Audit Report

OIG-09-028

Management Letter for the Fiscal Year 2008 Audit of the Department of the Treasury's Financial Statements

January 8, 2009

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

January 8, 2009

MEMORANDUM FOR PETER B. MCCARTHY
ASSISTANT SECRETARY FOR MANAGEMENT
AND CHIEF FINANCIAL OFFICER

FROM: Joel A. Grover /s/
Deputy Assistant Inspector General
for Financial Management and Information
Technology Audits

SUBJECT: Management Letter for the Fiscal Year 2008 Audit of the Department of the Treasury's 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 Year 2008 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 financial statements of the Department as of September 30, 2008 and for the year then ended. The contract required that the audit be performed in accordance with generally accepted government auditing standards; applicable provisions of Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*; and the *GAO/PCIE Financial Audit Manual*.

As part of its audit, KPMG issued and is responsible for the accompanying management letter that discusses other matters involving internal control over financial reporting and other operational matters that were identified during the audit, but were not required to be included in the audit 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) 927-5768, or a member of your staff may contact Mike Fitzgerald, Director, Financial Audits at (202) 927-5789.

Attachment

DEPARTMENT OF THE TREASURY
FISCAL YEAR 2008

Management Letter

November 17, 2008

DEPARTMENT OF THE TREASURY

Fiscal Year 2008
Management Letter Report

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

November 17, 2008

Inspector General
U.S. Department of the Treasury
Washington, D.C.

We have audited the consolidated financial statements of U.S. Department of the Treasury (Department/Treasury) as of and for the year ended September 30, 2008, and have issued our report thereon dated November 17, 2008. Our report indicated that we did not audit the amounts included in the consolidated financial statements related to the Internal Revenue Service (IRS), a component entity of the Department. The financial statements of the IRS were audited by another auditor whose report has been provided to us.

In planning and performing our audit of the consolidated financial statements of the Department in accordance with auditing standards generally accepted in the United States of America, we considered the Department's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

During our fiscal year (FY) 2008 audit of the Department's consolidated financial statements, we and the other auditor noted certain matters involving internal control and other operational matters that we considered to be significant deficiencies under standards established by the American Institute of Certified Public Accountants (AICPA). A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of internal control was for the limited purpose described above and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In our Independent Auditors' Report dated November 17, 2008, we reported the following matters involving internal control and its operations that we and the other auditor considered to be significant deficiencies.

- Financial Systems and Reporting at the IRS (Repeat Condition)
- Financial Management Practices at the Departmental Level (Repeat Condition)
- Controls Over Foreign Currency Transactions

We consider the significant deficiency related to Financial Systems and Reporting at the IRS, noted above, to be a material weakness. Detailed findings and recommendations to address the above significant deficiencies are not repeated within this document.

Although not considered significant deficiencies, we noted certain matters involving internal control and other operational matters that are presented in the attachment for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of the Department's management, are intended to improve internal control or result in other operating efficiencies. The matters presented in this letter do not include internal control or operational matters that have been presented to the management of the Department's offices or operating bureaus that were audited separately by other auditors.

Exhibit 1 provides the status of the 11 comments included in our management letter arising from our FY 2007 audit. We have not considered the Department's internal control since the date of our report.

We appreciate the courteous and professional assistance that Department personnel extended to us during our audit. We would be pleased to discuss these comments and recommendations with you at any time.

The Department's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the management of the Department, the Department's Office of Inspector General, the Office of Management and Budget, the Government Accountability Office, and Congress and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

FISCAL YEAR 2008 COMMENTS

***08-01: President's Budget Reconciliation* (Repeat Comment)**

The Department of the Treasury's (Treasury/Department) Office of Performance Budgeting and Strategic Planning (OPBSP) prepares the annual reconciliation of Treasury's Budgetary Resources, Outlays, Offsetting Receipts, and Obligations Incurred reported in the President's Budget (PB) to comparable information contained in Treasury's Statement of Budgetary Resources (SBR) (PB Reconciliation) for disclosure in Treasury's consolidated financial statements as required by Statement of Federal Financial Accounting Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources*. The PB Reconciliation is then provided to the Department's Office of Accounting and Internal Control (AIC) for final review and approval prior to inclusion in the Department's consolidated financial statements. Our review of the PB Reconciliation prepared for inclusion in the FY 2008 consolidated financial statements revealed the following:

- Sufficient management reviews were not performed on documentation provided to support the PB Reconciliation by either OPBSP or AIC.

