represent the type of work performed by an employee and the hours are assigned directly or allocated to FEC's three major programs. FEC could not provide crosswalk documentation or definitions supporting the basis of assignment or allocation. The data accumulation and analysis is performed by one person and not subjected to a second review.

The manually intensive and elaborate cost allocation process dictates the need for a formal comprehensive policy and procedures.

A control activity in the GAO *Standards for Internal Control in the Federal Government* is appropriate documentation of transactions and internal control. Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. All documentation and records should be properly managed and maintained.

Recommendations:

1. Establish formal and comprehensive cost allocation methodology and related policy and procedures.

2. Cross-train employees to minimize the risks of major interruptions in normal business operations.

3. Establish a review process wherein a person, other than the preparer, reviews the work performed to ensure accuracy and propriety.

4. Maintain audit trails to support the allocation methodology and amounts.

B. Managerial Cost Accounting (Repeat Finding)

Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* requires reporting components to perform a minimum-level of cost accounting and provide basic information necessary to accomplish the many objectives associated with planning, decision-making, and reporting. This minimum-level of cost accounting includes, among others: providing information for performance measurement; integrating both cost accounting and general financial accounting by using the United States Standard General Ledger (USSGL); providing useful information; and accommodating management's special cost information needs or any other needs that may arise due to unusual or special situations or circumstances. The present FEC cost accounting system does not provide the minimum-level identified above.

FEC is currently testing a new cost accounting system with a target implementation date of January 2006. The FEC believes the conditions noted above will be corrected by the new cost accounting system.

Recommendation:

5. Evaluate the functional requirements for the new cost accounting system to ensure that at least, the minimum level of cost accounting required in SFFAS No. 4 is attained.

II. Administrative Fines, Civil Penalties and Miscellaneous Receipts (Custodial Receipts) (New Condition)

The weaknesses identified below collectively resulted in a material weakness in FEC's custodial receipts.

FEC does not have adequate systems and controls in place to ensure that custodial receipts are properly accounted for and recorded timely. There were no formal accounting policy and procedures to ensure that various offices periodically forward to, or notify, the finance office of all identifiable, legally enforceable claims (receivable and revenue) for recording of activities in accordance with the accounting standards. The lack of a policy, standard mechanism and consistent approach resulted in transactions not being recorded and reported timely and required the FEC to expend significant effort towards the end of the fiscal year to identify all transactions that should be recorded.

Moreover, for receivables already recorded in the books, FEC lacked adequate documentation of analysis applied in determining the allowance for doubtful accounts. In addition, transactions related to the custodial receipts, which are non-appropriated funds, were recorded in Standard General Ledger (SGL) account no. 1011, an account used for appropriated funds. The use of the incorrect SGL account was corrected in September 2005 when the auditors brought this issue to FEC's attention.

SFFAS No. 7, *Accounting for Revenue and Other Financing Sources,* states that non-exchange revenue (e.g. penalties and fines) should be recognized when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. An allowance for uncollectible accounts receivable should be recognized as a revenue adjustment.

The United States Standard General Ledger (USSGL) provides a uniform Chart of Accounts and technical guidance to be used in standardizing federal agency accounting.

Recommendations:

6. Establish and implement policy and procedures ensuring communication and coordination between program offices and finance office on activities with financial impact. The policy should also clearly establish the FEC's revenue recognition policy. The finance office should design a standard report outlining all the necessary information to record the financial activities. The report should be prepared and submitted timely at least monthly by the program offices to the finance office.

7. Document the policy and basis for the allowance for uncollectible accounts.

III. General Property and Equipment (Property) (Modified Repeat Finding)

FEC's accounting for property involves a time-consuming effort that increases the risk of errors due to its process of expensing its property at the time of acquisition and preparing a journal voucher to reclassify the expense to an asset for reporting purposes. In mid-September 2005, FEC changed to a new property management system. However, the accounting for property did not change.

Our audit disclosed deficiencies, errors or omissions that questioned the effectiveness of FEC's internal control on property. The weaknesses identified below collectively resulted in a material weakness in FEC's general property and equipment. Some examples are noted below:

- The internal control to ensure completeness and proper valuation of property recorded in the books was not properly designed, and consequently, was not effective. The periodic property reconciliation process did not identify software that should have been capitalized until during the audit process. In addition, the monthly management analysis of financial activities did not show an analysis of property.
- Although the number of items in FEC's capitalized asset is not many, most of these assets are bulk purchases comprised of many individual properties which are individually entered into the property system for accountability purposes. The information contained in the property system is not always complete. We found that some items in the property system did not have the bar code identification, serial number and location of the asset.
- Although we were informed that a property physical inventory was conducted, FEC could not provide the instructions, complete results and reconciliation of the physical inventory to the property system and the general ledger balance.

- FEC did not always capitalize assets in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*. Moreover, FEC's processes of identifying software in progress and completed were not adequate to ensure that all software was identified and recorded.
- For 12 of the 18 property additions tested, the receiving reports were not complete or included incorrect information.
- The obligating memo for one of the 15 sample items was not approved by the accounting officer, an authorized approving officer.
- There was no standard process, mechanism or a policy to ensure that program offices notify the finance office of the acquisition or disposition of property such as software in development, completed software, construction in progress, and completed construction to ensure the accounting impact of the transaction is recorded timely and properly.

One of the five standards for internal control in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* is control activities. Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records, which provide evidence of execution of these activities as well as appropriate documentation.

Recommendations:

8. Reconcile the total of the individual property items in the property system to the bulk purchase total recorded in the books to ensure completeness of the property system records.

9. Document physical inventory procedures, results, and reconciliation and maintain the documentation for audit trail purposes.

10. Revise the software capitalization policy to comply with SFFAS No. 10.

11. Enforce compliance and consistent implementation of policies and procedures related to completing receiving reports and the review and approval of obligating memos or documents.

12. Establish a standard process and policy where program offices are required to notify the finance office of any property acquisition or disposition with accounting impact to ensure proper and timely recording of the transaction.

IV. Information Technology (IT)

The reportable conditions below, when evaluated together, make the IT area a material weakness.

A. Entity-Wide Security Program

GAO reported in July 2005 that the underlying cause for information security weaknesses is that agencies have not yet fully implemented entity-wide information security programs. An entity-wide security program provides a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer-related controls. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, and improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources. (U.S. Government Accountability Office, *Weaknesses Persist at Federal Agencies Despite Progress Made in Implementing Related Statutory Requirements*, GAO-05-552 [Washington, D.C.: July 2005]).

FEC has taken important steps to establish an effective information security program, but has not completed the documentation, approval and implementation of an entity-wide security program plan. In October 2004, FEC issued a memo informing employees that the "Information System Security Program Policy" (Policy Number 58A) was approved and should be followed by all employees. Policy Number 58A was created to "manage the risk to information rather than just systems" and serve as the backbone of FEC's entity-wide security program. Policy 58A and its subsets supplement Directive 58, "Electronic Records, Software and Computer Usage," which was issued in November 1997.

In fiscal year 2005, FEC has completed the identification of its major applications and mission critical general support systems (MCGSS) as part of its risk mitigation strategy. FEC management also created a Security Review Policy that calls on management to perform annual external penetration testing, disaster recovery tests, a review of incident response procedures, a network vulnerability study, a code review of one major application and a review of access control procedures. Additionally, FEC management is currently in the process of soliciting bids for risk assessments. Management has completed the statement of work, received proposals and is currently reviewing the proposals. The risk assessment and business impact analysis are key components in the development of security plans and disaster recovery plans. These components are essential in the establishment of the framework for the development and implementation of the FEC's security plans and disaster recovery plans.

