



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

SELECTED INTERNAL CONTROLS IN THE OFFICE OF SPECIAL TRUSTEE FOR AMERICAN INDIANS



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

DEC 08 2011

Memorandum

To: David J. Hayes
Deputy Secretary of the Interior

From: Mary L. Kendall *Mary L. Kendall*
Acting Inspector General

Subject: Audit of Selected Internal Controls in the Office of Special Trustee for American Indians
Report No. ZZ-EV-OST-0001-2012

This memorandum transmits our report detailing the results of our audit of six internal control weaknesses that had been asserted to exist in the Office of Trust Fund Investments (OTFI), a component of the Office of Special Trustee for American Indians (OST). The principal deputy special trustee (PDST) made these assertions in his draft memorandum titled "FY 2011 Annual Assurance Statement on Internal Controls."

The PDST asserted that OST had insufficient internal controls to ensure that only authorized personnel initiated and approved investment transactions. He also stated that OST did not have sufficient internal controls because the office lacks an automated order management system. The fact that the same investment contractor provided two distinct services was also a concern for the PDST. Finally, the PDST asserted that three transactions from FY 2010 did not identify the rating of the securities that had been traded, which did not comply with OST policies in place at that time.

When we examined the related internal controls, however, we could not substantiate the PDST's assertions. We found that the internal controls for initiating and approving transactions were adequate. The internal controls the PDST described as being insufficient without an order management system were also sufficient. We could not confirm any weaknesses resulting from the same contractor using two systems to perform two separate functions, and we could not substantiate the assertion about the three securities because the securities actually had AAA ratings.

If you have any questions about this report, please do not hesitate to contact 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

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Results in Brief

At the request of the U.S. Department of the Interior, we evaluated six internal control weaknesses that had been asserted to exist in the Office of Trust Fund Investments (OTFI), a component of the Office of Special Trustee for American Indians (OST). The weaknesses were asserted by the principal deputy special trustee (PDST) in his draft memorandum titled “FY 2011 Annual Assurance Statement on Internal Controls.” The PDST’s feeling that internal controls over OTFI were insufficient was based on two investment errors that occurred during fiscal year (FY) 2011. Although both mistakes were caught, the PDST qualified the draft assurance statement due to his concerns about the controls.

The PDST asserted that OST had insufficient internal controls to ensure that only authorized personnel initiated and approved investment transactions (assertions 1 and 2). He also stated that OST did not have sufficient internal controls because the office lacks an automated order management system (assertions 3 and 4). The fact that the same investment contractor provided two distinct services was also a concern for the PDST (assertion 5). Finally, the PDST asserted that three transactions from FY 2010 did not identify the rating of the securities that had been traded, which did not comply with OST policies in place at that time (assertion 6).

When we examined the related internal controls, however, we were unable to validate the PDST’s assertions. We found that the internal controls for initiating and approving transactions were adequate. The internal controls the PDST described as being insufficient without an order management system were also sufficient. We could not confirm any weaknesses resulting from the same contractor using two systems to perform two separate functions, and we could not substantiate the assertion about the three securities because the securities actually had AAA ratings.

Introduction

Objective

Our objective was to assess the validity of six internal control weaknesses asserted to exist in the Office of Trust Funds Investments (OTFI). These weaknesses were asserted by the principal deputy special trustee (PDST) in the Office of Special Trustee for American Indians (OST) draft memorandum titled, “FY 2011 Annual Assurance Statement on Internal Controls.”

Background

Established by the American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412), OST was created to improve the accountability and management of Indian funds held in trust by the Federal Government. As trustee, the Department of the Interior (DOI) is responsible for managing both tribal trust funds and Individual Indian Money (IIM) accounts, as well as resources that generate income for those accounts. Each year, OTFI enters into approximately 170 trades involving IIM and tribal accounts.

In order to meet the requirements of Office of Management and Budget Circular A-123, DOI requires OST to issue an annual assurance letter on internal controls. This letter provides assurance to DOI that OST’s internal controls—operations, policies, and procedures that managers use to achieve program goals and safeguard program integrity—are in place and sufficient. Internal controls are designed to provide reasonable (but not absolute) assurance that programs achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Weaknesses or deficiencies in internal controls compromise program effectiveness and can lead to fraud, waste, and mismanagement.

The PDST felt that the internal controls over OTFI were insufficient due to two incidents that occurred in fiscal year (FY) 2011. In the first incident, OTFI erroneously purchased an unrated security. In the second, the trust services system contractor, SEI Investments, Inc., erroneously posted a full call that should have been a partial call.¹ Although both errors were caught, in October 2011 the PDST provided the Office of Policy Management and Budget a “qualified” draft assurance letter based on his concerns over the internal controls.

