

Without a well-designed program, security controls may be inadequate, responsibilities may be unclear, misunderstood, or improperly implemented, and controls may be inconsistently applied. Such conditions may increase the risk that OPM may be providing inadequate protection over sensitive or critical resources, or may be expending a disproportionate amount of funds to protect low-risk, noncritical resources.

(c) Access Controls

OPM's EDP physical and logical access controls require modification. We noted that OPM is not properly disposing of sensitive records and data. We also noted certain user account groups and security administrators have excessive access privileges to mainframe resources that could potentially undermine proper segregation of duties.

Access controls should provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. The objectives of limiting access are to ensure that (1) users have only the access needed to perform their duties; (2) access to very sensitive resources, such as security software programs, is limited to very few individuals; and (3) employees are restricted from performing incompatible functions or functions beyond their responsibilities.

(d) Application Change Control/Systems Development

Certain controls over OPM's modification of application software programs are deficient. Establishing controls over the modification of application software programs helps to ensure that only authorized programs and authorized modifications are implemented. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or "turned off", or that processing irregularities or malicious code could be introduced.

As noted in our prior year report, OPM has not developed a systems development methodology for application software and the current "RSOD Retirement ADP Standards and Procedures" is missing critical chapters, including data set design and allocation, system development procedures, testing and acceptance, and system software installation and maintenance.

(e) Service Continuity

Losing the capability to process, retrieve, and protect information maintained electronically can significantly impact OPM's ability to accomplish its mission. For this reason, procedures should be in place to protect information resources, minimize the risk of unplanned interruptions, and recover critical operations should interruptions occur. To mitigate service interruptions, it is essential that the related controls be understood and supported by management and staff throughout the organization.

- OPM needs to take steps to overcome the following weaknesses in service continuity: OPM has several separate ongoing service continuity-related initiatives. Draft plans need to be finalized, formalized, and properly coordinated to ensure that critical functions will be available in the event of a disruption.
- Improvements are needed in the Disaster Recovery Testing Assumptions to better ensure the viability of the recovery plans.

- Improvements are needed to strengthen the completeness and accuracy of the resource and personnel contact information sections of the Disaster Recovery plan.
- OPM does not have a network recovery plan that will provide for proper coordination and execution of the Continuity of Operations and the Disaster Recovery Plans.

Recommendation

We recommend that OPM develop a formal action plan to review and revise its EDP general controls. This plan should address each of the areas discussed above as well as other areas that impact the general EDP control environment, set forth appropriate corrective action steps, assign responsibilities to employees, and establish target completion dates for each action.

This plan should be reviewed by the Office of the Inspector General (OIG) and adopted by the executive management of OPM and the plan should provide for periodic reviews of progress towards the achievement of corrective actions.

2. Account Analysis and Other Significant Reconciliation Procedures of the OCFO

Key internal controls for detecting and correcting accounting errors and preventing misstatements of the financial statements include the performance of periodic account analyses, reconciliation of subsidiary ledgers to general ledger control accounts, and supervisory review and approval of the posting of accounting transactions and related general ledger journal entries.

The OCFO, who maintains the accounting function for OPM's Revolving Fund Programs and Salaries and Expenses (S&E) funds, was unable to provide adequate evidence that its key accounting controls were in place and functioning in the OCFO during the audit period. For example, procedures for reconciling fund balance with Treasury were not applied properly and consistently throughout the fiscal year, not all the Salaries and Expenses funds' accounts were reconciled, and not all accounting transactions were posted to the general ledger in a timely manner. Consequently, several adjustments and recalculations were necessary to produce the individual Revolving Fund Programs and Salaries and Expenses funds' financial statements.

Based on our limited observations of the OCFO's accounting functions, we believe there is inadequate communication among functions within the accounting office, weak enforcement of policies and procedures, and a shortage of personnel with the technical skills necessary to perform and oversee account analysis and reconciliation procedures. Therefore, management and staff have been unable to identify the causes of differences in the Revolving Fund Programs and Salaries and Expenses fund balances with Treasury and make corrections in a timely manner.

While the Revolving Fund Programs and Salaries and Expenses funds are not material in relation to OPM's FY 2000 consolidated financial statements, the weaknesses in OCFO's account reconciliation controls indicate significant deficiencies in the operation of OCFO's internal control over financial reporting. In our judgment, these deficiencies adversely affect OPM's ability to accurately record, process, summarize, and report financial data for the Revolving Fund Programs and Salaries and Expenses funds.

