



# United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Washington, DC 20240

NOV 15 2008

Memorandum

To: Secretary

From: Earl E. Devaney  
Inspector General

Subject: Independent Auditors' Report on the Department of the Interior Financial Statements for Fiscal Years 2008 and 2007 (Report No. X-IN-MOA-0011-2008)

## ***INTRODUCTION***

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This memorandum transmits the KPMG LLP (KPMG) auditors' report of the Department of the Interior (DOI) financial statements for fiscal years (FYs) 2008 and 2007. 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 FY2008 and FY2007 financial statements. The contract required that the audit be performed in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements."

## ***RESULTS OF INDEPENDENT AUDIT***

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In its audit report dated November 15, 2008, KPMG issued an unqualified opinion on the DOI financial statements. However, KPMG identified six significant deficiencies in internal controls over financial reporting, of which one was considered a material weakness. In addition, KPMG identified two instances where DOI did not comply with laws and regulations, specifically, the Single Audit Act Amendments of 1996 and with the Federal Financial Management Improvement Act of 1996 (FFMIA).

KPMG has also audited the financial statements for Indian Affairs, Bureau of Reclamation, Departmental Offices, National Park Service, and the U.S. Geological Survey. In addition, KPMG performed certain auditing procedures at the Bureau of Land Management, U.S. Fish and Wildlife Service, Minerals Management Service and Office of Surface Mining, Reclamation and Enforcement to support the DOI consolidated financial statement audit.

## ***EVALUATION OF KPMG AUDIT PERFORMANCE***

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To ensure the quality of the audit work performed, the 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;
- coordinated periodic meetings with DOI management to discuss audit progress, findings, and recommendations;
- reviewed and accepted KPMG's audit report; and
- performed other procedures we deemed necessary.

KPMG is responsible for the attached auditors' report dated November 15, 2008, and the conclusions expressed therein. We do not express an opinion on DOI financial statements nor on KPMG's conclusions regarding 1) effectiveness of internal controls, 2) compliance with laws and regulations, or 3) substantial compliance of DOI financial management systems with the Federal Financial Management Improvement Act of 1996.

## ***REPORT DISTRIBUTION***

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The legislation, as amended, creating the OIG requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and unimplemented recommendations. Therefore, we will include the information in the attachment 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.

### **Attachments**

cc: Chief Financial Officer  
Chief Information Officer  
Director, Office of Financial Management  
Associate Director, Office of Financial Management  
Focus Group Leader, Internal Control and Audit Follow-up, Office of Financial Management  
Audit Liaison Officer, Office of Financial Management



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## Independent Auditors' Report

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

We have audited the accompanying balance sheets of the U.S. Department of the Interior (Interior) as of September 30, 2008 and 2007, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the years then ended (hereinafter referred to as financial statements). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our fiscal year 2008 audit, we also considered Interior's internal controls over financial reporting and tested Interior's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements.

### Summary

As stated in our opinion on the financial statements, we concluded that Interior's financial statements as of and for the years ended September 30, 2008 and 2007, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. As discussed in our opinion, Interior changed its method of accounting for and reporting of heritage assets and stewardship land to adopt changes in accounting standards in fiscal year 2008.

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

### Significant Deficiency Considered to be a Material Weakness

- A. Controls over Unfilled Customer Orders

### Other Significant Deficiencies

- B. General and Application Controls over Financial Management Systems
- C. Controls over Property
- D. Controls over Undelivered Orders
- E. Grant Monitoring Controls
- F. Controls over Indian Trust Funds

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

- G. *Single Audit Act Amendments of 1996*
- H. *Federal Financial Management Improvement Act of 1996*



The following sections discuss our opinion on Interior's financial statements; our consideration of Interior's internal controls over financial reporting; our tests of Interior's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.

### **Opinion on the Financial Statements**

We have audited the accompanying balance sheets of the U.S. Department of the Interior as of September 30, 2008 and 2007, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the years then ended.