- Initial documentation provided to support the PB Reconciliation did not fully support reconciling amounts reported in the PB Reconciliation. For example, the detailed analyses prepared by OPBSP for each Treasury component of what was reported in the PB compared to what was reported in the respective component's Statement of Budgetary Resources was either incorrect in some instances or not provided. In addition, extracts from the PB for amounts used in the reconciliation were not provided that would directly link back to amounts in the detailed analysis provided by OPBSP in support of the PB Reconciliation.

In response to questions raised, the OPBSP provided additional documentation, revised the PB Reconciliation on several occasions to incorporate auditor-requested changes, and assisted with resolving the issues identified.

Further improvements are needed to improve the process of preparing the reconciliation and expediting its review. Although differences identified were ultimately fully explained and supported, the initial supporting documentation provided was not comprehensive enough to eliminate the detailed discussions needed to understand the Department's unique budget transactions and how they contribute to the PB Reconciliation.

Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements* (OMB Circular No. A-136), provides guidance for preparing the note on Reconciliation of the SBR to the PB. Section II.4.2 of OMB Circular No. A-136, states "Agencies should discuss any material changes to budgetary information subsequent to the publication of the audited SBR with their auditors to determine if restatement or note disclosure is necessary. At a minimum, any material differences between comparable information contained in the SBR and the actual information presented in the Budget of the United States Government must be disclosed in the notes to the SBR."

In addition, GAO's *Standards for Internal Control in the Federal Government*[1] (GAO Internal Control Standards) states "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form."

The adequacy of review issues discussed above occurred mainly because existing OPBSP and AIC senior staff work loads exceed what can be reasonably conducted by senior staff. Therefore, insufficient time is available to be spent on supervisory reviews and other financial management activities. This has resulted in increased reliance being placed on the audit of the PB Reconciliation to identify errors and omissions.

Further, Treasury relies on the knowledge and skills of key experienced OPBSP officials to prepare the PB Reconciliation. However, because the PB Reconciliation is performed at the Department level, the lack of intimate knowledge of component transactions contributed to initial misclassification of budgetary resources for reconciliation purposes. This led to additional efforts to obtain documentation and increased time spent on the PB Reconciliation that, had the PB Reconciliation been performed by each component, could have been minimized.

08-01 Recommendations

We recommend that the CFO with input from the Director, OPBSP, and the Director, AIC:

(1) Update policies and procedures to include the details of the required documentation that is necessary to support the PB Reconciliation, as well as review and approval procedures required by authorized Treasury officials.

(2) Instruct all Treasury components to reconcile their respective SBR amounts to amounts included in the PB, and provide the operating procedures needed for the PB Reconciliation to components. This will streamline the process, provide better detail and clarification of reconciling items, and remove the significant time demands on already stretched Departmental staff. Once received, OPBSP and AIC should only consolidate the data. At the component level, management should classify amounts reported in the SBR and PB by reconciling budgetary sources to fund symbols, along with an explanation for each reconciling item, and also explain what funds are included in the line item. Components should be instructed to utilize the President's Budget Appendix Program and Financing Schedule amounts for the reconciliation. By reconciling all balances, Treasury will be able to better analyze the material differences between the SBR and the actual amounts reported in the PB.

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[1] U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1, November, 1999.

Management Response

The Department agrees with these recommendations. AIC and OPBSP will update the PB reconciliation policies and procedures to ensure that proper preparation, review, approval and documentation requirements are addressed.

We believe the PB reconciliation process should be streamlined to the maximum extent possible. AIC/OPBSP reviewed the reconciliation procedure in FY 2008. AIC and OPBSP developed a CFO Vision standardized template to prepare the Department's reconciliation worksheet. This worksheet identifies bureau and component entity differences. By automating the initial reconciliation process, OPBSP and AIC staff focused more time on explaining differences and getting supporting documents from bureaus. The template developed and used for FY 2008 was complicated. It was not sufficiently complete to provide all detailed information needed to support the reconciliation. Accordingly, it was only useful in providing accurate information on Expired and Treasury Managed Accounts. Subsequent meetings between OPBSB and KPMG produced a template that if generated by CFO Vision would adequately provide supporting documentation for the President's Budget Reconciliation and facilitate the review by OPBSP and AIC. We plan on exploring the possibility of automating this template in FY 2009.

