



# Audit Report



OIG-11-061

Management Letter for the Audit of the Department of the Treasury's Fiscal Years 2010 and 2009 Financial Statements

February 24, 2011

Office of  
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

OFFICE OF  
INSPECTOR GENERAL

February 24, 2011

**MEMORANDUM FOR DANIEL TANGHERLINI  
ASSISTANT SECRETARY FOR MANAGEMENT  
AND CHIEF FINANCIAL OFFICER**

**FROM:** Michael Fitzgerald  
Director, Financial Audits

**SUBJECT:** Management Letter for the Audit of the Department of the  
Treasury's Fiscal Years 2010 and 2009 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 2010 and 2009 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, 2010 and 2009 and for the years 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*, as amended; and the *GAO/PCIE Financial Audit Manual*.

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 and other operational matters 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 Audits at (202) 927-5329.

Attachment



**U.S. DEPARTMENT OF THE TREASURY  
FISCAL YEAR 2010**

Management Letter

November 15, 2010

**U.S. DEPARTMENT OF THE TREASURY**

Fiscal Year 2010  
Management Letter

**Table of Contents**

	<b>Page</b>
Transmittal Letter	1
10-01: Consolidated Financial Statements Compilation	3
10-02: Budget Reconciliations	6
10-03: Grants for Specified Energy Property in Lieu of Tax Credits	7
10-04: Service Provider Reviews	10
10-05: Financial Reporting Standards for Treasury's Component Entities (Repeat Comment)	11
10-06: Access Controls	12
 Exhibit 1 – Status of Prior Year Management Letter Comments	 14



KPMG LLP  
2001 M Street, NW  
Washington, DC 20036-3389

November 15, 2010

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

We have audited the consolidated financial statements of the U.S. Department of the Treasury (Department/Treasury) as of and for the year ended September 30, 2010, and have issued our report thereon dated November 15, 2010. Our report indicated that we did not audit the amounts included in the consolidated financial statements related to the Internal Revenue Service (IRS) or the Office of Financial Stability (OFS), both component entities of the Department. The financial statements of the IRS and the OFS were audited by another auditor whose reports were 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) 2010 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 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 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. 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 Department's financial statements will not be prevented or detected and corrected on a timely basis.

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 15, 2010, we reported the following material weakness and significant deficiencies in the following areas involving internal control over financial reporting:

Material Weakness

- Financial Systems and Reporting at the IRS (Repeat Condition)
- 

Significant Deficiencies

- Financial Management Practices at the Departmental Level (Repeat Condition)
- Financial Accounting and Reporting at the OFS (Repeat Condition)
- Information System Controls at the Financial Management Service (Repeat Condition)



Detailed findings and recommendations to address the above material weakness and 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 seven comments included in our management letter arising from our fiscal year 2009 audit. We have not considered the Department's internal control since the date of our report.

We appreciate the courteous and professional assistance that the 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 (GAO), 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 2010 COMMENTS

### *10-01: Consolidated Financial Statements Compilation*

Improvement is needed in the processes and procedures followed by the Department of the Treasury (Department/Treasury) in compiling its consolidated financial statements. While some policies and procedures have been developed to assist with the compilation of consolidated financial statements, the errors we continue to identify reflect the need for improvement in the knowledge of consolidated financial statement compilation requirements and improved supervisory review. In addition, existing written procedures are not sufficiently detailed for staff to follow so as to ensure the completeness and accuracy of the amounts reported in the consolidated financial statements and related disclosures. The following are examples of areas where issues were noted:

#### Component Financial Statement Tie-outs

Several instances were noted whereby amounts reported in the Department's components' stand-alone audited financial statements or note disclosures did not agree to what was reported by the Department in its consolidated financial statements at year end.

The Office of Accounting and Internal Control (AIC) within Treasury's Office of the Deputy Chief Financial Officer (CFO) is responsible for:

- Establishing and maintaining financial policies that guide consolidated financial reporting throughout the Department
- Implementing internal controls to ensure the overall integrity of financial data reported at the consolidated level.

