AUDITORS' REPORT

DEPARTMENT OF COMMERCE
UNITED STATES OF AMERICA

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

January 16, 2003

MEMORANDUM FOR: The Honorable Donald L. Evans
Secretary of Commerce

FROM: Johnnie E. Frazier

SUBJECT: *Department of Commerce's Fiscal Year 2002 Consolidated Financial Statements*
Audit Report No. FSD-15214-3-0002

I am pleased to provide you with the following audit report, which presents an unqualified opinion on the U.S. Department of Commerce's FY 2002 consolidated financial statements. The report also includes a discussion of the Department's internal control structure and compliance with laws and regulations. The independent certified public accounting firm of KPMG LLP (KPMG) performed the FY2002 audit. My office defined the audit's scope and oversaw its performance and delivery.

We commend the Department for the noteworthy accomplishment of again attaining an unqualified opinion.

In the opinion of KPMG, the Department's consolidated financial statements are presented fairly, in all material respects and in conformity with generally accepted accounting principles, as of and for the year ended September 30, 2002. In addition to the Department's unqualified opinion, each of its separately audited entities—the U.S. Patent and Trademark Office and the National Technical Information Service—received unqualified opinions on their statements.

The Department has made significant progress toward correcting internal control weaknesses over the past several years. In FY 2002, it resolved most of the financial management and reporting weaknesses noted in the previous year's audit. In addition, the Department made significant progress in implementing the Commerce Administrative Management System (CAMS) at the National Oceanic Atmospheric Administration (NOAA). NOAA used CAMS to closeout and to report its FY 2002 financial data. However, a material weakness in financial management systems persists: Commerce needs to strengthen general information technology controls, continue integrating its financial management systems and reducing legacy systems, and ensure that budgetary controls are adequately automated.

KPMG also identified weaknesses in the Department's accounting for property in FY 2002, (a reportable condition). Specifically, NOAA needs to improve its accounting for personal property, including construction work-in-progress and capital leases. During the FY 2002 audit, NOAA identified that costs incurred during prior years of developing a new satellite system were incorrectly expensed.

KPMG's report discusses instances where the Department is not in compliance with laws and regulations—all of which are repeat conditions. Specifically, NOAA and the National Institute for Standards and Technology (NIST) did not comply with OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*; the International Trade Administration (ITA) did not comply with OMB Circular A-25, *User Charges*; and the Department's financial management systems did not substantially comply with the Federal Financial Management Improvement Act.

I am greatly concerned that all of the findings in the audit report are repeat conditions. Commerce senior officials must remain committed to sound financial management and continue to emphasize to managers and staff their important role in eliminating the conditions noted in the auditors' report and in ultimately producing reliable and meaningful financial and performance information that fully complies with federal laws and regulations.

In accordance with Department Administrative Order (DAO) 213-5, we ask the Department's Chief Financial Officer and Assistant Secretary for Administration to provide for our review and concurrence an audit action plan that addresses all of the recommendations contained in this report—those pertaining to the Department as a whole, as well as to NOAA, NIST, and ITA—within 60 days of the date of this memorandum. It is important that the plan include the specificity and milestones that will better ensure that the Department is, in fact, moving to resolve its repeat conditions and achieving the level of financial management success required.

If you or your staff wish to discuss the contents of this report or the audit action plan, please call me on (202) 482-4661, or Michael Sears, Assistant Inspector General for Auditing, on (202) 482-1934. We appreciate the cooperation and courtesies that Commerce managers and staff extended to KPMG LLP and my staff during the audit.

KPMG

2001 M Street NW
Washington, D.C. 20036

Independent Auditors' Report

Office of Inspector General, U.S. Department of Commerce and
Secretary, U.S. Department of Commerce:

We have audited the accompanying consolidated balance sheets of the U.S. Department of Commerce (Department) as of September 30, 2002 and 2001, and the related consolidated statements of net cost for the years then ended, and the related consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002 (hereinafter referred to as "consolidated financial statements"). The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our audits, we also considered the Department's internal control over financial reporting and tested the Department's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its consolidated financial statements.

We did not audit the financial statements of the National Technical Information Service or the U.S. Patent and Trademark Office, bureaus within the Department, which combined, represent 10 percent and 2 percent of the total consolidated assets and net costs of operations of the Department, respectively. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the National Technical Information Service and the U.S. Patent and Trademark Office is based solely upon the reports of the other auditors.

