



# United States Department of the Interior

Office of Inspector General  
Washington, D.C. 20240

March 21, 2003

## Memorandum

To: Assistant Secretary – Policy, Management and Budget

From: Roger La Rouche  
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Interior Franchise Fund's Financial Statements for Fiscal Years 2002 and 2001 (Report No. 2003-I-0038)

We contracted with KPMG LLP (KPMG), an independent certified public accounting firm, to audit the Interior Franchise Fund's (IFF) financial statements as of September 30, 2002 and for the year then ended. The contract required that KPMG conduct its audit in accordance with the Comptroller General of the United States of America's *Government Auditing Standards*, the Office of Management and Budget's Bulletin 01-02 *Audit Requirements for Federal Financial Statements*, and the General Accounting Office/President's Council on Integrity and Efficiency's *Financial Audit Manual*.

In its audit report dated January 17, 2003 (Attachment), KPMG disclaimed an opinion on IFF's fiscal year 2002 financial statements because the accounting records were not maintained during fiscal year 2002, particularly with respect to the balances for accounts receivable and advances from others. KPMG expressed an unqualified opinion on IFF's fiscal year 2001 financial statements. KPMG identified seven reportable conditions related to internal controls and financial operations: (1) revenue process, (2) reconciliation of transactions with trading partners, (3) organizational structure, (4) application and general controls over financial management systems, (5) timeliness of recording transactions, (6) reconciliation of Fund Balance with Treasury, (7) investigation and resolution of old and negative account balances. KPMG considered the first three reportable conditions to be material weaknesses. With regard to compliance with laws and regulations, KPMG found IFF noncompliant with portions of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Specifically, KPMG reported IFF's financial management systems did not substantially comply with federal financial management systems requirements and federal accounting standards. In regard to compliance with laws and regulations exclusive of those referred to in the FFMIA, KPMG found IFF to be noncompliant with Section 113 of Public Law 104-208 regarding advances for the Interior Franchise Fund.

In connection with the contract, we monitored the progress of the audit at key points, reviewed KPMG's report and selected related working papers, and inquired of its

representatives. Our review, as differentiated from an audit in accordance with the *Government Audit Standards*, was not intended to enable us to express, and we do not express, an opinion on IFF's financial statements, conclusions about the effectiveness of internal controls, conclusions on whether IFF's financial management systems substantially complied with the three requirements of FFMIA, or conclusions on compliance with laws and regulations. KPMG is responsible for the auditors' report 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*.

The IFF's management concurred with all of the recommendations except for the recommendation related to finding "H. Section 113 of Public Law 104-208 – Advances for the Interior Franchise Fund". The IFF proposed an alternative solution which if implemented should resolve the issue. Based on management's response, we consider all the recommendations resolved but not implemented. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

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



2001 M Street, NW  
Washington, DC 20036

## INDEPENDENT AUDITORS' REPORT

Executive Board of the Interior Franchise Fund and  
Inspector General  
U.S. Department of the Interior:

We were engaged to audit the accompanying balance sheet of the Interior Franchise Fund as of September 30, 2002, and the related accompanying statements of net cost, changes in net position, budgetary resources, and financing for the year then ended. Further, we have audited the accompanying balance sheet of the Interior Franchise Fund as of September 30, 2001, and the related accompanying statement of net cost for the year then ended. (hereinafter referred to as financial statements). In connection with our engagement, we also considered the Interior Franchise Fund's internal control over financial reporting and tested the Interior Franchise Fund'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 report on the financial statements, the scope of our work was not sufficient to express an opinion on the financial statements as of and for the year ended September 30, 2002. Also as stated in our report on the financial statements, we concluded that the accompanying balance sheet of the Interior Franchise Fund as of September 30, 2001 and the related accompanying statement of net cost for the year then ended, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

The Interior Franchise Fund prepared the accompanying financial statements assuming that the Interior Franchise Fund will continue as a going concern. As discussed in Note 1 to the financial statements, the expiration of the Interior Franchise Fund's authorizing legislation on October 1, 2003 creates an uncertainty about the Interior Franchise Fund's ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 7 to the financial statements, the Interior Franchise Fund discontinued certain products and services and the remainder of the Interior Franchise Fund operations transferred from Departmental Offices to Minerals Management Service within the Department of the Interior, as of October 1, 2003.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:



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a member of KPMG International, a Swiss association.



