



**PRIVACY AND CIVIL LIBERTIES
OVERSIGHT BOARD**

**FISCAL YEAR 2018
FINANCIAL STATEMENT REPORT**

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Independent Auditor's Reports

Independent Auditor's Report on the Financial Statements

To the Chairman and Board of the Privacy and Civil Liberties Oversight Board

Report on the Financial Statements

We were engaged to audit the accompanying balance sheets of the Privacy and Civil Liberties Oversight Board (PCLOB), as of September 30, 2018 and 2017 and the related statements of net cost, changes in net position, and budgetary resources for the fiscal years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements 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*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. Because of the matters described in the Basis for Disclaimer of Opinion section below, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion that the financial statements are free from material misstatement when taken as a whole. PCLOB was unable to assert that the financial statements are presented in accordance with accounting principles generally accepted in the United States of America. We were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to support the completeness and accuracy of the financial statements as of September 30, 2018 and 2017 in accordance with accounting principles generally accepted in the United States of America as detailed in the following conditions:

- Inadequate Internal Controls Environment and Insufficient Governance Structure and Financial Resources
- Inadequate Controls over Financial Reporting and Account Reconciliation Processes

- Inadequate Controls over Recognizing and Reporting of Property, Plant & Equipment
- Inadequate Controls over Recording of Undelivered Orders, Accounts Payable, and Expenditures
- Inadequate Controls over Recording of Advances and Prepayments

The effects of the conditions described in the preceding section cannot be fully quantified, nor was it practical, given the available information, to extend audit procedures to sufficiently determine the extent of the misstatements to the financial statements. The effects of the conditions discussed in the preceding section and overall challenges in obtaining sufficient audit evidence also makes it impractical to execute all planned audit procedures. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary for the elements making up the PCLOB financial statements as of and for the years ended September 30, 2018 and 2017.

Disclaimer of Opinion on the Financial Statements

Because of the significance of the matters described in the Basis for Disclaimer of Opinion section above, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements as of September 30, 2018 and 2017.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the *Required Supplementary Information*, including *Management's Discussion and Analysis*, be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. The supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the basic financial statements. PCLOB did not prepare the *Required Supplementary Information*, including the *Management's Discussion and Analysis*. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because of matters described in the Basis of Disclaimer of Opinion section above. We do not express an opinion or provide any assurance on the information.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. Other Information as named in the Agency Financial Report is presented for purposes of additional analysis and is not a required part of the financial statements. PCLOB did not prepare the *Other Information*. Had PCLOB prepared the *Other Information*, such information would not have been subjected to auditing procedures applied in the audit of the financial statements; accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with U.S. *Government Auditing Standards* and OMB Bulletin No. 19-01, we have also issued our reports dated February 25, 2019, on our consideration of PCLOB's internal control over financial reporting and the results of our tests of its compliance with certain provisions of laws, regulations, and other matters that are required to be reported under *Government Auditing Standards*. 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 an audit performed in accordance with U.S. *Government Auditing Standards* and OMB Bulletin 19-01 in considering PCLOB's internal control and compliance, and should be read in conjunction with this report in considering the results of our audit.

This report is intended solely for the information and use of PCLOB management and Board, OMB, U.S. Government Accountability Office, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Castro & Company, LLC

February 25, 2019

Alexandria, VA

Independent Auditor's Report on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Chairman and Board of the Privacy and Civil Liberties Oversight Board

We were engaged to audit the financial statements of the Privacy and Civil Liberties Oversight Board (PCLOB), which comprise the balance sheets as of September 30, 2018 and 2017, and the related statements of net cost, changes in net position, and budgetary resources for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated February 25, 2019. We were engaged to perform 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. 19-01, *Audit Requirements for Federal Financial Statements*. Our report disclaims an opinion on such financial statements because we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Internal Control Over Financial Reporting

In planning and performing our engagement to audit the financial statements as of and for the year ended September 30, 2018, we considered PCLOB's internal control over financial reporting by obtaining an understanding of the design effectiveness of PCLOB's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of PCLOB's controls as a basis for designing our auditing procedures for the purpose of expressing an opinion on the effectiveness of PCLOB's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PCLOB's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-01. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings to be material weaknesses. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purposes described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our engagement to audit, we did not identify any deficiencies in internal control that we consider to

be significant deficiencies. We did identify certain deficiencies in internal control, described in the Schedule of Findings below, that we consider to be material weaknesses.

PCLOB's Response to Findings

PCLOB's response to the findings identified in our engagement to audit is described in a separate memorandum attached to this report. PCLOB's response was not subject to auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

We noted less significant matters involving internal control and its operations which we have reported to PCLOB management in a separate letter dated February 25, 2019.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of PCLOB's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PCLOB's internal control. Accordingly, this communication is not suitable for any other purpose.

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

A handwritten signature in black ink that reads "Castro & Company, LLC". The signature is written in a cursive, slightly slanted style.

February 25, 2019

Alexandria, VA

Schedule of Findings

Material Weaknesses

Through the course of our audit work, internal control deficiencies were encountered which were considered for the purposes of reporting on internal control over financial reporting for PCLOB. The five material weaknesses identified during our engagement to audit presented below have been formulated based on our determination of how individual control deficiencies in aggregate, affect internal controls over financial reporting.

- I. Inadequate Internal Controls Environment and Insufficient Governance Structure and Financial Resources
- II. Inadequate Controls over Financial Reporting and Account Reconciliation Processes
- III. Inadequate Controls over Recognizing and Reporting of Property, Plant & Equipment
- IV. Inadequate Controls over Recording of Undelivered Orders, Accounts Payable, and Expenditures
- V. Inadequate Controls over Recording of Advances and Prepayments

I. Inadequate Internal Controls Environment and Insufficient Governance Structure and Financial Resources

Deficiencies in two related areas define this material weakness:

- A. Internal Control Environment
- B. Accounting and Financial Reporting Governance Structure and Financial Resources

Background: Entity-level internal controls relate to an entity's control environment, risk assessment processes, information and communication, and monitoring of control effectiveness over time. They are enterprise-wide and have a pervasive effect on an entity's internal control system. The Federal Managers' Financial Integrity Act (FMFIA) of 1982¹ (Public Law 97-255) requires each Executive agency to establish and implement controls in accordance with standards prescribed by the Comptroller General of the United States, as codified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (the Green Book).

A. Internal Control Environment

PCLOB did not meet the standards for an effective internal control system, as defined in GAO's Green Book. PCLOB did not establish an adequate risk assessment process and evaluation of its systems of internal accounting and administrative controls; as such, it did not preemptively self-identify auditor identified pervasive internal control weaknesses or comply with FMFIA. Although PCLOB began drafting certain manuals regarding its internal controls, it did not have detailed desk procedures to allow PCLOB's Chief Financial Officer (CFO) office personnel to properly perform their accounting and oversight functions. Due to PCLOB's ineffective internal control system, as discussed in our Independent Auditor's Report on the Financial Statements, we were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to support the completeness and accuracy of the financial statements as of September 30, 2018 and 2017 in accordance with accounting principles generally accepted in the United States of America.

PCLOB was in sub-quorum status from January 2017 to October 2018, was without a Chairman from July 2016 to October 2018, and lacked the ability to hire between July 2016 and January 2018; all of these factors contributed to PCLOB's large number of vacancies within the oversight, accounting, and financial reporting positions negatively affecting PCLOB's ability to comply with FMFIA requirements. Further, PCLOB's large number of vacancies also contributed to its inability to ensure it had detailed desk procedures to allow PCLOB's CFO office personnel to properly perform their accounting and oversight functions.

Public Law 97-255, *Federal Managers' Financial Integrity Act of 1982*, states,

"...internal accounting and administrative controls of each executive agency² shall be established...evaluation by agencies of their systems of internal accounting and administrative control to determine such systems' compliance with the requirements of paragraph (1) of this

¹ This code provision applies to PCLOB to the extent consistent with its status as an ATDA agency, 31 U.S.C. § 3515, and its modified GPRA compliance.

² Appendix C of OMB Bulletin 19-01 (October 4, 2018) lists PCLOB as a "covered executive agency" subject to the ATDA. 31 U.S.C. § 3515(f).

subsection...the head of each executive agency shall, on the basis of an evaluation conducted in accordance with guidelines prescribed under paragraph (2) of this subsection, prepare a statement -

‘(A) that the agency's systems of internal accounting and administrative control fully comply with the requirements of paragraph (1); or

‘(B) that such systems do not fully comply with such requirements.

...the head of such agency shall include with such statement a report in which any material weaknesses in the agency's systems of internal accounting and administrative control are identified and the plans and schedule for correcting any such weakness are described...”

GAO's *Green Book* issued 2014 effective 2016, paragraphs 6.02-6.03, 7.08, 10.03, states,

“Management defines objectives in specific and measurable terms to enable the design of internal control for related risks...Management defines objectives in specific terms so they are understood at all levels of the entity...Management designs responses to the analyzed risks so that risks are within the defined risk tolerance for the defined objective. Management designs overall risk responses for the analyzed risks based on the significance of the risk and defined risk tolerance...”

Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination. The documentation may appear in management directives, administrative policies, or operating manuals, in either paper or electronic form. Documentation and records are properly managed and maintained...”

Without an effective entity-level internal control program in place, PCLOB is susceptible to inefficient and ineffective operations, unreliable financial reporting, and noncompliance with laws and regulations. PCLOB did not have an adequate system of internal controls throughout the fiscal year, which led to auditor identified pervasive internal control weaknesses. Further, as a result of not having appropriate level of detail in its policies and procedures and not performing an adequate risk assessment, PCLOB's CFO office personnel were unable to effectively monitor the control activity to properly perform their accounting and oversight functions.

Recommendations:

We recommend that PCLOB management:

1. Establish a structured and documented process for risk assessment and evaluation of its systems of internal accounting and administrative controls. This process should also ensure timely self-identification and correction of agency internal control weaknesses needed for an effective ongoing monitoring of its internal control environment.
2. Complete detailed desk procedures to allow PCLOB's CFO office personnel to properly perform their accounting and oversight functions, and the proper establishment of auditable beginning and current year financial statement balances (2018 and 2019) for the fiscal year 2019 financial statement audit.

B. Accounting and Financial Reporting Governance Structure and Financial Resources

PCLOB did not have an effective enterprise-level accounting and financial reporting governance structure and oversight function to achieve its accounting and financial reporting objectives and responsibilities. PCLOB was in sub-quorum status from January 2017 to October 2018, was without a Chairman from July 2016 to October 2018, and lacked the ability to hire between July 2016 and January 2018; all of these factors contributed to PCLOB's large number of vacancies within the oversight, accounting, and financial reporting positions. PCLOB's current organizational structure lists the following essential oversight and accounting and financial reporting management positions which were vacant throughout the entire fiscal year of 2018: PCLOB's Chairman of the Board; four (4) board members, and three (3) directors to include the CFO, Internal Controls Officer, and Chief Information Officer.

PCLOB did not have sufficient resources to implement financial reporting requirements and adequate internal controls in place to ensure that the financial statements and supporting information were thoroughly prepared, reviewed and presented in accordance with applicable OMB guidance and Federal financial accounting standards. Additionally, PCLOB placed heavy reliance on the U.S. Department of Agriculture (USDA) and General Services Administration (GSA), which provide financial management and payroll support services to PCLOB including USDA's preparation of PCLOB's financial statements. PCLOB, however, is responsible for the review and approval of its financial statement package, account reconciliations and management reports prepared by its service providers.

During the performance of our engagement to audit, we identified material errors in PCLOB's financial statements which were contributed to by the following conditions:

- Key vacancies in PCLOB's oversight board impacted PCLOB's ability to establish effective policies, procedures, and to oversee and approve PCLOB's hiring of individuals with the prerequisite knowledge, skills, and abilities to carry out the day to day accounting and financial reporting functions.
- Key vacancies in PCLOB's financial management and reporting team, to include a CFO and accounting staff to carry out day to day accounting and financial reporting functions, impacted PCLOB's ability to effectively accumulate, assemble, and analyze information presented in its financial statements in accordance with applicable guidance. Although PCLOB assigned personnel to fill these positions temporarily while these vacancies existed, these replacement personnel have a background in law and budget, but lack experience in accounting and financial reporting. Further, PCLOB's Budget Officer was performing accounting functions usually assigned to the role of a staff accountant or accounting supervisor.
- PCLOB lacked a process in place to cross-train personnel to perform day-to-day financial accounting, analysis, review, approval of work performed by PCLOB's service providers such as reconciliations and management reports, and other financial reporting tasks.

We identified the following causes that are related to the conditions listed above:

- The key vacancies in PCLOB's board that caused it to enter into sub-quorum status were due to previous board member resignations and political delays involved with appointing new board members that were out of PCLOB management's control.
- As a result of PCLOB not having a full-time Chairman and Human Resources Specialist (as well as a mandatory office move), PCLOB's hiring process was limited during fiscal year 2018. Therefore, PCLOB's financial team did not have sufficient or adequate resources; nor did it have personnel with appropriate skill sets and expertise to perform financial management accounting and reporting functions throughout the fiscal year.
- PCLOB had not designed and implemented an annual accounting and financial reporting training process for personnel performing day to day accounting functions.

