



United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

March 15, 2002

Memorandum

To: Director, Minerals Management Service

From: Roger La Rouché
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Minerals Management Service's Financial Statements for Fiscal Years 2001 and 2000 (No. 2002-I-0023)

We contracted with KPMG LLP, an independent certified public accounting firm, to audit the Minerals Management Service's (MMS) financial statements for fiscal year 2001. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States of America; Office of Management and Budget Bulletin No. 1-02, *Audit Requirements for Federal Financial Statements*; and the General Accounting Office/President's Council on Integrity and Efficiency *Financial Audit Manual*. The Office of Inspector General (OIG) is responsible for the opinion on the statement of custodial activity and related notes for fiscal year 2000.

In connection with the contract, 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 MMS's financial statements or on conclusions about the effectiveness of internal controls or on conclusions about compliance with laws and regulations. KPMG is responsible for the auditors' report on the fiscal year 2001 financial statements (Attachment 1) and for the conclusions expressed in the report.

In its audit report, KPMG issued an unqualified opinion on the MMS's balance sheet and statement of custodial activity for fiscal year 2001. KPMG did not express an opinion on the accompanying statements of net cost, changes in net position, budgetary resources, and financing for the year ended September 30, 2001. The OIG in its report (Attachment 2) issued an unqualified opinion on the MMS's fiscal year 2000 statement of custodial activity. The OIG did not express an opinion on the balance sheet as of September 30, 2000, and statement of net cost of operations for the year then ended.

KPMG found one reportable material weakness in internal controls and one reportable condition related to internal controls and financial reporting. With regard to compliance with laws and regulations, KPMG found MMS to be noncompliant with a portion of the *Federal Financial Management Improvement Act*. Specifically, MMS's financial management systems did not substantially comply with the United States Government Standard General Ledger at the transaction level and did not meet Federal financial management systems requirements. In addition, KPMG found that MMS was not in full compliance with the *Prompt Pay Act*.

MMS in its February 7, 2002 response (Attachment 3) concurred with the recommendations and indicated corrective action would be taken. Based on MMS's response we consider the recommendations resolved but not implemented. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for resolution and tracking of implementation.

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.

The Independent Auditors' Report is intended for the information of the management of MMS, 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.

Attachments (2)

[CONTACT THE MINERALS MANAGEMENT SERVICE FOR INFORMATION ON ITS 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

Office of Inspector General and
Director of Minerals Management Service
Department of the Interior:

We have audited the accompanying consolidated balance sheet of the Minerals Management Service (MMS) as of September 30, 2001 and the related statement of custodial activity for the year then ended. The objective of our audit was to express an opinion on the fair presentation of the consolidated balance sheet and statement of custodial activity. In connection with our audit, we also considered MMS's internal control over financial reporting and tested MMS's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on the consolidated balance sheet and statement of custodial activity.

SUMMARY

As stated in our opinion, we concluded that the MMS's consolidated balance sheet and statement of custodial activity 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. We did not audit the accompanying statements of net costs, changes in net position, budgetary resources, and financing for the year ended September 30, 2001, and, accordingly, we do not express an opinion on them.

Our consideration of internal control over financial reporting resulted in certain Information Technology (IT) data security control weaknesses and year-end accrual weaknesses being identified as a reportable condition. We consider the IT data security control reportable condition to be a material weakness.

The results of our tests of compliance with laws and regulations disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*:

- Prompt Payment Act
- Federal Financial Management Improvement Act (FFMIA)

The following sections discuss our opinion on MMS's consolidated balance sheet and statement of custodial activity as of and for the year ended September 30, 2001, our consideration of MMS's internal control over financial reporting, our tests of MMS's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

OPINION ON THE CONSOLIDATED BALANCE SHEET AND STATEMENT OF CUSTODIAL ACTIVITY

We have audited the accompanying consolidated balance sheet of the Minerals Management Service as of September 30, 2001 and the related statement of custodial activity for the year then ended. The accompanying statements of net costs, changes in net position, budgetary resources, and financing for the year ended September 30, 2001, were not audited by us and, accordingly, we do not express an opinion on them.

In our opinion, the consolidated balance sheet and statement of custodial activity referred to above, present fairly, in all material respects, the financial position of the Minerals Management Service as of September 30, 2001 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 10 to the financial statements, MMS changed its accounting and financial reporting for Federal royalty distributions to states.

