



United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

March 25, 2002

Memorandum

To: Commissioner, Bureau of Reclamation

From: Roger La Rouché
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Bureau of Reclamation's Financial Statements for Fiscal Years 2001 and 2000 (No. 2002-I-0024)

We contracted with KPMG LLP, an independent certified public accounting firm, to audit the Bureau of Reclamation's (BOR) 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 (OMB) No. 01-02, *Audit Requirements for Federal Financial Statements*; and the General Accounting Office/President's Council on Integrity and Efficiency's *Financial Audit Manual*. The Office of Inspector General (OIG) is responsible for the opinion on the balance sheet 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 BOR'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. However, our review disclosed no instances where KPMG did not comply in all material respects with the *Government Auditing Standards*.

In its audit report dated January 9, 2002 KPMG stated that in its opinion the BOR's financial statements for fiscal year 2001 present fairly, in all material respects, the financial position of the BOR as of September 30, 2001 and its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America. In our report dated January 9, 2002 (Attachment 2) we stated that in our opinion the BOR's consolidated balance sheet presents fairly, in all material respects,

the financial position of the BOR as of September 30, 2000 in conformity with accounting principles generally accepted in the United States of America.

KPMG found two reportable material weaknesses and eight reportable conditions related to internal controls over financial reporting. With regard to compliance with laws and regulations, KPMG found BOR to be noncompliant with the *Debt Collection Improvement Act of 1996* and that BOR's financial management systems did not substantially comply with the OMB Circular A-130, *Management of Federal Information Resources*.

In its January 22, 2002 response to KPMG's draft audit report, the BOR concurred, or believed it had complied with, 19 of the 20 recommendations reported in KPMG's draft audit report. As a result of BOR's response, we consider 19 recommendations resolved but not implemented and 1 recommendation unresolved. All 20 recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for resolution and tracking of implementation.

The BOR did not concur with recommendation J.2, which recommended that BOR conduct quarterly reviews of its outstanding undelivered order balances. KPMG made this recommendation to assist BOR in the transition to the new reporting requirements of OMB. BOR's response stated that they would implement semiannual reviews of outstanding undelivered order balances in compliance with the Departmental direction issued from the Deputy Assistant Secretary for Budget and Finance.

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

Attachments (2)

cc: Chief Financial Officer, Bureau of Reclamation

[CONTACT THE BUREAU OF RECLAMATION FOR INFORMATION ON ITS FINANCIAL STATEMENTS FOR FISCAL YEAR 2001, WHICH ARE NOT INCLUDED.]



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Independent Auditors' Report

Commissioner of the United States Bureau of Reclamation and Inspector General
U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheet of the United States Bureau of Reclamation (Reclamation) as of September 30, 2001, and the related consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources for the year then ended (hereinafter referred to as financial statements). 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 Reclamation's internal control over financial reporting and tested Reclamation's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that Reclamation'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 the following conditions being identified as reportable conditions:

- A. Reclamation needs improved security and internal control over its information technology systems;
- B. Reclamation needs improved controls over its land inventory;
- C. Reclamation needs improved controls over its construction-in-progress account;
- D. Reclamation needs improved controls over accounting for investigations and development costs;
- E. Reclamation needs an improved financial reporting process related to its allowance for doubtful loans receivable account;
- F. Reclamation needs improved controls over its allowance for doubtful accounts receivable account;
- G. Reclamation needs improved controls over its accrued liabilities;
- H. Reclamation needs improved controls over its deferment of trust revenue;
- I. Reclamation needs an improved quality control program; and
- J. Reclamation needs improved controls over its accounting for undelivered orders.



KPMG LLP. KPMG LLP, a U.S. limited liability partnership, is a member of KPMG International, a Swiss association.

We consider reportable conditions A and B, discussed above, to be material weaknesses.

The results of our tests of compliance with the laws and regulations disclosed instances of noncompliance with 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*.

