



## United States Department of the Interior

OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20240

January 31, 2003

### Memorandum

To: The Secretary

From: Earl E. Devaney  
Inspector General

Subject: Independent Auditors' Report on the U.S. Department of the Interior's Fiscal Year 2002 Annual Report on Performance and Accountability (No. 2003-I-0014)

We contracted with KPMG LLP (KPMG), an independent certified public accounting firm, to audit the Department of the Interior's (DOI) financial statements as of September 30, 2002 and for the year then ended. The contract required that KPMG conduct its audit in accordance with the Comptroller General of the United States of America's *Government Auditing Standards*, the Office of Management and Budget's Bulletin 01-02 *Audit Requirements for Federal Financial Statements*, and the General Accounting Office/President's Council on Integrity and Efficiency's *Financial Audit Manual*.

### ***AUDIT RESULTS***

In its audit report dated January 28, 2003, (Attachment 1), KPMG issued an unqualified opinion on DOI's financial statements for fiscal years 2002 and 2001. The report also identified 12 internal control weaknesses and 3 instances of noncompliance with laws and regulations related to the following areas:

### ***INTERNAL CONTROL WEAKNESSES***

#### ***Material Weaknesses***

- Security and General Controls Over Financial Management Systems
- Controls Over Property, Plant, and Equipment
- Controls Over Financial Reporting
- Controls to Reconcile Intra-Governmental Transactions and Balances
- Controls Over Indian Trust Funds
- Financial Processes at the Geological Survey

***Reportable Conditions***

- Controls Over Undelivered Orders and Accruals
- Controls for Recording and Disclosing Claims and Assessments
- Controls Over Environmental Liabilities
- Controls Over Revenue Process
- Controls Over Interior Franchise Fund
- Reporting on Deferred Maintenance

***NONCOMPLIANCE WITH LAWS AND REGULATIONS***

- *Debt Collection Improvement Act of 1996*
- *Public Law 104-208 Advances for Interior Franchise Fund*
- *Federal Financial Management Improvement Act of 1996*

Most of the issues identified by KPMG are longstanding weaknesses that were identified in previous years. For the DOI to make meaningful and significant progress in correcting these weaknesses, major changes are needed in its financial management infrastructure. These changes include (1) developing DOI-wide financial policies that all finance and program offices are required to implement, (2) ensuring that DOI's policy-setting representatives have the authority to enforce financial policies and that sufficient resources are available to monitor compliance with the policies, (3) requiring that succession planning be done for financial positions to minimize the impact of turnover, and (4) providing periodic training to finance and program representatives to ensure they understand and effectively implement Interior's financial policies. DOI indicated general concurrence with the findings and recommendations.

KPMG is responsible for the auditor's report, dated January 28, 2003. We monitored the progress of the audit at key points, reviewed KPMG's report and selected related working papers, and inquired of its representatives. Our review, as differentiated from an audit in accordance with the *Government Auditing Standards*, was not intended to enable us to express, and we do not express, an opinion on DOI's financial statements, conclusions about the effectiveness of internal controls, conclusions on whether DOI's financial management systems substantially complied with the three requirements of the *Federal Financial Management Improvement Act of 1996*, or conclusions on compliance with laws and regulations. We continue to review KPMG's work as the final information is provided to us. Our review to date has disclosed no instances where KPMG did not comply, in all material respects, with the *Government Auditing Standards*.

***MANAGEMENT CHALLENGES***

We identified, in accordance with Public Law 106-531, *Reports Consolidation Act of 2000*, the most serious management challenges facing the DOI. The challenges, which are discussed in detail in "Management Challenges" (Attachment 2), are in the following areas:

- Financial Management
- Information Technology
- Health, Safety and Emergency Management
- Maintenance of Facilities
- Responsibility to Indians and Insular Areas
- Resource Protection and Restoration
- Revenue Collections
- Procurement, Contracts, and Grants

In accordance with Section 5(a) of the *Inspector General Act* (5 U.S.C. App. 3), we will list this report in our semiannual report to the Congress. In addition, a copy of this report will be provided to the Congress.

