OFFICE OF
INSPECTOR GENERAL
U.S.DEPARTMENT OF THE INTERIOR

NOV 13 2015

Memorandum

To: Secretary Jewell

From: Mary L. Kendall
Deputy Inspector General

Subject: Independent Auditors' Report on the U.S. Department of the Interior Financial Statements for Fiscal Years 2015 and 2014
Report No. 2015-FIN-046

Introduction

This memorandum transmits the KPMG LLP (KPMG) auditors' report of the U.S. Department of the Interior (DOI) financial statements for fiscal years (FYs) 2015 and 2014. The Chief Financial Officers Act of 1990 (Public Law 101-576), as amended, requires the DOI Inspector General or an independent auditor, as determined by the Inspector General, to audit the DOI financial statements.

Under a contract issued by DOI and monitored by the Office of Inspector General (OIG), KPMG, an independent public accounting firm, performed an audit of the DOI FY 2015 and FY 2014 financial statements. The contract required the audit to be performed in accordance with the generally accepted Government Auditing Standards, issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 15-02, "Audit Requirements for Federal Financial Statements."

Results of Independent Audit

In its audit report, KPMG issued an unmodified opinion on the DOI financial statements. KPMG identified two material weaknesses and one significant deficiency in internal control over financial reporting. In addition, KPMG identified one instance in which DOI did not comply with laws and regulations, specifically the Federal Financial Management Improvement Act of 1996.

KPMG performed auditing procedures at Departmental Offices, Indian Affairs, Bureau of Reclamation, National Park Service, U.S. Geological Survey, Bureau of Land Management, U.S. Fish and Wildlife Service, Bureau of Ocean Energy Management, Bureau of Safety and Environmental Enforcement, and Office of Surface Mining, Reclamation and Enforcement to support the DOI consolidated financial statement audit.

Evaluation of KPMG Audit Performance

To ensure the quality of the audit work performed, OIG-

- reviewed KPMG's approach and planning of the audit;
- evaluated the qualifications and independence of the auditors;
- monitored the progress of the audit at key points;
- attended periodic meetings with DOI management and KPMG to discuss audit progress, findings, and recommendations;
- reviewed KPMG's audit report; and
- performed other procedures we deemed necessary.

KPMG is responsible for the attached report and the conclusions expressed therein. We do not express an opinion on DOI financial statements nor on KPMG's conclusions regarding the effectiveness of internal controls or compliance with laws and regulations.

Report Distribution

The legislation creating OIG requires semiannual reporting to Congress on all audit reports issued, actions taken to implement audit recommendations, and unimplemented recommendations. Therefore, we will include a summary of the information contained in the attached audit report in our next semiannual report. The distribution of the report is not restricted, and copies are available for public inspection.

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

Attachment

KPMG LLP
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Washington, DC 20006

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the U.S. Department of the Interior (the Department), which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements (hereinafter referred to as "financial statements").

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of the Interior as of September 30, 2015 and 2014, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Management has elected to reference information on websites or other forms of interactive data outside the Agency Financial Report to provide additional information for the users of its financial statements. Such information is not a required part of the basic financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The Introduction, Message from the Chief Financial Officer, and Other Information sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2015, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described below under items A. and B. to be material weaknesses. Entity management did not report the material weakness described below under item A. Controls over General Property, Plant, and Equipment in the Department's Statement of Assurance, included in the Management's Discussion and Analysis section of the accompanying Annual Financial Report.

A. Controls over General Property, Plant, and Equipment

OMB Circular A-123, *Management's Responsibility for Internal Control,* states that management is responsible for developing and maintaining effective internal control. The Department's internal controls over general property, plant, and equipment (PP&E) were not effective in fiscal year 2015 as a result of the following internal control deficiencies which could result in a material misstatement of general property, plant and equipment:

- Policies and procedures established to account for PP&E lack effective risk assessment and monitoring functions to ensure that controls over completeness, existence, accuracy and valuation are appropriately designed, implemented, and/or operating effectively, and that PP&E is properly supported by appropriate and retrievable accounting records.

- Supervisory review and monitoring controls over PP&E reporting were not effective in identifying instances when policies were not being followed, or monitoring the effectiveness of existing PP&E controls, and developing corrective actions as needed in a timely manner.