Current weaknesses that exist in FEC's information security program include the following:

- **(Repeat Finding)** FEC has not fully implemented its documented framework of policies and standards to mitigate risks associated with the management of information resources.
- **(Repeat Finding)** FEC has not completed the documentation, approval and implementation of its entity-wide security program plan.
- **(Modified Repeat Finding)** FEC has not completed the documentation, approval and implementation of security plans for six of the 13 identified major applications and MCGSS.
- Resource Classifications in FEC's security plans are not based on Risk Assessments.
- **(Modified Repeat Finding)** FEC has not fully implemented a program for the continuous monitoring and evaluation of the computer security policy and control effectiveness. Although the FEC has created a Security Review Policy, the FEC did not provide evidence of several components of the security reviews to be conducted during the fiscal year that would document the continuous monitoring and evaluation of the security policy. For example, the auditors were not provided with evidence of the following reviews required by the policy: MCGSS reviews; test of the incident response procedures; and a code review of one major application. The FEC has created a Security Review Policy that calls on management to perform annual external penetration testing, disaster recovery testing, a review of incident response procedures, a network vulnerability study, and a review of access control procedures. Additionally, FEC management issued a memo on May 21, 2004 outlining a schedule of review of its major applications and MCGSS with reviews of the MCGSS beginning in the third quarter of fiscal year 2005.
- **(Repeat Finding)** Risk assessments have not been conducted for more than three years. FEC management is currently in the process of soliciting bids for risk assessments.
- **(Repeat Finding)** Major applications and MCGSS have not been certified and accredited to ensure that they are operating according to FEC's security requirements.
- There are weaknesses in FEC's program to document corrective actions and verify that the weaknesses identified have been addressed.

Recommendations:

13. Implement a framework of policies and standards to mitigate risks associated with the information resources management.
14. Complete the documentation, approval and implementation of an entity-wide security program plan.
15. Develop and implement security plans for all major applications and MCGSS as part of a risk mitigation strategy.
16. Ensure that Resource Classifications in FEC's security plans accurately reflect the risk and vulnerabilities of FEC systems.
17. Complete the implementation of the program for the continuous monitoring and evaluation of the computer security policy and control effectiveness.
18. Conduct risk assessments at least every three years as part of an overall strategy to mitigate risks associated with its information technology environment.
19. Certify that the major applications and MCGSS are operating according to FEC's security requirements.
20. Strengthen FEC's program to document corrective actions and verify that weaknesses identified have been addressed. Ensure and document that recommendations from the most recent network security review have been implemented.

B. Controls to Protect Information

For a computerized organization like FEC, achieving an adequate level of information protection is highly dependent upon maintaining consistently effective access controls and system software controls. Access controls limit and monitor access to computer resources (i.e., data files, application programs, and computer-related facilities and equipment) to the extent necessary to provide reasonable assurance that these resources are protected against waste, loss, unauthorized modification, disclosure, or misappropriation. Access controls include logical/technical controls such as designing security software programs to prevent or detect unauthorized access to sensitive data. Similarly, system software controls limit and monitor access to powerful programs and sensitive files that control computer processing and secure the application and data supported by the system.

Our limited testing of internal controls identified weaknesses related to the information protection in the FEC's information systems environment. Impacted areas included the local area and wide area networks as well as its midrange computer systems (e.g. servers). These vulnerabilities expose FEC and its computer systems to risks of external and internal intrusion, and subject sensitive information related to its major applications to potential unauthorized access, modification, and/or disclosure.

Current weaknesses in access controls include the following:

- **(Modified Repeat Finding)** The principle of "least privilege" is not enforced. A high-level finance officer has system administrator access to the GL system.
- **(Repeat Finding)** FEC does not maintain visitor logs for data center access and has not implemented adequate compensating controls to monitor and record visitor access to the data center.
- **(Modified Repeat Finding)** FEC does not use access request forms to document user access rights or periodically review all access rights for appropriateness. Specifically, we noted that data center access request e-mails were only available for three out of 40 users and there was no evidence of data center access revalidation. Additionally, we noted that access rights for the new property system were not documented; access requests were verbally approved, according to management.
- **(Modified Repeat Finding)** The GL system application does not have the built in functionality to enforce password controls. Specifically,
  - It does not enforce password changes,
  - It does not have an account lockout policy,
  - It does not prevent users from using previous passwords, and
  - It does not have the ability to enforce strong password requirements.
- **(Repeat Finding)** FEC does not comply with its auditing policy because it does not automatically log the network activity described in its *Audit Event Standards*, even though it has the capability to do so.
- FEC is not actively monitoring the use of budgetary overrides in the GL application.
- FEC does not periodically review its firewall rule set for appropriateness.
- Local area network (LAN) user accounts are not appropriately reviewed:
  - One account has not been used since 1998;
  - One account has not been used since 2002; and
  - Two accounts have not logged on since 2004.

Recommendations:

21. Create a new GL system application role to give employees with necessary and appropriate access rights to fulfill their job responsibility.

22. Monitor and record visitor access to the data center.

23. Use access request forms to document user access rights and periodically review the access for appropriateness.

24. Develop mitigating controls to ensure that GL system passwords are in agreement with FEC policy.

25. Automatically log network activity as required by the *Audit Events Standards.*

26. Institute a process to manually review logs of users using budgetary overrides where the reviewer is an individual who does not have access to utilize the overrides.

27. Periodically review the firewall rule set for appropriateness.

28. Periodically review LAN user accounts and disable unnecessary user accounts.

C. Contingency Plan

Losing the capability to process and protect information maintained on FEC's computer systems can significantly impact FEC's ability to accomplish its mission to serve the public. The purpose of service continuity controls is to ensure that, when unexpected events occur, critical operations continue without interruption or critical operations are promptly resumed.

To achieve this objective, FEC should have procedures in place to protect information resources and minimize the risk of unplanned interruptions and a plan to recover critical operations should interruptions occur. These plans should consider activities performed at FEC's general support facilities (e.g. FEC's LAN, wide area network, and telecommunications facilities), as well as the activities performed by users of specific applications. To determine whether the disaster recovery plans will work as intended, FEC should establish and periodically test the capability to perform its functions in disaster simulation exercises.