SUMMARY

As stated in our opinion on the consolidated financial statements, based on our audits and the reports of other auditors, we concluded that the Department's consolidated financial statements presented in the *Fiscal Year 2002 Performance and Accountability Report*, as of and for the years ended September 30, 2002 and 2001, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 21 to the consolidated financial statements, the fiscal year 2001 consolidated balance sheet and statement of net cost were restated for a correction to the general property, plant, and equipment accounts.

Our consideration of internal control over financial reporting resulted in the identification of one material weakness, relating to the Department's financial management systems, including weaknesses in general information technology controls, the lack of integrated financial management systems, and inadequate automated budgetary controls; and one reportable condition, relating to accounting for the Department's personal property.

The results of our tests of compliance with certain provisions of laws and regulations disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *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*:

- OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*.
- OMB Circular A-25, *User Charges*.
- *Federal Financial Management Improvement Act* (FFMIA).

The following sections present our opinion on the Department's consolidated financial statements; the results of our consideration of the Department's internal control over financial reporting and our tests of the Department's compliance with certain provisions of applicable laws and regulations; and management's and our responsibilities.

OPINION ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the U.S. Department of Commerce as of September 30, 2002 and 2001, and the related consolidated statements of net cost for the years then ended, and the related consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002.

We did not audit the financial statements of the National Technical Information Service or the U.S. Patent and Trademark Office, bureaus within the Department, which combined, represent 10 percent and 2 percent of the total consolidated assets and net costs of operations of the Department, respectively. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the National Technical Information Service and the U.S. Patent and Trademark Office is based solely on the reports of the other auditors.

As discussed in Note 21 to the consolidated financial statements, the fiscal year 2001 consolidated balance sheet and statement of net cost were restated for a correction to the general property, plant, and equipment accounts.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2002 and 2001, and its net costs for the years then ended, and its changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the year ended September 30, 2002, in

conformity with accounting principles generally accepted in the United States of America.

The information in the Management Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections of the Department's *Fiscal Year 2002 Performance and Accountability Report* is not a required part of the consolidated financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The September 30, 2002 consolidating balance sheet is presented for purposes of additional analysis of the related consolidated balance sheet, rather than to present the financial position of the Department's bureaus individually. The September 30, 2002 consolidating balance sheet has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, based on our audits and the reports of the other auditors, is fairly stated in all material respects in relation to the September 30, 2002 consolidated balance sheet, taken as a whole.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of 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 over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated 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 consolidated 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.

In our fiscal year 2002 audit, we noted certain matters relating to the Department's financial management systems, summarized below and in more detail in Exhibit I, that collectively, we consider to be a material weakness in internal control over financial reporting:

- **General information technology controls.** We found that although the Department has taken corrective actions to address certain information technology control

weaknesses, significant information technology weaknesses still exist. Despite the positive efforts made by the Department during fiscal year 2002, the Department needs to make significant improvements in its information technology control environment to fully ensure the integrity, confidentiality, and availability of financial data processed by the Department's systems.

- **Integrated financial management systems.** The Department has not fully complied with OMB Circular A-127, *Financial Management Systems*, although progress has been made. During fiscal year 2002, two bureaus – the National Oceanic and Atmospheric Administration (NOAA), which processes financial transactions for itself and the Bureau of Industry and Security; and the National Institute of Standards and Technology (NIST), which processes financial transactions for itself, as well as for the National Telecommunications and Information Administration and the Technology Administration – operated legacy, non-integrated systems that did not comply with Federal financial systems requirements. These five bureaus accounted for approximately 72 percent of the Department's total consolidated assets as of September 30, 2002. On October 1, 2002, NOAA converted to the Commerce Administrative Management System (CAMS), and NIST is scheduled to convert to CAMS in October 2003.

- **Automated budgetary controls.** Neither NOAA's legacy system, used for the fiscal year 2002 disbursements not processed through CAMS, nor NIST's legacy system, have automated budgetary controls. The automated funds control module in CAMS was used by NOAA for some of its fiscal year 2002 disbursements, but was not implemented at a level that would ensure the required budgetary control. Therefore, bureaus using the NOAA and NIST systems, described above, relied upon manual processes to monitor their budgetary status. These manual processes do not prevent an over-obligation of funds.

