



# United States Department of the Interior

Office of Inspector General  
Washington, D.C. 20240

February 27, 2002

## Memorandum

To: Secretary  
Department of the Interior

From: Earl E. Devaney  
Inspector General

Subject: Independent Auditors' Report on the U.S. Department of the Interior Fiscal Year 2001 Annual Departmental Report on Accountability (No. 2002-I-0018)

We contracted with KPMG LLP (KPMG), an independent certified public accounting firm, to audit the Department of the Interior's (DOI) financial statements for fiscal year 2001. In addition, the Office of Inspector General (OIG) audited the amounts for the balance sheet, statement of custodial activity and related notes for fiscal year 2000. The KPMG and OIG audits were performed in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States of America, Office of Management and Budget Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, and the General Accounting Office/President's Council on Integrity and Efficiency *Financial Audit Manual*.

## ***AUDIT RESULTS***

In its audit report dated February 25, 2002 (Attachment 1), KPMG stated that in its opinion the DOI's financial statements for fiscal year 2001 present fairly, in all material respects, the financial position of the DOI as of September 30, 2001, and its net cost of operations, changes in net position, custodial activity, budgetary resources, and reconciliation of net cost of operations to budgetary obligations for the year then ended in accordance with accounting principles generally accepted in the United States of America. In our report dated February 25, 2002 (Attachment 2), we stated that in our opinion the DOI's fiscal year 2000 consolidated balance sheet and statement of custodial activity present fairly, in all material respects, the financial position of the DOI as of September 30, 2000, and its custodial activity for the year then ended in accordance with accounting principles generally accepted in the United States of America.

KPMG identified 15 internal control weaknesses and 4 instances of noncompliance with laws and regulations, as follows:

## ***INTERNAL CONTROL WEAKNESSES***

### ***Material Weaknesses***

- General and Application Controls Over Financial Management Systems
- Timeliness of Transaction Entry and Reconciliation
- Controls Over Undelivered Orders and Accruals
- Controls Over Property, Plant, and Equipment
- Reconciliation of Intra-Departmental and Intra-Governmental Transactions
- Indian Trust Fund Management

### ***Reportable Conditions***

- Financial Accounting Processes at the Geological Survey
- Controls Over Revenue Process
- Controls Over Recording and Disclosing Claims and Assessments
- Controls Over Aquatic Trust Fund
- Recording of Budgetary Accounts
- Controls Over Interior Franchise Fund
- Controls Over Credit Card Purchases
- Accounting for Inventory
- Deferred Maintenance Reporting

## ***NONCOMPLIANCE WITH LAWS AND REGULATIONS***

- Debt Collection Improvement Act of 1996
- Prompt Payment Act
- Public Law 104-208 Advances for Interior Franchise Fund
- Federal Financial Management Improvement Act of 1996

KPMG made 39 recommendations to correct the problems in these areas. In DOI's response, which was incorporated in the report, it indicated general concurrence with the findings and recommendations. **It is imperative that DOI expeditiously correct the material internal control weaknesses in order to prepare financial statements in the future that are timely and accurate.**

KPMG is responsible for the auditors' report on the fiscal year 2001 financial statements and for the conclusions expressed in their report. We monitored the progress of the audit at key points and reviewed KPMG's report and related working papers and inquired of their representatives. Our review, as differentiated from an audit in accordance with *Government Auditing Standards*, was not intended to enable us to express, and we do not express, opinions on the DOI's financial statements for fiscal

year 2001 or on conclusions about the effectiveness of internal controls or on conclusions about compliance with laws and regulations for fiscal year 2001. Our review disclosed no instances where KPMG did not comply, in all material respects, with *Government Auditing Standards*.

## ***MANAGEMENT CHALLENGES***

We identified, in accordance with Public Law 106-531, *Reports Consolidation Act of 2000*, the most serious management challenges facing the DOI. The challenges, which are discussed in detail in "Management Challenges" (Attachment 3), are in the following areas:

- Financial Management
- Information Technology
- Health and Safety
- Maintenance of Facilities
- Responsibility to Indians and Insular Areas
- Resource Protection/Restoration
- Revenue Collections
- Implementation of the Government Performance and Results Act
- Procurement, Contracts, and Grants
- Emergency Management

The Independent Auditors' Report is intended for the information of the management of DOI, the Office of Management and Budget, and the United States Congress. The report, however, is a matter of public record, and its distribution is not limited.

Section 5(a) of the *Inspector General Act* (5 U.S.C. App. 3) requires the OIG to list this report in its semiannual report to the Congress. In addition, the OIG provides this audit report to the Congress.

We appreciate the cooperation and assistance of DOI personnel during the audit. If you have any questions, please contact me at (202) 208-5745.

Attachments (3)

***[CONTACT THE CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF THE INTERIOR FOR INFORMATION ON THE FINANCIAL STATEMENTS FOR FISCAL YEAR 2001, WHICH ARE NOT INCLUDED.]***

A COPY OF THE  
INDEPENDENT AUDITOR'S REPORT  
IS ON THE PAGES THAT FOLLOW.



2001 M Street, NW  
Washington, DC 20036

## **INDEPENDENT AUDITORS' REPORT**

Secretary and Inspector General  
U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheet of the U.S. Department of the Interior (Interior) as of September 30, 2001, and the related consolidated statements of net cost of operations, changes in net position, and financing, the statement of custodial activity, and the combined statement of budgetary resources (hereinafter referred to as the financial statements) for the year then ended. The objective of our audit was to express an opinion on the fair presentation of these financial statements. In connection with our audit, we also considered Interior's internal control over financial reporting and tested Interior's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

The consolidated balance sheet as of September 30, 2000 and the related statement of custodial activity for the year then ended, were audited by the Office of Inspector General of the U.S. Department of the Interior and their report thereon is contained within the accompanying Accountability Report.

### **Summary**

As stated in our opinion on the financial statements, we conclude that Interior's financial statements as of and for the year ended September 30, 2001, 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 identifying the following reportable conditions:

#### Reportable Conditions That Are Considered to be Material Weaknesses

- A. Improve general and application controls over financial management systems
- B. Improve timeliness of transaction entry and reconciliation
- C. Improve controls over undelivered orders and accruals
- D. Improve controls over property, plant, and equipment
- E. Improve reconciliation of intra-departmental and intra-governmental transactions
- F. Improve Indian trust fund management controls

#### Other Reportable Conditions

- G. Improve financial accounting processes at the U.S. Geological Survey
- H. Improve controls over the revenue process
- I. Improve controls for recording and disclosing claims and assessments
- J. Improve controls over the Aquatic Resources Trust Fund

- K. Improve recording of budgetary transactions
- L. Improve controls over Interior Franchise Fund financial reporting
- M. Improve controls over credit card purchases
- N. Improve accounting for inventory
- O. Improve deferred maintenance reporting

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

- P. Debt Collection Improvement Act of 1996
- Q. Prompt Payment Act
- R. Section 113 of Public Law 104-208 - Advances for Interior Franchise Fund

In addition, our tests of compliance with FFMIA section 803(a) requirements disclosed instances where Interior's financial management systems did not substantially comply with Federal financial management systems requirements, federal accounting standards, or the United States Government Standard General Ledger at the transaction level.

The following sections discuss our opinion on Interior's financial statements, the results of our consideration of the Interior's internal control over financial reporting, the results our tests of the Interior's 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 sheet of Interior as of September 30, 2001, and the related consolidated statements of net cost of operations, changes in net position, and financing, the statement of custodial activity, and the combined statement of budgetary resources, for the year then ended. The consolidated balance sheet as of September 30, 2000 and the related statement of custodial activity for the year then ended, were audited by the Office of Inspector General of the U.S. Department of the Interior and their report thereon is contained within the accompanying Accountability Report.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Interior as of September 30, 2001, and its net cost of operations, changes in net position, custodial activity, budgetary resources, and reconciliation of net cost of operations to budgetary obligations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections is not a required part of the financial statements, but is supplementary information required by the Federal Accounting Standards Advisory Board or OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. 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. Based upon our limited procedures, we determined that Interior did not complete the intragovernmental balance reconciliations with its trading partners, as specified by OMB requirements because Interior's trading partners did not provide information by Interior component or Treasury fund symbol.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The consolidating information in the Other Supplementary Information section is presented for purposes of additional analysis of the consolidated balance sheet and consolidated statement of changes in net position, rather than to present the financial position and changes in net position of Interior's components individually. The consolidating information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

### **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 Interior's ability to record, process, summarize, and report financial data consistent with the assertions by management in the 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. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

We noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable conditions A through F are material weaknesses:

#### **A. Improve General and Application Controls over Financial Management Systems**

Interior does not have adequate information technology security and general controls to protect its financial information systems. These conditions could affect Interior's ability to prevent and detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information resources. Interior needs to improve its security and general controls to meet the minimum requirements of OMB Circular A-130, *Management of Federal Information Resources*, as discussed below.

