Audit Report

OIG-14-020

Management Letter for the Audit of the Department of the Treasury's Fiscal Years 2013 and 2012 Financial Statements

January 22, 2014

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

January 22, 2014

MEMORANDUM FOR NANI A.COLORETTI
ASSISTANT SECRETARY FOR MANAGEMENT

FROM: Michael Fitzgerald
Director, Financial Audit

SUBJECT: Management Letter for the Audit of the Department of the Treasury's Fiscal Years 2013 and 2012 Financial Statements

I am pleased to transmit the attached management letter in connection with the audit of the Department of the Treasury's (Department) Fiscal Years 2013 and 2012 financial statements. Under a contract monitored by the Office of Inspector General, KPMG LLP (KPMG), an independent certified public accounting firm, performed an audit of the Department's FY 2013 and 2012 financial statements. The contract required that the audit be performed in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*.

As part of its audit, KPMG issued, and is responsible for, the accompanying management letter that discusses certain matters involving internal control over financial reporting that were identified during the audit, but were not required to be included in the auditors' report.

In connection with the contract, we reviewed KPMG's letter and related documentation and inquired of its representatives. Our review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted government auditing standards.

Should you have any questions, please contact me at (202) 927-5789, or a member of your staff may contact Ade Bankole, Manager, Financial Audit at (202) 927-5329.

Attachment

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

January 15, 2014

Inspector General
U.S. Department of the Treasury:

In planning and performing our audit of the consolidated financial statements of the U.S. Department of the Treasury (Department), as of and for the year ended September 30, 2013, 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 Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*, we considered the Department'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 Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

We did not audit the financial statements of the Internal Revenue Service and the Office of Financial Stability, component entities of the Department. Those statements were audited by another auditor.

During our audit we noted certain matters involving internal control and other operational matters that are presented below for your consideration. In addition, we and the other auditor noted additional matters that were reported separately to component management. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

1. Callable Capital Commitments to Multilateral Development Banks

The Multilateral Development Banks (MDBs) consist of the World Bank Group (International Bank for Reconstruction and Development (IBRD), International Finance Corporation, and Multilateral Investment Guarantee Agency) and five regional development banks (the African, Asian, European, Inter-American, and North American institutions). The Department, on behalf of the United States, has subscribed to capital for certain MDBs, some of which is paid-in and some of which is callable.

Callable capital represents a financial commitment made by shareholders, but there is no actual transfer of funds. Callable capital subscriptions are subject to call, under limited circumstances, and only when required to meet the obligations of the respective MDBs created by borrowing or guaranteeing loans. Funds for callable commitment increases are provided through appropriation legislation.

The callable capital commitment is disclosed in the notes to the financial statements. The Credit Accounting Branch (CAB) at the Bureau of the Fiscal Service (Fiscal Service) maintains the callable capital commitment balance for each MDB. CAB updates callable capital commitments quarterly based on annual and supplemental appropriation acts that provide the increases to the limitations on callable capital.

CAB did not record callable capital commitment increases provided for in Public Law 113-6 Continuing Resolution, which was enacted on March 26, 2013, resulting in an $8.3 billion understatement in callable capital commitments. As a result of our observations, CAB appropriately increased the callable capital commitments to reflect the additional $8.3 billion of callable capital commitments in accordance with the accounting standards.

Recommendations

We recommend the Department implement the following actions in accordance with its current policies and procedures:

a. Review appropriation legislation to identify changes to callable capital commitments each quarter.

b. Reconcile callable capital commitments from the subsidiary ledger to the schedule supporting the note disclosure each quarter to ensure all activity is properly disclosed.

c. Confirm callable capital commitments with MDBs each year to ensure the callable capital commitment activity is properly disclosed.

Management Response

The Department agrees with the finding and recommendations. Accordingly, the Department will ensure that Fiscal Service accurately records newly subscribed callable capital consistent with the program limitations provided in appropriations legislation. Further, Fiscal Service will reconcile, on a quarterly basis, callable capital commitments from the subsidiary ledger to the schedule supporting the note disclosure. Finally, the Fiscal Service will confirm, on an annual basis, the callable capital commitments with the MDBs to ensure proper recording of the commitments.

2. Custodial Revenue Accrual

The Fiscal Service did not use the appropriate general ledger posting model to record a $3.1 billion custodial revenue accrual transaction. Fiscal Service used the following posting model:

Debit 1340 – Interest Receivable, Not Otherwise Classified
Credit 2980 – Custodial Liability

In accordance with the United States Standard General Ledger (USSGL), the Fiscal Service should have used the following posting model:

Debit 1340 – Interest Receivable, Not Otherwise Classified
Debit 5991 – Accrued Collections for Others - Statement of Custodial Activity
    Credit 2980 – Custodial Liability
    Credit 5900 – Other Revenue

As a result of our observations, Fiscal Service recorded the following adjusting entry for $3.1 billion, to correct the year-end accrual adjustment:

Debit 5991 – Accrued Collections for Others - Statement of Custodial Activity
    Credit 5900 – Other Revenue

Recommendations

We recommend that the Department work with the Fiscal Service to complete the following:

a. Review its accounting entries to ensure that accounting entries comply with the USSGL.

b. Reconcile the balances from the Fiscal Service Schedule of Treasury-Managed Accounts to the balances reported on the Department's financial statements.