We also noted the following matter relating to accounting for the Department's personal property, summarized below and in more detail in Exhibit II, that we consider to be a reportable condition in internal control over financial reporting:

- **Accounting for personal property.** The Department has a substantial investment in general property, plant, and equipment, amounting to approximately $4.5 billion or nearly 40 percent of the Department's total consolidated assets as of September 30, 2002. NOAA maintains $3.8 billion of the Department's general property, plant, and equipment balance. During our fiscal year 2002 audit, we identified numerous issues in the accounting for NOAA's personal property, including construction work-in-progress (CWIP), and capital leases. These matters included the identification of ongoing CWIP projects that had been expensed in prior years, completed CWIP projects that had not been transferred to the completed project accounts, projects incorrectly classified as CWIP, unreconciled or unexplained differences in the CWIP reconciliations and between the personal property subsidiary and general ledgers, inaccuracies in the personal property roll-forward schedules, and incorrect values for assets acquired through capital leases.

* * * * *

A summary of the status of prior year reportable conditions is included as Exhibit III. As noted in the exhibit, the prior year findings related to financial reporting have been resolved.

We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of the Department in two separate letters addressing information technology and other matters, respectively.

COMPLIANCE WITH LAWS AND REGULATIONS

Our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report, exclusive of FFMIA, disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and are described below.

- **OMB Circular A-11.** As noted in prior year audit reports, NOAA capital leases are not fully funded, as required by OMB Circular A-11. NOAA currently has 23 capital leases that are not fully funded. In fiscal year 1999 and again on September 8, 2000, NOAA's Chief Financial Officer issued a memo requiring that "all future capital leases exceeding $200,000 have sufficient budgetary resources at the inception of the lease to cover the present value of the lease payments discounted using Treasury interest rates." This memo addressed leases with inception dates after fiscal year 1999, in accordance with the requirements of OMB Circular A-11. However, NOAA did not fully fund 6 capital leases with inception dates after October 1, 1999. In fiscal year 2002, NOAA prepared a draft policy requiring that contract authority be requested for all capital lease obligations. This policy is currently being reviewed by management and is expected to be finalized in calendar year 2003.

  In addition, as discussed in the Internal Control Over Financial Reporting section of this report, the legacy accounting systems used by NOAA and NIST do not have automated budgetary controls; and the CAMS automated funds control module used by NOAA for certain fiscal year 2002 disbursements was not set at the level of control required by OMB Circular A-11. The manual control processes, used by bureaus relying on these systems, do not prevent an over-obligation of funds.

- **OMB Circular A-25.** As reported in prior audits, the International Trade Administration (ITA) is not in compliance with OMB Circular A-25, *User Charges,* which requires federal agencies to recover the full cost of providing goods or services to the public. ITA has completed several analyses of its user fees. Its costs are not fully allocated and, therefore, ITA has requested a waiver of Circular A-25 requirements from OMB. There is a concern that ITA trade events, which produced earned revenue of approximately $7 million in fiscal year 2002, are not self-sustaining. ITA is continuing to work with OMB to obtain the requested waiver.

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The results of our tests of compliance with other laws and regulations, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

FFMIA. The results of our tests of compliance with FFMIA disclosed instances, listed below, and described in the Internal Control Over Financial Reporting section of this report and in Exhibit I, in which the Department's financial management systems did not substantially comply with the Federal financial management systems requirements discussed in the Responsibilities section of this report, including:

- Weaknesses in general information technology controls.
- Lack of integrated financial management systems.
- Inadequate automated budgetary controls.

Our recommendations to address these matters are presented in Exhibit I.

The results of our tests of FFMIA disclosed no instances in which the Department's financial management systems did not substantially comply with Federal accounting standards and the United States Government Standard General Ledger at the transaction level.

Other Matters. A review is being conducted by the Department's Office of Inspector General, as a result of work conducted by the Office of Inspector General of the Department of Defense, related to the use of Department of Defense funds by NOAA on a jointly sponsored project. NOAA disagrees with the Department of Defense Office of Inspector General's findings. NOAA believes this matter may have arisen due to the issues relating to budgetary funds control described in the Internal Control Over Financial Reporting section of this report. The ultimate resolution of these matters cannot presently be determined.

RESPONSIBILITIES

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA) requires each federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, the Department prepares annual financial statements.

Management is responsible for:

- Preparing its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America.
- Establishing and maintaining internal controls over financial reporting, and preparing the Management Discussion and Analysis (including the performance measures),

Required Supplementary Stewardship Information, and Required Supplementary Information.
- Complying with laws and regulations, including FFMIA.