Our review of the service continuity controls identified deficiencies that could affect FEC's ability to respond to a disruption in business operations as a result of a disaster or other long-term emergency. The deficiencies were as follows:

- **(Modified Repeat Finding)** FEC has not performed a Business Impact Analysis (BIA) to formally identify and prioritize all critical data and operations on its networks and the resources needed to recover them if there is a major interruption or disaster. In addition, we could not determine whether FEC had established emergency processing priorities that will help manage disaster situations more effectively for the network. FEC also has not included business owners in the discussion to determine how much backup data is needed on-hand to minimize the impact of a disaster. FEC is currently in the process of creating a request for proposal for completing a BIA.
- **(Modified Repeat Finding)** FEC has not established an alternate processing site for its operations in the event of a disaster, including its general ledger system. Additionally, the FEC disclosure database is replicated at an off-site location as a web-enabled, read-only database the public can access. In the event that data cannot be updated at FEC and then replicated to the off-site location, there is no operational mechanism to update the disclosure database at the off-site location. FEC has developed a cost analysis of establishing an alternate site and is currently pursuing interagency agreements to address this issue.
- FEC has not developed a Continuity of Operations Plan (COOP) to support the continuation of its core mission in the event of a disaster that renders the FEC's facilities unusable.
- **(Modified Repeat Finding)** FEC has not developed and documented a comprehensive contingency plan of its data centers, networks and telecommunication facilities. FEC has created a contingency plan that includes procedures for restoring its network and the GL system application in the event of a disaster. Although FEC has identified the system resources and relevant points of contact associated with the two systems, the following elements were missing from the contingency plan:
    - The plan does not cover all major applications and mission critical systems, and
    - The plan does not prioritize resources or set a timeframe for recovery.

Recommendations:

29. Perform a Business Impact Analysis to formally identify and prioritize all critical data and operations on FEC's networks and the resources needed to recover them if there is a major interruption or disaster. Ensure that emergency processing priorities are established to assist in managing disaster situations more effectively for the network and include business owners in the discussion to determine how much backup data is needed on-hand to minimize the impact of a disaster.

30. Establish alternative processing site for FEC's operations in the event of a disaster and ensure that an operational mechanism exists to update the disclosure database in the event that the FEC database is unavailable to replicate the disclosure database resident at the off-site location.

31. Develop a Continuity of Operations Plan (COOP) to support the continuation of the FEC's core mission in the event of a disaster that renders the FEC's facilities unusable.

32. Develop and document a comprehensive contingency of operations plan of FEC's data centers, networks and telecommunication facilities.

D. Software Development and Change Controls

Establishing controls over the modification of application software programs helps to ensure that only authorized programs and authorized modifications are implemented. This is accomplished by instituting policies, procedures, and techniques that help make sure all programs and program modifications are properly authorized, tested, and approved and that access to and distribution of programs is carefully controlled. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or "turned off" or that processing irregularities or malicious code could be introduced.

(Modified Repeat Finding) FEC has not fully implemented its System Development Life Cycle (SDLC) Methodology, specifically:

- The FEC is not using Change Implementation/Notices to document change requests,
- One change did not show evidence of user acceptance testing,
- Two changes did not show evidence of implementation approval,
- Test results and approvals are not documented on Test Problem Reports and Test Approval Determinations, as indicated in the SDLC, and
- The FEC did not perform a feasibility study or cost-benefit analysis for the acquisition of Probar, a new property management system.

Recommendation:

33. Fully implement the System Development Life Cycle Methodology.

REPORTABLE CONDITIONS

V. Financial Reporting (Modified Repeat Finding)

A. General Ledger (GL) System Setup and Posting Model Definitions (Modified Repeat Finding)

The GL system setup and posting model definitions do not fully comply with the transactions posting models consistent with the USSGL guidance and policies when recording and classifying certain transactions. The resources expended to periodically review and research incorrect posting logic errors, reconciliation, and adjustments to the general ledger accounts could be devoted to the routine daily business operations of FEC. FEC is aware of the inherent limitations of the GL system and has requested assistance from the vendor to correct posting logic. FEC anticipates corrections will be finalized in fiscal year 2006.

Recommendation:

34. Ensure that corrections made to the posting logic comply with the USSGL and that the USSGL accounts and posting logic are updated as changes to USSGL are issued.

B. Continuing Resolution Accounting (New Finding)

FEC did not record apportionments granted during the continuing resolution period in accordance with the instructions from the OMB Circular No. A-11, *Preparation and Submission of Budget Estimates,* and OMB Bulletin No. 04-05, *Apportionment of Continuing Resolution(s) for Fiscal Year 2005.* Specifically, FEC recorded the entire requested appropriation of $52 million as budget authority in October 2004 even though the entire budget authority did not become available until January 2005. Under the continuing resolution accounting scenario provided by the U.S. Treasury, amounts recorded as appropriation/ apportionment should only be in amounts determined in accordance with OMB Bulletin No. 04-05. Although the incorrect entries automatically became correct entries upon the receipt of the full appropriation, which was apportioned in January 2005, the system's funds control during the continuing resolution period was not effective and the risk that unavailable funds could be expended during this period was high.

In addition, proper reconciliation should be performed by reflecting what was actually recorded in the books versus what was reported by the U.S. Treasury FMS 6653, *Undisbursed Appropriation Account Ledger.*

Recommendation:

35. Comply with the continuing resolution accounting scenario prescribed by U.S. Treasury in accordance with memorandum issued by OMB.

C. Integrated Financial Management System (Repeat Finding)

A single, integrated financial management system is a unified set of financial systems linked together electronically in an efficient and effective manner to provide agency-wide financial system support. Integration means that the user is able to have one view into systems such that, at whatever level the individual is using the system, he or she can obtain needed information efficiently and effectively through electronic means. It does not necessarily mean having only one software application covering all financial management system needs within an agency. Interfaces are acceptable as long as the supporting details are maintained and accessible to managers. Interface linkages must be electronic unless the number of transactions is so small that it is not cost beneficial to automate the interface. Easy reconciliation between systems, where interface linkages are appropriate, must be maintained to ensure data accuracy.

FEC does not have an integrated financial management system. Significant financial management systems such as the cost system, receivable systems and the property and equipment system do not interface with the GL system.

Recommendation:

36. Continue to assess the degree of integration necessary to have a single, unified financial system by evaluating the functional requirements and the costs and benefits of integrating the financial reporting, property and equipment, receivable, and the cost systems with the GL system.

VI. Payroll (Modified Repeat Finding)

The results of our internal control tests disclosed weaknesses in payroll processing similar to the prior year, as follows:

- Transmitting certain payroll transactions, such as leave balance adjustments, to FEC's payroll service provider is a two-step process initiated by the FEC. We noted that in two instances, FEC made the first step in adjusting an employee's leave balance but failed to perform the second step. As a result, the leave adjustment was not transmitted or reflected in the service provider's system.
- Documentation such as election forms for payroll deduction authorization (FEGLI, federal tax withholding, savings bond, FEHB, and TSP-FERS) and SF-50 form were

not consistently maintained in the payroll files, and therefore some were not available for our review.

- FEC's policy requires timekeepers to perform bi-weekly reconciliations between the leave balances in FEC's records and the payroll service provider. The timekeepers are to forward leave balance certifications to the finance office indicating whether balances agree or disagree. Thirteen of the 45 leave balance certification forms were not submitted and five of the 45 submitted were incomplete. Furthermore, there was no indication that the finance office followed-up on the certifications that were not received or incomplete.
- For two of the 45 employees tested, the T&A (time and attendance) report did not agree with the service provider's leave balance report. However, the timekeeper certified that the leave balance report agreed with individual leave records. In addition, there were also two instances where the timekeeper submitted a leave balance certification but there was no leave balance on the employee's T&A report.
- For two of the 45 employees tested, we noted four instances where the approved T&A reports were not properly completed.

OMB Circular A-123, *Management Accountability and Control* (Revised June 21, 1995), requires that "the documentation for transactions, management controls and other significant events must be clear and readily available for examination." GAO *Standards for Internal Control in the Federal Government* states that transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use or commit resources and other events are initiated or entered into."

