LIBRARY OF CONGRESS

Office of the Inspector General

MEMORANDUM

DATE April 5, 2017

TO Dr. Carla Hayden
Librarian of Congress

FROM Kurt W. Hyde
Inspector General

SUBJECT Results of the Library of Congress *FY 2016 Financial Statements Audit*

The attached reports present the results of the annual audit of the Library of Congress financial statements for fiscal years (FY) 2016 and 2015.

We contracted with the independent certified public accounting firm of Kearney & Company (Kearney) for the FY 2016 audit. The contract required that Kearney perform the audit in accordance with U.S. generally accepted government auditing standards; the Office of Management and Budget Bulletin 15-02, *Audit Requirements for Federal Financial Statements*; and the GAO/PCIE *Financial Audit Manual*.

Results of Independent Audit

Financial Statements

For the twenty-first consecutive year, we are pleased to report that the auditors issued an unmodified (clean) opinion on the Library's financial statements. In its audit, Kearney found that the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles.

Report on Internal Controls

Kearney's consideration of internal controls over financial reporting (including the safeguarding of assets) resulted in no material weaknesses and the identification of four significant deficiencies.[1] Kearney noted significant deficiencies regarding the internal controls for 1) internal use software development

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[1] 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 Library's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or 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. 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.

capitalization, 2) unliquidated obligations, 3) investment gains and losses, and 4) accounts payable accruals.

Compliance with Laws and Regulations

Kearney found no instances of noncompliance with laws and regulations tested.

Office of the Inspector General Oversight of Kearney & Company

In connection with the audit contract, the Office of the Inspector General reviewed Kearney's report and related documentation and inquired of its representatives. Our review as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on the Library's financial statements, conclusions about the effectiveness of internal controls, and compliance with laws and regulations. Kearney is responsible for the attached auditor's reports dated March 14, 2017 and the conclusions expressed in the reports.[2] However, our review disclosed no instances where Kearney did not comply in all material respects with generally accepted government auditing standards.

cc: Deputy Librarian
Chief Operating Officer
Chief of Staff
General Counsel
Chief Financial Officer

Attachments

[2] In accordance with generally accepted government auditing standards, Kearney's report is dated as of the last day of their audit fieldwork. Kearney's final report was delivered to the Office of the Inspector General on March 30, 2017.

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INDEPENDENT AUDITOR'S REPORT

Inspector General
United States Library of Congress

Librarian
United States Library of Congress

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Library of Congress (the Library), which comprise the consolidated balance sheet as of September 30, 2016, the related consolidated statement of net cost and changes in net position, and the combined statement of budgetary resources (hereinafter referred to as the "financial statements") for the year then ended, as well as the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audit contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Library as of September 30, 2016, as well as its net cost of operations, changes in net position, and budgetary resources for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

FY 2015 Financial Statements Audited by a Predecessor Auditor

The Library's consolidated financial statements for fiscal year (FY) 2015, as of and for the year ended September 30, 2015, were audited by a predecessor auditor whose report, dated March 18, 2016, expressed an unmodified opinion on those consolidated financial statements.

We were not engaged to audit, review, or apply any procedures on the FY 2015 consolidated financial statements. Accordingly, we do not express an opinion or any other form of assurance on the FY 2015 financial statements as a whole.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis and other Required Supplementary Information (hereinafter referred to as the "required supplementary information") be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by the Federal Accounting Standards Advisory Board (FASAB), who consider it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing it for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audit of the consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KEARNEY&
COMPANY

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The Management Report is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated 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 *Government Auditing Standards* and OMB Bulletin No. 15-02, we have also issued reports, dated March 14, 2017, on our consideration of the Library's internal control over financial reporting and on our tests of the Library's compliance with provisions of applicable laws, regulations, contracts, and grant agreements, as well as other matters for the year ended September 30, 2016. 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 internal control over financial reporting or on compliance and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 15-02 and should be considered in assessing the results of our audit.

Kearney & Company

Alexandria, Virginia
March 14, 2017

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Inspector General
United States Library of Congress

Librarian
United States Library of Congress

We have audited the consolidated financial statements of the Library of Congress (the Library) as of and for the year ended September 30, 2016, and we have issued our report thereon dated March 14, 2017. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*.

Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Library's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Library's internal control. Accordingly, we do not express an opinion on the effectiveness of the Library's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 15-02. 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 entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or 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 purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Reponses, that we consider to be significant deficiencies.

We noted certain additional matters involving internal control over financial reporting that we will report to the Library's management in a separate letter.

The Library's Response to Findings

The Library does not have a response to the findings identified in our audit at this time, but it will respond to the findings identified in our audit at a later date. The Library's response will not be subjected to the auditing procedures applied in our audit of the consolidated financial statements; accordingly, we will 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 internal control and the results of that testing and not to provide an opinion on the effectiveness of the Library's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 15-02 in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
March 14, 2017

Schedule of Findings

Significant Deficiencies

I. Untimely De-Obligation of Funds (*New Condition*)

Unliquidated Obligations (ULO) represent binding agreements for goods and services that have not yet been delivered or received and will require future outlays. Agencies should maintain policies, procedures, and information systems to ensure that the balance of ULOs reported in their financial systems represents required Federal outlays.

The Library of Congress (Library) records obligations in its financial management system when it enters into an agreement, such as a contract or purchase order, to purchase goods or services. Once recorded, obligations remain open until they are fully reduced by disbursements or de-obligated or the appropriation funding the obligations is closed.

As part of our obligations testing, Kearney & Company, P.C. (Kearney) reviewed $7.1 million of the $12.8 million obligations, using a stratified risk-based population to identify older obligations. During our testing, we noted that the Library had 13 ULOs with a cumulative balance of approximately $3 million for which the agency did not anticipate future outlays of funds. For one exception noted, Kearney found that the contract was terminated in fiscal year (FY) 2015, which de-obligated the funds on the contract. However, the de-obligation was not recorded in the financial system. The remaining 12 exceptions we noted in our ULO testing agreed to the current contract amount for which the respective service units acknowledged that the funds were no longer needed.

Failure to maintain an effective ULO control environment in which invalid open obligations are identified and de-obligated in a timely manner may result in difficulties in managing funds, improper payments, inaccurate budgetary reports, and possible violations of Federal regulations.

Kearney recommends that the Library:

1. Strengthen the process to review open obligations and ensure that the status of open obligations, to include the identification of older obligations, is formally documented and reviewed by the appropriate personnel, as well as that action is taken to timely de-obligate unneeded funds. The Office of the Chief Financial Officer (OCFO) should explore the possibility of developing an ULO aging report in Momentum to identify all ULOs with no activity in the previous six months, filtered by obligation origination date. If feasible, this report could be used as the basis for a periodic review of obligations. The Contracting Officers (CO) Contracting Officer's Representatives (COR), in conjunction with the service units, should perform this review to determine if obligations are still valid or to identify obligations that are no longer needed, so that the COs and CORs can take action to de-obligate the funds.

2. Document the new ULO review process and train personnel in the service units, the Office of Contracts, and OCFO on how to execute the review, in addition to understanding the importance of de-obligating unneeded funds in a timely manner.
3. OCFO should monitor the review process to ensure service units are providing an accurate status on open obligations in a timely manner and, when necessary, that the COs are issuing contract modifications and de-obligating funds timely.

II. Internal Use Software Development Cost Capitalization Procedures Need Improvement (*New Condition*)

Internal Use Software (IUS) development costs represent cumulative project costs that will be transferred to Property, Plant, and Equipment (PP&E) as an asset when the software application is functional. Federal accounting standards establish criteria for the capitalization of IUS project costs. These costs can include internal labor, overhead, and third-party vendors. The Library is responsible for establishing appropriate policies and monitoring their operation to ensure project costs are accurately capitalized. Failure to establish and execute appropriate policies may result in erroneous financial statements, inappropriate oversight over project costs, and software deployment that is delayed or does not meet functional requirements.