1. Entity-wide Security Program - An entity-wide security program, including security policies and a related implementation plan, is the foundation of an entity's security control structure and a reflection of senior management's commitment to addressing security risks. As outlined in OMB Circular A-130, an effective security program includes a risk assessment process, a certification process, and an effective incident response and monitoring capability. Interior has not finalized and communicated an entity-wide security plan which identifies established security plans, security program management and related personnel, as well as ongoing management of security policies and procedures. In addition, Interior has not consistently performed security and risk assessments of financial systems or initiated a formal program for management review and accreditation of its security program and major applications.
2. Access Controls - 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. We noted that Interior does not have adequate controls to prevent or detect unauthorized access to its financial systems. Interior needs to improve controls over password security, other logical access, physical access, and network administration. We also noted that Interior does not consistently review security violation logs and does not terminate user accounts in a timely manner. Finally, we noted that certain operating systems are not configured to provide optimal security and protection to prevent access to sensitive datasets and libraries.
3. Software Development and Change Controls - Establishing controls over the modification of software programs assists in ensuring 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 could be introduced. Interior has not fully established system software controls that limit and monitor access to the programs and sensitive files that control the computer hardware and secure applications supported by the system. Interior has not fully developed procedures for controlling changes over software that would prevent unauthorized programs or modifications to an existing program from being implemented. In addition, Interior has not fully developed procedures to ensure that tests of system software changes are performed and documented, system software changes are reviewed, approval is documented before implementation, and duties are properly segregated. Furthermore, duties are not properly segregated as certain application programmers responsible for making changes to application software also approve these changes and move them to production.
4. Service Continuity - Losing the capability to process, retrieve, and protect information maintained electronically could significantly impact Departmental Offices' ability to accomplish its mission. Thus, procedures should be in place to protect information resources, minimize the risk of unplanned interruptions, and recover critical operations should interruptions occur. Interior has not prepared and tested contingency plans for all systems and operations. In addition, Interior does not consistently rotate backup tapes to off-site facilities.



### **Recommendation**

We recommend that Interior develop and implement a formal action plan to improve the general and application controls over the financial management systems. This plan should address each of the areas discussed above, as well as other areas that might impact the EDP control environment to ensure adequate security and protection of Interior's information systems.

### **Management Response**

Management concurs with this finding and recognizes the importance of the need for general and application controls over financial management systems. Departmental security policies were issued in September 2001 and are being implemented. Specifically, Interior has accelerated the training and awareness program with emphasis on trust and financial systems; fast-tracked development of certain aspects of the IT Security Plan; and, developed performance measurement criteria for IT security compliance. Certain court actions have disrupted Interior's connectivity with the internet and have focused computer security actions toward protecting Indian trust information. Interior is making every effort to address computer security within legal and resource constraints placed on the Department.

## **B. Improve Timeliness of Transaction Entry and Reconciliation**

Interior does not consistently record financial transactions or analyze its financial records in a timely manner. In addition, Interior does not consistently reconcile the general ledger accounts to subsidiary ledgers and other supporting documentation on a routine basis. We noted that Interior expended a significant amount of time and resources recording transactions, analyzing financial records, and reconciling accounts after the end of the fiscal year that increased the level of effort necessary to complete the fiscal year 2001 financial statements.

### **Recommendations**

We recommend that Interior record financial transactions at the time the financial event occurs. We also recommend that Interior develop and implement formal month-end financial reporting procedures that include the following:

1. Reconcile all general ledger accounts to the subsidiary ledgers or other supporting documentation and resolve reconciling items.
2. Reconcile applicable general ledger accounts to the information provided to and received from the U.S. Department of the Treasury.
3. Reconcile, where applicable, proprietary to budgetary accounts.
4. Quickly resolve items in and remove such items from clearing, suspense, and other temporary general ledger accounts.
5. Review receivable and payable aging reports and resolve all older items.

Interior should ensure that there is appropriate staffing to complete and review these month-end procedures as well as perform the day-to-day financial processing in a timely manner. We also recommend that Interior provide periodic training to staff involved in recording and reconciling financial transactions. This will help Interior meet OMB's goal of issuing timely and accurate financial statements on a regular basis.

#### **Management Response**

Management concurs with this finding. Interior plans to take appropriate steps during 2002 to improve timely recording of transactions from the time financial events occur through the implementation of follow-up action on audit findings and implementation of "best practices" to improve processing.

### **C. Improve Controls over Undelivered Orders and Accruals**

Interior has not fully implemented internal controls to ensure that obligations are liquidated and liabilities are accrued for goods and services received prior to the end of the reporting period. In addition, Interior does not de-obligate funds in a timely manner. Specifically, we identified numerous instances where the undelivered order balance and the accrued liability balance were either understated or overstated. As a result, Interior re-analyzed the undelivered order and accrued liability balances and adjusted the balances, appropriately.

#### **Recommendations**

We recommend that Interior develop and communicate internal controls to ensure that accruals are recorded and undelivered orders are adjusted for services and products received prior to the end of the reporting period. We also recommend that Interior implement internal controls to ensure that the accruals and undelivered orders that are recorded are properly supported. These procedures should be completed at least each quarter, as Interior will be required to prepare and submit to OMB quarterly financial statements starting in fiscal 2003.

#### **Management Response**

Management concurs with this finding. Steps were taken to begin to address this issue in 2001. However, Interior recognizes that substantial work remains to be done and will aggressively continue to improve controls over undelivered orders and accruals

### **D. Improve Controls over Property, Plant, and Equipment**

Interior needs to improve controls over the recording of property, plant, and equipment as follows:

1. Acquisitions and Disposals - Interior does not consistently record property, plant, and equipment in a timely manner. Specifically, we determined that some Interior components expend a significant amount of time and resources identifying and recording property, plant, and equipment transactions after the end of the fiscal year. We also noted that the physical inventory and certification processes used by some Interior components do not consistently identify acquisitions and disposals that need to be recorded. Furthermore, we noted that

Interior does not consistently maintain source documents to support the acquisition and disposal of property, plant, and equipment.

2. Reconciliation of Subsidiary Ledgers to General Ledgers – Interior is not able to efficiently reconcile its subsidiary and general ledgers for property, plant, and equipment. This is because Interior does not maintain and reconcile its subsidiary ledgers throughout the fiscal year and has several different subledgers, including spreadsheets, that add to the complexity of the reconciliation process.
3. Inventory Process – Interior completes an annual inventory of certain property, plant, and equipment as of September 30. We noted that the inventory process is not effective. Specifically, after the inventories we identified some assets that were not recorded in the accounting records (i.e., completeness exceptions) and we were unable to physically locate other assets that are recorded in the accounting records (i.e., existence exceptions). We also noted that Interior does not consistently adjust the general or subsidiary ledgers based on the inventory results.
4. Transfers – Interior does not have controls to ensure property transferred within and to Interior is properly recorded. We noted that Interior's posting models are designed to change the cost and accumulated depreciation of assets transferred within a bureau. We also noted that equipment transferred from other federal agencies is recorded at the original acquisition value instead of the net book value or fair value at the time of the transfer.
5. Land and Land Rights – Interior does not have a complete and accurate inventory system for land and land rights. In fiscal year 2000, Bureau of Reclamation established a five-year action plan to develop a complete and accurate inventory of land and land rights. As of September 30, 2001, Bureau of Reclamation has completed approximately 10% of this inventory and expects to complete the remaining 90% within the five-year period.
6. Construction in Progress – Interior does not consistently record transactions in the construction in progress account. Specifically we determined that Interior capitalized disbursements in the construction in progress account that should have been expensed. We also determined that Interior recorded amounts in the investigations and development asset account that should have been capitalized as part of the construction in progress account. Furthermore, Interior does not consistently reconcile transfers from the construction in progress account to the appropriate property, plant, and equipment account.
7. Recording Depreciation – Interior has not established and implemented controls to ensure depreciation starts when assets are placed in service and to ensure useful lives are consistently applied for the purposes of recording depreciation. In addition, certain segments within Interior do not calculate and record depreciation until the end of the year or consistently record depreciation on all items. Furthermore, Interior does not properly consider the accounting implications of subsequent changes to the useful lives or dates assets are placed in service.

