

FEDERAL ELECTION COMMISSION

OFFICE OF INSPECTOR GENERAL



FINAL REPORT

**Audit of the Federal Election Commission's
Fiscal Year 2004 Financial Statements**

December 2004
ASSIGNMENT OIG-04-01



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 2004 Financial Statements

DATE: December 16, 2004

This letter transmits the final audit report of the Federal Election Commission's (FEC) fiscal year (FY) 2004 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 2004 financial statements.

In the report dated December 8, 2004, CG-LLP issued an unqualified opinion on the FEC's financial statements. The OIG commends the FEC for the noteworthy accomplishment of receiving an unqualified opinion, the first year the FEC was subject to the requirements of the Accountability of Tax Dollars Act of 2002. Although the OIG recognizes this significant accomplishment, it is important to recognize that a tremendous amount of effort by FEC management, staff, and consultants was necessary to achieve the unqualified opinion. In addition, the auditor report on internal control includes both reportable conditions and material weaknesses, and numerous audit recommendations that must be addressed by management.

Audit Process

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:

- Financial Reporting
- Information Technology

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

- Cost Accounting System and Processes
- General Property and Equipment
- Payroll

Opinion on the Financial Statements

CG-LLP audited the balance sheet of the FEC as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the year then ended. In the report dated December 8, 2004, CG-LLP issued an unqualified opinion on the FEC's financial statements.

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

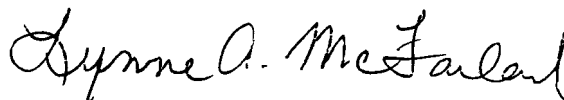
weaknesses detailed, the OIG and CG-LLP intend to work with management through the follow-up and audit process to ensure the weaknesses are addressed satisfactorily. In accordance with OMB Circular No. A-50, *Audit Followup*, revised, and based on an agreement with the Offices of the Staff Director and 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 December 8, 2004. 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
Inspector General

Attachments

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

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Independent Auditor's Report

To the Inspector General of the
Federal Election Commission

We have audited the balance sheet of the Federal Election Commission (FEC) as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the year 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.

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. 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 principal statements' presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of FEC as of September 30, 2004, and its net cost, changes in net position, custodial activity, budgetary resources and reconciliation of net cost to budgetary obligations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 8, 2004 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.

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Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management Discussion and Analysis and Required Supplementary Information are not a required part of the basic financial statements, but are supplementary information required by OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures to such information, which consisted principally of inquiries of FEC management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Clifton Henderson LLP

Calverton, Maryland
December 8, 2004



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, 2004, and have issued our report dated December 8, 2004. 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 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.

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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.

MATERIAL WEAKNESSES

I. Financial Reporting

The Accountability of Tax Dollars Act of 2002 extends to FEC a requirement to prepare and submit to the Congress and the Director of the OMB an audited financial statement. Fiscal year 2004 is the first year FEC is preparing and submitting audited financial statements.

FEC has attained a major achievement by having its financial statements audited for the first time. FEC, however, had to expend a tremendous amount of effort to "cleanup" its accounting records in order to prepare auditable financial statements as of and for the year ended September 30, 2004.

The weaknesses identified below collectively resulted in a material weakness in FEC's financial reporting process.

A. Financial Statement Preparation

Our audit of the interim financial statements disclosed several misstatements and/or misclassifications resulting from ineffective or lack of adequate quality and supervisory reviews and internal controls over the financial statement preparation and reporting process. These errors or omissions, some illustrated below, have consumed significant FEC resources in researching and correcting. The resources expended could have been devoted to the normal daily business operations of FEC.

- FEC downloads the trial balance from the general ledger (GL) system to a spreadsheet to generate its financial statements. The unadjusted trial balance used in preparing the March 31, 2004 financial statements did not agree to the balances in the GL system for most of its financial statement line items such as fund balance with treasury (FBWT), accounts payable (AP), net position and related accounts. Accordingly, the financial statements submitted to OMB did not have the correct balances because the errors were identified by both the FEC and the auditors only after the financial statements were submitted.
- The March 31, 2004 financial statements did not properly report the appropriation received and the status of budgetary resources.

- Software-in-development was not reported in the interim financial statements because FEC was still compiling the data.
- Certain on-top financial statement adjustments were posted incorrectly and key account relationships did not always agree.
- The interim financial statements did not reflect the current accounting activities for certain areas and only partially met the guidance in OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*.

In addition, “catch-up” journal vouchers and significant past activities detected during this “clean-up” process were recorded for the first time as adjusting journal entries or “on-top” financial statement adjustments.

Moreover, OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, states that preparation of the annual financial statements is the responsibility of the agency’s management. In carrying out this responsibility, each agency chief financial officer should prepare a policy bulletin or guidance memorandum that guides the agency’s fiscal and management personnel in the preparation of the annual financial statements. FEC does not have formal plans, methodology, or procedures to guide the financial statement preparation and reporting process.

Two of the five standards for internal control as stated in the Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government* are (1) information and communications, and (2) control activities.

- (1) Information should be recorded and communicated to management and others within the entity who need it and in a form and within a timeframe that enables them to carry out their internal control and other responsibilities.
- (2) Examples of control activities are: Reviews by management at the functional or activity level, proper execution of transactions and events, and accurate and timely recording of transactions and events.

B. Timely Recording, Reconciliation and Analysis

A major objective of internal control is to ensure the integrity of the underlying accounting data supporting the financial statements. An important control in this regard is the reconciliation of accounting records. An adequate reconciliation provides the assurance that processed transactions are properly and timely recorded in the accounting records and financial statements, which then allows management the ability to analyze its financial condition and results of operations on a routine basis.

The FEC has not performed many of the periodic account reconciliations and analyses necessary during the year. Account reconciliations not performed included certain FBWT reports from the Department of Treasury, budgetary accounts such as

obligations, intragovernmental activities, and general property and equipment, among others. In addition, reconciliations that were performed were often not completed in a timely manner and certain account reconciliations contained reconciling items that have long been outstanding. Moreover, certain assets, such as software-in-development, were not reported in the interim financial statements because FEC was still compiling the data.

Furthermore, due to FEC's delay in submitting the June 30, 2004 accounting data in the Treasury's Federal Agencies' Centralized Trial-Balance System (FACTS II), FEC was prevented by the system to submit the data. Thus, FEC did not submit its June 30, 2004 accounting data. The accounting data includes mostly budgetary information that is required for the Report on Budget Execution and Budgetary Resources (SF 133), and the Year-End Closing Statement (FMS 2108).

C. GL System Setup and Posting Model Definitions

The GL system setup and posting model definitions do not fully comply with the transactions posting models consistent with the United States Standard General Ledger (USSGL) guidance and policies when recording and classifying certain transactions. As a result, certain proprietary accounts and budgetary accounts do not agree, and certain trial balance accounts do not trace to the USSGL crosswalk.

FEC is aware of the inherent limitations of the GL system and has attempted to upgrade the GL system during fiscal year 2004 to correct weaknesses identified. However, due to the enormous resources consumed in testing and monitoring the system upgrade and the problems arising from the upgrade process and the audit of the financial statements, FEC has decided to postpone its upgrade until fiscal year 2005.

D. Integrated Financial Management System

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” and the property and equipment system are not interfaced with the GL system.

