



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

## **MANAGEMENT ADVISORY**

REGARDING OFFICE OF INSPECTOR GENERAL'S  
REVIEW OF THE INTERNAL CONTROLS FOR THE  
OFFICE OF SPECIAL TRUSTEE FOR AMERICAN INDIANS

**This report contains information that has been redacted pursuant to 5 U.S.C. §§ 552(b)(5) and (b)(6) of the Freedom of Information Act.**

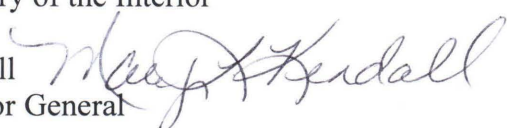


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DEC 08 2011

Memorandum

To: David J. Hayes  
Deputy Secretary of the Interior

From: Mary L. Kendall   
Acting Inspector General

Subject: Management Advisory Regarding OIG Review of OST Internal Controls

The principal deputy special trustee's (PDST) draft memorandum titled "FY 2011 Annual Assurance Statement on Internal Controls" made several assertions concerning insufficient internal controls in the Office of the Special Trustee for American Indians (OST). In October, the Department requested that the Office of Inspector General (OIG) conduct a review of six assertions related to OST's Office of Trust Funds Investments (OTFI). In our audit report on the relevant internal controls (report number ZZ-EV-OST-0001-2012), we concluded that these six assertions were invalid.

During our fieldwork, however, we identified several additional potential issues. Because the issues were outside the scope of our audit, we did not fully review them in accordance with generally accepted Government accounting standards. Nevertheless, these matters point to possible future internal control problems if they are not fully reviewed and addressed. We are bringing these issues to your attention so that you can look into them further and take any necessary action.

**Changes to OTFI Policy and Internal Controls**

The PDST has authorized the removal of several key internal controls from the OTFI policy and desk operating procedure (DOP), both signed on September 26, 2011. (These controls were still in place, however, during FY 2011, the timeframe under review in our audit.) Specifically, he authorized these changes—

- The revised OTFI policy removed the requirement to purchase only securities with a rating of AA or better. The policy now does not require a security to be rated in order to be purchased. OST limits investment purchases to "securities that are issued or guaranteed by the U.S. Government and its agencies or instrumentalities." One of the world's largest and most liquid markets is comprised of debt securities issued by the U.S. Treasury, U.S. Government agencies, and U.S. Government sponsored enterprises (GSEs), which are also sometimes referred to as Federal agencies or Federally sponsored agencies. U.S. Treasury securities are considered to have the bond market's lowest risk because they are guaranteed by the U.S. Government's "full faith and credit." Unless

explicitly stated, however, GSE debt securities are not guaranteed by the Federal Government. In general, debt securities issued by GSEs are considered to be of high credit quality; nevertheless, the lack of a Government guarantee makes it even more important to know the credit rating of securities before purchasing them.

- The revised DOP removed the requirement to obtain approval from the director of OTFI *before* a purchase is finalized. Now the policy simply requires the director to review and approve the purchase *after* it is completed. Therefore, it is possible for an inappropriate security to be purchased.
- The revised OTFI policy removed the requirements to maintain a \$10 million balance in cash or Treasury “overnighter” and to limit the percentage of thinly traded securities for the Individual Indian Money portfolio. If a sufficient balance is not maintained in cash, payouts to account holders could force OST to sell securities at a loss. In addition, a high percentage of thinly traded securities could prevent OST from promptly selling securities to cover unexpected payouts.
- The revised OTFI policy has restricted membership in the Investment Management Committee<sup>1</sup> to the OTFI staff and the PDST. Even fiduciary trust officers, who work directly with the account holders to determine portfolio objectives, are not included. Such restricted membership, coupled with closed meetings with no access to meeting notes, limits the information available to investment officers as they determine whether the portfolio is structured to meet the needs of the account holders. The new committee can also make any changes to the investment policy based on a vote; essentially, because OTFI makes up the committee, OTFI can now write or revise its own policies without impartial review and comment.
- The revised DOP removed the requirement to obtain three bids to purchase a security on the secondary market. Newly issued (or primary market) securities did not, and should not, require three bids because these securities are usually sold at (or close to) full face value. Securities on the secondary market, however, include a markup consisting of the dealer’s costs and profit. Each firm establishes its own price (within regulatory guidelines) which will vary depending on the type of security, size of the transaction, and the services the broker provides; therefore, the prudent customer should compare several prices before making a purchase.
- The revised DOP removed the requirement to complete the Bloomberg Global Product Certification Program. Certification ensures OTFI investment officers fully understand the available features of the Bloomberg investment analysis product and have all the information they need to complete the best investment transactions for the account holders.