GAO's *Green Book*, paragraphs 4.02, 4.04, and 4.06-4.08 states,

“Management establishes expectations of competence for key roles, and other roles at management's discretion, to help the entity achieve its objectives. Competence is the qualification to carry out assigned responsibilities. It requires relevant knowledge, skills, and abilities, which are gained largely from professional experience, training, and certifications. It is demonstrated by the behavior of individuals as they carry out their responsibilities...Personnel need to possess and maintain a level of competence that allows them to accomplish their assigned responsibilities, as well as understand the importance of effective internal control. Holding individuals accountable to established policies by evaluating personnel's competence is integral to attracting, developing, and retaining individuals. Management evaluates competence of personnel across the entity in relation to established policies. Management acts as necessary to address any deviations from the established policies. The oversight body evaluates the competence of management as well as the competence overall of entity personnel...”

Management defines succession and contingency plans for key roles to help the entity continue achieving its objectives. Succession plans address the entity's need to replace competent personnel over the long term, whereas contingency plans address the entity's need to respond to sudden personnel changes that could compromise the internal control system...Management defines succession plans for key roles, chooses succession candidates, and trains succession candidates to assume the key roles. If management relies on a service organization to fulfill the assigned responsibilities of key roles in the entity, management assesses whether the service organization can continue in these key roles, identifies other candidate organizations for the roles, and implements processes to enable knowledge sharing with the succession candidate organization...Management defines contingency plans for assigning responsibilities if a key role in the entity is vacated without advance notice. The importance of the key role in the internal control system and the impact to the entity of its vacancy dictates the formality and depth of the contingency plan.”

Without an effective enterprise-wide financial management governance and oversight process in place, inconsistent policies and procedures can lead to control failures and potential misstatements in the financial statements. Without adequate staffing levels, the proper skill sets, and cross-training, PCLOB's financial team will continue to encounter challenges in its accounting and financial reporting processes. Effective management oversight greatly increases PCLOB's ability to proactively identify

and resolve issues that could result in misstatements in accounting and financial reporting records; however, lack of segregation of duties caused by extensive vacancies greatly detracts from this ability. Further, the large number of vacancies within the oversight positions, accounting, and financial reporting positions of PCLOB has the potential to lead to additional internal control gaps within the agency that may hinder the accounting and financial reporting team's ability to effectively manage the financial operations of the agency and ensure the reliability of financial reporting.

Recommendations:

We recommend that PCLOB management:

3. Perform an assessment of its organizational structure and develop a plan to ensure the CFO's Office is adequately staffed with individuals that possess adequate experience in Federal accounting and financial reporting, and with relevant certifications. Once the assessment is completed, corrective action should be taken for any deficiencies identified in current staffing competencies or additional staffing needs. The plan should also ensure that appropriate staffing levels are monitored on an ongoing basis, with succession planning and cross-training.
4. Design and implement a structured annual Federal accounting and financial reporting training program to enhance PCLOB's ability to produce accurate and reliable financial statements, account reconciliations and other financial information that comply with Federal accounting standards.

II. Inadequate Controls over Financial Reporting and Account Reconciliation Processes

PCLOB's financial reporting process includes the preparation of PCLOB's financial statements including the related notes and disclosures. PCLOB's Shared Service Provider (SSP), USDA, prepares the financial statements and provides them to PCLOB's CFO office personnel. Currently, PCLOB relies heavily on USDA to perform financial reporting functions such as preparing the financial statements and the notes to the financial statements.

The Accountability of Tax Dollars Act of 2002 (ATDA) extends to PCLOB the requirement to submit to OMB audited financial statements. OMB Circular No. A-136, *Financial Reporting Requirements*, defines the form and content of financial statements to be prepared by PCLOB. To accomplish the objective of complying with the ATDA, PCLOB is required to develop a process to prepare a complete set of financial statements in accordance with U.S. generally accepted accounting principles. The statements are to result from an integrated financial reporting process containing sufficient structure, effective internal control and reliable data. Financial reporting also consists of policies and procedures related to the processing and summarizing of accounting entries, and the preparation of financial statements.

We were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to support the completeness and accuracy of the financial statements as of September 30, 2018 and 2017 in accordance with accounting principles generally accepted in the United States of America. During our testing of PCLOB's financial statement preparation, we noted that improvement is needed to ensure that PCLOB can accurately produce its financial statements and perform related analyses. The errors we noted related to incorrect accumulation of account balances and incorrect postings to the accounting system. These errors occurred because of ineffective management reviews

and approvals to ensure that transactions and adjustments were accurate and properly supported. A major objective of internal control is to ensure the integrity of the underlying accounting data supporting the financial statements. A key control is performing reconciliations of significant account balances. An adequate reconciliation provides assurances that transactions are properly processed and recorded in the accounting records in a timely manner.

During our review of PCLOB's financial statement preparation and account reconciliation processes, we identified certain issues, as summarized below that impacted PCLOB's ability to effectively accumulate, assemble, and analyze information presented in its financial statements in accordance with applicable guidance and standards. Specifically, we noted the following:

- PCLOB did not prepare a complete Agency Financial Report (AFR) in accordance with OMB A-136 requirements, including the Required Supplementary Information (RSI), such as the Management's Discussion and Analysis (MD&A), and Other Information (OI) such as the Fraud Reduction Report.
- PCLOB did not review the System and Organization Control (SOC) 1/ Statement on Standards for Attestation Engagements (SSAE) No. 18 reports for the GSA Payroll Accounting and Reporting System and USDA's Pegasys Financial Services (PFS) and did not implement any complementary user entity controls (CUECs). For example, PCLOB did not determine the completeness and accuracy of data input and output of data submitted to its services providers such as reviewing and approving USDA's monthly Fund Balance with Treasury (FBwT) reconciliation.
- USDA did not provide PCLOB with crosswalks that were used to prepare PCLOB's September 30, 2018 financial statements; as such, PCLOB did not have any controls in place to review the financial statement crosswalks and PCLOB did not prepare a financial statement crosswalk on its own to validate the accuracy and presentation of all balances reported in its financial statements. For example, for its fiscal year 2018 financial statements, PCLOB/USDA misclassified its 465000 – Allotments – Expired Authority general ledger account in the Unapportioned, Unexpired Accounts line of its Statement of Budgetary Resources (SBR) when it should have been classified in the Expired Unobligated Balance, End of Year line of its SBR.
- PCLOB did not prepare a timely analysis, including explanations of significant variances between its current and prior year financial statements as required by OMB A-136.
- PCLOB did not have controls in place to ensure that all on top Journal Vouchers (JVs) prepared by USDA documented the purpose of the JV, were accurate and complete, and were properly approved by appropriate PCLOB CFO office personnel for inclusion in the financial statements.
- PCLOB has not designed and implemented the following monitoring controls to ensure that all major elements of its financial statements were accurate and properly supported:
 - The financial statement package did not contain evidence of final review and approval by PCLOB management.
 - PCLOB did not review and approve reconciliations and accounting entries against key supporting documents to ensure that they were properly posted to the Pegasys general ledger (GL) by USDA and GSA. For example, this would include comparing FBwT Government-wide Accounting (GWA) Statement to the trial balance; comparing

appropriations received against any Treasury Warrants received; and comparing reimbursable authority against any Standard Form (SF) 132 – Apportionment and Reapportionment Schedules received.

- For process areas not prepared by USDA or GSA, PCLOB did not have a process in place for preparing, reviewing and approving key account reconciliations from supporting documentation to the trial balance, including of property, plant, and equipment (PP&E), advances and prepayments, and accounts payable (AP).

We identified the following causes that are related to the conditions listed above:

- Due to PCLOB's lack of an ability to hire between July 2016 and January 2018 and because it was without a Chairman from July 2016 to October 2018, PCLOB's large number of vacancies within the oversight, accounting, and financial reporting positions negatively affected PCLOB's ability to stay current with financial reporting requirements and have sufficient controls in place throughout the fiscal year to ensure that the financial statements were thoroughly prepared, reviewed, and presented in accordance with applicable OMB guidance and Federal financial accounting standards.
- Although USDA and GSA provide support services to PCLOB, including the preparation of PCLOB's financial statements and account reconciliations, PCLOB is still responsible for the review and approval of its financial statement package and account reconciliations performed by its service providers. Based on PCLOB's current processes, it is placing heavy reliance on its service providers, and as such, has not provided the appropriate level of oversight of its service provider's work.
- PCLOB did not have written policies and procedures in place for its financial reporting process to ensure that the statements prepared by USDA were free of misstatements and accurately represented the financial condition of PCLOB. Additionally, it was unaware of its requirement to implement CUECs as recommended in the GSA/ Payroll Accounting and Reporting System and USDA/PFS SOC 1/ SSAE 18 reports.

Statement of Federal Financial Accounting Standards (SFFAS) No. 15, *Management's Discussions and Analysis*, paragraphs 1-3, states,

“A report that presents a Federal reporting entity's financial statements in conformance with Federal accounting principles should include management's discussion and analysis (MD&A) of the financial statements and related information. MD&A should provide a clear and concise description of the reporting entity and its mission, activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition. MD&A should provide a balanced presentation that includes both positive and negative information about these topics. MD&A should be regarded as “required supplementary information” as that term is used in auditing standards.”

OMB Circular A-136, Revised (7/30/2018), *Financial Reporting Requirements*, states,

“II. 1.1 Required Contents of the AFR or PAR

Agency Head Transmittal Letter. Pursuant to the Reports Consolidation Act of 2000, a transmittal letter from the Agency Head must be included. The letter must contain an

assessment by the Agency Head of the reliability and completeness of financial and performance data in the report and describe any material internal control weaknesses and actions the agency is taking to resolve the weaknesses...

II.4.6. Fraud Reduction Report

Under the Fraud Reduction and Data Analytics Act of 2015 (Pub. L. 114-186, 31 USC 3321 note), each agency must include in its AFR or PAR a report on its fraud reduction efforts..."

GAO's *Green Book*), paragraphs OV1.05 and 10.03, state,

"Internal control is not one event, but a series of actions that occur throughout an entity's operations. Internal control is recognized as an integral part of the operational processes management uses to guide its operations rather than as a separate system within an entity. In this sense, internal control is built into the entity as a part of the organizational structure to help managers achieve the entity's objectives on an ongoing basis..."

Management designs appropriate types of control activities for the entity's internal control system. Control activities help management fulfill responsibilities and address identified risk responses in the internal control system. Examples of Common Categories of Control Activities: ...Establishment and review of performance measures and indicators...Segregation of duties...Proper execution of transactions...Accurate and timely recording of transactions... Appropriate documentation of transactions and internal control...

Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination. The documentation may appear in management directives, administrative policies, or operating manuals, in either paper or electronic form. Documentation and records are properly managed and maintained."

We have identified the following effects related to the above identified conditions:

- Without performing a detailed management review to ensure its financial statements are in compliance with the requirements of OMB Circular A-136, PCLOB increases the risk that its financial statements present inaccurate, misleading and/or inconsistent information.
- A lack of controls and written policies and procedures in place at PCLOB increases PCLOB's risk that transactions will be processed in a manner inconsistent with applicable accounting standards; thereby causing the financial records and statements to be misstated.
- Without reviewing and implementing CUECs recommended by its service providers (e.g., USDA/GSA) in the service auditor issued SOC 1/SSAE 18 reports, PCLOB increases the risk that its financial statements and the accompanying notes (as a whole) could be materially misstated.

Due to lack of adequate performance of management functions specific to monitoring, analysis, review and oversight, discrepancies may exist but go undetected and uncorrected; thereby, causing the financial information to be misstated. Effective management oversight greatly increases

PCLOB's ability to proactively identify and resolve issues that could result in misstatements to its financial statements.

Recommendations:

We recommend that PCLOB management:

5. Prepare a complete AFR in accordance with applicable OMB A-136 requirements, including the RSI such as the MD&A and associated FMFIA assurance statement, and OI such as the Fraud Reduction Report.
6. Establish a procedure to annually review, document, and implement the CUECs recommended in the GSA/ Payroll Accounting and Reporting System and USDA/PFS SOC 1/ SSAE 18 reports.
7. Establish and document policies and procedures over the financial statement preparation process which clearly identify financial reporting functions to be performed by USDA and those to be performed by PCLOB, and which establish a process for PCLOB's CFO office personnel to review USDA prepared elements of the financial reporting process prior to final submission of PCLOB's AFR.
8. Ensure analysis including sufficient and supported explanations of significant variances between its current and prior year financial statements as required by OMB A-136 are prepared by either USDA or PCLOB and reviewed by PCLOB's CFO Office personnel before finalizing its financial statements.
9. Design and implement policies and procedures for PCLOB to ensure controls are in place for reviewing and approving USDA prepared on top JVs to ensure that they are accurate, complete, supported, and have been properly approved by appropriate PCLOB's CFO office personnel for inclusion in the financial statements.
10. Design and implement monitoring controls over each of PCLOB's key financial reporting and account reconciliation process areas to assist in identifying and correcting errors that may otherwise go undetected on PCLOB's financial statements. Additionally, ensure that PCLOB evidences its review and approval of the financial statement package. Further, to proactively assist in ensuring completeness and accuracy of PCLOB's financial statement package and compliance with Federal reporting requirements, consider developing and utilizing a PCLOB specific financial reporting checklist as a best practice, or regular use of the GAO Financial Audit Manual (FAM) 2010 – *Checklist for Federal Accounting*, and of the 2020 – *Checklist for Federal Reporting and Disclosures* checklist.
11. Develop and provide on-going training to PCLOB staff on Federal accounting and reporting requirements to enhance PCLOB's ability to prepare its AFR and account reconciliations in accordance with applicable standards.