Recommendations

The OCFO should reemphasize the importance of timely reconciliation procedures to those responsible for their performance and enforce reasonable deadlines for their completion after each month end. The task of performing reconciliation procedures (including identification of reconciling differences and researching and resolving those differences) should be assigned to individuals with appropriate training and skills. Correction and resolution of reconciling items should be reviewed by appropriate supervisory personnel, properly documented, and posted to the general ledger.

Specifically, we recommend the OCFO take the necessary actions to ensure that:

- Specific duties and control responsibilities are communicated effectively to all employees involved in the OCFO;
- Assignments of responsibility and delegation of authority to deal with operational functions and regulatory requirements are structured to prevent control breakdowns;
- Communication across the different operational team members within the OCFO and program offices is adequate and timely so as to enable OCFO personnel to discharge their responsibilities effectively; and
- Personnel skill levels are appropriate for the size of the department and the nature and complexity of the activities they are required to perform.

3. Budgetary Accounting Structure of the OCFO

The OCFO has not adequately implemented a budgetary accounting structure within its general ledger for the Revolving Fund Programs and Salaries and Expenses funds, and has not developed and documented policies and procedures to account for budgetary transactions. In previous years, the OCFO did not prepare the SF-133 forms and the statements of budgetary resources based on budgetary account balances. As a result, the beginning balances on the fiscal year 2000 Funds' individual statements of budgetary resources do not agree to fiscal year 1999 ending balances. During fiscal year 2000, the OCFO began a reconciliation process to identify and correct budgetary account balances. However, due to time and staff resource constraints, the OCFO was unable to reflect all adjustments to the statement of budgetary resources in the fourth quarter Form SF-133.

Recommendations

We recommend the OCFO develop and implement budgetary accounting policies and procedures to ensure that all budgetary transactions are properly recorded, and complete and accurate supporting trial balances for the Revolving Fund Programs and Salaries and Expenses funds can be prepared. We also recommend the OCFO take the necessary actions to ensure that budgetary transactions are consistently recorded using the Standard General Ledger (SGL) descriptions and posting attributes. Additionally, we recommend the OCFO strengthen control procedures over the budgetary accounting structure to support the preparation, execution, and reporting of the Revolving Fund Programs and Salaries and Expenses funds' budgets, in accordance with OMB Circulars A-11 and A-34.

4. Quality Control over Annual Financial Statement Preparation

Beginning in fiscal year 2000, OPM prepared consolidated financial statements as required by OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. To meet this requirement, OPM segregated its annual financial reporting responsibilities among the following departments:

- The Benefits Accounting Branch (BAB), which prepared the Programs' individual financial statements and assembled the consolidated financial statements;
- The OCFO, which prepared the Revolving Fund Programs and Salaries and Expenses funds' individual financial statements; and
- The Financial Policy Staff, which prepared the footnotes to the consolidated financial statements.

Regular communications and cross-reviews were essential for complete and accurate consolidated financial reporting. However, the complexity of OMB Bulletin No. 97-01 reporting and disclosure requirements, OPM's staffing limitations, and turnover of key management personnel affected the adequacy of OPM's quality control function for annual financial reporting. As a result, we observed the following weaknesses over the preparation of the consolidated and individual financial statements and related footnotes:

- Due to OPM's financial management staff limitations, cross-reviews of financial statements and footnote drafts were not performed with sufficient technical oversight to ensure that accounts were properly classified and that all required disclosures were included in the accompanying footnotes; and
- Difficulty was experienced in producing complete and accurate consolidated financial statement drafts in a timely fashion for review by management and the auditors.

Recommendations

OPM should seek ways to strengthen the effectiveness of its financial reporting controls to prevent financial reporting errors and inconsistencies, and to improve the timeliness of the year-end financial statement preparation. We recommend that OPM:

- Continue to refine its consolidated financial statement preparation process by taking the necessary actions for planning, organizing, directing, and monitoring the consolidated financial statement preparation efforts;
- Enlist personnel having sufficient experience and technical expertise to review the financial statements to assure compliance with applicable accounting principles and disclosures;
- Formalize a detailed plan for preparing the Revolving Fund Programs and Salaries and Expenses funds' individual financial statements to ensure that appropriate financial statement relationships exist, and all required disclosures are included; and
- Evaluate OPM's current accounting resources and processing methods to determine whether persons with higher level of accounting skills, additional accounting staff, or additional accounting procedures are needed to accomplish the objectives set forth in the preceding recommendations.