The information in the Management Discussion and Analysis section 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. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the consolidated balance sheet and statement of custodial activity taken as a whole. The consolidating information on pages 58 to 62 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, net costs, changes in net position, and budgetary resources of MMS's components individually. The consolidating balance sheet has been subjected to the auditing procedures applied in the audit of the consolidated balance sheet and, in our opinion, is fairly stated in all material respects in relation to the consolidated balance sheet taken as a whole. However, we did not audit the consolidated statements of net costs, changes in net position, and budgetary resources, and, accordingly, we do not express an opinion on the related consolidating statements of net costs, changes in net position, and budgetary resources.

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 MMS'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, described below, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable condition no. 2001-01 is a material weakness.

No. 2001-01- Information Technology Data Security Control Weaknesses

Condition

MMS did not have adequate information security policies and procedures to meet the requirements of OMB Circular A-130, *Security of Federal Automated Information Resources*. OMB Circular A-130 provides requirements to ensure adequate security for information relating to general support systems and major application systems. The MMS also did not have effective policies and procedures to control and protect information systems. Specifically, we noted weaknesses in the following areas:

Entity-wide Security Program: The MMS security plan did not contain all of the information required by OMB Circular A-130, Appendix III. Specifically, MMS did not:

- Perform an adequate risk assessment of the Advanced Budget/Accounting Control and Information System (ABACIS)
- Obtain approval for the ABACIS security plan
- Document, implement, and update appropriate security policies
- Establish and document a bureau-wide policy for security-related personnel actions
- Develop an entity-wide security awareness training program

Access Controls: MMS did not have adequate controls to limit or detect access to information systems to protect against unauthorized modification, loss, and disclosure of data. We noted that MMS had weaknesses in:

- Review and timely deactivation of physical access
- Timely removal of terminated and temporary access to information systems
- Application security software
- Granting and deleting dial-up access privileges
- Password administration
- Network security

System Software Controls: MMS did not establish controls to monitor operating system activities and operating system security parameters have not been set for effective logging of user activity.

Service Continuity: MMS had not conducted recent tests of its contingency plans to minimize the risk of unplanned interruptions and to minimize the risk of recovery of critical operations to protect data should interruptions occur.

Recommendation

MMS should improve controls over information technology systems to ensure adequate security and protection of information resources. MMS should test contingency plans annually and analyze the results once testing has been conducted.

Management Response

Entity-wide Security Program: The MMS concurs with the finding and recommendation. We will revise the security plan to fully comply with OMB Circular A-130, Appendix III, by June 30, 2002. Additionally, we will contract to have an independent risk assessment of ABACIS completed by June 30, 2002.

Access Controls and System Software Controls: The MMS concurs with the finding and recommendation. We have developed a project schedule to address each of the noted deficiencies to permit full compliance by June 30, 2002. Additionally, we installed on the Hewlett Packard mini-computer on December 17, 2001, a finer grain access control software package that limits failed login attempts.

Service Continuity: The MMS concurs with the finding and recommendation. We have developed milestones to test and analyze all applicable contingency plans (HP COOP/Mutual Aid Agreement, LAN COOP, and Atrim Building COOP) by August 30, 2002.

No. 2001-02- Year-end Accounts Payable and Accounts Receivable Accrual Process

Condition

At the conclusion of the fiscal 2000 audit, the OIG issued a reportable condition related to certain deficiencies in MMS's processes for making year-end accruals for both accounts payable and unbilled accounts receivable. During the fiscal 2001 audit, we noted that management established and implemented new policies and procedures to facilitate the preparation of year-end accruals for accounts payable and accounts receivable. However, we also identified numerous over and under accruals of accounts payable and unbilled accounts receivable as a result of analysts not appropriately implementing MMS's new policies and procedures.

Recommendation

We recommend that MMS provide additional training to analysts responsible for preparing year-end accruals and strengthen supervisory review controls.

Management Response

The MMS acknowledges that additional effort is required to ensure that sufficient accruals are recorded for accounts payable and accounts receivable at year-end. We will host an audit lessons learned training session to address the deficiencies and will also institute an internal control review process to ensure that program offices are following the established guidelines. The lessons learned session is scheduled for mid-spring 2002.

A summary of the status of prior year reportable conditions can be found at Exhibit 1. We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of MMS in a separate letter dated January 9, 2002.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with the laws and regulations described in the *Responsibilities* section of this report disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02:

Prompt Payment Act

We identified six invoices totaling approximately \$2.6 million in our test sample of 198 payments to vendors which were paid after the allowable time period under the Prompt Payment Act and the payments did not include interest as required by the Act.

Management Response

The MMS concurs with the finding and recommendation. We will implement additional internal control procedures and provide additional training to the Procurement staffs to ensure that invoices are received timely in accordance with the Prompt Payment Act. Training and procedures will be developed by June 30, 2002.