We will also consider involving the bureaus and other components in the reconciliation process to the extent practicable. In most cases, the bureaus' data will always be identical to the PB data; it is just certain unique situations which cause the reconciliation complications. For example, the FMS data in the PB are the responsibility of five different accounting offices, one of those outside of Treasury. Bureaus in this situation will need to create additional worksheets to show what they are reconciling to, which may make it overly cumbersome for these bureaus to perform complete reconciliations. Thus, we need to work with the bureaus to determine the most efficient approach to the overall reconciliation process.

***08-02: Financial Reporting Standards for Treasury's Component Entities* (Repeat Comment)**

The Department's consolidated financial statements are prepared in conformity with accounting principles prescribed by the Federal Accounting Standards Advisory Board (FASAB), the accounting standards-setting body for the Federal Government, as recognized by the AICPA in October 1999. However, certain Treasury component entities prepare their financial statements in accordance with accounting standards prescribed by the Financial Accounting Standards Board (FASB), the private sector standards-setting body, since the FASAB has allowed entities that issued financial statements prior to October 1999 using FASB accounting to continue to do so. These component entities include the Bureau of Engraving and Printing, the Office of Thrift Supervision, the Exchange Stabilization Fund, the Federal Financing Bank, and the Community Development Financial Institutions Fund.

The use of a combination of generally accepted accounting principles (GAAP) by the Department and its component entities complicates the preparation of the Department's consolidated financial statements since additional information required for Federal GAAP reporting must be developed, mapped, and submitted to the Department's data warehouse by component entities, and reviewed for compliance with Federal GAAP and overall reasonableness by Department accounting management. In addition, the separately issued financial statements of the component entities using FASB accounting principles do not adequately portray the importance of the budgetary process as it relates to Federal entities. Consequently, the concept of "presents fairly" for those entities does not adequately convey the significant budgetary disclosures required by Federal GAAP.

Private sector GAAP does not contemplate budgetary reporting, and therefore, components using this basis of accounting do not prepare the SBR, although this statement is an integral part of the Department's consolidated financial statements, and must be prepared regardless of whether the component receives appropriations from the U.S. Government or not. Moreover, information reported in the Department's SBR must be reconciled to enacted amounts in the President's Budget and disclosed in the notes to the Department's consolidated financial statements. Considerable additional preparation is required to develop and report this data at the Department level for components using private sector GAAP.

Additionally, private sector GAAP does not provide sufficient information regarding the costs of programs and activities. The Statement of Net Cost required by Federal GAAP requires that costs and offsetting earned revenues be presented by responsibility segments, with net costs identified for each of the segments, in order to provide more meaningful information to evaluate the operating results of major activities.

Further, inconsistencies exist in how certain costs are reported by entities using private sector GAAP. For example, Federal GAAP requires that nonreimbursed costs paid by the Office of Personnel Management for retirement plans be recognized by the receiving entity as an imputed cost in order to report the full cost of operations. Since private sector GAAP does not provide guidance for the reporting of such imputed costs, these costs are being reported inconsistently, or not at all, by the Department's component entities.

This matter has been reported since FY 2004, and has not been resolved. The continued use of private sector GAAP by certain Treasury component entities decreases the usefulness of information reported by these entities for users of Federal financial statements and complicates the preparation of the Department's consolidated financial statements.

08-02 Recommendations

We recommend that the CFO, with input from the Director, AIC, work with those Treasury bureaus following FASB reporting standards to achieve conformance so that all reporting entities within the Department prepare their financial statements in accordance with Federal GAAP in order to strengthen and standardize financial accounting and reporting throughout the Department. If statutorily required to report on a different basis of accounting, then a separate set of financial statements should be prepared by these entities to meet such requirements.

Management Response

The Federal Accounting Standards Advisory Board (FASAB) has issued an exposure draft entitled The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Federal Accounting Standards Board which addresses this recommendation. This exposure draft proposes to clarify that a federal entity that is preparing GAAP-based financial statements for the first time is required to implement FASAB standards unless the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards. The Department is required to provide FASAB exposure draft comments by February 2, 2009.