FEC Accounting Manual Vol. I, Section 1.3.2.2.10, Reconciliation, states that "transactions recorded in the FEC accounting system [should be] periodically reconciled with source documents." Section 1.3.2.2.15, Compensation, also states "timely, accurate, and complete subsidiary records [should be] maintained of vacation [and] sick leave and other balances."

Recommendations:

37. Implement procedures to ensure that leave adjustments are completely processed and transmitted to the service provider.

38. Maintain in the personnel files all payroll deduction authorization forms initiated through FEC, i.e., not done directly by the employee with a service provider.

39. Ensure that timekeepers: perform the bi-weekly reconciliation between leave balances reported in its records and the service provider's records; and submit the bi-weekly leave balance certification to the finance office timely.

40. Implement procedures for ensuring all payroll and personnel documents are properly completed and authorized before payroll data is transmitted to the payroll service provider for processing.

41. Consider automating payroll processing to decrease the risk of errors.

VII. Status of Prior Year Comments

As required by *Government Auditing Standards* and OMB Bulletin No. 01-02, as amended, we have reviewed the status of FEC's corrective actions with respect to the findings and recommendations from the previous year's report on internal controls. For those items not addressed in various sections of our Independent Auditor's Report on Internal Control, summarized above, the following discusses the current status of resolutions for matters raised:

Financial Reporting

- **Condition:** FEC did not have a written policy and procedures to formalize plans, methods, and procedures to guide the financial statement preparation and reporting process.

  In fiscal year 2005, FEC established an accounting department annual calendar and audit schedule and developed written procedures for the compilation of the quarterly reports. Therefore, we have removed this as a material weakness.

- **Condition:** FEC did not prepare and analyze monthly reconciliations of subsidiary and summary account balances.

  In fiscal year 2005, FEC continued with the monthly reconciliations and analysis that it started at the end of fiscal year 2004 for Fund Balance with Treasury, budgetary accounts, and general property and equipment accounts. However, we continue to identify deficiencies in the reconciliation of software in development and physical inventory. This condition, therefore, continues to exist for certain accounts as explained above.

Entity-Wide Security Program

- **Condition:** There is no periodic security awareness training. Training is only provided to new employees and contractors. FEC did conduct a baseline awareness training program, but does not have a process in place to provide security awareness training on an annual basis.

In fiscal year 2005, FEC provided periodic computer security awareness training to all employees and contractors (i.e. contractors granted access to the FEC's network). Therefore, we have removed this as a reportable condition.

Controls to Protect Information

- **Condition:** No documentation or verification that the vulnerabilities identified in the February 2004 network penetration scan had been addressed.

  In fiscal year 2005, FEC rescanned its systems and verified that the vulnerabilities identified in the February 2004 network penetration scan had been addressed. Therefore, we have removed this as a reportable condition.

- **Condition:** There are no records of access requests granted to remote users. FEC was unable to provide access request approval documentation to support the access of all dial-up and virtual private network (VPN) users that we sampled for our review. In addition, there was no evidence of periodic re-validations of these users.

  In fiscal year 2005, FEC documented and revalidated VPN and dial-up access rights and privileges. Therefore, we have removed this as a reportable condition.

- **Condition:** GL system access requests are not properly documented or reviewed. FEC was only able to provide us original access matrices for eight of the 33 current GL system users. Additionally, FEC does not periodically perform revalidations of GL system access.

  In fiscal year 2005, FEC documented access requests for new users and performed revalidations of access rights granted to existing users of the GL system. Therefore, we have removed this as a reportable condition.

- **Condition:** Data center access is not adequately documented or reviewed:
  - Four employees have their names misspelled on the cardholder report;
  - One of the individuals with access to the data center was terminated recently, but his access key is still active and the physical location of the key could not be determined; and
  - FEC could not identify one user who has access to the data center or justify why the individual has access to the data center

  In fiscal year 2005, FEC disabled the active access keys of users not requiring access to the data center and identified all users with access to the data center, but FEC needs to ensure names are correctly spelled on the cardholder report. Therefore, we have removed this as a reportable condition.

Contingency Plan

- **Condition:** FEC does not have adequate capacity for most of its back-up tapes in its fireproof safe; hence, back-up tapes are not kept in a fireproof safe.

  In fiscal year 2005, FEC has procured an additional fireproof safe(s) for back-up tapes. Therefore, we have removed this as a reportable condition.

- **Condition:** FEC's data center is fully exposed to a wet pipe sprinkler system, with no compensating controls to avoid inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm.

  FEC has compensating controls to avoid inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm from the wet pipe sprinkler system. Therefore, we have removed this as a reportable condition.

Software Development and Change Controls

- **Condition:** No written policy has been created to manage software libraries.

  In fiscal year 2005, FEC has established a written policy to manage software libraries. Therefore, we have removed this as a reportable condition.

- **Condition:** Written procedures to modify, test, approve or release software for any of its applications, including the GL system, have not been documented.

  In fiscal year 2005, FEC documented written procedures to modify, test, approve and release software for its applications. Therefore, we have removed this as a reportable condition.

- **Condition:** Emergency change procedures and procedures for installing patches are not documented.

  In fiscal year 2005, FEC documented written emergency change procedures for installing patches. Therefore, we have removed this as a reportable condition.

- **Condition:** Certain software code changes for the GL system were not reviewed before being implemented.

  In fiscal year 2005, FEC has established policies and procedures to ensure that the software code is reviewed prior to moving the modified code into production.

Additionally, there were no software changes to the GL system for fiscal year 2005. Therefore, we have removed this as a reportable condition.

OTHER MATTERS

Federal Managers' Financial Integrity Act (31 U.S.C. 3512) (FMFIA)

OMB Circular No. A-123, *Management Accountability and Control,* provides the reporting guidelines for the FMFIA. OMB Circular No. A-123 states that annually, by December 31, the head of each executive agency submit to the President and the Congress (i) a statement on whether there is reasonable assurance that the agency's controls are achieving their intended objectives, (ii) a report on material weaknesses in the agency controls, and (iii) whether the agency's financial management systems conform with government-wide requirements.

OMB Bulletin No. 01-02 requires that the auditor's report on internal control "identify those material weaknesses disclosed by the audit that were not reported in the reporting entity's FMFIA report." FEC's FMFIA report dated October 4, 2005 reports that FEC management did not identify material weaknesses, but acknowledged the FEC fiscal year 2004 Independent Auditor's Report on Internal Control included material weaknesses. FEC disagreed with the material weaknesses identified in the internal control report, and therefore, did not prepare a report on material weaknesses, including agency plans to correct the material weaknesses and progress against those plans in the FMFIA report submitted.

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In addition to the material weaknesses and reportable conditions described above, we noted certain matters involving internal control and its operation that we reported to the management of FEC in a separate letter dated November 7, 2005.

This report is intended solely for the information and use of the management of FEC, FEC Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
November 7, 2005

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Compliance with Laws and Regulations

To the Inspector General of the
Federal Election Commission

We have audited the financial statements of the Federal Election Commission (FEC) as of and for the year ended September 30, 2005, and have issued our report dated November 7, 2005. In our report, our opinion was qualified for the effects of adjustments, if any, as might have been necessary had we been able to perform adequate audit procedures on the allocation of program costs in the statement of net cost. Except as described above, we conducted our audit 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. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

The management of FEC is responsible for complying with laws and regulations applicable to FEC. As part of obtaining reasonable assurance about whether FEC's financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to FEC.