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

- A. Controls over the Revenue Process
- B. Controls to Reconcile Transactions with Trading Partners
- C. Organizational Structure

### Other Reportable Conditions

- D. Application and General Controls Over Financial Management Systems
- E. Timeliness of Recording Transactions
- F. Controls to Reconcile Fund Balance with Treasury
- G. Investigate and Resolve Old and Negative Account Balances

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

- H. Section 113 of Public Law 104-208 – Advances for Interior Franchise Fund
- I. *Federal Financial Management Improvement Act of 1996 (FFMIA)*

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

### **REPORT ON THE FINANCIAL STATEMENTS**

We have audited the accompanying balance sheet of the Interior Franchise Fund as of September 30, 2001, and the related accompanying statement of net cost for the year then ended. Further, we were engaged to audit the accompanying balance sheet of the Interior Franchise Fund as of September 30, 2002, and the related accompanying statements of net cost, changes in net position, budgetary resources, and financing for the year then ended. These financial statements are the responsibility of the Interior Franchise Fund's management. Our responsibility is to express an opinion on the 2001 financial statements based on the results of our audit.

The Interior Franchise Fund did not maintain its accounting records during fiscal year 2002, particularly with respect to accounts receivable and advances from others, thus requiring reconciliation and adjustment of these accounts subsequent to year end. As a result, management was unable to provide timely evidential matter to support accounts receivable and advances and deferred revenue prior to the end of our audit. It was impracticable to extend our procedures sufficiently to determine the extent to which the financial statements as of and for the year ended September 30, 2002, may have been affected by these conditions.



Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements as of and for the year ended September 30, 2002.

In our opinion, the balance sheet of the Interior Franchise Fund as of September 30, 2001 and the related accompanying statement of net cost for the year then ended, present fairly, in all material respects, the financial position of the Interior Franchise Fund as of September 30, 2001, and its net costs for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Interior Franchise Fund prepared the accompanying financial statements assuming that the Interior Franchise Fund will continue as a going concern. As discussed in Note 1 to the financial statements, the expiration of the Interior Franchise Fund's authorizing legislation on October 1, 2003 creates an uncertainty about the Interior Franchise Fund's ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 7 to the financial statements, the Interior Franchise Fund discontinued certain products and services and the remainder of the Interior Franchise Fund operations transferred from Departmental Offices to Minerals Management Service within the Department of the Interior, as of October 1, 2003.

The information in the Management Discussion and Analysis and Required Supplementary Information sections are not a required part of the financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. 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.

## **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 the Interior Franchise Fund'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.

In our fiscal year 2002 engagement, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable conditions A through C are material weaknesses.

## A. Controls Over the Revenue Process

The Interior Franchise Fund needs to improve controls over the recording of transactions related to the revenue process. Specifically, during the year-end closing process, we noted that the balances for accounts receivable and advances and deferred revenue (advances) changed frequently and ranged from \$3 million to \$160 million and \$403 million to \$494 million, respectively. We also noted the following:

1. Customer Level Adjustments – During the year-end closing process the Interior Franchise Fund analyzed balances at the customer level and recorded an adjustment to improperly reduce accounts receivable and advances from others by \$54 million. In addition, we determined that the year-end accounts receivable sub-ledger included one account totaling \$6.5 million that related to several customer agreements.
2. Customer Agreements with both Accounts Receivable and Advances – We compared the year-end accounts receivable and advances sub-ledgers and noted over 300 customer agreements with both an accounts receivable (\$11 million) and an advances from others balance (\$19 million). This occurred because the Interior Franchise Fund did not consider accounts receivable and advance balances as of September 30, 2001 when recording manual entries in the current year and because the accounting system did not properly consider the advance or accounts receivable balance as of September 30, 2001 when posting automated entries to the current year.
3. Incorrect Balances – We tested a sample of 103 accounts receivable balances and identified 23 balances with exceptions and we tested a sample of 152 advance balances and identified 6 balances with exceptions. These exceptions related to the Interior Franchise Fund increasing receivables instead of reducing advances as well as recording the incorrect amount of the Interior Franchise Fund fees, funds collected, agreement amounts, and revenue earned. We also noted that the Interior Franchise Fund fees are not consistently recorded in the proper period and that the Interior Franchise Fund fees are not consistently documented in the customer agreements.