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, 2008 and 2007, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 10 to the financial statements, Interior changed its method of accounting for and reporting of heritage assets and stewardship land to adopt changes in accounting standards in fiscal year 2008.

The information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. 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 audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The consolidating information in the Other Supplementary Information section is presented for purposes of additional analysis of the financial statements rather than to present the financial position and changes in net position of Interior's components individually. The consolidating 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. The Introduction, Performance Data and Analysis, and Other Accompanying Information sections and the special account funds in the Other Supplementary Information section are presented for purposes of additional analysis and are not required as part of the financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

### **Internal Control Over Financial Reporting**

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Interior's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Interior's financial statements that is more than inconsequential will not be prevented or detected by Interior's internal control. A material weakness is a significant deficiency, or



combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Interior's internal control.

In our fiscal year 2008 audit, we consider the deficiencies, described below, to be significant deficiencies in internal control over financial reporting. We consider significant deficiency A to be a material weakness. Exhibit I presents the status of prior year significant deficiencies.

#### **A. Controls over Unfilled Customer Orders**

Interior reported \$5.2 billion of budgetary resources received from customer orders with other federal entities and public organizations in fiscal year 2008. Interior needs to improve controls to ensure customer orders are promptly recorded, properly classified, and accounted for, in order to prepare timely and reliable reports. Interior did not record the entire unfilled customer order when the order was received or incorrectly removed unfilled customer orders at the end of each fiscal year that were recorded again in the following fiscal year because of accounting system limitations and the components not fully understanding the accounting standards. These actions resulted in Interior understating budgetary resources by over \$467 million in fiscal year 2008. In addition, Interior did not effectively review outstanding unfilled customer orders because Interior should have removed approximately \$43 million of unfilled customer orders that had expired. As a result of our observations, Interior analyzed and adjusted its unfilled customer orders.

#### **Recommendations**

We recommend that Interior implement the following recommendations to improve controls over its unfilled customer order balances:

1. Develop and communicate accounting policies and procedures for unfilled customer orders.
2. Provide training to personnel on accounting for unfilled customer orders.
3. Record the entire amount of the unfilled customer order when the order is received.
4. Monitor and close out unfilled customer orders when the order expires or funding is no longer available for obligation.

#### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

#### **B. General and Application Controls over Financial Management Systems**

Interior did not have adequate information technology controls to protect its financial management systems as required by OMB Circular No. A-130, *Management of Federal Information Resources*. These conditions could affect Interior's ability to prevent and detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information resources. Although Interior has improved its application and general controls, Interior needs to continue improving the security and general controls over its financial information systems, as discussed below.

##### **1. Entity-wide Security Program and Planning**

An entity-wide security program, including security policies and a related implementation plan, is the foundation of an entity's security control structure. Interior had not certified and accredited four financial applications and had not certified and accredited another application until the end of the year. In addition, Interior did not fully document or perform certain procedures to support two of its certification and accreditation reports.



2. *Access Controls and Segregation of Responsibilities*

Access controls protect computer resources from unauthorized modification, disclosure, and loss; however, Interior did not fully establish controls to prevent and detect unauthorized access. Interior did not formally document and approve policies and procedures regarding access controls, segregation of system roles and responsibilities, reviews and segregation of duties, or facility access controls. Interior granted excessive access to and did not effectively segregate system administrator responsibilities for one application. Interior also did not establish appropriate system parameter settings for password expiration and automatic log off in accordance with its policies for two applications.

Interior did not periodically review segregation of responsibilities to ensure conflicting access rights are not granted for certain applications. Additionally, Interior did not configure three applications to ensure segregation of duties. Interior also did not consistently recertify user access, document reviews of user access, segregate responsibilities for reviewing access profile changes, prepare and maintain access forms, complete rule of behavior forms, complete background investigations, maintain vulnerability scan results, minimize duplicate accounts, prepare exit clearance forms, or remove separated users. Additionally, Interior did not establish controls over contractor access to applications, background investigations, and security training. Furthermore, Interior did not configure certain applications to capture changes to accounts, changes to security profiles, and transactions on security and audit logs. Finally, Interior did not consistently review security and audit logs, document that log reviews were completed, or maintain logs.