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

OPINION ON FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheet of Reclamation as of September 30, 2001, and the related consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources for the year then ended.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of Reclamation as of September 30, 2001, and its net cost, changes in net position, budgetary resources, and reconciliation of net cost 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 Discussion and Analysis section, the Required Supplementary Stewardship Information in the Stewardship Assets section of Supplemental section, and Required Supplementary Information in the other sections of the Supplemental section are not a required part of the financial statements, but is supplementary information required by the Federal Accounting Standards Advisory Board or Office of Management and Budget 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information in the Combining Statement of Budgetary Resources is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit 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 Reclamation'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 the following reportable conditions are material weaknesses:

A. Reclamation Needs Improved Security and Internal Control over Its Information Technology Systems

Condition

Security and general controls over Reclamation's financial management systems have not been fully implemented. Reclamation has made recent progress in implementing security and controls over its information systems. Reclamation has commenced developing policies, directives and standards, security mechanisms, and procedures to protect its information technology (IT) assets and has established priorities to correct known weaknesses. Many of the weaknesses being addressed were identified in independent IT security assessments conducted by the National Security Agency (NSA), Sandia National Laboratories (SNL), and Jarvis Automation and Engineering, Inc. that were initiated by Reclamation. However, controls need to be improved in the areas described below, as required by OMB Circular A-130, *Management of Federal Information Resources*. These conditions could affect Reclamation's ability to prevent and detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information resources.

Security Programs

Security programs, including security policies and a related implementation plan, for general support systems and major applications are 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. Reclamation has developed a security program, which provides a high-level strategy for establishing a sound security framework. However, the supporting directives and standards that establish processes and procedures have just recently been finalized and have not been fully implemented.

Segregation of Duties

Reclamation has not ensured proper segregation of duties through its policies, procedures, and organizational structure to ensure that one individual cannot control key aspects of computer-related operations or financial transactions, and thereby conduct unauthorized actions or gain unauthorized access to assets or records.

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. Access controls over certain Reclamation systems, applications, and data have not been configured and/or developed to reduce the risk of unauthorized access. Reclamation has not fully implemented measures to minimize security risks on the Reclamation Data Communications Network. Network security configuration settings are not sufficiently robust and appropriate mechanisms have not been implemented to prevent and monitor unauthorized access to Reclamation's network.

Application Software Development and Change Controls

Establishing controls over the modification of application software programs helps to ensure that only authorized programs and authorized modifications are implemented. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or "turned-off" or that processing irregularities could be introduced. Reclamation does not consistently follow established procedures for controlling changes over application software that would prevent unauthorized programs or modifications to an existing program from being implemented.

Service Continuity

Losing the capability to process, retrieve, and protect information maintained electronically could significantly impact Reclamation's ability to accomplish its mission. Reclamation has not sufficiently tested information technology continuity controls to ensure that when unexpected events occur, operations continue without interruption or are promptly resumed and that data are adequately protected.

National Business Center

The Interior National Business Center (NBC) administers several of Reclamation's financial management systems, including: the Federal Personnel and Payroll System (FPPS), Federal Financial System (FFS), Hyperion, and the Interior Department Electronic Acquisitions System (IDEAS). Although NBC has recently improved the security and controls over these information systems, NBC needs to continue improvements in the areas of: entitywide security planning, configuration of operating systems, system software controls, software development and change controls, and service continuity. Weaknesses in these control areas could affect Reclamation's ability to prevent and detect unauthorized changes to its financial information and increases Reclamation's need for less efficient manual controls to monitor and reconcile financial information.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Continue to develop and implement a formal action plan to improve the security and general 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 Electronic Data Processing (EDP) control environment to ensure adequate security and protection of Reclamation's financial management systems.
2. Take the necessary steps to improve network security, which would include the development of security standards for each platform type and procedures to implement and monitor those standards as part of its network security architecture.
3. Annually obtain assurance (similar to a SAS 70 Type II report) from NBC that adequate security and controls are in place over the financial management systems.