Recommendations:

1. Establish written policy and procedures to formalize plans, methods and procedures to guide the financial statement preparation and reporting process.
2. Prepare and analyze monthly reconciliations of subsidiary and summary account balances. Consider a “formal closing” of all accounts at an interim date(s), which will reduce the level of accounting activity and analysis required at year-end. This “formal closing” entails ensuring that all transactions are recorded in the proper period through the month-end. With complete and timely transaction recording, analysis of all major accounts can be performed effectively.
3. Ensure that supervisory reviews are applied to the financial statements and its supporting documentation, and the reviews are documented.
4. Ensure that upgrades to the financial management system comply with the posting model definitions in the USSGL.
5. Evaluate the functional requirements to integrate the financial reporting, property and equipment and the cost systems with the GL system; assess the degree of integration necessary to have a single, unified financial management system.

II. Information Technology (IT)

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

A. Entity-Wide Security Program

Effective information security management is critical to FEC’s ability to ensure the reliability, availability, and confidentiality of its information assets, and thus its ability to perform its mission. If effective information security practices are not in place, FEC’s data and systems are at risk of inadvertent or deliberate misuse, fraud, improper disclosure, or destruction—possibly without detection.

GAO’s research of public and private sector organizations, recognized as having strong information security programs, shows that their programs include (1) establishing a central focal point with appropriate resources, (2) continually assessing business risks, (3) implementing and maintaining policies and controls, (4) promoting awareness, and (5) monitoring and evaluating policy and control effectiveness. (U.S. Government Accountability Office, *Executive Guide: Information Security*

Management, Learning From Leading Organizations, GAO/AIMD-98-68 [Washington, D.C.: May 1998]), and (GAO's *Information Security Risk Assessment: Practices of Leading Organizations, A Supplement to GAO's May 1998 Executive Guide on Information Security Management*, GAO/AIMD-00-33 [Washington, D.C.: November 1999]).

FEC has taken important steps to establish an effective information security program, but much remains to be done. In January 2004, FEC revised the Computer Security Officer position description to further strengthen the Commission's computer security program. In April 2004, FEC issued an Interim Final "Information System Security Program Policy", Policy Number 58A. Policy Number 58A was issued to "manage the risk to information rather than just systems". The FEC approved Policy Number 58A and supplements to Policy Number 58A in September 2004.

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

- FEC did not finalize its Information System Security Policy until September 2004. This policy was not fully implemented in fiscal year 2004;
- A framework of policies and standards to mitigate risks associated with the management of information resources has not yet been implemented;
- Risk assessments, as part of FEC's overall strategy to mitigate risks associated with its information technology environment, have not been conducted for more than three years. The FEC conducted a risk assessment in March of 2000, with several recommendations for strengthening its information technology environment. We noted that the FEC has not implemented many of the recommendations. Furthermore, the FEC has not updated its risk assessment since March of 2000 to ensure that its strategy to mitigate risk reflects changes in its information technology environment;
- There was no documented and approved entity-wide security program plan. FEC has indicated that it is in the process of documenting its entity-wide security program plan. The FEC has just established in September 2004 policy guidelines which it will use in the development and implementation of an entity-wide security program plan;
- The FEC completed the identification of its major application and mission critical general support systems in September 2004, as part of its risk mitigation strategy. Thus, the FEC has not completed the development of security plans for these applications and systems;
- Major applications and mission critical general support systems have not been certified to ensure that they are operating according to FEC's security requirements;
- A program for the continuous monitoring and evaluation of FEC's policy and controls to ensure operating effectiveness has not been established; and
- There is no periodic security awareness training. Training is only provided to new employees and contractors. The 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.

Recommendations:

6. Implement a framework of policies and standards to mitigate risks associated with the information resources management.
7. Conduct risk assessments at least every three years as part of an overall strategy to mitigate risks associated with its information technology environment.
8. Complete the documentation, approval and implementation of an entity-wide security program plan.
9. Develop, and implement security plans for major applications and mission critical general support systems as part of a risk mitigation strategy.
10. Certify that the major applications and mission critical general support systems are operating according to FEC's security requirements.
11. Establish a program for the continuous monitoring and evaluation of the computer security policy and control effectiveness.
12. Provide periodic computer security awareness training to all employees and contractors (i.e. contractors granted access to the FEC's network).

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 information protection related weaknesses in 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.

FEC has not assessed the risk of inadequate protection for its sensitive and mission critical files. No written criteria have been established to guide security personnel in monitoring and restricting access to production data and program files.

Current weaknesses in access controls include the following:

- No documentation or verification that the vulnerabilities identified in the February 2004 network penetration scan have been addressed;
- Visitor (individuals that do not have approved daily access) logs for data center access were not maintained and no compensating controls to monitor and record visitor access to the data center have been implemented;
- Password controls are weak:
 - There is no password lifetime set on the local area network (LAN);
 - There are no technical controls to enforce password changes on the LAN and the GL system;
 - Some passwords on the FEC LAN have not been changed since 1997;
 - The password policy cannot be updated or changed in the current version of the GL system;
 - The GL system passwords do not expire;
 - There is no limitation on the number of GL system password attempts (i.e. no lock-out policy);
 - There is no policy on the GL system composition of passwords; and
 - There are no controls on password length for the GL system.
- There are no records of access requests granted to remote users. The 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;
- GL system access requests are not properly documented or reviewed. The FEC was only able to provide us original access matrices for eight of the 33 current GL system users. Additionally, the FEC does not periodically perform revalidations of GL system access;
- The principle of “least privilege” is not consistently applied in the GL system application. A high level IT official has similar access rights and privileges in the GL system application as the Accounting Officer;
- 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.

- The FEC is not in compliance with its auditing policy because it does not automatically log the network activity described in the *Audit Event Standards*, even though it has the capability to do so.

Recommendations:

13. Establish a 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.
14. Monitor and record visitor access to the data center.
15. Strengthen the password controls for the FEC's network and major applications, including the GL system.
16. Document and periodically revalidate VPN and dial-up access rights and privileges.
17. Document access requests and approvals for the GL system. Perform periodic revalidation of access granted to the GL system.
18. Ensure that the principle of "least privilege" is enforced. Ensure access in the GL system is granted according to job function and responsibility.
19. Disable the active access keys of users not requiring access to the data center. Correct the misspelled names on the cardholder report.
20. Use access request forms to document user access rights and periodically review the access for appropriateness.
21. Automatically log network activity as required by the *Audit Events Standards*.

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 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 (WAN), 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:

- FEC has not formally identified and prioritized all critical data and operations on its major applications 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 does not have alternative processing sites for most of its operations in the event of a disaster, including its general ledger system;
- 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 the FEC and then replicated at the off-site location, there is no operational mechanism to update the Disclosure Database replicated at the offsite location;
- 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. Back-up tapes, however, are rotated on a weekly basis to an off-site facility;
- FEC data center is fully exposed to a wet pipe sprinkler system, with no compensating controls to avert inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm; and
- FEC has not developed and documented a comprehensive contingency of operations plan of its data centers, networks and telecommunication facilities.

Recommendations:

22. 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.
23. Establish alternative processing sites for FEC's operations in the event of a disaster.
24. Establish operational mechanisms to update the Disclosure Database in the event the FEC database is unavailable to replicate the Disclosure Database resident at the offsite location.
25. Procure an additional fireproof safe(s) for back-up tapes.

26. Investigate and document options for 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.
27. 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.

Weaknesses that currently exist in the FEC's controls over modification of application programs include the following:

- System Development Life Cycle Methodology has not been finalized and implemented;
- No written policy has been created to manage software libraries;
- Written procedures to modify, test, approve or release software for any of its applications, including the GL system, have not been documented;
- Emergency change procedures and procedures for installing patches are not documented; and
- Certain software code changes for the GL system were not reviewed before being implemented.

Recommendations:

28. Finalize and implement the System Development Life Cycle Methodology.
29. Create a written policy to manage software libraries.
30. Document written procedures to modify, test, approve or release software for any of its applications.
31. Document written emergency change procedures for installing patches.
32. Establish policies and procedures to ensure that the software code is reviewed prior to moving the modified code into production.

