



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

NOV 15 2012

Memorandum

To: Secretary Salazar

From: Mary L. Kendall
Deputy Inspector General

Bruce Deplewski for Mary Kendall

Subject: Independent Auditors' Report on the U.S. Department of the Interior Financial Statements for Fiscal Years 2012 and 2011
Report No. X-IN-MOA-0002-2012

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) 2012 and 2011. 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 2012 and FY 2011 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. 07-04, "Audit Requirements for Federal Financial Statements."

Results of Independent Audit

In its audit report, KPMG issued an unqualified opinion on the DOI financial statements. KPMG identified three significant deficiencies in internal controls over financial reporting. In addition, KPMG identified one instance in which DOI did not comply with laws and regulations, specifically the Single Audit Act Amendments 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, Regulation and 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;
- coordinated periodic meetings with DOI management 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
Suite 12000
1801 K Street, NW
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Independent Auditors' Report

Secretary and Acting 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, 2012 and 2011, 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 2012 audit, we also considered Interior's internal control 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, 2012 and 2011, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our Opinion on the Financial Statements, Interior changed its presentation for reporting the Statement of Budgetary Resources in fiscal year 2012.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies that we consider to be significant deficiencies, as defined in the Internal Control Over Financial Reporting section of this report, as follows:

- A. Information Technology Controls Over Financial Management Systems
- B. Controls Over Future Operating Lease Payments
- C. Grant Monitoring Controls

We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined in the Internal Control Over Financial Reporting section of this report.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instance 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*, as amended.



D. Single Audit Act Amendments of 1996

The following sections discuss our opinion on Interior's financial statements; our consideration of Interior's internal control 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, 2012 and 2011, 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, 2012 and 2011, 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 18 to the financial statements, Interior changed its presentation for reporting the Statement of Budgetary Resources in fiscal year 2012, based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*. As a result, Interior's Statement of Budgetary Resources for fiscal year 2011 has been adjusted to conform to the current year presentation.

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.

The information in the Message From the Secretary, About This Report, Message From the Chief Financial Officer, and Other Accompanying Information sections is presented for the 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 audits of the basic



financial statements, and accordingly, we do not express an opinion or provide any assurance on the information.

Internal Control Over Financial Reporting

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2012 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting described below that we consider to be significant deficiencies in internal control over financial reporting. 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.

A. Information Technology 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 should continue improving the information technology controls over its financial management systems, as discussed below.

1. Access Controls

Access controls protect financial and sensitive information from unauthorized modification, disclosure, and loss; however, Interior did not fully establish controls to prevent and detect unauthorized access. Interior did not consistently document review and approval of user access and recertify user access for three applications, did not consistently remove terminated users' access for four applications timely, and did not establish controls over contractor access to applications. In addition, one component did not complete an effective review of restrictions of physical access rights to data.



2. Configuration Management

Configuration management controls ensure that only authorized programs and modifications are implemented. Interior did not consistently test and approve changes prior to implementation for one application. In addition, Interior has not fully segregated responsibilities for developing, testing and migrating changes at one component, did not fully segregate user roles and responsibilities for one application, and did not configure one application to segregate responsibilities for the entering, reviewing, and approving of journal entries.

3. Security Program

A security program is the foundation of an entity's security control structure. Interior did not fully conduct an assessment of security controls documented in one of its system security plans.

Recommendations

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

1. Document review and approval of user access, recertify user access, remove access for terminated users, establish controls over contractor access to applications, and periodically review and approve physical access rights.
2. Test and approve software changes prior to implementation and fully segregate responsibilities for software changes, user roles, and journal entries.
3. Conduct an assessment of security controls as part of the security program.

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.

B. Controls Over Future Operating Lease Payments

Interior is required to disclose future operating lease payments in accordance with the accounting standards. In fiscal year 2012, Interior issued guidance for identifying and reporting future operating lease payments as required by the accounting standards; however, Interior's components did not consistently follow the guidance. Specifically, four Interior components did not report all future operating lease payments and another Interior component did not properly calculate its future operating lease payments. As a result, the total future operating lease payments were understated by approximately \$301 million. In response to our observations, Interior analyzed and adjusted the future operating lease payments disclosure.



Recommendations

We recommend that Interior improve its controls over future operating lease payments as follows:

1. Review the future operating lease payment guidance with the individuals responsible for preparing the future operating lease payment schedules and determine if such guidance should be clarified or include additional monitoring procedures.
2. Require a second individual to verify the mathematical accuracy of the future operating lease payment schedules.
3. Require the Office of Financial Management to review each component's future operating lease payment schedule for consistency and compliance with Interior's guidance.

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.

C. Grant Monitoring Controls

Interior is required to monitor its grantees in accordance with the *Single Audit Act Amendments of 1996*, the related OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular No. A-133), and other laws. Interior did not clearly communicate grant monitoring responsibilities. As a result, Interior did not obtain single audit reports within nine months of the grantee's fiscal year-end for 19 of 58 grantees tested and did not issue management decisions on audit findings within six months after receipt of single audit reports for 1 of the 58 grantees tested. Interior also did not obtain or follow up on past due financial, narrative, and progress reports for 16 of the 50 grants tested.