During our test over IUS in development, Kearney noted that the Library did not capitalize all development costs related to the Copyright Office's Electronic Licensing (eLi) system. As of September 30, 2016, the Library capitalized $1.7 million as IUS in development for the eLi system. The Copyright Office reported $11.6 million for eLi development costs, primarily through third-party vendors. Because of the large gap between the dollar amount spent by the Copyright Office on its modernization efforts and what was capitalized for the eLi software development, Kearney performed a cursory review of contracts initiated by the Copyright Office between FYs 2010 and 2016 and preliminarily determined, at a minimum, there was an additional $1.2 million in costs that should have been included in the amount the Library capitalized for the eLi software. While the remaining $8.7 million contained additional capital costs, Kearney did not pursue further quantification efforts due to the Library's decision to formally cease development in October 2016. The resulting write-off of the eLi project prevented the above issue from resulting in financial statement errors. However, the Library needs to enhance this control activity by verifying that information for an accurate capitalization decision is readily available to ensure the financial statement errors are prevented prospectively.

Kearney also noted that the Library OCFO does not collect internal labor hours as part of the biweekly time and attendance process. Instead, the OCFO relies on semi-annual data calls to collect internal labor hours. This after-the-fact (up to six months) information collection method is inefficient compared to real-time data collection as part of time and attendance processing. It is also prone to errors, as it relies on memory and other ad hoc data gathering methods.

Without proper identification of all capital costs related to IUS projects, the Library is at risk of understating its asset balance and overstating expenses during the years the IUS asset is under development.

Additionally, without an integrated enterprise risk management program that includes all relative stakeholders, the Library may not proactively identify new risks. This increases the likelihood that the Library will not proactively implement the proper procedures and internal controls to mitigate new risks as they arise.

Kearney recommends that the Library:

1. Continue its efforts to centralize all software development projects under the Office of the Chief Information Officer (OCIO) and ensure the Information Technology Steering Committee (ITSC) reviews and approves all IT projects.
2. The OCFO, in coordination with the OCIO, should appoint a staff member from the OCFO to sit on the ITSC. This staff member should be responsible for making the OCFO aware of any approved IT project that may result in a capital asset.
3. OCFO should establish an asset record in Momentum's Fixed Asset Module at project inception for all ITSC-approved projects meeting capital asset thresholds.
4. OCIO should ensure that all purchase requisitions related to capital IT projects and approved by the ITSC are coded appropriately and linked to the corresponding asset record in Momentum.
5. Compare the costs/benefits of expanding the use of WebTA to track the Library Government employees' time spent on capital projects.
6. Perform formal enterprise risk management activities, including routine risk assessment and control monitoring, to ensure any changes within the Library operating environment that may introduce new risk or change current risks are identified. Once identified, existing control measures can be modified or new measures created to mitigate risks. The enterprise risk management activities should include all relevant stakeholders, such as Chief Financial Officer (CFO), Chief Information Office (CIO), General Counsel, Director, Contracts and Grants, and Service Unit Chiefs.

III. Improper Recording of Investment Gains and Losses (*New Condition*)

The Library holds private investments in stock, index, and money market funds as part of its gift and trust fund board (TFB) programs. The Library needs to implement policies and procedures to ensure that they record investment activity in compliance with generally accepted accounting principles (GAAP) and Department of the Treasury (Treasury) regulations.

During our test over investments, Kearney noted that the Library was not properly recording gains and losses on its non-Treasury investments. The Library considers these investments to be available for sale. Available for sale investments are adjusted to the current market value at the end of each FY. When the value of investments is adjustment to market, the resulting gain or loss is also recognized as an unrealized gain or loss at that time. When an organization sells an investment, the unrealized gain or loss is recognized as a realized gain or loss.

In discussions with management, we noted that the Library was not recognizing previously unrecognized gains or losses during the sale of investments if the proceeds of that sale were used to immediately purchase new investments. Additionally, the realized gain or loss was not reflected on the Statement of Budgetary Resources (SBR) in accordance with Treasury guidance.

In this situation, the Library would not adjust the investment account to remove the historical cost of the sold investment and record the cost of the new investment, but, instead, it left the historical cost of the sold investment in the investment account and the associated previously unrecognized gain or loss in the market adjustment account.