Response

- A.1 Concur. Reclamation recognized the potential risks related to its Information Technology (IT) security practices several years ago and contracted with consultants to assist with better defining those risks and recommending changes to improve IT security. At that time a formal action plan for implementing those recommendations was developed. Since then, Reclamation's Chief Information Officer has worked with Reclamation's executives to develop strategies for improving IT security Reclamation-wide and to fund and accomplish those efforts. In continuing these efforts, and in order to address each of the areas discussed in the audit report, Reclamation will add an addendum to this plan focusing on security programs, segregation of duties, access controls, application software development and change control, service continuity, and the National Business Center (NBC).

The responsible official is Reclamation's Chief Information Officer. The target date for completing the addendum to the existing action plan is July 1, 2002.

- A.2 Complied. Prior to and during the period of time encompassed by the audit, Reclamation management had taken steps to improve Reclamation's Data Communication Network that were necessary and reasonable and did not jeopardize mission accomplishment. Specifically, Reclamation management:

- Completed a comprehensive IT security risk assessment to evaluate critical vulnerabilities. The assessment was conducted by Sandia National Laboratories (a government-owned, contractor-operated division of the Department of Energy) in fiscal year 2000.
- Published and began implementation of the IT Security Policy in December 2000 and Directives and Standards in September 2001.
- Published the Network Systems Directives and Standards, which established the network security architecture, in September 2001.
- Planned, funded, and began implementation of Reclamation's Data Communication Network Perimeter Security Architecture project during fiscal years 2000 and 2001. Project tasks are proceeding and scheduled for completion by December 2002.

Network security has and will continue to improve incrementally as each task is accomplished.

- Established an IT Security Steering Committee to provide executive-level management of the program in fiscal year 2001.
- Initiated the process of consolidating platform security standards in general support system security plans with the publication of the IT Systems Accreditation Directives and Standards in September 2001.
- Published and began implementation of the Configuration Management of Security Mechanisms Directives and Standards in 2001 that established standards for managing security mechanisms such as firewalls, screening routers, intrusion detection systems virtual private networks, etc.
- Published and began implementation of the IT Intrusion Detection System (IDS) Directives and Standards in 2001 which established guidelines for how and where to use IDS systems and defines the minimum requirements for operation. Improved intrusion detection measures have been implemented to monitor and prevent unauthorized access to key financial systems.
- Defined an IT security audit process in the Audits and System Logging Directives and Standards in September 2001 to ensure business practices comply with IT security requirements.
- Is in the process of developing and finalizing the Information/Data Security Directives and Standards that defines categories of information/data for the purposes of security and management. These directives and standards are targeted for completion in February 2002.

Although weaknesses were identified during the audit process, we believe the steps taken by management have and will continue to improve the security of Reclamation's systems.

- A.3 Complied. Reclamation has requested annual assurance from the NBC that adequate security and controls are in place over the financial management systems that they administer for Reclamation.

B. Reclamation Needs Improved Controls over Its Land Inventory

Condition

Reclamation did not have a complete and accurate inventory system to support the \$1.9 billion of land and land rights reported in the financial statements as a component of general property, plant, and equipment. The weakness occurred because Reclamation had not established adequate procedures for maintaining an accurate inventory of land and land rights and for reconciling its subsidiary records with its financial accounting system. Reclamation's financial accounting system support for land and land rights costs is detailed in a cost summary report that had not been reconciled with subsidiary records, including individual project plat book maps, which contain data from individual land purchase contracts.

In fiscal year 2000, Reclamation recognized the need for supporting records and issued a five-year action plan to develop a complete and accurate land inventory that supported the financial

accounting system, issued interim guidelines and procedures for reconciling land records, and developed a schedule for completing the reconciliation within the five-year plan period. As of September 30, 2001, Reclamation has completed approximately 10 percent of the reconciliations required per the action plan, and expects to complete the requirements of the plan within the five-year plan period.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Continue to complete the reconciliation of the financial accounting system support for lands and land rights costs with the subsidiary records, including individual project plat book maps, which contain data from individual land purchase contracts.
2. Continue to include a material land inventory system internal control weakness in Reclamation's Federal Managers' Financial Integrity Act (FMFIA) report to the Department of the Interior until resolved.