As a result, the Interior Franchise Fund analyzed these accounts and adjusted the balances.

### Recommendations

The Interior Franchise Fund should improve controls over the recording of transactions related to the revenue process as follows:

1. Customer Level Adjustments – We recommend that the Interior Franchise Fund record transactions at the agreement level instead of the customer level to ensure that receivables and advances are properly recorded on the financial statements.
2. Customer Agreements with both Accounts Receivable and Advances – We recommend that the Interior Franchise Fund configure the accounting system to properly reduce advances instead of recording accounts receivable. In addition, the Interior Franchise Fund should investigate and resolve agreements with both accounts receivable and advance balances as part of the month-end closing process.
3. Incorrect Balances – We recommend that the Interior Franchise Fund establish procedures and controls to ensure transactions are recorded in the accounting system at the proper amount and in the proper period. We also recommend that the Interior Franchise Fund consistently document the agreed-upon Interior Franchise Fund fee in its customer agreements.

### **Management Response**

Management concurs with the recommendations. The Interior Franchise Fund is enhancing the accounting system to ensure that agreements are fully tracked at that level. The processing will automatically liquidate outstanding advance balances before converting to an accounts receivable. Procedures and controls are being developed ensure that transactions are recorded in the accounting system at the proper amount and in the proper period. The Interior Franchise Fund will establish a consistent agreed-upon service charge (fee) for its customer agreements.

### **B. Controls to Reconcile Transactions with Trading Partners**

The Interior Franchise Fund needs to improve controls to reconcile the intra-departmental and non-fiduciary intra-governmental activity and balances as follows:

1. Intra-Departmental Transactions – The Interior Franchise Fund purchased products and services from other components of the Department of the Interior. The Interior Franchise Fund did not reconcile transactions and balances with other components of the Department of the Interior in accordance with the Department of the Interior's *Fiscal Year 2002 Financial Statement Preparation Guidance*, OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and Treasury's *Federal Intragovernmental Transactions Accounting and Policies Guide* in a timely manner. This occurred because the reconciliations are performed manually and the Interior Franchise Fund does not have the necessary resources focused on the reconciliation process.
2. Reconciliation of Non-Fiduciary Intra-governmental Transactions – The Interior Franchise Fund provides products and services to other Federal entities. The Department of the Interior reconciles the fiduciary intra-governmental transactions and balances; however, the Department of the Interior has not fully reconciled its non-fiduciary intra-governmental transactions and balances. As a result, the Interior Franchise Fund does not fully reconcile its non-fiduciary transactions with other Federal entities. In addition, the Interior Franchise Fund did not designate the proper trading partner for Department of Defense transactions. Specifically, the Interior Franchise Fund coded certain Department of Defense transactions as Office of the Secretary of the Department of Defense instead of the individual components of the Department of Defense (i.e., Army, Navy, Air Force, and Office of the Secretary). Therefore, the Interior Franchise Fund's transactions and balances with other federal entities may not properly eliminate on the government-wide financial statements.

### **Recommendations**

We recommend that the Interior Franchise Fund improve the process to identify and reconcile the intra-departmental and non-fiduciary intra-governmental activity and balances as follows:

1. Intra-Departmental Transactions – We understand that the Department of the Interior is developing an automated process to facilitate the reconciliation of intra-Departmental transactions. We recommend that the Department of the Interior complete and implement this automated process. Until the automated process is implemented, we recommend that the Interior Franchise Fund improve the manual process to reconcile transactions and balances with the other components of the Department of the Interior.



2. Reconciliation of Non-Fiduciary Intra-governmental Transactions – We recommend that the Interior Franchise Fund in conjunction with the Department of the Interior establish procedures to reconcile non-fiduciary transactions and balances with other federal entities. We also recommend that the Interior Franchise Fund code intra-governmental transactions and balances to the appropriate trading partners.

These reconciliation processes should be completed quarterly and should include procedures to resolve any identified differences in a timely manner.

#### **Management Response**

Management agrees that it must reconcile its trading partner balances and resolve differences no less frequently than quarterly. Resources will be added as necessary and, where possible, the use of automated tools will be explored to mitigate the need for additional resources prior to release of the Department's automated reconciliation process.