The Library was not compliant with the Treasury Financial Manual (TFM) and United States Standard General Ledger (USSGL), which left some USSGL accounts misstated in the agency's general ledger (GL). Specifically, the investment account balance was understated and the market adjustment account balance was overstated. The accounts are reported on the same line on the balance sheet, so these errors off-set each other and did not result in a misstatement. However, these errors resulted in the understatement of the historical cost of private investment in the footnote disclosure by $28.7 million.

Additionally, the realized gain or loss accounts were understated and the unrealized gain or loss accounts were overstated. This resulted in the Library not recognizing $1 million gain when it sold investments and used the proceeds to immediately purchase a new investment; therefore, the sale and the purchase transaction were not reflected appropriately on the SBR.

Kearney recommends that the Library:

1. Record correcting entries to account for current-year realized gains on sale of investments not previously recognized and to correct the investment balances.
2. Separately recognize current-year gains and losses and unrealized gains and losses in the financial statements.
3. Update memo accounts based on the adjustments above so that the investment footnote properly reflects the historical cost of investments.
4. Update the appropriate cash accounts based on the correcting adjustments so that the Financial Management Service (FMS) 224, *Statement of Transactions*, properly reflects the gain on the sale of investments.
5. Establish procedures to record the USSGL entries listed above when investments are sold or purchased. These procedures should also ensure that investments sales and purchases are properly reflected on the SBR.
6. Establish procedures to perform a quarterly reconciliation of non-Treasury investments. As part of the quarterly reconciliation, the Library personnel should compare the market value of investment per statements received from the financial institutions with the investment balance recorded in the financial system. Any difference noted in the market value should be recorded as an adjustment to the balance of Market Adjustment – Investments account and the unrealized gain or loss accounts. The Library should also use this reconciliation to ensure the appropriate historical cost and current market value

amounts are recorded in memo accounts used to create the investment footnote that accompanies the financial statements.

IV. Lack of Validation for the Accounts Payable Accrual (*New Condition*)

The Library should record an accounts payable (AP) accrual for all goods and services received as of the financial statement date. The AP accrual may include estimated amounts for goods and services received for which the Library has not yet obtained an invoice. Additionally, the Library must accumulate sufficient, relevant, and reliable data on which to base accrual estimates, and Library management should ensure that adequate documentation is available to support the estimates. Failure to validate estimations may result in erroneous financial statements and failure to identify emerging financial risks in a timely manner.

During our test over the AP accrual process, Kearney noted that the Library updated its methodology to estimate a portion of the AP accrual related to FEDLink expenses, which is mainly made up of costs incurred to purchase goods for customers. For FY 2016, the estimated AP accrual amount for FEDLink was $16.8 million. Through discussion with management, Kearney noted that the Library did not validate the new AP accrual methodology for FEDLink expenses to ensure that the estimated AP accrual was accurate. Management stated that they could not compare the AP accrual estimate to the actual amount of expenses incurred in FY 2016 but paid in FY 2017 because the FEDLink system does not accurately capture the date of receipt for purchase orders. Since the Library did not perform a validation of its AP accruals estimates for FEDLink, it increases the risk of reporting erroneous information on the financial statements.

Kearney recommends that the Library:

1. Modify FEDLink processes and/or system to capture the date that goods or services are received.
2. Implement a process to regularly validate the AP accrual methodology for FEDLink by comparing the estimate to actual data. The OCFO should review the results of the validation and update the AP accrual methodology for FEDLink, as necessary, to ensure estimates accurately reflect actual data.

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS, REGULATIONS, CONTRACTS, AND GRANT AGREEMENTS

Inspector General
United States Library of Congress

Librarian
United States Library of Congress

We have audited the consolidated financial statements of the Library of Congress (the Library) as of and for the year ended September 30, 2016, and we have issued our report thereon dated March 14, 2017. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Library's consolidated financial statements are free from material misstatement, we performed tests of its compliance with provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance which could have a direct and material effect on the determination of financial statement amounts. We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the Library. Providing an opinion on compliance with those provisions was not an objective of our audit; accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 15-02.

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 the effectiveness of the entity's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 15-02 in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
March 14, 2017