



Audit Report



OIG-06-020

Management Letter for Fiscal Year 2005 Audit of the
Federal Financing Bank's Financial Statements

December 27, 2005

Office of
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

December 27, 2005

**MEMORANDUM FOR BRIAN D. JACKSON, CHIEF FINANCIAL OFFICER
FEDERAL FINANCING BANK**

FROM: William H. Pugh, *William H. Pugh*
Deputy Assistant Inspector General
for Financial Management and Information
Technology Audits

SUBJECT: Management Letter for Fiscal Year 2005 Audit of the
Federal Financing Bank's Financial Statements

I am pleased to transmit the attached management letter in connection with the audit of the Federal Financing Bank's (FFB) Fiscal Year (FY) 2005 financial statements. We contracted with the independent certified public accounting firm KPMG LLP to audit FFB's financial statements for FY 2005. 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. 01-02, *Audit Requirements for Federal Financial Statements*; and the *GAO/PCIE Financial Audit Manual*.

As part of its audit, KPMG LLP issued and is responsible for the accompanying management letter that discusses certain matters that were identified during the audit, which were not required to be included in the audit reports.

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

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Should you have any questions, please contact me at (202) 927-5400, or a member of your staff may contact Mike Fitzgerald, Director, Financial Audits at (202) 927-5789.

Attachment

cc: Donald V. Hammond
Vice President, FFB

Roger Kodat
Vice President and Treasurer, FFB



KPMG LLP
2001 M Street, NW
Washington, DC 20036

October 31, 2005

Inspector General, U.S. Department of the Treasury, and the
Fiscal Assistant Secretary of the U.S. Department of the Treasury:

We have audited the financial statements of the Federal Financing Bank (the Bank), for the year ended September 30, 2005, and have issued our report thereon dated October 31, 2005. In planning and performing our audit of the financial statements of the Bank, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit, we noted certain matters involving internal control and other operational matters that we present for your consideration. These comments and recommendations are summarized in Exhibit I and have been discussed with the appropriate members of management and are intended to improve internal control or result in other operating efficiencies. We also provide in Exhibit II the status of the comments and recommendations included in our letter arising from the fiscal year 2004 audit.

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 Bank gained during our work to make comments and suggestions that we hope will be useful to you.

This report is intended solely for the information and use of the Bank's management, the U.S. Department of the Treasury's Office of Inspector General, the U.S. Government Accountability Office, OMB, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

FEDERAL FINANCING BANK

Comments and Recommendations

September 30, 2005

1. Financial Reporting Standards

The Federal Accounting Standards Advisory Board (FASAB), the accounting standards-setting body for the Federal Government, has allowed the Bank and other Federal entities that issued financial statements prior to October 1999 using Financial Accounting Standards Board (FASB) accounting principles, to either continue doing so or to issue financial statements using FASAB accounting principles. The Bank elected to continue issuing financial statements using FASB accounting principles. The Bank also prepares financial statements and related disclosures using the FASAB accounting principles; however, the Bank only provides this information to the U.S. Department of the Treasury for consolidation into the Treasury Department-wide financial report. As a result, users of the Bank's financial statements do not receive key information that is required to be disclosed under FASAB accounting principles, such as:

- Mission, programs, and related organizational structure;
- Most important challenges;
- Assessment of the reliability and completeness of the performance and financial data in the financial report and management's plan to address any deficiencies;
- Statement of assurance indicating whether (a) management controls are in place and (b) financial systems conform with government-wide standards;
- Systems, controls, and compliance with applicable laws and regulations;
- Forward-looking information regarding significant demands, risks, uncertainties, events, conditions, and trends;
- Performance goals and results;
- Financial statement highlights;
- Statement of budgetary resources; and
- Statement of financing.

Recommendation

We recommend that the Bank consider issuing a single set of financial statements using the FASAB accounting principles. At a minimum, the Bank should add a management discussion and analysis section to the report issued under FASB accounting principles that provides the information that is required to be disclosed under FASAB accounting principles. This will provide additional financial information to users of the Bank's financial statements.