Response

- B.1 Concur. Reclamation will continue the reconciliation of the financial accounting system support for lands and land rights costs with subsidiary records, including individual project plat book maps in accordance with the 5-year corrective action plan.

The responsible officials are the Director, Management Services, and the Director, Operations.

- B.2 Concur. Reclamation included the land inventory material weakness in the Commissioner's fiscal years 2000 and 2001 Annual Assurance Statements and will continue to report this weakness until corrective actions are implemented.

The responsible official is the Director, Management Services. The target date for reporting this weakness is October 1 of each year until resolved.

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

C. Reclamation Needs Improved Controls over Its Construction-in-Progress Account

Condition

Reclamation did not sufficiently implement internal controls to ensure that the general ledger control account for Construction-in-Progress (CIP) was accurate. In Reclamation's fiscal year 2000 audit, the Office of Inspector General (OIG) reported a material weakness and a reportable condition related to Reclamation's CIP account. Despite new policy and procedures established in response to the OIG finding, Reclamation continued to include in the CIP account \$21.2 million in assets that should have been expensed as incurred. Reclamation reviewed the account balances and transactions and made the necessary adjustments.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Implement and follow sufficient procedures, including management oversight, to ensure that the CIP account only includes costs for items meeting the definition of capitalizable general property, plant, and equipment, and that costs which should be expensed are reported in the proper accounting periods.

Response

- C.1 Concur. Reclamation will implement existing quality assurance procedures, including management oversight, to ensure that the Construction on Progress (CIP) account only includes costs meeting the definition of general property, plant, and equipment and that costs which should be expensed are reported in the proper accounting periods in accordance with existing Reclamation Manual guidance. In fiscal year 2001, Reclamation issued Reclamation Manual Supplements on construction in progress, plant accounting responsibilities, construction in abeyance and nontraditional assets which provide guidance for the analysis of the CIP and CIP-related accounts to ensure that costs are properly accounted for.

The responsible officials are the Director, Management Services, and the Director, Operations. The quality assurance procedures, including management oversight, will be implemented by September 30, 2002.

D. Reclamation Needs Improved Controls over Accounting for Investigations and Development Costs

Condition

Reclamation did not sufficiently implement internal controls to ensure that the general ledger control account for investigations and development costs (Investigations) were accurate. In the fiscal year 2000 financial statements, Reclamation disclosed a change in accounting principle related to the accounting for Investigations. Despite draft policies and procedures established governing these types of transactions, Reclamation recorded in the investigations control account approximately \$51.6 million that should have been expensed and \$1.7 million that should have been transferred to CIP. When informed of the inconsistencies in the account, Reclamation reviewed the account balances and transactions and made the necessary adjustments.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Implement and document sufficient procedures, including formalized policy, quality assurance at the regional office level, and management oversight at the Finance and Accounting Services level, to ensure that the Investigations and development balances are clearly defined and properly and consistently accounted for throughout Reclamation.
2. These procedures should include sufficiently documented reviews of these account balances to ensure proper and consistent accounting treatment.

Response

- D.1 Concur. Reclamation will finalize and implement its draft policy and procedures to ensure that the Investigations and Development account balances are properly and consistently accounted for throughout Reclamation.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for Reclamation's Finance and Accounting Services to issue final policy and procedures is May 31, 2002. The target date for the implementation of policy, procedures, and reviews of account balances is September 30, 2002.

- D.2 Concur. Reclamation will sufficiently document reviews of the Investigations and Development account balances to ensure proper and consistent accounting treatment.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for the implementation of the review of account balances is September 30, 2002.