Certain quality control procedures are conducted by AIC to ensure that component financial and other data is accurate and complete for inclusion in the consolidated financial statements. Data required for inclusion in the consolidated financial statements and related note disclosures are submitted by Treasury components to AIC, which is then incorporated into the consolidated financial statements and relevant note disclosures after certain data checks are processed by AIC. However, several discrepancies were noted in what was provided by these components to AIC, to what was reported in their stand-alone audited financial statements, and to what was reported in Treasury's consolidated financial statements. In one such example, initial data required for Note 26, *Collection and Disposition of Custodial Revenue* (Note 26), was submitted by the IRS to AIC. Subsequent to submission to AIC of initial Note 26 data, a formula error was identified by the IRS which resulted in a correction to the amounts reported between tax years, although the total of collections and refunds did not change. Although AIC was informed by IRS of the formula error, it did not follow up to ensure all corrections were processed as needed, and IRS amounts were not reconciled to the IRS stand-alone audited financial statements. Since AIC did not notice the changes in the supporting tax year amounts, these changes were not reflected in its year-end consolidated financial statements.

#### Note Disclosures

Errors were noted in the computation of the Reconciliation of Net Cost of Operations to Budget reconciliations (Reconciliation) which resulted in incorrect disclosures in Note 28, *Reconciliation of Net Cost of Operations to Budget* (Note 28), in the draft consolidated financial statements.

Specifically, payments to the GSEs during fiscal year 2010, liability to the GSEs, and net cost amounts used in the computation of the Reconciliation were incorrect. This occurred because the on-top adjustments causing changes to these amounts were not properly incorporated when AIC compiled the respective component information for Note 28, nor did AIC check to ensure that on-top adjustments impacting this note were properly processed. In addition, we also noted that there was a lack of understanding by staff involved in preparing this Reconciliation of the relationship requirements between budget and cost and the related linkages in the Reconciliation to the various amounts reported in other sections of the consolidated financial statements.

In addition, instances were noted whereby adequate support was not available nor requested by AIC for note disclosures included in the consolidated financial statements. For example, Note 31, *Commitments and Contingencies*, included disclosures for the Department's commitments to Multilateral Development Banks (MDB) for callable capital. The fiscal year-end 2010 draft consolidated financial statements provided for our review reported prior year amounts for an MDB with respect to callable capital in Note 31. This disclosure was not questioned nor reviewed for accuracy and completeness by AIC. In addition, AIC neither followed-up with the component responsible to confirm the accuracy and completeness of the note nor requested supporting documentation until questioned and requested as part of the audit.

The *Federal Managers' Financial Integrity Act of 1982* (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the GAO's *Standards for Internal Control in the Federal Government* (*Standards*). The GAO *Standards* require that internal controls be documented in management directives, administrative policies, or operating manuals; transactions and other significant events be clearly documented; and information be recorded and communicated timely with those who need it within a time frame that enables them to carry out their internal control procedures and other responsibilities. The GAO defines "internal control" as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. The GAO *Standards* also identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

OMB Circular No. A-123, *Management's Responsibility for Internal Control* (A-123) states that monitoring the effectiveness of internal control should occur in the normal course of business. In addition, periodic reviews, reconciliations, or comparisons of data should be included as part of the regular assigned duties of personnel. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations.

### ***10-01 Recommendations***

We recommend that the Department's CFO, with input from the Director, AIC:

- (1) Develop a process in conjunction with components' management for receipt of draft/final audited financial statements at year end from all components subject to stand-alone audit.
- (2) Require complete financial statement tie out at year end of component balances included in the consolidated financial statements to the respective Treasury components' final and/or most recent draft financial statements.



