Inspector General Audit Opinion

E-IN-MOA-001-99-M

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

APR 19 1999

AUDITORS REPORT

Memorandum

To: Assistant Secretary for Policy, Management and Budget and Chief Financial Officer

Subject: Auditors Report on Department of the Interior Financial Report for Fiscal Years 1998 and 1997 (No. 99-I-438)

SUMMARY

In our audit of the Department of the Interior's financial report for fiscal year 1998, we found the following:

- The principal financial statements were presented fairly in all material respects. The Department of the Interior's principal financial statements consist of the Consolidated Statement of Financial Position as of September 30, 1998, and 1997; the Consolidated Statement of Net Cost of Operations, the Consolidated Statement of Changes in Net Position, and the Consolidated Statement of Custodial Activity for the fiscal years ended September 30, 1998, and 1997; and the Combined Statement of Budgetary Activity for the fiscal year ended September 30, 1998.

- Our tests of internal controls identified weaknesses in the following areas that we consider to be material weaknesses: National Park Service controls over the construction-in-progress account, Bureau of Indian Affairs controls over the property management accounts, Bureau of Indian Affairs general controls over automated information systems, and Bureau of Indian Affairs controls over financial integrity reviews. We believe that weaknesses in the following areas are reportable conditions: the Department and bureau controls over deferred maintenance, U.S. Geological Survey controls over its data processing environment, Department and bureau controls over summarizing transactions as Government and non-Government, and Department and bureau controls over trading partner data.

- Our tests of compliance with laws and regulations identified specific noncompliance issues for the Bureau of Indian Affairs that are required to be reported concerning the Chief Financial Officers Act of 1990, the Debt Collection Improvement Act of 1996, the Credit Reform Act of 1990, the Prompt Payment Act, and the Federal Financial Management Improvement Act of 1996.

Our conclusions are detailed in the sections that follow.

OPINION ON FINANCIAL STATEMENTS

In accordance with the Chief Financial Officers Act of 1990, we audited the Department of the Interior's principal financial statements for the fiscal years ended September 30, 1998, and 1997, as contained in the Department of the Interior's accompanying "1998 Annual Report." The Department of the Interior is responsible for these principal financial statements, and we are responsible for expressing an opinion, based on our audit, on these principal financial statements. We did not audit the information contained in Note 18 related to Indian Trust Funds. This information was audited by other auditors whose report has been provided to us, and our opinion, insofar as it relates to the information contained in Note 18, is based solely on the report of the other auditors.

Our audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States, and with Office of Management and Budget Bulletin 98-08, "Audit Requirements for Federal Financial Statements," as amended, and was completed on March 31, 1999. These audit standards require that we plan and perform the audit to obtain reasonable assurance as to whether the accompanying principal financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the principal financial statements and the accompanying notes. An audit also includes assessing the accounting principles used and the significant estimates made by management. We believe that our audit work provides a reasonable basis for our opinion.

In our opinion, the principal financial statements, including the accompanying notes, present fairly, in all material respects, the consolidated financial position of the Department of the Interior as of September 30, 1998, and 1997, and its consolidated net cost, changes in net position, and custodial activity for the years ended September 30, 1998, and 1997, and combined budgetary resources and outlays for the year ended September 30, 1998, on the basis of accounting described in Note 1 to the financial statements.

As explained in Note 16, the Department reclassified land costs that were previously recorded in the structures and other facilities account to the standard general ledger account for land and adjusted the accumulated depreciation. In addition, the Department, as explained in Note 16, changed its method for reporting royalty collections that were transferred to the Bureau of Reclamation. In fiscal year 1997, the Department reported this as revenue in its Consolidated Statement of Net Cost. However, to comply with Statement of Federal Financial Accounting Standard No. 7, "Accounting for Revenue and Other Financial Sources," the Department reported these collections as other financing sources in its fiscal year 1998 Consolidated Statement of Changes in Net Position.

In addition, as discussed in Note 16, the Department adjusted its construction-in-progress account to remove heritage assets and general property, plant, and equipment that had been previously completed. These adjustments were made to comply with Statement of Federal Accounting Standard No. 6, "Accounting for Property, Plant, and Equipment."

Our audit was conducted for the purpose of forming an opinion on the consolidated and combined principal financial statements taken as a whole. The accompanying consolidating and combining information is presented for purposes of additional analysis of the consolidated and combined principal financial statements. The consolidating and combining financial statements for fiscal year 1998 (pages 92-99) were subjected to the auditing procedures applied in the audit of the consolidated and combined principal financial statements and, in our opinion, are fairly stated in all material respects in relation to the consolidated and combined principal financial statements taken as a whole.