- Process level internal controls were not designed, implemented, or operating effectively to ensure that:
  - Costs recognized as assets under construction were properly capitalized, regularly reviewed for completion, and classified as placed in service timely and accurately;
  - Assets under construction where construction activities have been suspended, were reviewed to determine whether the assets still exist, have future service utility, and are properly valued at the balance sheet date;
  - Policies and procedures require detailed reviews over PP&E records including asset code classification, gross square footage, and cost factor survey data used for the asbestos liability calculation;
  - A three way reconciliation of property records is performed between the cost factor database, operational subsidiary ledgers and the financial accounting system to support the asbestos liability calculation;
  - Certain costs that should be capitalized, including design fees, freight charges, and other costs related to construction and installation were capitalized timely and consistently;
  - Property additions and deletions were recorded timely;

- Non-capitalizable costs such as capital asset maintenance, prompt pay interest, repair costs, and labor costs associated with non-capital activities were properly expensed as incurred during the year;
- Physical property reconciliations, and adjustment of physical inventory records, were performed timely and consistently; and
- Useful lives were appropriately assigned in the accounting system.

Recommendations

We recommend that the Department improve controls over property, plant, and equipment to prevent a material misstatement of general property, plant and equipment as follows:

- Perform a review and risk assessment of PP&E policies and procedures at all Bureaus to identify weaknesses, inconsistencies, and potential gaps in documented internal controls over property, plant, and equipment;
- Establish routine supervisory reviews and monitoring controls over PP&E reporting at the Department level and within the Bureaus to identify instances where policies may not be consistently followed;
- Design and implement process level PP&E controls to ensure that assets under construction exist, are accounted for accurately, are timely classified as in-use, and have future service utility;
- Design and implement policies and procedures to require detailed reviews over PP&E records (i.e. gross square footage, asset classification and cost factor survey data) as well as a reconciliation between the cost factor database, the operational subsidiary ledgers and the financial accounting system to support the asbestos liability calculation;
- Reinforce existing policies over PP&E additions and deletions to ensure activities are capitalizable, are recorded accurately and timely; and
- Reinforce existing internal controls over property records to effectively validate and review property records, including physical property reconciliations review and validation that depreciable useful lives are accurately assigned in the accounting system, and ensuring supporting documentation is readily available to management.

B. Department-wide Information Technology Controls

OMB Circular A-123, *Management's Responsibility for Internal Control*, states that management is responsible for developing and maintaining effective internal control. During our fiscal year 2015 assessment of general information technology (IT) controls (GITCs), process-level IT application controls, and information produced by the entity (IPE), we noted the following internal control deficiencies:

- Certain policies and procedures were outdated, or were not consistently followed, in relation to computer security incident response guidance, despite recent efforts by management to document and update policies. Failure to implement policies and procedures may lead to delays in resolving incidents or prevent correlating an incident within the expected timeframe and holding responsible individuals fully accountable;

- Management did not ensure that a user's access in one system was terminated in accordance with policy and on a timely basis. In addition, several users maintained an active account in one system following their termination. Additionally, several users maintained active user IDs and active application accounts in another system following their separation. Management did not detect this inappropriate access during the annual recertification process or through review of user access rights.

This could lead to unauthorized changes to financial information or unauthorized electronic access to sensitive information;

- A lack of segregation of duties across multiple financial systems which indirectly impacts other GITC elements (change management, program development, and computer operations) and application controls. For example, we noted:

    - One instance where a shared privileged user account was created and used throughout the fiscal year without detailed audit logging of the usage. This could lead to unauthorized changes to financial information or unauthorized electronic access to sensitive information; and
    - Several Bureau specific financial systems lacked appropriate segregation of duties, coupled with weaknesses in audit logging. This increases the potential for unauthorized, improper, or erroneous changes being placed in the production environment without detection through formal review processes.

- Several deficiencies related to change management processes where software security patches were not consistently implemented across multiple systems on a timely basis. In addition, monthly vulnerability scanning was not being performed with proper authentication. Inconsistent patch management can lead to increased organizational risk to the computing environment as well as the financial reporting process, including access and change management functionality.

The indirect impact of the above findings includes the inability to rely on application controls and information produced by the entity that is used by management in the operation of the Department's key processes.

Recommendations

We recommend that the Department improve controls over GITCs, process-level IT application controls, and IPE as follows:

- In coordination with Bureau management, complete the review of and update existing policies and procedures related to information technology financial systems, and GITCs. Updated policies should include processes to implement security patches and perform system maintenance timely throughout the Department;
- Reinforce policies to ensure the consistent and effective operation of information technology controls throughout the Department including focus on access and segregation of duties reviews;
- Perform further analysis to understand the root cause of access control deficiencies, and implement corrective policies or procedures to strengthen access controls where necessary; and
- While completing the update of policies and procedures, perform a risk assessment of GITC and IT application controls to identify IT management and maintenance responsibilities that should be segregated to strengthen internal controls and manage risk caused by incompatible duties.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiency to be a significant deficiency.