REPORTABLE CONDITIONS

III. Cost Accounting System and Processes

A. Cost Allocation Methodology

FEC does not have a cost accounting system that is integrated with the GL system. The current cost accounting system is not adequate to produce the cost data for the Statement of Next Cost (SNC) in an efficient manner. Accordingly, the cost data presented on the SNC is compiled from three systems' raw data, which is then gathered and analyzed in an elaborate, complex, and manually intensive spreadsheet. Raw data used in the allocation of costs, such as payroll, is sometimes based on estimates due to the timing of the availability of the data. Expenses on the budget execution report, another source of raw data, are not reconciled with the general ledger balances.

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.

In addition, the FEC did not have a formal comprehensive policy and procedures for the program cost allocation. Although a written procedures document was provided to us, the document was written in response to our audit request and did not include a comprehensive set of procedures.

The manually intensive and elaborate cost allocation process dictates the need for a formal comprehensive policy and procedures. Moreover, the heavy reliance on a single person to carry out this process could impair FEC's ability to generate a timely and accurate report when the person becomes unavailable.

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:

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

34. Cross-train employees to minimize the risks of major interruptions in normal business operations.
35. Establish a review process wherein a person, other than the preparer, reviews the work performed to ensure accuracy and propriety.

B. Managerial Cost Accounting

Statement of Federal Financial Standard 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 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 management notified us that it is in the process of developing a new cost accounting system.

Recommendation:

36. 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.

IV. General Property and Equipment (Property)

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.

Our audit disclosed deficiencies, errors or omissions that questioned the effectiveness of FEC's internal control on property. Some examples are noted below:

- Depreciation expense and accumulated depreciation reported on the depreciation report were not correct. We were informed that although the property management system calculates depreciation correctly, when the data is converted into another system to generate the depreciation report, the calculation gets corrupted. This error was identified during the audit and was subsequently adjusted.
- Software-in-development was not adequately tracked and was not reported until the September 30, 2004 financial statements. There was one instance of software-in-

development being reported as completed software in the property management system; therefore, the asset was being improperly depreciated. Another instance was completed software that was not recorded. These errors were only identified during the audit process.

- Several assets were recorded using the purchase order amount, instead of the actual cost.
- For the 45 sample items we tested, we noted that 45 receiving reports were not completed properly, that is, they were either not signed, did not have the date of receipt, did not have a description of the goods or services received, or lacked a reference to the invoice to be paid. Although only 6 of the 45 items pertained to acquisitions in fiscal year 2004, this deficiency persisted throughout fiscal year 2004.

One of the five standards for internal control in 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:

37. Enforce current procedures to require documentation of approvals and certifications for procurement and disbursements transactions.
38. Formally communicate to all appropriate personnel to ensure compliance and consistent application of the policies and procedures.

V. Payroll

We identified the following weaknesses related to the 45 items tested for payroll:

- Twelve employees' leave and/or credit hour balances reported on the time & attendance (T&A) reports did not agree with comparable data on the Statement of Earnings and Leave from the payroll service provider;
- FEC's policy requires timekeepers to perform a monthly reconciliation 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. Nine leave balance certification forms were either not completed or not submitted by the timekeepers to the finance office;
- Forty one documents supporting payroll activities such as requests for leave, approved absence forms, and certain payroll deduction elections forms were not available for review; and
- Changes made to some T&A reports were not authorized or properly authorized. In addition, the T&A reports of two employees were already approved by the certifying officer even though the pay period has not yet ended.

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.”

Recommendations:

39. Implement procedures to ensure that payroll deduction elections are authorized by maintaining adequate supporting documentation or an ability to query the service provider systems to verify these deductions if initiated by an employee without the FEC’s intervention. Consider training/re-training payroll employees on the proper procedures for obtaining and retaining support documents for payroll elections.
40. Ensure that timekeepers perform a monthly reconciliation of leave balances reported in its records and the service provider records and submit the leave balance certification to the finance office monthly.
41. Implement procedures for ensuring hours recorded on the T&A reports are properly supported and authorized. Consider further automating payroll processing to decrease the risk of errors.
42. 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.

OTHER MATTERS

Federal Managers’ Financial Integrity Act (31 U.S.C. 3512) (Integrity Act) Compliance and Reporting

OMB Circular No. A-123 provides the reporting guidance for the Integrity Act. OMB Circular 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’s controls, and (iii) whether the agency’s financial management systems conform with government-wide requirements.

OMB Bulletin No. 01-02 requires that we compare the material weaknesses in the agency’s controls and material non-conformances on the agency’s financial management systems in the FEC’s Integrity Act report to our report on internal control dated December 8, 2004. Since the

Integrity Act report is due by December 31, 2004, FEC has not started and does not intend to start the process of accumulating the information required for its report until November 2004. Accordingly, since the Integrity Act report has not been completed, the comparison of reports could not be performed.

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 December 8, 2004.

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 Henderson LLP

Calverton, Maryland
December 8, 2004



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, 2004, and have issued our report thereon dated December 8, 2004. 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 December 8, 2004.

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
December 8, 2004

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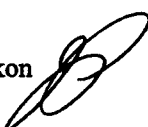


December 14, 2004

MEMORANDUM

To: Lynne A. McFarland
Inspector General

From: John C. O'Brien 
Acting Deputy Staff Director for Management
Acting CFO

Through: James A. Pehrkon 
Staff Director

SUBJECT: Comments on Draft Reports on Compliance with Laws and Regulations
and Internal Control

Attached are FEC Management's responses to and comments on the draft reports on compliance with laws and regulations and internal control. The FEC is pleased to find that the review conducted by the independent public accounting firm of Clifton Gunderson LLP (CG), under the auspices of the FEC's Office of Inspector General, rendered an unqualified opinion of the FEC's FY 2004 Financial Reports. We also note that the FEC's financial statements are fairly presented. This is a noteworthy achievement for a first year audit.

We are also pleased to find that the FEC was not in violation of any law or regulation to which the FEC was subject. We are working within the attached responses to eliminate or at least reduce the number and/or scope of reportable conditions and the potential for any material weaknesses. The FEC's goal is to receive an unqualified opinion with no material weaknesses or reportable conditions each year.

It is important to FEC Management that the audit of the FEC's financial statements as of and for the year ended September 30, 2004 indicated that the FEC financial systems are in general 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.

Thank you for the opportunity extended by you, your staff and CG to respond to the draft audit report. Everyone involved in the audit process worked extremely hard to ensure a successful conclusion to the audit. The FEC views the unqualified opinion as a success although it required an extensive commitment of staff and contract resources, and a large amount of staff time that could have been committed to other activities and on-going operations.

We will use CG's report as an opportunity to continue to improve the FEC's financial management systems, policies and procedures. The FEC viewed a previous review several years ago of the overall operations of the Commission by Pricewaterhouse-Coopers (PwC) in a similar fashion and used the results of their review to improve and enhance FEC programs where appropriate. The FEC takes such recommendations seriously and will study them to seek ways to implement appropriate proposals to enable us to serve the public better and to more effectively and efficiently meet our mission to administer and enforce the campaign finance disclosure laws.

Attachments

MATERIAL WEAKNESSES

I. Financial Reporting

The Accountability of Tax Dollars Act of 2002 extends to FEC a requirement to prepare and submit to the Congress and the Director of the OMB an audited financial statement. Fiscal year 2004 is the first year FEC is preparing and submitting audited financial statements. FEC has attained a major achievement by having its financial statements audited for the first time. FEC, however, had to expend a tremendous amount of effort to “cleanup” its accounting records in order to prepare auditable financial statements as of and for the year ended September 30, 2004.