In fulfilling these responsibilities, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud, may nevertheless occur and not be detected.

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2002 and 2001 consolidated financial statements of the Department based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements.
- Assessing the accounting principles used and significant estimates made by management.
- Evaluating the overall consolidated financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2002 audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, we considered the Department's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the Department's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over Required

Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the Department's fiscal year 2002 consolidated financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the Department. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No 01-02 and FFMIA, we are required to report whether the Department's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

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

KPMG LLP

December 27, 2002

Financial Management Systems Need Improvement *(Repeat Condition)*

The Office of Inspector General (OIG), U.S. General Accounting Office (GAO), and Departmental self-assessments have, for many years, identified weaknesses in the Department's information technology (IT) controls, most notably related to information security. Our fiscal year (FY) 2002 audit of the Department's consolidated financial statements, found that, despite corrective actions taken, significant weaknesses still exist, prompting the Department to declare information security a material weakness under the *Federal Managers' Financial Integrity Act of 1982* (FMFIA).

In February 2002, the Department's Chief Information Officer (CIO) underscored the problem during a public radio interview, as follows:

> Computer security, or IT security is our biggest challenge. Our Department, like many other Federal agencies and private organizations, has not kept up with the threats that have resulted from the growth of networking over the last several years. We are now playing catch-up to strengthen our Department's computer security and to reduce the vulnerability of our systems and data to hackers.

During our FY 2002 audit, the CIO stated that the Department's goal is to improve its information security program sufficiently in FY 2003 so as to eliminate the related FMFIA material weakness.

The Department took several actions in FY 2002 to improve controls and processes for its entity-wide information security program: (1) directing secretarial officers and heads of operating units to give information security high priority, sufficient resources, and their personal attention, and to restructure and strengthen IT management by having a CIO at each unit report to the unit head or principal deputy and to the Department's CIO; (2) establishing a centralized Departmental IT security management group, led by the managers of the IT security and critical infrastructure programs, and (3) completing several corrective actions in response to prior-year information security findings.

The OIG noted these efforts in the Executive Summary of its 2002 report on the Department's compliance with the *Government Information Security Reform Act* (GISRA) (Final Inspection Report No. OSE-15260):

> With leadership and commitment from senior management, Commerce has made considerable progress over the past year toward establishing the foundation for an effective information security program. However, because information security did not receive enough attention in the past, the effort required to develop and direct a program that safeguards the approximately 600 diverse and complex Commerce systems is daunting. We believe the groundwork is being laid. Commerce now needs to ensure that sound policies, procedures, and practices are

implemented in the operating units, that each system has the needed information security measures, and that these measures are reviewed and maintained throughout the system's life cycle.

Despite these positive efforts, we found that as FY 2002 ended, the Department's IT control environment still needed significant improvements in the following three areas, to fully ensure the integrity, confidentiality, and availability of financial data processed by the Department's systems: general information technology controls, integrated financial management systems, and automated budgetary controls.

General Information Technology Controls

Our FY 2002 audit reviewed general information technology controls over the Department's major financial management systems and supporting network infrastructure, using GAO's *Federal Information System Controls Audit Manual* (FISCAM) as a guide. Effective general controls provide assurance that data used to prepare financial statements is reliable. The six FISCAM review areas and our related findings are as follows:

- **Entity-wide security program.** An entity-wide security program for security planning and management is the foundation of an organization's information security control structure. The program should provide a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of computer-related security controls. Although the Department has made improvements in this area, additional efforts are needed. For instance, the Department has not established a process for promptly notifying its bureaus of the status or outcome of security background investigations on prospective or current employees. In addition, several bureaus need to enhance their entity-wide security policies and practices to improve compliance with requirements of Office of Management and Budget (OMB) Circular A-130, *Management of Federal Information Resources*.

- **Security access controls.** Access controls should provide reasonable assurance that computer resources, such as data files, application programs, and computer-related facilities and equipment, are protected against unauthorized modification, disclosure, loss, or impairment. These controls include physical controls over computer hardware as well as logical controls over system files, programs, and data. Although the Department has implemented controls over the granting and monitoring of system access, it needs to improve password management, database security, intrusion detection, and incident response. We identified weak or easily guessed passwords for operating devices at several bureaus, enabling us to gain unauthorized access to sensitive financial data and other program information, such as personnel records.