This statement also proposes to clarify GAAP for those federal entities that are currently applying financial accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). This clarification is intended to address concerns that moving the GAAP hierarchy into the accounting standards would cause a sudden and dramatic change in practice for federal entities that apply FASB GAAP. The Board will determine whether additional reporting should be required of federal entities that are currently applying FASB accounting standards as part of its separate project on reporting by federal entities that primarily apply standards issued by the FASB, formerly referred to as the "Appropriate Source of GAAP" project.

While AIC will continue to encourage Treasury-reporting entities to conform to FASAB standards, we are also monitoring FASAB's efforts to clarify this issue so that appropriate guidance is communicated to the affected Treasury reporting entities.

08-03 Mortgage Backed Securities (MBS) Purchase Reconciliations

As a result of the Housing and Economic Recovery Act of 2008, the Office of Financial Management (OFM), with budgetary support from OPBSP was involved in various financial transactions unique to the Department. These transactions were processed in a shortened time-frame causing various control deficiencies related to documentation of policies and procedures and financial reporting. One transaction type involved the purchase of Government Sponsored Enterprise MBS totaling $3.3 billion. We noted that while MBS purchases that were traded and settled as of September 30, 2008 were ultimately reconciled to the information reported by the Custodian (a qualified financial institution designated to be the depository and financial agent), the reconciliation process was not well documented and there were no written procedures due to the timing of the transactions. In addition, initial documentation provided to support the MBS reconciliation was either incomplete or incorrect.

FMFIA requires "internal accounting and administrative controls of each executive agency shall be in accordance with standards prescribed by the Comptroller General." The GAO Internal Control Standards state, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular, management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

The *Treasury Financial Manual* (TFM), Chapter 3400, "*Accounting for and Reporting on Cash and Investments held Outside of the U.S. Treasury,"* Section 3420 states, "Treasury requires that agencies develop policies, systems, and procedures to ensure that cash and investment activity in Treasury and non-Treasury accounts is conducted in the following manner:

- To maintain full accountability and reconciliation control over funds owned by or in the custody of the Federal Government or any Federal Government officer, employee, or agent;
- To comply with applicable statutes regarding the deposit and/or investment of such funds; and
- To support Governmentwide collateral, accounting, and reporting requirements, as described in the TFM."

In response to questions raised, OFM officials provided additional documentation, revised the MBS reconciliation as needed, and assisted in resolving the issues identified.

08-03 Recommendations

We recommend that the CFO with input from the Directors, OFM and OPBSP:

(1) Ensure that staff responsible for the reconciliation between the MBS assets reported by the Department and the MBS assets held by and reported by the Custodian is fully trained and that adequate resources are provided.

(2) Ensure that Treasury implements a formal reconciliation process including appropriate documentation as described in Section 3420 of the TFM, as it is likely that Treasury will continue to increase its exposure to additional asset purchases during FY 2009.

(3) Continue to meet and communicate with the Custodian to ensure all reconciling items are cleared in a timely manner, and to ensure Treasury management has a firm understanding of the reconciling items.

Management Response

The Department agrees with these recommendations, and actions are underway to address them. OFM is primarily responsible for performing these reconciliations, and is working with both the Custodian and the Asset Managers to learn more about the availability of information and to provide further training to responsible staff. Resource requirements are also being reviewed.

A thorough reconciliation was performed as of the end of FY 2008, although not without having to rework the reconciliation as we learned more about the transactions and obtained additional information. However, due to these MBS transactions occurring so late in the fiscal year, there was insufficient time to develop formal reconciliation procedures and documentation requirements. Formal reconciliation procedures and documentation requirements are being developed in FY 2009.

***08-04: Disaster Recovery Procedures* (Repeat Comment)**

A Disaster Recovery Plan (DRP) has not yet been fully developed and implemented for two key systems of the Department, the Treasury Information Executive Repository (TIER) and the Chief

Financial Office Vision (CFO Vision) financial systems, responsible for the Department's consolidated financial statement reporting activities.