We also noted that a section describing the Secretary’s and OST’s responsibilities has been added to the OTFI policy, but the responsibilities are incomplete. Specifically, the policy states that the “Secretary of Interior is responsible for the investment of all Indian trust funds” and OST “is responsible for the investment management of tribal monies, Individual Indian Monies, and special funds entrusted to the Secretary of the Interior.” We are concerned that, by focusing only on the investment aspect of the trust responsibilities and not accounting for and

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<sup>1</sup> The Investment Management Committee was previously called the Portfolio Review Committee.

reporting fund balances, controlling account receipts and disbursements, or performing account reconciliations, the PDST may not be giving sufficient emphasis to the other duties of the Secretary and OST.

Further, the updates to both the OTFI policy and DOP did not go through the required evaluation process. OST has a standard procedure, implemented because of the *Cobell* lawsuit, defining how policies and procedures must be drafted, reviewed, updated, and released. Proposed policies are reviewed by the deputy trustees and other senior leadership to identify and correct any unintended consequences the changes may have on other OST components or divisions. The procedure also calls for the release of new policies three times a year and includes training to ensure all OST staff members are aware of and understand any new requirements. The new policy and DOP did not go through either the review or the release processes. Therefore, the changes described above could have unintended consequences in components outside OTFI.

### **Communication Breakdowns**

In addition to the limited communication surrounding the policy and DOP updates, we identified other indicators of significant communication problems within OST. These problems appear to be centered around the PDST. The deputy trustee for trust accountability qualified her statement of assurance letter (SAL) based on these issues, stating: “Lack of communication from the Office of the Principal Deputy Special Trustee and the transfer, administrative detail and elimination of key support staff with little or no notice impacted the Office's ability to meet performance goals and program objectives.” As an example, the deputy trustee for trust services was unaware that the PDST had changed the Trust Services SAL from unqualified to qualified until we asked him questions related to the qualification as part of our audit.

Without open interaction between management and staff, miscommunications are difficult to identify and correct. The PDST, however, has not granted his deputy trustees’ numerous requests for meetings to clarify his directions and requests. As a result, miscommunications often go undetected or unaddressed. For example, the associate principal deputy special trustee (APDST) told us that after the erroneous purchase of an unrated security in June 2011, the PDST emailed her questions about the incident. In his email, the PDST referred to a “system.” While the APDST interpreted *system* to mean a system of controls, the PDST used the word to mean a computer system. No one in OST understood that the PDST and the APDST were referring to two different types of system until we uncovered the misunderstanding during our review.

To further complicate communication, the PDST is also bypassing his deputy trustees and directly managing his section directors. While the directors know their own areas, they are not always fully informed of the impact their work may have on other areas. By not communicating with senior managers who understand the various interdependencies and conflicts among offices, it appears that the PDST is making decisions without having all the necessary information or knowing all potential consequences.

The PDST has been changing the reporting structure of OST by moving offices out from under the deputy trustees and having the offices report directly to him. By doing so, the PDST risks stove piping the organization and increasing communication problems. This is especially true when work in one area affects work in another area.

The PDST is also moving offices between organizational elements. For example, he moved the Risk Management group from Trust Accountability to the Office of Trust Review and Audit (OTRA). While the PDST indicated he moved Risk Management to ensure the independence of their work, he has potentially compromised the ability of OTRA to conduct reviews in accordance with generally accepted government auditing standards (GAGAS). GAGAS specifically precludes an audit organization from auditing its own work. Because the Risk Management group works with managers to define the internal controls for all of OST, OTRA would be prevented from auditing OST's internal controls because it would be instrumental in defining the controls.

### **Incomplete or Inaccurate Information Used in Decision Making**

The PDST is making decisions based on incomplete, inaccurate, and sometimes misleading information. For example, the PDST referenced both OTRA's final November 1, 2011 report, "Audit of Internal Controls in the Office of Trust Funds Investments (OTFI)," and the draft iStat report when talking with us about his concerns related to internal controls and TFAS. Both of these reports, however, contained inaccuracies.