As a result of our observations, Interior expended a significant amount of time and resources analyzing, counting, reconciling, and adjusting property, plant, and equipment to ensure the amounts were fairly stated.

## **Recommendations**

1. Acquisitions and Disposals – We recommend that Interior implement internal controls to ensure that property, plant, and equipment transactions are recorded in the subsidiary ledger and general ledger at the time the financial event occurs and at the proper amount. We also recommend that Interior maintain source documents related to property plant and equipment acquisitions and disposals.
2. Reconciliation of Subsidiary Ledgers to General Ledgers – We recommend that Interior consider consolidating several of its subsidiary property systems. We also recommend that Interior reconcile its subsidiary and general ledgers on a monthly basis, including resolving any reconciling items.
3. Inventory Process – We recommend that Interior improve its inventory process to verify existence and completeness of property, plant and equipment. We also recommend that Interior record adjustments to the subsidiary and general ledgers as a result of the inventory observations in a more timely manner.
4. Transfers – We recommend that Interior review accounting transactions to ensure that assets transferred within and to Interior are properly recorded. This should include revising the posting models to properly record assets transferred within a bureau.
5. Land and Land Rights – We recommend that Interior monitor the Bureau of Reclamation's five-year action plan to establish a complete and accurate inventory of land and land rights and to reconcile the inventory records (i.e., subsidiary ledger) to the general ledger.
6. Construction in Progress – We recommend that Interior establish and communicate policies defining the types of transactions that should be recorded in the construction in progress account versus expense and investigation and development accounts. We also recommend that Interior establish controls to ensure that transactions are recorded in the proper accounts. These controls should include reviewing the propriety of the balances included in the construction in progress and investigation and development accounts on a monthly basis.
7. Recording Depreciation – We recommend that Interior design, communicate, and implement internal controls to ensure that depreciation begins when assets are placed in service and useful lives are consistently applied. The process should include improving the communication between the Interior finance departments and the managers, purchasers, and users of the assets. We also recommend that Interior develop internal controls to identify and properly record subsequent changes to the useful lives of assets and the date assets are placed in service.

## **Management Response**

Management concurs with this finding. Working with the property managers through the Property Management Partnership and with individual bureaus, Interior will move aggressively to address these findings and implement the recommendations.

## **E. Improve Reconciliation of Intra-departmental and Intra-governmental Transactions**

Interior does not reconcile its intra-departmental or intra-governmental activity and balances on a periodic basis. Instead, after the end of the fiscal year, Interior began the process to reconcile intra-departmental and intra-government activity and balances. After incurring a significant amount of time and resources, Interior was able to reconcile intra-departmental balances and activity to within an insignificant amount. However, Interior could not complete the intragovernmental balance reconciliations, even at year end, because its trading partners did not provide information by Interior component or Treasury fund symbol. We also noted that Interior is unable to allocate the intra-departmental eliminations of costs to the programs on the consolidated statement of net cost of operations and to the budget functional classifications in the footnotes in accordance with OMB reporting requirements.

### **Recommendations**

We recommend that Interior improve the process to identify and reconcile the intra-departmental and intra-governmental activity and balances. The reconciliation process should be completed quarterly and include procedures to resolve any differences identified in a timely manner. We also recommend that Interior revise its process for recording costs to enable Interior to allocate the intra-departmental eliminations to programs and budget functional classifications in accordance with OMB reporting requirements.

### **Management Response**

Management concurs with the need to improve the process to identify and reconcile intra-departmental and intra-governmental activity and balances. In 2001, Interior made a major effort to improve tracking and reconciliation of activity among Interior bureaus and with fiduciary trading partners. Significant improvement was made in the accuracy of data with fiduciary trading partners, and some progress was made in the accuracy of data within Interior. Interior recognizes that additional steps, including quarterly reconciliation, are needed to streamline this process and to eliminate the major effort required at the end of the fiscal year to reconcile out of balance conditions. Interior will investigate alternatives for allocating intra-departmental eliminations of cost to programs on the consolidated statement of net cost of operations and the budget functional classifications recognizing the need to report full cost of programs.

## **F. Improve Indian Trust Fund Management Controls**

The U.S. Congress has designated the Secretary of the Interior as a primary fiduciary with responsibility for monetary resources held in trust on behalf of American Indian Tribes, Individual Indians, and Other Special Trust Funds (hereafter collectively referred to as the Indian Trust Funds). The Secretary carries out this fiduciary responsibility through the Office of Trust Funds Management (OTFM) in coordination with the bureaus of Interior.

The Indian Trust Funds are not part of Interior. As a result, the assets, trust fund balances, collections and disbursements of the Indian Trust Funds are not recorded in Interior's financial statements. However, the Indian Trust Funds' transactions and balances are disclosed in a footnote to Interior's financial statements in accordance with federal accounting standards.

We noted that the procedures and internal controls are not adequate to ensure that the Indian Trust Fund activity and balances are recorded properly or timely. We noted the following weaknesses:

1. Cash Balances – Interior is unable to reconcile the Indian Trust Fund cash balances that are disclosed in the footnotes to Interior's financial statements with the cash balances reported by the U.S. Department of the Treasury. The Indian Trust Fund cash balances are \$33 million greater than balances reported by the U.S. Department of the Treasury as of September 30, 2001. In addition, Interior needs to resolve approximately \$12.6 million of balances in Treasury suspense and budget clearing accounts as of September 30, 2001.
2. Trust Fund Balances – Interior is unable to provide accounting records to properly support the Indian Trust Fund balances. For example, the total of the Individual Indian Monies trust fund balances in the subsidiary ledger exceed the total balance in the control account by \$6.7 million as of September 30, 2001. In addition, the Individual Indian Monies subsidiary ledger contains negative trust fund balances totaling \$44 million as of September 30, 2001. Furthermore, certain account holders do not agree with the trust fund balances and have filed claims against the U.S. Government and Interior.
3. Special Deposit Accounts – In accordance with section 25 of the Code of Federal Regulations, Interior records receipts into a special deposit account within the Individual Indian Monies subsidiary ledger when the recipient trust fund account is unknown at time of receipt. When Interior identifies the proper trust fund account, Interior transfers the amount from the special deposit account to the proper trust fund account. OTFM needs to investigate and resolve approximately \$67 million of special deposit accounts included in the Individual Indian Monies subsidiary ledger as of September 30, 2001. A significant number of special deposit accounts have remained inactive for the past several years and new accounts continue to be established.
4. Trust Fund Information Systems – Interior has not established adequate security and general controls over the Trust Fund information systems. Specifically, Interior needs to develop and implement a security policy and program, improve segregation of duties, strengthen controls to prevent unauthorized access, establish formal application software development and change controls, and improve and test the disaster recovery plan.
5. Entering and Maintaining Trust Fund Information – The regional and agency offices of the Bureau of Indian Affairs (BIA) perform a critical role in the initial input and subsequent changes to the Indian Trust Funds information disclosed by Interior. We noted the following weaknesses related to the internal controls performed by regional and agency offices:
  - a. Segregation of Duties – The responsibilities for trust fund processing are not properly segregated to prevent or detect errors. Specifically, in some locations an individual employee has the ability to initiate lease agreements; generate annual billings for property leases; collect payment for leases; send instructions to OTFM to create Individual Indian Money (IIM) accounts; and send instructions to OTFM via a change order directing OTFM to change the named monetary property recipients and IIM accounts to which future collections should be posted.

- b. Related Party Transactions – There are not adequate procedures and internal controls over the processing of transactions for related parties. Employees who have the authority to initiate, bill, collect, open IIM accounts, and change account holder distribution instructions also have the same authority for accounts of related parties.
- c. Probate Backlog – The probate orders for land title are not entered into the trust management systems timely. One location has a probate backlog that is over a year old. This results in the potential for inaccurate distributions of lease income to the Indian Trust Fund account holders.
- d. Appraisal Compacts – One of the key elements in performing realty trust transactions is the requirement of obtaining appraisals for realty transactions. The regional and agency offices have a fiduciary duty to land title owners and monetary property recipients (e.g., life estate holders) to establish the fair value of property transactions, including establishing the fair value of property leases, before entering into lease agreements or sales transactions on behalf of the owners. Current laws allow the appraisal function to be compacted to tribes, who are often the named parties involved in realty transactions. As a result, transactions are consummated based on prices established or influenced by the eventual beneficial owners of the property. Controls are not in place to ensure that the fair value of property transactions are established by parties independent of the transaction.
- e. Untimely Deposits – We determined that agency offices did not consistently forward trust receipts to OTFM in a timely manner. Some of these delays occurred at agency offices where OTFM and BIA personnel reside and other delays occurred at agency offices occupied by BIA personnel only.