E. Reclamation Needs an Improved Financial Reporting Process related to its Allowance for Doubtful Loans Receivable Account

Condition

Reclamation did not have sufficient internal controls to ensure that the general ledger control account for the allowance for doubtful loans receivable was accurate. Reclamation's financial statements differentiate between Credit Reform Loans, which are loans made after 1991 subject to the provisions of the Credit Reform Act of 1990, and those loans made prior to the requirements of the Credit Reform Act (pre-credit reform loans). While an allowance for subsidy costs is recorded on the Credit Reform Loans to present the present value of these loans in the financial statements, an allowance for uncollectible amounts were not established for pre-credit reform loans. When informed of the deficiencies, Reclamation reviewed the account balances and transactions and made the necessary adjustments.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Establish procedures to consider the need for an allowance for doubtful loan receivables in each reporting period. In so doing, Reclamation should apply the following five factors listed in Statement of Federal Financial Accounting Standards (SFFAS) No. 2 to both pre-credit reform loans and credit reform loans:
 - (1) Current and forecasted international, national or regional economic conditions that may affect the performance of the loans.
 - (2) Financial and other relevant conditions of borrower.
 - (3) Value of collateral to loan balance.
 - (4) Changes in recoverable value of collateral.
 - (5) Newly developed events that would affect the loans' performance.

Response

- E.1 Concur. For the fiscal year 2001 financial statements, Reclamation followed the criteria in SFFAS No. 2 for Credit Reform Loans and properly recorded the associated allowance. Reclamation has also recorded an adjusting entry to properly record the allowance for Pre-Credit Reform Loans. In addition, Reclamation will issue procedures for the recording of an allowance for both Credit Reform and Pre-Credit Reform loans.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for Finance and Accounting Services to issue procedures for the allowance for Credit Reform and Pre-Credit Reform loans is May 31, 2002. The procedures will be implemented by September 30, 2002.

F. Reclamation Needs Improved Controls over Its Allowance for Doubtful Accounts Receivable Account

Condition

Reclamation did not have sufficient internal controls to ensure that the general ledger control account for the allowance for doubtful accounts receivable was adequate. The accounts receivable account included a significant amount of aged balances where collectibility is uncertain, which were not reserved for as an allowance for doubtful accounts. When informed of the deficiencies, Reclamation reviewed the account balances and transactions and made the necessary adjustments.

Further, two regional offices within Reclamation are not notifying on a timely basis the Secretary of the Treasury of all eligible receivables aged greater than 180 days for referral to Treasury Cross Servicing, as required by the Debt Collection Improvement Act of 1996.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Improve quality assurance over the allowance for doubtful accounts receivable at the regional offices and Finance and Accounting Services levels.
2. Record an adequate allowance for doubtful accounts where collectibility is uncertain.
3. Ensure collection efforts regarding these past due account receivable balances, notify the Secretary of the Treasury of all eligible accounts aged greater than 180 days, and write off the balances considered uncollectible, if necessary.

Response

- F.1 Concur. Reclamation will ensure implementation of existing quality assurance procedures at the regional office and Finance and Accounting Services levels for the process of recording the allowance for doubtful accounts receivable.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for implementation of the procedures is September 30, 2002.

- F.2 Concur. For fiscal year 2001 financial statement reporting, Reclamation analyzed accounts receivable balances and recorded an allowance for doubtful accounts where collectibility was uncertain. Reclamation will evaluate the process of determining sufficient balances for the Allowance for Doubtful Accounts account. If necessary,

Finance Accounting Services will issue additional guidance on the reporting of allowance for doubtful accounts.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for implementation of guidance and procedures is September 30, 2002.

- F.3 Concur. Reclamation will emphasize the need to implement and follow existing procedures, including the transfer of debts aged greater than 180 days to the Department of the Treasury for collection and the writeoff of balances considered uncollectible, if necessary.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for implementation of the procedures is September 30, 2002.

