



Audit Report



OIG-18-035

FINANCIAL MANAGEMENT

Management Letter for the Audit of the Alcohol and Tobacco Tax and Trade Bureau's Fiscal Years 2017 and 2016 Financial Statements

January 26, 2018

Office of Inspector General
Department of the Treasury

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

January 26, 2018

**MEMORANDUM FOR JOHN J. MANFREDA, ADMINISTRATOR
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU**

FROM: James Hodge /s/
Director, Financial Audit

SUBJECT: Management Letter for the Audit of the Alcohol and Tobacco
Tax and Trade Bureau's Fiscal Years 2017 and 2016
Financial Statements

I am pleased to transmit the attached subject management letter. Under a contract monitored by our office, KPMG LLP (KPMG), an independent certified public accounting firm, audited the financial statements of the Alcohol and Tobacco Tax and Trade Bureau (TTB) as of September 30, 2017 and 2016, and for the years then ended. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, and the Government Accountability Office/President's Council on Integrity and Efficiency, *Financial Audit Manual*.

As part of its audit, KPMG LLP issued the attached management letter dated December 18, 2017, that discusses matters involving internal control over financial reporting that were identified during the audit, but were not required to be included in the auditors' reports.

In connection with the contract, we reviewed KPMG's management letter and related documentation and inquired of its representatives. KPMG is responsible for the letter and the conclusions expressed in the letter. However, our review disclosed no instances where KPMG did not comply, in all material respects, with U.S. generally accepted government auditing standards with respect to this management letter.

Should you have any questions, please contact me at (202) 927-0009, or Shiela Michel, Manager, Financial Audit, at (202) 927-5407.

Attachment



ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

Management Letter

For the Year Ended September 30, 2017

**ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
MANAGEMENT LETTER**

For the Year Ended September 30, 2017

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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

December 18, 2017

Inspector General
Department of the Treasury
875 15th Street, NW,
Washington, DC 20005

Administrator
Alcohol and Tobacco Tax and Trade Bureau
1310 G Street, NW, Box 12
Washington, DC 20005

Gentlemen:

In planning and performing our audit of the financial statements of the Alcohol and Tobacco Tax and Trade Bureau (TTB), as of and for the years ended September 30, 2017 and 2016, 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. 17-03, *Audit Requirements for Federal Financial Statements*, we considered TTB's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of TTB's internal control. Accordingly, we do not express an opinion on the effectiveness of TTB's internal control.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized in Appendix A.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of TTB's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

TTB's responses to the deficiencies identified in our audit are described in Appendix A. TTB's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

The purpose of this letter is solely to describe comments and recommendations intended to improve internal control or result in other operating efficiencies. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

A-1 Controls over HR Connect Third Party Applications Security Controls Monitoring Should be Strengthened

The Alcohol and Tobacco Tax and Trade Bureau (TTB) utilizes the HR Connect application to process their personnel and payroll transactions. The HR Connect application is managed by Treasury Enterprise Business Services, and the application and its General Support System (GSS) is hosted by Treasury Departmental Offices (DO). Treasury procures the HR Connect Software as a Service (SaaS) from DO. DO provides this SaaS to multiple Treasury bureaus and at the time of our audit was in the process of obtaining an annual third-party attestation report to provide to its customers. DO initially expected the final report to be issued in the current audit period to provide to its user organizations. However, a final attestation report was not issued during the audit period.

Since the Statement on Standards for Attest Engagements (SSAE 18) System and Organization Control Report (SOC 1) report was not readily available during the audit period, we tested relevant general IT controls (GITCs) at Treasury's Enterprise Business Services and DO in support of the FY 2017 TTB financial statement audit. In addition, National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53, the Treasury Directive Publication (TD P) 85-01, and the GAO Green Book requires management to assess the effectiveness of the HR Connect security controls.