The weaknesses identified below collectively resulted in a material weakness in FEC’s financial reporting process.

A. Financial Statement Preparation

Our audit of the interim financial statements disclosed several misstatements and/or misclassifications resulting from ineffective or lack of adequate quality and supervisory reviews and internal controls over the financial statement preparation and reporting process. These errors or omissions, some illustrated below, have consumed significant FEC resources in researching and correcting. The resources expended could have been devoted to the normal daily business operations of FEC.

FEC Response: FEC acknowledges that there were misstatements in its March 31, 2004 financial reports, but does not agree that the controls surrounding its quarterly and annual financial statement preparation process is so ineffective to warrant the classification of this finding as a material weakness in FEC’s financial reporting function. During the audit, we have made significant improvements to our supervisory controls. Though we are continuing to identify ways to improve further, we believe our current processes have improved to the point that they are no longer a material weakness.

Fiscal Year 2003 was the first year for which FEC was required to compile a full set of financial statements to comply with the provisions of the Accountability of Tax Dollars Act of 2002. Although FEC was waived from the requirement to submit such statements to the Office of Management and Budget (OMB), it endeavored to conduct an internal evaluation of its fiscal year 2003 financial data and financial reporting risks to ensure that its annual and quarterly financial statements were materially accurate. Additionally, in fiscal year 2002, FEC replaced its accounting system and converted its financial information from the “old” system to the “new” accounting system. As part of its internal evaluation, FEC sought to analyze and correct any inconsistencies resulting from the data conversion, and identify and correct any misstatements and/or relationship discrepancies related to its general ledger accounts.

The agency made great strides in its commitment to present a complete set of financial statements, which not only appropriately reflect current year activities, but also

reflect accurate historical financial information. "Catch-up" journal vouchers and "on top" adjustments to FEC's accounting records for fiscal year 2003 and the first and second quarters of fiscal year 2004 were necessary to achieve its commitment. The misstatement found in the March 31, 2004 financial statements was due to human error. However, FEC has since prepared accurate financial statements for the third and fourth quarter of fiscal year 2004.

In light of FEC's implementation of compensating management controls (i.e., extensive data analysis to appropriately reflect account balances) and given that the error found in the second quarter of the fiscal year 2004 financial statements was not a persistent problem in FEC's financial statements compilation process, FEC does not concur with this material weakness. FEC believes that process for the latter half of the fiscal year was vastly improved (better controls) and the risk of misstatement to the financial statements was effectively mitigated.

Improper reporting of the appropriation received and the status of budgetary resources in the March 31, 2004 statements was cited by the auditors. At the time the appropriation received amount was recorded, FEC was under a Continuing Resolution. FEC's efforts to solicit the guidance from OMB as to how the Appropriations should be reported, given the Continuing Resolution, were unsuccessful, as information received from OMB was not received timely (before the financials statements submission due date).

FY 2004 was the first year FEC had to file quarterly financial statements with OMB. Many agencies use spreadsheet models supplied by CPA firms to compile the complex quarterly and annual statements. It is common to download ledger information into these models. The minor error noted in a spreadsheet formula was caught and corrected by FEC. Once the FY 2003 corrections were entered the June statements were submitted on time and accurately. Since this is FEC's first audit, CG's audit plan was to control the year end processing schedule. FEC will tailor this to its operations and incorporate it into a formal schedule in FY 2005.

B. Timely Recording, Reconciliation and Analysis

A major objective of internal control is to ensure the integrity of the underlying accounting data supporting the financial statements. An important control in this regard is the reconciliation of accounting records. An adequate reconciliation provides the assurance that processed transactions are properly and timely recorded in the accounting records and financial statements, which then allows management the ability to analyze its financial condition and results of operations on a routine basis.

The FEC has not performed many of the periodic account reconciliations necessary during the year. Account reconciliations not performed included certain FBWT reports from the Department of Treasury, budgetary accounts, intragovernmental activities, and general property and equipment, among others. In addition, reconciliations that were performed were often not completed in a timely manner and certain account

reconciliations contained reconciling items that have long been outstanding. Moreover, certain assets, such as software-in-development, were not reported in the interim financial statements because FEC was still compiling the data.

Furthermore, due to FEC's delay in submitting the June 30, 2004 accounting data in the Treasury's Federal Agencies' Centralized Trial-Balance System (FACTS II), FEC was prevented by the system to submit the data. Thus, FEC did not submit its June 30, 2004 accounting data. The accounting data includes mostly budgetary information that is required for the Report on Budget Execution and Budgetary Resources (SF 133), and the Year-End Closing Statement (FMS 2108).

FEC Response: FEC understands the critical role played by reconciliations in internal control and acknowledges the lack of routine reconciliations during the first half of the fiscal year. However, we do not concur with the classification of this finding as a material weakness in FEC's financial reporting function. We have taken steps to implement an appropriate reconciliation schedule in the future

As a result of its internal evaluation of the fiscal year 2003 financial data and financial reporting process, FEC identified the need to acquire additional personnel resources to assist with the preparation of periodic reconciliations, in order to mitigate the risk of material misstatements to its financial statements. As such, FEC engaged contractors who have expended considerable effort to bring reconciliations up to date in fiscal year 2004. Though these reconciliations lagged for the first and second quarters of fiscal year 2004, they were completed prior to the completion of the audit and have revealed insignificant reconciling items on the Fund Balance with Treasury account. The PPE reconciliation was performed on time and provided to the auditors.

Additionally, with assistance from contractors, FEC is currently performing routine reconciliations of its subsidiary records to the general ledger balances and is committed to this effort for fiscal year 2005. With respect to the submission of FEC's financial information to Treasury, when FEC tried to log on to submit the June 30, 2004 reports by the due date, the Treasury computer system was not operational. Since Treasury did not extend the deadline to agencies for FACTS submissions, FEC's accounting data was not submitted by the due date. All first, second and fourth quarter reports were submitted to Treasury and OMB on time. To date, CG has had no adjustments to the reports except minor reclassifications.

Finally, FEC concurs with the matters pertaining to the compilation of software-in-development financial data. FEC has revised the data-gathering procedures and methodology for accounting for software-in-development.

C. GL System Setup and Posting Model Definitions

The GL system setup and posting model definitions do not fully comply with the transactions posting models consistent with the United States Standard General Ledger

(USSGL) guidance and policies when recording and classifying certain transactions. As a result, certain proprietary accounts and budgetary accounts do not agree, and certain trial balance accounts do not trace to the USSGL crosswalk.

FEC is aware of the inherent limitations of the GL system and has attempted to upgrade the GL system during fiscal year 2004 to correct weaknesses identified. However, due to the enormous resources consumed in testing and monitoring the system upgrade and the problems arising from the upgrade process and the audit of the financial statements, FEC has decided to postpone its upgrade until fiscal year 2005.

FEC Response: FEC does not concur with this finding as a material weakness. According to generally accepted auditing standards (AU 319), “the auditor should obtain sufficient knowledge of the entity’s risk assessment process to understand how management considers risks relevant to financial reporting objectives and decides about actions to address those risks”. FEC was fully aware of the posting model glitches and adequately considered the risk of misstatements in the financial reports. As such, FEC reengaged the implementer of the accounting system to upgrade the system and correct posting model glitches. However, the upgrade was postponed to dedicate resources and attention to the audit. FEC adequately compensated for the posting model glitches with extensive reconciliations and analyses. Relationships between proprietary and budgetary accounts were tested on a monthly basis and were provided to the auditors throughout the audit. FEC expects the upgrade of its financial system to be completed in FY 2005 but will continue the reconciliation of the accounts impacted by the posting model glitches. The upgraded financial system will be fully compliant with the USSGL.