3. *System Software Controls*

System software controls protect computer resources from unauthorized modification, disclosure, and loss. Interior did not document approval of administrator access for one system, allowed shared administrator access for one system, and allowed approvers to share identifications to approve system software changes for one system. In addition, Interior had not developed procedures for limiting access to one system, fully developed procedures for capturing and reviewing changes for three systems, or fully implemented procedures to detect unauthorized changes to system software for two systems. Furthermore, Interior did not consistently segregate responsibilities over the review of security violations or consistently document reviews and resolutions of security violations. Finally, Interior did not have vendor support or implement security upgrades for several systems.

4. *Software Development and Change Controls*

Software development and change controls ensure that only authorized programs and modifications are implemented. Interior did not have formal system development and change management procedures or the capability to generate a list of changes for one application. In addition, Interior did not use library management software to control software changes or fully segregate software development and change responsibilities for three applications. Finally, Interior did not log changes or review changes implemented for one system.

5. *Service Continuity*

Service continuity plans protect information resources, minimize the risk of unplanned interruptions, and recover critical operations should interruptions occur. Interior did not have finalized, approved and tested contingency plans for three applications. In addition, Interior did not update one contingency plan for significant changes to the operating environment or include recovery goals in the contingency plan. Interior also did not have a comprehensive plan to train all essential employees on emergency responsibilities outlined within the critical system and application contingency plans. Additionally, Interior did not establish disaster recovery sites for two applications. Furthermore, Interior did not develop backup and off-site storage procedures for three applications. Finally, Interior did not use a backup tape log, secure backup tapes, or maintain backup tape testing results for one application.



### **Recommendations**

We recommend that Interior continue to improve the security and general controls over its financial information systems to ensure adequate security and protection of the information systems as follows:

1. Certify and accredit its facilities timely and fully document its certifications and accreditations.
2. Develop and finalize access control policies, restrict access, configure systems for password expirations, review segregation of responsibilities, review and approve user access, maintain access documentation, prepare rule of behavior and exit clearance forms, complete background investigations, maintain vulnerability scan results, control contractor access, and configure, review, and maintain security and audit logs.
3. Document approval of administrator access, limit administrator access, assign unique identifications to administrators, develop access and change procedures, segregate responsibilities over the review of security violations, document reviews and resolutions of security violations, secure vendor support, and implement security upgrades for system software.
4. Finalize system development and change management procedures, use library management software to control software changes, configure systems to capture changes, fully segregate responsibilities for software development and changes, and log and review changes.
5. Finalize, approve and test contingency plans and related training plans, establish disaster recover sites, develop backup and off-site storage procedures, use backup tape logs, secure back up tapes, and maintain backup testing results.

### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

### **C. Controls over Property**

Interior needs to improve controls over accounting for property, plant, and equipment, to ensure that transactions are promptly recorded and properly classified and accounted for, to prepare timely and reliable financial reports. We noted control deficiencies in the following areas:

#### **1. *General Property, Plant and Equipment***

Interior did not consistently record property additions, disposals, and transfers when they occurred and capitalized costs that should have been expensed. Interior had not properly established property projects in the accounting system and did not consistently communicate across one component, resulting in a net \$176 million overstatement of property balances. In addition, Interior had not completed or reviewed cost structures in the accounting system for 4 of 45 cost structures tested. Interior also did not record \$36 million of property at the time of purchase because Interior did not realize that it owned the property. Interior did not perform effective periodic inventory procedures because 7 of the 158 inventory items tested at one component did not exist. Finally, Interior did not record property additions and disposals when they occurred for 27 of the 224 transactions tested at three components. As a result of our observations, Interior analyzed and adjusted its property balances.