We appreciate the cooperation and assistance of DOI personnel during the audit. If you have any questions, please contact me at (202) 208-5745.

Attachments (2)



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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets of the Department of the Interior (Interior) as of September 30, 2002 and 2001, the related consolidated statements of net cost and custodial activity for the years then ended, and the related consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002 (hereinafter referred to as the financial statements). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered Interior's internal control over financial reporting and tested Interior's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

### SUMMARY

As stated in our opinion on the financial statements, we concluded that Interior's financial statements presented in Interior's *Fiscal Year 2002 Annual Report on Performance and Accountability* as of and for the years ended September 30, 2002 and 2001, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. As discussed in Notes 21 and 24 to the financial statements, Interior restated its fiscal year 2001 consolidated balance sheet and statement of net cost, and its beginning of fiscal year 2002 unobligated budgetary balances. Also as discussed in Note 24 to the financial statements, Interior changed its method of accounting for allocation transfers as of October 1, 2001.

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

#### Reportable Conditions that are Considered to be Material Weaknesses

- A. Security and general controls over financial management systems
- B. Controls over property, plant, and equipment
- C. Controls over financial reporting
- D. Controls to reconcile intra-governmental transactions and balances
- E. Indian Trust Fund controls
- F. Financial processes at the U.S. Geological Survey



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### Other Reportable Conditions

- G. Controls over undelivered orders and accruals
- H. Controls for recording and disclosing claims and assessments
- I. Controls over environmental liabilities
- J. Controls over revenue process
- K. Controls over Interior Franchise Fund
- L. Deferred maintenance reporting

The results of our tests of compliance with certain provisions of laws and regulations disclosed the following instances of noncompliance that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, or Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*:

- M. *Debt Collection Improvement Act of 1996*
- N. Section 113 of Public Law 104-208 – Advances for Interior Franchise Fund
- O. *Federal Financial Management Improvement Act of 1996 (FFMIA)*

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 and regulations, and management's and our responsibilities.

### **OPINION ON THE FINANCIAL STATEMENTS**

We have audited the accompanying consolidated balance sheets of Interior as of September 30, 2002 and 2001, and the related consolidated statements of net cost and custodial activity for the years then ended, and the related consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Interior as of September 30, 2002 and 2001, and its net costs and custodial activities for the years then ended, and its changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the year ended September 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 21 and 24 to the financial statements, Interior restated its fiscal year 2001 consolidated balance sheet and statement of net cost, and its beginning of fiscal year 2002 unobligated budgetary balances. Also as discussed in Note 24 to the financial statements, Interior changed its method of accounting for allocation transfers as of October 1, 2001.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.



Based upon our limited procedures, we determined that Interior did not complete the non-fiduciary intragovernmental reconciliations with its trading partners, as specified by OMB requirements because Interior's trading partners did not provide information by Interior component or Treasury fund symbol and Interior did not designate the appropriate trading partners for certain transactions.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information in the Other Supplementary Information section is presented for purposes of additional analysis of the consolidated balance sheet and consolidated statement of changes in net position, rather than to present the financial position and changes in net position of Interior's components individually. The consolidating information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

The other accompanying information included in the Appendices is presented for purposes of additional analysis and is not a required part of the financial statements. We did not audit this information and, accordingly, we express no opinion on it.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Interior'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.

In our fiscal year 2002 audit, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable conditions A through F are material weaknesses.

### A. Security and General Controls over Financial Management Systems

Although Interior is working towards improving the security and controls over information systems, controls need to be improved in the areas described below, as required by OMB Circular 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.

1. Entity-wide Information Technology (IT) Security Program – An entity-wide IT security program, including security policies and a related implementation plan, is the foundation of an entity's security control structure and a reflection of senior management's commitment to addressing security risks. As outlined in OMB Circular A-130, an effective security program includes a risk assessment process, certification process, and effective incident response and monitoring capabilities. Interior is making progress towards establishing a security infrastructure; however, continued efforts need to be made in assigning security responsibilities, developing and implementing security policies and procedures, conducting security awareness training, and in monitoring the security program. Without a clear security program, Interior's systems are vulnerable to unauthorized access, use, or loss of sensitive information.



