



**KPMG LLP**  
2001 M Street, NW  
Washington, DC 20036

## **Independent Auditors' Report**

Director and Inspector General  
U.S. Office of Personnel Management:

We have audited the accompanying balance sheets of the United States (U.S.) Office of Personnel Management (OPM) as of September 30, 2004 and 2003, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended (hereinafter referred to as the "consolidated financial statements"). We have also audited the individual balance sheets of the Retirement, Health Benefits, and Life Insurance Programs (hereinafter referred to as the "Programs") as of September 30, 2004 and 2003, and the related individual statements of net cost, changes in net position, budgetary resources, and financing for the years then ended (hereinafter referred to as the Programs' "individual financial statements").

The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered OPM's and the Programs' internal control over financial reporting and tested OPM's and the Programs' compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on its financial statements.

### **SUMMARY**

As stated in our opinion on the financial statements, based on our audits and the results of other auditors, we concluded that OPM's consolidated financial statements and the Programs' individual financial statements as of and for the years ended September 30, 2004 and 2003, as presented in OPM's Fiscal Year 2004 Performance and Accountability Report, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14 to the financial statements, OPM restated the fiscal year 2003 combined statement of budgetary resources and the fiscal year 2003 statement of budgetary resources for the Retirement Program.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

1. Financial management and reporting processes of the Division of Management and Chief Financial Officer (MCFO).
2. Information systems general control environment.
3. Segregation of duties over the letter-of-credit system related to Experience-Rated Carriers.
4. Managerial cost accounting to determine full cost associated with strategic goals and major outcomes.

We consider the reportable condition financial management and reporting process of the MCFO noted above to be a material weakness.



The results of our tests of compliance with certain provisions of laws, regulations, and contracts—exclusive of those referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA)—disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, or OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The results of our tests of FFMIA disclosed instances where OPM's financial management systems did not substantially comply with applicable federal accounting standards and the United States Standard General Ledger (USSGL) at the transaction levels. The results of FFMIA disclosed no instances in which OPM's and the Programs' financial management systems did not substantially comply with Federal financial management system requirements and no instances in which the Programs' financial management systems did not substantially comply with the applicable Federal accounting standards and the USSGL at the transaction levels.

The following sections discuss our opinion on OPM's consolidated financial statements and individual financial statements of the Programs, our consideration of OPM's and the Programs' internal control over financial reporting, our tests of OPM's and the Programs' compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

## **OPINION ON THE FINANCIAL STATEMENTS**

We have audited the accompanying consolidated balance sheets of the U.S. Office of Personnel Management as of September 30, 2004 and 2003, and the related consolidated statements of net cost, changes in net position, and financing for the years then ended and the combined statement of budgetary resources for the years then ended. We have also audited the individual balance sheets of the Programs as of September 30, 2004 and 2003, and the related individual statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. The Programs' individual financial statements are included in the consolidating financial statements presented in the Consolidating Financial Statements section of OPM's Fiscal Year 2004 Performance and Accountability Report.

In fiscal year 2003, we did not audit the financial statements of the experience-rated health carriers, which statements comprise less than one percent of total assets reflected in the consolidated balance sheet as of September 30, 2003, and less than one percent of total assets reflected in the Health Benefits Program (HBP) individual balance sheet as of September 30, 2003. These statements also comprise 7.6 percent of total gross costs reflected in the consolidated statement of net cost for the year ended September 30, 2003, and 21.5 percent of total gross costs reflected in the HBP individual statement of net costs for the year then ended. In addition, these statements also comprise 10.5 percent of total status of budgetary resources reflected in the combined statement of budgetary resources for the year ended September 30, 2003, and 32.3 percent of total status of budgetary resources reflected in the HBP individual statement of budgetary resources for the year then ended. The experience-rated carrier financial statements were audited by other auditors, whose reports thereon have been provided to us, and our opinion, insofar as it relates to the amounts included for the experience-rated health carriers, is based solely on the reports of the other auditors as of and for the year ended September 30, 2003.

Additionally, in fiscal year 2003, we did not audit the financial statements of Metropolitan Life Insurance Company's Office of Federal Employees Group Life Insurance Program (OFEGLI), which statements comprise less than one percent of total assets reflected in the consolidated balance sheet as of September 30, 2003, and 2.3 percent of total assets reflected in the Life Insurance Program (LP) individual balance sheet as of September 30, 2003. These statements also comprise 1.2 percent of total gross costs reflected in the consolidated statement of net cost for the year ended September 30, 2003, and 52.6 percent of total gross costs reflected in the LP individual statement of net costs for the year then ended. In addition,



these statements also comprise 1.7 percent of total status of budgetary resources reflected in the statement of budgetary resources for the year ended September 30, 2003, and 7.3 percent of total status of budgetary resources reflected in the LP individual statement of budgetary resources for the year then ended. Those financial statements were audited by other auditors, whose reports thereon have been provided to us, and our opinion, insofar as it relates to the amounts included for OFEGLI, is based solely on the reports of the other auditors as of and for the year ended September 30, 2003.