- (3) Develop specific policies and procedures for the preparation and review of the financial statement tie outs, and include detailed mapping for required references and cross-checks of all applicable consolidated financial statements and related note disclosures. Policies and procedures developed should also include guidance for incorporating on-top adjustments in the consolidated financial statements.
- (4) Develop training for financial statement tie out requirements for all staff involved in the preparation of the consolidated financial statements to ensure there is adequate knowledge and understanding of the tie outs and account relationships throughout the consolidated financial statements.
- (5) Develop a process for formal notification by components to AIC of any financial statement changes subsequent to release of component audited financial statement information to AIC, to ensure adequate follow-up on changes that may be needed to the consolidated financial statements. A copy of this notification should be provided to a supervisory-level Treasury official within AIC so that there is joint responsibility for follow-up and action.
- (6) Enforce the procedures for supervisory review requirements over the consolidated financial statement compilation process, including required reviews of documentation supporting note disclosures.
- (7) Require an experienced and knowledgeable Treasury official independent of the consolidated financial statement compilation process to conduct a final review of all financial statement tie outs, including review of on-top adjustments that need to be processed through the consolidated financial statements.

### ***Management Response***

- (1) The Department already had a process in place to ensure AIC receives all stand-alone component level audited financial statements as soon as they are available. However, AIC will more closely manage the review over these component statements to ensure consistency with the Performance and Accountability Report (PAR).
- (2) The Department agrees with this recommendation and will require component financial statement tie out at year end of all material balances reported in the PAR. These tie outs will be performed using the component's final audited statement or the latest draft received no more than five days prior to the PAR submission date.
- (3) The Department agrees with this recommendation and will develop policies and procedures for component financial statement tie outs which will include appropriate cross-referencing. Policies and procedures around posting of top-sided adjustments are already included in other existing policy.
- (4) The Department agrees with this recommendation and will provide training to staff on the process for component financial statement tie outs.
- (5) The Department agrees with this recommendation and will develop a formal process to ensure all component financial statement changes, subsequent to the release of component stand-alone financials, are communicated to the appropriate AIC staff level.
- (6) The Department agrees with this recommendation and will reevaluate the current review process and continue to reinforce the requirement for appropriate supervisory review procedures.

- (7) The Department will ensure that a review of consolidated financial statement tie outs will be performed by well-trained individuals who understand how to properly agree financial statement data back to source documentation and to component entity stand-alone audited financial statements and related footnote disclosures for purposes of assuring the accuracy of the financial data.

#### ***10-02: Budget Reconciliations***

##### ***Reconciliation of the Statement of Budgetary Resources to the SF-133, Report on Budget Execution and Budgetary Resources***

The fiscal year 2010 fourth quarter reconciliation of the SF 133, *Report on Budget Execution and Budgetary Resources (SF 133)*, to the fourth quarter Statement of Budgetary Resources (SBR) reconciliation (SF 133 to SBR Reconciliation), for certain comparable budget line items, contained significant discrepancies. In addition, the first version of the SF 133 to SBR Reconciliation provided for audit revealed footing and cross-footing errors. Multiple versions of the fourth quarter SF 133 to SBR Reconciliation provided subsequently for review continued to reflect significant discrepancies due to the use of incorrect fourth quarter SBR amounts. Specifically, the final year-end SBR amounts were not used by the Office of Performance Budgeting (OPB) during the preparation of the fourth quarter SF 133 to SBR Reconciliation.

OMB Circular No. A-136, *Financial Reporting Requirements*, Sections II.4.6.5, 6, and 8 states, “The resources reported on this statement shall agree with, and be reconciled to, the total budgetary resources reported for the aggregate of all budget accounts on the SF 133... The status of budgetary resources reported on this statement shall agree with, and be reconciled to, the total status reported for the aggregate of all budget accounts on the SF 133...The outlays shall also agree with, and be reconciled to, the aggregate of outlays reported on the SF 133 for the aggregate of all budget accounts, including nonbudgetary financing accounts and the disbursements and collections reported to the Treasury Department on a monthly basis (SF 224, *Statement of Transactions*; SF 1219, *Statement of Accountability*; and SF 1220 *Statement of Transactions*) per Circular No. A-11.”