Because the effectiveness of these internal controls has a direct impact on the scope of work for DOI’s annual financial statement audits, DOI asked us on October 20 to determine the validity of the PDST’s assertions related to six OTFI controls.

¹ Under certain circumstances, a bond issuer can *call*, or redeem, a bond before it matures. The issuer can redeem either the full value of the bond, which is known as a *full call*, or a percentage of the value, or *partial call*.

Findings

At DOI's request, we evaluated six of the PDST's assertions related to the sufficiency of OTFI internal controls. We could not substantiate his assertions.

Assertions 1 and 2: Investment Transactions

The PDST asserted that OST had insufficient internal controls to ensure only authorized personnel initiated and approved investment transactions.² The PDST gave two reasons for stating the controls were insufficient: (1) OTFI investment officers phone the brokers/dealers directly to place an investment order instead of placing orders through an automated order management system (OMS), and (2) there is no automated approval of transactions.

While these conditions are true, OST has compensating controls in place to prevent unauthorized personnel from initiating or approving transactions. Based on our interviews with key personnel, document reviews, and an examination of 30 investment transactions completed in FY 2011, we determined that the internal controls for initiating and approving investment transactions were adequate. In particular, we found that—

- The OTFI investment officer must use an authorized broker/dealer from OST's official list, which is reviewed and updated annually. This control helps ensure brokers/dealers are familiar with the investment officers and thus prevent an unauthorized person from initiating an investment.
- The approved brokers/dealers also have a letter listing the authorized OTFI investment officers who may initiate transactions. This control helps prevent unauthorized individuals from initiating an investment. Moreover, OST notifies the brokers/dealers that the investment officers can only purchase "securities that are issued or guaranteed by the U.S. Government and its agencies or instrumentalities." As a result, this control should keep even authorized OTFI investment officers from purchasing an inappropriate security.
- All investment transactions must be entered in the investment module of OST's Trust Funds Accounting System (TFAS) for finalization. Until the transaction is entered in TFAS, OST has not actually bought or sold the investment. Only the five OTFI employees have access to the investment module. This control ensures that only individuals authorized by OST to initiate an investment can obligate OST and finalize a transaction.

² Assertion 1 stated: "...Investments had insufficient internal controls to insure that only authorized personnel initiated investment transactions."

Assertion 2 stated: "...Investments had insufficient internal controls to insure that only authorized personnel approved investment transactions."

- SEI Investments automatically compares TFAS and broker/dealer entries against each other to make sure all the details match. If SEI identifies a discrepancy, it will hold the deal and research the matter further. All discrepancies must be corrected before the transaction can be completed. This control prevents a single individual from being able to initiate a transaction.
- Since July, the director manually reviews transactions daily. Settlements occur at least 1 day after the transaction, giving the director time to cancel the transaction if he identifies a problem during his review. In the 30 sample transactions we examined, an average of 14 days elapsed from agreement to settlement. This control helps ensure that only authorized transactions are confirmed.

Although these internal controls are currently sufficient, OST could strengthen its approval controls by enabling an existing feature in TFAS that would require an automated approval to complete an investment transaction. In August 2011, the associate PDST requested this feature be enabled, but she was overruled by the PDST.

Assertions 3 and 4: Order Management System

The PDST asserted that OST had insufficient internal controls because it lacked an OMS.³ An OMS, however, is not an internal control in and of itself; it is a tool for buying and selling investments. Therefore, the lack of an OMS is not an internal control weakness.

Based on a closer review of the PDST's assertions, we determined the underlying internal controls he described as being insufficient without an OMS were actually in place:

- *Compliance.* A compliance check reviews the investment transaction against a set of standards to ensure the transaction meets those standards. For example, a compliance check may validate that the security in the transaction has the required rating. A separate, automated compliance check is not necessary because the director of OTFI manually reviews transactions for compliance with policy.

³ Assertion 3 stated: "...Investments had insufficient internal controls to insure that only authorized personnel initiate, approve and execute transactions independently with the oversight of a compliance function using an order management system or other system that provides for the ability to perform real time audits for trading approvals, third party price comparison to validate orders, compliance with all applicable policies and laws and the safeguarding of assets and investment transaction are conducted by law by an individual dispassionate individual from a separate reporting authority from the portfolio manager and supervisor."

Assertion 4 stated: "...Investments had insufficient internal controls since an order management system, trust and custody and accounting systems fails to provide through put processing of transactions, fails to provide adequate separation of duties, fails to provide real time audit information that illustrates compliance with all applicable laws and policies and controls to initiate and complete transactions."