III. Inadequate Controls Over Recognizing and Reporting of Property, Plant & Equipment

Deficiencies in two areas define this material weakness:

- A. Recognizing and Recording Capital Equipment and Construction-in-Process

B. Leases and Leasehold Improvements

A. Recognizing and Recording Capital Equipment and Construction-in-Process

Since PCLOB's Board approved and issued its PP&E capitalization and depreciation policy on March 9, 2018, PCLOB recorded current year purchases as "bulk purchases" on its financial statements. PCLOB's current capitalization threshold is \$5,000. Castro & Company identified the following PP&E related conditions:

- PCLOB has retained ownership of capital equipment that it procured in previous fiscal years; however, since the March 9th policy was approved, it had not yet adjusted prior year amounts to reflect its possession of these assets as "individual units" onto its financial statements.
- We identified a material audio-visual (AV) contract that PCLOB entered into that has the entire equipment contract line item (CLIN) physically delivered in fiscal year (FY) 2018, but that had not yet been recorded as construction in-progress (PP&E) onto its financial statements.

We were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to support the completeness and accuracy of PP&E as of September 30, 2018 and 2017 in accordance with accounting principles generally accepted in the United States of America.

We identified the following causes that are related to the conditions listed above:

- PCLOB did not have a PP&E policy on capitalization and depreciation in place until March 9, 2018; although PCLOB recorded bulk equipment purchases made in FY 2018 after issuance of this policy, it had not yet gone back in time to capitalize assets as "individual units" for equipment still in its possession that were procured in prior fiscal years and were above its capitalization threshold.
- PCLOB's PP&E policy covers "bulk purchases" but does not address how to systematically track and capitalize "bulk purchase" assets as construction in-progress in situations where equipment on "bulk purchase" contracts have been physically received and substantially, but not yet fully, placed in service.
- PCLOB did not complete receiving reports for "bulk purchase" equipment received under its AV contract throughout the fiscal year to quantify the total dollar amount of AV equipment currently in its possession that it was required to record as construction in-progress onto its general ledger. However, we conducted our walkthrough in the conference room equipped with the AV system that appeared to be substantially complete, functional, and in use (e.g., functioning televisions, phone lines, conference lines, etc.).

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 17, states,

"Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria:

- they have estimated useful lives of 2 years or more;
- they are not intended for sale in the ordinary course of operations; and
- they have been acquired or constructed with the intention of being used, or being available for use by the entity."

SFFAS No. 6, paragraph 26, states,

“All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors
- transportation charges to the point of initial use;
- handling and storage costs;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid.”

SFFAS No. 6, paragraphs 34-37, states,

“PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E.

Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E, except land and land rights of unlimited duration.

Depreciation expense shall be accumulated in a contra asset account—accumulated depreciation... General PP&E shall be reported in the basic financial statements: the balance sheet, and the statement of net cost. The acquisition cost of general PP&E shall be recognized as an asset. Subsequently, except for land which is a nondepreciable asset, that acquisition cost shall be charged to expense through depreciation. The depreciation expense shall be accumulated in a contra asset account—accumulated depreciation...

Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity shall be capitalized and depreciated/amortized over the remaining useful life of the associated general PP&E.”

SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraphs 81-82, states,

“The net cost of operations should be adjusted by

- components of net cost that are not part of net outlays (e.g., depreciation and amortization expenses of assets previously capitalized, change in asset/liabilities);
- components of net outlays that are not part of net cost (e.g., acquisition of capital assets); and
- other temporary timing differences (e.g., prior period adjustments due to correction of errors).

The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between net outlays and the accrual basis amounts used in financial accounting.”

SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*, paragraphs 10-11, states,

“Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared.” When errors are discovered after the issuance of financial statements, and if the financial statements would be materially misstated absent correction of the errors, corrections should be made as follows:

- ...If comparative financial statements are presented, then the error should be corrected in the earliest affected period presented by correcting any individual amounts on the financial statements. If the earliest period presented is not the period in which the error occurred, and the cumulative effect is attributable to prior periods, then the cumulative effect should be reported as a prior period adjustment. The adjustment should be made to the beginning balance of cumulative results of operations, in the statement of changes in net position for the earliest period presented.
- The nature of an error in previously issued financial statements and the effect of its correction on relevant balances should be disclosed. Financial statements of subsequent periods need not repeat the disclosures.

Prior period financial statements should only be restated for corrections of errors that would have caused any statements presented to be materially misstated.

GAO' *Green Book*, paragraph 10.03, states,

“Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records. In addition, management designs control activities so that all transactions are completely and accurately recorded.”

United States Department of the Treasury's (Treasury), *U.S. Standard General Ledger (USSGL) – a Treasury Financial Manual Supplement*, Bulletin No. 2018-05, Account Transactions – section III, entry code B604, states,

“To record the current-year expended authority where the undelivered order was prepaid or advanced. The current-year authority is the same as the original order.

Budgetary Entry

Debit 480200 – Undelivered Orders - Obligations, Prepaid/Advanced

Credit 141000 – Delivered Orders - Obligations, Paid

Proprietary Entry

Debit 172000 – Construction in Progress

Credit 141000 – Advances and Prepayments”

PCLOB Office of the Chief Financial Officer (OCFO) Memorandum, Process Cycle Memorandum for PP&E, effective March 9, 2018, states,

“An item is capitalized when it meets two criteria:

1. Must have an estimated useful life of 2 or more years; and
2. The total cost must equal or exceed the PCLOB's capitalization threshold of \$5,000. Total cost includes all costs incurred to bring the item to a form and location suitable for its intended use (e.g., transportation, contract price, contract fee, installation/labor, etc.).”

We have identified the following effects related to the above identified conditions:

- Although the extent of these potential misstatements may be greater than the amount identified by PCLOB, PCLOB performed a preliminary analysis and identified approximately \$210,145 of capital equipment procured prior to the PP&E capitalization policy effective date of March 9, 2018, but that it had not yet recorded in its comparative financial statements as of September 30, 2018. PCLOB's beginning balance (i.e., September 30, 2017) General PP&E, net line on its Balance Sheet was understated by this amount of capital equipment net relevant accumulated depreciation. Additionally, as these capital equipment purchases were expensed in the period of purchase, prior year gross costs were overstated by this amount of operating expenses/program costs on the Gross Costs line of the Statement of Net Cost (SNC). Further, current year depreciation expense and accumulated depreciation related to this balance were understated on the Gross Costs line of the SNC and on the General PP&E, net line of the Balance Sheet, respectively.
- Without policies and procedures to provide guidance on how to record “bulk purchase” assets as construction in-progress that has been physically received and substantially, but not yet fully, placed in service, the completeness and accuracy of PCLOB's PP&E related balances may continue to be at risk.

- Although PCLOB did not provide receiving reports for and cannot quantify the exact amount of labor that it has received under this AV contract throughout the fiscal year, PCLOB indicated that it has physically received its entire equipment CLIN of approximately \$405,365 but that its contractor is currently in the process of swapping out certain equipment due to malfunctions. In addition to this equipment CLIN, additional potential misstatements related to the AV equipment of the portion of the total \$201,246 labor and direct costs CLINs in PCLOB's AV contract that it has received but not yet fully accepted on contractual basis. PCLOB's PP&E, net line on its September 30, 2018 Balance Sheet was understated by the amount of construction in-progress that PCLOB had received throughout the fiscal year.

Recommendations:

We recommend that PCLOB management:

12. Perform an extensive analysis to determine the completeness and accuracy of the beginning balance of its capital equipment as of September 30, 2018.
 - After identifying a complete and accurate beginning balance figure as of September 30, 2018, if making this correction within fiscal year 2019, post a prior-period adjustment – years preceding the prior year entry to adjust for the effects of this misstatement to the September 30, 2018 beginning balance in PCLOB's fiscal year 2019 comparative financial statements.
13. Perform a retrospective receiving report analysis over any "individual units" or "bulk purchase" equipment received but not yet recorded as construction in-progress (e.g., AV equipment) throughout fiscal year 2018 to determine the dollar amount of construction in-progress that should have been recorded as an asset within fiscal year 2018.
 - After identifying the amount of construction in-progress received within fiscal year 2018, if making this correction within fiscal year 2019, post a prior-period adjustment to adjust for the effects of this misstatement to PCLOB's financial statements.
14. Update PCLOB's PP&E capitalization and depreciation policy to address systematically tracking and recording "bulk purchase" assets as construction in-progress when equipment and portions of any related labor has been physically received and is currently in PCLOB's possession, does not yet fully meet initial operating capability levels, and exceeds PCLOB's capitalization limit.
15. Design and execute training to ensure that PCLOB's financial and IT personnel understand how to use the updated policy for tracking both "individual units" and "bulk purchase" capital equipment.
16. Follow PCLOB's updated capital equipment policy for recording current and future capital equipment and construction in-progress and working with its service provider to timely record all capital equipment and related depreciation in its general ledger and on its financial statements.

B. Leases and Leasehold Improvements

During our audit procedures, we discussed PCLOB's process for obtaining necessary security improvements to its real property occupancy agreement with GSA. PCLOB indicated that although its

previous occupancy agreement was fully furnished with its security needs, its current occupancy agreement requires improvements that PCLOB is responsible for procuring. As part of this occupancy agreement, GSA has summarized PCLOB's Tenant Improvement Allowance (TIA), or financial responsibilities for making this lease fit its security needs, in the form of various award letters. Note: from an accounting perspective, we consider GSA real property occupancy agreements and leases to be one in the same and hereafter, will refer to this occupancy agreement as a lease. Castro & Co has identified the following conditions:

- PCLOB disbursed funds for leasehold improvements without recording them as an asset in its general ledger account code (GLAC) 182000 – Leasehold Improvements. For leasehold improvements currently in progress, PCLOB did not record these amounts into GLAC 172000 – Construction-in-Progress. Specifically, we identified a total amount of \$1,792,888 worth of leasehold improvements payments made by PCLOB within fiscal year 2018.
- PCLOB did not perform a timely lease determination worksheet to determine if its real property lease was an operating or capital lease.

PCLOB personnel stated that it did not consider occupancy agreements to be leases, because they are listed as occupancy agreements, and not leases, on GSA provided documentation. Additionally, PCLOB personnel were not aware of Federal accounting standard requirements to perform a determination as to whether its real property lease was considered an operating or a capital lease for accounting purposes.

SFFAS No. 6, paragraphs 18 and 20, states,

“Property, plant, and equipment also includes:

- assets acquired through capital leases (See paragraph 20), including leasehold improvements...

Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

1. The lease transfers ownership of the property to the lessee by the end of the lease term.
2. The lease contains an option to purchase the leased property at a bargain price.
3. The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
4. The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.”

SFFAS No. 6, paragraphs 34-37, states,

“PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E...

Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E, except land and land rights of unlimited duration...Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity shall be capitalized and depreciated/amortized over the remaining useful life of the associated general PP&E.”

Treasury's *USSGL – a Treasury Financial Manual Supplement*, Bulletin No. 2018-05, Account Transactions – section III, entry codes B402 and D510, respectively, states,

“... ‘To record the delivery of goods or services and to accrue a liability’

Budgetary Entry

Debit 480100 Undelivered Orders - Obligations, Unpaid
Credit 490100 Delivered Orders - Obligations, Unpaid

Proprietary Entry

Debit 182000 Leasehold Improvements...
Debit 141000 – Construction in Progress
Credit 211000 Accounts Payable”

‘To record the transfer of construction-in-progress to capitalized assets or expenses.’

Budgetary Entry

None

Proprietary Entry

Debit 182000 Leasehold Improvements
Credit 141000 – Construction in Progress

‘To record depreciation, amortization, and depletion expense on assets other than investments.’

Budgetary Entry

None

Proprietary Entry

Debit 671000 Depreciation, Amortization, and Depletion
Credit 182900 – Accumulated Amortization on Leasehold Improvements”

We have identified the following effects related to the above identified conditions:

- PCLOB's Gross Cost line of its SNC as of September 30, 2018 was overstated by \$1,792,888 of leasehold improvements previously expensed, less expense amounts that PCLOB misclassified that should have been recorded as an amortization expense. Further, its PP&E line on its Balance Sheet was understated by this same amount, net accumulated amortization.

- PCLOB currently has approximately \$8,641,238 of future lease payments; without performing a capital lease determination, PCLOB may be potentially understating its PP&E and its Other Liabilities lines on its Balance Sheet for this amount. Further, if this amount is determined to be a capital lease, PCLOB's financial statement disclosures would also be incorrect.

Recommendations:

We recommend that PCLOB management:

17. Work with its USDA service provider to post an adjusting entry to reclassify leasehold improvement amounts previously expensed and record as a leasehold improvement asset that rolls up into the General PP&E line, net of accumulated amortization on its Balance Sheet. Further, perform an analysis to determine if it has corrected all relevant leasehold improvements previously expensed, and if performing these adjustments within FY 2019, record a prior period adjustment to account for the material effects of prior period SNC misstatements, to include both reversing expense amounts and posting relevant amortization expenses.
18. Design and implement a process for performing a capital lease determination as to whether any real and personal property leases meet one or more of the four capital lease requirements listed in the criteria above; as part of this process, document PCLOB's methodology to arrive at any conclusions made so that all capital lease test conclusions are properly supported and available for inspection.
19. Retrospectively perform a capital lease determination process for all real and personal property over the capitalization threshold, and in going forward, continue to perform these analyses at the initiation of each new lease term.