##### ***President’s Budget Reconciliation***

OPB prepares the annual reconciliation of Treasury’s Budgetary Resources, Outlays, Offsetting Receipts, and Obligations Incurred that is reported in the President’s Budget (PB) to comparable information contained in Treasury’s SBR (PB Reconciliation). This is a required disclosure in Treasury’s consolidated financial statements in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources*. The PB Reconciliation is then provided to 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 2010 consolidated financial statements revealed the following:

- Sufficient management reviews were not performed on documentation provided to support the PB Reconciliation by either OPB or AIC.
- Initial documentation provided to support the PB Reconciliation was not adequate or was inaccurate. For example, in several instances, the detailed analysis prepared by OPB for each Treasury component comparing the PB to the respective component’s SBR was either incorrect or not provided. In other instances, extracts from the PB for a component’s budget amounts extracted and

included in the PB Reconciliation did not directly agree to amounts included in the detailed analysis provided by OPB in support of the PB Reconciliation. Further, a schedule (Offsetting Receipts Schedule) provided to support the offsetting receipts reported in the PB Reconciliation reflected a cross-footing error amounting to approximately \$300 million.

OMB Circular No. A-123 states that monitoring the effectiveness of internal control should occur in the normal course of business. In addition, periodic reviews, reconciliations, or comparisons of data should be included as part of the regular assigned duties of personnel. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations.

### ***10-02 Recommendations***

We recommend that the CFO, with input from the Directors of OPB and AIC:

- (1) Strengthen current policies and procedures related to the quarterly SF 133 to SBR Reconciliation to provide more detailed guidance on the supervisory review process.
- (2) Update policies and procedures to include the details of the required documentation to support the PB Reconciliation. Include samples of appropriate documentation and templates as guidance for future preparation of PB Reconciliations.
- (3) Mandate a completion date for the PB Reconciliation. Since the PB is available in February annually, the PB Reconciliation should be completed within two months of availability of the PB.

### ***Management Response***

Current policies and procedures require supervisory review of the SF 133 to SBR Reconciliation, and supervisory reviews were completed by both OPB and AIC. These reviews led to improvements in the final reconciliation. OPB and AIC will continue to focus on reviewing the reconciliation and supporting documentation. Current policies and procedures documents will be expanded to provide more detailed guidance for the reviewer, details of required documentation, and a completion date for the PB Reconciliation within two months of availability of the PB.

### ***10-03: Grants for Specified Energy Property in Lieu of Tax Credits***

The scope of responsibilities and reporting requirements within Treasury for management and monitoring of the American Recovery and Reinvestment Act of 2009 (ARRA), Division B, Title I, Subtitle G, *Other Provisions*, Section 1603 (*Grants for Specified Energy Property in Lieu of Tax Credits*) disbursements (Section 1603 Program) should be clearly documented and communicated within Treasury's Office of the Fiscal Assistant Secretary (OFAS) and the IRS. While some steps have been taken to formalize responsibilities and reporting requirements, further improvements are needed. Additionally, while OFAS has developed a preliminary compliance monitoring plan (plan), and initial steps have been taken to conduct monitoring, OFAS is not currently staffed to fully implement this compliance monitoring plan in house and cannot do so without a significant increase in personnel and funding.

OFAS has been tasked with managing the Section 1603 Program. In general, the Section 1603 Program is set up such that once the funds are disbursed, no restrictions are placed on the use of funds as they are a partial reimbursement of costs already incurred by the grantee (taxpayer). However, taxpayers who receive payments for property under Section 1603 are not eligible for the production or investment tax

credit under Sections 45 and 48 of the IRS code with respect to the same property for the taxable year of the payment or subsequent years. In addition, any credit under Section 48 previously allowed with respect to progress expenditures for the property is to be recaptured. This aspect of the program requires involvement by the IRS. Therefore, OFAS needs to report payments made under the Section 1603 program to the IRS for purposes of IRS monitoring so that taxpayers do not both receive grant funds and also claim the tax credit. OFAS therefore provides a quarterly listing of those taxpayers certifying that a tax credit was taken on the specified property to the IRS. In addition, an annual listing of all grantees for the current year is required to be submitted to the IRS for tax credit monitoring.