During our audit fieldwork, we examined OTRA's audit report as well as selected supporting work papers, but the report's quality was such that we were unable to rely on it for our audit. For example, we found—

- *Factual inaccuracies.* The work papers we reviewed support that the actual value of the FY 2011 investment transactions was about \$417 million. The report, however, stated that the total value of the FY 2011 investment transactions was just over \$441 million—a major discrepancy.
- *Misleading information.* Although OTRA stated that "OTFI lacks internal controls which would be in place in a typical industry standard trust and custody operation," the work papers indicated that the PDST actually defined the "typical industry standard" for OTRA. The report stated OTRA followed GAGAS standards, but the office did not conduct an independent assessment to determine whether the PDST's input was correct.
- *Questionable work quality.* SEI referred to an OST employee in its explanation of events surrounding an erroneous full call made in FY 2011. While researching the issue, however, OTRA made only a superficial effort to locate the employee, who had changed her last name when she got married. OTRA reviewed OST's employee directory and, when the individual was not listed under her maiden name, concluded that she was not an OST employee. OTRA made this conclusion even though it had actually interviewed the individual during the course of its review.

During our audit fieldwork, we also examined the draft “iStat Report Office of the Special Trustee (OST) Trust Financial Accounting System (TFAS)” dated September 20, 2011. The draft report contained information that was confusing and that appeared to be beyond the scope of a review of the system. Based on interviews with the iStat team, we were told that the iStat report was being updated to correct misleading information about TFAS. Rather than waiting for the final report, however, the PDST has been using the draft iStat report, which states that “improvement is needed,” to make management decisions regarding the need he perceives for an order management system (OMS) for OTFI and a new trust and custody provider.

### **Inappropriate Contracting Actions**

During the course of the review, we received several allegations of inappropriate contracting actions and pending actions. Numerous sources, from both inside and outside of OST, alleged the following—

- The PDST is interested in purchasing and implementing an OMS for OTFI. While OST talked with its contract office about the feasibility of receiving a demonstration of the Bloomberg Asset and Investment Manager (AIM) system, OST’s contact with Bloomberg does not appear to have been limited to a demonstration. The director of OTFI provided us with documentation he obtained from Bloomberg that not only outlines the AIM system’s capabilities, but also identifies how the system would interface with TFAS as well as the cost of implementing it and designing the interface. Such extensive contact with a company without going through formal contracting channels could lead to future allegations of a lack of required competition, unfair advantage, and sole-source contracting.
- The contracting officer has concerns about a request for bid (RFB) the PDST submitted in an attempt to contract with a consultant who would evaluate the management of the trust funds, with an emphasis on trust fund investment operations, processes, and systems. The RFB’s statement of work (SOW) includes assisting with the implementation of a new system to correct deficiencies; however, there are no deficiencies identified that would require a new system. In addition, the PDST has directed the contracting officer not to discuss the SOW or the RFB with program personnel / technical experts. The contracting officer has also been told that the program personnel / technical experts will not be included on the technical panel that will evaluate any bids received. Without these experts involved in the SOW writing and bid evaluation processes, the government may not obtain the necessary services or receive full value for the money it spends.

## **Recommendation**

OST processes a limited number of investment transactions per year. Therefore, before spending time and money to evaluate an OMS, OST should do a complete review of TFAS. The review should identify all available features and determine which of them (such as the automated approval feature) should be enabled and which should be disabled.

## **Conclusion**

OST fulfills a vital function within DOI, satisfying the Secretary's responsibilities to properly invest, account for, and manage Indian funds. The concerns we identified during our audit fieldwork have the potential to create difficulties for DOI; they could weaken the foundation of trust between the Secretary's office and the tribes that depend on the proper stewardship of their assets.

We have provided this information for your evaluation and action, as you determine appropriate, to help prevent serious problems in the future. If you have any questions, please do not hesitate to call me at (202) 208-5745.

cc:     DOI Chief of Staff  
          Assistant Secretary for Policy, Management and Budget  
          Deputy Assistant Secretary for Budget, Finance, Performance, and Acquisitions