- **Application software development and change control.** Controls over changes to application software programs help ensure that only authorized and tested programs

and modifications are implemented. The Department's bureaus have not developed a standardized change control methodology, consistently documented changes, or maintained sufficient access controls for application programmers. Without proper change controls, there is an increased risk of unauthorized changes being made to devices, incorrect versions of a program being implemented, viruses being introduced, or security features being inadvertently disabled.

- **System software.** Controls over the modification of system software should provide reasonable assurance that operating system controls are not compromised. The Department should improve the level of monitoring and documentation of system software changes at key bureaus/operating units. Without sufficient system software controls, unauthorized individuals using the system software could circumvent controls to read, modify, or delete critical or sensitive programs and data.

- **Segregation of duties.** Organizations should have policies, procedures, and a structure to prevent individuals from having full control over key aspects of computer-related operations, thus helping minimize the possibility of unauthorized access or actions. The Department needs to improve controls to ensure responsibilities over key IT functions, such as system development, production and information security, and system administration, are better segregated. Inadequate segregation of duties increases the risk of erroneous or fraudulent transactions, improper program changes, and damage or destruction to computer resources.

- **Service continuity.** Procedures should be in place to protect information resources, minimize the risk of unplanned interruptions, and quickly recover critical operations in the event that such interruptions occur. Many bureaus/operating units within the Department have not prepared and tested disaster recovery plans and contingency plans for all systems and operations, or developed emergency procedures and related training programs. Without adequate disaster preparedness, even relatively minor interruptions could result in lost or incorrect data and expensive recovery efforts, and could threaten the Department's ability to accomplish its mission.

These matters could adversely affect the ability of the Department and its reporting entities to manage financial data.

Recommendation

Specific recommendations are included in a separate limited distribution IT report, issued during our FY 2002 audit. The Department should monitor bureau actions to ensure effective implementation of our recommendations.

Integrated Financial Management Systems

The Department has not fully complied with OMB Circular A-127, *Financial Management Systems*. The Circular requires each agency to establish and maintain a single, integrated financial management system, which is defined as a unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls, and data necessary to carry out financial management functions; manage financial operations of the agency; and report on the agency's financial status to central agencies, the Congress, and the public.

A "unified set" means that the systems are planned for and managed together, operated in an integrated fashion, and linked electronically in an efficient and effective manner to provide organization-wide financial system support necessary to carry out the agency's mission and support its financial management needs.

In its *Federal Financial Management Improvement Act* (FFMIA) statement included in the *Fiscal Year 2002 Performance and Accountability Report*, the Department has reported that the Commerce Administrative Management System (CAMS), in conjunction with the Corporate Database, will allow the Department to be in substantial compliance with FFMIA federal systems requirements, including the requirement for a single integrated financial management system. During FY 2002, significant progress was made in implementing the CAMS resulting in the National Oceanic and Atmospheric Administration (NOAA), the Department's largest bureau, and the Bureau of Industry and Security (BIS), converting to CAMS as their system of record on October 1, 2002. In addition, NOAA and BIS used CAMS to close out their FY 2002 activity and report their FY 2002 financial statement data. Full implementation of CAMS within the Department is projected for October 2003.

As described below, during FY 2002, two bureaus – NOAA, which processes financial transactions for itself and BIS; and the National Institute of Standards and Technology (NIST), which processes financial transactions for itself, the National Telecommunications and Information Administration, and the Technology Administration – operated legacy, non-integrated systems that did not comply with federal financial systems requirements. These five bureaus accounted for approximately 72 percent of the Department's total consolidated assets, as of September 30, 2002.

- NOAA's accounting system of record during FY 2002, the Financial Information Management System (FIMA), was not fully integrated with other NOAA systems that capture source financial data, resulting in numerous manual adjustments. In addition, FIMA was not integrated with other Departmental financial systems. We also noted significant general and application control weaknesses with respect to FIMA. While NOAA used the CAMS accounts payable module for some of its disbursements during FY 2002, slightly more than 50 percent of NOAA's non-payroll disbursements

were processed through its legacy systems. As noted above, on October 1, 2002, NOAA began using CAMS as its accounting system of record.

- NIST's separate accounting system, the Corporate Information System, is not integrated with other NIST financial data systems (for example, the property accounting system), resulting in numerous manual adjustments, does not record all accounting events at the transaction level (that is, batch processing is used to post to the general ledger), and is not integrated with other Departmental financial systems. We also noted significant general and application control weaknesses with this system. NIST is expected to convert to CAMS in October 2003.