While communications have been noted from OFAS to IRS regarding submission of grantee names and notification of various issues identified to date, no formal documentation or procedures exist that describe OFAS and IRS responsibilities, and the structure and timelines for reporting and any follow-up requirements with respect to the Section 1603 Program.

In addition, while some limited up-front steps have been implemented to assess the reasonableness of the grantee requests for reimbursement under the Section 1603 Program, such as requiring an independent CPA certification of expenses incurred for those claiming over a \$1 million, agreed-upon procedures over expenses for those claiming over \$500,000, and reviews for eligibility by the Department of Energy's National Renewable Energy Laboratory, OFAS has not performed any reviews to determine if improper payments have been made to recipients of the grants. Specifically, the documentation currently provided by those requesting reimbursement under the Section 1603 Program, and the related reviews, will not ensure that the expenses incurred are valid and thus meet criteria for reimbursement. For example, not all costs are covered by the CPA certification or the agreed-upon procedures. Although OFAS has drafted a plan for monitoring Section 1603 compliance, the plan states that OFAS does not have the necessary resources to implement compliance monitoring of the Section 1603 program. This increases the risk of improper payments.

### ***10-03 Recommendations***

We recommend that the Fiscal Assistant Secretary:

- (1) Develop documentation such as a memorandum of agreement that specifies both OFAS and IRS responsibilities as well as the structure and timing of both reporting and any follow-up requirements.
- (2) Perform a staffing resource needs assessment, with particular focus on the assistance needed to fully implement monitoring of the Section 1603 program. Once these needs are assessed, hire staff, or consider transferring suitable staff from other offices within Treasury to meet these immediate needs.
- (3) Provide the training and guidance to staff as necessary to ensure that compliance monitoring conducted is effective in identifying improper payments.

## ***Management Response***

(1) The Department partially concurs with the auditors' recommendation. The responsibility of OFAS to report Section 1603 recipients to IRS and the responsibility of IRS to ensure that those recipients do not also receive tax credits with respect to the same property are set forth in statute. See 26 U.S.C. Sections 48(d) and 605D. The timing and form of reporting is prescribed by IRS and not subject to an interagency agreement. Nevertheless, we concur that it would be beneficial to supplement internal procedures related to this reporting to ensure the process is fully documented and understood.

(2) and (3)

The Department partially concurs with the auditor's recommendations. Overall, we believe our current pre-award procedures and planned enhancements to the Section 1603 program, as described below, should minimize the risk of improper payments occurring, or where necessary, should identify improper payments so they can be recaptured by the IRS as part of their administration of the tax laws. However, we recognize that alternative procedures may be required in the interim until our planned enhancements are fully implemented.

Recipients of Section 1603 funds have no ongoing responsibilities regarding the use of funds. Their postaward responsibilities are limited to ensuring that, for a period of five years, the property for which the funds were received remains qualified energy property. Treasury has established an electronic reporting process to monitor compliance with this requirement and to ensure appropriate action is taken in the event of noncompliance including, if appropriate, return of the funds to Treasury.

Treasury has carefully considered conducting postaward audits or reviews of recipients to ensure the amount paid was appropriate, and generally believes that the risk of overpayment is being minimized without incurring the significant increase in staffing and cost that would be otherwise required by implementing postaward audits. The program manages this risk through several means. Before funds are awarded, a rigorous review process takes place. All applicants must document their costs, and those seeking payments in excess of \$167,000 must submit an independent accountant's certification attesting to all claimed costs. These certifications are generally conducted by large, reputable accounting firms with extensive experience in energy issues. Additionally, the Department of Energy's technical review staff uses the considerable data and other resources available to them to compare claimed costs and design plans to costs for similar properties. Claimed costs which fall outside of a reasonable range are questioned, and the amount awarded is reduced when those costs are not substantiated. Furthermore, where the appropriateness of the claimed costs involves complex tax issues, input is sought from IRS counsel and determinations are based on that input.