The required supplementary stewardship information (pages 101-116) is not a required part of the principal financial statements but is supplemental information required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which include discussions with management on the methods of measurement and presentation of the supplemental information. However, we did not audit the information and therefore express no opinion on it.

REPORT ON INTERNAL CONTROLS

Management of the Department of the Interior is responsible for establishing and maintaining an internal control structure which provides reasonable assurance that the following objectives are met:

- Transactions are properly recorded, processed, and summarized to permit the preparation of the principal financial statements and required supplementary stewardship information in accordance with Federal accounting standards.

- Assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

- Transactions are executed in accordance with (1) laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the principal financial statements or required supplementary stewardship information and (2) any other laws, regulations, and Governmentwide policies identified by the Office of Management and Budget.

Because of inherent limitations in any internal control structure, errors or fraud may occur and not be detected. Also, projections of the internal controls over financial reporting to future periods are subject to the risk that the internal controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

In planning and performing our audit, we obtained an understanding of the relevant internal control policies and procedures, determined whether these internal controls had been placed in operation, assessed control risks, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing an opinion on the principal financial statements and not to express assurance on the internal controls over financial reporting. Consequently, we do not express an opinion on internal controls. We also reviewed the Department's most recent report required by the Federal Managers' Financial Integrity Act of 1982 and compared it with the results of our evaluation of the Department's internal control structure.

Our consideration of the internal controls over financial reporting and compliance would not necessarily disclose all matters in the internal control structure over financial reporting that might be reportable conditions. Under standards established by the American Institute of Certified Public

Accountants and by Office of Management and Budget Bulletin 98-08, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted certain matters discussed in the paragraphs that follow involving the internal control structure and its operation that we consider to be material weaknesses or reportable conditions.

Material Weaknesses

A. National Park Service Needs Improved Controls Over Construction-in-Progress Account

The National Park Service did not have sufficient internal control procedures to ensure that the general ledger control account for construction-in-progress was accurately stated and properly supported. The account included construction costs that were not in compliance with the Federal Accounting Standards for heritage assets; non-Federal assets; and general property, plant, and equipment that had been placed into service prior to the current period. When this deficiency was brought to the attention of Park Service management, adjustments totaling $480.8 million were made to the construction-in-progress account, with related adjustments made to buildings, other structures, and expenses and prior period adjustments for fiscal years 1998 and 1997. According to Park Service officials, a project team will be established in fiscal year 1999 to verify the adjustments and ensure that all costs for completed projects are posted to the appropriate accounts.

B. Bureau of Indian Affairs Needs Improved Controls Over Property Management Accounts

The Bureau of Indian Affairs did not have sufficient internal control procedures to ensure that the construction-in-progress, land improvements, buildings, other structures and facilities, equipment, and related accumulated depreciation and depreciation expense accounts were accurately stated and properly supported. For example, we identified items that were included in the property accounts which did not belong to the Bureau, items that had incorrect acquisition costs, items that were duplicated in the accounts, and completed projects that were not transferred out of the construction-in-progress account after they had been completed.

C. Bureau of Indian Affairs Needs Improved General Controls Over Automated Information Systems

The Bureau of Indian Affairs continues to have ineffective general controls over certain automated information systems operated by the Bureau and is not in compliance with the requirements of Office of Management and Budget Circulars A-127, "Financial Management Systems," and A-130, "Management of Federal Information Resources," and with the Federal Managers' Financial Integrity Act of 1982. Specifically, the Bureau did not (1) have an effective system security program and had not enforced personnel policies and procedures to ensure adequate system security, (2) classify its resources to determine the level of security needed, (3) monitor visitor activities and perform adequate housekeeping to safeguard computer hardware, (4) perform periodic reviews to ensure that users' access levels were appropriate, (5) ensure that the proper version of an application was used in production, (6) have segregation of duties for the system support functions, (7) have controls over system software to effectively detect and deter inappropriate use, and (8) have an effective means of recovering or of continuing computer operations in case a system fails.

