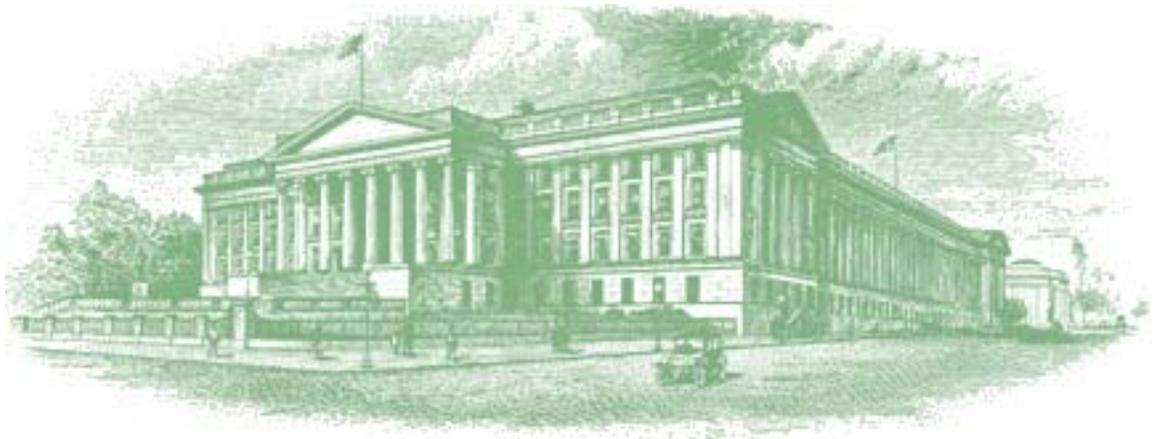




Audit Report



OIG-07-012

Management Letter for Fiscal Year 2006 Audit of the
Federal Financing Bank's Financial Statements

November 15, 2006

Office of
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

November 15, 2006

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

FROM: Michael Fitzgerald *Michael Fitzgerald*
Acting Deputy Assistant Inspector General
for Financial Management and Information
Technology Audits

SUBJECT: Management Letter for Fiscal Year 2006 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) 2006 financial statements. We contracted with the independent certified public accounting firm KPMG LLP to audit FFB's financial statements for FY 2006. 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. 06-03, *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 other matters involving internal control over financial reporting and its operation that were identified during the audit, but 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) 927-5789.

Attachment

cc: Donald V. Hammond
Vice President, FFB

Roger Kodat
Vice President and Treasurer, FFB



KPMG LLP
2001 M Street, NW
Washington, DC 20036

November 10, 2006

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, 2006, and have issued our report thereon dated November 10, 2006. 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 2005 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, 2006

1. Premium Amortization

The Bank is required to calculate and record amortization of the premium on the borrowings from the Bureau of the Public Debt using the interest method in accordance with the accounting standards and the Bank's accounting policies. The Bank did not record amortization for the period of July 1, 2005 through September 30, 2005. The Bank recorded the amortization of the premium on borrowings in June and December at the time of the interest payment dates, but the Bank did not record an adjustment at year end. As of September 30, 2005, the Bank should have recorded amortization of \$13.7 million for the period of July 1, 2005 through September 30, 2005.

Recommendation

We recommend that the Bank develop and implement year-end procedures to ensure that amortization is recorded for the entire fiscal year.

Management's Response

Management concurs with the finding and recommendation. Prior to the most recent debt limit related transactions between the Office of Personnel Management and the Bank, the Bank had few if any occurrences of debt premiums and discounts to record. Transactions of that nature were not anticipated with the Bank's accounting system; therefore, the accounting for the amortization of premiums and discounts is handled manually leading to a potential source of human error. The Bank has implemented procedures to address the process until the accounting system is updated to automate the activity.

2. Prepayment Error

The Bank did not properly calculate the premium/discount on certain prepayments of loans to the Rural Utilities Services (RUS). This resulted because the Bank used rates that were not in accordance with the rates in the related promissory notes. Management performed an analysis of the prepayments and determined that the Bank under-collected \$25.8 million from its customers and underpaid the Secretary of Treasury by \$20.7 million. Management is working with its customers and the Secretary of Treasury to determine whether the Bank will collect from its customers and reimburse the Secretary of Treasury.

Recommendation

We recommend that the Bank require that a second person compare the prepayment rate stipulated in the promissory note to the rate in the financial system to ensure that the proper premium/discount is calculated and document the review and approval on the prepayment memo.

Management's Response

Management concurs with the finding and recommendation. The Bank will compare the terms from the physical note in the files to the database to ensure that the terms are recorded properly. In addition, the Bank will incorporate a second person to review the prepayment terms and calculation.

Federal Financing Bank
Comments and Recommendations
September 30, 2006

3. Policy to Deactivate Users

The Bank has not defined the period of time a user account for the accounting system may be inactive before being disabled by system administrators in accordance with NIST SP 800-53, *Recommended Security Controls for Federal Information Systems*. Of the 14 active Bank users, we noted that all users had logged on to the system within the last 5 business days of the date we performed our testing.

Recommendation

We recommend that the Bank formally define a realistic period of time a user account can be inactive before being disabled by Bank system administrators and document this policy in the system security plan.

Management's Response

Management concurs with the finding and recommendation. The system hosting the accounting system is under the control of U.S. Department of the Treasury's Information Technology department, which provides hosting services to the Bank along with several other customers. Management has formally requested that the U.S. Department of the Treasury's Information Technology department design and execute a software change that automatically disables a user account that has been dormant for 90 days.

4. System Development Methodology and Configuration Management Plan

The Bank does not have a formally documented system development methodology or configuration management plan in place in accordance with NIST SP 800-64, *Security Considerations in the Information System Development Life Cycle*.

Recommendation

We recommend that the Bank continue its efforts in developing a system development methodology and a configuration management plan. The system development methodology should describe programming naming conventions, a description of the system development phases and what is to be performed in each, procedures for handling emergency programming changes, application test procedures, and development, test, and production of Access Control Lists (ACLs) and other areas.

Management's Response

Management concurs with the finding and recommendation. A development process is currently under way, with assistance of a third-party provider, to document a system development methodology as part of an overall information technology system restructuring. This first stage is a series of three steps scheduled to be completed over the next 12 months, toward the evaluation, documentation, and design of a test tool to assist in-house development work. Out of this we expect to have improved documentation of the system design and a practiced system development methodology which will be utilized as the standard for the Bank.

Federal Financing Bank
Status of Prior Year Recommendations
September 30, 2006

Prior Year Recommendations	Current Year Status
1. Financial Reporting Standards	This comment has been closed.
2. System Development Methodology and Configuration Management Plan	This comment has not been corrected and is repeated as comment 4.
3. Interest Credit	This comment has been corrected.
4. Review of Journal Entries	This comment has been corrected.