Treasury also is pursuing initiatives to strengthen postaward compliance monitoring over the program. For example, the IRS is initiating a compliance initiative project relative to the Section 1603 program in FY 2011. This project is being designed to ensure, among other things, that Section 1603 recipients have properly stated their cost basis for federal tax purposes. As part of this initiative, IRS will use the quarterly and annual data provided by OFAS to help identify taxpayers to review. In addition, OFAS has and will continue to identify applications of concern and refer them to IRS for consideration in their compliance efforts. In order to strengthen Treasury's Section 1603 program compliance efforts, we are seeking a technical correction to the Section 1603 legislation that would authorize IRS to audit all Section 1603 recipients and treat any overpayments as tax liabilities. This would enable the IRS to use its full suite of collection tools to recapture any improper payments. This

effort, combined with IRS' planned initiative on Section 1603 compliance, is, in our view, the most efficient and effective means to further enhance our ability to prevent and reduce improper payments.

Until these initiatives are fully implemented, OFAS, with the support of the DCFO, will pursue arranging with the IRS to conduct some level of postaward reviews for purposes of detecting improper payments. We will continue to assess the adequacy of Treasury staffing resources associated with the Section 1603 program based upon the significance of improper payment activity detected.

#### ***10-04: Service Provider Reviews***

As a result of the Housing and Economic Recovery Act of 2008, the Department set up the Housing Finance Authority New Issue Bond Program (NIBP) and the Temporary Credit Liquidity Program (TCLP). A large portion of the administration of these programs is handled by third-party service providers. The services provided by these service providers are specialized with respect to these programs. As a result, the current service organization audit reports do not provide sufficient assurance over the processes and controls related to the services and reports provided to Treasury. Given the unique nature of the services provided, it is important for management to adequately design and implement controls to address the completeness, existence, and accuracy of information and amounts provided by these service organizations.

Based on our review of the process documentation and inquiry, we noted that management has certain controls informally in place over these service providers. However, these controls are not documented and were not systematically applied throughout fiscal year 2010. Existing controls include random spot checks of reports provided and monthly meetings with these service providers.

The GAO *Standards* states "Internal control should generally be designed to ensure 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."

#### ***10-04 Recommendation***

We recommend that the CFO, with input from the Directors of the Office of Financial Management and AIC, develop and implement policies and procedures, and controls (management review and reconciliation) over the reports and services performed by these service providers.

#### ***Management Response***

The Department agrees with the initial observation of the auditors that the controls over the service provider (financial agent) were not sufficiently well formalized and the recommendation that the controls should be strengthened. In response, Treasury had the agent prepare an independent risk assessment of the processes used to provide service on the Housing Finance Agency program. This assessment provides comfort that the activities being performed are being executed competently and accurately. Should any indicators of problems arise, we will work to further strengthen these controls, as necessary. The audit work of the internal controls is ongoing, and documentation of the continuing utilization of appropriate controls will be provided by JP Morgan on an annual basis. They have provided documentation of the controls in place, and there is no reason to believe that additional reconciliation on the part of the program office would provide any further comfort.

#### ***10-05: 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 components 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 the Department's 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.

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 or not the component receives appropriations from the U.S. Government. Moreover, information reported in the Department's SBR must be reconciled to enacted amounts in the PB 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.

This matter has been reported since fiscal year 2004. The continued use of private sector GAAP by certain 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.

