Audit Report

OIG-20-010

FINANCIAL MANAGEMENT

Management Letter for the Audit of the Federal Financing Bank's Financial Statements for Fiscal Years 2019 and 2018

November 8, 2019

Office of Inspector General
Department of the Treasury

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

November 8, 2019

**MEMORANDUM FOR CHRISTOPHER L. TUTTLE, CHIEF FINANCIAL OFFICER
FEDERAL FINANCING BANK**

FROM: James Hodge /s/
Director, Financial Audit

SUBJECT: Management Letter for the Audit of the Federal Financing Bank's Financial Statements for Fiscal Years 2019 and 2018

We hereby transmit the attached subject management letter. Under a contract monitored by our office, KPMG LLP (KPMG), a certified independent public accounting firm, audited the financial statements of the Federal Financing Bank as of September 30, 2019 and 2018, and for the years then ended. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements,* and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, *Financial Audit Manual.*

As part of its audit, KPMG LLP issued the attached management letter dated November 8, 2019, that discusses a matter involving a deficiency in internal control over financial reporting that was identified during the audit. This matter relates to a control deficiency over the process of preparing and evaluating disclosures for certain loan commitments.

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

If you wish to discuss this report, please contact me at (202) 927-0009, or Shiela Michel, Manager, Financial Audit, at (202) 927-5407.

Attachment

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

November 8, 2019

Acting Inspector General, U.S. Department of the Treasury and
The Board of Directors, Federal Financing Bank
Washington, DC

Ladies and Gentlemen:

In planning and performing our audit of the financial statements of the Federal Financing Bank (the Bank) as of and for the years ended September 30, 2019 and September 30, 2018, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, we considered the Company's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses and/or significant deficiencies and therefore, material weaknesses and/or significant deficiencies may exist that were not identified. In accordance with *Government Auditing Standards* and OMB Bulletin 19-03, we issued our combined report dated November 8, 2019 on our consideration of the Bank's internal control over financial reporting.

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. During our audit, we identified a matter involving a deficiency in internal control.

The Federal Financing Bank's response to the findings identified in our audit are described in Appendix A. The Bank's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

See Appendix A for the deficiency identified, and management's response. See Appendix B for status of prior year findings.

The purpose of this letter is solely to describe the deficiencies in internal control identified during our audit. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

Appendix A

Federal Financing Bank (FFB) Incomplete Commitments Disclosure

FFB's control ensuring disclosures are complete is not sufficiently designed to capture agreements that may not have advanced to the latter stages of funding. During the FY19 audit, FFB did not properly include standby lines of credit to Federal bank insurers and others in the disclosure of total loan commitments. Upon our inquiries and observations, FFB corrected the loan commitments disclosure to increase the commitment balances accordingly by approximately $110 billion as well as related qualitative disclosure of conditions and other similar arrangements.

We applied the following criteria:

- Government Accountability Office (GAO) GAO-14-704G Standards for Internal Control in the Federal Government (the Green Book), Principle 7 – *Identify, Analyze, and Respond to Risks:* 7.04
- FASB's Accounting Standards Codification (ASC) Subtopic 942-825-50-1 *Off-Balance Sheet Credit Risk*
- FASB's Accounting Standards Codification (ASC) Subtopic 942-825-50-2 *Off-Balance Sheet Credit Risk*

We determined FFB did not perform a sufficiently robust risk assessment process to identify/analyze risk to potential omitted disclosures as it relates to commitment balances.

Without a sufficiently designed and effective control in place to perform risk assessment procedures to evaluate whether NPAs/PFAs warrant disclosure and thus ensure that required disclosures are included in the footnotes, the commitment balances disclosures could be materially misstated.

We recommend that FFB strengthen their procedures over risk assessment of the financial statements, especially the loan commitments disclosure, to ensure that disclosures are complete. At a minimum, we recommend that FFB complete a FASB disclosure checklist annually, and continue to assess whether there are any new and or relevant contracts and arrangements between FFB and its counterparty borrowers/guarantors which may warrant disclosure.

Management's Response

Management concurs with the recommendation and will implement new rules and procedures on the disclosure of amounts associated with agreements, notes, and advances. The FFB's operating model includes (1) note purchase agreements and program financing agreements, (2) future advance promissory notes, and (3) advances or loans. Historically, because the FFB employs the construct of future advance promissory notes, which are commitments to make future loans, the FFB has disclosed amounts associated with executed notes as its loan commitments. In the future, the FFB will disclose all three categories separately.

Fiscal Year 2018 Management Letter Comments Status – Fiscal Year 2019 Status

We also issued a management letter related to the subject of financial reporting, specifically that FFB did not have effective controls over the review of Statement of Cash Flows. This matter is closed in fiscal year 2019.

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