TTB management did not assess the effectiveness of the HR Connect security controls, which is required by NIST, SP 800-53, TD P 85-01, and the GAO Green Book. Although TTB does not own and/or operate this system, TTB is reliant on HR Connect for the operation of its mission. As such, TTB management is required to assess and determine if applicable controls are in place and are designed and operating effectively to meet TTB's needs.

NIST SP 800-53, Revision 4, *Security and Privacy Controls for Federal Information Systems and Organizations*, states:

SA-9 External Information System Services

The organization:

- a. Requires that providers of external information system services comply with organizational information security requirements and employ [Assignment: organization-defined security controls] in accordance with applicable federal laws, Executive Orders, directives, policies, regulations, standards, and guidance;
- b. Defines and documents government oversight and user roles and responsibilities with regard to external information system services; and
- c. Employs [Assignment: organization-defined processes, methods, and techniques] to monitor security control compliance by external service providers on an ongoing basis.

TD P 85-01, Version 2.4.23, Control AC-20, states:

The organization permits authorized individuals to use an external information system to access the information system or to process, store, or transmit organization-controlled information only when the organization:

- a. Verifies the implementation of required security controls on the external system as specified in the organization's information security policy and security plan; or
- b. Retains approved information system connection or processing agreements with the organizational entity hosting the external information system.

United States Government Accountability Office (GAO) Green Book, dated September 2014, Section 4 *Additional Considerations*, stated:

OV4.01 Management may engage external parties to perform certain operational processes for the entity, such as accounting and payroll processing, security services, or health care claims processing. For the purpose of the Green Book, these external parties are referred to as service organizations. Management, however, retains responsibility for the performance of processes assigned to service organizations. Therefore, management needs to understand the controls each service organization has designed, has implemented, and operates for the assigned operational process and how the service organization's internal control system impacts the entity's internal control system.

TTB does not have a process in place to evaluate the appropriateness of IT controls performed by the third party service provider for HR Connect, including the determination of which controls are essential to its business needs and compliance requirements. TTB was under the impression that through a combination of DO obtaining a SOC 1 Report over IT controls, a FISMA-compliant Authority to Operate (ATO), and the mitigating controls it has in place through business processes, the risks of utilizing HR Connect were addressed. However, TTB has an Independent Assessor that evaluates security controls, as outlined by NIST requirements, for TTB's GSS and major applications.

Without adequate oversight of HR Connect, TTB is unable to ensure its IT security policies and procedures are being enforced. TTB cannot provide a basis by which management can ensure security measures are working, and the exposure for unauthorized access to data is increased for HR Connect. This exposure could result in potential data breach, increased errors, inadvertent deletion of data, and/or critical management decisions based on incorrect, invalid, or inconsistent data.

We recommend that TTB management:

1. Develop a process by which management performs an IT controls needs assessment when procuring external solutions, support, and services with a service organization or provider.
2. Develop and implement policy and procedures to assess the key HR Connect security controls managed by Treasury Enterprise Business Services and DO on a defined frequency.
3. Assess the effectiveness of the HR Connect security controls based on the frequency determined from recommendation 1. For any control gaps identified by TTB management, assess mitigating controls, if applicable, and coordinate with the service organization or provider to obtain controls coverage.

Management Response:

While management concurs with this finding, TTB has assessed the overall financial statement impact of the reported NFR as very low and no further action is planned other than reviewing future SOC 1 reports for HR Connect, when made available by the Treasury Departmental Offices, and determining if any additional compensating controls are necessary.

Currently, TTB has assessed the financial impact of this issue as extremely low, for the following reasons:

1. Limited financial transactions originate in HR Connect;
2. The vast majority financial transactions that originate in HR Connect are reviewed and reconciled in great detail as part of other control activates over award payments;
3. If a control weakness did exist in HR Connect, it, in itself, would not pose a risk to payroll transactions unless TTB's timekeeping system, WebTA, was also compromised;

4. TTB relies on separate control activates, such as frequent reviews of its payroll transactions, payroll employee listings, and employee grade/step information from sources outside of HR Connect, to ensure the Bureau's largest budgetary component is valid, complete, and accurate; and
5. TTB has an Independent Assessor that evaluates security controls, as outlined by NIST requirements, for TTB's general support system (GSS) and major applications and maintains a FISMA-compliant Authority to Operate (ATO).