C. Controls over Financial Reporting

OMB Circular A-123, *Management's Responsibility for Internal Control*, states that management is responsible for developing and maintaining internal control activities that comply with the key objectives including: control environment, risk assessment, control activities, information and communications, and monitoring. The Government Accountability Office's *Standards of Internal Control for Federal Government*, state that an effective internal control system requires that each of the five components (listed above) are effectively designed, implemented, and operating together in an integrated manner. In fiscal year 2015, although the Department implemented a corrective action plan and significantly improved entity level controls, we continue to note internal control deficiencies related to financial reporting which could result in a misstatement within the financial statements. Specifically, we found:

- Bureau controls were not operating effectively to appropriately identify and analyze events that may have an accounting and/or financial reporting impact. This includes events and changes in circumstances used as important inputs in developing management estimates, such as including Federal Trading Partner activity in the undelivered order accrual. Also, management's reviews of key estimates did not always include detailed reviews of the underlying data, comprehensive look back analyses, and appropriate consideration of how changes in operations or activity levels should be reflected in the methodologies. These weaknesses were evident through review of account balances such as accounts payables, accruals, and legal contingencies;

- Financial reporting internal controls were not operating effectively to ensure that errors were identified at the Bureau and Department level on a timely basis. Specifically, there were several accounting analyses performed by Management which resulted in adjusting entries including accounting for helium inventory and classification of assets as entity or non-entity. In addition, there were several accounting analyses performed by Management which resulted in adjusting entries that were found to impact the prior year's financial statements and not reflected appropriately, including stewardship land, classification of assets as entity or non-entity, classification of net cost by mission goals, Fund Balance with Treasury disclosures, Museum collections and stewardship land disclosures;

- Controls were not operating effectively over the Department and Bureau review of trial balances;

- Monitoring controls at the Bureau level over key process level controls intended to mitigate risks posed by systems limitations over segregation of duties for sales orders and journal entries were not operating effectively; and

- Bureau controls were not operating effectively over the validation of open obligations and unfilled customer order balances. Further, adjustments to undelivered orders, including recoveries, were not always recorded timely and accurately.

Recommendations

We recommend that the Department and Bureaus improve controls over financial reporting to prevent a financial statement misstatement as follows:

- Implement or enhance controls over key estimates to include detailed reviews of the underlying data, comprehensive look back analyses (including adjustment to methodologies, if appropriate), and reviews of operations and activity levels to ensure the methodology is consistent and appropriate based on current trends;

- Perform an assessment and update, if necessary, its policies and procedures over financial reporting at the Department and Bureau level, including implementing controls at the Department and Bureau level that include detailed account analysis over significant accounts and estimates and significant financial statement footnotes. Adjustments, if any, resulting from this process should be recorded to the financial statements timely;

- Perform a detailed review of the trial balances used by management to ensure the completeness and accuracy of the information contained within;

- Reinforce the importance of monitoring controls at the Bureau level to ensure that controls over sales orders and journal entries are effective; and

- Improve controls over budgetary accounting at the Bureau level to include implementing or enhancing controls over the review and validation of undelivered orders and unfilled customer orders. Controls at the Bureau level should include setting and documenting appropriate and defined precision thresholds if used in the operation of controls, as well as processes and procedures to ensure that adjustments identified as a result of the review are accounted for timely and accurately.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 15-02.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of FFMIA disclosed instances, described below, in which the Department's financial management systems did not substantially comply with Federal financial management system requirements. The results of our tests of FFMIA disclosed no instances in which the Department's financial management systems did not substantially comply with (a) applicable Federal accounting standards and (b) the United States Government Standard General Ledger at the transaction level.

D. Federal Financial Management Improvement Act of 1996

FFMIA Section 803(a) requires that agency Federal financial management systems comply with (1) Federal financial management system requirements; (2) applicable Federal accounting standards; and (3) the United States Government Standard General Ledger at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

As discussed in item B. of the Internal Control over Financial Reporting section of this report, we identified a material weakness related to information technology controls and the related control deficiencies resulted in the Department's financial management systems to not substantially comply with the Federal financial management system requirements of FFMIA.

Recommendation

We recommend the Department improve its financial management systems to ensure compliance with FFMIA, and implement the recommendations provided in Item B above.

Department's Responses to Findings

The Department's responses to the findings identified in our audit are described and presented as a separate attachment to this report. The Department's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

***Purpose of the Other Reporting Required by* Government Auditing Standards**

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
November 13, 2015