



United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

March 17, 2003

Memorandum

To: Commissioner, Bureau of Reclamation

From: Roger La Rouché
Assistant Inspector General for Audits

Subject: Management Issues Identified During the Audit of the Bureau of Reclamation's Fiscal Year 2002 Financial Statements (No. 2003-I-0037)

We contracted with KPMG LLP, an independent certified public accounting firm, to audit the Bureau of Reclamation's (BOR) financial statements as of September 30, 2002 and for the year then ended. In conjunction with its audit, KPMG noted certain matters involving internal control and other operational matters that should be brought to management's attention. These matters, which are discussed in the attached letter, are in addition to those reported in KPMG's audit report on BOR's financial statements (Report No. 2003-I-0020) and do not constitute reportable conditions as defined by the American Institute of Certified Public Accountants.

The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. If you have any questions regarding KPMG's letter, please contact me at (202) 208-5512.

Section 5(a) of the Inspector General Act (5 U.S.C. App. 3) requires the Office of Inspector General to list this report in its semiannual report to the Congress.

Attachment

cc: Assistant Secretary for Water and Science
Chief Financial Officer, Bureau of Reclamation
Director, Office of Financial Management
Audit Liaison Officer, Water and Science
Audit Liaison Officer, Bureau of Reclamation
Focus Leader for Management Control and Audit Followup,
Office of Financial Management



January 14, 2003

The Commissioner of the United States Bureau of Reclamation and the Inspector General
United States Department of the Interior
Washington, D.C.

Ladies and Gentlemen:

We have audited the consolidated financial statements of the Bureau of Reclamation (Reclamation) as of and for the year ended September 30, 2002 and have issued our report thereon, dated January 11, 2003. In planning and performing our audit of the consolidated financial statements of Reclamation, we considered internal controls over financial reporting in order to determine our audit procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on internal controls over financial reporting. We have not considered internal controls over financial reporting since the date of our report.

During our audit, we noted certain matters involving internal controls over financial reporting and other operational matters, not included in our above referenced report as material weaknesses or reportable conditions, that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal controls over financial reporting, or result in other operating efficiencies.

1. Revenue Recognition

During our audit we noted that Reclamation has a significant amount of multi-year repayment contracts where payment is received annually or semi-annually. Revenue on these contracts is received on various dates during the year and revenue is recorded at the time that the amounts are billed. Additionally, during our testing of revenue transactions we noted one instance where revenue that related to fiscal year 2001 was recorded in fiscal year 2002.

Recommendation

We recommend that Reclamation establish a process for determining the revenue period of its contracts and record unearned revenue for the portion of revenue not yet earned. This treatment would result in revenue recognition proportionate to the passage of time or the use of the assets. We also recommend that Reclamation implement a process to ensure that revenue is recorded in the proper accounting period.

2. Direct Funding Agreements

During fiscal year 2002, the Office of Inspector General (OIG) performed an audit at Reclamation, wherein they noted that three California Water Authorities have individually contracted with Reclamation to perform the operation and maintenance of the conveyance, and conveyance pumping, facilities of the Central Valley Project (CVP) water. The Water Authorities have been given authority to assess and collect revenues due the government for CVP water deliveries to local water districts. These collections can be used by the Water Authorities to fund

the operation and maintenance of these facilities. Under this arrangement the Water Authorities were required to collect and remit federal funds directly to the U.S. Treasury, however, the OIG noted that the current arrangement does not include sufficient controls to ensure that all revenues due from the water districts are collected. Also, Reclamation is not able to ensure that the Water Authorities accurately and consistently measure the water delivery, which would allow for a reconciliation check between revenue collected and water sold.

Recommendation

We recommend that Reclamation amend the direct funding agreements to terminate Water Authority designation as fiscal agents and reestablish financial mechanisms by which water districts would directly pay Reclamation for their water use. Also, Reclamation should reconcile each of the water district payments with the amounts retained and forwarded by the Water Authorities since the inception of the agreements, and establish a Quality Assurance Program to ensure the integrity of the water measurement activities.

3. Allowance for Doubtful Accounts Receivable

During our audit we noted that the allowance for doubtful accounts receivable was inadequate due to Reclamation excluding several accounts receivable status codes from the allowance calculation. Accounts receivable classified with these status codes that are excluded from the allowance calculation might result in overdue receivables not being adequately reserved for during the proper accounting period. Reclamation reviewed the accounts receivable excluded from the allowance calculation and adjusted its consolidated financial statements to allow for these amounts.

Recommendation

We recommend that Reclamation update its policies and procedures for calculating the allowance for doubtful accounts receivable to include the status codes that were previously excluded from the allowance calculation.