#### **2. *Heritage Assets and Stewardship Land***

In fiscal year 2008, Interior adopted the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS) No. 29, *Heritage Assets and Stewardship Land*. Interior did not consistently establish controls over the implementation of SFFAS No. 29, *Heritage Assets and Stewardship Land*, because Interior had reported heritage asset and stewardship land units that did not meet the accounting criteria, did not exist, were previously transferred to other entities, or were owned by other entities. In addition, Interior did not report heritage asset and stewardship land units that met the accounting criteria for reporting. These actions resulted in Interior incorrectly



reporting 485 units or 20% of the beginning balances at five of its components. As a result of our observations, Interior analyzed and adjusted the heritage assets and stewardship land beginning balances.

### **Recommendations**

We recommend that Interior implement the following recommendations to improve controls over property:

1. Establish controls to ensure that Interior records property additions, disposals, and transfers when the transaction occurs.
2. Implement procedures requiring supervisory review of cost structures to ensure that the cost structures are properly entered into the accounting system.
3. Enhance periodic inventory procedures, including semi-annual certifications and other procedures that document completeness and accuracy.
4. Continue to train personnel on recording property transactions and conducting inventories.
5. Implement additional controls, such as requiring supervisory reviews and evaluations of accounting standard implementations, to ensure consistent implementation of new accounting standards.

### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

## **D. Controls over Undelivered Orders**

Interior obligates its budgetary resources by placing orders with other federal entities and public organizations and reduces the order balances as goods and services are received. Interior policies require components to review and certify undelivered orders quarterly and to de-obligate invalid obligations. Although Interior has improved compliance with its policies, Interior needs to continue improving the effectiveness of the review and certification procedures because three Interior components incorrectly certified 23 of the 364 undelivered orders tested. In addition, Interior prepared inaccurate undelivered order certifications at one component. Interior did not record recoveries of undelivered orders timely for 98 of the 291 items tested at four components. Interior also did not consistently maintain documentation or modify the period of performance for expired orders in a timely manner. Finally, Interior did not implement sufficient obligation controls at one component because Interior incorrectly recorded \$5 million in obligations for future annual leave causing one fund to have obligations in excess of available budgetary resources. As a result of our observations, Interior analyzed and adjusted its undelivered orders.

### **Recommendations**

We recommend that Interior implement the following recommendations to improve controls over its undelivered orders:

1. Provide training to program and finance personnel on certifying and closing out undelivered orders.
2. Improve the effectiveness of the review and certifications of undelivered orders.
3. Monitor and close out as appropriate undelivered orders with minimal to no activity during the past three months, on at least a quarterly basis.
4. Modify expired orders either before the order expires or within 30 days of expiring.
5. Improve and maintain documentation to support its undelivered orders.
6. Implement controls to prevent over-obligating.

### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.





## **E. Grant Monitoring Controls**

Interior is required to monitor its grantees in accordance with the *Single Audit Act Amendments of 1996*, and the related OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular No. A-133). Interior needs to improve controls over grant monitoring. Interior did not have a complete listing of grant awards or grantees to ensure that it monitored grantees, obtained single audit reports, and issued management decisions on audit findings for one Interior component. Interior also did not consistently document its review and approval of grant system reconciliations. In addition, Interior did not obtain or follow up on past due financial status or performance reports for 35 of the 148 grantees tested at three components. Further, Interior did not obtain single audit reports within nine months of the grantee's fiscal year-end for 3 of 59 grantees tested at one component. Interior also did not issue management decisions on audit findings within six months after receipt of single audit reports or ensure that the grantees completed appropriate and timely corrective action on such findings for 14 of the 66 grantees tested at two components. Finally, Interior identified 55 grantees as having audit findings related to its grant programs when these grantees did not.

### **Recommendations**

We recommend that Interior perform the following to improve its grant monitoring process:

1. Maintain a complete and accurate listing of grantees to enable monitoring of grantees, receipt of single audit reports, and issuance of management decisions on findings.
2. Document review and approval of grant system reconciliations.
3. Follow up on financial status, performance, and single audit reports not received and consider the need to limit future grant awards until these reports are received.
4. Issue management decisions on audit findings within six months after receipt of single audit reports and verify that grantees take appropriate and timely corrective action.
5. Provide training on identifying audit findings related to Interior's programs.