IV. Inadequate Controls over Recording of Undelivered Orders, Accounts Payable, and Expenditures

During our audit procedures performed, we noted issues in the recording of undelivered orders (UDO), accounts payables AP, and expenditures. Sufficient documentation was not provided to support the validity of the UDO, AP, and expenditure balances for both fiscal years ending September 30, 2018 and 2017, including accruals not being properly and timely recorded. PCLOB did not perform adequate open obligations reviews throughout the fiscal year, nor did it recognize and record accruals on a regular basis. Rather, management only recorded certain estimated accruals at year-end. During our testing, we noted multiple issues surrounding the accounting for UDO, AP, and expenditures as summarized below:

- PCLOB did not perform an adequate ongoing review of open obligations throughout the fiscal year to determine if they were properly supported and valid obligations. For example, there was a GSA relocation project that was originally initiated on January 2016 and expired January 2018. As of September 30, 2018, PCLOB had not expended any funds on this project, and only posted one unsupported AP accrual in September 2018 for a small portion of the total agreement amount.
- Based on our audit procedures performed related to the current year-end to prior year-end AP balances, PCLOB did not record all its AP transactions as of September 30, 2017.

- Accruals were not recorded on a regular basis throughout both fiscal years 2017 and 2018. PCLOB only performed a one-time estimated accrual within fiscal year 2018 at year-end. We noted that PCLOB did not always have a detailed and documented methodology to accrue for goods/services that were received but not yet paid. Specifically, certain accruals were not supported by proper documentation such as an estimated methodology for determining services received based on past services received and paid.
- PCLOB did not have proper controls in place throughout the fiscal year to ensure documentation for UDO, AP, and expenditure transactions were properly supported. Specifically, PCLOB was not able to provide sufficient obligating documents, receiving reports, invoices, and disbursement support.

We identified the following causes related to the conditions listed above:

- PCLOB did not have policies and procedures to perform ongoing review throughout the fiscal year of open obligations to determine if UDOs, AP, and related expenditures were properly supported and valid transactions.
- As of September 30, 2017, except for an \$839 AP balance, and throughout the majority of fiscal year 2018, PCLOB's widespread process was to wait until the invoice was received to post and immediately reverse AP transactions once the disbursement was made.
- PCLOB did not have policies and procedures to perform ongoing recording of accruals, did not have a consistent and routine process in place across all significant transaction classes to document its receipt and acceptance of goods and services via receiving reports, and for posting the related accounting entries to its general ledger.

SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, paragraphs 74 and 76-77, states,

“Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities... Amounts owed for goods or services received from federal entities represent intragovernmental transactions and should be reported separately from amounts owed to the public. When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated.”

SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, paragraph 15, states,

“Cost is the monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service. Costs incurred may benefit current and future periods. In financial accounting and reporting, the costs that apply to an entity's operations for the current accounting period are recognized as expenses of that period.”

GAO's *Green Book*, paragraph 10.03, states,

“Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records. In addition, management designs control activities so that all transactions are completely and accurately recorded...”

Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination. The documentation may appear in management directives, administrative policies, or operating manuals, in either paper or electronic form. Documentation and records are properly managed and maintained.”

By not performing an adequate open obligations review on a routine basis, the financial data used to generate management reports and financial reports required by applicable laws and regulations are not accurate. As a result, those charged with governance have no reasonable assurance as to whether they have reliable financial information to manage the operations of the Agency. Because PCLOB did not perform the necessary review of open obligations, properly recognize accruals when goods and services were received, or maintain proper documentary transaction support, we could not rely on the UDO, AP, and expenditure balances as of September 30, 2018 and 2017, respectively.

Recommendations:

We recommend that PCLOB management:

20. Establish, document, and implement policies for performing open obligation reviews on a regular basis, including documented quality control procedures and approvals over the reviews. If deemed necessary, coordinate with the agencies/vendors to determine if goods or services were ever received. If the results of this analysis show that that these obligations are not valid, then initiate appropriate contract/agreement closeout procedures.
21. Establish, document, and implement policies to ensure accruals are recorded when goods and/or services are received throughout the fiscal year, at least on a quarterly basis, rather than at only year-end. Accruals recorded should be clearly documented with detailed estimation methodologies to support the amounts recorded. The accrual methodologies should be reviewed and approved by appropriate PCLOB personnel who receive the goods and services, with quality control review procedures and approvals performed and documented by PCLOB's CFO office personnel.
22. Perform a data clean-up for all open obligations and AP general ledger balances to ensure that the balances are properly recorded, with appropriate adjustments posted at the detailed general ledger level.
23. Train responsible PCLOB personnel who receive the goods and services and CFO office personnel on how to monitor obligations and report accruals on an ongoing basis to enhance compliance with the applicable requirements. As part of the training, consider establishing a process for conducting an AP lookback analysis to systematically quantify and estimate goods and services that PCLOB has received, but for which it did not receive an invoice, and record the AP at the transaction level (e.g., review of subsequent disbursements).

24. Design and implement a process, in coordination with USDA, to ensure documentation for UDO, AP, and expenditure transactions are properly supported and timely recorded, including obligating documents, receiving reports (e.g., whether to post an expense, draw down an advance payment, or capitalize an asset), invoices, and disbursement support.

V. Inadequate Controls over Recording of Advances and Prepayments

During our audit procedures performed, we tested PCLOB's process for recording advances and prepayments, and the related budgetary and proprietary accounting entries. Because of the complexities of ensuring that its contracts are written in accordance with applicable laws and regulations, as well as the costs associated with procuring a contracting system of its own, PCLOB has elected to enter into an interagency agreement with the Department of Interior (DOI), whereby DOI establishes contracts with commercial contractors on PCLOB's behalf. PCLOB makes a payment in advance for the full value of the DOI agreement when the agreement is finalized. Further, PCLOB has entered into advance paid arrangements with other intragovernmental trading partners as well. We were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to support the completeness and accuracy of Advance and Prepayments as of September 30, 2018 and 2017 in accordance with accounting principles generally accepted in the United States of America.

We identified the following conditions related to PCLOB's accounting and financial reporting over advances and prepayments and related budgetary and proprietary accounts:

- When making advance payments on contracts initiated by DOI and other intragovernmental trading partners, PCLOB recorded the full amount of the interagency agreement to operating expenses in the proprietary entry, and to Undelivered Orders—Obligations, Unpaid in the accounting period that it makes the advance payment to DOI. PCLOB does not record proprietary and budgetary entries to GLACs 141000 – Advances and Prepayments or 480200 – Undelivered Orders - Obligations, Prepaid/Advanced, respectively. In addition, the entries were incorrectly posted by PCLOB's service provider, USDA on PCLOB's behalf.
- PCLOB's CFO office personnel did not have sufficient quality control procedures in place to detect these accounting and financial reporting errors over advances and prepayments. Instead, the incorrect entries were detected and brought to its attention by the auditors.
- After we brought PCLOB's initial error of recording DOI prepaid advance balances in 480100 instead of in 480200 and related 141000 advances balances to its attention, PCLOB worked with USDA to post an on top adjusting entry to correct this error in its September 30, 2018 financial statements. However, PCLOB and USDA did not correctly record the adjustment, in that it did not remove all advance paid open balances from its undelivered orders accounts (e.g., 480100 – Undelivered Orders - Obligations, 487100 – Downward Adjustments of Prior-Year Unpaid Undelivered Orders – Obligations, Recoveries, and 488100 – Unpaid, Upward Adjustments of Prior-Year Undelivered Orders - Obligations, Unpaid) upon correction of these errors.
- Further, PCLOB did not perform an analysis to determine whether any of the 141000 – Advances and Prepayment and 480200 – Undelivered Orders – Obligations, Prepaid/Advanced balances included in these on top adjusting entries pertain to fiscal year 2017 and required a prior period adjustment.

PCLOB CFO office personnel were not aware that 141000 – Advances and Prepayments and related budgetary and proprietary GLACs such as 480200 – Undelivered Orders - Obligations, Prepaid/Advanced existed, or that they were required to use. Consequently, PCLOB recorded these transactions, as a budgetary entry into the 480100 – Undelivered Orders – Obligations, Unpaid and immediately expensed them as a proprietary entry into 610000 – Operating Expenses/Program Costs in the period that it made advance payments to DOI and other trading partners for these interagency agreements. Additionally, when recording these transactions on PCLOB's behalf, USDA did not advise PCLOB of the correct GLACs to post the transactions to until it was brought to PCLOB's attention by the auditors. Further, although USDA posted an on top adjustment for the fiscal year ending September 30, 2018 in response to the identified material misstatement, the amount posted was incorrect because PCLOB did not perform a thorough analysis to consider all the effects required as part of this cleanup process. Additionally, posting on top adjustment adjusting entries does not allow for PCLOB and USDA to effectively draw down the advances and prepayment balance as part of its regular business process as services are received in the future.

SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, paragraphs 57-61, states,

“*Advances* are cash outlays made by a federal entity to its employees, contractors, grantees, or others to cover a part or all the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Examples include travel advances disbursed to employees prior to business trips, and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee...*Prepayments* are payments made by a federal entity to cover certain periodic expenses before those expenses are incurred. Typical prepaid expenses are rents paid to a lessor at the beginning of a rental period. Progress payments made to a contractor based on a percentage of completion of the contract are not advances or prepayments...Advances and prepayments should be recorded as assets. Advances and prepayments are reduced when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire. A travel advance, for example, should be initially recorded as an asset and should be subsequently reduced when travel expenses are incurred. Amounts of advances and prepayments that are subject to refund (for example, a settled travel claim indicating the traveler owes part of the advance to the government) should be transferred to accounts receivable...Advances and prepayments paid out by an entity are assets of the entity. On the other hand, advances and prepayments received by an entity are liabilities of the entity (see the recommended standard for other current liabilities). In financial reports of an entity, advances and prepayments the entity paid out (assets) should not be netted against advances and prepayments that the entity received (liabilities)...Advances and prepayments made to federal entities are intragovernmental items and should be accounted for and reported separately from those made to nonfederal entities.”

SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, paragraph 15, states,

“...‘Cost’ is the monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service. Costs incurred may benefit current and future periods. In financial accounting and reporting, the costs that apply to an entity's operations for the current accounting period are recognized as expenses of that period.”

GAO's *Green Book*, paragraph 10.03, states,

“Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records. In addition, management designs control activities so that all transactions are completely and accurately recorded...”

Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination. The documentation may appear in management directives, administrative policies, or operating manuals, in either paper or electronic form. Documentation and records are properly managed and maintained.”

Treasury's *USSGL – a Treasury Financial Manual Supplement*, Bulletin No. 2018-05, Account Transactions – section III, entry code B308 and B604, states,

“...‘To record current-year undelivered orders with an advance.’

Budgetary Entry

Debit 461000 Allotments - Realized Resources

Credit 480200 Undelivered Orders - Obligations, Prepaid/Advanced

Proprietary Entry

Debit 141000 Advances and Prepayments

Credit 101000 Fund Balance with Treasury...

‘To record the current-year expended authority where the undelivered order was prepaid or advanced. The current-year authority is the same as the original order.’

Budgetary Entry

Debit 480200 Undelivered Orders - Obligations, Prepaid/Advanced

Credit 490200 Delivered Orders - Obligations, Paid

Proprietary Entry

Debit 610000 Operating Expenses/Program Costs

Credit 141000 Advances and Prepayments”

We identified the following effects on PCLOB's financial statements and internal control environment related to the above auditor identified conditions:

- Based on PCLOB analysis, the initial error of recording 480200 amounts in the 480100 account and immediately expensing these amounts, PCLOB's year-end 141000 – Advances and Prepayment Other Assets line on its Balance Sheet was understated by all undelivered DOI transactions still contributing to PCLOB's 480100 balance. Additionally, PCLOB's Gross Costs line on its SNC as of September 30, 2018 was overstated by all related expenses made within fiscal year 2018.

- Although PCLOB / USDA made an on top adjustment to post advances and prepayments after it prepared its September 30, 2018 financial statements, we identified the following material instances which its on top adjusting entries did not accurately correct the initial error of recording 480200 amounts in the 480100 account and immediately expensing these amounts.
 - PCLOB and USDA left material open balances in its unpaid obligations GLACs (i.e., 480100, 487100, and 488100) with DOI and other intragovernmental trading partners; these open balances should have been removed as part of PCLOB/USDA's on top adjustment entries. These material balances were incorrectly classified between 480100 and 480200 and result in an understatement to the Outlay, Net line on PCLOB's Statement of Budgetary Resources and an overstatement in PCLOB's Gross Costs line on its SNC.
 - During an auditor prepared fluctuation analysis, we noted PCLOB's September 30, 2018 year-end comparative financial statements did not include a balance in 141000 – Advances and Prepayment as of September 30, 2017. Based on PCLOB's analysis used to post its advance and prepayment on top adjusting entries, PCLOB's beginning balance 141000 amount may have been understated on its Balance Sheets.
 - As PCLOB and USDA reclassified transactions from 480100 – Undelivered Orders - Obligations into 480200 – Undelivered Orders - Obligations, Prepaid/Advanced as on top adjustments, it does not currently have any detailed transactions posted in its accounting system against which to systematically draw down these 480200 balances as part of its regular business process in the future.