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OPM and the financial position of each of the Programs as of September 30, 2004 and 2003, and the consolidated and individual Programs' net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14 to the financial statements, OPM restated the fiscal year 2003 combined statement of budgetary resources and the fiscal year 2003 statement of budgetary resources for the Retirement program.

The information in the Management Discussion and Analysis and Required Supplementary Information sections of OPM's Fiscal Year 2004 Performance and Accountability Report is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements of OPM taken as a whole and on the Programs' individual financial statements. The individual financial statements of the Revolving Fund Programs (RF Programs) and Salaries and Expenses funds (the Funds) included in the Consolidating Financial Statements section of OPM's *Fiscal Year 2004 Performance and Accountability Report* (Schedules 1 through 5) are presented for purposes of additional analysis of the consolidated financial statements of OPM rather than to present the financial position, net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations of the individual Funds. The presented financial statements of the Funds have been subjected to the auditing procedures applied in the audits of the consolidated financial statements of OPM and, in our opinion, are fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

In addition, the consolidating information of Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS), included in the Consolidating Financial Statements section of OPM's *Fiscal Year 2004 Performance and Accountability Report*, is presented for purposes of additional analysis of the consolidated financial statements of OPM and the individual financial statements of the Retirement Program rather than to present the net costs of the CSRS and FERS funds. The presented consolidating information of the CSRS and FERS funds have been subjected to the auditing procedures applied in the audit of OPM's consolidated financial statements and the individual financial statements of the Retirement Program, in our opinion, are fairly stated in all material respects in relation to OPM's consolidated financial statements and the individual financial statements of the Retirement Program taken as a whole.

The Introduction (Part 1), FY 2004 Highlights (Part 2), FY 2004 Performance Information (Part 4), and other accompanying information included in Appendices A and B are an integral part of OPM's *Fiscal Year 2004 Performance and Accountability Report*. However, this information is not a required part of the financial statements and is presented for purposes of additional analysis. The information in the



Introduction, FY 2004 Highlights, FY 2004 Performance Information, and other accompanying information included in Appendices A and B have not been subjected to the auditing procedures and, accordingly, we express no opinion on it.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect OPM's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated and Programs' individual financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

In our fiscal year 2004 audits, we noted certain matters, described in Items 1 through 4 below, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the reportable condition described in Item 1 below is a material weakness.

### **1. Financial Management and Reporting Process of the Division of Management and Chief Financial Officer (MCFO)**

Since 1995, there have been significant deficiencies in the operation of the MCFO's internal control over financial management and reporting that have continued to affect the accuracy of the RF Programs and Salaries and Expenses (S&E) Funds. Specifically:

- a. **Timeliness of Transaction Entry and Reconciliation** – The MCFO does not consistently record financial transactions or analyze its financial records in a timely manner. In addition, the MCFO does not consistently reconcile the general ledger accounts to subsidiary ledgers and other supporting documentation on a routine basis. Further, the MCFO has not fully implemented procedures for reconciling Fund Balance with Treasury and reconciliation procedures between proprietary and budgetary accounts to ensure that all key account relationships exist.
- b. **Budgetary Accounting Structure** – The MCFO has not fully implemented effective budget controls to provide reasonable assurance that budgetary transactions, such as obligations and outlays, are properly recorded, processed, and summarized to permit the preparation of the RF Programs and S&E Funds' financial statements, mainly the statements of budgetary resources, and financing, in accordance with accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*.

In our judgment, these deficiencies adversely affect OPM's ability to record, process, summarize, and report financial data for the RF Programs and S&E Funds. In addition, the combination of weak budgetary controls and unreconciled Fund Balance with Treasury increase the risk of noncompliance with budgetary laws and regulations. While the RF Programs and S&E Funds are not material to OPM's consolidated financial statements presented herein, because of these control weaknesses we



performed supplemental procedures to mitigate the risk of the potential effect of these weaknesses on the integrity of the consolidated financial statements.