The results of our tests of compliance with laws and regulations described in the preceding paragraph disclosed no instances of noncompliance with the laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

We noted certain immaterial instances of noncompliance that we have reported to management of FEC in a separate letter dated November 7, 2005.

This report is intended solely for the information and use of the management of FEC, FEC Office of Inspector General, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
November 7, 2005

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

Management Comments and Response to the Independent Auditor's Report

EXECUTIVE SUMMARY

This year the independent auditors, Clifton Gunderson (CG), identified four material weakness (cost accounting system and processes, custodial receipts, general property and equipment and information technology) and two reportable conditions (financial reporting and payroll). While area for improvement exists, the FEC fundamentally disagrees with several of CG's findings. The FEC has made significant progress in addressing the material weaknesses and reportable conditions identified last year. We demonstrated the improvements made throughout the financial and information technology (IT) areas, and yet very little improvement was recognized.

We firmly believe that the FEC improved its financial reporting and IT policies and procedures, both in response to audit findings and in compliance with all laws and regulations. Following are specific highlights:

- *Cost allocation methodology* - although the process is manual, it meets the flexible standards allowed for in this area. There were no changes in the cost allocation methodology from last year to this year. Yet, last year it was not a material weakness and this year it not only was a material weakness, it was enough to qualify a statement. A new system will be implemented in early FY 2006. Management found it was neither cost effective nor practical to implement the system so close to the end of the fiscal year. The new system will ensure accurate and more efficient processing.

- *Managerial cost accounting* – should not be classified as a material weakness because the critical elements of SFFAS No. 4 have been met.

- *Custodial receipts* - the process we had in place was sufficient given the nature of the activity. For FY 2006 we require monthly, standardized reports from the relevant divisions.

- *General property and equipment* - we believe that none of the weaknesses cited by CG, either alone or collectively, are substantial enough to warrant classification as a material weakness.

- *Information Technology* - none of the reportable conditions in the area of IT, either individually or collectively, rise to the level of material weakness. The FEC meets the standards set forth in all applicable IT standards and regulations.

Most important, any issue noted by CG was detected within a timely period by employees in the normal course of performing their assigned functions and, therefore, by definition does not constitute a material weakness.

COMMENTS AND RESPONSE

Following are the FEC's responses to and comments on the auditor's report on internal control. Clifton Gunderson (CG) also provided a report on compliance with laws and regulations. They found that the FEC was in compliance with laws and regulations.

The FEC is proud of the significant progress made over the past fiscal year in terms of strengthening our internal controls. Such strides have been noted both by the Inspector General and the independent auditors. Fully mindful of the IG's and auditor's comments from the previous year, we took a critical look at the issues and prioritized them. Most findings in the finance area were resolved in FY 2005. For example, in prior years it had taken us up to three weeks to prepare quarterly financial reports. Now we are able to complete this process in a matter of days. We were also able to improve our timeliness with respect to reconciliations. Not only have we become more efficient at producing financial reports, we have become more effective. This year we only had to make six "on top" adjustments; down from thirteen last year.

We implemented several process changes. We standardized and formalized reconciliation processes. We added purchase order reconciliation, relationship testing and property modules to automate our system processes and reduce error. All of these improvements have been formally documented. The Accounting Policy and Procedure manual was changed and formally reviewed and approved by the Chief Financial Officer. The manuals have allowed for better cross training of staff to ensure that no process is fully dependent on one employee.

The overriding issue for the FEC's comments is what constitutes a material weakness. GAO defines material weakness as ". . . reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions." Reportable conditions "are matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation. . .." (OMB Bulletin 01-02).

MATERIAL WEAKNESSES

I. Cost Accounting System and Processes

A. Cost Allocation Methodology (Repeat Finding) (NFR #37, #38, #40)

Recommendations

1. Establish formal and comprehensive cost allocation methodology and related policy and procedures.

FEC RESPONSE:

The FEC established and provided the auditors with a simple, straightforward crosswalk, supporting the basis of allocations. The FEC also established and pωvided the auditors with cost allocation methodology and related policy and procedures.

2. Cross-train employees to minimize the risks of major interruptions in normal business operations.

FEC RESPONSE:

The FEC cross-trained three employees on the cost allocation process. The FEC provided evidence to the auditors that personnel were crossed trained and able to perform the cost-allocation process.

3. Establish a review process wherein a person, other than the preparer, reviews the work performed to ensure accuracy and propriety.

FEC RESPONSE:

The FEC established a review process for the cost allocation process. The FEC provided evidence to the auditors that a review process was in place and was followed in the cost-allocation process.

4. Maintain audit trails to support the allocation methodology and amounts.

FEC RESPONSE:

The FEC maintained an audit trail that supports the allocation methodology and provided the audit trail to the auditors.

B. Managerial Cost Accounting (Repeat Finding)

Recommendation:

5. Evaluate the functional requirements for the new cost accounting system to ensure that at least, the minimum level of cost accounting required in SFFAS No. 4 is attained.

FEC RESPONSE:

The FEC disagrees with this finding and its classification as a material weakness. SFFAS No. 4 gives agencies the flexibility to devise methods for allocating costs that are appropriate for the agency's size, mission and nature of costs incurred, so long as the method is reliable and timely. The FEC's system provides sufficient information to both high level management and program managers on the full cost of federal programs, our activities, and outputs. The FEC system meets the fundamental elements of managerial cost accounting as set forth in SFFAS No. 4. It: (1) accumulates and reports FTE usage rates on a regular basis for management information purposes; (2) establishes responsibility segments to match costs with outputs; (3) determines full costs of government goods and services; and (4) uses appropriate costing methodologies to accumulate and assign costs to outputs. The new system will meet the same requirements.

II. Administrative Fines, Civil Penalties and Miscellaneous Receipts (Custodial Receipts) (New Condition) (NFR #19, #36, #38)

FEC RESPONSE:

While we are cognizant of the issues presented in this finding, we do not believe it warrants classification as a material weakness. Although the FEC recognizes this as an area that needs to be strengthened with more formal processes, the FEC does have adequate systems and controls in place to ensure custodial receipts are properly accounted for and timely recorded.

During FY 2005, the relevant divisions reported internally on a quarterly basis. Take for example the Administrative Fine program. After an initial attempt to collect debts, delinquent civil penalties are referred to Treasury. This requires significant reporting and documentation. The FEC and Treasury amounts must balance each month, and this reconciliation serves as an external check.

Of the total in-house serviced debt outstanding at September 30, 2005, over 70% of it accrued in September 2005. Thus, most of the accounts receivable (AR) balance could not have been entered into the general ledger (GL) before year end. The increase in in-house serviced debt was due in part to the fact that Treasury put a hold on submission of collections. CG did not propose any adjustments to any balances recorded in GL. Therefore, FEC believes it is unlikely material misstatements could have occurred in this area and not have been detected in a timely manner by the staff in the routine performance of their jobs.