Management Response

Management does not concur with the finding and recommendation. Management is not in favor of changing the Federal Financing Bank's publicly distributed financial statements to the FASAB principles and detailed the strategic and practical reasons why in the response to similar recommendations included in the fiscal year 2004 management letter. In summary, management's response to the fiscal year 2004

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management letter indicated that the financial statement users are not and would not be familiar with FASAB statements in general and more specifically the FASAB format of financial presentation clearly does not capture the key financial measurements of a financial institution. Management also finds it curious that this recommendation is repeated in fiscal year 2005 since FASAB has accepted the continued use of FASB accounting principles by federal entities. Nevertheless, in the interest of providing those disclosures not required under FASB but deemed useful to the U.S. Department of the Treasury consolidated reporting, management will incorporate a management's discussion and analysis section in future financial reports provided this will satisfy the recommendation.

Auditors' Response to Management's Response

We understand the Bank's need to report the appropriate financial information to meet user needs and believe that including a management discussion and analysis that provides the information that is disclosed under FASAB accounting principles will improve the usefulness of the FFB financial report.

2. System Development Methodology and Configuration Management Plan

The Bank implemented certain programming changes without a formally documented system development methodology plan or configuration management plan. National Institute of Standards and Technology Special Publication (NIST SP) 800-18, *Guide for Developing Security Plans for Information Technology Systems*, includes requirements and guidance on planning for security applicable to systems development life cycle stages.

Recommendation

We recommend that the Bank formally document its system development methodology and configuration management plans. The system development methodology plan should include programming naming conventions, a description of the system development phases, procedures to be performed in each phase, emergency program change procedures, application test procedures, as well as a development, test and production access control lists. The configuration management plan should discuss the process for migrating LMCS source code changes into the production environment and the DEC Code Management System as well as the dual password authentication process.

Management's Response

Management concurs with the finding and recommendation. Management will develop and document a system development methodology as part of an overall information technology system restructuring. Management plans to complete the systems restructuring 18 to 24 months from now - in fiscal year 2007.

3. Interest Credit

As mandated by legislation, the Rural Utilities Service (RUS) receives an interest credit from the Bank equal to the amount of interest RUS pays to the private utility companies. RUS calculates the interest credit semi-annually and submits the calculation and supporting schedules to the Bank. The Bank did not

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effectively review the calculation as we determined that RUS incorrectly calculated the interest credit resulting in an overstatement of approximately \$4.8 million.

Recommendation

We recommend that the Bank recalculate the interest credit calculation submitted by RUS, including verifying the mathematical accuracy of calculation and ensuring that the calculation is based on the appropriate number of days and interest rate. We also recommend that the Bank require a supervisor to review and approve the recalculation and journal entry recording the interest credit.

Management's Response

Management concurs with the finding and recommendation and will incorporate procedures to test the calculation of RUS interest credits prior to their acceptance.

4. Review of Journal Entries

The Bank did not consistently document the review and approval of all journal vouchers consistent with the guidance in OMB Circular No. A -123, *Management Accountability and Control*, that states: "The documentation for transactions, management controls, and other significant events must be clear and readily available for examination." Specially, we determined that the Bank did not document their review and approval of recurring journal vouchers.

Recommendation

We recommend that the Bank require supervisors to compare the journal vouchers to the general ledger and supporting documentation to verify that the journal voucher is properly recorded and to document his/her review and approval of each journal voucher. This will help ensure that the journal vouchers are properly recorded and assist the Bank in complying with the guidance in OMB Circular No. A -123, *Management Accountability and Control*.

Management's Response

Management concurs with the need for supervisory over-sight of all journal entries. Management indicated that a significant system change will be required to alter the current procedure of recording and routing journal entries in the manner of the recommendation. Management will incorporate this as a process improvement during the information technology systems restructuring, which is planned for fiscal year 2007.

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Status of Prior Year Recommendations

September 30, 2005

Prior Year Recommendations	Current Year Status
1. Financial Reporting Standards	This comment has not been corrected and is repeated as comment 1.
2. Memorandum of Agreement	This comment has been corrected.
3. System Development Methodology and Configuration Management Plan	This comment has not been corrected and is repeated as comment 2.
4. Policies	This comment has been corrected.