G. Reclamation Needs Improved Controls over Its Accrued Liabilities

Condition

Reclamation did not implement or enforce controls sufficient to ensure that its regional offices are making the proper accruals for accounts payable and the associated asset or expense. Exceptions were noted related to improper or incomplete accruals at each regional office, and included such things as accruals not made, accruals made for the obligation balances rather than the amount that should be recognized during the current fiscal year, accruals made and reversed in the same fiscal year prior to payment, resulting in no accruals at year-end, accruals made for insufficient balances, lack of sufficient documentation supporting the accrual amounts, accruals made but not being reviewed at year-end to determine if the accrual balance still exists, and accruals not reversed in the fiscal year payments are made. Certain accruals were found to be significantly aged, and upon further review were determined to be invalid. Improperly accounting for expenses in the appropriate period results in a misstated accounts payable balance and associated asset or expense balance. Reclamation reviewed the account balances and transactions and made the necessary adjustments.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Implement and follow quality controls to ensure that accruals are complete, exist, are accurately recorded, and are adequately supported by documentation.
2. Implement oversight procedures to ensure compliance with current Reclamation policies and improved coordination within Reclamation's finance and program organizations.

Response

- G.1 Concur. Reclamation will implement and follow existing quality controls as stated in Reclamation's Manual Supplement, Estimating Contract Earnings (Accruals) and in the Fiscal Year 2001 Closing Procedures to ensure that accruals are accurately recorded and adequately supported by documentation.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for implementation of the procedures is September 30, 2002.

- G.2 Concur. Reclamation will implement a management oversight process to ensure compliance with current Reclamation policies and improve coordination within Reclamation's finance and program organizations for accounts affected by accruals.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for implementation of the management oversight process is September 30, 2002.

H. Reclamation Needs Improved Controls over Its Deferment of Trust Revenue

Condition

Reclamation did not establish an appropriate accounting model to ensure that the general ledger control accounts for revenue and deferred revenue were accurate. Reclamation has established several trust accounts whereby Reclamation receives advance payments for services to be provided in the future. However, Reclamation has not established posting routines in its accounting system that allow for the deferral of revenue not applicable to the current fiscal year. Accordingly, \$7.3 million was recorded as fiscal year 2001 revenue, which should be deferred to future periods. When informed of the deficiencies, Reclamation reviewed the account balances and transactions and made the necessary adjustments.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Establish procedures to ensure that trust accounts and similar transactions are monitored, such that revenue not applicable to the current fiscal year is properly deferred and appropriately amortized.

Response

- H.1 Concur. Reclamation will establish accounting models and sufficient procedures to ensure that all available receipts (trust and special receipts accounts) are recorded as advances (unearned revenue) for the portion of cash receipts not yet earned. Reclamation has made all the necessary adjustments to ensure all revenue not applicable to fiscal year 2001 was properly deferred.

The responsible official is the Director, Management Services. Finance and Accounting Services will establish accounting models and procedures by May 31, 2002. The target date for implementation of these procedures is September 30, 2002.

I. Reclamation Needs an Improved Quality Control Program

Condition

Reclamation did not have a sufficient quality control program to ensure that previously established Reclamation Manual supplements are completely and consistently implemented among the various regional offices. Reclamation Manual supplements establish accounting policies and procedures based on appropriate authoritative literature, and are created by the Finance and Accounting Services Group, housed in the Management Services Office of Reclamation. However, Finance and Accounting Services, or another group, does not perform compliance review procedures to ensure that the Reclamation Manual supplements are implemented fully and consistently at each regional office. As a result, certain balances, including

CIP and Investigations discussed above, did not properly and consistently reflect the requirements of the Reclamation Manual supplements.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Implement a practice whereby Reclamation's policy making body is empowered to ensure compliance with the Reclamation Manual supplements among the regions.
2. Establish procedures to address the completeness, accuracy, and consistency of implementation of Reclamation Manual supplements among the various regional offices.

Response

- I.1 Concur. Reclamation has recognized the need for an improved financial oversight function; Reclamation management formed the Chief Financial Officer (CFO) Audit Projects Team to address various financial management issues, including oversight.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for developing a plan for the oversight and quality assurance function is July 1, 2002. The target date for implementation of an oversight program is September 30, 2003.