D. Integrated Financial Management System

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” and the property and equipment system are not interfaced with the GL system.

FEC Response: FEC does not concur with this finding as a material weakness. The FEC made a decision based on acceptable risk and on a cost benefit basis that the

MIS, budget projection, and other performance reporting processes would be migrated after other priority commission programs were migrated to the new environment. This process is on-going: in FY 2004 and now in FY 2005 the FEC is engaged in a legacy system off-load process to migrate legacy systems over to the new IT platform. In addition, the FEC has been engaged since late FY 2003 in developing and implementing a budget preparation and MIS system that will be totally integrated with the financial system and all other oracle based IT systems.

The OMB guidance and GAO standards do not require agencies to have totally integrated financial management systems with all other agency systems. OMB Directives A-127 and A-123 and the GAO standards, as well as the CFO Act, were designed to make agencies modernize, automate, and integrate outdated and disparate accounting systems. In addition the goal was to make sure all agency accounting systems were compliant with GAO standards and OMB directives. These initiatives do not require all agency systems to be totally integrated—they must use the same information in preparing performance and cost allocation reports and data. The FEC does this. The FEC budget projection process uses the same pay information from NFC as the accounting system does, and both use the same HR information from the FEC Personnel system. In that regard, they are integrated.

The A-123 and A-127 Directives and the GAO standards provide for agencies to make decisions on a cost-benefit basis with regard to management controls. The FEC determined that limited funds and staff resources available for the FEC IT initiatives mandated a priority for the main Disclosure database and other major disclosure and compliance programs. In addition, funds were allocated to acquire a financial and accounting system that was compliant with GAO standards and was JFMIP certified. The migration of other systems such as the MIS, budget projection, and other performance reporting processes to the new oracle based client server platform was given a lower priority.

The FEC also made decisions not to acquire vendor produced COTS HR packages due to costs and general reports from other agencies about the performance of these systems. A similar decision was made with regard to the procurement and property systems. The determination was made to not incur additional costs until the financial system upgrade to a newer version was completed. At that time a determination would be made on a cost benefits and potential risk analysis basis on whether it was worth the costs to totally integrate the procurement, property and financial systems. Currently the FEC is comfortable with the acceptable risks with the two systems not totally integrated.

Recommendations:

1. Establish written policy and procedures to formalize plans, methods and procedures to guide the financial statement preparation and reporting process.
2. Prepare and analyze monthly reconciliations of subsidiary and summary account balances. Consider a “formal closing” of all accounts at an interim date(s), which will

reduce the level of accounting activity and analysis required at year-end. This “formal closing” entails ensuring that all transactions are recorded in the proper period through the month-end. With complete and timely transaction recording, analysis of all major accounts can be performed effectively.

3. Ensure that supervisory reviews are applied to the financial statements and its supporting documentation, and the reviews are documented.

4. Ensure that upgrades to the financial management system comply with the posting model definitions in the USSGL.

5. Evaluate the functional requirements to integrate the financial reporting, property and equipment and the cost systems with the GL system; assess the degree of integration necessary to have a single, unified financial management system.

FEC Response: Per the discussion above, the FEC will continue to evaluate the acceptable risk levels and the costs and benefits of integrating the financial system with the procurement and property systems; as noted the MIS and Budget systems are in the process of being upgraded and enhanced, including integrating them further with the FEC NFC and accounting systems.

The FEC IT Strategic Plan provides for the future evaluation of the costs and benefits of further integrating the HR and other systems with the FEC financial system. Decisions to proceed will be based on Commission priorities and available resources and funds.

As noted in the Financial Reporting section a formal plan for monthly closing, reconciliation review and statement analysis will be prepared in FY 2005. Finally, when the financial system upgrade is complete the system will be USSGL compliant.

II. Information Technology (IT)

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

FEC General 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 can not 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.

The audit for IT support of financial statements was broken down into four areas: (1) Entity-wide Security Program, (2) Controls to Protect Information, (3) Contingency Plan and (4) Software Development and Change Controls.

Entity-wide Security Program:

It was noted in the draft report that the “FEC has taken important steps to establish an effective information security program, but much remains to be done.” The references cited in the audit report, provide general guidance and are not audit standards. The FEC, in strengthening and building upon its security policy, has implemented the level of security that is commensurate with the FEC mission, best practices, budget and available resources. The resulting updated and modernized security program demonstrates the FEC’s commitment to information security and a continuing pursuit of a balanced security program and costs to the agency.

Controls to Protect Information:

The FEC has installed an automated key entry system to all sensitive areas, such as the data center and hub rooms, in addition to the general building entry security processes. The access to the general areas where data is stored are further protected via password protection systems installed on each server and all personal computers. In an effort to follow the NIST guidance and protect to the level required by overall agency mission, the methodology employed by the FEC for physical security of the IT systems and data is in keeping with GSA, GAO and NIST standards and best practices.

Contingency Plan:

The FEC has taken reasonable precautions in preserving data in the event of a catastrophe. All FEC information and data is backed up daily, weekly and monthly and stored at an off-site facility. The main disclosure data base is retained at an acceptable level of redundancy in order to reproduce it in the event of catastrophe. Although the

FEC identified a potential budget request for FY 2006 of over \$15 million to fully replicate the FEC IT systems and provide a staffed continuity of operations back-up site, there is no interest at either OMB or our oversight and appropriation committees for such and expenditure. The existing spending and resulting level of risk in this area is at an acceptable level, based on the costs benefits test.

Software Development and Change Controls:

The FEC has established a System Development Life Cycle Plan that reflects the existing development environment of the FEC. That environment consists of purchased application software that is in compliance with existing certifications, and set-up and adapted for specific, particular FEC mission requirements. There is very little, if any, homegrown software that is developed solely by FEC personnel at this time. The level of controls over the modification and implementation of application systems are adequate for the size and single location of the agency. The use of system modification logs has been an effective method of control, yet use of this methodology was not acknowledged in the report. The agency has established an IT Quality Assurance Office, in an effort to incorporate the latest best practices in software application control.

A. Entity-wide Security Program

- FEC did not finalize its Information System Security Policy until September 2004. This policy was not fully implemented in fiscal year 2004;

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 detail, and issued in policy 58A. The updating of Directive 58 was begun in December 2001 with the establishment of an agency Information Systems Security Officer, and followed with the establishment of an interim Information System Security Program Policy 58A dated April 2004. This interim policy became final in September 2004 as approved by the agency's Chief Technology Officer (CTO).

- A framework of policies and standards to mitigate risks associated with the management of information resources has not yet been implemented;

FEC Response: As a vital component of the Information Systems Security Program Policy (ISSPP) 58A, the FEC has 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 FEC is in the early stages of implementing this new policy.

- Risk assessments, as part of FEC's overall strategy to mitigate risks associated with its information technology environment, have not been conducted for more than three

years. The FEC conducted a risk assessment in March of 2000, with several recommendations for strengthening its information technology environment. We noted that the FEC has not implemented many of the recommendations. Furthermore, the FEC has not updated its risk assessment since March of 2000 to ensure that its strategy to mitigate risk reflects changes in its information technology environment;

FEC Response: The FEC Risk Management policy specifies a risk assessment of its major applications and general supports systems every 3 years. The FEC has addressed many of the recommendations outlined in the March 2000 risk assessment; greater detail is required from the auditors as to which specific recommendations they believe have not been met. The FEC has updated its risk assessment program by developing and implementing 58A Information System Security Program Policy and 58-2.1 Risk Management. A risk assessment was conducted February 24, 2004 in the form of a Security Audit, the purpose of which was to identify any vulnerabilities in the IT infrastructure and to identify the risks associated with those vulnerabilities.

