



Audit Report



OIG-09-035

Management Letter for Fiscal Year 2008 Audit of the Exchange
Stabilization Fund's Financial Statements

March 11, 2009

Office of
Inspector General

Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

March 11, 2009

MEMORANDUM FOR MARK SOBEL
ACTING ASSISTANT SECRETARY FOR INTERNATIONAL
FINANCIAL MARKETS AND INVESTMENT POLICY

FROM: Michael Fitzgerald /s/
Director, Financial Audits

SUBJECT: Management Letter for Fiscal Year 2008 Audit of the
Exchange Stabilization Fund's Financial Statements

I am pleased to transmit the attached management letter in connection with the audit of the Exchange Stabilization Fund's (ESF) Fiscal Year 2008 financial statements. Under a contract monitored by the Office of Inspector General, KPMG LLP, an independent certified public accounting firm, performed an audit of the ESF's financial statements 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 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 a matter involving internal control over financial reporting that was identified during the audit, but was 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.

Should you have any questions, please contact me at (202) 927-5789, or a member of your staff may contact Catherine Yi, Manager, Financial Audits at (202) 927-5591.

Attachment

**EXCHANGE STABILIZATION FUND
FISCAL YEAR 2008**

Management Letter Report

February 13, 2009



KPMG LLP
2001 M Street, NW
Washington, DC 20036

February 13, 2009

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

We have audited the statement of financial position of the Exchange Stabilization Fund (ESF) as of September 30, 2008, and the related statement of income and retained earnings, and statement of cash flows (hereinafter referred to as financial statements) for the year then ended, and have issued our report thereon dated February 13, 2009. In planning and performing our audit of the financial statements of the ESF, in accordance with auditing standards generally accepted in the United States of America, we considered ESF'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 ESF's internal control. Accordingly, we do not express an opinion on the effectiveness of ESF's internal control.

During our audit, we noted a matter involving internal control that is presented for your consideration. This comment and related recommendations which have been discussed with the appropriate members of management, are intended to improve internal controls and are summarized as follows.

Management Supervision and Review

Improvements are needed in supervisory and monitoring control procedures over financial statements and work prepared by ESF accounting staff during the year.

Journal Entries

Certain journal entries supporting monthly ESF activities transactions were not reviewed timely. The ESF Accountant prepares the monthly journal entry that summarizes the financial transactions reported to ESF on transaction activities applicable to that month. The journal entries are then used as the basis for purposes of recording these transactions in Oracle, ESF's general ledger system. These journal entries are reviewed by the ESF Account Supervisor for accuracy and reasonableness, prior to posting into Oracle. We inspected the monthly Account Supervisor signoff sheets for the period October 1, 2007 through June 30, 2008 for evidence of review and noted that for 3 of the 9 months during the period reviewed, the Account Supervisor either reviewed the journal entries late or failed to date the signoff sheet.

Financial Statements

ESF's financial statements are not subject to proper supervisory review and approval. Further, our review of the draft year end financial statements revealed that (i) not all required footnote disclosures for ESF's investments were included clearly articulating the accounting policy followed by ESF for various transactions; (ii) statement of cash flow reporting for foreign exchange gains and losses transactions was not in accordance with Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows*, resulting in significant additional work compiling the amounts to be reported and a reclassification of prior year foreign exchange gains and losses transactions amounts; and (iii) the accounting policies and disclosures for the new Money Market Fund Insurance Program were not adequate, and did not follow



prescribed disclosure requirements. For example, an accounting policy describing the accounting basis for the insurance premiums was not included as part of significant accounting policies in the footnotes to the financial statements.

ESF prepares a complete set of financial statements only once during the year which coincides with year end reporting. For the remainder of the year, the financial statements issued for internal management review excludes disclosure information. The year end financial statements are prepared by the ESF Accountant and consist of updating prior year information without a detailed review or assessment of the requirements for new accounting and/or reporting disclosures.

Further, there appears to be no clear management oversight responsibilities and processes defined or documented to allow for effective review and supervision of financial activities.

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires internal accounting and administrative controls of each executive agency to be established in accordance with standards prescribed by the Comptroller General. The Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Reliable financial reporting requires sufficient human resources, with the appropriate skills and abilities, coupled with an organizational structure with clearly defined responsibilities and effective internal controls. FMFIA further states that "transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

Due to the critical and material nature of the information contained in the monthly journal entries and financial statements, proper review of financial statements is needed to detect and prevent errors in the financial statements.

Recommendation

We recommend that the ESF's Chief Executive Officer and Chief Financial Officer:

- 1) Implement steps to improve supervisory review procedures and practices over journal entries and any related supporting documentation.
- 2) Require the preparation of a full set of the financial statements, including footnotes, on at least a semi-annual basis, in addition to those prepared at year end. Develop formal review procedures with detailed responsibilities assigned over financial statement preparation and analysis. Procedures developed should include: (i) an annual review of any new accounting and reporting requirements related to ESF related transactions, along with the related assessments of whether or not such requirements apply; and (ii) a comprehensive period to period (quarterly) variance analysis with documented explanations. Documentation evidencing supervisory reviews of the procedures conducted should be retained.
- 3) Document the procedures and policies to be followed for review and approval of journal entries and related supporting documentation, as well as financial statements, along with related responsibilities.



Management's Response

Management's Response to Recommendation 1:

Management concurs with the recommendation.

Management's Response to Recommendation 2:

We concur with the recommendation to prepare a full set of stand-alone financial statements as of June 30, in addition to that prepared at year end. We currently prepare financial statements for Departmental consolidation at June 30 and there are currently review procedures in place. These will be augmented to focus on an annual review of any new accounting and reporting requirements related to ESF transactions, along with an assessment of whether or not such requirements apply. The Department's consolidated statements also require ESF to conduct a variance analysis with documented explanations submitted with evidencing supervisory reviews. This documentation is retained by both ESF and the Department. We will perform this same variance analysis on the June 30 stand-alone financial statements.

Management's Response to Recommendation 3:

Management concurs with the recommendation.

In addition, we identified certain deficiencies in internal control that we consider to be significant deficiencies and communicated them in writing to management and those charged with governance on February 13, 2009.

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 the knowledge of the ESF gained during our work to make comments and suggestions that we believe will be useful to you.

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

The ESF's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the ESF 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 ESF, the Department of the Treasury'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