These weaknesses may result in a potential liability to the United States Government and Interior, who are currently the subject of litigation.

### **Recommendation**

We recommend that Interior develop and implement procedures and internal controls to ensure that the Indian Trust Fund activity and balances are recorded properly and timely.

### **Management Response**

Management concurs with this finding. A variety of actions are underway within the Office of the Special Trustee to address management control deficiencies in coordination with direction from senior policy officials of Interior and the December 1999, court decision.

We noted the following reportable conditions that are not considered to be material weaknesses:

#### **G. Improve Financial Accounting Processes at the U.S. Geological Survey**

We issued a disclaimer of opinion on the component financial statements of the U.S. Geological Survey as Interior was unable to fully support fund balance with Treasury, inventory, advances and prepayments, property plant and equipment, other assets and expended appropriations. In addition, U.S. Geological Survey expended a significant amount of time and resources reconciling and supporting balances as a result of our audit procedures.

##### **Recommendations**

We recommend that Interior improve the accounting processes and internal controls at the U.S. Geological Survey. We also recommend that Interior should ensure that there is appropriate staffing to complete the day-to-day accounting processing in a timely manner.

##### **Management Response**

Management concurs with this finding. The U.S. Geological Survey will take corrective actions to resolve the issues identified in the 2001 audit so that the 2002 financial statement audit can be completed timely and successfully.

#### **H. Improve Controls over the Revenue Process**

Interior needs to improve controls over the revenue process as follows:

1. Reimbursable Agreements – Interior has not fully established controls over reimbursable agreements. Specifically we identified the following:
  - a. Interior improperly charged expenses to reimbursable agreements and incorrectly reversed reimbursable expenses when bills were issued. Although Interior reviews the expenses charged to reimbursable agreements, we determined that the review process is not always effective to prevent inappropriate expenses from being charged to certain reimbursable agreements.
  - b. Interior does not consistently record reimbursable agreements or issue bills in a timely manner. We noted that Interior issued certain bills more than twelve months late and we identified certain bills that were prepared manually but were not recorded into the accounting system until payments were received.
  - c. Interior maintains several subledger systems that do not enable Interior to efficiently or effectively record and reconcile activity from the subledger to the general ledger. In addition, we noted that Interior was unable to provide documentation for certain transactions due to difficulty in retrieving supporting documents.

As a result of our comments, Interior performed a detailed analysis of reimbursable activity and adjusted the balances appropriately.



2. Aged Accounts Receivable - Interior does not consistently investigate and resolve older accounts receivable balances. In addition, Interior does not consistently establish an allowance for older accounts receivable and older non-Federal Credit Reform Act loans receivable. When informed of the need to review older receivables, Interior analyzed the older receivables and recorded the appropriate adjustments to the receivable and the allowance accounts.
3. Advances – Interior receives advance payments for services to be provided in the future. We determined that Interior did not establish the appropriate posting model to properly record deferred revenue at the time of the advance and recognize revenue when the services are provided. We also noted that Interior was unable to support certain amounts recorded as advances. As a result of our comments, Interior analyzed and adjusted the advances to properly report the amount of revenue earned versus the amount of revenue that is deferred.
4. Segregation of Duties – Interior has not fully segregated duties of the billing and collection process at the Bureau of Land Management. We determined that one individual may access the mailroom, deposit cash and checks, and record transactions. Proper segregation of duties is necessary to help prevent and detect errors.

### **Recommendations**

1. Reimbursable Agreements – We recommend that Interior fully develop and implement controls over reimbursable agreements. We recommend that Interior:
  - a. Improve the process for reviewing and tracking expenses charged to reimbursable agreements and train the individuals who record and review the reimbursable agreement transactions.
  - b. Implement procedures to ensure that all reimbursable activity is recorded in the accounting system at the time the financial event occurs and that all bills are issued on a timely basis.
  - c. Upgrade systems to reduce manual intervention and utilize automated system interfaces and maintain supporting documentation.
2. Aged Receivables – We recommend that Interior review receivable aging reports and refer public receivables older than 180 days to the U.S. Department of the Treasury on a monthly basis. We also recommend that Interior establish a formal policy for calculating the allowance for doubtful accounts. This policy should define the key factors that management considers in assessing the collectibility of receivables and describe how the allowance is calculated and recorded. Interior should also ensure that a supervisor reviews and approves the allowance calculation.
3. Advances – We recommend that Interior revise the revenue posting models to ensure amounts received in advance of performing the services are recorded as deferred revenue until the services are provided. We also recommend that Interior periodically review amounts recorded as advances to ensure amounts are properly supported and recorded.

4. Segregation of Duties – We recommend that Interior fully segregate the duties of the billing and collection process at the Bureau of Land Management. If complete segregation is not feasible, Interior should establish mitigating controls including routine supervisory reviews and independent inspections of transactions.

### **Management Response**

Management concurs with this finding. Interior plans to take appropriate steps during 2002 to improve controls over revenue processes.

## **I. Improve Controls for Recording and Disclosing Claims and Assessments**

Ideally, Interior financial management departments would request and receive from the solicitor's office a quarterly summary of the status of major claims and assessments against Interior. In addition, the solicitor's office would communicate to the Interior financial management departments, more timely than quarterly, the changes in the status of major cases affecting Interior.

Interior has not fully developed or communicated internal controls to ensure that these types of communications take place. As a result, the Interior financial management departments generally do not receive or review any formal reports on the status of claims and assessments until after the end of the year. In addition, the finance departments do not communicate with the solicitor's office on a regular basis to ensure changes to significant claims and assessments are recorded timely. Furthermore, the Interior does not have internal controls to ensure that legal claims and assessments related to multiple bureaus are accrued and disclosed in the appropriate bureau financial statements. As a result, Interior expended a significant amount of time in December 2001 and January 2002 ensuring that claims and assessments were properly accrued and disclosed in the financial statements.

### **Recommendations**

We recommend that Interior fully develop and implement internal controls to ensure that the Interior financial management departments request from the solicitor's office a quarterly analysis of all legal claims and assessments and record an accrual or prepare a disclosure for inclusion in the interim and year end financial statements. In addition, the solicitor's office should provide updates, more timely than quarterly, on the status of major cases to the Interior financial management departments.

We also recommend that Interior establish internal controls to ensure that legal claims and assessments related to multiple bureaus are accrued and disclosed in the appropriate bureau financial statements. These communications will facilitate the timely and correct preparation of Interior's interim and year-end financial statements.

### **Management Response**

Management concurs with this finding. Interior will work with the Office of the Solicitor to streamline the tracking of legal claims and assessments and recording accrual or disclosure information for inclusion in year-end financial statements. Steps will be taken, if practical, to provide updated information for interim financial statements recognizing the large number of legal claims and assessments that Interior is involved in, the changing nature of these claims and assessments, and the limited resources available in the Office of the Solicitor.

### **J. Improve Controls over the Aquatic Resources Trust Fund**

Interior included the Aquatic Resources Trust Fund in its financial statements for the first time in fiscal year 2001. The Aquatic Resources Trust Fund includes two accounts: (1) Sport Fish Restoration Account and (2) Boat Safety Account. Interior is the primary recipient of funds from the Sport Fish Restoration Account. Interior has not fully implemented controls over recording the activity and balances related to the Aquatic Resources Trust Fund. Interior did not properly record the activity related to the Aquatic Resources Trust Fund and was unable to initially provide supporting documentation for approximately \$400 million of receivables related to the Sport Fish Restoration Account. We also noted that Interior has three different divisions within the Fish and Wildlife Service (i.e., Division of Finance, Division of Budget, and Division of Federal Aid) and each division recommended that Interior report a different budget authority amount related to the Sport Fish Restoration Account. After additional research, Interior reconciled the differences and adjusted the budget authority appropriately.

### **Recommendation**

We recommend that Interior develop and implement internal controls to ensure that the appropriation information is available to properly record the balances and activity related to the Aquatic Resources Trust Fund. The internal control process should include:

1. Responsibilities and lines of communication within Fish and Wildlife Service's Division of Finance, Division of Budget, and Division of Federal Aid.
2. Memorandum of understanding between Interior, U.S. Department of the Treasury, and the other program agencies involved in accounting and reporting of the Aquatic Resources Trust Fund. This memorandum should describe each party's responsibility related to the trust fund.