- There was no documented and approved entity-wide security program plan. FEC has indicated that it is in the process of documenting its entity-wide security program plan. The FEC has just established in September 2004 policy guidelines which it will use in the development and implementation of an entity-wide security program plan;

FEC Response: This issue is addressed in the response to the first bullet above.

- The FEC completed the identification of its major application and mission critical general support systems in September 2004, as part of its risk mitigation strategy. Thus, the FEC has not completed the development of security plans for these applications and systems;

FEC Response: The FEC identified its major applications, mission critical in May 2004. The lone General Support System was identified in March 2000, when the development of the security plan was completed for that system. These documents have been provided to the audit team.

- Major applications and mission critical general support systems have not been certified to ensure that they are operating according to FEC's security requirements;

FEC Response: The FEC has a policy that provides for the certification and accreditation of major applications and mission critical systems. That policy is 58-2.4: Certification and Accreditation Policy. The agency Security Officer attended an Accreditation and Certification workshop sponsored by NIST in order to apply the NIST guidelines that may be appropriate to the FEC, in June 2004.

- A program for the continuous monitoring and evaluation of FEC's policy and controls to ensure operating effectiveness has not been established; and

FEC Response: The FEC has established the position of Information Systems Security Officer. This is a full-time management position, and as indicated in the position description, has the responsibility for continuously monitoring the overall policies and controls. This position description has been provided to the audit team.

- There is no periodic security awareness training. Training is only provided to new employees and contractors. The 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.

FEC Response: The FEC has finalized and approved a Security Awareness training policy which provides initial and ongoing training for all current and new employees, as well as contractors. This training has been in place during the past year and-a-half. The FEC has a security awareness program in place and documented, this documentation was provided to the audit team. All new employees and contractors undergo this training upon arrival at the FEC. Security awareness is emphasized in all FEC training classes as it pertains to the particular lesson being taught. Security awareness is re-enforced by the help desk personnel as problems are reported, and each time a help mission is launched. Information concerning virus protection, new viruses reported in trade journals and as reported through our support contracts are disseminated on a regular basis by the FEC security team, Help Desk personnel and trainers. Since the Security Awareness Training Program has only been established for a short period of time, an appropriate periodic training refresh period has yet to be established.

B. Controls to Protect Information

- No documentation or verification that the vulnerabilities identified in the February 2004 network penetration scan have been addressed;

FEC Response: The FEC has addressed and verified that the vulnerabilities pinpointed by the Nessus scan have been addressed. We are in the process of fully documenting all corrective actions.

- Visitor (individuals that do not have approved daily access) logs for data center access were not maintained and no compensating controls to monitor and record visitor access to the data center have been implemented;

FEC Response: The FEC does, in fact, maintain an electronic log which is the Kastle Key system. Each time a person enters the room the date and time is recorded. The only way to access the data center is with a Kastle key. Only individuals with Kastle Key access privileges for the data center are allowed entry.

- Password controls are weak:
 - There is no password lifetime set on the local area network (LAN);
 - There are no technical controls to enforce password changes on the LAN and the GL system;
 - Some passwords on the FEC LAN have not been changed since 1997;

- The password policy cannot be updated or changed in the current version of the GL system;
- The GL system passwords do not expire;
- There is no limitation on the number of GL system password attempts (i.e. no lock-out policy);
- There is no policy on the GL system composition of passwords; and
- There are no controls on password length for the GL system.

FEC Response: The FEC is in the process of implementing the recommendations to provide stronger password controls. Users will be forced through system control to change their password periodically. Below is the implementation of the agency's password policy, as outlined in policy 58A:

As many of you are aware, the Federal government has increased its focus on computer security. Agencies that process sensitive but unclassified information are required to enforce more stringent access control policies. One stipulation of these policies is that we enhance our identification/authentication methods. Due to this increased focus and recently initiated audit by the Office of Inspector General, the Commission is implementing a formal password policy. The policy (58-3.1 Logical Access Policy) and its derived FEC password standard can be found in WNTSRV1\FEC-WIDE\FEC IT Policies and Standards. Please take the time to review them both.

This password standard requires a change of passwords no less than every 180 days. In order to ensure that every one has changed their Network, Lotus Notes and other logon passwords, current passwords will expire at midnight (12:00 AM) December 13, 2004. In order to logon after that time you will need to change your password. As usual, any questions should be addressed to the Helpdesk.

Summary of FEC IT Security Password and Standard

Passwords must contain a minimum of eight (8) characters.

Passwords must consist of a mix of upper and lower case letters, numbers, and special characters.

Passwords must not contain any word found in any dictionary in any language, or be based on any word or character in literature.

Passwords must not be based on user IDs, or related to personal information.

Passwords must be changed no less than once every 180 days.

Passwords will not be allowed to be repeated for at least five generations.

Users passwords must not be related to one another such that compromise of one makes others easier to guess; e.g., "abCdefg1", "abCdefg2", "abCdefg3".

User IDs will be disabled or revoked following five (5) consecutive failed login attempts.

Please note, we highly recommend our employees use Pass Phrases such as *SeeU2morrow!* or **CU2morrow.*

Again, please be aware that these password standards are effective as of December 13, 2004 and apply to all FEC Information Systems that require a password including;

Windows(your network account)

Lotus Notes

PeopleSoft

FEC (Keaterm)

Comprizon.buy

To assist you in implementing these standards the ITD HelpDesk has created instructions on changing passwords to meet these criteria. These instructions are located in \\Ntsrv1\FEC-WIDE\Help Desk Information\Password Information & Instructions. As always, the HelpDesk can be reached at X1255 or via email.

- There are no records of access requests granted to remote users. The 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;

FEC Response: There is a record of those individuals that have been granted access through the use of the VPN. The individuals on the access list have been approved by the CTO. The list is maintained by the Systems Branch. The list is periodically reviewed by the CTO. It is FEC policy that all FEC employees may access the network via dialup connection. Many FEC personnel have been provided with FEC laptops so that dial-up access may be available at home.

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

FEC Response: GL user matrix has been provided to the audit team. Supervisors request access for people that require access to the GL system either directly to the administrator or report them via the GL system Lotus notes database that is used to record all administrator activity. For example, log number 159 is a request for access rights.

- The principle of “least privilege” is not consistently applied in the GL system application. A high level IT official has similar access rights and privileges in the GL system application as the Accounting Officer;

FEC Response: The privileges for the high level IT official, were modified to allow the appropriate level necessary to perform the functions of the position, at the time it was identified by the audit team. This was complete months ago.

- 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.

FEC Response: Data Center is adequately documented and reviewed through the use of the automated Kastle Key secure entry system. Kastle is under contract to monitor access 24-7 to the building as well as the data center. On occasion, since names are entered

manually by the administrative division, spelling errors may occur and go undetected, due to the reviewers may be unaware of the correct spelling.

The individual in question in the second sub-bullet above, was not terminated, but in fact passed away. His Kastle Key was in his possession at the time of death and was unrecoverable at the time. Lost key procedures were instituted and his access was revoked during August 2004. He passed away on July 21, 2004. When personnel are terminated, or they leave the employ of the FEC voluntarily, their key is collected in accordance with personnel check out policy.

The individual that could not be identified was unknown to the Systems Branch Manager when asked. It is not expected of the Systems Branch manager to know each person on an access list. The person was a contract employee with proper credentials to be on the access list.

- The FEC is not in compliance with its auditing policy because it does not automatically log the network activity described in the *Audit Event Standards*, even though it has the capability to do so.