5. Controls over Program Administration for the Community-Rated Health Carriers

OPM remits premiums it receives from federal agencies to Community-Rated Health Carriers (CRCs) twice a month. As noted in prior years, OPM's existing systems were not designed to centrally associate the monies paid as premiums to participating carriers with the enrollees for whom they are being paid. Consequently, the potential exists for carriers to provide benefits to employees who are not covered by their plan at the time the services are rendered. To reinforce the need for effective enrollment reconciliation procedures, OPM's OIG reviews CRC enrollment reconciliation activities during their regularly scheduled audits of health carriers.

In addition, the Office of Insurance Programs has signed an agreement with a contractor to build, implement, and maintain a centralized enrollment system that will allow a central control point for reconciling and resolving enrollment issues between Agency Payroll Offices and CRCs. However, the database was still under development as of September 30, 2000. Consequently, OPM needs to implement mitigating controls to monitor whether payroll offices are complying with these requirements and whether carriers are reconciling their enrollment records regularly.

Recommendations

We recommend that OPM continue its efforts to develop a centralized enrollment system that would allow a central control point to reconcile and resolve enrollment issues between agency payroll offices and CRCs. In addition, until the centralized enrollment system can be developed and implemented, we continue to recommend that OPM's OIG make CRC enrollment reconciliation review a priority in their annual audit planning.

Compliance with Laws and Regulations

Our tests of compliance with certain provisions of laws and regulations, exclusive of those requirements referred to in FFMIA, performed as part of obtaining reasonable assurance about whether the fiscal year 2000 consolidated financial statements are free of material misstatement, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

In addition, under OMB Bulletin No. 01-02 and FFMIA, we are required to perform tests of compliance with FFMIA section 803(a) requirements that indicate whether OPM's 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. However, providing an opinion on compliance with certain provisions of laws and regulations or compliance with FFMIA Section 803(a) requirements was not an objective of our audits. Accordingly, we do not express such an opinion.

The results of our tests of compliance disclosed instances, described below, where the OPM's financial management systems did not substantially comply with the requirements discussed in the preceding paragraph. The OCFO is responsible for the financial management systems of the Revolving Fund Programs and Salaries and Expenses funds, while the OCIO is responsible for systems' hardware and software shared by the OCFO and the Retirement and Insurance Services (RIS).

1. **Federal financial management system requirements.** OPM's financial management systems do not meet the following Federal financial management system requirements:
 - a. *Financial reporting requirements* – The OCFO's financial management systems do not provide accurate and timely financial information necessary for compliance with the requirements of Treasury and OMB Bulletin No. 97-01, as amended. Transactions are not consistently recorded at the time of the event or soon afterward, preventing the OCFO from preparing trial balances that adequately support the Revolving Fund Programs and Salaries and Expenses funds' individual financial statements. Additionally, the OCFO's financial management systems do not include a system of internal controls to ensure that resources are used consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and disclosed in reports. These findings resulted in noncompliance with OMB Circular A-127, *Policies and Standards for Financial Management Systems*, as amended.
 - b. *Provide adequate system security* – As discussed in the section of our report entitled "Internal Control over Financial Reporting", OPM has several weaknesses in its entity-wide security program that contributes to noncompliance with OMB Circular A-130. OPM has not managed and coordinated entity-wide security procedures, lacks an effective incidence response and monitoring capability, has not conducted periodic entity-wide risk assessments, and has not developed adequate security-related management control processes to protect physical and logical assets from unauthorized access or improper use.
2. **Federal accounting standards.** OMB Circular A-127, as amended, states that agency financial management systems shall enable the agency to prepare, execute and report on the agency's budget in accordance with the requirements of OMB Circulars A-11 and A-34. The lack of a formal budgetary structure and the lack of formal budget policies and procedures compromises the OCFO's ability to comply with the budget preparation, execution and reporting requirements for the Revolving Fund Programs and Salaries and Expenses funds, as set forth in the OMB Circulars mentioned above.
3. **SGL at the transaction level.** OMB Circular A-127, as amended, states that the criteria for recording financial events in all financial management systems shall be consistent with accounting transaction definitions and processing rules defined in the SGL. The OCFO's general ledger system is unable to produce complete and accurate trial balances for the Revolving Fund Programs and Salaries and Expenses funds. Additionally, the OCFO has not implemented an adequate accounting structure to support budgetary controls and to ensure that budgetary transactions are recorded in accordance with posting attributes reflected in the SGL.

Recommendations

To achieve substantial conformance with FFMIA, we recommend that the OCFO take actions to ensure that the financial management systems supporting the Revolving Fund Programs and Salaries and Expenses funds have the ability to:

- Collect accurate, complete, reliable, and consistent information;
- Provide for adequate management reporting;
- Support government-wide and agency level policy decisions;
- Support the preparation and execution of agency budgets;

- Facilitate the preparation of financial statements and other financial reports in accordance with Federal accounting and reporting standards; and
- Provide a complete audit trail to facilitate audits.