#### ***10-05 Recommendation***

We recommend that the CFO, with input from the Director, AIC, work with those components 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 a component is 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 Department agrees with the observations of the auditors in terms of the complications that result from certain Treasury component entities that use commercial GAAP in preparing their stand-alone financial statements. We will continue to work with these Treasury components to influence them to transition towards federal GAAP reporting in their stand-alone statements. We will also continue to monitor FASAB's ongoing work on this topic. However, we recognize that FASAB standards currently allow component entities who have historically reported on a commercial GAAP basis to continue reporting in the same manner.

### ***10-06: Access Controls***

We noted that 16 user accounts for the Departmental Offices (DO) Local Area Network (LAN) were accessed after an individual separated from DO. Out of these 16 user accounts, 5 were accessed the following day, 4 were accessed two days after separation, 3 were accessed three days after separation, 2 were accessed four days after separation, and 2 were accessed five and thirteen days after separation respectively.

DO Information Technology Security Policy Handbook Version 1.0, Section 5.8.4 PS-4: Personnel Termination, General Policy, states: The Manager (DO employee or contractor employee) in conjunction with the System Owner (e.g., supervisor, team lead) and/or Contracting Officers' Technical Representative is responsible for:

- Reviewing information systems/facilities access authorizations when personnel are reassigned or transferred to other positions within the organization
- Communicating personnel termination to facilities
- Removing system access for the exiting employee
- Ensuring the following items are returned to DO:
  - All Treasury documentation and media
  - Treasury issued computers
  - All other Treasury resources (Blackberries, credit cards, keys, badges, etc.)

The Purpose subsection states that "Terminated or reassigned employees/contractors should have access privileges removed and should no longer have access to Treasury resources." Section 6.1.2 AC-2: Account Management, in AC-2(e) states: System administrators shall remove roles from account users who have separated.

Management explained that individuals were completing their exit process after their official separation date and that requests for extension of LAN access were previously handled verbally. This includes coming into the office to finish cleaning out their office, logging into the system to transfer work products to peers and supervisors, and then turning in all of their government equipment.

By not adhering to its policy to disable and collect all required items on the separating individual's last day, Treasury is allowing individuals who are no longer employees access to Treasury resources, and this could compromise access to Treasury's sensitive information.



### ***10-06 Recommendation***

We recommend that the Acting Chief Information Officer reinforce the Department's policy to disable user accounts so that access privileges are removed as of the individual's last day (separation date).

### ***Management Response***

The Department agrees with the finding and recommendation. It is Treasury's general practice to delete network access on the individual's last day of employment with the Department. However, there are exceptions when a former employee requests additional time to close out or transfer work in progress to other employees. Formal procedures have been revised and tested for all requests concerning extension of DO LAN access past an employee's departure date. All extensions are adjudicated and approved on a case-by-case basis by the Chief Information Security Officer within the CIO's office. A principal determining factor is whether or not access directly benefits Treasury and if the request for extended access is being made by an appropriate supervisory level of the terminated employee. Access is limited to those specific files and folders needed by the terminated employee during the extension period. Extended access may only be granted to those terminated employees who transfer to other agencies within the Federal Government. Terminated employees who are no longer Federal Government employees or retired employees are prohibited from being granted such extended access.

**EXHIBIT 1****U.S. DEPARTMENT OF THE TREASURY**

Fiscal Year 2010

Management Letter Report

Status of Prior Year Management Letter Comments

<b>Prior Year Comments</b>		<b>Current Year Status</b>
09-01	Financial Reporting Standards for Treasury's Component Entities (Repeat Comment)	This finding has not been corrected and is repeated in the current year as comment 10-05.
09-02	Opening Balances	This finding has been corrected.
09-03	Intragovernmental Transactions and Activities	This finding has been corrected.
09-04	Reconciliation of the SBR to the SF-133, <i>Report on Budget Execution and Budgetary Resources</i>	This finding has been corrected.
09-05	Audit Logs	This finding has been corrected.
09-06	Baseline Configurations	This finding has been corrected.
09-07	Encryption	This finding has been corrected.