### **Management Response**

Management concurs with this finding. This is the first year that Interior was required to report the Aquatic Resources Trust Fund. Certain of the management activities of the Fund involve other agencies including the U.S. Department of the Treasury, U.S. Department of the Transportation and the Army Corps of Engineers. Interior recognizes that management improvements are needed and will work with the Office of Management and Budget, the U.S. Department of the Treasury and the other agencies to improve the overall management and timely reporting of activity related to the Aquatic Resources Trust Fund.

## **K. Improve Recording of Budgetary Transactions**

Interior needs to improve the internal controls over recording budgetary transactions as follows:

1. Budget Authority and Undelivered Orders – We noted that one Interior component was unable to reconcile undelivered orders included on the statement of budgetary resources to the general ledger by approximately \$29 million. Thus, resulting in a potential overstatement of Interior’s recorded undelivered orders.
2. Recoveries of Prior Year Obligations – We noted that certain components of Interior improperly recorded budget adjustments as recoveries of prior year obligations. We also noted that the statement of budgetary resources and SF-133 *Report on Budget Execution and Budgetary Resources*, incorrectly included recoveries of prior year obligations as part of obligations incurred. As a result of our comments, Interior analyzed the annual and multi-year appropriations and determined the appropriate adjustments to properly report recoveries.

### **Recommendations**

1. Budget Authority and Undelivered Orders – We recommend that Interior improve the process for recording and reporting budgetary transactions. We also recommend that a supervisor review and approve the recording and reporting of budgetary information.
2. Recoveries of Prior Year Obligations – We recommend that Interior establish procedures to identify and properly record recoveries of prior year obligations. We also recommend that Interior ensure supervisory reviews are completed of the SF-133 and statement of budgetary resources.

### **Management Response**

Management concurs with this finding and will take steps to implement these recommendations.

## **L. Improve Controls Over Interior Franchise Fund Financial Reporting**

Interior needs to improve the financial reporting processes of the Interior Franchise Fund (IFF). Specifically we noted:

1. Interior does not consistently record IFF transactions or reconcile IFF activity and balances with its trading partners in a timely manner. In addition, Interior needs to redesign the process for recording service provider activity to automate the process and enable IFF to efficiently reconcile activity and balances from IFF’s records to the service providers' records.
2. Interior has not fully implemented controls and procedures to ensure that IFF records obligations when they are incurred or liabilities when they are incurred. In addition, Interior does not consistently review and resolve older accounts receivable and payable balances. Furthermore, Interior has not fully documented its procedures for recording and monitoring financial transactions and preparing financial statements.

3. IFF is a “virtual organization” that utilizes personnel from both of its service providers. Although several personnel are fully dedicated to working on IFF activity, there are several personnel who only spend part of their time working on IFF activity. As a result of utilizing personnel from different service organizations, IFF does not have clear lines of responsibility or reporting. This causes delays in processing of IFF transactions because IFF activity does not appear to receive the same priority as the other activity processed by the service providers.

### **Recommendations**

We recommend that Interior improve the accounting processes and internal controls at IFF. We also recommend that Interior should ensure that there is appropriate staffing to complete the day-to-day accounting processing in a timely manner.

### **Management Response**

Management concurs with this finding and will take steps to implement these recommendations.

## **M. Improve Controls Over Credit Card Purchases**

Interior has issued over 50,000 credit cards to employees as of September 30, 2001 and purchased over \$600 million using credit cards during fiscal year 2001. We determined that Interior does not consistently have a supervisor review and approve credit card statements. We also noted that the Office of Inspector General issued a report in December 2001 that identifies several areas that Interior needs to improve related to the credit card program, such as, reviewing and adjusting credit card limits, reconciling credit card statements to invoices and receipts, maintaining records related to credit cards, and terminating credit cards when employees leave.

### **Recommendations**

We recommend that Interior improve the controls over credit card purchases. We recommend that Interior designate and require supervisors to review and approve monthly credit card statements. Supervisors should be trained and in a position to determine if transactions were appropriate and reasonable. We also recommend that Interior review and adjust credit card limits on a periodic basis, improve the process for reconciling credit card statements to invoices and receipts, improve the record keeping process, and ensure credit cards are deactivated when employees leave.

### **Management Response**

Management concurs with these recommendations and has already begun a process to improve supervisory review and oversight of credit card transactions. One issue identified by the Office of the Inspector General has been resolved and implemented.

## **N. Improve Accounting for Inventory**

Interior needs to improve the internal controls over inventory as follows:

1. Helium Inventory - Interior maintains perpetual records for its Helium inventory and verifies the perpetual records using periodic engineering studies. For the past eight years, Interior has identified differences between the perpetual records and periodic engineering studies. However, Interior has not adjusted the perpetual records based on the results of the studies because Interior does not believe that the studies are accurate enough to support adjusting the perpetual records.
2. Map and Hydrological Equipment Inventory – Interior has not fully established procedures to properly record the cost of map and hydrological equipment inventory. We noted that Interior expenses certain costs at the time of disbursement instead of including these costs as part of inventory. We also noted that Interior adjusts inventory to its net realizable value based on limited inventory analysis procedures.

### **Recommendations**

1. Helium Inventory - We recommend that Interior thoroughly investigate the differences between the perpetual records and the engineering studies to determine the nature of the differences. Based on the results of the investigation, Interior should either adjust the perpetual records or revise the process for conducting the engineering studies. We also recommend that Interior consider utilizing an independent third party engineering specialist to perform future studies.
2. Map and Hydrological Equipment Inventory – We recommend that Interior review and adjust its costing model to ensure all appropriate costs are included in inventory. We also recommend that Interior improve its process for determining the net realizable value of inventory.

### **Management Response**

Management concurs with this finding. The bureaus responsible for Helium inventory and the map and hydrological equipment inventory will review approaches for maintaining inventory valuations and appropriately adjusting inventory costs.

## **O. Improve Deferred Maintenance Reporting**

Interior has not fully established controls to identify and report deferred maintenance. We noted that Interior has not completed condition assessments for certain assets and therefore has not properly disclosed all deferred maintenance amounts. In addition, Interior does not report deferred maintenance by major asset category and has not defined acceptable operating conditions for each major class of assets.

### **Recommendation**

We recommend that Interior develop and implement internal controls to ensure the following:

1. Condition assessments are completed following a standard process and on a regular basis.
2. Deferred maintenance is calculated for each asset following a standard process.
3. Condition and deferred maintenance is summarized and reported by major asset category.

### **Management Response**

Management concurs with this finding. Interior has identified “Inadequate Department-wide Maintenance Management Capability” as a mission critical weakness. The corrective action plan includes implementing a comprehensive maintenance management system with an appropriate linkages to the accounting systems; conducting comprehensive condition assessments; implementing a five-year deferred maintenance and capital improvement plan; and, utilizing a capital asset planning process.

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

## **Compliance with Laws and Regulations**

The results of our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report, exclusive of the FFMIA of 1996, disclosed instances of noncompliance with the following laws and regulations that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02 and are described below.

### **P. Debt Collection Improvement Act of 1996**

In accordance with the Debt Collection Improvement Act of 1996, Interior is required to refer eligible receivables that are delinquent to the U.S. Department of the Treasury for collection or offset. Eligible receivables include those that are not the subject of litigation, related to foreclosure proceedings, or from organizations in bankruptcy. We determined that Interior did not consistently refer receivables that are over 180 days delinquent to the U.S. Department of the Treasury. Specifically we noted that Interior did not refer Bureau of Indian Affairs, Bureau of Reclamation, and U.S. Geological Survey receivables of approximately \$722 thousand, \$16,381 thousand, and \$740 thousand, respectively

### **Recommendation**

We recommend that the Interior establish a process, in fiscal year 2002, to ensure eligible receivables are referred to the U.S. Department of the Treasury in a timely manner.

### **Management Response**

Management concurs with this finding and will work to improve the current process of transferring eligible debt to the U.S. Department of the Treasury.

### **Q. Prompt Payment Act**

In accordance with the Prompt Payment Act, Interior is required to pay bills on time and pay interest penalties when payments are late. We determined that Interior did not consistently pay interest penalties when payments were late. We identified 6 exceptions out of 198 items tested related to the Minerals Management Service and 1 exception out of 199 items tested related to the U.S. Geological Survey, where the prompt payment interest was due, but not paid.

### **Recommendation**

We recommend that Interior establish a process, in fiscal year 2002, to ensure late payments include interest penalties.