Further, by relying on auditors to identify deficiencies, discrepancies may exist but go undetected and uncorrected, thereby causing the financial statements to be misstated. Without documented policies and procedures and effective management oversight, including a comprehensive knowledge of accounting entry requirements, PCLOB's ability to proactively identify and resolve issues that could result in misstatements in financial accounting and reporting records greatly decreases.

Recommendations:

We recommend that PCLOB management:

25. Perform a detailed analysis of all intragovernmental agreements where advances are made to determine the proper amounts to be expensed or prepaid and in which current accounting period and/or prior period adjustments should be made, in addition to the listing of DOI interagency agreements that PCLOB/ USDA utilized to post its on top adjusting entries in response to the auditor identified deficiencies listed in the conditions above.
26. Establish and document policies and procedures over identifying and recording advances and prepayments and establish a receiving report process for drawing them down as goods/services are received as part of PCLOB's regular business process (e.g., on a transaction by transaction basis). As part of this new regular business process, work with USDA to ensure these transactions are posted to the general ledger correctly and timely.
27. In coordination with USDA, reverse all incorrectly posted 480100 transactions and generate detailed 480200 entries to continue to draw the 480200 and 141000 balances down on a transaction by transaction basis as part of its regular business process, even though USDA and PCLOB posted on top adjustment entries to move the DOI prepaid advance balance from 480100 to 480200 and related 141000 advances balances.

28. Design and implement robust monitoring controls to detect and correct any transactions that have been improperly classified and to ensure timely draw down to advances and prepayments and related budgetary accounts (e.g., 480200) as work is performed on the agreement.

**Independent Auditor's Report on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance with *Government Auditing Standards***

To the Chairman and Board of the Privacy and Civil Liberties Oversight Board

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*, the financial statements of the Privacy and Civil Liberties Oversight Board (PCLOB) as of and for the years ended September 30, 2018 and 2017, and have issued our report thereon dated February 25, 2019. Our report disclaims an opinion on such financial statements because we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Compliance and Other Matters

The management of PCLOB is responsible for complying with laws and regulations applicable to PCLOB. As part of obtaining reasonable assurance about whether PCLOB's financial statements were free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the financial statements, and certain other laws and regulations specified in OMB Bulletin No. 19-01, including the requirements referred to in the Federal Managers' Financial Integrity Act of 1982 (FMFIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to PCLOB. Providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our testing of compliance with applicable laws and regulations, and government-wide policies described in the preceding paragraph disclosed an instance of reportable noncompliance that is required to be reported under *Government Auditing Standards* or OMB guidance and is described in the following Schedule of Findings. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported therein.

Schedule of Findings

Noncompliance and Other Matters

The Federal Managers' Financial Integrity Act of 1982

The FMFIA requires agencies to establish a process to document, assess, and assert to the effectiveness of internal control over financial reporting. PCLOB has not established and implemented controls in accordance with standards prescribed by the Comptroller General of the United States, as codified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal*

Government (the Green Book), as evidenced by the following material weaknesses included in our Independent Auditor's Report on Internal Control:

- Inadequate Internal Controls Environment and Insufficient Governance Structure and Financial Resources
- Inadequate Controls over Financial Reporting and Account Reconciliation Processes
- Inadequate Controls over Recognizing and Reporting of Property, Plant & Equipment
- Inadequate Controls over Recording of Undelivered Orders, Accounts Payable, and Expenditures
- Inadequate Controls over Recording of Advances and Prepayments

Additionally, as discussed in the first Material Weakness in the Independent Auditor's Report on Internal Control, *Inadequate Internal Controls Environment and Insufficient Governance Structure and Financial Resources*, the audit identified the following instances of noncompliance with FMFIA. PCLOB did not establish an adequate process for risk assessment and evaluation of its systems of internal accounting and administrative controls; as such, it did not preemptively self-identify auditor identified pervasive internal control weaknesses or comply with FMFIA. Due to extensive design and effectiveness internal control failures noted, PCLOB did not achieve the GAO-prescribed principles for an effective internal control system. Additionally, PCLOB lacked an established governance structure and financial resources to effectively implement, direct, and oversee the internal control assessment and evaluation process.

PCLOB's Response to Findings

PCLOB's response to the findings identified in our engagement to audit is described in a separate memorandum attached to this report. PCLOB's response was not subjected to auditing procedures applied in our engagement to audit the financial statements; accordingly, we do not express an opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on PCLOB's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin 19-01 in considering PCLOB's compliance. Accordingly, this communication is not suitable for any other purpose.

This report is intended solely for the information and use of PCLOB's management and Board, OMB, the Government Accountability Office, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Castro & Company, LLC

February 25, 2019
Alexandria, VA

PCLOB Response to Auditor's Reports



PRIVACY AND CIVIL LIBERTIES OVERSIGHT BOARD

TO: Castro & Company, LLC

FROM: Privacy and Civil Liberties Oversight Board

DATE: February 25, 2019

RE: Response to FY 18 Financial Audit Report

On September 30, 2018, when the period covered by this audit ended, the Privacy and Civil Liberties Oversight Board (PCLOB) had ten full-time employees working at the agency. Two were responsible for finance and accounting. The Board had no Chairman—that role had been vacant since July 2016—and only one part-time Board Member, who lived in Chicago. The Board had been without a quorum of Senate-confirmed Members for more than 18 months. Beginning in July 2016, when the previous Chairman departed, the Board was unable to hire new staff members. On top of these challenges, the Board was forced to move offices twice during this period, after its original headquarters location was sold and demolished.

Despite these headwinds, the Board’s tiny staff kept the agency operating, continuing to work on existing oversight and advice projects while maintaining the Board’s ability to survive and function as a freestanding federal agency. The Board’s two-person finance team, supported by two experienced attorneys, managed the Board’s finances diligently and professionally. The result: Despite facing a staffing situation perhaps unprecedented for an independent agency in the modern federal government, the Board maintained careful stewardship of all appropriated funds. Most importantly, this audit found no evidence of waste, fraud, or abuse of taxpayer dollars. We are grateful to the staff members whose hard work made this possible.

Three new Board Members, including the Board’s first full-time Chairman in more than two years, were sworn in on October 16, 2018, after the period covered by this audit had ended. The new Board appreciates the opportunity to use the information provided by this audit to further professionalize the agency’s financial management.

The Board views this audit as the first step in a process of self-evaluation and continual improvement, with the goal of achieving the highest attainable standard of federal financial management. At the same time, given the Board’s small size, it is inevitable that the Board’s path to excellence will be different than that taken by vastly larger federal agencies that undergo audits of this type. For example, as the GAO’s Green Book notes, a smaller entity “faces greater challenges in segregating duties because of its concentration of responsibilities.” The Board will work diligently to develop resourceful solutions to the tasks identified by its auditors, within the constraints imposed by its small size and unavoidable reliance on other agencies to provide vital services.

With its quorum restored and its first full-time Chairman in more than two years, the Board is working energetically to staff up and execute the mission assigned to it by Congress: ensuring that efforts to protect the nation against terrorism are balanced with the need to preserve privacy and civil liberties. At the same time, the Board will continue to pursue excellence in financial management, despite its small size. As a new agency, the Board is grateful for the support of Congress, the Office of Management and Budget, and other repositories of experience and expertise as it develops its institutional capacity and continues its responsible stewardship of taxpayer funds.

The attached audit report describes various issues related to accounting and internal controls, as compared with the standards in GAO's Green Book. Despite the lack of a Chairman, quorum, and permanent office space, the agency nevertheless complied with all applicable laws and regulations, including the Federal Managers' Financial Integrity Act (FMFIA), to the extent possible under challenging circumstances. The agency's responses to specific audit recommendations are below.

Auditor Recommendations and PCLOB Responses

1. Establish a structured and documented process for risk assessment and evaluation of its systems of internal accounting and administrative controls. This process should also ensure timely self-identification and correction of agency internal control weaknesses needed for an effective ongoing monitoring of its internal control environment.

Response: The PCLOB instituted interim internal and financial controls documents in March 2018, which have since been ratified, and will continue to improve its controls.

2. Complete detailed desk procedures to allow PCLOB's CFO office personnel to properly perform their accounting and oversight functions, and the proper establishment of auditable beginning and current year financial statement balances (2018 and 2019) for the fiscal year 2019 financial statement audit.

Response: The PCLOB has already begun to develop further processes in line with its internal and financial controls documents, such as its PP&E memorandum, and will continue to build out these processes.

3. Perform an assessment of its organizational structure and develop a plan to ensure the CFO's Office is adequately staffed with individuals that possess adequate experience in Federal accounting and financial reporting, and with relevant certifications. Once the assessment is completed, corrective action should be taken for any deficiencies identified in current staffing competencies or additional staffing needs. The plan should also ensure that appropriate staffing levels are monitored on an ongoing basis, with succession planning and cross-training.

Response: This is attributable to the PCLOB's small staff and FY 18 staffing difficulties, but since the return of a Chairman and quorum, staffing has been and will be an agency priority, including the recent hiring of an Internal Controls Officer.

4. Design and implement a structured annual Federal accounting and financial reporting training program to enhance PCLOB's ability to produce accurate and reliable financial statements, account reconciliations and other financial information that comply with Federal accounting standards.

Response: Due to its small size, the PCLOB uses a shared service provider for financial and accounting, USDA, which determines the precise accounting techniques and methods used. The PCLOB will also procure a contract accountant to assist the Finance Office.

5. Prepare a complete AFR in accordance with applicable OMB A-136 requirements, including the RSI such as the MD&A and associated FMFIA assurance statement, and OI such as the Fraud Reduction Report.

Response: Now that the PCLOB has completed its first financial audit, the PCLOB will file an AFR in FY 19.

6. Establish a procedure to annually review, document, and implement the CUECs recommended in the GSA/ Payroll Accounting and Reporting System and USDA/PFS SOC 1/ SSAE 18 reports.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but will continue to work on ways to improve applicable controls, including any CUECs.

7. Establish and document policies and procedures over the financial statement preparation process which clearly identify financial reporting functions to be performed by USDA and those to be performed by PCLOB, and which establish a process for PCLOB's CFO office personnel to review USDA prepared elements of the financial reporting process prior to final submission of PCLOB's AFR.

Response: The PCLOB instituted interim internal and financial controls documents in March 2018, which have since been ratified, and will continue to improve its controls, and has also begun to develop further processes in line with those documents. The PCLOB will continue to build out those processes, including policies and procedures where needed.

8. Ensure analysis including sufficient and supported explanations of significant variances between its current and prior year financial statements as required by OMB A-136 are prepared by either USDA or PCLOB and reviewed by PCLOB's CFO Office personnel before finalizing its financial statements.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but will continue to work on ways to improve financial analysis.

9. Design and implement policies and procedures for PCLOB to ensure controls are in place for reviewing and approving USDA prepared on top Journal Vouchers (JVs) to ensure that they are accurate, complete, supported, and have been properly approved by appropriate PCLOB's CFO office personnel for inclusion in the financial statements.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but the PCLOB will ensure it is informed about JV changes prior to their being made.

10. Design and implement monitoring controls over each of PCLOB's key financial reporting and account reconciliation process areas to assist in identifying and correcting errors that may otherwise go undetected on PCLOB's financial statements. Additionally, ensure that PCLOB evidences its review and approval of the financial statement package. Further, to proactively assist in ensuring completeness and accuracy of PCLOB's financial statement package and compliance with Federal reporting requirements, consider developing and utilizing a PCLOB specific financial reporting checklist as a best practice, or regular use of the GAO Financial Audit Manual (FAM) 2010 – *Checklist for Federal Accounting*, and of the 2020 – *Checklist for Federal Reporting and Disclosures* checklist.

Response: This is attributable to the PCLOB's small staff and FY 18 staffing difficulties, but since the return of a Chairman and quorum, staffing has been and will be an agency priority, including the recent hiring of an Internal Controls Officer, who will look into this best practice.

11. Develop and provide on-going training to PCLOB staff on Federal accounting and reporting requirements to enhance PCLOB's ability to prepare its AFR and account reconciliations in accordance with applicable standards.

Response: This is attributable to the PCLOB's small staff and FY 18 staffing difficulties, but since the return of a Chairman and quorum, staffing has been and will be an agency priority, including the recent hiring of an Internal Controls Officer, as well as a

forthcoming contract accountant who can assist the Finance Office with these activities, including providing additional training where necessary.

12. Perform an extensive analysis to determine the completeness and accuracy of the beginning balance of its capital equipment as of September 30, 2018.
 - After identifying a complete and accurate beginning balance figure as of September 30, 2018, if making this correction within fiscal year 2019, post a prior-period adjustment – years preceding the prior year entry to adjust for the effects of this misstatement to the September 30, 2018 beginning balance in PCLOB’s fiscal year 2019 comparative financial statements.

Response: The PCLOB has already begun to develop further processes in line with its internal and financial controls documents, such as its PP&E memorandum, and will finalize this analysis after consultation with its new Internal Controls Officer.