FFMIA

The results of our tests of FFMIA disclosed instances, described below, where MMS's financial management systems did not substantially comply with the Federal financial management systems requirements and the U.S. Standard General Ledger at the transaction level.

- Federal Financial Management Systems Requirements

As previously discussed in the Internal Control Over Financial Reporting section of this report, MMS did not have adequate information security policies and procedures to meet the Federal financial management system requirements of FFMIA.

Management Response

The MMS concurs with the finding and recommendation. System-specific policies will be developed and implemented to improve the authentication process and to minimize network security risks. These policies will be published by June 30, 2002.

- U.S. Standard General Ledger at the Transaction Level

MMS accounts for its Minerals Revenue Management (MRM) activities using the Auditing and Financial System (AFS). The AFS system does not account for transactions using the U.S. Standard General Ledger at the transaction level. Consequently, it is not FFMIA compliant.

Management Response

The MMS concurs with the finding and recommendation. The new MRM system will account for transactions using the U.S. Standard General Ledger. This new system was brought on-line November 1, 2001. On December 6, 2001, the U.S. District Court issued an order that required the Department of the Interior to disconnect from the Internet all systems that may have Indian Trust related data. This order effectively shut-down the new MRM system for processing and producing reports. As an interim measure, MRM has processed payments to state governments for December 2001 and January 2002 based on a percentage of the three month average of the three preceding months; and has forwarded to the Office of Trust Funds Management, using SF-1081s, those amounts applicable to Tribal Trust and Individual Indian Monies accounts based on collection receipt and advice from the payors.

The results of our tests disclosed no instances in which MMS's financial management systems did not substantially comply with the Federal accounting standards.

RESPONSIBILITIES

Management's Responsibility

The Government Management Reform Act (GMRA) of 1994 requires federal agency's 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, MMS 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 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' Responsibility

Our responsibility is to express an opinion on MMS's consolidated balance sheet as of September 30, 2001, and the statement of custodial activity for the year then ended, 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*, issued by the Comptroller General of the United States, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated balance sheet and statement of custodial activity are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures relating to the consolidated balance sheet and statement of custodial activity;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated balance sheet and statement of custodial activity presentation.

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

In planning and performing our audit, we considered MMS's internal control over financial reporting by obtaining an understanding of MMS'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 consolidated balance sheet and statement of custodial activity. 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, with respect to internal control related to performance measures determined by management to be key and reported in the Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether MMS's fiscal year 2001 consolidated balance sheet and statement of custodial activity are free of material misstatement, we performed tests of MMS's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of consolidated balance sheet and statement of custodial activity 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 MMS. 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 FFMIA, we are required to report whether MMS'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 MMS's management, the 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

January 9, 2002



United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

Independent Auditors' Report

To: Director, Minerals Management Service

Subject: Minerals Management Service's Financial Statements for Fiscal Year 2000

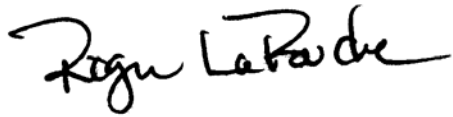
We have audited the Minerals Management Service's (MMS) statement of custodial activity and related notes. The objective of our audit was to express an opinion on the fair presentation of the statement of custodial activity. This financial statement is the responsibility of the MMS, and our responsibility is to express an opinion, based on our audit, on this financial statement.

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 No. 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 accompanying statement of custodial activity is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures contained in the statement of custodial activity and the accompanying notes. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall presentation of the statement of custodial activity. We believe that our audit of the statement of custodial activity provides a reasonable basis for our opinion.

In our opinion, the statement of custodial activity referred to above presents fairly, in all material respects, the custodial activity of MMS for the year ended September 30, 2000, in conformity with accounting principles generally accepted in the United States of America.

As discussed in notes 1.2C and D to the financial statements, MMS restated its statement of custodial activity for accruals and for a change in accounting related to undistributed custodial fund balances. In addition, as discussed in note 10 to the financial statements, MMS changed its accounting and financial reporting for royalty distributions to the states.

In our report dated September 4, 2001, we did not express an opinion on MMS's consolidated balance sheet as of September 30, 2000, consolidated statement of net cost, consolidated statement of changes in net position, statement of budgetary resources and statement of financing for the year ended September 30, 2000 because MMS did not present its financial statements and related disclosures for audit in a timely manner. Accordingly, we are not expressing an opinion on the restated consolidated balance sheet as of September 30, 2000, and the restated consolidated statement of net cost for the year ended September 30, 2000.

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

Roger La Rouché
Assistant Inspector General for Audits
September 4, 2001 except for Notes 1.2, 10, and 13 to 16
as to which the date is January 9, 2002