### **Management Response**

Management concurs with this finding and will work with the indicated bureaus that have experienced difficulty in complying with the Prompt Payment Act.

### **R. Section 113 of Public Law 104-208 - Advances for Interior Franchise Fund**

In accordance with section 113 of Public Law 104-208, Interior is required to obtain advances from Franchise Fund customers before costs are incurred to provide goods or services to the customer. We determined that Interior does not consistently obtain advances from customers as Interior reported Franchise Fund accounts receivable of \$15.8 million as of September 30, 2001.

### **Recommendation**

We recommend that Interior, in fiscal year 2002, require Franchise Fund customers to pay in advance, in accordance with the laws or consider requesting the U.S. Congress to change the laws governing this requirement.

### **Management Response**

Interior developed appropriation language supporting the Interior Franchise Fund under the Government Management Reform Act establishing the franchise fund pilot program following the Office of Management and Budget guidelines. The intent of the pilot program was to allow these pilot programs to provide quality service at reduced costs to Federal agencies through competition. Interior does not believe that the recommended appropriation language was intended to require advances for all services but was intended to allow the pilot program to receive advances so that the organizations could operate in a more business like manner. However, Interior can see how the existing language could be interpreted as described above. Interior will work with the Office of Management and Budget and Congress to adjust the appropriation to support the intent of the stated Government Management Reform Act objectives.



The results of our tests of compliance with other laws and regulations, exclusive of FFMIA, disclosed no other instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

The results of our tests of FFMIA section 803(a) requirements disclosed instances, described below, where Interiors' financial management systems did not substantially comply with the Federal financial management systems requirements, federal accounting standards, or the United States Government Standard General Ledger at the transaction level.

## **S. Financial Management Systems Requirements**

As required by FFMIA, Interior is to secure its financial management systems in accordance with OMB Circular A-130, Appendix 3, Section 3, *Automated Information System Security Programs*. As discussed in the section of our report entitled "Internal Control over Financial Reporting," Interior needs to improve its EDP security and general control environment. Interior has not finalized and communicated an entity-wide security plan; does not have adequate controls to prevent or detect unauthorized access to its financial systems; has not fully developed procedures for controlling changes over software that would prevent unauthorized programs or modifications to an existing program from being implemented; has not prepared and tested contingency plans for all systems and operations; and has not fully segregated responsibilities related to application and general controls. As a result, Interior does not comply with the system requirements of FFMIA.

### **Recommendation**

We recommend that during fiscal year 2002, Interior's Chief Information Officer improve the security and general controls over its financial management systems to meet the requirements set forth in OMB Circular A-130, Appendix 3, Section 3, *Automated Information System Security Programs*.

### **Management Response**

Management concurs with this finding. Actions are underway to address this issue. See also management's response for item A above.

## **T. Federal Accounting Standards**

Interior is required to prepare its financial statements in accordance with federal accounting standards. As discussed in the Internal Control over Financial Reporting section of this report, we identified material weaknesses that affected Interior's ability to prepare its financial statements and related disclosures in accordance with federal accounting standards. Specifically, we determined that Interior needs to improve the timeliness of transaction entry and reconciliation of the general ledger accounts to subledgers and other supporting documentation. We also noted that Interior needs to improve procedures and controls over undelivered orders, accruals, property plant and equipment, intra-departmental transactions, and intra-governmental transactions.

### **Recommendation**

We recommend that during fiscal year 2002, Interior financial management fully develop and implement strengthened procedures and internal controls that ensure the financial statements and related disclosures are prepared in accordance with the federal accounting standards.

### **Management Response**

Management concurs with this finding. See also management's response to items B, C, D, and E above.

## **U. United States Government Standard General Ledger**

In accordance with OMB Circular A-127, *Financial Management Systems*, Interior is to record financial events consistent with the applicable account descriptions and attributes reflected in the United States Standard General Ledger (SGL) at the transaction level.

Interior records its royalty activity in a system entitled, Auditing and Financial System (AFS). We determined that AFS does not enable Interior to account for its royalty activity using the SGL at the transaction level. We also determined that Interior records certain receivables and property, plant, and equipment in the general ledger at a summary level instead of at the transaction level.

### **Recommendation**

We understand that Interior is in the process of implementing a new accounting system to record and report royalty activity and expects to implement this system during fiscal year 2002. We recommend that Interior ensure the new royalty system will enable Interior to account for its royalty activity using the SGL at the transaction level. We also recommend that Interior revise its process for recording receivables and property, plant and equipment during fiscal year 2002 to ensure that this activity is recorded consistent with the SGL at the transaction level.

### **Management Response**

Management concurs with this finding. A new system for tracking and collecting royalty payments was implemented in November 2001. Unfortunately, as a result of a Court Order related to Indian Trust Fund information security, Minerals Management Service has been unable to operate the system since early December. Interior is actively trying to obtain approval from the Court to begin to operate the system again and restore appropriate support for the royalty collection and monitoring process.

## **Responsibilities**

### ***Management's Responsibilities***

The Government Management Reform Act (GMRA) of 1994 requires each federal 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, Interior prepares annual financial statements.

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting; required supplementary information; required supplementary stewardship information; other supplementary information and performance measures; 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' Responsibilities***

Our responsibility is to express an opinion on the fiscal year 2001 financial statements of Interior based on our audit. We conducted our audit 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 audit 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 financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our fiscal year 2001 audit, we considered Interior's internal control over financial reporting by obtaining an understanding of Interior'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 opinion on the financial statements. 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 relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982. The objective of our audit was not to provide assurance on internal controls over financial reporting. Consequently, we do not provide an opinion on internal control over financial reporting.

As required by OMB Bulletin No. 01-02, we considered Interior's internal control over Required Supplementary Stewardship Information by obtaining an understanding of Interior's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion on such controls.

As further 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's 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 on such controls.

As part of obtaining reasonable assurance about whether Interior's fiscal year 2001 financial statements are free of material misstatement, we performed tests of Interior's compliance with certain provisions of laws and regulations, 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 and regulations applicable to Interior. Providing an opinion on compliance with laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether Interior'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. 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 the U.S. Department of the Interior's management, the U.S. Department of the Interior'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 25, 2002

**U. S. Department of the Interior**  
**Summary of the Status of Prior Year Reportable Conditions**  
**September 30, 2001**

Ref	Condition Area	Status
A	Account Analysis and Reconciliation.	This condition has not been corrected and is repeated in FY 2001.
B	Construction in Progress.	This condition has not been corrected and is repeated in FY 2001.
C	Unliquidated Obligations.	This condition has not been corrected and is repeated in FY 2001.
D	Land and Land Rights.	This condition has not been corrected and is repeated in FY 2001.
E	Accruals.	This condition has not been corrected and is repeated in FY 2001.
F	Trading Partners.	This condition has not been corrected and is repeated in FY 2001.
G	Property, Plant, and Equipment.	This condition has not been corrected and is repeated in FY 2001.
H	Financial Management and Accounting Processes at Mineral Management Service.	This condition has been corrected.
I	Security and General Controls over Financial Management Systems.	This condition has not been corrected and is repeated in FY 2001.
J	Trust Funds.	This condition has not been corrected and is repeated in FY 2001.
K	Budgetary Data Reporting.	This condition has been partially corrected and is repeated in FY 2001.
L	Deferred Maintenance Management and Reporting.	This condition has not been corrected and is repeated in FY 2001.
M	Grant Payments at Fish and Wildlife Service.	This condition has been corrected.

**U. S. Department of the Interior  
Summary of the Status of Prior Year Reportable Conditions  
September 30, 2001**

Ref	Condition Area	Status
N	Interior Franchise Fund.	This condition has not been corrected and is repeated in FY 2001.
O	Debt Collection Act.	This instance of non-compliance has not been corrected and is repeated in FY 2001.
P	Office of Management and Budget Circular A-11.	This instance of non-compliance has been corrected.
Q	Prompt Payment Act.	This instance of non-compliance has not been corrected and is repeated in FY 2001.
R	FFMIA – Federal Accounting Standards.	This instance of non-compliance has been corrected. However, we have reported a different instance of non-compliance with this regulation in FY 2001.
S	FFMIA – Financial Management System Requirements.	This instance of non-compliance has not been corrected and is repeated in FY 2001.