13. Perform a retrospective receiving report analysis over any “individual units” or “bulk purchase” equipment received but not yet recorded as construction in-progress (e.g., AV equipment) throughout fiscal year 2018 to determine the dollar amount of construction in-progress that should have been recorded as an asset within fiscal year 2018.
 - After identifying the amount of construction in-progress received within fiscal year 2018, if making this correction within fiscal year 2019, post a prior-period adjustment to adjust for the effects of this misstatement to PCLOB’s financial statements.

Response: The PCLOB’s new Internal Controls Officer and contract accountant will perform this analysis.

14. Update PCLOB’s PP&E capitalization and depreciation policy to address systematically tracking and recording “bulk purchase” assets as construction in-progress when equipment and portions of any related labor has been physically received and is currently in PCLOB’s possession, does not yet fully meet initial operating capability levels, and exceeds PCLOB’s capitalization limit.

Response: The PCLOB has already begun to develop further processes in line with its internal and financial controls documents, such as its PP&E memorandum, which will be revised or updated as needed, with analysis performed as necessary by the Internal Controls Officer and contract accountant.

15. Design and execute training to ensure that PCLOB’s financial and IT personnel understand how to use the updated policy for tracking both “individual units” and “bulk purchase” capital equipment.

Response: The PCLOB has already begun to develop further processes in line with its internal and financial controls documents, such as its PP&E memorandum, which will be revised or updated as needed, with analysis performed as necessary by the Internal Controls Officer and contract accountant.

16. Follow PCLOB's updated capital equipment policy for recording current and future capital equipment and construction in-progress and working with its service provider to timely record all capital equipment and related depreciation in its general ledger and on its financial statements.

Response: The PCLOB has already begun to develop further processes in line with its internal and financial controls documents, such as its PP&E memorandum, which will be revised or updated as needed, with analysis performed as necessary by the Internal Controls Officer and contract accountant.

17. Work with its USDA service provider to post an adjusting entry to reclassify leasehold improvement amounts previously expensed and record as a leasehold improvement asset that rolls up into the General PP&E line, net of accumulated amortization on its Balance Sheet. Further, perform an analysis to determine if it has corrected all relevant leasehold improvements previously expensed, and if performing these adjustments within FY 2019, record a prior period adjustment to account for the material effects of prior period SNC misstatements, to include both reversing expense amounts and posting relevant amortization expenses.

Response: The PCLOB has already begun to develop further processes in line with its internal and financial controls documents, such as its PP&E memorandum, which will be revised or updated as needed, with analysis performed as necessary by the Internal Controls Officer and contract accountant.

18. Design and implement a process for performing a capital lease determination as to whether any real and personal property leases meet one or more of the four capital lease requirements listed in the criteria above; as part of this process, document PCLOB's methodology to arrive at any conclusions made so that all capital lease test conclusions are properly supported and available for inspection.

Response: The PCLOB does not believe that it has any capital leases of real or personal property, but it will confirm and so document if needed.

19. Retrospectively perform a capital lease determination process for all real and personal property over the capitalization threshold, and in going forward, continue to perform these analyses at the initiation of each new lease term.

Response: The PCLOB does not believe that it has any capital leases of real or personal property, but it will confirm and so document if needed.

20. Establish, document, and implement policies for performing open obligation reviews on a regular basis, including documented quality control procedures and approvals over the reviews. If deemed necessary, coordinate with the agencies/vendors to determine if goods or services were ever received. If the results of this analysis show that that these obligations are not valid, then initiate appropriate contract/agreement closeout procedures.

Response: The PCLOB instituted interim internal and financial controls documents in March 2018, which have since been ratified, and will continue to improve its controls.

21. Establish, document, and implement policies to ensure accruals are recorded when goods and/or services are received throughout the fiscal year, at least on a quarterly basis, rather than at only year-end. Accruals recorded should be clearly documented with detailed estimation methodologies to support the amounts recorded. The accrual methodologies should be reviewed and approved by appropriate PCLOB personnel who receive the goods and services, with quality control review procedures and approvals performed and documented by PCLOB's CFO office personnel.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but will continue to work on ways to improve accruals.

22. Perform a data clean-up for all open obligations and AP general ledger balances to ensure that the balances are properly recorded, with appropriate adjustments posted at the detailed general ledger level.

Response: This is attributable to the PCLOB's small staff and FY 18 staffing difficulties, but since the return of a Chairman and quorum, staffing has been and will be an agency priority, including the recent hiring of an Internal Controls Officer. The PCLOB will also procure a contract accountant who can assist the Finance Office with individualized recommendations for data clean-up.

23. Train responsible PCLOB personnel who receive the goods and services and CFO office personnel on how to monitor obligations and report accruals on an ongoing basis to enhance compliance with the applicable requirements. As part of the training, consider establishing a process for conducting an AP lookback analysis to systematically quantify and estimate goods and services that PCLOB has received, but for which it did not receive an invoice, and record the AP at the transaction level (e.g., review of subsequent disbursements).

Response: This is attributable to the PCLOB's small staff and FY 18 staffing difficulties, but since the return of a Chairman and quorum, staffing has been and will be an agency priority, including the recent hiring of an Internal Controls Officer. The PCLOB will also procure a contract accountant who can assist the Finance Office with these activities, including providing additional training where necessary.

24. Design and implement a process, in coordination with USDA, to ensure documentation for UDO, AP, and expenditure transactions are properly supported and timely recorded, including obligating documents, receiving reports (e.g., whether to post an expense, draw down an advance payment, or capitalize an asset), invoices, and disbursement support.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but will continue to work on ways to improve advances.

25. Perform a detailed analysis of all intragovernmental agreements where advances are made to determine the proper amounts to be expensed or prepaid and in which current accounting period and/or prior period adjustments should be made, in addition to the listing of DOI interagency agreements that PCLOB/ USDA utilized to post its on top adjusting entries in response to the auditor identified deficiencies listed in the conditions above.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but will continue to work on ways to improve advances.

26. Establish and document policies and procedures over identifying and recording advances and prepayments and establish a receiving report process for drawing them down as goods/services are received as part of PCLOB's regular business process (e.g., on a transaction by transaction basis). As part of this new regular business process, work with USDA to ensure these transactions are posted to the general ledger correctly and timely.

Response: The PCLOB has already begun to develop further processes in line with its internal and financial controls documents, such as a process cycle memorandum, and will continue to build out these processes, which will be revised or updated as needed as recommended by the Internal Controls Officer and contract accountant.

27. In coordination with USDA, reverse all incorrectly posted 480100 transactions and generate detailed 480200 entries to continue to draw the 480200 and 141000 balances down on a transaction by transaction basis as part of its regular business process, even though USDA and PCLOB posted on top adjustment entries to move the DOI prepaid advance balance from 480100 to 480200 and related 141000 advances balances.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but will continue to work on ways to improve posting of advances.

28. Design and implement robust monitoring controls to detect and correct any transactions that have been improperly classified and to ensure timely draw down to advances and prepayments and related budgetary accounts (e.g., 480200) as work is performed on the agreement.

Response: Due to its small size, the PCLOB uses USDA for finance and accounting. USDA determines the precise accounting techniques and methods used. The PCLOB's small staff reviews USDA products, but will continue to work on ways to improve reconciliation.

Principal Financial Statements

PRIVACY AND CIVIL LIBERTIES OVERSIGHT BOARD

BALANCE SHEETS

As of September 30, 2018 and 2017

		<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
		<hr/>	<hr/>
Assets:			
Intragovernmental:			
Fund Balance With Treasury	(Note 2)	\$ 24,065,030.54	\$ 25,465,115.47
Accounts Receivable	(Note 4)	172,971.70	-
Other:			
Advances and Prepayments	(Note 3)	1,021,891.38	-
Total Intragovernmental		<hr/> 25,259,893.62	<hr/> 25,465,115.47
Accounts Receivable, net	(Note 4)	-	1,426.04
General Property, Plant and Equipment, Net	(Note 5)	<hr/> 1,250,031.02	<hr/>
Total Assets		<hr/> \$ 26,509,924.64	<hr/> \$ 25,466,541.51
Liabilities:	(Note 6)		
Intragovernmental:			
Accounts Payable		\$ 3,336,026.82	\$ -
Other:	(Note 7)		
Employer Contributions and Payroll Taxes Payable		19,132.80	22,805.65
Total Intragovernmental		<hr/> 3,355,159.62	<hr/> 22,805.65
Accounts Payable		54,779.02	839.00
Other:	(Note 7)		
Accrued Funded Payroll and Leave		73,063.20	86,373.36
Employer Contributions and Payroll Taxes Payable		3,255.42	3,746.92
Unfunded Leave		145,421.56	144,004.31
Total Liabilities		<hr/> 3,631,678.82	<hr/> 257,769.24
Net Position:			
Unexpended Appropriations - All Other Funds (Consolidated Totals)		21,773,636.36	25,351,350.54
Cumulative Results of Operations - All Other Funds (Consolidated Totals)		1,104,609.46	(142,578.27)
Total Net Position - All Other Funds (Consolidated Totals)		<hr/> 22,878,245.82	<hr/> 25,208,772.27
Total Net Position		<hr/> 22,878,245.82	<hr/> 25,208,772.27
Total Liabilities and Net Position		<hr/> \$ 26,509,924.64	<hr/> \$ 25,466,541.51

The accompanying notes are an integral part of these statements.

PRIVACY AND CIVIL LIBERTIES OVERSIGHT BOARD
STATEMENTS OF NET COST
For the Fiscal Years Ended September 30, 2018 and 2017

	<i>Unaudited</i>	<i>Unaudited</i>
	2018	2017
Program Costs:		
PCLOB:		
Gross Costs	(Note 9) \$ 10,588,936.42	\$ 6,638,936.98
Less: Earned Revenue	172,971.70	
Net Program Costs	10,415,964.72	6,638,936.98
Net Cost of Operations	\$ 10,415,964.72	\$ 6,638,936.98

The accompanying notes are an integral part of these statements.

PRIVACY AND CIVIL LIBERTIES OVERSIGHT BOARD
STATEMENTS OF CHANGES IN NET POSITIONS
For the Fiscal Years Ended September 30, 2018 and 2017

	Unaudited FY 2018
Unexpended Appropriations:	
Beginning Balance	\$ 25,351,350.54
Beginning balance, as adjusted	25,351,350.54
Budgetary Financing Sources:	
Appropriations received	8,000,000.00
Other Adjustments (+/-)	(28,632.11)
Appropriations used	(11,549,082.07)
Total Budgetary Financing Sources	(3,577,714.18)
Total Unexpended Appropriations	21,773,636.36
Cumulative Results from Operations	
Beginning Balances	(142,578.27)
Beginning balances, as adjusted	(142,578.27)
Budgetary Financing Sources:	
Appropriations used	11,549,082.07
Other Financing Sources (Nonexchange):	
Imputed Financing	114,070.38
Total Financing Sources	11,663,152.45
Net Cost of Operations	10,415,964.72
Net Change	1,247,187.73
Cumulative Results of Operations	1,104,609.46
Net Position	\$ 22,878,245.82

The accompanying notes are an integral part of these statements.

PRIVACY AND CIVIL LIBERTIES OVERSIGHT BOARD
STATEMENTS OF CHANGES IN NET POSITION
For the Fiscal Years Ended September 30, 2018 and 2017

	Unaudited FY 2017
Unexpended Appropriations:	
Beginning Balance	\$ 21,806,611.78
Beginning balance, as adjusted	21,806,611.78
Budgetary Financing Sources:	
Appropriations received	10,100,000.00
Appropriations used	(6,555,261.24)
Total Budgetary Financing Sources	3,544,738.76
Total Unexpended Appropriations	25,351,350.54
Cumulative Results from Operations	
Beginning Balances	(157,911.38)
Beginning balances, as adjusted	(157,911.38)
Budgetary Financing Sources:	
Appropriations used	6,555,261.24
Other Financing Sources (Nonexchange):	
Imputed Financing	99,008.85
Total Financing Sources	6,654,270.09
Net Cost of Operations	6,638,936.98
Net Change	15,333.11
Cumulative Results of Operations	(142,578.27)
Net Position	\$ 25,208,772.27

The accompanying notes are an integral part of these statements.

PRIVACY AND CIVIL LIBERTIES OVERSIGHT BOARD
STATEMENTS OF BUDGETARY RESOURCES
For the Fiscal Years Ended September 30, 2018 and 2017

	<i>Unaudited</i> <u>FY 2018</u>	<i>Unaudited</i> <u>FY 2017</u>
Budgetary resources:		
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	\$ 13,257,173.97	\$ 10,032,334.32
Appropriations (discretionary and mandatory)	8,000,000.00	10,100,000.00
Spending authority from offsetting collections (discretionary and mandatory)	<u>181,269.87</u>	<u>-</u>
Total budgetary resources	<u>\$ 21,438,443.84</u>	<u>\$ 20,132,334.32</u>
Status of budgetary resources:		
New obligations and upward adjustments (total)	(Note 10) \$ 7,594,229.67	\$ 8,309,397.83
Apportioned, unexpired account	11,689,137.97	11,484,275.86
Unapportioned, unexpired accounts	2,155,076.20	300,708.47
Unexpired unobligated balance, end of year	13,844,214.17	11,784,984.33
Expired unobligated balance, end of year	<u>-</u>	<u>37,952.16</u>
Unobligated balance, end of year (total)	<u>13,844,214.17</u>	<u>11,822,936.49</u>
Total budgetary resources	<u>\$ 21,438,443.84</u>	<u>\$ 20,132,334.32</u>
Outlay, net:		
Outlays, net (total) (discretionary and mandatory)	\$ 9,371,452.82	\$ 6,598,272.07
Agency outlays, net (discretionary and mandatory)	<u>\$ 9,371,452.82</u>	<u>\$ 6,598,272.07</u>

The accompanying notes are an integral part of these statements.