Recommendations

We recommend that Interior improve its grant monitoring process as follows:

1. Continue to communicate the updated grant monitoring policies and procedures to those responsible for implementing such policies and procedures.
2. Develop a grant monitoring process that identifies grantees requiring single audit reports, grantees missing single audit reports, and single audit reports needing management decisions on audit findings.
3. Periodically query the Federal Audit Clearinghouse to identify missing single audit reports and single audit reports needing management decisions on audit findings for all grants recorded in Interior's accounting systems.
4. Require component leadership to 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. Follow up on single audit, financial, narrative, and progress reports not received and consider the need to limit future grant awards until these reports are received.



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.

Exhibit I presents the status of prior year significant deficiencies and material weakness.

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 one instance of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and is described below.

D. *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*, the related OMB Circular No. A-133, and other laws. Interior did not consistently obtain and review financial, narrative, progress, and single audit reports, issue management decisions on audit findings, and monitor grantees timely.

Recommendation

We recommend that in fiscal year 2013, Interior obtain and review financial, narrative, progress, and single audit reports, issue management decisions on audit findings, and monitor grantees to ensure compliance with the *Single Audit Act Amendments of 1996*, the related OMB Circular No. A-133, and other laws.

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.

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 no instances in which Interior's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.



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 over financial reporting; 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 2012 and 2011 financial statements of 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 2012 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, but not for the purpose of expressing 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. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.



As part of obtaining reasonable assurance about whether Interior's fiscal year 2012 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.

Interior's written response to the findings identified in our audit, and presented as a separate attachment to this report, was not subjected to the auditing procedures applied in the audit of Interior's financial statements and, accordingly, we express no opinion on it.

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, 2012

Exhibit I**U.S DEPARTMENT OF THE INTERIOR**

Status of Prior Year Findings

September 30, 2012

FY2011 Ref	Fiscal Year 2011 Finding	Status of Fiscal Year 2011 Findings
A	Controls over Contingencies	Corrective actions implemented.
B	Information Technology Controls over Financial Management Systems	This condition has not been corrected and is repeated in fiscal year 2012. See finding A.
C	Controls over Undelivered Orders	Corrective actions implemented.
D	Grant Monitoring Controls	This condition has not been corrected and is repeated in fiscal year 2012. See finding C.
E	<i>Single Audit Act Amendments of 1996</i>	This condition has not been corrected and is repeated in fiscal year 2012. See finding D.
F	<i>Federal Financial Management Improvement Act of 1996</i>	Corrective actions implemented.



United States Department of the Interior

OFFICE OF THE SECRETARY

Washington, DC 20240

NOV 14 2012

Memorandum

To: Mary L. Kendall
Acting Inspector General

KPMG LLP
2001 M Street, NW
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From: Rhea Suh 
Assistant Secretary – Policy, Management and Budget and
Chief Financial Officer

Subject: Management's Response to Independent Auditors' Report for Fiscal Year 2012
(Assignment No. X-IN-MOA-0002-2012)

The Department of the Interior (Department) has reviewed the draft Auditors' Report prepared by KPMG LLP. We are pleased that the result of the audit is an unqualified opinion on the Department's Consolidated Financial Statements and that no material weaknesses were found. The Department appreciates the recognition noted of the progress we have achieved during Fiscal Year (FY) 2012 in further improving our financial management. We also appreciate the recommendations and notes from the auditors. We look forward to working with you to continue improving financial management in the Department. Our response to the findings and recommendations follow.

INTERNAL CONTROL OVER FINANCIAL REPORTING

A. Information Technology Controls over Financial Management Systems

Management concurs. During FY 2012, Interior continued to improve its information technology controls including policies and guidance. Significant gains have been made and will continue with deployment of the Financial and Business Management System (FBMS) and the termination of legacy systems. Through FBMS deployments and other means, in FY 2013, we will continue to enhance application and general controls over financial management systems with a specific focus on the areas of access controls, configuration management, and service continuity. We strive to improve and strengthen the related programmatic aspects of Information Technology (IT) security programs (including awareness training) and will continue to review all aspects of the IT program for refinement. We are in the process of implementing reforms including the consolidation of information technology infrastructure, management, and oversight that will improve the efficiency and effectiveness of IT services and our ability to ensure the implementation of policies and controls.

B. Controls Over Future Operating Lease Payments

Management concurs. Management will convene a working group to review the current lease policy to determine if additional policy or clarification is needed in order to assure consistency in the implementation of the policy. In addition, management will consider what approval and monitoring options should be employed to further ensure that our future lease payment disclosures are accurate.

C. Grant Monitoring Controls

Management concurs. Management will continue to improve grantee communication and outreach procedures to yield a timelier and more effective single audit recipient and follow-up process. The Department is currently developing a process that compares a listing of grantees from FBMS to listings of Department grantees and their audit reports in the Single Audit Clearing House. In addition, we are exploring methods for reporting/monitoring the status of grantee audit reports and the status of management's decisions on audit findings in the grantee audit reports. 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. In FY 2013, Interior will also evaluate its grant monitoring policies and processes to ensure that grant monitoring roles and responsibilities are properly defined and communicated.

COMPLIANCE AND OTHER MATTERS

D. Single Audit Act Amendments of 1996

Management concurs. As noted in the Grant Monitoring Controls section above, the Department will work to obtain single audit reports and management decisions in a timely manner. Enhancements will continue to be made to the business process for complying with the *Single Audit Act Amendments of 1996*.

In closing, I would like to thank your offices for their contribution to a strong and ever improving internal control environment with the Department of the Interior. We are committed to the continuous improvement of our financial management activities.