### **Management Response**


Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

## **F. Controls over Indian Trust Funds**

The United States Congress has designated the Secretary of the Interior as the trustee delegate with responsibility for the financial and non-financial resources held in trust on behalf of American Indian Tribes (Tribal Trust Funds), individual Indians, and other trust funds (hereafter collectively referred to as the Indian Trust Funds). The Secretary carries out this fiduciary responsibility through the Office of the Special Trustee for American Indians (OST), Indian Affairs (IA), other Interior bureaus, and agreements with American Indian Tribes.

The Indian Trust Funds' balances include two categories: (1) Trust Funds that are held by Interior because the corpus of specific accounts is non-expendable or the funds that are held for future transfer to Indian Tribes upon satisfaction of certain conditions and thus are reflected in Interior's financial statements; (2) Trust Funds for Indian Tribes and individual Indians that are considered non-Federal accounts and thus are not reflected in Interior's financial statements but are disclosed in a note to Interior's financial statements, in accordance with the accounting standards.

Interior has invested a significant amount of resources to improve controls over Indian Trust Funds; however, we noted that Interior needs to continue its efforts to resolve historical differences and to improve



procedures and internal controls for entering and maintaining trust fund information, including recording receivables, to ensure that the Indian Trust Funds' activity and balances are recorded properly and timely, including:

1. *Trust Fund Balances*

The financial information systems and internal control procedures used in the processing of Indian Trust Fund transactions have suffered historically from a variety of system and procedural internal control weaknesses. In addition, Interior is burdened with the ongoing impact of decades of accumulated discrepancies in the accounting records. Furthermore, certain Indian Trust Fund beneficiaries do not agree with the trust fund balances and/or have requested an accounting of the Indian Trust Funds. However, Interior has invested a significant amount of resources identifying historical records, isolating and working to resolve historical differences, and preparing an accounting of the Indian Trust Fund balances and will continue with this historical accounting effort.

2. *Individual Indian Monies Subsidiary Ledger*

The control account for Individual Indian Monies (IIM) account holders represents the aggregate net balance of trust funds held on behalf of IIM account holders, house accounts, and suspense accounts as reflected in the detailed subsidiary ledger of IIM accounts (subsidiary ledger). The control account balance has historically not agreed to the sum of the balances from the subsidiary ledger, and it cannot be determined which balance, if either, is correct. The amount invested for IIM is based on the IIM control account balance. Consequently, the balance of funds invested for IIM account holders may not be correct, which in turn would affect interest earnings. As of September 30, 2008, the aggregate sum of all balances included in the subsidiary ledger exceeded the control account by approximately \$6 million. In prior years, management adjusted the subsidiary ledger eliminating the negative account balances totaling approximately \$44 million (of which approximately \$113,000 was attributed to individual Indian accounts); however, we were unable to conclude on the propriety of such adjustment.

3. *Special Deposit Accounts*

As of September 30, 2008 and 2007, there were approximately 11,000 and 13,000 special deposit accounts, respectively, reflected in the IIM subsidiary ledger with balances totaling approximately \$31 million and \$33 million, respectively. In accordance with Title 25 of the Code of Federal Regulations and as directed by IA, historically OST recorded receipts into special deposit accounts within the IIM subsidiary ledger when the recipient trust fund account was unknown at the time of receipt. When IA determines the appropriate trust fund account(s), OST transfers the amount from the special deposit account(s) to the designated trust fund account(s) in accordance with IA instructions. Beginning in fiscal year 2003, the Office of Historical Trust Accounting (OHTA) began working with OST and IA to distribute funds in special deposit accounts that were opened on or before December 31, 2002. At September 30, 2008 and 2007, the number of special deposit accounts represents historical balances that continue to require resolution and OHTA management is actively pursuing the resolution of these accounts.