- *Audit Logging.* Audit logging refers to a computer system logging all activity on the system so that a third party (such as an auditor) can audit the log as the activity happens to ensure compliance with policies. TFAS already does this.
- *Third-Party Price Comparison.* A third-party price comparison is a comparison of the actual purchase or sale price against prices available from other brokers/dealers. The policy in effect during FY 2011 required OFTI investment officers to obtain three bids for each security purchase or sale; therefore, a price comparison control is already in place.

Assertion 5: One Service Provider

The PDST asserted that OST had insufficient internal controls because SEI provided both custody and accounting services.⁴ This means that the custody service provider's records cannot be reconciled to an accounting system provider's record.⁵ The use of one provider for both custody and accounting services, however, is not an internal control weakness in and of itself.

SEI uses two separate systems, one for custody of assets and the other for accounting. Custody is maintained by a subsidiary of SEI, while accounting records are maintained by SEI. In September 2011, Pricewaterhouse Coopers LLP completed a Statement on Standard for Attestation Engagements (SSAE) 16 review on both systems. The SSAE 16 review compared the internal controls of the two systems against SEI management descriptions of the systems' design and control objectives during a specified period. The review did not identify any deficiencies with the systems.

Assertion 6: Unrated Securities

The PDST asserted that OST had insufficient internal controls because three transactions from FY 2010 did not identify the rating of the securities being traded.⁶ This assertion is misleading for two reasons. First, OST's investment policy required only that securities be rated AA or better, not that the rating be specifically identified. Second, the wording of the assertion implies that these three transactions were unrated. All three transactions, however, were Fannie Mae securities and all Fannie Mae securities have AA+ Standards and Poor ratings. Therefore, we could not substantiate this assertion.

⁴ Assertion 5 states: "...Trust Services fails to utilize a trust and custody service provider to provide, custody, asset servicing and safekeeping of assets. Currently Trust Services utilizes SEI Investments Trust 3000 product as a custodian that does not provide for Trustee Services to maintain a separate record of assets to reconcile the OST's transactions."

⁵ A custody provider maintains physical custody of an asset, either in an electronic format or as a hard copy asset. In OST's case, the asset would be the security purchased.

⁶ Assertion 6 states: "Investments had identified a weakness on the Statement of Assurance on Internal Controls over Financial Reporting as of 6/30/2011 because an unrated security was purchased. During an OTRA review of 18 additional transactions, 3 transactions did not identify the ratings for the securities as required by OST investment policies."

Conclusion

The PDST made multiple assertions concerning the effectiveness of the internal controls used by OTFI to prevent or detect investment issues. Based on the reasons we outline in this report, we could not substantiate his assertions.

Appendix I: Scope and Methodology

Scope

Our scope was limited to the six assertions in the annual assurance statement related to internal controls in effect during FY 2011. Our audit was not intended to provide an opinion on OTFI's internal controls or the accuracy of their financial records. In addition, our audit was limited to the assertions in the annual assurance statement related to internal controls over investments at OTFI, and we express no conclusions or opinions regarding any of the other assertions in the memorandum.

We conducted this audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Methodology

We summarized the assertions in the draft “Annual Assurance Statement on Internal Controls” for readability. We have, however, included the exact text of each assertion in a footnote for accuracy.

In order to achieve our audit objective, we—

- Interviewed appropriate OST personnel at all levels of the organization;
- Interviewed appropriate NBC personnel responsible for contracting for OST goods and services;
- Interviewed appropriate OCIO personnel responsible for completing the TFAS iStat review;
- Identified and reviewed laws, regulations, policies and procedures related to OST and its investment process, including policies in place at SEI, an OST contractor;
- Identified and reviewed reports related to OST controls, including the system security plan for TFAS, draft iStat for TFAS, Statement of Auditing Standards 70 review of SEI, and SSAE 16 review for SEI;
- Gained an understanding of investments and the investment process;
- Reviewed the Office of Trust Review and Audit (OTRA) final report, “Audit of Internal Controls in the Office of Trust Funds Investments (OTFI),” dated November 1, 2011, as well as 24 supporting work papers;

- Selected and reviewed a judgmental sample of 30 investment transactions completed in FY 2011 and validated compliance with policies and procedures;
- Selected and reviewed a judgmental sample of 30 system controls in TFAS and validated they were operational;
- Selected and reviewed a judgmental sample of two monthly statements of Treasury transactions and validated they matched supporting documentation;
- Selected and reviewed 12 daily cash reconciliations and validated all differences were identified and corrected;
- Selected and reviewed 23 daily investment exception monitoring reports and validated the par value of securities agreed with the value of the securities held by SEI (the security custodian); and
- Conducted other work that we considered necessary to answer the objective.

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