While we believe that quarterly reporting was sufficient given the nature of the activities, we have implemented monthly reporting for FY 2006. We are in the process of developing a standard format for each division to use. Each month all internally generated reports will be reconciled to the GL and each division will be provided a status report. FEC will continue reconciling cash and receivables with Treasury and adding aging categories to facilitate review by management and preparation of the quarterly report on receivables to Treasury. All of these changes, including a description of how the Allowance for Uncollectible Accounts is calculated, will be put into the Accounting Manual once they are finalized.

Recommendations:

6. Establish and implement policy and procedures ensuring communication and coordination between program offices and finance office on activities with financial impact. The policy should also clearly establish the FEC's revenue recognition policy. The finance office should design a standard report outlining all the necessary information to record the financial activities. The report should be prepared and submitted timely at least monthly by the program offices to the finance office.

FEC RESPONSE:

A policy will be developed and distributed to program offices for monthly reporting. Expected completion: November 30, 2005.

7. Document the policy and basis for the allowance for uncollectible accounts.

FEC RESPONSE:

Procedures will be developed and included in the Accounting Policy and Procedures Manual. Expected completion: November 30, 2005.

III. General Property and Equipment (Property) (Modified Repeat Finding) (NFR #38, #39, #32)

FEC RESPONSE:

The FEC agrees with this comment in general, but not its classification as a Material Weakness. The FEC made significant strides in the property accounting area in FY 2005. Furthermore, the FEC did not have to make any material adjustments to the GL or schedules provided to CG as a result of the audit.

Significant improvements from last year's report on internal controls include:

- A new property system was implemented in September 2005 which eliminated difficulty in calculating depreciation which stemmed from programming issues with the prior contractor;
- Software-in-development was tracked and reported quarterly;
- All assets were recorded at invoice values (vs. estimates for some last year); and
- Exceptions to internal control sample items decreased significantly

As noted to CG, the new property system facilitates preparation of audit schedules and related notes. Moreover, the new system, along with improved policies and procedures to be implemented in FY 2006, will: 1) help link individual assets to bulk purchases by PO number; 2) help identify new assets that meet the capitalization criteria; and 3) capture additional data regarding custody and location of assets. For example, all new computers made as part of a bulk purchase were entered in the system with the associated purchase order and reports were developed to list individual items. These improvements should result in a more seamless integration between the inventory system and the identifying, reporting and tracking of capitalized assets to the balances in the general ledger. FEC is also continuing to review all inventory items to complete the information coded in the system.

The process of conducting a physical inventory of assets for FY 2005 was contracted out to a vendor. The contractor used a bar code scanner for all assets and uploaded the information to the property system. The general ledger balance was reconciled to the balances in the property system and the reconciliation was provided to CG. The physical inventory did not disclose any capitalized assets that needed to be adjusted. In FY 2006 specific procedures will be written for the contractor and FEC staff to use and assist with the reconciliation.

FEC software capitalization policy is in compliance with SSFAS No. 10. The FEC believes the process to identify software in progress and completed software in progress was adequate and that all such software was identified and recorded correctly. CG has not provided specifics as to why it believes FEC is not in compliance with SFFAS No. 10, which was taken almost verbatim from the standard. FEC is continuing to develop more formalized methods of notifications for various property events to trigger entries in the general ledger. This will include coding training in FY 2006 for affected offices. The timeliness of completed construction was more a function of a delay in obtaining adequate information from General Services Administration (GSA) than a lack of internal notifications. FEC notes these types of transactions were all recorded accurately well before the year end statements were prepared.

The FEC is only aware of problems with nine receiving reports, not twelve as indicated in the report. Most of these were for the lack of descriptions on the receiving report, which is *not* required by FEC. We agree with one noted problem where the approving official cited the work authorization number instead of the invoice number on the receiving report; however, the invoice was paid correctly.

Recommendations:

8. Reconcile the total of the individual property items in the property system to the bulk purchase total recorded in the books to ensure completeness of the property system records.

<u>FEC RESPONSE:</u>

The FEC implemented a new property system to accomplish this. For example, all new computers made as part of a bulk purchase were entered in the system with the associated purchase order and reports were developed to list individual items. The FEC maintains that for each individual asset of a bulk purchase, the reconciliation of cost between the general ledger and the inventory system is not necessary and will not be accurate due to freight and/or installation costs which are not recorded at the individual asset level. The damage/loss of an individual asset of a bulk purchase would not materially impact the balances in the general ledger. Bulk buys are recorded in the general ledger at the actual total invoice cost. The individual items are tracked in the physical inventory system and are inventoried annually.

9. Document physical inventory procedures, results, and reconciliation and maintain the documentation for audit trail purposes.

FEC RESPONSE:

Procedures will be developed for the next inventory which is planned for FY 2006. The reconciliation will be maintained for audit.

10. Revise the software capitalization policy to comply with SFFAS No. 10.

FEC RESPONSE:

The software capitalization policy is in compliance with SSFAS No. 10. No specific area of non compliance was identified by CG.

11. Enforce compliance and consistent implementation of policies and procedures related to completing receiving reports and the review and approval of obligating memos or documents.

FEC RESPONSE:

As noted in last year's response and throughout this year's fieldwork, the description on the receiving report is an optional, not a required, field. In FY 2006 the form and procedures will be rewritten to make this clearer.

12. Establish a standard process and policy where program offices are required to notify the finance office of any property acquisition or disposition with accounting impact to ensure proper and timely recording of the transaction.

FEC RESPONSE:

FEC agrees with this recommendation and has already started to write the policy and develop necessary procedures and forms. Expected completion: December 31, 2005.

IV. Information Technology (IT)

FEC RESPONSE:

The FEC does not agree that the reportable conditions in the IT area reach the level of a material weakness. In conjunction with the Financial Statements Audit of the FEC, four areas of Information Technology were examined for material weaknesses. The outcome of the audit in IT revealed a number of reportable conditions, none of which, individually, rise to the level of material weakness. FEC Management is also of the opinion that the collective "weight" of these reportable conditions does not together result in a material weakness. The reason for this position is that reportable conditions have been recognized and corrective actions have been and are being taken. The cost benefits test may be used for portions of these conditions, but for the majority the FEC has initiated corrective actions, some of which pre-date the audit.

FEC Management has also indicated our position on the FEC exemption from the Paperwork Reduction Act, which also exempts the FEC from many of the related and underlying statutes and regulations. We agree that best practices and sound management controls justify the use of some of the recommendations made during the audit in the area of IT control (many of which the FEC as implemented already). However, the FEC strongly believes that these recommendations, either singularly or collectively, do not rise to the level of material weaknesses. In addition, the FEC maintains that the agency cannot be held to guidance and criteria identified in studies and analyses as if these were standards that are required to be adhered to.

Finally, the FEC continues to maintain that it is not appropriate to find the existence of financial management material weaknesses for systems and applications that do not directly impact on the accuracy and security of information used in the FEC financial statements.

A. Entity-Wide Security Program

Recommendations:

13. Implement a framework of policies and standards to mitigate risks associated with the information resources management.

FEC RESPONSE:

As a vital component of the Information Systems Security Program Policy (ISSPP) 58A, the FEC developed and approved sub-policy 58-2.1: Risk Management Policy. This policy establishes a framework of procedures and standards to mitigate risks associated with the management of information resources. The Risk Management Policy states that external risk assessments should be perfomed within the recommended 3 year period; however, current budgetary restraints have prevented this.