- I.2 Concur. Existing Reclamation Manual supplements provide procedures to address completeness, accuracy, and consistency of financial information for each financial-management topic addressed. For example, the Reclamation Manual Supplement, Plant Accounting-Responsibilities, establishes procedures for the consistent application and accuracy of Reclamation's general property, plant, and equipment accounts. However, as mentioned above, Reclamation has recognized the need for an improved financial-oversight function to ensure implementation of the Reclamation Manual guidance. Reclamation will establish additional procedures as necessary.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for establishing procedures, as necessary, to address the completeness, accuracy, and consistency of implementation of Reclamation Manual supplements among the various regional offices is July 1, 2002. The target date for implementation of an oversight program is September 30, 2003.

J. Reclamation Needs Improved Controls over Its Accounting for Undelivered Orders

Condition

Reclamation has a process in place to review outstanding undelivered orders to ensure validity of the outstanding balance, especially those items greater than one year old. However, Reclamation did not fully implement the controls identified in the Reclamation Manual supplement Fin 03-20-20-100-B, Reconciliation of SGL Accounts, and the Finance and Accounting Services year-end memorandum to ensure that the remaining balances represent valid undelivered orders. We reviewed a sample of the outstanding undelivered orders account at year-end and determined that Reclamation continued to account for balances that were no longer valid. Further, Reclamation has not established policies and procedures to ensure that recovered undelivered orders are accounted for in accordance with the guidance in the OMB Budget Accounting Guide. When

informed of the deficiencies, Reclamation reviewed the account balances and transactions and made the necessary adjustments.

Recommendation

We recommend that the Commissioner, Bureau of Reclamation:

1. Improve the process for reviewing undelivered orders by implementing formal review requirements, both at Finance and Accounting Services and regional office levels, and following established criteria to ensure objectivity and financial statement accuracy.
2. Although the current departmental guidance requires that these amounts be reviewed semi-annually, we recommend quarterly reviews of outstanding balances to assist in the transition to semi-annual and quarterly reporting for fiscal years 2002 and 2003, respectively.
3. Establish policies and procedures to ensure that recovered undelivered orders are accounted for in accordance with the guidance in the OMB Budget Accounting Guide.

Response

- J.1 Concur. Reclamation will improve its formal review process for outstanding undelivered orders to follow established criteria.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for implementation of the formal review process is September 30, 2002.

- J.2 Nonconcur. Reclamation will implement semiannual reviews of outstanding undelivered orders balances in compliance with direction issued June 15, 2001, by the Department of the Interior's Deputy Assistant Secretary for Budget and Finance.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for implementation of the semiannual reviews of outstanding undelivered orders balances is September 30, 2002.

- J.3 Concur. Reclamation will establish and improve its existing process for tracking recovered undelivered orders (prior year recoveries) and will implement policies and procedures to ensure that recovered undelivered orders are accounted for in accordance with the guidance in the OMB Budget Accounting Guide.

The responsible officials are the Director, Management Services, and the Director, Operations. The target date for establishing and implementing the policies and procedures is September 30, 2002.

A summary of the status of prior year reportable conditions is included as Exhibit I. We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of Reclamation 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, exclusive of the *Federal Financial Management Improvement Act* (FFMIA) of 1996, disclosed one instance of noncompliance that is required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

Condition

Reclamation is not in compliance with the requirements of the Debt Collection Improvement Act of 1996. We noted instances where the Secretary of the Treasury had not been notified of eligible account receivable balances that are aged greater than 180 days.

Recommendation

Our recommendations are addressed in the reportable condition discussed in the Internal Control over Financial Reporting section of our report.

The results of our tests of FFMIA disclosed instances, described below, where Reclamation's financial management systems did not substantially comply with the Federal financial management systems' requirements.

Condition

Reclamation is not in compliance with OMB Circular A-130, *Management of Federal Information Resources*. We noted weaknesses in Reclamation's computer security controls including entitywide security, access controls, segregation of duties, system software controls, software development and change controls, service continuity, and network security.

Recommendation

Our recommendations are addressed in the material weakness discussed in the Internal Control over Financial Reporting section of our report.