D. Bureau of Indian Affairs Needs Improved Controls Over Financial Information Integrity Reviews

The Bureau of Indian Affairs did not have sufficient internal control procedures to ensure that errors and invalid transactions contained in its general and subsidiary ledgers, listings, and reports were timely identified and corrected at September 30, 1998. This occurred because the Bureau had not developed and implemented an effective financial information integrity review, reconciliation, and correction process.

Department of the Interior Comments

The Department concurs with the need for the Park Service to ensure that completed assets are removed from the construction-in-progress account. However, the Department does not concur with an interpretation of accounting guidance that requires that the cost of heritage assets under construction be omitted from construction-in-progress accounts. Rather, the Department believes that general ledger control over this activity is essential to the proper management of construction activity and that heritage assets under construction should be accounted for and managed in the same manner as other construction projects. However, for fiscal years 1998 and 1997, the Department agreed to post appropriate adjustments to expense heritage assets under construction. The Department intends to raise this issue with appropriate financial standard setting authorities during fiscal year 1999.

Regarding the Bureau of Indian Affairs material weaknesses, the Department has reported real property management and accounting as a material weakness under the Federal Managers' Financial Integrity Act program and has a corrective action plan to correct the material weakness. Further, the Department is taking steps to improve general controls over automated information systems, and corrective action plans on other material weaknesses identified under the program are addressing the need to improve controls over financial information.

Reportable Conditions

A. The Department and the Bureaus Need Improved Controls Over Deferred Maintenance Management and Reporting

In accordance with Office of Management and Budget Bulletin 98-08, we reviewed the internal controls related to transactions and other data that support the reported information on deferred maintenance in the bureaus to determine whether the transactions were properly recorded, processed, and summarized. We found that formal policies and procedures for conducting periodic condition assessment surveys and computing deferred maintenance funding estimates needed to be established by the Department and the bureaus to promote consistency and accuracy. In addition, the supervisory and monitoring controls over deferred maintenance reporting required strengthening to ensure that the deferred maintenance estimates are supported by adequate documentation.

B. U.S. Geological Survey Needs Improved Controls Over the Data Processing Environment at the Reston Enterprise Data Services Center

The November 1998 report "Additional Controls Over the Data Processing Environment at the U.S. Geological Survey, Reston Enterprise Data Services Center" (No. 98-CAO-13), issued by the Office of Inspector General, U.S. House of Representatives, was the second report issued by the House's Office of Inspector General on the Data Services Center. The report stated that the Geological Survey had made significant progress in addressing the weaknesses and problems identified in the first report. However, the report identified additional weaknesses in the general control areas of Data Center management and operations; mainframe computer system physical and logical security; telecommunications security; and contingency planning, including backup procedures for preventing data loss and for the recovery of data in case of a disaster. According to the report, the identified weaknesses increased the risk of unauthorized access and modifications to, and disclosure of, information processed on the Data Center's mainframe computer. Also, the report noted that the weaknesses increased the potential for operational errors, which could adversely affect service continuity. The report identified 46 recommendations (24 from the prior report and 22 from the current report) that had not been implemented.

C. The Department and the Bureaus Need Improved Controls Over Summarizing Transactions as Government and Non-Government

The Department's and the bureaus' internal controls were not sufficient to provide reasonable assurance that transactions were properly summarized as Federal (Government) or Public (non-Government) in the general ledger accounts as required by Office of Management and Budget Bulletin 97-01, "Form and Content of Agency Financial Statements," as amended.

D. The Department and the Bureaus Need Improved Controls Over Trading Partner Data

The Department's and the bureaus' internal controls were not sufficient to provide reasonable assurance that transactions with other Federal agencies (trading partners) were properly summarized as required by the Treasury Financial Manual. Trading partner data are not reported in the Department of the Interior's principal financial statements. The Department of the Treasury requires the trading partner data to be included in support of the Governmentwide consolidated financial report.

Department of the Interior Comments

The Department recognizes the need to improve controls over deferred maintenance management and reporting and, this past year, declared this a material weakness under the Federal Managers'

Financial Integrity Act program. A corrective action plan is being developed to improve controls in this area.

The Department recognizes the need to continue to improve the controls over the data processing environment at the Reston Enterprise Data Services Center. Actions are being taken to implement recommendations to improve the controls over the data processing environment.

The Department also recognizes the need to continue to improve the accuracy of Government and non-Government data and trading partner data submitted to the Department of the Treasury in support of the Governmentwide consolidated financial statements. Fiscal year 1998 was the first year that trading partner information was required. The Department continues to improve the processes supporting submission of financial data to the Department of the Treasury.