4. *Undistributed Interest and Unusual Balances*

OST and/or IA have not been able to determine the proper recipients of undistributed interest related to IIM Trust Fund accounts of approximately \$3.9 million and \$3.8 million as of September 30, 2008 and 2007, respectively. Furthermore, there were Tribal Trust Funds accounts with negative cash balances totaling approximately \$721,000 as of September 30, 2008 and September 30, 2007, which continue to require resolution.



##### 5. *Entering and Maintaining Trust Fund Information*

The regional and agency offices of IA perform a critical role in the initial input and subsequent changes to the Indian Trust Funds' information disclosed by Interior. We noted weaknesses in the following areas:

###### a. *Distribution of Funds to OST*

IA did not consistently transfer funds to OST within 24 hours of receipt for 4 of the 103 IIM receipts tested. In addition, IA did not use the fastest means possible in forwarding these items to the lockbox in accordance with its policies. Finally, IA did not provide OST with disbursement requests in a timely manner for 2 of 89 Tribal disbursements tested.

###### b. *Accounts Receivable*

IA fully implemented an accounts receivable system as of May 31, 2008; however, management was unable to confirm that all historical balances had been entered into the accounting system and has identified controls over the accounting system that need to be improved. This increases the risk that amounts due to Indian Trust Funds are not identified and ultimately collected.

###### c. *Probate Backlog*

Although IA made progress in reducing the backlog, IA indicated that it had probate orders that had not been prepared, adjudicated, recorded, and/or encoded. This increases the potential for untimely distributions of income to the account holders of the Indian Trust Funds.

###### d. *Supervised and Restricted Accounts*

IA revised their internal guidance requiring a report of all active supervised and restricted accounts prior to IA performing annual reviews of supervised and restricted accounts. Although IA has revised its procedures, the current procedures do not ensure that IA completed reviews of supervised and restricted accounts within one year. This increases the potential for some active accounts to not be reviewed within one year of becoming active. In addition, IA reports of active accounts did not identify individuals with active accounts who no longer physically reside in their "home agency," resulting in the potential for some active accounts to not be reviewed on an annual basis.

### **Recommendation**

We recommend that Interior develop and implement procedures and internal controls to address the deficiencies in controls related to Indian Trust Funds.

### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with the findings because management believes that its efforts to address internal control deficiencies in the Indian Trust Funds are substantially complete and that the auditors' report did not contain findings suggesting current operational control deficiencies. We did not audit Interior's response and, accordingly, we express no opinion on it.

### **Auditors' Response to Management's Response**

As summarized above, we identified control deficiencies in the current year that adversely affect Interior's ability to initiate, authorize, record, process, and report Indian Trust Fund data reliably. Therefore, we continue to believe that the control deficiencies identified constitute a significant deficiency.



## **Compliance and Other Matters**

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed an instance of noncompliance or other matters that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and is described below.

### **G. Single Audit Act Amendments of 1996**

As discussed in the Internal Control over Financial Reporting section of this report, Interior did not perform adequate monitoring of grantees in accordance with the *Single Audit Act Amendments of 1996* and the related OMB Circular No. A-133. Interior needs to ensure that it obtains financial status, performance, and single audit reports, and issues management decisions on audit findings in a timely manner.

#### **Recommendation**

We recommend that in fiscal year 2009, Interior obtain financial status, performance, and single audit reports, and issue management decisions on audit findings in accordance with the requirements of the *Single Audit Act Amendments of 1996* and the related OMB Circular No. A-133.

#### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendation. We did not audit Interior's response and, accordingly, we express no opinion on it.

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The results of our other tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed an instance, described below, where Interior's financial management systems did not substantially comply with applicable Federal accounting standards. The results of our tests of FFMIA disclosed no instances in which Interior's financial management systems did not substantially comply with the Federal financial management systems requirements or the United States Government Standard General Ledger at the transaction level.