### **Recommendation**

The MCFO is currently reviewing its existing processes. We recommend that written policies and procedures be established and implemented to address control weaknesses and improve financial management and reporting. These policies and procedures should address reconciliation procedures, account analysis, review of financial statements and monitoring controls. Further, we recommend that the MCFO develop and implement formal month-end financial reporting procedures that include the following:

- Reconciling all general ledger accounts to the subsidiary ledgers or other supporting documentation and resolving reconciling items;
- Reconciling applicable general ledger accounts to the information provided and received from the Department of the Treasury;
- Reconciling, where applicable, proprietary and budgetary accounts; and
- Researching, identifying, and removing items from clearing, suspense, and other temporary general ledger accounts within the month they occur.

The MCFO should ensure that the staff completing and reviewing these month-end procedures and perform day-to-day financial processing possess the necessary skills, experience, and training to perform these tasks efficiently and effectively. To that end, we recommend that the MCFO staff be trained on the revised procedures and accounting related matters periodically and, at a minimum, annually.

### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.

## **2. Information Systems General Control Environment**

The MCFO continues to make progress in enhancing its technology and information security infrastructure for OPM and the Programs. However, the MCFO needs to strengthen certain access controls to meet requirements of the *Federal Information Security Management Act*.

The *Federal Information Security Management Act* requires Federal agencies to identify and provide security protection commensurate with risk resulting from the loss, misuse, unauthorized access, or modification of information collected or maintained.

### **Recommendation**

We recommend that the MCFO continue the implementation of planned security enhancements to its internal information technology infrastructure. The continued implementation of planned security enhancements will assist in enhancing agency-wide monitoring of critical IT resources to prevent and detect unauthorized use.



### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.

### **3. Segregation of Duties Over the Letter-of-Credit System for the Experience-Rated Carriers**

In accordance with OMB Circular A-123, Management Accountability and Control, key duties and responsibilities in authorizing, processing, recording, and reviewing official agency transactions should be separated among individuals. OPM maintains a letter-of-credit (LOC) system whereby Experience-Rated Health Carriers (ERC) participating in the Programs draw down funds to pay for employees' claims and administration expenses.

As reported in the prior years, during our review of OPM's and the Programs' internal controls over the HBP, we noted the Team Leader and certain other team members for the Health Benefit and Life Insurance Program team within the Business Units & Financial Services Group have the authorization to perform an emergency draw down on behalf of an ERC and also have the ability to access, record, and change related accounting transactions in the financial management system. The team leader was also involved in reconciling the LOC fund balances with Treasury's fund balances.

OPM has instituted certain mitigating manual controls over this area; however, segregating the emergency draw down function from the supervisory functions is necessary to reduce the risk that unauthorized use or disposition of the entity's assets having a material effect on the financial statements will occur and not be detected in a timely manner.

### **Recommendation**

We recommend that application security is documented and user access lists for application functions, libraries, and programs are created and periodically reviewed. We also recommend that duties over changes to payment information of ERC carriers and request for emergency draw downs are further segregated, and that authorizations are required for both functions. This may be enforced as follows:

- The system is modified so that a person, other than the individual entering the change, approves the request for changes in payments information and emergency draw downs before such payment can be processed;
- The system produces a report for any updates that have been entered but not yet approved on a regular basis. Policies and procedures should be established for a supervisor to review these reports and take appropriate action if necessary; and
- The user changing critical ERC information would not be able to request emergency draw downs for carriers.

### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.





#### **4. Managerial Cost Accounting to Determine Full Cost Associated with Strategic Goals and Major Outcomes**

OPM's information technology systems are not designed or configured in a way that allows them to accumulate RF Programs and S&E Funds costs from their responsibility segment "Provide Human Resource Services" to its four strategic goals. Instead, OPM manually aggregated data within the system to derive the amount of costs for each strategic goal. According to Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *The Managerial Cost Accounting Concepts and Standards for the Federal Government*, "costs may be accumulated through the use of cost accounting systems or through the use of cost finding techniques. A cost accounting system is an organized grouping of methods and activities designed to consistently produce reliable cost information."

##### **Recommendation**

We recommend that OPM utilize its integrated information systems to capture and report the costs of services and products that each responsibility segment produces and delivers. The costs should be aligned with OPM's strategic goals, including the major goals and outputs of the programs and activities.

##### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.

\* \* \* \* \*

A summary of the status of prior year reportable conditions is included as Exhibit I.

We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of OPM in a separate letter dated November 5, 2004.

#### **COMPLIANCE AND OTHER MATTERS**

Our tests of compliance with certain provisions of laws, regulations, and contracts as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed instances where OPM's financial management systems did not substantially comply with applicable Federal accounting standards and the USSGL at the transaction levels.