National Institute of Standard and Technology (NIST) Special Publication (SP) 800-34, *Contingency Planning Guide for Information Technology Systems*, states that "Information Technology (IT) and automated information systems are vital elements in most business processes. Because these IT resources are so essential to an organization's success, it is critical that the services provided by these systems are able to operate effectively without excessive interruption. Contingency planning supports this requirement by establishing thorough plans and procedures and technical measures that can enable a system to be recovered quickly and effectively following a service disruption or disaster." NIST SP 800-34 also states that "IT systems are vulnerable to a variety of disruptions, ranging from mild (e.g., short-term power outage, disk drive failure) to severe (e.g., equipment destruction, fire). Many vulnerabilities may be minimized or eliminated through technical, management, or operational solutions as part of the organization's risk management effort; however, it is virtually impossible to completely eliminate all risks. Contingency planning is designed to mitigate the risk of system and service unavailability by focusing effective and efficient recovery solutions."

Additionally, NIST SP 800-12, *An Introduction to Computer Security: The NIST Handbook (Chapter 11)* states "Contingency planning directly supports an organization's goal of continued operations. Organizations practice contingency planning because it makes good business sense. To avert potential contingencies and disasters or minimize the damage they cause, organizations can take steps early to control the event. Generally called contingency planning, this activity is closely related to incident handling, which primarily addresses malicious technical threats such as hackers and viruses. Contingency planning involves more than planning for a move offsite after a disaster destroys a data center. It also addresses how to keep an organization's critical functions operating in the event of disruptions, both large and small. This broader perspective on contingency planning is based on the distribution of computer support throughout an organization."

Should a disaster occur without a documented DRP for TIER and CFO Vision, the Deputy Chief Financial Officer's (DCFO) office's ability to restore and/or continue operations related to these systems may be significantly delayed.

08-04 Recommendations

We recommend that the DCFO's office:

(1) Finalize the TIER and CFO Vision DRP.

(2) Test the DRP annually in accordance with the guidance outlined in NIST SP 800-34.

(3) Update the DRP following any changes made to these systems to ensure that the current version is available for recovery.

Management Response

Management agrees with these recommendations. The Department has installed the TIER and CFO Vision software on the disaster recovery servers (as well as for all FARS applications). A conceptual framework has been developed for the monthly refresh of Treasury data and software code and the annual testing of the disaster recovery site. Treasury's team is documenting the procedures and will test them to ensure that they work as anticipated.

08-05 Database-level User Access

The Oracle® database management system that supports TIER has not been configured to log database-level user access.

NIST SP 800-53, Revision 2, *Recommended Security Controls for Federal Information Systems*, states "The organization regularly reviews/analyzes information system audit records for indications of inappropriate or unusual activity, investigates suspicious activity or suspected violations, reports findings to appropriate officials, and takes necessary actions."

By not logging the actions of individuals, including those with system administration-level privileges, the potential exists for security-related incidents to go unnoticed and uninvestigated, thus allowing potential unauthorized users to continue attempting to access system resources.

08-05 Recommendation

We recommend that the DCFO's office configure the TIER Oracle database to log database-level access and actions. At a minimum, this logging should include access attempts, both successful and unsuccessful, and include database administrator and system-level accounts (i.e., sys, system, and sysman).

Management Response

Management agrees with this recommendation. The DCFO's Office will work with DO's CIO and the FARS team to develop procedures for the monitoring of the logs of database-level access and actions. The FARS team will need to develop the policy, plans, and procedures for reviewing the logs and taking appropriate actions to address any issues that are identified. Resource requirements will need to be estimated and staff will need to be assigned to support the function. The budgetary impact will need to be developed and included in the FARS budget estimate.

EXHIBIT 1

DEPARTMENT OF THE TREASURY

Fiscal Year 2008
Management Letter Report
Status of Prior Year Management Letter Comments

Prior Year Comments		**Current Year Status**
07-01	President's Budget Reconciliation	This comment has not been corrected and is repeated in the current year as comment # 08-01.
07-02	Financial Reporting Standards for Treasury's Component Entities	This comment has not been corrected and is repeated in the current year as comment # 08-02.
07-03	Disaster Recovery Procedures	This comment has not been corrected and is repeated in the current year as comment # 08-04.
07-04	Documentation of Application-Level Changes	This comment has been corrected.
07-05	User Account Passwords	This comment has been corrected.
07-06	Systems Security Plan	This comment has been corrected.
07-07	Password Configurations	This comment has been corrected.
07-08	Plan of Action and Milestones Reporting	This comment has been corrected.
07-09	User Access Policies and Procedures	This comment has been corrected.
07-10	Segregation of Duties	This comment has been corrected.
07-11	Individual User Accountability	This comment has been corrected.