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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, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources, 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, 2005 and 2004, 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, we concluded that OPM's consolidated financial statements and the Programs' individual financial statements as of and for the years ended September 30, 2005 and 2004, as presented in OPM's *Fiscal Year 2005 Performance and Accountability Report*, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

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 Office of Chief Financial Officer (OCFO).
2. Information systems general control environment.
3. Managerial cost accounting to determine full cost associated with strategic goals and major outcomes.

However, none of the reportable conditions are believed to be a material weakness.

The results of our tests of compliance with certain provisions of laws, regulations, and contracts, disclosed the following instances of non-compliance or other matters that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*:

1. Prompt Payment Act
2. Federal Financial Management Improvement Act (FFMIA)

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The following sections discuss our opinion on OPM's consolidated financial statements and the Programs' individual financial statements, 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, regulations, and contracts, 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, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, and financing, 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, 2005 and 2004, 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 2005 Performance and Accountability Report*.

In our opinion, 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, 2005 and 2004, and the consolidated and individual Programs' net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the Management Discussion and Analysis and Required Supplementary Information sections of OPM's *Fiscal Year 2005 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 Circular A-136, *Financial Reporting Requirements*, Part A, *Form and Content of the Performance Accountability Report*. 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 2005 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 financial statements of the Funds have been subjected to the auditing procedures applied in the audit of the consolidated financial statements of OPM and, in our opinion, are fairly stated in all material respects in relation to OPM's consolidated financial statements taken as a whole.

In addition, the statement of net cost information of Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) included in the consolidating statement of net cost (Schedule 2) 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 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 statement of net cost and the individual statements of net cost of the Retirement Program taken as a whole.

The Introduction to OPM (Part 1), FY 2005 Highlights (Part 2), Performance Information (Part 4), Top Management Challenges (Part 7) and other accompanying information included in Appendices A and B are an integral part of OPM's *Fiscal Year 2005 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 to OPM, FY 2005 Highlights, Performance Information, Top Management Challenges 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.

We noted certain matters, described in Items 1 through 3 below, involving internal control over financial reporting and its operation that we consider to be reportable conditions. However, none of the reportable conditions are believed to be material weaknesses.

1. Financial Management and Reporting Process of the Office Chief Financial Officer (OCFO)

Since 1995, OPM has had significant deficiencies in the operation of the OCFO's internal control over financial management and reporting, which affected the accuracy of the Revolving Fund Programs and Salaries and Expenses (S&E) Fund. In FY 2005, OPM implemented corrective actions to record financial transactions more timely, review and analyze general ledger accounts, implement budgetary accounting policies and procedures and provide training to staff. However, certain deficiencies still exist.

Specifically:

a. The Government Financial Information System (GFIS) does not properly capture certain financial information and is not properly configured to produce useful financial reports that provide accurate information regarding related intragovernmental activities and balances.

b. Reconciliations are not consistently or always clearly documented and are not always performed in a timely manner.

c. Supervisory reviews of financial statements and other financial reports submitted to oversight agencies are not documented for mathematical accuracy and receipt of appropriate supporting documentation.

d. Manual entries are made to adjust for unidentified differences between the total trial balance as reported in GFIS and the balance as reported on the Undisbursed Appropriation Account Trial Balance (FMS 6533).

According to OMB Circular A-123, 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 documentation.

Deficiencies in the ability to record, process, summarize and report financial data for the Revolving Fund Programs and Salaries and Expense Fund may misstate the financial statements.

Recommendation

The OCFO should continue implementation of its corrective action plan. Further, we recommend that:

a. OPM consider implementing a new accounting system or modify the existing accounting system as appropriate to ensure that all financial information is properly captured and is properly configured to produce useful financial reports that provide accurate information regarding related intra-governmental activities and balances.

b. OPM continue to identify and correct existing differences between OPM's internal data and the information reported by Treasury.

c. OPM establish and implement formal procedures and a checklist for the supervisory review of financial statements and other financial reports.

d. OPM OCFO management actively enforce procedures regarding the documentation and timely performance of reconciliations in accordance with guidelines outlined in the "Treasury Financial Manual" and OPM's "Cash Management Policy and Procedures".

Management Response

OPM acknowledges the deficiencies in its internal control over financial management and reporting as it pertains to the Revolving Fund Programs and Salaries and Expenses accounts and concurs fully with each of KPMG's recommendations. Many of these deficiencies are attributable, as the report correctly points out, to GFIS, which cannot be effectively configured to capture essential financial information and generate useful accurate financial information related to intragovernmental activities and balances. The deficiencies in GFIS have in fact prompted OPM to enter into an agreement with the Department of the Treasury, Bureau of the Public Debt's Administrative Resource Center to host the systems that OPM will use to support the Revolving Fund Programs and Salaries and Expenses accounts. In the meantime, OPM will take the necessary actions to correct each of the specific deficiencies.

2. Information systems general control environment

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

The *Federal Information Security Management Act (FISMA)* 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 OCFO continue the implementation of planned security enhancements to its internal and external 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

OPM concurs with the recommendation and will continue to implement security controls, to include access controls, in accordance with FISMA and National Institute for Standards and Technology, Special Publication 800-53.