A-2 Information Produced by the Entity (IPE) Control Gap

Management does not have a process and related controls in place to review the completeness and accuracy of Information Produced by the Entity (IPE) when it is used in the course of Management's controls and operations.

OMB Circular No. A-123, Management's Responsibility for Internal Control, states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs."

GAO Green Book 13.05 states, "Management states, processes the obtained data into quality information that supports the internal control system. This involves processing data into information and then evaluating the processed information so that it is quality information. Quality information meets the identified information requirements when relevant data from reliable sources are used. Quality information is appropriate, current, complete, accurate, accessible, and provided on a timely basis. ... Management uses the quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks."

TTB lacks the policies and procedures to ensure controls over reports generated through system software are designed, implemented, and operating effectively to ensure completeness and accuracy of the information provided.

Management relies on system generated reports without controls to ensure that the reports are complete and accurate. Failing to ensure that reports are complete and accurate increases the risk that potential misstatements are not prevented nor detected.

We recommend that management establish and implement policies, procedures, and controls to ensure that IPE is complete and accurate.

Management Response:

While management concurs with this finding, TTB has assessed the overall financial statement impact of the reported NFR as extremely low and no further action is planned.

Currently, TTB has assessed the financial impact of this issue as extremely low, for the following reasons:

1. Report results are routinely compared to check figures from sources like the trial balance and line items from the financial statements, as well as budget documentation that staff members are intimately familiar with, such as funding amounts in the appropriation law, apportionments, and internally developed financial plans;
2. Financial statements for TTB are prepared by three separate entities: Treasury, Bureau of the Fiscal Service Administrative Resource Center (ARC), and TTB. The financial statements are independently compiled from separate sources, the first two from sources originating directly from Oracle. The statements are compared on a monthly basis and provide the means to identify differences and make updates where necessary; and
3. TTB relies heavily on the controls of its service provider, ARC, for accounting, budget, payroll, human resource, travel, procurement, and other data/reports, which have no reported weakness and, as a result, significantly reduce TTB's IPE risk exposure.

A-3 Tax and Trade Receivable Allowance Review Control Gap

Management does not have a control in place to ensure the review of the collectability of Tax and Trade Receivables is updated, for any activity occurring between the review date and year end. Specifically, the Tax and Trade Receivables that have a gross value over \$250K are reviewed to determine the collectability of the balance due. This is done by reviewing all of the case information known as of the date of the review, in late September, and then determining the likely collectible value. For one such receivable, TTB identified that there was an Offer in Compromise (OIC) in process and noted that only that amount would be collected. However, between the date of review and year end the OIC was paid by the taxpayer, but TTB failed to adjust the assessed collectible amount to reflect that there was no longer any collectible amount remaining. As a result we identified this as a control gap and a related audit misstatement.

OMB Circular No. A-123, Management's Responsibility for Internal Control, states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs."

GAO Green Book OV3.06 states, "In evaluating operating effectiveness, management determines if controls were applied at relevant times during the period under evaluation, the consistency with which they were applied, and by whom or by what means they were applied."

Section 12.04, also states, "... Procedures may include the timing of when a control activity occurs and any follow-up corrective actions to be performed by competent personnel if deficiencies are identified"

TTB failed to identify the potential control gap, related to the timing of the review of the collectability of tax receivables.

Due to the specific item nature of the assessment, failure to properly review the collectability of the Tax and Trade Receivables resulted in a \$312,000 gross up of the receivables and the offsetting custodial liability on the balance sheet as well as the Accrual Adjustment and the Increase / (Decrease) in the amounts to be provided on the Statement of Custodial Activity.

We recommend that management establish and implement a controls to ensure that the Tax and Trade Receivable Collectability Analysis is reviewed properly.

Management Response:

Management concurs with the Notification of Finding and Recommendation.

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