### **C. Organizational Structure**

The Interior Franchise Fund is a “virtual organization” that utilizes personnel from both of its service providers. Although several personnel are fully dedicated to working on the Interior Franchise Fund activity, there are several personnel who only spend part of their time working on the Interior Franchise Fund activity. As a result of utilizing personnel from different service organizations, the Interior Franchise Fund does not have clear lines of responsibility or reporting and delays in processing result.

#### **Recommendation**

We understand that the Interior Franchise Fund is in the process of re-organizing responsibilities within its service providers. We recommend that the Interior Franchise Fund complete this re-organization process and ensure there is appropriate staffing to complete the day-to-day accounting processing in a timely manner.

#### **Management Response**

Effective October 1, 2002, the GovWorks operation of the Minerals Management Service is the sole service provider to the Interior Franchise Fund. Thus, management and accounting for the fund will reside in one organization, eliminating the “virtual organization.” Additionally, staff is being recruited and trained to ensure that daily processing is completed timely and accurately.

### **D. Application and General Controls Over Financial Management Systems**

The Interior Franchise Fund needs to improve the information technology controls that protect its financial information systems. Specifically, we noted the following:

1. National Business Center - The Interior National Business Center (NBC) administers the Interior Franchise Fund financial management systems, including the Federal Financial System and Hyperion. Although NBC has improved the security and controls over these information systems, NBC needs to continue improvements in the areas of entity-wide security planning; configuration of the operating systems; system software controls; software development and change controls; and service continuity. Weaknesses in these control areas could affect the Interior Franchise Fund's ability to prevent and detect unauthorized changes to its financial information and increases the need for less efficient manual controls to monitor financial information.



2. Access Controls – The Interior Franchise Fund does not have policies over granting users access to Federal Financial System and Hyperion. In addition, the security officer for the Interior Franchise Fund is not consistently informed of employee terminations or transfers. Furthermore, the Interior Franchise Fund does not consistently monitor user access listings to ensure that access granted to users is appropriate considering the users’ responsibilities.

### **Recommendations**

We recommend that the Interior Franchise Fund improve the information technology controls that protect its financial information systems as follows:

1. National Business Center – We understand the Interior Franchise Fund is undergoing a re-organization that will replace Federal Financial System but not Hyperion. As the Interior Franchise Fund plans to continue using Hyperion, which is supported by the NBC, we recommend that the Interior Franchise Fund 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.
2. Access Controls – We recommend that the Interior Franchise Fund establish policies for granting users access to Federal Financial System and Hyperion as well as informing the security officer of user terminations or transfers. We also recommend that the Interior Franchise Fund monitor user access listings on a monthly basis to ensure that access granted to users is appropriate considering the users responsibilities. The Interior Franchise Fund should investigate and resolve any unauthorized access in a timely manner.

### **Management Response**

Management concurs.

## **E. Timeliness of Recording Transactions**

The Interior Franchise Fund does not consistently record transactions in a timely manner. For example, the June 30, 2002 financial statements did not include approximately 80% of NBC-related activity and did not include most of the MMS-related revenue. This occurred because the Interior Franchise Fund did not record NBC-related expenses until the expenses were matched with a customer agreement and because the Interior Franchise Fund did not start entering fiscal year 2002 activity into the general ledger until after January 2002. In addition, the Interior Franchise Fund recorded numerous adjustments during the year-end closing process.

### **Recommendation**

We recommend that the Interior Franchise Fund record transactions when the financial event occurs.

### **Management Response**

Management concurs with the recommendation. Interior Franchise Fund has developed and published policies and will continue as necessary to develop procedures for recording transactions in a timely manner during the month and performing reconciliations on a monthly basis, including prompt follow-up on any differences identified. Development by Minerals Management Service of an electronic extract from ABACIS, which interfaces with the Interior Franchise Fund’s application in FFS, has significantly improved the timeliness of data entry but further work needs to be done for Minerals Management Service’s fees/retained earnings and National Business Center’s cost transactions.