#### **5. Federal Financial Management Improvement Act of 1996 (FFMIA)**

##### **a. Federal Accounting Standards –**

In accordance with FFMIA, as amended, OPM is to prepare financial statements and related disclosures, budget reports, or other financial information for agency management decision-making purposes that are consistent with Federal accounting standards. The material weakness noted above, "*Financial Management and Reporting Process of the MCFO*," resulted in OPM preparing financial statements and related disclosures, along with other financial information for



agency management decision-making, related to the RF Programs and S&E Funds accounts that are not consistent with Federal Accounting Standards, specifically the SFFAS No. 1, “*Accounting for Selected Assets and Liabilities.*”

b. United States Standard General Ledger at the Transaction Levels –

In accordance with OMB Circular A-127, *Financial Management Systems*, as amended, OPM is to record financial events consistent with the applicable definitions, attributes, and processing rules defined in the USSGL at the transaction level. The MCFO does not consistently record RF Programs and S&E Funds transactions at the time of an event or soon afterward, preventing the MCFO from preparing trial balances that support the RF Programs and S&E Funds financial statements. Additionally, the MCFO has not implemented an accounting structure to support budgetary controls and ensure that budgetary transactions are recorded in accordance with posting attributed to the USSGL.

### **Recommendation**

We recommend OPM review the GFIS system and related processes and procedures to enable the MCFO to account for the RF Programs and S&E Funds’ transactions in accordance with the USSGL at the transaction level in fiscal year 2005. The MCFO should develop policies and procedures to prepare financial statements and related disclosures, budget reports, or other financial information for agency management decision-making purposes that are consistent with Federal accounting standards.

### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.

The results of our tests of FFMIA disclosed no instances in which OPM’s and the Programs’ financial management systems did not substantially comply with the Federal financial management systems requirements and no instances in which the Programs’ financial management systems did not substantially comply with the applicable Federal accounting standards and the USSGL at the transaction levels.

## **RESPONSIBILITIES**

### **Management’s Responsibilities**

The *Government Management Reform Act of 1994* (GMRA) requires each Chief Financial Officer (CFO) Act agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, OPM prepares annual financial statements.

Management is responsible for the financial statements, including:

- Preparing the consolidated financial statements of OPM and the individual financial statements of the Programs in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting and preparation of the Management Discussion and Analysis (including the performance measures) and Required Supplementary Information; and





- Complying with laws, regulations, and contracts, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements—due to error or fraud—may nevertheless occur and not be detected.

### **Auditors' Responsibilities**

Our responsibility is to express an opinion on the fiscal year 2004 and 2003 consolidated financial statements of OPM and the individual financial statements of the Programs based on our audits and the reports of other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the overall consolidated and Programs' individual financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated and Programs' individual financial statement presentation.

We believe that our audits and the reports of other auditors provide a reasonable basis for our opinions.

In planning and performing our fiscal year 2004 audits, we considered OPM's and the Programs' internal control over financial reporting by obtaining an understanding of OPM's and the Programs' internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on OPM's consolidated financial statements and the individual financial statements of the Programs. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audits were not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the OPM's fiscal year 2004 consolidated and Programs' individual financial statements are free of material misstatement, we performed tests of OPM's and the Programs' compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws, regulations, and contracts specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable



to OPM and the Programs. Providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audits and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether OPM's and the Programs' financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

## **DISTRIBUTION**

This report is intended for the information and use of OPM's management, OPM's Office of the Inspector General, OMB, the Government Accountability Office, 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*

November 5, 2004

**Exhibit I**

No.	Title of Finding from FY03 Report	Program/Fund	Prior Year Status	Current Year Status	Factors Affecting Current Year Status
<b>1</b>	Financial Management Reporting Processes of the Office of the Chief Financial Officer (OCFO)	Salaries and Expenses, Revolving Fund Program	Reportable Condition	Material Weakness – See FY 2004 condition No. 1	This condition is determined to be a material weakness due to management's indication of issues as significant deficiencies in its FFMIA assessment; the amount of time lapsed for correction of issues present; and the sensitivity of affected accounts, specifically, Fund Balance with Treasury related to RF Programs.
<b>2</b>	Information Systems General Control Environment	All <sup>1</sup>	Reportable Condition	Reportable Condition – See FY 2004 condition No. 2	The general control environment has improved from the prior year; however, there are certain areas that still require improvement.
<b>3</b>	Segregation of Duties Over the Letter-of-Credit System for the Experience – Rated Carriers	HBP <sup>2</sup>	Reportable Condition	Reportable Condition – See FY 2004 condition No. 3	OPM has implemented certain controls; however, there are certain areas that still require improvement.

1. Includes the Retirement Program, Health Benefits Program (HBP), Life Insurance Program, Revolving Fund (RF) Program and Salaries and Expenses Funds.
2. HBP: Health Benefits Program