Notes to the Principal Statements

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The mission of the Privacy and Civil Liberties Oversight Board (“PCLOB” or the “Board”) is to ensure that efforts undertaken by our government to protect the United States from terrorism also respect and preserve the freedoms that define our nation.

The Board was created upon the recommendation of the 9/11 Commission, whose 2004 report firmly declared that preventing terrorism does not require sacrificing the values that make us strong. Liberty and security, the Commission wrote, need not be in opposition but instead can be mutually reinforcing:

We must find ways of reconciling security with liberty, since the success of one helps protect the other. The choice between security and liberty is a false choice, as nothing is more likely to endanger America’s liberties than the success of a terrorist attack at home. Our history has shown us that insecurity threatens liberty. Yet, if our liberties are curtailed, we lose the values that we are struggling to defend.¹

Legal changes adopted after the September 11 attacks, the Commission noted, “vested substantial new powers” in the government’s investigative agencies, prompting “concerns regarding the shifting balance of power to the government.”² The Commission found, however, that “there is no office within the government whose job it is to look across the government at the actions we are taking to protect ourselves to ensure that liberty concerns are appropriately considered.”³

To fill that gap, the 9/11 Commission unanimously recommended the creation of what is now the Privacy and Civil Liberties Oversight Board. In the words of the Commission: “At this time of increased and consolidated government authority, there should be a board within the executive branch to oversee adherence to the guidelines we recommend and the commitment the government makes to defend our civil liberties.”⁴

In 2007, Congress responded to this proposal through the Implementing Recommendations of the 9/11 Commission Act, which established the Board as an independent agency within the executive branch.⁵ The agency is led by a bipartisan, five-member Board, comprised of a full-time chairman and four part-time Board members, all of whom are appointed by the President, with the advice and consent of the Senate, for staggered six-year terms. No more than three of the five Board members may be from the same political party, and the President must consult with the congressional leadership of the opposing party before appointing members who are not from the President’s political party.⁶

¹ THE 9/11 COMMISSION REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON TERRORIST ATTACKS UPON THE UNITED STATES, at 395 (2004).

² *Id.* at 394.

³ *Id.* at 395.

⁴ *Id.* at 395.

⁵ See Pub. L. No. 110-53, § 801(a), 121 Stat. 266, 352-58 (2007). Under the Act, the new PCLOB replaced an earlier agency with the same name that was situated within the Executive Office of the President. See Intelligence Reform and Terrorism Prevention Act of 2004, Pub. L. No. 108-458, § 1061(b), 118 Stat. 3638, 3684 (2004).

⁶ See 42 U.S.C. § 2000ee(h)(2).

Although the PCLOB was formally created as an independent agency in 2007, it did not come into existence until August 2012 when the Board's four part-time members were confirmed by the Senate, providing the Board with a quorum to begin activity. The Board did not have the ability to become fully functioning until 2013. The Board's chairman, who is vested by statute with the exclusive power to hire staff, was confirmed in May 2013, enabling the Board to become truly operational for the first time.⁷

Since then, the Board has been establishing itself as a functioning independent agency while simultaneously pursuing its statutory mission — most notably playing a lead role in confronting pressing questions about the scope of government surveillance carried out by the Intelligence Community.

The Board has two fundamental responsibilities under its authorizing statute:

- (1) To analyze and review actions the executive branch takes to protect the nation from terrorism, ensuring that the need for such actions is balanced with the need to protect privacy and civil liberties; and
- (2) To ensure that liberty concerns are appropriately considered in the development and implementation of laws, regulations, and policies related to efforts to protect the nation against terrorism.⁸

These responsibilities encompass two distinct functions: providing oversight and providing advice. In its oversight role, the Board is authorized to continually review the substance and implementation of executive branch regulations, policies, procedures, and information sharing practices relating to efforts to protect the nation from terrorism, in order to ensure that privacy and civil liberties are protected. The Board also is authorized to continually review any other actions of the executive branch relating to efforts to protect the nation from terrorism, in order to determine whether such actions appropriately protect privacy and civil liberties and whether they are consistent with governing laws, regulations, and policies regarding privacy and civil liberties.⁹

In its advice role, the Board is authorized to review proposed legislation, regulations, and policies related to efforts to protect the nation from terrorism (as well as the implementation of new and existing policies and legal authorities), in order to advise the President and the elements of the executive branch on ensuring that privacy and civil liberties are appropriately considered in the development and implementation of such legislation, regulations, and policies.¹⁰

By offering its independent but informed views and analyses, the Board assists the executive branch in formulating policy regarding counterterrorism efforts, and it adds an important voice to broader discussions involving lawmakers and the public about striking the right balance between liberty and security in those efforts.

⁷ See 42 U.S.C. § 2000ee(j)(1). Before the chairman's Senate confirmation, the Board relied on a small number of detailees from other federal agencies to begin standing up the Board as a functioning agency. See 42 U.S.C. § 2000ee(j)(2).

⁸ See 42 U.S.C. § 2000ee(c).

⁹ See 42 U.S.C. § 2000ee(d)(2).

¹⁰ See 42 U.S.C. § 2000ee(d)(1).

Basis of Presentation

These financial statements have been prepared from the accounting records of the Board in accordance with generally accepted accounting principles (“GAAP”) as promulgated by the Federal Accounting Standards Advisory Board (“FASAB”), and the form and content for entity financial statements specified in Office of Management and Budget (“OMB”) Circular A-136, “Financial Reporting Requirements.” GAAP for Federal entities is the hierarchy of accounting principles prescribed in Statement of Federal Financial Accounting Standards (“SFFAS”) 34, “The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards issued by the Financial Accounting Standards Board.”

OMB Circular A-136 requires agencies to prepare principal statements, which include a Balance Sheet, a Statement of Net Cost, a Statement of Changes in Net Position, and a Statement of Budgetary Resources. The Balance Sheet presents, as of September 30, 2018 and 2017, amounts of future economic benefits owned or managed by the Board (assets), amounts owed by the Board (liabilities), and amounts which comprise the difference (net position). The Statement of Net Cost reports the full cost of the Board’s operations, which includes costs of identifiable supporting services provided by other federal agencies. The Statement of Budgetary Resources reports the Board’s budgetary activity.

Basis of Accounting

Transactions where possible are recorded on the accrual accounting basis in accordance with general government practice. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. However, PCLOB is unable to fully implement all elements of U.S. GAAP as promulgated by FASAB and the form and content requirements for federal government entities specified by OMB in Circular A-136, *Financial Reporting Requirements*, due to limitations of financial and nonfinancial management processes that support the financial statements.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Budgets and Budgetary Accounting

The Board follows standard federal budgetary accounting policies and practices in accordance with OMB Circular A-11, “Preparation, Submission, and Execution of the Budget.” Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. In fiscal years 2018 and 2017, the Board received an appropriation of multi-year funds to incur obligations in support of agency programs. The Board recognizes budgetary resources as assets when cash (funds held by Treasury) is made available through warrants and when spending authority from the offsetting collection is incurred.

Revenues and Other Financing Sources

The Board receives the funding needed to support its operating costs and program expenses through appropriations. The Board receives a multi-year appropriation which is used exclusively for operational costs of the Board, such as personnel costs, office rent, telephones, and service agreements with other federal agencies for administrative support, publications, supplies, etc.

Imputed Financing Sources

In certain instances, operating costs of the Board are paid out of funds appropriated to other federal agencies. In accordance with SFFAS 5, "Accounting for Liabilities of the Federal Government," all expenses of a federal entity should be reported by that agency regardless of whether the agency will ultimately pay those expenses. Amounts for certain expenses of the Board, which will be paid by other federal agencies, are recorded in the Statement of Net Cost. A related amount is recognized in the Statement of Changes in Net Position as an imputed financing source. The Board records imputed expenses and financing sources for employee retirement plan contributions, group term life insurance, and health benefit costs, which are paid by the Office of Personnel Management ("OPM").

Personnel Compensation and Benefits

Salaries and wages of employees are recognized as accrued payroll expenses and related liabilities as earned. These expenses are recognized as a funded liability when accrued. Annual leave is accrued as it is earned by employees and is included in personnel compensation and benefit costs. An unfunded liability is recognized for earned but unused annual leave, since from a budgetary standpoint, this annual leave will be paid from future appropriations when employees use the leave. The amount accrued is based upon current pay rates for employees. Sick leave and other types of leave that are not vested are expensed when used and no future liability is recognized for these amounts.

The Board's employees participate in one of two retirement programs, either the Civil Service Retirement System ("CSRS") or the Federal Employees Retirement System ("FERS"), which became effective on January 1, 1987. The Board and its employees both contribute to these systems. Although the Board funds a portion of the benefits under CSRS and FERS and makes the necessary payroll withholdings, it does not report assets associated with these benefit plans in accordance with SFFAS 5.

For CSRS employees, the Board contributes an amount equal to 7 percent of the employees' basic pay to the plan. For FERS employees covered under FERS prior to January 1, 2013, the Board contributes an amount equal to 13.2 percent of the employees' basic pay to the plan. FERS employees covered under FERS-RAE or FRAE hired on or after January 1, 2013 pay a higher percentage of their pay for their retirement, and thus the Board contributes only 11.1 percent of each employee's basic pay to the plan. Both CSRS employees and FERS employees are eligible to participate in the Thrift Savings Plan ("TSP"). The TSP is a defined contribution retirement plan intended to supplement the benefits provided under CSRS and FERS. For FERS employees, the Board contributes an amount equal to 1 percent of the employee's basic pay to the TSP and matches employee contributions up to an additional 4 percent. CSRS employees receive no matching contribution from the Board.

OPM is responsible for reporting assets, accumulated plan benefits, and unfunded liabilities, if any, applicable to CSRS participants and FERS employees government-wide, including the Board's employees. The Board has recognized an Imputed Cost and Imputed Financing Source for the difference between the estimated service cost and the contributions made by the Board and its covered employees. The estimated cost of pension benefits is based on rates issued by OPM.

Employees are entitled to participate in the Federal Employees Group Life Insurance ("FEGLI") Program. Participating employees can obtain "basic life" term life insurance, with the employee paying two-thirds of the cost and the Board paying one-third. Additional coverage is optional, to be paid fully by the employee. The basic life coverage may be continued into retirement if certain requirements are met. OPM administers the FEGLI program and is responsible for the reporting of related liabilities. Each fiscal year, OPM calculates the U.S. Government's service cost for the post-retirement portion of basic life coverage. Because the Board's contributions to the basic life coverage are fully allocated by OPM to the pre-retirement portion of coverage, the Board has recognized the entire service cost of the post-retirement portion of basic life coverage as an Imputed Cost and Imputed Financing Source.

Assets and Liabilities

Intra-governmental assets and liabilities arise from transactions between the Board and other Federal entities.

Funds with the U.S. Treasury and Advances and Prepayments comprise the majority of assets on the Board's balance sheet. All other assets result from activity with non-federal sources.

Liabilities represent amounts that are likely to be paid by the Board as a result of transactions that have already occurred. The accounts payable portion of liabilities consists of amounts owed to federal agencies and commercial vendors for goods, services, and other expenses received but not yet paid.

Liabilities covered by budgetary or other resources are those liabilities of the Board for which Congress has appropriated funds, or funding is otherwise available to pay amounts due.

Fund Balance with Treasury

The U.S. Department of the Treasury ("Treasury") processes the Board's receipts and disbursements. The Fund Balance with Treasury is the aggregate amount of the agency's accounts with Treasury for which the agency is authorized to liquidate obligations, pay funded liabilities, and make expenditures. The fund balance is increased through the receipt of non-expenditure Treasury warrants for appropriations, positive non-expenditure transfers, and other expenditure inflows of funds. The Fund Balance with Treasury is reduced through non-expenditure Treasury Warrants for rescissions, negative non-expenditure transfers, disbursements, and other expenditure cash outflows of funds. The Board's funds with the U.S. Treasury are cash balances from appropriations as of the fiscal year-end from which the Board is authorized to make expenditures and pay liabilities resulting from operational activity.

General Property, Plant, and Equipment, Net

The PCLOB anticipates that furniture, fixtures, equipment (to include information technology, or

IT) are the only types of assets to be recognized. Software is generally acquired as annual subscription and not subject to capitalization. An item is capitalized when it meets two criteria: (1) must have an estimated useful life of 2 or more years; and (2) the total cost must equal or exceed the PCLOB's capitalization threshold of \$5,000. Total cost includes all costs incurred to bring the item to a form and location suitable for its intended use (e.g., transportation, contract price, contract fee, installation/labor, etc.).

Prepaid and Deferred Charges

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenses when the related goods and services are received.