FEC Response: 58-3.3: Auditing and Monitor Policy and the Audit Event Standards are recently approved policies and standards, they were developed just prior to the audit. All of the FEC Information Systems have not yet come under their purview. The accounting system is scheduled for compliance soon.

C. Contingency Plan

- FEC has not formally identified and prioritized all critical data and operations on its major applications 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 Response: The FEC Mission Critical, General Support Systems, and Major Applications have been identified. The resources and data necessary to recover those entities in the event of a major interruption or disaster will be identified when the FEC completes its disaster recovery plans and procedures which is in process.

- FEC does not have alternative processing sites for most of its operations in the event of a disaster, including its general ledger system

FEC Response: the FEC does not have the budget or the mission criticality to justify the expense of establishing an alternative site. The FEC has the appropriate level of data processing that is consistent with its mission.

- 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

the FEC and then replicated at off-site location, there is no operational mechanism to update the Disclosure Database replicated at the off-site location.

FEC Response: the FEC does not have the budget or the mission criticality to justify the expense of establishing an alternative site. The FEC has the appropriate level of data processing that is consistent with its mission.

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

FEC Response: The FEC will look into the expenses involved in expanding its fireproof safe capacities. In the interim, the off-site storage facility picks up tapes on a weekly basis, in the event of a catastrophe in the FEC Data Center, the maximum loss of data would be one week. At this time this is considered acceptable risk

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

FEC Response: In accordance with the NIST Computer Security Handbook chapter 15 Physical and Environmental Security, page 171, Water sprinkler systems are the preferred fire extinguishing systems. See below extract:

Fire Extinguishment. A fire will burn until it consumes all of the fuel in the building or until it is extinguished. Fire extinguishment may be automatic, as with an automatic sprinkler system or a HALON discharge system, or it may be performed by people using portable extinguishers, cooling the fire site with a stream of water, by limiting the supply of oxygen with a blanket of foam or powder, or by breaking the combustion chemical reaction chain.

When properly installed, maintained, and provided with an adequate supply of water, automatic sprinkler systems are highly effective in protecting buildings and their contents.¹⁰⁴ Nonetheless, one often hears uninformed persons speak of the *water damage* done by sprinkler systems as a disadvantage. *Fires that trigger sprinkler systems cause the water damage.*¹⁰⁵ In short, sprinkler systems reduce fire damage, protect the lives of building occupants, and limit the fire damage to the building itself. All these factors contribute to more rapid recovery of systems following a fire.

Halons have been identified as harmful to the Earth's protective ozone layer. So, under an international agreement (known as the Montreal Protocol), production of halons ended January 1, 1994. In September 1992, the General Services Administration issued a moratorium on halon use by federal agencies.

Each of these factors is important when estimating the occurrence rate of fires and the amount of damage that will result. The objective of a fire-safety program is to optimize these factors to minimize the risk of fire.

- FEC has not developed and documented a comprehensive contingency of operations plan of its data centers, networks and telecommunication facilities.

FEC Response: The FEC is in process of developing a disaster recovery plan that will address these issues.

D. Software Development and Change Controls

- System Development Life Cycle (SDLC) Methodology has not been finalized and implemented.

FEC Response: The overall agency SDLC has been drafted and the policies and procedures are written. The implementation will take place with the establishment of the Quality Assurance Branch within the IT Division, as soon as the IT organization plan takes effect. There is a Quality Assurance Manager on board and he has taken steps to begin the establishment of appropriate QA controls.

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

FEC Response: See the SDLC that was provided. The management of software libraries is addressed in the SDLC.

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

FEC Response: See the SDLC. In addition to the procedures in the SDLC, the procedures and flow are depicted in graphic form with the key players identified in the diagram for each system supported by the IT Division. The key players are identified as the business owners, the IT owners with the hardware and OS identified. See sample of the major systems diagram.

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

FEC Response: See SDLC

- Software code changes were not reviewed before being implemented.

FEC Response: All changes to the GL system are recorded in the Lotus Data Base set up to provide a log of all activity in the GL system. The changes are documented in this

log, and acceptance is verified by the business owner of the GL system. As far as code changes are concerned, the FEC does not own source code to any purchased software, and therefore is not capable of making any code changes. We do, however maintain and modify as requested, via the log any changes to application scripts developed in house pertaining to the specific applications requirements of the FEC.

REPORTABLE CONDITIONS

III. Cost Accounting System and Processes

A. Cost Allocation Methodology

FEC does not have a cost accounting system that is integrated with the 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. Accordingly, the cost data presented on the SNC is compiled from three systems' raw data, which is then gathered and analyzed in an elaborate, complex, and manually intensive spreadsheet.

FEC Response: The FEC prepares its cost allocation based on the MIS data, and the Budget Execution Report (BER)—two main sources of information. Our costs are based on data that is meaningful to OMB and our oversight committees in the presentation of budget requests and appropriation justifications: actual FTE allocated to programs and activities, and Budget Authority (BA), obligations, and final expenditures. These are the data that they are interested in reviewing in the context of the budget and appropriation processes. Both the OMB and congressional offices have commented on the quality and usability of FEC budget presentations in recent years, and the proof is that the FEC has attained a 3.5% increase in FY 2005 and a recommended 5.5% increase for FY 2006 when many domestic agencies and programs have been frozen or even reduce in recent years.

Raw data used in the allocation of costs, such as payroll, is sometimes based on estimates due to the timing of the availability of the data.

FEC Response: As noted during the audit in the responses to requests for information, use of data from the actual NFC and FEC payroll process necessarily requires the use of projections from actual data due to compressed time frames mandated by the Accountability of Tax Dollars Act and OMB regulations. Depending upon when the end of the last month of a quarter falls, there is a built in 10 day to two week processing time lag from when payroll data is collected and reported to the NFC and the payroll information is reported back to the FEC. This necessarily requires the use of projections to meet quarterly timeframes for reporting. These "estimates" are projections based on actual year to date data as available when the reporting time frame falls.

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. In addition, the FEC did not have a formal comprehensive policy and procedures for the program cost allocation. Although a written procedures document was provided to us, the document was written in response to our audit request and did not include a comprehensive set of procedures. The manually intensive and elaborate cost allocation process dictates the need for a formal comprehensive policy and procedures. Moreover, the heavy reliance on a single person to carry out this process could impair FEC's ability to generate a timely and accurate report when the person becomes unavailable.

FEC Response: Definitions of the three major programs are provided in the FEC Strategic Plan, Performance Plans, and FEC Mission Statement. A document describing the allocation process was provided and additional documentation and explanation was provided in both written and verbal form in meetings to describe the new allocation process (see below). The document in question was written prior to the audit request, but was in preparation for the audit—documenting procedures in preparation for an audit is part of the audit process. The FEC noted that comprehensive procedures were not required due to the limited scope of the allocation process at the FEC. In a small agency such as the FEC with a two person budget office, it is not unusual that one person performs a function. Costs negate the ability to double-check all functions—at some point officials are responsible for performing their tasks properly and efficiently, and this is acceptable risk under the costs benefits test.

Recommendations:

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

FEC Response: The FEC has documented formal cost allocation procedures; prior to the FY 2002 Act the FEC did not allocate management and overhead costs to the three major programs but reported them separately. The FEC does not see a cost effective need for “comprehensive” detailed procedures carried out solely by the budget office, particularly when as noted the system is being replaced by a new MIS and budget preparation system, automated and more fully integrated with the FEC financial system,. Due to the 2002 Act the FEC added requirements to the new system to automate the allocation process in the new system which will be fully documented.

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

FEC Response: The FEC will train several employees to use the new automated system and it will be fully documented.