### **H. Federal Financial Management Improvement Act of 1996**

Interior is required to prepare its financial statements in accordance with Federal accounting standards. As discussed in the Internal Control over Financial Reporting section of this report, we identified one material weakness related to controls over unfilled customer orders that affected Interior's ability to prepare its financial statements in accordance with Federal accounting standards. As a result of these conditions, Interior's financial management systems do not substantially comply with applicable Federal accounting standards.

#### **Recommendation**

We recommend that in fiscal year 2009, Interior improve its procedures and internal controls to ensure that the financial statements are prepared in accordance with the Federal accounting standards.



### **Management Response**

Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with the findings. We did not audit Interior's response and, accordingly, we express no opinion on it.

### **Auditors' Response to Management's Response**

As summarized above, we identified a material weakness that affected Interior's ability to prepare its financial statements in accordance with Federal accounting standards. Therefore, we continue to believe that Interior's financial management systems do not substantially comply with applicable Federal accounting standards.

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We noted certain additional matters that we will report to management of Interior in a separate letter.

### **Responsibilities**

**Management's Responsibilities.** Management is responsible for the financial statements; establishing and maintaining effective internal control; and complying with laws, regulations, contracts, and grant agreements applicable to Interior.

**Auditors' Responsibilities.** Our responsibility is to express an opinion on the fiscal year 2008 and 2007 financial statements of the U.S. Department of the Interior 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 OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Interior's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also 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 audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2008 audit, we considered Interior's internal control over financial reporting by obtaining an understanding of Interior's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. 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 express an opinion on the effectiveness of Interior's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Interior's internal control over financial reporting.





As part of obtaining reasonable assurance about whether Interior's fiscal year 2008 financial statements are free of material misstatement, we performed tests of Interior's 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 the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to Interior. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

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This report is intended solely for the information and use of Interior's management, Interior's Office of Inspector General, OMB, the U.S. Government Accountability Office, 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**

November 15, 2008

## U.S DEPARTMENT OF THE INTERIOR

## Status of Prior Year Findings

September 30, 2008

<b>FY2007 Ref</b>	<b>Fiscal Year 2007 Condition</b>	<b>Status of Fiscal Year 2007 Findings</b>
<b>A</b>	General and Application Controls over Financial Management Systems	This condition has not been corrected and is repeated in fiscal year 2008. See finding B.
<b>B</b>	Controls over Accruals	This condition has been corrected.
<b>C</b>	Controls over Undelivered Orders	This condition has not been corrected and is repeated in fiscal year 2008. See finding D.
<b>D</b>	Financial Reporting Controls	This condition has been corrected.
<b>E</b>	Controls over Charge Cards	This condition has been corrected.
<b>F</b>	Controls over Grants	This condition has not been corrected and is repeated in fiscal year 2008. See finding E.
<b>G</b>	Controls over the Indian Trust Funds	This condition has not been corrected and is repeated in fiscal year 2008. See finding F.
<b>H</b>	Single Audit Act Amendments of 1996	This condition has not been corrected and is repeated in fiscal year 2008. See finding G.



THE ASSOCIATE DEPUTY SECRETARY OF THE INTERIOR  
WASHINGTON

NOV 10 2008

Memorandum

To: Earl E. Devaney  
Inspector General

KPMG LLP  
2001 M Street, NW  
Washington, D.C. 20036

From: James E. Cason *James E. Cason*  
Assistant Deputy Secretary and Chief Financial Officer

Subject: Management's Response to Independent Auditors' Report for Fiscal Year 2008  
(Assignment No. X-IN-MOA-0011-2008)

The Department has reviewed the draft report prepared by KPMG LLP and provides its response to the findings and recommendations. We are pleased that the result of the audit is an unqualified opinion on the Department Consolidated Financial Statements. The Department appreciates the recognition noted in several findings and recommendations of the improvement and progress achieved during FY 2008. We appreciate the value of the audit process and look forward to working with you to continue our marked improvement of financial management in the Department of the Interior.