Liabilities

Liabilities represent amounts expected to be paid as the result of a transaction or event that has already occurred. Liabilities covered by budgetary resources are liabilities incurred which are covered by realized budgetary resources as of the Balance Sheet date. Available budgetary resources include new budget authority, spending authority from the offsetting collections, recoveries of unexpired budget authority through downward adjustments of prior year obligations, and unobligated balances of budgetary resources at the beginning of the year. Unfunded liabilities are not considered to be covered by such budgetary resources. Examples of unfunded liabilities are actuarial liabilities for future Federal Employees' Compensation Act payments and annual leave. The Government, acting in its sovereign capacity, can abrogate liabilities arising from other than contracts.

Contingencies

The criteria for recognizing contingencies for claims are (1) a past event or exchange transaction has occurred as of the date of the statements; (2) a future outflow or other sacrifice of resources is probable; and (3) the future outflow or sacrifice of resources is measurable (reasonably estimated). The Board recognizes material contingent liabilities in the form of claims, legal action, administrative proceedings and environmental suits that have been brought to the attention of legal counsel, some of which will be paid by the Treasury Judgment Fund. It is the opinion of management and legal counsel that the ultimate resolution of these proceedings, actions and claims, will not materially affect the financial position or results of operations.

Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts of budget authority to include unobligated or obligated balances not rescinded or withdrawn. Cumulative results of operations is comprised of the following: (1) the difference between revenues and expenses, (2) the net amount of transfers of assets in and out without reimbursement, and (3) donations, all since inception of the fund(s).

NOTE 2 – FUND BALANCE WITH TREASURY

The Board's funds with the U.S. Treasury consist only of appropriated funds. The status of these funds as of September 30, 2018 and 2017 is as follows:

	<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
A. Fund Balance with Treasury		
Appropriated General Fund	<u>\$24,065,030.54</u>	<u>\$25,465,115.47</u>
B. Status of Fund Balance with Treasury		
1) Unobligated Balance		
a) available	\$11,689,137.97	\$11,484,275.86
b) navailable	\$2,155,076.20	\$338,660.63
2) a) Obligated Balance not yet Disbursed	\$10,402,086.24	\$13,642,178.98
b) nge in Uncollected Payments	<u>(\$181,269.87)</u>	
Total	<u>\$24,065,030.54</u>	<u>\$25,465,115.47</u>

NOTE 3 – ADVANCES AND PREPAYMENTS

Advances and Prepayments represents advances to Department of Interior for 2018. There were no Advances and Prepayments recorded in 2017.

	<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
Deferred	<u>1,021,891.38</u>	<u>-</u>
Total	1,021,891.38	-

NOTE 4 – ACCOUNTS RECEIVABLE

Accounts Receivable from Federal sources represents the portion of reimbursable agreements that are earned but not yet reimbursed. Accounts Receivable from Non-Federal sources represents the gross amount of monies owed to the Board by associate claims. The Board has historically collected any receivables due and thus has not established an allowance for uncollectible accounts.

	<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
Accounts Receivable		
Claims - Associates	\$0	\$1,426.04
Accounts Receivable - Reimbursable	\$172,971.70	\$0

NOTE 5 - GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

The Board's total cost, accumulated depreciation, and net book value for PPE for the year ending September 30, 2018 is as follows. There was no PPE recorded for the year ending September 30, 2017.

Equipment	<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
Cost	\$1,309,857.90	\$0.00
Accumulated Depreciation	\$59,826.88	\$0.00
Book Value	<u>\$1,250,031.02</u>	<u>\$0.00</u>

NOTE 6 – LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Liabilities of the Board are classified as liabilities covered or not covered by budgetary resources. As of September 30, 2018, the Board had liabilities covered by budgetary resources of \$3,486,257.26 and liabilities not covered by budgetary resources of \$145,421.56. As of September 30, 2017, the Board had liabilities covered by budgetary resources of \$113,764.93 and liabilities not covered by budgetary resources of \$144,004.31.

	<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
Intragovernmental		
Employer Contributions & Payroll Taxes	19,132.80	22,805.65
Accounts Payable	3,336,026.82	
Total Intragovernmental	<u>3,355,159.62</u>	<u>22,805.65</u>
With the Public		
Accounts Payable	54,779.02	839.00
Accrued Funded Payroll & Leave	73,063.20	86,373.36
Employer Contributions & Payroll Taxes	3,255.42	3,746.92
Unfunded Leave	145,421.56	144,004.31
Total With the Public	<u>276,519.20</u>	<u>234,963.59</u>
Total Liabilities	<u>\$ 3,631,678.82</u>	<u>\$ 257,769.24</u>
Total liabilities not covered by budgetary resources	145,421.56	144,004.31
Total liabilities covered by budgetary resources	3,486,257.26	113,764.93
Total Liabilities	<u>\$ 3,631,678.82</u>	<u>\$ 257,769.24</u>

NOTE 7 – OTHER LIABILITIES

Other liabilities with the public for the year ended September 30, 2018 and 2017 consist of Accrued Funded Payroll and Leave, Employer Contributions and Payroll Taxes Payable and Unfunded Leave in the amounts shown below. Other Intragovernmental liabilities consist of Employer Contributions and Payroll Taxes Payable.

	<i>Unaudited</i> FY 2018		
	Non-Current	Current	Total
Intragovernmental			
Employer Contributions and Payroll Taxes Payable	-	19,132.80	19,132.80
Total Intragovernmental	-	19,132.80	19,132.80
Liabilities with the Public			
Accrued Funded Payroll & Leave	-	73,063.20	73,063.20
Employer Contributions and Payroll Taxes Payable	-	3,255.42	3,255.42
Unfunded Leave	145,421.56	-	145,421.56
Total Liabilities with the Public	145,421.56	76,318.62	221,740.18
Total Other Liabilities	<u>145,421.56</u>	<u>95,451.42</u>	<u>240,872.98</u>

	<i>Unaudited</i> FY 2017		
	Non-Current	Current	Total
Intragovernmental			
Employer Contributions and Payroll Taxes Payable	-	22,805.65	22,805.65
Total Intragovernmental	-	22,805.65	22,805.65
Liabilities with the Public			
Accrued Funded Payroll & Leave	-	86,373.36	86,373.36
Employer Contributions and Payroll Taxes Payable	-	3,746.92	3,746.92
Unfunded Leave	144,004.31	-	144,004.31
Total Liabilities with the Public	144,004.31	90,120.28	234,124.59
Total Other Liabilities	<u>144,004.31</u>	<u>112,925.93</u>	<u>256,930.24</u>

NOTE 8 – LEASES

Entity as Lessee:
Operating Leases:

Description of Arrangements: The Board began occupying office space at 800 N. Capitol St., NW, Suite 565, Washington, DC for a period of 120 months commencing on April 30, 2018.

Future Payments Due: The following is a schedule of minimum payments required by the General Services Administration for the North Capital Street location.

<u>Fiscal Year Ending</u>	<u>Unaudited Period Charge</u>
April 30, 2018 through September 30, 2018	\$ 0.00
October 1, 2018 through September 30, 2019	\$ 277,298.31
October 1, 2019 through September 30, 2020	\$ 900,833.97
October 1, 2020 through September 30, 2021	\$ 910,795.90
October 1, 2021 through September 30, 2022	\$ 921,056.68
October 1, 2022 through April 30, 2023	\$ 531,074.30
May 1, 2023 through September 30, 2023	\$ 419,225.62
October 1, 2023 through September 30, 2024	\$ 986,887.49
October 1, 2024 through September 30, 2025	\$ 998,099.72
October 1, 2025 through September 30, 2026	\$ 1,099,648.33
October 1, 2026 through September 30, 2027	\$ 1,021,543.39
October 1, 2027 through April 29, 2028	\$ <u>574,774.12</u>
Total Future Payments	<u>\$ 8,641,237.83</u>

Amounts due may vary due to operating costs escalation and real estate tax escalation clauses.

NOTE 9 – COSTS AND EXCHANGE REVENUE

Intragovernmental costs are those of goods/services purchased from a federal entity.

	<i>Unaudited</i>	<i>Unaudited</i>
	Total	Total
	2018	2017
	<hr/>	<hr/>
Program B		
Intragovernmental costs	\$ 8,501,811.65	\$ 3,157,231.98
Public costs	2,087,124.77	3,481,705.00
Total Program B costs	<u>\$ 10,588,936.42</u>	<u>\$ 6,638,936.98</u>
Intragovernmental earned revenue		
Total Program A earned revenue	172,971.70	0.00
Total Program A Net Costs	<u>10,415,964.72</u>	<u>6,638,936.98</u>

NOTE 10 – APPORTIONMENT CATEGORIES OF NEW OBLIGATIONS AND UPWARD ADJUSTMENTS: DIRECT VS REIMBURSABLE OBLIGATIONS

Apportionment is a plan, approved by the U.S. Office of Management and Budget (“OMB”), to spend resources provided by one of the annual appropriations acts, a supplemental appropriations act, a continuing resolution, or a permanent law (mandatory appropriations). Resources are apportioned by Treasury Account Fund Symbol (“TAFS”). The apportionment identifies amounts available for obligation and expenditure. It specifies and limits the obligations that may be incurred and expenditures made (or makes other limitations, as appropriate) for specified time periods, programs, activities, projects, objects, or any combination thereof. An apportioned amount may be further subdivided by an agency into allotments, suballotments, and allocations.

The Category B obligations incurred are both direct and reimbursable. For the fiscal year ended September 30, 2018, all obligations incurred for the Board were Category B, as defined by OMB Circular A-11, and reported on the Board’s latest SF 132. Category A apportionments distribute budgetary resources by fiscal quarters. Category B apportionments typically distribute budgetary resources by activities, projects, objects or a combination of these categories.

	<i>Unaudited</i>	<i>Unaudited</i>
	Total	Total
	2018	2017
	<hr/>	<hr/>
Direct		
Category B	7,421,257.97	8,309,397.83
Reimbursable		
Category B	172,971.70	0.00
Total New Obligations and Upward Adjustments	<u>\$ 7,594,229.67</u>	<u>\$ 8,309,397.83</u>

NOTE 11 – UNDELIVERED ORDERS AT THE END OF THE PERIOD

Undelivered orders represent the value of goods and services ordered and obligated that have not been received. This amount includes any orders for which advance payment has been made but for which delivery or performance has not yet occurred.

	<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>
	Undelivered Orders	Paid Undelivered Orders	Total Undelivered Orders
2018	\$ 6,915,828.98	\$ 1,021,891.38	\$ 7,937,720.36
2017	\$ 13,528,414.05	\$ -	\$ 13,528,414.05

NOTE 12 – EXPLANATION OF DIFFERENCES BETWEEN THE SBR AND THE BUDGET OF THE US GOVERNMENT

SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires an explanation of material differences between budgetary resources available, the status of those resources and outlays as presented in the Statement of Budgetary Resources to the related actual balances published in the *Budget of the United States Government* (Budget). The Budget that will include FY 2018 actual budgetary execution information is scheduled for publication in February 2019, which will be available through OMB’s website at <http://www.whitehouse.gov/omb>. Accordingly, information required for such disclosure is not available at the time of publication of these financial statements. Balances reported in the FY 2017 SBR and the related President’s Budget reflected the following:

FY2017	<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>
	Budgetary Resources	New Obligations & Upward Adjustments (Total)	Distributed Offsetting Receipts	Net Outlays
Statement of Budgetary Resources	\$ 20,132,334.32	\$ 8,309,397.83	\$ -	\$ 6,598,272.07
<i>Budget of the U.S. Government</i>	20,000,000.00	8,000,000.00	\$ -	6,000,000.00
Difference	<u>\$ 132,334.32</u>	<u>\$ 309,397.83</u>	<u>\$ -</u>	<u>\$ 598,272.07</u>

The difference between the Statement of Budgetary Resources and the *Budget of the United States Government* for budgetary resources, obligations incurred and net outlays are primarily due to rounding. A portion of the difference in the budgetary resources is due to expired unobligated balances being reported in the Statement of Budgetary Resources but not in the Budget of the United States Government.

NOTE 13 – RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

Liabilities not covered by budgetary resources total \$145,421.56 and the change in components requiring or generating resources in future period shows an increase of \$1,417.25. The \$1,417.25 is the difference of future funded expenses – leave between FY 2018 and FY 2017. Accrued funded payroll liability is covered by budgetary resources and is included in the net cost of operations. Whereas, the unfunded leave liability includes the expense related to the increase in annual leave liability for which the budgetary resources will be provided in a subsequent period.

Summary of Change in Components Requiring or Generating Resources

	<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
Liabilities not covered by budgetary resources	145,421.56	\$ 4.31
Change in components requiring/generating resources	1,417.25	\$ 13,907.07)

Summary of Net Cost of Operations

	<i>Unaudited</i> 2018	<i>Unaudited</i> 2017
Budgetary Resources Obligated	\$ 7,594,229.67	\$ 8,309,397.83
Spending Authority from Recoveries and Offsetting Collections	(1,644,139.46)	(343,375.39)
Imputed Financing from Costs Absorbed by Others	114,070.38	99,008.85
Changes in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided	5,598,991.86	(1,410,761.20)
.	(1,308,431.86)	(1,426.04)
Financing Sources Yet to be Provided	61,244.13	(13,907.07)
Net Cost of Operations	<u>\$ 10,415,964.72</u>	<u>\$ 6,638,936.98</u>