3. 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 the accumulation of RF Programs and S&E Funds costs from the 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) Number (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

OPM concurs with the recommendation. The GFIS financial system cannot be reconfigured to meet fully the management cost accounting standards. For its migration to the Department of the Treasury, Bureau of the Public Debt's Administrative Resource Center, OPM will provide for managerial cost accounting in its requirements definitions.

* * * * *

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 3, 2005.

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 FFMIA disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02, and is described below.

4. Prompt Payment Act

OPM does not have adequate controls to ensure a properly determined prompt payment date. As such, OPM did not make certain payments for property or services, excluding payments to their contractors associated with performing investigations and purchase and travel card transactions, within the proper time period in accordance with the Prompt Payment Act. In certain instances, OPM did not pay the interest penalty due to the improper determination of the prompt payment date.

The cause for noncompliance is due to several factors, which include:

- Lack of designed and implemented controls to ensure that the receipt of each invoice and the corresponding acceptance of goods and services is properly documented and recorded in the GFIS
- Lack of documented and disseminated policies and procedures to program officers regarding the processing of invoices; and
- Lack of adequate training to responsible personnel on a periodic basis.

Recommendation

We recommend OPM:

- Develop written policies and procedures regarding the Prompt Payment Act and that these policies and procedures require that the program offices document the date the invoice is received and the date of acceptance of goods, and
- Provide annual training on the application of Prompt Payment Act policies and procedures.

Management Response

OPM concurs with the recommendations and agrees that the Prompt Pay area is one for which additional attention is required. To that end, OPM has already initiated corrective actions for several aspects of Prompt Pay and will address the remainder in fiscal year 2006.

The results of our review of OPM's systems compliance with the provisions of FFMIA disclosed instances, described below, where OPM's financial management systems for the RF Programs and S&E Funds did not substantially comply with applicable Federal accounting standards and the U.S. Government Standard General Ledger (USSGL) at the transaction level.

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 reportable conditions noted above, *"Financial Management and Reporting Process of the OCFO"* and *"Managerial Cost Accounting to determine full cost associated with strategic goals and major outcomes"*, 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* and No. 4, *The Managerial Cost Accounting Concepts and Standards for the*

Federal Government. The RF Programs and S&E Funds are immaterial to the consolidated financial statements as a whole.

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

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. While improvements have been made, the OCFO does not consistently record RF Programs and S&E Funds transactions at the USSGL level to support the RF Programs and S&E Funds financial statements at the transaction level.

Recommendation

We recommend OPM review the GFIS system and related processes and procedures to enable the OCFO to account for the RF Programs and S&E Funds' transactions in accordance with the USSGL at the transaction level in fiscal year 2006. The OCFO should develop policies and procedures to prepare financial statements and related disclosures, budget reports, or other financial information for agency management decision-making purpose that are consistent with Federal accounting standards.

Management Response

OPM concurs with the recommendation. The GFIS financial system cannot be reconfigured to meet fully the requirements of FFMIA. For its migration to the Department of the Treasury, Bureau of the Public Debt's Administrative Resource Center, OPM will ensure that its requirements definitions and implementation include total compliance with FFMIA

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 requirement 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 level.

RESPONSIBILITIES

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA), *Accountability of Tax Dollars Act*, and *Government Corporation Control Act* require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, OPM prepares and submits annual financial statements in accordance with Part A of OMB Circular A-136.

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;
- Preparing the Management Discussion and Analysis (including the performance measures), and Required Supplementary Information;
- Establishing and maintaining internal controls over financial reporting;
- Complying with laws, regulations, and contracts, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments 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 2005 and 2004 consolidated financial statements of OPM and the individual financial statements of the Programs based on our audits. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of OPM's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also 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 provide a reasonable basis for our opinions.

In planning and performing our fiscal year 2005 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 opinions 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 was 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, in our fiscal year 2005 audit, 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 reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether OPM's fiscal year 2005 consolidated and the 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 and regulations 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 solely 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 3, 2005

Exhibit I

No.	Title of Finding from FY04 Report	Program/ Fund	Prior Year Status	Current Year Status	Factors Affecting Current Year Status
1	Financial Management Reporting Processes of the Office of the Chief Financial Officer (OCFO)	Salaries and Expenses (S&E), Revolving Fund (RF) Program	Material Weakness	Reportable Condition – See FY 2005 condition No. 1	OPM has implemented corrective actions to record financial transactions more timely, to review and analyze general ledger accounts, implement budgetary accounting polices and procedures and provide training to staff.
2	Information Systems General Control Environment	All[1]	Reportable Condition	Reportable Condition – See FY 2005, Condition No. 2	OPM has made continual annual improvements on a whole to Information Systems General Control Environment, however, deficiencies still exist.
3	Segregation of Duties Over the Letter-of-Credit System for the Experience – Rated Carriers	HBP[2]	Reportable Condition	Resolved	OPM established and implemented appropriate segregation of duties controls, both from a manual and system perspective.
4	Managerial cost accounting to determine full cost associated with strategic goals and major outcomes	S&E and RF	Reportable Condition	Reportable Condition – See FY 2005 condition No. 3	OPM has not addressed the condition as they had dedicated resources and focus in addressing the prior year material weakness.

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