I. Reportable Conditions that are considered to be Material Weaknesses

A. Controls over Unfilled Customer Orders

**Management concurs.** Interior agrees that the open unobligated amounts for unfilled customer orders at the close of the fiscal year were incorrectly removed. Although system limitations did contribute to this treatment, we feel that our components believed that the actions taken were part of a conservative management control process on estimated budget authority. Once identified, Interior took immediate action to analyze and correct these balances and believes that this issue is resolved. Management will work with all components to improve controls and procedures to ensure a standard and consistent accounting treatment for all customer orders.

## **II. Reportable Conditions that are considered to be Significant Deficiencies**

### **B. General and Application Controls over Financial Management Systems**

**Management concurs.** During FY 2008 Interior continued to improve its policies/guidance and will continue to enhance application and general controls over financial management systems during FY 2009. Although compliance with policies and guidance needs improvement, actual physical testing of the financial systems has demonstrated positive results. Interior is constantly striving to implement improvements and strengthen the related programmatic aspects of the IT security program (including awareness training) and will continue to review all aspects of the IT program for refinement, as appropriate.

### **C. Controls over Property**

**Management concurs.**

1. **General Property, Plant and Equipment.** Interior management recognizes the need to continuously evaluate and improve the methodology utilized for all facets of project and property recognition. These improvements will include the controls over individual projects, communication with internal and external stakeholders, consistent cost structures, as well as the periodic inventory and certification control procedures.
2. **Heritage Assets and Stewardship Land.** Interior agrees that the implementation related to the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS) No. 29, *Heritage Assets and Stewardship Land* created challenges due to the complex ownership surrounding Interior's stewardship responsibilities and the century plus time period spanning their acquisition. However, Interior will continue to strengthen and improve all aspects of reporting in this area.

### **D. Controls over Undelivered Orders**

**Management concurs.** Interior agrees that continuing to improve the quarterly review and certification of the undelivered orders (UDO) balances must be sustained. Both Interior and the components will work to improve the effectiveness of the review and certification process. Interior agrees that documentation modifying orders that had expired or that were extended can be improved and completed in a timely manner. This is a complex process that impacts many areas and functional disciplines across Interior. Management is committed to bringing each component together to address these concerns in an integrated and consistent basis.

**E. Grant Monitoring Controls**

**Management concurs.** Interior will continue to work with the components to ensure that all necessary reports are obtained and that management decisions on audit findings are issued in a timely and compliant manner. Management will continue to improve the procedures in place to determine if any modifications would yield a more timely and effective treatment.

**F. Controls over the Indian Trust Funds**

**Management does not concur.** Upon careful consideration of the significant corrective action progress, procedures, and internal controls that have been implemented, we continue to believe that the efforts to address the deficiencies in controls related to Indian Trust Funds are substantially complete and provide for reliable information. This position is based on the results of extensive internal controls testing which revealed that controls are in place and operating effectively; therefore, there is no adverse impact on the current financial internal control environment. We believe that there is a high degree of accuracy in the Trust Fund account balances, that the accounting and asset management resource systems are reliable, and that monies are being properly and timely accounted for.

The concerns regarding historical differences do not imply that a current control deficiency exists. Current system design and operations allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. Therefore, these four historical differences do not fit the description of a current control deficiency and should not continue as a barrier to recognition of the improved control environment. The auditors' report did not contain findings suggesting current operational control deficiencies.

**G. Single Audit Act Amendments of 1996**

**Management concurs.** During FY 2009 Interior will work to obtain Single Audit, Financial Status, Grant Performance, and Annual Reports in a timely manner. Enhancements will continue to be made to the business process for complying with the Single Audit Act.

**H. Federal Financial Management Improvement Act of 1996**

**Management does not concur.** Interior does not agree with the finding as it relates to applicable Federal accounting standards.

In closing, aggressive correction action plans will be established for each of these findings which will be monitored/tracked through completion. The Department is committed to improving these and all other elements of financial management.