FEC management completed the Statement of Work (SOW), received proposals from three vendors and is currently reviewing the proposals. In addition the FEC has allocated $250,000 in FY 2006 (pending no further budgetary constraints) to partially accomplish this goal. Until greater resources are allocated, the FEC shall continue to conduct its own internal reviews such as those specified in its Security Review Policy.

14. Complete the documentation, approval and implementation of an entity-wide security program plan.

FEC RESPONSE:

In November 1997, the FEC established Directive 58, outlining the Commission policy on the control of Commission software and the use of agency computers. This Directive formed the basis of the Agency's computer security program. This Directive has been enhanced and expanded incorporating the latest guidance and best practices provided by NIST. In December 2001 Directive 58 was updated by establishing an Information Systems Security Officer. In April 2004 Information System Security Program Policy 58A was developed and the final policy was approved by the Chief Information Officer in September 2004. The implementation of the FEC entity wide security program plan occurred on October 2004, when FEC issued a memo informing all employees/contractors that "Information System Security Program Policy" Policy Number: 58A was approved and should be adhered to by all employees/contractors.

15. Develop and implement security plans for all major applications and MCGSS as part of a risk mitigation strategy.

FEC RESPONSE:

The FEC has provided the financial auditors with system security plans for all of its financial systems and four non-financial systems for a total of seven. The financial auditors have been provided with planned target dates for the remaining four non-financial systems.

16. Ensure that Resource Classifications in FEC's security plans accurately reflect the risk and vulnerabilities of FEC systems.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies that external risk assessments should be perfomed within the recommended 3 year period. FEC management has completed the Statement of Work (SOW) has received proposals from three vendors and is currently reviewing the proposals. In addition the FEC has allocated $250,000.00 in fiscal 2006 (pending no further budgetary constraints) to partially accomplish this goal. Until greater resources are allocated, the FEC shall continue to utilize the considerable knowledge, skills and experience of the Information Technology Division to provide input for resource classifications.

17. Complete the implementation of the program for the continuous monitoring and evaluation of the computer security policy and control effectiveness.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies the establishment of a program for the continuous monitoring and evaluation of the computer security policy and control effectiveness. To this end the FEC has developed and implemented 58-2.11 Security Review Policy that specifies a minimum set of review activities such as: annual external penetration testing; disaster recovery testing; a review of incident response procedures; a network vulnerability study; a code review of one Major Application and a review of access control procedures. FEC has provided the auditors with documentation and evidence that the specified activities did occur.

18. Conduct risk assessments at least every three years as part of an overall strategy to mitigate risks associated with its information technology environment.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies that external risk assessments should be perfomed within the recommended 3 year period. FEC management completed the Statement of Work (SOW), received proposals from three vendors and is currently reviewing the proposals. In addition the FEC has allocated $250,000 in FY 2006 (pending no further budgetary constraints) to partially accomplish this goal. Until greater resources are allocated, the FEC shall continue to conduct its own internal reviews such as those specified in its Security Review Policy.

19. Certify that the major applications and MCGSS are operating according to FEC's security requirements.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies that the certification of its major applications and mission critical general support systems are operating according to FEC's security requirements. These certifications will occur upon the completion of external risk assessments. In lieu of such assessments, FEC has leveraged the considerable knowledge, skills and experience of the Information Technology Division senior management.

20. Strengthen FEC's program to document corrective actions and verify that weaknesses identified have been addressed. Ensure and document that recommendations from the most recent network security review have been implemented.

FEC RESPONSE:

The FEC has completed the majority of recommendations from the prior year's audit. In accordance with its risk management strategy, the FEC has assessed the risk associated with these deficiencies and has documented, developed and implemented compensating controls or has documented and developed multi-fiscal-year mitigation strategies to counteract the specified deficiency. These compensating controls and/or multi-fiscal-year mitigation strategies take into account that all associated risk may not be completely eliminated during the current audit year, resulting in some residual risk. Any residual risk has been accepted by the appropriate system owner.

B. Controls to Protect Information

Recommendations:

21. Create a new GL system application role to give employees with necessary and appropriate access rights to fulfill their job responsibility.

FEC RESPONSE:

The FEC has recognized the need to further refine the granularity of GL's access control matrix and has developed a system application role with appropriate access rights for employees to fulfill their job responsibility. The FEC is currently testing the system application role to reduce the possibility of disrupting critical business functions. The financial auditors have been provided planned target dates for the implementation of the system application role.

22. Monitor and record visitor access to the data center.

FEC RESPONSE:

Individuals requiring an escort within the FEC building are always escorted by an authorized employee when they enter the FEC computer facilities. The FEC has historically used the Kastle Key system to electronically log when someone enters the computer facility and will continue to do so. However, ITD has implemented the use of a written log for all escorted persons who enter the facility, even though we believe it is a manual redundant system.

23. Use access request forms to document user access rights and periodically review the access for appropriateness.

FEC RESPONSE:

The FEC has instituted a process that utilizes electronic mail to request, approve and document user access rights. Access rights are periodically reviewed in accordance with 58-2.11 Security Review Policy.

24. Develop mitigating controls to ensure that GL system passwords are in agreement with FEC policy.

FEC RESPONSE:

The current version of PeopleSoft does not contain a facility for the automated enforcement of passwords. The FEC is aware of this vulnerability and the risk associated with this version of PeopleSoft's lack of automated authentication enforcement. The FEC has implemented a series of compensating controls consisting of additional user awareness training, policy issuance and manual enforcement to mitigate associated risk. The FEC understands and accepts the residual risk until an automated solution can be found.

25. Automatically log network activity as required by the *Audit Events Standards.*

FEC RESPONSE:

The Audit Event Standards have been modified, and the FEC in now in compliance with these standards.

26. Institute a process to manually review logs of users using budgetary overrides where the reviewer is an individual who does not have access to utilize the overrides.

FEC RESPONSE:

Please refer to the Accounting Officer response in NFR-10.

27. Periodically review the firewall rule set for appropriateness.

FEC RESPONSE:

The FEC does periodically review the firewall rules. The rules were reviewed in May 2005.

28. Periodically review LAN user accounts and disable unnecessary user accounts.

FEC RESPONSE:

The System Administrators review computer accounts periodically and delete the accounts that have not been accessed within 90 days. The user accounts are also reviewed and deleted using the "Hiring Report" that is produced by HR. In addition, all user accounts that have not been accessed within 90 days will be disabled.

C. Contingency Plan

Recommendations:

29. Perform a Business Impact Analysis to formally identify and prioritize all critical data and operations on FEC's networks and the resources needed to recover them if there is a major interruption or disaster. Ensure that emergency processing priorities are established to assist in managing disaster situations more effectively for the network and include business owners in the discussion to determine how much backup data is needed on-hand to minimize the impact of a disaster.

FEC RESPONSE:

The BIA is a new requirement, and we do not have funds in the 06 Budget. Funds will be requested in the 2007 Budget.

The plan covers all major Financial Applications and does provide a detailed restoration time for the PeopleSoft restoration process. The other major application, Comprizon Buy, is a less complicated restoration and has a much shorter relative time frame for installation, making a detailed time breakdown unnecessary.

30. Establish alternative processing site(s) for FEC's operations in the event of a disaster and ensure that an operational mechanism exists to update the disclosure database in the event that the FEC database is unavailable to replicate the disclosure database resident at the offsite location.