## **F. Controls to Reconcile Fund Balance with Treasury**

The Interior Franchise Fund has not properly designed controls over fund balance with Treasury. Specifically we noted the following:

1. Reconciliation Process – Generally, a Federal entity routinely records disbursement and collection transactions into the general ledger and prepares, on a monthly basis, the SF-224 *Statement of Transactions* report. The Department of the Treasury (Treasury) compares the entity's SF-224 report to the disbursement and collection transactions it has processed and issues various Treasury reports for reconciliation by the federal entity. However, the Interior Franchise Fund does not follow this reconciliation process. The Interior Franchise Fund uses Treasury's CASHLINK report to prepare the SF-224 report for submission to Treasury. After submission to Treasury, the Interior Franchise Fund enters disbursement and receipt activity into the general ledger and reconciles both the CASHLINK report and the SF 224 report to the general ledger to ensure the activity was properly entered.
2. Segregation of Duties – The Interior Franchise Fund's fund balance with Treasury responsibilities are not properly segregated to prevent or detect potential errors. We noted that the Interior Franchise Fund representative responsible for performing the fund balance reconciliations may also process Intra-governmental Payment and Collection (IPAC) transactions and record fund balance transactions into the general ledger.

### **Recommendations**

We recommend that the Interior Franchise Fund improve the controls over fund balance with Treasury as follows:

1. Reconciliation Process – We recommend that the Interior Franchise Fund revise the fund balance with Treasury reconciliation procedures so that the fund balances transactions are recorded into the general ledger before they are reconciled with Treasury.
2. Segregation of Duties – We recommend that the Interior Franchise Fund have separate individuals perform fund balance reconciliations, process IPAC transactions, and record the fund balance transactions into the general ledger.

### **Management Response**

Management agrees that all fund balance transactions must be recorded in the general ledger in a timely manner prior to performing the monthly fund balance reconciliations. At this time, the Interior Franchise Fund is working to eliminate the current backlog of entering fund balance transactions into the general ledger prior to fiscal year-end, with the intention of performing the reconciliations, as recommended, beginning with the new fiscal year. The Interior Franchise Fund also agrees that the duties of fund balance reconciliation, IPAC, and recording should be segregated for purposes of better internal control.

## **G. Investigate and Resolve Old and Negative Account Balances**

The Interior Franchise Fund does not consistently review and resolve older accounts receivable and payable balances. Specifically, we identified several older accounts receivable and payable balances and several negative account balances. As a result, the Interior Franchise Fund investigated the older and negative accounts receivable and payable balances and adjusted the balances.

**Recommendation**

We recommend that the Interior Franchise Fund design formal system generated accounts receivable and payable aging reports and review these reports on a monthly basis. The Interior Franchise Fund should investigate and resolve any accounts receivable and payable balances that are negative or over 6 months old.

**Management Response**

Management concurs. IFF will design formal system generated accounts receivable and payable aging reports and review these reports on a monthly basis, as well as investigate and resolve any accounts receivable and payable balances that are over 6 months old.

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

**COMPLIANCE WITH LAWS AND REGULATIONS**

Our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report, exclusive of the FFMIA, disclosed an instance of noncompliance with the following laws and regulations that is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and is described below.

**H. Section 113 of Public Law 104-208 – Advances for Interior Franchise Fund**

In accordance with section 113 of Public Law 104-208, the Interior Franchise Fund shall obtain advances from customers before costs are incurred to provide goods or services to the customer. However, we noted that the Interior Franchise Fund does not consistently obtain advances from customers as the Interior Franchise Fund reported accounts receivable of approximately \$78 million as of September 30, 2002.

**Recommendation**

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

**Management Response**

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

The Interior Franchise Fund has provided language to the office of the Assistant Secretary – Policy, Management, and Budget that amends the FY 2003 appropriation wording to address this finding. The language essentially amends the original IFF appropriation language to provide for payment in advance or reimbursement after the fact. The Department of the Interior is presently working with the Office of Management and Budget and the U.S. Congress to adjust the appropriation language to support the intent of the stated Government Management Reform Act objectives.

## **I. Federal Financial Management Improvement Act of 1996 (FFMIA)**

The results of our tests of FFMIA disclosed instances, described below, where the Interior Franchise Fund's financial management systems did not substantially comply with the federal financial management systems requirements and the federal accounting standards. The results of our tests of FFMIA disclosed no instances in which the Interior Franchise Fund's financial management systems did not substantially comply with the United States Standard General Ledger at the transaction level.