4. Controls over Credit Card Authorization

During our audit we noted that Reclamation charged approximately \$62 million on credit cards for small purchases during fiscal year 2002. Reclamation's credit card approval policy requires that approving officials approve all charges prior to paying the credit card company. Typically, this is accomplished by having the cardholder's manager approve the statements of cardholders in a timely manner. In testing this authorization control, we noted 2 instances of a sample of 10 items where this approval did not occur.

Recommendation

We recommend that Reclamation improve controls over enforcement of credit card transaction approval by enforcing the policy that is in place and requiring that managers review all statements of Reclamation credit cardholders in a timely and thorough manner.

5. Stewardship Investments

During our audit we noted that Reclamation had identified the need to separate the required Stewardship Investment amounts into specific accounts, and report these amounts in the Required Supplemental Stewardship Information (RSSI) Section of its consolidated financial statements. However, Reclamation has not established posting routines to properly account for the Stewardship Investment amounts during the year at the transaction level.

Recommendation

We recommend that Reclamation implement posting routines to properly capture the Stewardship Investment amounts at the transaction level.

6. HAZ-MAT Audits

Reclamation is responsible for ensuring proper treatment and disposal of hazardous wastes and materials (HAZ-MAT) on Reclamation lands and at Reclamation-owned or operated sites. To ensure Reclamation complies with environmental laws and policies governing such materials, Reclamation's Environmental and Planning Coordination Office, which is under the direction of the Office of Policy, conducts regular audits of Reclamation facilities. According to its own recommended requirements, the Environmental and Planning Coordination Office is responsible for conducting five audits of area facilities and/or audit regional work each year. This allows for all area offices in each region to be covered within a five-year period.

During our audit we noted that Reclamation conducted only one audit during fiscal year 2002, and two additional audits prior to calendar year-end through its Environmental and Planning Coordination Office. We noted that Reclamation did not meet its goal due to a personnel vacancy in its HAZ-MAT Coordinator position. However, since this vacancy was filled toward the end of fiscal year 2002, three audits have been conducted, and Reclamation has established a five-year plan to cover the required audits.

Recommendation

We recommend that Reclamation's Environmental and Planning Coordination Office complete five audits a year in accordance with its policy, along with any additional audits necessary to complete the five-year plan on a timely basis.

7. Irrigation Assistance Revenue

During our audit we noted that Reclamation recorded revenue from irrigation assistance during fiscal year 2002 that should have been recorded in fiscal year 2001. Irrigation assistance is collected from power customers by Power Marketing Agencies to apply to irrigation capital investment costs that are above the irrigators' ability to pay. Power Marketing Agencies factor into the power transmission rates the amount of irrigation assistance required by law, and during the final year of contract repayment, remit the amount of irrigation assistance into the Reclamation Fund. Reclamation records the amount of the irrigation assistance as revenue in order to satisfy their contract repayment requirements.

Recommendation

We recommend that Reclamation design and implement effective internal controls, including improved communications with Power Marketing Agencies, to ensure revenue resulting from irrigation assistance is recognized and recorded in the proper fiscal year.

8. General Property, Plant, and Equipment Disposals

During our audit we noted that when an asset is removed from service, donated, or sold, the asset is properly removed from the accounting records. However, Reclamation does not properly account for any gain or loss on such disposals where cash is received from the disposed asset. We noted that the impact of the gain or loss is reflected in the consolidated statement of net cost, however, the amounts are not recorded in the proper lines on the consolidated financial statements. This accounting treatment is not consistent with current accounting standards.

Recommendation

We recommend that Reclamation implement procedures to ensure that the cash receipts related to disposed assets be properly and consistently accounted for in accordance with accounting principles generally accepted in the United States of America. These procedures should include reviews of the gain/loss standard general ledger accounts to ensure proper and consistent accounting treatment.

9. Leases

During our audit we noted that Reclamation had improperly classified one of its capital leases as an operating lease. This lease agreement contained a bargain purchase option, which results in treatment as a capital lease. Additionally, we noted that Reclamation has not established a process or posting routines for recording and tracking operating and capital leases.

Recommendation

We recommend that Reclamation implement a process to track all operating and capital leases. Further, Reclamation should implement procedures to ensure that leases meeting the capitalization criteria are recorded as capital leases in accordance with Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*, and track the lease activity using proper posting routines.

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Our audit procedures are designed primarily to enable us to form an opinion on the consolidated financial statements, and therefore may not bring to light all weaknesses in policies and procedures that may exist. We aim, however, to use our knowledge of Reclamation's organization gained during our work to make comments and suggestions that we hope will be useful to you. Should you have any questions concerning the matters presented herein, we would be pleased to discuss them with you at any time.

This report is intended for the information and use of the management of Reclamation. However, this report is a matter of public record and its distribution is not limited.

Very truly yours,

KPMG LLP

January 14, 2003