The results of our tests disclosed no instances in which management did not substantially comply with accounting standards and the United States Government Standard General Ledger at the transaction level requirements.

RESPONSIBILITIES

Management's Responsibility

The Government Management Reform Act (GMRA) of 1994 requires federal agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet the GMRA reporting requirements, Reclamation 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 stewardship 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' Responsibility

Our responsibility is to express an opinion on the fiscal year 2001 financial statements of Reclamation 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the 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 Reclamation's internal control over financial reporting by obtaining an understanding of Reclamation'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 Reclamation's internal control over the Required Supplementary Stewardship Information in the Stewardship Assets section of the Supplemental section by obtaining an understanding of Reclamation'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 Reclamation's fiscal year 2001 financial statements are free of material misstatement, we performed tests of Reclamation'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 Reclamation. 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 Reclamation'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 Department of the Interior's management, 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

Bureau of Reclamation
Summary of the Status of Prior Year Reportable Conditions
September 30, 2001

Ref	Condition	Status
A	Reclamation Needs Improved Controls over Land Inventory	This condition has not been corrected and is repeated in FY 2001.
B	Reclamation Needs Improved Controls over Construction-in-Progress Account	This condition has not been corrected and is repeated in FY 2001.
C	Inconsistent Accounting Treatment	This condition has been corrected.
D	Reclamation Needs Improved Controls over Prior Period Activity	This condition has been corrected.
E	Reclamation Needs Improved Controls over Undelivered Orders	This condition has not been corrected and is repeated in FY 2001.
F	Reclamation Needs Improved Controls over Prior Period Revenue Recognition	This condition has been corrected.



United States Department of the Interior

Office of Inspector General

Washington, D.C. 20240

March 25, 2002

Memorandum

To: Commissioner, Bureau of Reclamation

From: Roger La Rouché
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Bureau of Reclamation's Financial Statements for Fiscal Years 2001 and 2000 (No. 2002-I-0024)

We contracted with KPMG LLP, an independent certified public accounting firm, to audit the Bureau of Reclamation's (BOR) 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 (OMB) No. 01-02, *Audit Requirements for Federal Financial Statements*; and the General Accounting Office/President's Council on Integrity and Efficiency's *Financial Audit Manual*. The Office of Inspector General (OIG) is responsible for the opinion on the balance sheet 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 BOR'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. However, our review disclosed no instances where KPMG did not comply in all material respects with the *Government Auditing Standards*.

In its audit report dated January 9, 2002 KPMG stated that in its opinion the BOR's financial statements for fiscal year 2001 present fairly, in all material respects, the financial position of the BOR as of September 30, 2001 and its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America. In our report dated January 9, 2002 (Attachment 2) we stated that in our opinion the BOR's consolidated balance sheet presents fairly, in all material respects,

the financial position of the BOR as of September 30, 2000 in conformity with accounting principles generally accepted in the United States of America.

KPMG found two reportable material weaknesses and eight reportable conditions related to internal controls over financial reporting. With regard to compliance with laws and regulations, KPMG found BOR to be noncompliant with the *Debt Collection Improvement Act of 1996* and that BOR's financial management systems did not substantially comply with the OMB Circular A-130, *Management of Federal Information Resources*.

In its January 22, 2002 response to KPMG's draft audit report, the BOR concurred, or believed it had complied with, 19 of the 20 recommendations reported in KPMG's draft audit report. As a result of BOR's response, we consider 19 recommendations resolved but not implemented and 1 recommendation unresolved. All 20 recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for resolution and tracking of implementation.

The BOR did not concur with recommendation J.2, which recommended that BOR conduct quarterly reviews of its outstanding undelivered order balances. KPMG made this recommendation to assist BOR in the transition to the new reporting requirements of OMB. BOR's response stated that they would implement semiannual reviews of outstanding undelivered order balances in compliance with the Departmental direction issued from the Deputy Assistant Secretary for Budget and Finance.

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

Attachments (2)

cc: Chief Financial Officer, Bureau of Reclamation