The continued use of legacy systems was one reason for the Department's 2-week delay in providing us with final bureau-level trial balances and the initial draft of the Department's consolidated financial statements for FY 2002. Improving the overall integration of systems will be key to meeting expedited financial reporting due dates in future years.

Recommendation

We recommend that the Department continue its efforts to integrate its financial management systems, reduce the number of legacy systems in use, and in so doing, monitor planned actions to ensure that progress remains timely.

Automated Budgetary Controls

NOAA's financial system, FIMA, did not contain automated procedures or system controls to prevent over-obligation of apportioned funds at the required level. We noted that the CAMS accounts payable module, in conjunction with the budget module, has the capability to provide automated funds control at various levels. For example, the CAMS modules have automated features that include checks, balances, and edit functions to alert the user that a given entry or request would exceed currently available funds. The CAMS accounts payable module was used for approximately 50 percent of NOAA's non-payroll disbursements in FY 2002. However, the parameters for funds control in FY 2002 were set at the fund (i.e., appropriation) level, which is higher than the Category A and B levels that are necessary for budgetary control, as required by OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*.

NOAA relies on budget officers and program managers to manually monitor the budget below the appropriation level and control the obligational activity against their financial operating plans. Quarterly, NOAA's Execution and Operations Division compares obligations to the financial operating plan and makes inquiries if a variance occurs. Therefore, the current implementation of the CAMS accounts payable module, in conjunction with the budget module and manual processes, does not prevent NOAA from over-obligating funds.

We also noted that the NIST legacy accounting system does not include an automated budgetary controls feature, so all of NIST's budget controls are manual, and are implemented after disbursements have occurred.

Recommendations

We recommend that in FY 2003, the Department allocate the necessary budgetary and staffing resources to ensure implementation of CAMS funds control modules at the level required by OMB Circular A-11, at all applicable bureaus. The Department should also consider requiring its bureaus to implement the automated funds control features within CAMS at a lower level, such as the project level, to further strengthen overall budgetary controls.

Accounting for Personal Property Needs Improvement

The Department has a substantial investment in general property, plant, and equipment, amounting to approximately $4.5 billion or nearly 40 percent of the Department's total consolidated assets as of September 30, 2002. NOAA maintains $3.8 billion of the Department's general property, plant, and equipment balance. During our audit, we identified numerous issues with NOAA's accounting for personal property, including construction work-in-progress (CWIP) and capital leases, that required several audit adjustments to properly state the Department's property balances, as well as the related expenses and equity balances, as of and for the years ended September 30, 2002 and 2001.

- **CWIP.** During FY 2002, NOAA identified costs of approximately $171.5 million that had been expensed in prior years for the development of a new satellite system and that required the recording of a prior period adjustment to properly capitalize the costs as CWIP. In addition, we noted the following:

  - NOAA did not make a FY 2002 management fund adjustment of approximately $2.6 million to its CWIP balances, to appropriately reflect overhead costs, because the amount was calculated after the financial statement cut-off date.
  - Approximately $5 million of accrued costs remained in a satellite CWIP account, as of September 30, 2002, even though that satellite series was considered complete in December 2001. As a result, the completed personal property balance and FY 2002 depreciation expense were understated.
  - Two CWIP projects were included in both the CWIP and real property accounts, resulting in adjustments of approximately $4 million to eliminate the duplication.
  - One CWIP project amounting to approximately $4 million, was subsequently determined to be related to an abandoned design, which required an adjustment to remove it from the CWIP balance.
  - Six CWIP project reconciliations that we tested included reconciling items that were not adequately explained by the respective line offices or were posted incorrectly by NOAA's Financial Reporting Branch.

- **Personal property.** As of September 30, 2002, we identified unexplained differences totaling approximately $3 million between NOAA's personal property subsidiary ledger and the general ledger for the equipment asset and accumulated depreciation accounts. We also noted various inaccuracies in the personal property roll-forward schedules, which incorrectly identified certain additions as prior period adjustments or failed to identify other additions as originating in a prior period.

- **Capital leases.** During FY 2002, NOAA revised all of its lease determination worksheets for its ongoing personal property capital leases, but did not maintain adequate support for the adjustments made and did not perform an effective supervisory review over the capital lease calculations. NOAA ultimately had to retain an accounting firm and spend several months to correct the accounting for its

capital leases. Final adjustments to personal property capital lease accounts and capital lease liabilities were approximately $1.7 million and $4 million, respectively.