# United States Department of the Interior

Office of Inspector General  
Washington, D.C. 20240

## Independent Auditor's Report

To: Secretary  
Department of the Interior

Subject: Independent Auditors' Report on the Department of the Interior's Financial Statements for Fiscal Year 2000

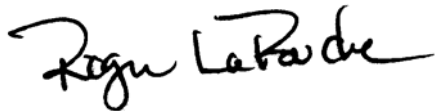
We have audited the Department of the Interior's (DOI) consolidated balance sheet as of September 30, 2000, statement of custodial activity for the year then ended and the related notes (herein after referred to as the financial statements). The objective of our audit was to express an opinion on the fair presentation of the financial statements. These financial statements are the responsibility of the DOI and our responsibility is to express an opinion, based on our audit, on these financial statements.

We conducted our audit in accordance with the auditing standards generally accepted in the United States of America; the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and with Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. These standards and OMB Bulletin No. 01-02 require that we plan and perform our audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures contained in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit of the financial statements provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the DOI as of September 30, 2000, and its custodial activity for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 23 to the financial statements, the financial statements have been restated as a result of a change in reporting entity, various changes in accounting and the correction of certain errors. In addition, other changes and reclassifications were made to conform the fiscal year 2000 presentation with the fiscal year 2001 presentation.

In our report dated February 27, 2001 we expressed the opinion that DOI's statement of net cost of operations for the year ended September 30, 2000 presented fairly, in all material respects, its net cost of operations in conformity with accounting principles generally accepted in the United States of America. As discussed in Note 20, the DOI has restated its statement of net cost of operations for the year ended September 30, 2000 to conform with the presentation of net cost for the year ended September 30, 2001. We did not audit the restated statement of net cost of operations for the year ended September 30, 2000 and, accordingly, we do not express an opinion on this statement and related notes.

A handwritten signature in black ink, reading "Roger LaRouche". The signature is fluid and cursive, with the first name "Roger" and last name "LaRouche" clearly distinguishable.

Roger La Rouche  
Assistant Inspector General for Audits  
February 27, 2001, except for Note 23  
as to which the date is February 25, 2002



## Management Challenges

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**1. Financial Management.** The preparation of reliable financial statements as required by the Chief Financial Officers Act continues to be a major challenge for DOI and its Bureaus. Although the Office of Inspector General (OIG) issued unqualified opinions on Fiscal Year (FY) 2000 financial statements for the Department of the Interior (DOI) and seven of its nine Bureaus, OIG was unable to express an opinion on financial statements for the Minerals Management Service (MMS) and qualified our opinion on financial statements for the U.S. Fish and Wildlife Service (FWS). Weak internal controls for both these Bureaus resulted in MMS not being able to issue auditable financial statements because of inaccurate, incomplete, and untimely data and FWS overstating its balance for undelivered orders by about \$23.4 million. In addition, the certified public accounting firm auditing the financial statements for Indian Trust Funds held by the Office of Special Trustee for American Indians qualified its opinion because of an irreconcilable difference of about \$35 million between recorded cash balances and the balances reported by the U.S. Treasury.

The FY 2000 financial statement audits also identified weak internal controls in several areas and noncompliance with certain laws and regulations. All nine Bureaus had internal control weaknesses related to account analysis and reconciliation and intra-Departmental transactions. Seven Bureaus had internal control weaknesses in accounting for obligations. Bureau delays in consistently performing account analyses and reconciliations resulted in over 1,000 time-consuming and complex adjustments at year-end to produce accurate financial information. Similarly, inconsistent tracking of intra-Departmental transactions resulted in DOI being out of balance by over \$2 billion at year-end. Although DOI eventually reconciled the intra-Departmental transactions to within \$71 million, a significant amount of time and resources was expended. The weak internal controls over obligations resulted in considerable work to correct balances for undelivered orders that were inaccurate because of invalid or inadequately supported obligations. OIG also noted that some Bureaus had not yet fully complied with appropriate laws and regulations; specifically, the Debt Collection Improvement Act of 1996, the Prompt Pay Act, and the Federal Financial Management Improvement Act.

DOI's FY 2001 financial statement audits, conducted by independent public accounting firm under our oversight, are addressing the same familiar, long-standing issues. For example, internal control weaknesses remain uncorrected in the areas of information systems, Indian Trust funds, accounting for property, eliminations, accruals, undelivered orders, deferred maintenance, and construction in progress.

**2. Information Technology.** DOI has not resolved its long-standing problems in the areas of computer security and overall system effectiveness. Congressman Steve Horn's subcommittee entitled Government Efficiency, Financial Management and Intergovernmental Relations annual assessments of agency information system security,

for example, have consistently ranked DOI near the bottom of the list, and DOI's failure to maintain systems to properly account for Indian trust assets is well known.

DOI reported computer security as a material weakness in both FY 2000 and 2001. Our first annual review of DOI's information technology security systems under the Government Information Security Reform Act found inadequate or non-existent security plans and risk assessments and employees who were poorly trained in their security responsibilities. The OIG report on DOI's Annual Departmental Report on Accountability for FY 2001 again identified material weaknesses in DOI's financial management systems. Although DOI's Chief Information Officer issued an information technology security plan on September 20, 2001, establishing minimum standards for secure operations, the plan did not specify the steps needed to meet these standards and is not expected to be fully implemented until FY 2006. Additionally, in FY 2001 audits of DOI's National Business Center's personnel and payroll processing policies and procedures and the Bureau of Land Management's (BLM) collection module of its Collections and Billing System, OIG found that improvements were still needed in developing policies and procedures for, and implementing appropriate internal controls over, DOI information technology systems.

**3. Health and Safety.** Ensuring the health and safety of employees and the increasing number of visitors to public lands and facilities under DOI jurisdiction remains a clear priority and a challenge. In fiscal year 2000, the National Park Service (NPS) reported more than 286 million visits, BLM reported approximately 54 million visits, FWS reported approximately 36 million visits, and the Bureau of Reclamation (BOR) reported approximately 80 million visits. Both BLM and NPS have reported material weaknesses in employee and public safety. BLM is providing safety training to its safety managers and officers, and NPS is implementing a Congressionally-directed Structural Fire Program plan as a result of a May 2000 General Accounting Office (GAO) report that NPS fire protection was inadequate. Also, in May 2000, OIG reported on long-standing, uncorrected health and safety problems with concessions at BOR's Canyon Ferry Reservoir and Lake Berryessa, that have degraded land and water resources at these sites. BOR began taking steps to correct these deficiencies in FY 2001.

Recent reviews by several independent management consultants and OIG have identified shortcomings in DOI law enforcement programs that could affect the safety of both DOI law enforcement officers and the people they are tasked with protecting. DOI law enforcement programs, for example, are significantly understaffed, making it difficult for officers to fully meet their law enforcement and resource protection responsibilities. This condition is particularly acute at the Bureau of Indian Affairs (BIA), where an alarming shortage of Correctional Officers not only puts existing officers and nearby communities in danger, but also represents considerable potential liability to both DOI and BIA in terms of reputation and monetary culpability. Similarly, NPS, BLM and FWS law enforcement officers have inadequate backup at many locations, thereby placing both the officers and the public at risk. The Department has already begun to address these concerns.

Another significant issue is DOI's continuing liability for cleaning up sites contaminated by hazardous materials, closing abandoned mine sites, plugging oil and gas wells, repairing leaking underground storage tanks and pipelines, and controlling illegal dumping. In its Accountability Report for FY 2000, DOI estimated that its total liability for environmental cleanup may range from \$457 million to \$830 million.

**4. Maintenance of Facilities.** DOI's maintenance program is in crisis. Costs to complete deferred maintenance on DOI's large and aging inventory of schools, office buildings, bridges, dams, irrigation systems, roads, and historic buildings and structures are currently estimated to range from \$7.2 billion to \$11.3 billion. These numbers can only be estimated since numerous reviews conducted by our office, GAO, and the Bureaus have shown that DOI has not been able to develop a reliable estimate of the extent of the backlog.

DOI's failure to implement an adequate, standardized automated maintenance management system has severely inhibited its ability to effectively fulfill its maintenance responsibilities. Although DOI reported its "Inadequate Department-wide Maintenance Management Capability" as a mission-critical material weakness, it has not yet taken sufficient action to address the considerable extent of this deficiency. In our December 2001 report on maintenance processes within NPS, BIA, BLM and FWS, we highlighted both the positive changes already being implemented and the critical actions needed to enable DOI to quickly reduce the backlog and develop a comprehensive, proactive, and reliable facilities maintenance management program. The report's recommended actions were designed to provide the management oversight and proactive measures needed to complement the on-going efforts of individual Bureaus and reinvigorate DOI efforts begun in recent years.