Management Response

The Department agrees with the finding and recommendations. Accordingly, the Department will ensure that Fiscal Service reviews its accounting entries for compliance with the USSGL. Further, the Department will require that Fiscal Service reconcile the applicable lines of the stand-alone Schedule of Treasury-Managed Accounts to the applicable balances reported on the Department's CFO Vision (CFOV)-generated financial statements during the 3rd and 4th quarters.

3. Financial Statement Crosswalk

The Department requires components that issue stand-alone financial statements to reconcile balances from their stand-alone financial statements to the components' CFOV financial statements through the use of the "Stand-Alone to CFOV Crosswalk" template (crosswalks). The Department indicated that it reviewed the completed crosswalks; however, the Department did not document its review, nor did it adequately review the crosswalks to identify errors. The Bureau of Engraving and Printing did not properly complete the crosswalk and provided several incorrect versions of the crosswalk before providing a proper crosswalk. Incorrect completion and inadequate review of crosswalks limits the Department's ability to ensure the component stand-alone financial statements reconcile to the CFOV financial statements.

Recommendation

We recommend that the Department work with Bureau of Engraving and Printing to ensure that it understands how to prepare the crosswalk, agree the balances from the components' stand-alone financial statements to the Bureau BS Line Description' and 'Bureau's FS Balance' on the crosswalks, work with the components to understand and resolve any differences, verify the appropriateness of the 'Bureau Reclassification Balance' amounts on the crosswalks, agree the 'Calculated CFO Vision Statement' amounts to the CFOV financial statements, verify the mathematical accuracy of the crosswalk, and document evidence of completion and review of such procedures.

Management Response

The Department agrees with the findings and recommendations. Accordingly, the Department will ensure that bureaus properly complete the stand-alone financial statement crosswalk reconciliation by educating bureaus as to the appropriate use of their stand-alone financial statement detail line descriptions/amounts within the crosswalk template. The Department will require that the bureau stand-alone financial statement crosswalk incorporate any approved post-closing accounting adjustments reported on the Department's financial statements. Furthermore, the Department will adequately review bureaus' crosswalk reconciliations by: *(i)* ensuring agreement between stand-alone report data appearing on the crosswalk to the bureaus' stand-alone financial report, and *(ii)* agreeing CFOV data appearing on the crosswalk to CFOV financial reports. The Department will ensure that reconciliation differences are adequately explained or resolved. Finally, the Department will prepare a cover letter that indicates that the crosswalks have been adequately reviewed by the Department.

4. Oversight of 3rd Party Service Provider for the Housing Finance Agency (HFA) Initiative New Issue Bond Program (NIBP)

Under the Housing and Economic Recovery Act of 2008 (HERA) the Department, together with the Federal Housing Finance Agency, Fannie Mae, and Freddie Mac, announced in October 2009, an initiative to provide support to state and local housing finance agencies (HFAs). The initiative was designed to support low mortgage rates and expand resources for low and middle income borrowers to purchase or rent homes, making them more affordable over the long term.

In accordance with HERA, the Department purchased $15 billion of Fannie Mae and Freddie Mac (Government-sponsored Enterprises (GSEs)) securities and the GSEs used the proceeds to disburse the funds to state and local HFAs. The state and local HFAs used the funds to purchase mortgages in their locality and securitized such mortgages. The resulting HFA mortgage revenue bonds became the underlying collateral of the GSE securities.

The Department entered into a service provider agreement with JPMorgan Chase Bank N.A. (JPMorgan) to provide the Department custody services for the GSE securities. JPMorgan's responsibilities include custody over the GSE securities, principal and interest collection, and maintaining records of the underlying collateral of the GSE securities (the HFA mortgage revenue bonds). The Department records financial transactions using reports from JPMorgan.

JPMorgan engages a service auditor to perform periodic examinations of JPMorgan's internal controls in accordance with Statements on Standards for Attestation Engagements No. 16, *Reporting on Controls at Service Organizations* (SSAE 16). The periodic examinations result in reports on the Suitability of the Design and Operating Effectiveness of Controls (SOC 1 report) that provides the Department with an assessment of design, implementation, and operating effectiveness of JPMorgan's internal controls over the HFA mortgage revenue bonds for the entire fiscal year. Historically, the timing of the SOC 1 report covering the period April 1 through September 30 has not been available by November 15th of such year. As a result, the Department may not have a SOC 1 report for the last six months of fiscal year to provide the Department the assessment it needs to assess its overall control environment.

Recommendations

We recommend the Department perform one of the following:

a. Coordinate with JPMorgan to obtain a SOC 1 report or Agreed-Upon Procedures report addressed to Department management and the Department's auditors over the controls that are relevant to the Department's control environment for the period October 1, 2013 through at least June 30, 2014. The Department should ensure that it receives such report on or before October 31, 2014 to enable the Department to evaluate and react to such report before it issues its agency financial report on November 15, 2014.

b. Periodically (at least annually) confirm with local HFAs the following information and reconcile the confirmed information to JPMorgan reports:

    1) Principal and interest paid to the Department
    2) Mortgage revenue bond portfolio details

Management Response

The Department agrees with the finding and recommendations. The Department has begun the process of obtaining an Agreed-Upon Procedures report from JPMorgan.

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

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

The Department's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

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

Very truly yours,

KPMG LLP