Recommendations

We recommend that NOAA:

- Improve the process of identifying new CWIP projects, including new satellite systems, for capitalization and update its CWIP policies to address cost accumulation and recording procedures.

- Improve the process of identifying CWIP projects that are no longer viable, by updating its CWIP policies to include periodic reviews of recorded projects and specific write-off procedures.

- Improve procedures for reconciling the cost details of CWIP projects to the subsidiary ledger, to ensure that the reconciliations are complete and accurate, and that the necessary adjustments are made to the accounting records.

- Develop a method to calculate and record the management fund cost allocation adjustment to CWIP on a schedule to meet future accelerated reporting requirements.

- Establish procedures to reconcile the subsidiary system personal property balances to the general ledger, at least quarterly, and to prepare accurate personal property roll-forward schedules.

- Improve the controls over accounting for personal property capital leases, including ensuring accurate completion and supervisory review of lease determination worksheets, and retention of supporting documentation.

More detailed recommendations on these matters are presented in our management letter, dated December 27, 2002.

Reported Issue	Prior Year Recommendation	Fiscal Year 2002 Status
Material Weakness - Financial Management Systems Need Improvement		
a. *Integrated financial management systems.*		
The Department has not fully complied with OMB Circular A-127, *Financial Management Systems*. The Circular requires each agency to establish and maintain a single, integrated financial management system.	Continue efforts to integrate financial management systems, reduce the number of legacy systems in use, and monitor planned actions to ensure that progress remains timely.	Material weakness (see comments in Exhibit I).
b. *General information technology controls.*		
Weaknesses in general controls were identified in all six FISCAM review areas.	The Department should monitor the implementation of recommendations made to the bureaus in separate information technology reports and ensure they are implemented effectively.	Material weakness (see comments in Exhibit I).
Reportable Condition - Financial Management and Reporting Needs Improvement		
a. *Overall comment.*		
Further improvements in financial management are necessary at the reporting bureau level to correct the internal control weaknesses identified by the consolidated Department audit and the separate audits of certain bureaus in fiscal year 2001.	OFM should monitor the bureaus' efforts to resolve the conditions cited and recommendations made to ensure the recommendations are implemented effectively.	Completed.

Reported Issue	Prior Year Recommendation	Fiscal Year 2002 Status
b. *Financial reporting.*		
Weaknesses were identified in financial reporting at Census, Economic Development Administration (EDA), and National Institute for Standards and Technology (NIST).	Census recommendations were issued in a separate audit report in FY 2001. That report recommended that Census implement the Hyperion software for financial statement submission, ensure that CAMS has the capability to provide for multiple preliminary year-end closings, and ensure a more detailed supervisory review of financial statement submissions.	Completed.
	For EDA, ensure that all adjustments to the general ledger are adequately documented and appropriately captured in FACTS II, and use the most recent SF-133 crosswalk to accurately comply with Treasury and Departmental requirements.	Completed.
	For NIST, consider the system functionality requirements to provide financial information at the appropriation and budget fiscal year level throughout the year.	Completed.

U.S. Department of Commerce
Independent Auditors' Report
Exhibit III – Status of Prior Year Findings, Continued

Reported Issue	Prior Year Recommendation	Fiscal Year 2002 Status
c. *Reconciliations of financial data*		
Extensive reconciliations were needed to resolve errors in data produced by Census and NOAA systems or provided manually for inclusion in Departmental financial statements.	Census recommendations were issued in a separate audit report in FY 2001. That report recommended Census ensure that accurate and timely account reconciliations, with supervisory review, are performed and that data clean-up efforts continue until resolved.	No longer a reportable condition; remaining issues will be included in the management letter.
	NOAA recommendations were issued in a separate audit report in FY 2001. That report recommended that NOAA establish policies, implement oversight procedures, and perform overall reviews of CWIP balances.	Reportable condition (see Exhibit II).
d. *Vulnerability in financial data supporting financial reporting.*		
NOAA's Financial Management Information System (FIMA) does not contain automated procedures or system controls to prevent over-obligation of apportioned funds.	NOAA recommendations were issued in a separate report in FY 2001. Allocate the necessary budgetary and staffing resources to ensure timely implementation of CAMS, including budgetary funds control modules that would prevent over-obligations at the line item level, and provide for related management information reports.	Combined with material weakness (see comments in Exhibit I).

DEPARTMENT OF COMMERCE
UNITED STATES OF AMERICA