## **5. Responsibility to Indians and Insular Areas.**

**Responsibility to Indians.** BIA continues to experience administrative and management problems that constrain its ability to effectively fulfill its trust responsibilities and promote self-determination on behalf of Tribal governments, American Indians and Alaska Natives. Reviews conducted by our office, GAO, BIA, and management consultants have identified serious deficiencies in many areas, including trust responsibility, Indian self-determination and self-governance, facilities and road maintenance, safety management, law enforcement, housing, social services, and education.

Another area of concern is BIA's administration of its 171 schools and 14 dormitories, which serve about 50,000 Indian students in 23 states. The OIG audits in FY 2001 identified problems in construction and operational planning. At one school, the failure to follow construction-planning documents resulted in additional construction costs of \$666,000. Four other schools could not ensure that operating funds were properly expended because of the failure to comply with requirements for preparing and executing local financial plans. Problems in overall administration are exacerbated by the poor physical condition of school facilities. In spite of significant funding increases for school

replacement, modernization, maintenance, and repair, it will take several years to address the existing backlog of needed work.

**Responsibility to Insular Areas.** Our audits continue to reveal the existence of long-standing financial and program management deficiencies in U.S. Insular Areas, some of which are in financial crisis. Specifically, insular area governments experience difficulties in accurately accounting for expenditures, collecting taxes and other revenues, controlling the level of expenditures, and delivering program services. Contributing to the long-standing problems is the fact that, although each of the Insular Areas has an internal audit organization, these organizations, with few exceptions, lack the staff, resources, or independence necessary to provide effective and objective audit coverage of local government operations.

Under the Insular Areas Act of 1982, we have audit authority over both Federal and non-Federal funds in Guam, American Samoa, the U.S. Virgin Islands, and the Commonwealth of the Northern Mariana Islands. Pursuant to the Compact of Free Association Act of 1985, OIG has audit authority over Federal funds in the Federated States of Micronesia, the Republic of Palau, and the Republic of the Marshall Islands. However, neither OIG nor DOI has authority to enforce resolution and implementation of our audit recommendations to Insular Area government officials. As a result, OIG recommendations, as well as recommendations in single audit reports issued by independent accounting firms, are rendered meaningless.

Despite this situation, OIG continues efforts to improve financial and program management in the Insular Areas. In FY 2001, OIG assisted the Government of the Virgin Islands in complying with past requirements of the Single Audit Act and negotiated arrangements to provide technical assistance and training to the local public auditors of the Pacific Insular Areas in auditing local funds. OIG also performed detailed reviews of the Virgin Islands Lottery, Department of Education, Port Authority, and Bureau of Internal Revenue and the Economic Development Authority in Guam.

**6. Resource Protection/Restoration.** The protection and restoration of natural and cultural resources is a primary DOI responsibility and represents an ongoing management challenge. DOI administers about 439 million acres of Federal land throughout the United States and the Insular Areas and has numerous responsibilities for protecting and restoring the Nation's natural and cultural resources. For example, the Office of Surface Mining Reclamation and Enforcement (OSM) ensures that coal mining operations are conducted in an environmentally sound manner and lands damaged by past coal mining practices are restored; BLM ensures the appropriate economic and recreational uses of public lands and protects the wild horse and burro population; FWS maintains healthy habitats for fish and wildlife resources, particularly endangered and threatened species; NPS protects natural and cultural resources in our parks; USGS protects and improves the quality and quantity of our Nation's water; and BOR manages, develops, and protects water and related resources on Reclamation project lands. DOI faces growing challenges in these areas as the demand for economic and recreational uses of our lands and water resources increases.

In FY 2001, OIG reviewed the potential damage to Indian Trust lands because of insufficient bonding for plugging of abandoned oil and gas wells and the use of substandard materials in reservation roads. OIG found that DOI could face a potential liability of as much as \$584 million to plug the insufficiently bonded abandoned oil and gas wells of companies leasing Indian Trust lands and recommended that BIA and BLM, which share Indian Trust land leasing responsibility, initiate corrective actions. In regard to reservation roads, an investigation resulted in the conviction of a lab technician for falsifying lab records that allowed a BIA contractor to use substandard aggregate materials in constructing a 12-mile road. BIA estimates that restoration of the road to proper specifications will cost millions of dollars.

**7. Revenue Collections.** Although DOI collects over \$8 billion in revenues each year, OIG and GAO reports have shown that bureaus could enhance revenues collected for royalty payments, recreational fees, and costs recovered for services provided. In 16 reports issued over the last four years, OIG identified more than \$141 million in lost or potential additional revenues, including \$71.7 million of undercollected royalties, \$17.5 million lost because excess lands were not sold, and \$6.6 million of unrecovered firefighting costs. Also, since 1998, OIG, MMS and the Department of Justice have recovered underpaid royalties of about \$500 million through settlements with energy companies resulting from our investigations.

Because of the significant monetary amounts involved, OIG continues to devote substantial resources to revenue collection and are currently conducting three audits in this area: one on MMS royalty compliance, one on BOR billing and collection activities, and one on measurement activities of a gas processing plant operator for royalty payment determination purposes. The OIG FY 2002 work plan includes an additional eight reviews on revenue collection.

**8. Government Performance and Results Act (GPRA) of 1993.** DOI and its Bureaus face significant challenges in implementing GPRA requirements to establish performance goals and measures that effectively demonstrate mission accomplishment. In FY 2001, at the request of the Chairman of the U.S. House of Representatives Committee on Government Reform, OIG reviewed 10 DOI performance measures for FY 2000 and found that many needed to be clarified, expanded to include other Bureaus, or supplemented to explain their significance or to better describe reported accomplishments. During FY 2001, OIG continued or initiated reviews of specific performance measures at FWS and BLM, including the suitability of the measures used, methods of data collection, and procedures for data verification. Preliminary analyses indicate deficiencies in each of these areas, illustrating the considerable challenges that remain in meeting GPRA reporting requirements.

**9. Procurement, Contracts, and Grants.** DOI spends substantial resources each year in contracting for goods and services and in providing Federal assistance to states and Indian organizations. Procurement has historically been an area subject to fraud and waste government-wide, and managing procurement activities is an unending challenge

requiring constant attention. In FY 2000, the volume of procurement activity exceeded \$3 billion, of which over \$2 billion was provided to states and Indian tribes in grants and other types of Federal aid assistance

DOI has reported on the material inadequacy of BIA's acquisition management organization, policies, procedures, and guidelines since FY 1991. DOI has also reported since 1999 that controls over management oversight and accountability in FWS's Federal Aid Program have been materially weak because of inadequate management controls and lack of a centralized audit follow-up program and guidance governing the administration of the Program. Implementation of corrective actions is not expected until FY 2002 and 2003.

Recently OIG completed an audit of procurement activities in DOI's integrated charge card program. We found that improper transactions went undetected because DOI had not established an effective process to review and validate purchases, sufficiently monitor and adjust credit limits, or deactivate ex-employee cards. The total effect of these deficiencies included not only the potential loss of monetary resources, but also the potential loss of confidence in the integrity of DOI operations.

OIG procurement audits currently in progress include evaluating the operation of MMS's Gov. Works procurement organization, evaluating DOI's Travel Card Program, and reviewing long-term water service contracts for BOR's Central Valley Project.

**10. Emergency Management.** The attacks on America on September 11, 2001, exposed the vulnerability of DOI employees, visitors, infrastructure, and national monuments to the extreme danger and damage caused by terrorist actions. As a result, OIG elevated the objective of ensuring the adequacy of DOI's contingency planning and preparedness for natural disasters and terrorist attacks to a critical management challenge. As part of responding to this new challenge, OIG recently completed a Comprehensive Assessment of DOI Law Enforcement, including a review of security and emergency preparedness within DOI, and provided several recommendations to the Secretary. Both OIG and DOI are committed to providing maximum protection to DOI resources under all possible circumstances, and OIG is now determining where it can best apply its resources to maximize its contribution to protecting DOI and its visitors.

Since September 11, DOI has also responded to the threat of terrorist activities by operating at a heightened level of security through reallocating currently budgeted funding and using \$85.5 million of supplemental appropriations authorized by the President for disaster recovery and security needs. To implement its overall stratagem of providing heightened security for FY 2003 and beyond, DOI has established four priorities: (1) establishing security personnel in each Bureau, (2) protecting facilities that significantly affect national security or the economy, (3) identifying and upgrading the security for all appropriate facilities, and (4) strengthening law enforcement on DOI lands adjacent to the Nation's northern and southwestern borders. DOI has requested that its Bureaus prepare their budget needs for FY 2003 based on working towards achieving these established priorities.