Additionally, we recommend that OPM take necessary actions to address the finding related to systems security required by Circulars A-127 and A-130. The resolution of these findings should be a priority for fiscal year 2001.

Responsibilities

Management's Responsibility. The Government Management Reform Act (GMRA) of 1994 requires Federal agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' consolidated financial position and results of operations. To meet the GMRA reporting requirements, OPM prepares annual financial statements.

Management is responsible for:

- Preparing the consolidated financial statements of OPM and the individual financial statement 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
- Complying with laws and regulations, 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.

Auditors' Responsibility. Our responsibility is to express an opinion on the fiscal year 2000 consolidated financial statements of OPM, taken as a whole, 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*, issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

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

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

In planning and performing our audits, we considered OPM's internal control over financial reporting by obtaining an understanding of OPM's 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 OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls as defined by the Federal Managers' Financial Integrity Act of 1982.

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 MD&A, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions.

As part of obtaining reasonable assurance about whether OPM's fiscal year 2000 financial statements are free of material misstatement, we performed tests of OPM's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain requirements referred to in the FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the OPM.

Distribution

This report is intended solely for the information and use of OPM's management, OPM's Office of the Inspector General, 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

February 16, 2001

Exhibit I

**Office of Personnel Management
Status of Prior Year Findings
Fiscal Year 2000**

No.	Title of Finding from FY99 Report	Program /Fund	Prior Year Status	Current Year Status	Factors Affecting Current Year Status
1.	EDP general control environment	RP, HBP, LP, S&E, RF	Reportable Condition	Reportable Condition – See condition No.1	The general control environment has not changed substantially from prior year.
2.	Financial Statement Preparation	S&E, RF	Material Weakness	Reportable Condition agency-wide – See FY 2000 condition No. 4	Certain procedures for consolidated financial statements were performed. OCFO continues to experience difficulties in preparing consolidating financial statements for S&E and RF.
3.	Control over program administration for CRC health carriers	HBP	Reportable Condition	Reportable Condition – See FY 2000 condition No.5	CRC enrollment reconciliation controls did not change substantially from prior year.
4.	Budgetary accounting structure	RP, HBP, LP	Reportable Condition	Reportable Condition for OCFO only – See FY 2000 condition No. 3	RIS implemented a budget module in its general ledger system and was able to prepare the statements of budgetary resources and financing. The OCFO continues to experience difficulties in preparing accurate statements of budgetary resources and financing.
5.	Actuarial Census Data	RP, LP	Reportable Condition	Management letter comment	Management implemented certain procedures to detect significant changes made to the PDF file in the last month of the fiscal year.
6.	Reconciliation of inter-program transactions	HBP, LP	Reportable Condition	Closed	Internal controls over reconciliation of inter-program transactions were improved in FY 2000.
7.	Operating Policies and Procedures	S&E, RF	Material Weakness	Reportable Condition – See FY 2000 condition No. 3	Financial procedure manuals were implemented in certain areas. The OCFO still needs to develop policies and procedures for budgetary accounting – See FY 2000 condition No. 3.
8.	Controls Over Recorded Transactions	S&E, RF	Material Weakness	Reportable Condition – See condition No. 2	Controls over Fund Balance with Treasury have not changed substantially from prior year. However, S&E and RF balances do not have a material impact on the consolidated financial statements.
9.	Fund Balance With Treasury	S&E, RF	Material Weakness	Reportable Condition – See FY 2000 condition No. 2	Controls over Fund Balance with Treasury have not changed substantially from prior year. However, S&E and RF balances do not have a material impact on the consolidated financial statements.

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**Office of Personnel Management
Status of Prior Year Findings
Fiscal Year 2000**

No.	Title of Finding from FY99 Report	Program /Fund	Prior Year Status	Current Year Status	Factors Affecting Current Year Status
10.	IS Transactions and Balances	RF	Material Weakness	Reportable Condition – See FY 2000 condition No. 2	Controls over IS transactions have not changed substantially from prior year. However, S&E and RF balances do not have a material impact on the consolidated financial statements.
11.	Accounts Receivable	S&E, RF	Material Weakness	Not Addressed	Finding was outside the consolidated financial statement audit scope.
12.	Accounts Payable	S&E, RF	Material Weakness	Not Addressed	Finding was outside the consolidated financial statement audit scope.