FEC RESPONSE:

Currently an alternate processing site for operations is not in the budget, and we could not afford an alternate site.

31. Develop a Continuity of Operations Plan (COOP) to support the continuation of the FEC's core mission in the event of a disaster that renders the FEC's facilities unusable.

FEC RESPONSE:

The COOP plan is a new requirement that was raised by the audit this year, and funds will be requested in the 2007 budget.

32. Develop and document a comprehensive contingency of operations plan of FEC's data centers, networks and telecommunication facilities.

FEC RESPONSE:

This has been done. Please see the disaster recovery plan

D. Software Development and Change Controls

Recommendation:

33. Fully implement the System Development Life Cycle Methodology.

FEC RESPONSE:

Establishing controls over the modification of application software programs is an industry Best Practice and one the FEC agrees with. The FEC has instituted policies, procedures and techniques that help make sure all programs and program modifications are properly authorized, tested and approved. This has been accomplished through the implementation of the SDLC and the associated policies and procedures (for example: the Change Management Policy, Requirements Procedure, Release Procedure, Change Management Procedure, etc.) The SDLC has been fully implemented; however, we have found that there are a couple instances where the SDLC does not match the actual practice. For example, changes are documented using ClearQuest (an industry standard for managing changes). However, the SDLC mentions documenting changes using a Change Implementation Notice. As a result of this difference the FEC is in the process of making sure the SDLC reflects the actual practice. To reiterate, the FEC does have procedures and controls in place to ensure programs and program modifications are properly authorized, tested and approved, and the FEC is in the process of making sure those procedures and controls are identified properly in the SDLC.

REPORTABLE CONDITIONS

V. Financial Reporting (Modified Repeat Finding)

A. General Ledger (GL) System Setup and Posting Model Definitions (Modified Repeat Finding) (NFR #41)

Recommendation:

34. Ensure that corrections made to the posting logic comply with the USSGL and that the USSGL accounts and posting logic are updated as changes to USSGL are issued.

FEC RESPONSE:

As noted, FEC disagrees with this as a Reportable Condition. However, FEC is in full compliance with this in FY 2006.

C. Integrated Financial Management System (Repeat Finding) (NFR #40)

FEC RESPONSE:

While the FEC is pleased that CG has downgraded this from a material weakness to a reportable condition, we still disagree with this classification. To be fully integrated, a system must use the same information in preparing performance and cost allocation reports and in this regard, FEC's systems are fully integrated. Even if one were to adopt a more broad definition of integration, the FEC is compliant with OMB and GAO standards. CG is fully aware that a budget preparation and MIS system will be fully operational and integrated with the financial system as of January 1, 2006. The FEC implemented these new systems even though OMB guidance and GAO standards do not require agencies to have totally integrated systems.

Recommendation:

36. Continue to assess the degree of integration necessary to have a single, unified financial system by evaluating the functional requirements and the costs and benefits of integrating the financial reporting, property and equipment, receivable, and the cost systems with the GL system;

FEC RESPONSE:

The FEC continues to perform a cost-benefit analysis to determine whether total integration of all budget, procurement, property and financial systems is worth the cost for a small federal agency. Based upon the accuracy and reliability of our current financial systems, the FEC is comfortable with the risks of the current interfaces we have developed between the systems.

Additionally, the FEC has requested funding in the FY 2006 and FY 2007 budgets to fully examine our finance system requirements, with the objectives ranging from a system upgrade to a complete system replacement that would be fully integrated with the FEC's budget, procurement, inventory, and HR system. The FEC has been meeting with US Government agencies that have been selected as Centers of Excellence (COE), as well representatives of the Office of Management and Budget to refine our quest for a integrated financial management system.

FEC RESPONSE:

As noted, FEC disagrees with this as a Reportable Condition. However, FEC is in full compliance with this in FY 2006.

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VI. Payroll (Modified Repeat Finding)

<u>**FEC RESPONSE:**</u>

The FEC believes it has strong controls in the payroll area, but as in all areas we believe controls can be improved. The FEC improved several important control processes in the payroll area in FY 2005. Compliance with requirements to submit leave verification reports requested from timekeepers saw improvement in the latter part of the year.

Recommendations:

37. Implement procedures to ensure that leave adjustments are completely processed and transmitted to the service provider.

<u>**FEC RESPONSE:**</u>

Instructions will be issued in early FY 2006 to ensure staff is clear on this issue. Another technician will initial the changes have been made correctly.

38. Maintain in the personnel files all payroll deduction authorization forms initiated through FEC, i.e., not done directly by the employee with a service provider.

<u>**FEC RESPONSE:**</u>

Finance and HR met in May 2005 to coordinate the roles of the respective offices. Most of the documents cited as missing by CG were subsequently located. More attention will be paid to this in FY 2006, including spot checks by management.

39. Ensure that timekeepers: perform the monthly reconciliation between leave balances reported in its records and the service provider's records; and submit the bi-weekly leave balance certification to the finance office timely.

<u>**FEC RESPONSE:**</u>

As noted to CG during the audit, compliance with this requirement increased significantly during the latter part of the fiscal year and is continuing in FY 2006. Finance management will also have a technician audit one timesheet for completeness per timekeeper for each pay period. Results will be documented.

40. Implement procedures for ensuring all payroll and personnel documents are properly completed and authorized before payroll data is transmitted to the payroll service provider for processing.

FEC RESPONSE:

FEC will place more emphasis on this in FY 2006 including sampling of timesheets for completeness and accuracy.

41. Consider automating payroll processing to decrease the risk of errors.

FEC RESPONSE:

FEC is studying the merging of time and attendance with the management information system. Part of that study will include whether it is feasible to further automate the payroll process.

OTHER MATTERS

Federal Managers' Financial Integrity Act (31 U.S.C. 3512) (FMFIA)

OMB Circular No. A-123, *Management Accountability and Control,* provides the reporting guidelines for the FMFIA. OMB Circular No. A-123 states that annually, by December 31, the head of each executive agency submit to the President and the Congress (i) a statement on whether there is reasonable assurance that the agency's controls are achieving their intended objectives, (ii) a report on material weaknesses in the agency controls, and (iii) whether the agency's financial management systems conform with government-wide requirements.

OMB Bulletin No. 01-02 requires that the auditor's report on internal control "identify those material weaknesses disclosed by the audit that were not reported in the reporting entity's FMFIA report." FEC's FMFIA report dated October 4, 2005 reports that FEC management did not identify material weaknesses, but acknowledged the FEC fiscal year 2004 Independent Auditor's Report on Internal Control included material weaknesses. FEC disagreed with the material weaknesses identified in the internal control report, and therefore, did not prepare a report on material weaknesses, including agency plans to correct the material weaknesses and progress against those plans in the FMFIA report submitted.

FEC RESPONSE:

We believe that our annual assurance letter satisfies the requirements of A-123 for FY 2005. OMB Circular A-123 Management's Accountability and Control states "[t]he statement on reasonable assurance represents the agency head's informed judgment as to the overall adequacy and effectiveness of management controls within the agency." When monitoring and evaluating internal controls, A-123 clearly states that management should independently make the determination as to whether any material weaknesses exist. The "auditor's reports" is only one of ten possible sources.

We further believe that our documentation is sufficient under A-123. A-123 states "[a]gency management should determine the appropriate level of documentation needed to support this assessment." We are comfortable with our current level of documentation.