Stewardship and Performance Measures

We considered the Department of the Interior's internal controls over the required supplementary stewardship information by obtaining an understanding of the Department's internal controls relating to the preparation of the required supplementary stewardship information to determine whether these internal controls had been placed in operation, assessed the control risk, and performed tests of these controls. However, providing assurance on these internal controls was not an objective of our audit, and accordingly, we do not provide assurance on such controls.

Finally, with respect to the internal controls related to the reported performance measures, we did not obtain an understanding of the design of significant internal controls related to the existence and completeness assertions. Accordingly, we do not provide assurance on such controls.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Management of the Department of the Interior is responsible for complying with laws and regulations applicable to that agency. As part of obtaining reasonable assurance about whether the agency's principal financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on amounts contained in the principal financial statements and certain other laws and regulations specified in Bulletin 98-08, including the requirements referred to in the Federal Financial Management Improvement Act of 1996. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance with laws and regulations discussed in the preceding paragraph exclusive of the Federal Financial Management Improvement Act disclosed the instances of noncompliance that are required to be reported under the "Government Auditing Standards" or Bulletin 98-08 as follows:

- **Chief Financial Officers Act of 1990.** The Bureau of Indian Affairs had not effectively established and implemented general and financial management practices and improved its systems of accounting, financial management, and internal controls to ensure the issuance of reliable financial information and to provide for the production of complete, reliable, timely, and consistent financial information. As such, the Bureau was not in compliance with these requirements of the Chief Financial Officers Act.

- **Debt Collection Improvement Act of 1996.** The Bureau of Indian Affairs was not in compliance with the Debt Collection Improvement Act, which requires that all eligible receivables delinquent for more than 180 days be referred to the U.S. Treasury for collection. The Bureau had accounts receivable of at least $31.3 million and loans receivable of at least $16.7 million that were delinquent for more than180 days and were eligible for referral at September 30, 1998.

- **Credit Reform Act of 1990.** The Bureau of Indian Affairs was not in compliance with the Credit Reform Act, which requires that Federal agencies properly record and account for loan costs and guarantees, including performing subsidy reestimates for the post-1991 credit reform direct and guaranteed loans. The Bureau used assumptions in developing subsidy reestimates that were not consistent with the guidance in Federal Financial Accounting Standard No. 2, "Accounting for Direct Loans and Loan Guarantees," and Office of Management and Budget Circular A-11, "Preparation and Submission of Budget Estimates." As a result, we were unable to determine whether the Bureau's reestimate adjustments included in its financial statements for fiscal year 1998 were accurate.

- **Prompt Payment Act.** The Bureau of Indian Affairs was not in compliance with the Prompt Payment Act, which requires that Federal agencies pay their bills on time, pay interest penalties when payments are made late, and take discounts only when payments are made within the discount period and are advantageous to the Government. A December 11, 1998, Prompt Payment Act quality control review prepared by the Chief, Washington Administrative Service Center - West, which covered the fourth quarter of fiscal year 1998, stated that the overall accuracy of the Bureau's Prompt Payment Report was not acceptable because of the number of payment processing errors found.

Under the Federal Financial Management Improvement Act, we are required to report whether the Department's financial management systems are in substantial compliance with requirements for Federal financial management systems, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. To meet these requirements, we performed tests of compliance using the implementation guidance for the Federal Financial Management Improvement Act included in Appendix D of Bulletin 98-08.

- **Federal Financial Management Improvement Act.** As discussed in the Report on Internal Controls section of this report, we believe that the material internal control weaknesses concerning the ineffective general controls over the Bureau of Indian Affairs automated information systems are significant departures from the requirements of Office of Management and Budget Circulars A-127 and A-130 and are therefore instances of substantial noncompliance with the Federal financial management systems requirements under the Federal Managers' Financial Integrity Act of 1982.

Department of the Interior Comments

The Department recognizes that the Bureau of Indian Affairs continues to need to improve financial operations. Accordingly, the Department has declared Bureau material weaknesses in the following areas: real property management, debt collection, acquisition management, irrigation operation and management, and records management. The Department has corrective action plans under way to address and correct each weakness. The Department continues to work with the Bureau in its efforts to eliminate the qualification on the Bureau's financial statements.

CONSISTENCY OF OTHER INFORMATION

We reviewed the financial information presented in the Department of the Interior's overview and in the required supplemental information to determine whether the information was consistent with the principal financial statements. Based on our review, we determined that the information in the overview and in the required supplemental information was consistent with information in the principal financial statements.