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

FEC Response: The FEC notes again that at some point in a small agency with limited staff the costs benefits test requires that officials perform their tasks responsibly and effectively. There is a limit to what tasks can be double-checked with a two person budget office. Furthermore, as noted the new automated system will be in place and will provide a built in check.

B. Managerial Cost Accounting

Statement of Federal Financial Standard 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...The present FEC cost accounting system does not provide the minimum-level identified above. FEC management notified us that it is in the process of developing a new cost accounting system.

Recommendations:

38. 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 notes that SFFAS No. 4 is a very broadly worded and applied standard that was designed to be so by OMB when it was developed. The FEC believes that the current MIS and other FEC reporting systems provide beneficial and useful high level management information, and make even more detailed information available to division and office managers. This will be improved upon in the new fully integrated budget and MIS systems which will contain an automated cost allocation process. It is not cost effective to take action to improve the existing system while the new system is being developed. The FEC notes that existing systems pre-dated the 2002 Act that required the full allocation of all management and overhead costs.

IV. General Property and Equipment (Property)

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. Our audit disclosed deficiencies, errors or omissions that questioned the effectiveness of FEC's internal control on property. Some examples are noted below:

- Depreciation expense and accumulated depreciation reported on the depreciation report were not correct. We were informed that although the property management system calculates depreciation correctly, when the data is converted into another system to generate the depreciation report, the calculation gets corrupted. This error was identified during the audit and was subsequently adjusted.

- Software-in-development was not adequately tracked and was not reported until the September 30, 2004 financial statements. There was one instance of software-in-development being reported as completed software in the property management system; therefore, the asset was being improperly depreciated. Another instance was completed software that was not recorded. These errors were only identified during the audit process.
- Several assets were recorded using the purchase order amount, instead of the actual cost.
- For the 45 sample items we tested, we noted that 45 receiving reports were not completed properly, that is, they were either not signed, did not have the date of receipt, did not have a description of the goods or services received, or lacked a reference to the invoice to be paid. Although only 6 of the 45 items pertained to acquisitions in fiscal year 2004, this deficiency persisted throughout fiscal year 2004.

One of the five standards for internal control in 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:

37. Enforce current procedures to require documentation of approvals and certifications for procurement and disbursements transactions.

38. Formally communicate to all appropriate personnel to ensure compliance and consistent application of the policies and procedures.

FEC Response: FEC agrees with these recommendations. In FY 2003 and in preparation for the audit FEC needed to establish asset values for prior year purchases. Detailed records were not always available. Federal accounting standards allow for the use of estimates where detailed records are not available. In some cases that meant using reports and estimates (purchase orders) from as far back as FY 1997. Thus, not all receiving reports were available. FEC provided the audit team with invoices, purchase orders and receiving reports for FY 2004 purchases. FEC will modify its stated requirement on receiving reports to delete the provision requiring a description of goods and services received. Since this information is on the purchase order and invoice, it is not necessary to require it on the receiving report. Instead, FEC will add an invoice number field to the receiving report. This will tie the approval to the goods or services received.

The error in the spreadsheet calculation of depreciation expense was caught and corrected by FEC in its regular review of the financial statements. Software in Progress was a new account added in FY 2004 and will be tracked quarterly in FY 2005.

Current procedures will be enforced. Late in FY 2004 some minor procedures changed (e.g., Software in Progress). These changes will be documented and communicated to appropriate staff in early FY 2005.

V. Payroll

Recommendations:

39. Implement procedures to ensure that payroll deduction elections are authorized by maintaining adequate supporting documentation or an ability to query the service provider systems to verify these deductions if initiated by an employee without the FEC's intervention. Consider training/re-training payroll employees on the proper procedures for obtaining and retaining support documents for payroll elections.

40. Ensure that timekeepers perform a monthly reconciliation of leave balances reported in its records and the service provider records and submit the leave balance certification to the finance office monthly.

41. Implement procedures for ensuring hours recorded on the T&A reports are properly supported and authorized. Consider further automating payroll processing to decrease the risk of errors.

42. 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's payroll is processed by USDA's National Finance Center. Seventy percent of FEC's annual budget is for payroll. We were pleased that after an extensive audit, CG found no incorrect payments or leave balances and had only minor suggestions on improvements. .

The official record of an employee's leave balance is the earnings and leave statement, not the manually prepared timesheets.

FEC agrees it is responsible for obtaining original documents (tax forms, health deductions, etc.) when employees are hired. However, FEC employees may use OPM's Employee Express to change certain deductions. In some cases changes are made by NFC employees (TSP loan repayments) or an authorized contractor such as for enrollment in the Flex Fund HCA Program. Thus, there is not necessarily a form in FEC's files for every change to an employee's deductions. Of the 41 documents CG states were not in FEC's files, Payroll personnel were able to produce computer screen shots showing the

changes were made either by the employee through Employee Express, NFC or an authorized FEC employee or contractor.

FEC recognizes there are some situations (i.e., holidays, travel) where timesheets may be approved before the end of the pay period. Both cases noted by CG in the audit were around holiday time, when many employees are off. Supervisors remain responsible for hours worked by their employees. There is no indication this is widespread problem or anyone was paid incorrectly as a result of the advanced approval of the timesheets.

Timekeepers and supervisors will be reminded of the proper procedures for approving leave, correcting timesheets to minimize potential errors and submitting leave verifications to payroll each pay period.

OTHER MATTERS

Federal Managers' Financial Integrity Act (31 U.S.C. 3512) (Integrity Act) Compliance and Reporting

OMB Circular No. A-123 provides the reporting guidance for the Integrity Act. OMB Circular 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's controls, and (iii) whether the agency's financial management systems conform with government-wide requirements. OMB Bulletin No. 01-02 required that we compare the material weaknesses in the agency's controls and material non-conformances on the agency's financial management systems in the FEC's Integrity Act report to our report on internal control dated November 1, 2004. Since the Integrity Act report is due by December 31, 2004, FEC has not started and does not intend to start the process of accumulating the information required for its report until November 2004. Accordingly, the comparison of reports could not be performed.

FEC Response: The FEC noted to CG that the A-123 annual statement process is an annual one based on calendar years, not fiscal years, and is due to the President December 31, 2004, not by September 30, 2004. Given the heavy workload faced by FEC managers during an election year (2004), FEC management stated that we would not require division and office managers to prepare their statements prior to September 30, 2004. The FEC notes that CG was made aware that the A-123 process at the FEC requires all managers to integrate concern for management controls into the on-going managerial and supervisory duties they perform on a continuing basis. This conforms to the last OMB revision of the A-123 process designed to integrate management controls and A-123 into the overall management processes of federal agencies.

It is therefore incorrect to state that the process has not been started—it is on-going on a regular basis. The process of preparing and submitting the annual statements to the Staff Director will not have been completed by September 30, 2004.

FEC management did note that the December 31, 2003 letters and statement indicated that managers had discovered no major potential weaknesses or potential vulnerabilities in their self assessment process. The FEC notes that the A-127 financial systems management controls review process can be more than covered by the extensive self-assessment the FEC and its contract audit support performed for FY 2003 processes in preparation for the FY 2004 audit. It should also be noted that the review and evaluation process covered by the audit is more extensive than any self-assessment provided for in A-127 of financial management controls.

The FEC has noted in prior communications to the FEC OIG that the FEC does not require a comprehensive plan to integrate its one existing financial system with any other financial systems. In terms of integrating the financial system with other systems such as the Budget and MIS systems, as well as property, the FEC indicates in both the main FEC and FEC IT Strategic Plans and Performance Plans, the schedule for improving these systems. As noted the FEC is currently engaged in developing and implementing a more fully integrated MIS and budget system with the financial system.