2. Access Controls – Access controls should provide reasonable assurance that computer resources such as data files, application programs, and computer-related facilities and equipment are protected against unauthorized modification, disclosure, and loss or impairment. Interior needs to improve controls over the process of granting, terminating, and monitoring system access in specific applications. In addition, Interior has not fully limited access to system information and has not finalized and communicated guidelines regarding posting of information on the Internet.
3. Segregation of Duties – Proper segregation of duties should be ensured through the establishment of policies, procedures, and organizational structure such that one individual cannot control key aspects of financial transactions, and thereby conduct unauthorized actions or gain unauthorized access to assets or records. We noted that duties are not properly segregated, because application programmers responsible for making changes to customized bureau application software also approve these changes and move them into production; security managers perform primary and secondary security functions; and technology staff perform change management responsibilities and network monitoring.
4. System Software Controls – Controls over the modification of system software change controls should provide reasonable assurance that operating system controls are not compromised. Without proper system software controls, unauthorized individuals using the system software could circumvent controls to read, modify, or delete critical or sensitive information or programs. Interior should complete the implementation of the automated system for managing Interior's software library and the automated process for reviewing and securing the implementation of changes to software. Once these systems have been fully implemented, Interior needs to develop procedures and assign responsibility for monitoring these systems to ensure that system software is adequately protected.
5. Software Development and Change Controls – Establishing controls over the modification of application software programs helps ensure that only authorized programs and modifications are implemented. Without proper change controls, there is an increased risk that either intentional or unintended changes are made to the system's processing functionality, the wrong version of a program could be implemented, a virus could be inserted, or built-in security features could be disabled. Interior has not fully developed procedures for controlling changes over software that would prevent unauthorized programs or modifications to an existing program from being implemented. In addition, Interior has not fully developed procedures to ensure that tests of system software changes are performed and documented, system software changes are reviewed, and approval of changes is documented prior to implementation.
6. Application Controls – Application controls help ensure that transactions are valid, properly authorized, and completely and accurately processed and reported. Interior's accounting system incorrectly records certain budgetary transactions resulting in an overstatement of total budgetary resources and obligations incurred.
7. Service Continuity – Losing the capability to process, retrieve, and protect information maintained electronically could significantly affect Interior's ability to accomplish its mission. Thus, procedures should be in place to protect information resources, minimize the risk of unplanned interruptions, and recover critical operations should interruptions occur. Interior has not formalized an incident response capability to mitigate the risk of service interruptions.

#### **Recommendation**

We recommend that Interior develop and implement a formal action plan to improve the general and application controls over its financial management systems. This plan should address each of the areas



discussed above, as well as other areas that might impact the information technology control environment to ensure adequate security and protection of Interior's information systems.

### Management Response

Management concurs with this finding. IT security is currently being addressed as part of the Department's FMFIA material weaknesses. Substantial progress was made in 2002 and continues. Interior will conduct a comprehensive IT security assessment to determine the remaining security and control issues in bureaus and offices. Based on these findings, the Interior will develop and implement a comprehensive information security plan, including capital budgeting requirements, implement the plan on a phased basis, and monitor it under the Department's Management Control Program.

## B. Controls Over Property, Plant, And Equipment

Interior needs to improve controls over the recording of property, plant, and equipment, as follows:

1. Capitalization of Assets – Interior does not consistently capitalize property, plant, and equipment. Specifically, we determined that Interior capitalized stewardship land, stewardship land improvements, heritage asset improvements, and investments in non-federal physical property that should have been expensed and conversely, Interior expensed certain property that should have been capitalized. In addition, we noted that Interior does not consistently apply its capitalization thresholds. Finally, we determined that Interior does not have adequate procedures to determine, at the inception of a lease, if it should be accounted for as a capital or an operating lease.
2. Inventory and Certification Processes – Interior completes annual inventory or certification processes to confirm the accuracy, existence, and completeness of certain property, plant, and equipment. We noted that the physical inventory and certification processes are not always effective, because they do not consistently identify acquisitions and disposals that need to be reflected in the financial statements. We also noted that Interior does not consistently adjust the general or subsidiary ledgers based on the inventory and certification results timely.
3. Acquisitions and Disposals – Interior does not consistently record property, plant, and equipment in a timely manner. Specifically, we determined that some Interior components expend a significant amount of time and resources identifying and recording property, plant, and equipment transactions after the end of the fiscal year. Furthermore, we noted that Interior does not consistently maintain source documents to support the acquisition and disposal of property, plant, and equipment.
4. Construction in Progress – Interior does not consistently record transactions in its construction in progress account. Specifically, we determined that Interior improperly capitalized disbursements in the construction in progress account that should have been expensed, expensed disbursements that should have been capitalized as construction in progress, and incorrectly recorded revenue as a reduction to construction in progress. In addition, we noted that Interior needs to improve processes for capturing internal payroll costs and donated labor related to the construction of property. We also determined that Interior does not consistently transfer completed construction projects at the time the asset is placed in service or consistently expense projects that will no longer provide any future benefit. When transfers are made, Interior does not consistently reconcile the transfers from the construction in progress account to the appropriate property, plant, and equipment account.
5. Transfers – Interior does not have controls to ensure property transferred within and to Interior is consistently recorded. We also noted that equipment transferred from other federal agencies is recorded at the original acquisition value, instead of the net book value or fair value at the time of the transfer, as required.





6. Land and Land Rights – Interior does not have a complete and accurate inventory system for Bureau of Reclamation land and land rights. In fiscal year 2000, Interior established a five-year action plan to develop a complete and accurate inventory of land and land rights. As of September 30, 2002, Interior expects to complete the inventory system within the five-year period.
7. Recording Depreciation – Interior has not established and implemented controls to ensure depreciation starts when assets are placed in service and to ensure useful lives of property and improvements to property are consistently applied for the purposes of recording depreciation. We also determined that depreciation is not always calculated properly, and that certain segments within Interior do not calculate or record depreciation until the end of the year.
8. Reconciliation of Subsidiary Ledgers to General Ledgers – Interior is not able to efficiently reconcile its subsidiary and general ledgers for property, plant, and equipment. This is because Interior does not consistently maintain and reconcile its subsidiary ledgers throughout the fiscal year and has several different subledgers, including manual spreadsheets, that add to the complexity of the reconciliation process.

As a result of our observations, Interior expended a significant amount of time and resources analyzing, counting, reconciling, and adjusting property, plant, and equipment to ensure the amounts were fairly stated.

### Recommendations

We recommend that Interior perform the following to improve controls over its property, plant and equipment:

1. Capitalization of Assets – We recommend that Interior develop a formal property, plant and equipment capitalization policy to be used by all Interior components. This policy should indicate the types of disbursements that should be capitalized, expensed as acquisition and improvements to stewardship land, expensed because it is incidental to the acquisition of stewardship land, expensed as acquisition and improvements to heritage assets, and expensed as investments in non-federal physical property. This policy should also indicate the capitalization thresholds to be used for each property category. We also recommend that Interior establish procedures to determine, at the inception of the lease, if the lease should be accounted for as a capital or operating lease. Interior should also establish a database to track and monitor all operating and capital leases to enable Interior to properly report this information in its financial reports. Finally, we recommend that Interior communicate the property policy and lease procedures by providing training to individuals at all the bureaus regarding implementing the property policy and lease procedures.
2. Inventory and Certification Processes – We recommend that Interior improve its inventory and certification processes to verify accuracy, existence, and completeness of property, plant and equipment. Interior should establish required inventory and certification policies and train individuals on how to perform inventories. We also recommend that Interior record adjustments to the subsidiary and general ledgers as a result of the inventory observations in a more timely manner.
3. Acquisitions and Disposals – We recommend that Interior implement internal controls to ensure that property, plant, and equipment transactions are recorded in the subsidiary ledger and general ledger at the time the financial event occurs and at the proper amount. We also recommend that Interior maintain source documents related to property plant and equipment acquisitions and disposals.
4. Construction in Progress – We recommend that Interior establish and communicate policies defining the types of transactions that should be recorded in the construction in progress account