1. Federal Financial Management Systems Requirements – As discussed in the section of our report entitled “Internal Control Over Financial Reporting,” the Interior Franchise Fund needs to work with NBC to improve its EDP security and general control environment and needs to strengthen access controls. Due to weaknesses in these areas, the Interior Franchise Fund does not substantially comply with the security and general EDP control requirements of OMB Circular A-130, *Management of Federal Information Resources*.
2. Federal Accounting Standards – The Interior Franchise Fund is required to prepare its financial statements in accordance with federal accounting standards. As discussed in the section of our report entitled “Internal Control over Financial Reporting,” we identified material weaknesses that affect the Interior Franchise Fund's ability to prepare its financial statements and related disclosures in accordance with federal accounting standards. Specifically, we determined that the Interior Franchise Fund needs to improve its controls over the revenue and trading partner reconciliation processes. In addition, the Interior Franchise Fund needs to improve its organizational structure.

### **Recommendations**

1. Federal Financial Management Systems Requirements – We recommend that, in fiscal year 2003, the Interior Franchise Fund take the necessary actions to improve the application and general controls over its financial management systems in accordance with requirements set forth in OMB Circular A-130, *Management of Federal Information Resources*.
2. Federal Accounting Standards - We recommend that, in fiscal year 2003, the Interior Franchise Fund strengthen its procedures and internal controls to ensure the financial statements and related disclosures are prepared in accordance with the federal accounting standards.

### **Management Response**

Management concurs. See response to items A through D above.

## **RESPONSIBILITIES**

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

The Government Management Reform Act (GMRA) of 1994 requires each federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, the Interior Franchise Fund 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 control over financial reporting, and preparation of the Management Discussion and Analysis (including the performance measures) and required supplementary information; 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. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

### ***Auditors' Responsibilities***

Our responsibility is to express an opinion on the fiscal year 2001 financial statements of the Interior Franchise Fund 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 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 on the fiscal year 2001 financial statements.

Because of the matters discussed above in our report on the financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements as of and for the year ended September 30, 2002. We considered the limitations on the scope of our work in forming our conclusions.

In planning and performing our fiscal year 2002 engagement, we considered the Interior Franchise Fund's internal control over financial reporting by obtaining an understanding of its internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our procedures 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 engagement was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.



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 thereon.

As part of obtaining reasonable assurance about whether the Interior Franchise Fund's fiscal year 2002 financial statements are free of material misstatement, we performed tests of the Interior Franchise Fund'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 the Interior Franchise Fund. Providing an opinion on compliance with laws and regulations was not an objective of our engagement and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether the Interior Franchise Fund'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 17, 2003

**Exhibit I**

**Interior Franchise Fund  
Summary of the Status of Prior Year Findings  
September 30, 2002**

<b>Ref</b>	<b>Condition Area</b>	<b>Status</b>
A	Establish Procedures and Controls to Record Obligations	This condition has been corrected and is not repeated in fiscal year 2002.
B	Re-Design the Process for Recording Minerals Management Service (MMS) Activity	This condition has not been corrected and is repeated in fiscal year 2002. See finding A.
C	Improve Controls Over Accruals	This condition has been corrected and is not repeated in fiscal year 2002.
D	Improve Timeliness of Transaction Entry and Reconciliation	This condition has not been corrected and is repeated in fiscal year 2002. See finding E.
E	Improve Organizational Structure	This condition has not been corrected and is repeated in fiscal year 2002. See finding C.
F	Improve Application and General Controls Over Financial Management Systems	This condition has not been corrected and is repeated in fiscal year 2002. See finding D.
G	Document Policies and Procedures for Certain Areas	This condition has been corrected and is not repeated in fiscal year 2002.
H	Review and Investigate Old and Negative Account Balances	This condition has not been corrected and is repeated in fiscal year 2002. See finding G.



**Interior Franchise Fund  
Summary of the Status of Prior Year Findings  
September 30, 2002**

<b>Ref</b>	<b>Condition Area</b>	<b>Status</b>
I	Section 113 or Public Law 104-208 – Advances for Interior Franchise Fund	This condition has not been corrected and is repeated in fiscal year 2002. See finding H.
J	Provide Adequate Application and General Controls Over Financial Management Systems	This condition has not been corrected and is repeated in fiscal year 2002. See finding I.
K	Federal Accounting Standards	This condition has not been corrected and is repeated in fiscal year 2002. See finding I.