PRIOR AUDIT COVERAGE

Based on our review of prior Office of Inspector General audit reports, we found that the material internal control weaknesses for the Bureau of Indian Affairs identified in the Internal Control section of this report were also reported as internal control weaknesses as follows:

- The June 1998 report "Followup of General Controls Over Automated Information Systems, Operations Service Center, Bureau of Indian Affairs" (No. 98-I-483) stated that the general control weaknesses and risks identified in our audit for fiscal year 1996 continued to exist during fiscal year 1997.

- The April 1998 report "Bureau of Indian Affairs Principal Financial Statements for Fiscal Years 1996 and 1997" (No. 98-I-407) identified internal control weaknesses in property management accounts, general controls over automated information systems, and controls over financial integrity reviews. In addition, the report noted that the Bureau's general controls over its automated information systems were not in compliance with requirements of Federal financial management systems under the Federal Managers' Financial Integrity Act and that the Bureau was not in compliance with the Debt Collection Improvement Act of 1996, the Prompt Payment Act, and the Credit Reform Act of 1990.

- The May 1997 report "Bureau of Indian Affairs Consolidated Financial Statements for Fiscal Years 1995 and 1996" (No. 97-I-834) stated that the Bureau's internal control structure was not sufficient to support the balances for other buildings and structures and that the Bureau had not timely collected its accounts and loans receivable and therefore was not in compliance with the Debt Collection Act of 1982.

- The April 1997 report "General Controls Over Automated Information Systems, Operations Service Center, Bureau of Indian Affairs" (No. 97-I-771) stated that the Bureau's general controls over its automated information systems at the Center were not effective. Specifically, according to the report, the Bureau did not (1) have an effective system security program and had not enforced personnel policies and procedures to ensure adequate system security, (2) classify its resources to determine the level of security needed, (3) monitor visitor activities and perform adequate housekeeping to safeguard computer hardware, (4) perform periodic reviews to ensure that users' access levels were appropriate, (5) ensure that the proper version of an application was used in production, (6) have segregation of duties for the system support functions, (7) have controls over system software to effectively detect and deter inappropriate use, and (8) have an effective means of recovering or of continuing computer operations in case a system fails.

OBJECTIVE, SCOPE, AND METHODOLOGY

Management of the Department of the Interior is responsible for the following:

- Preparing the principal financial statements and the required supplemental information referred to in the Consistency of Other Information section of this report in conformity with the basis of accounting described in Note 1 to the principal financial statements and preparing the other information contained in the "1998 Annual Report."

- Establishing and maintaining an internal control structure over financial reporting. In fulfilling this responsibility, estimates and judgments are required to assess the expected benefits and related costs of internal control structure policies and procedures.

- Complying with applicable laws and regulations.

We are responsible for the following:

- Expressing an opinion on the Department of the Interior's principal financial statements.

- Obtaining an understanding of the internal controls over financial reporting and compliance and reporting the results of this review, based on the internal control objectives in Bulletin 98-08, which require that transactions be properly recorded, processed, and summarized to permit the preparation of the principal financial statements and the required supplemental information in accordance with Federal accounting standards, and that assets be safeguarded against loss from unauthorized acquisition, use, or disposal.

- Testing the Department's compliance with selected provisions of laws and regulations that could materially affect the principal financial statements or the required supplemental information.

In order to fulfill these responsibilities, we took the following actions:

- Examined, on a test basis, evidence supporting the amounts disclosed in the principal financial statements.

- Assessed the accounting principles used and the significant estimates made by management.

- Evaluated the overall presentation of the principal financial statements.

- Obtained an understanding of the internal control structure related to safeguarding assets; compliance with laws and regulations, including the execution of transactions in accordance with budget authority; and financial reporting.

- Tested relevant internal controls over the safeguarding of assets, compliance with laws and regulations, and financial reporting.

- Tested compliance with selected provisions of laws and regulations.

We did not evaluate all of the internal controls related to the operating objectives as broadly defined by the Federal Managers' Financial Integrity Act, such as those controls related to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to those controls necessary to achieve the objectives outlined in our report on internal controls.

This report is intended for the information of management of the Department of the Interior, the Office of Management and Budget, and the Congress. However, this report is a matter of public record, and its distribution is not limited.

Robert J. Williams
Assistant Inspector General
for Audits