versus expense accounts. We also recommend that Interior establish controls to ensure that construction in progress transactions are properly recorded. These controls should include verifying that transactions are properly recorded and supported, completed projects are properly transferred from the construction in progress account, and transfers from the construction in progress account reconcile to the other property accounts on a monthly basis. These controls should also include procedures for capturing internal payroll costs and donated labor related to the construction of property.

5. Transfers – We recommend that Interior review accounting transactions to ensure that assets transferred within and to Interior are properly recorded. This should include implementing posting models to properly record property transferred within Interior and revising the procedures to properly record property received from others at net book value of the transferring entity or fair value of the asset on the date of transfer.
6. Land and Land Rights – We recommend that Interior complete the five-year action plan to establish a complete and accurate inventory of land and land rights and to reconcile the inventory records (i.e., subsidiary ledger) to the general ledger.
7. Recording Depreciation – We recommend that Interior design, communicate, and implement internal controls to ensure that depreciation begins when assets are placed in service and useful lives are consistently applied. The process should establish useful lives of newly constructed/purchased property, property received and previously owned by other entities, improvements to property, and changes in useful lives of improved property. The process should also include improving the communication between the Interior financial departments and the managers, purchasers, and users of the property.
8. Reconciliation of Subsidiary Ledgers to General Ledgers – We recommend that Interior consider consolidating several of its subsidiary property systems. We also recommend that Interior reconcile its subsidiary and general ledgers on a monthly basis, including resolving any reconciling items.

### Management Response

Management concurs with this finding and recognizes certain inconsistencies among bureaus related to property policies and the need to improve real and personal property management. The Department has established a team of property and finance personnel to address standardizing real and personal property policies to be implemented for FY 2004. However, certain systems issues will not be addressed until the new systems are implemented under the Finance and Business Management Systems Project.

### C. Controls over Financial Reporting

Interior needs to improve controls over the recording and reporting of financial transactions as follows:

1. Financial Policies and Resources – Interior's financial processing is very decentralized as key financial transactions are initiated and processed by individuals located throughout finance and program offices. We also noted that Interior has not fully developed and communicated its financial policies. In addition, the policy-setting offices do not always have the authority to enforce and the resources to monitor compliance with financial policies. Furthermore, Interior's financial positions have experienced turnover and extended vacancies causing reassignment of critical financial functions to existing employees who already have full workloads.
2. Transaction Entry – Interior does not consistently utilize automated posting models to minimize manual entries. In addition, Interior does not consistently ensure manual entries are properly



recorded. Finally, Interior does not consistently record entries throughout the year. As a result, Interior's interim financial information is not consistently complete or accurate and Interior expends a significant amount of time and resources recording transactions after the end of the year.

3. Reconciliation – Interior does not consistently reconcile subsidiary ledgers to general ledgers, budgetary to proprietary accounts, the statement of financing to other statements or consistently resolve reconciling differences in a timely manner. In addition, we noted that certain Interior segments did not ensure that interim SF-133 *Reports on Budget Execution and Budgetary Resources* were properly reconciled to the general ledger or interim general ledger balances for investments and fund balance with Treasury were properly reconciled to Treasury's records. Furthermore, Interior does not consistently investigate and resolve aged accounts, suspense accounts, or accounts with unusual balances, timely.
4. Activity-based costing – Interior does not consistently apply activity-based costing methodologies to allocate costs in accordance with accounting standards. Specifically, we determined that Interior has not fully developed activity-based costing policies and that certain Interior components do not code transactions in the accounting system to facilitate activity-based costing at the customer and program level. Furthermore, Interior components do not consistently capture costs in the accounting systems to enable them to efficiently report GPRA program activity in accordance with the Department's Annual Performance Plans.
5. Grant monitoring – Interior requests grant performance reports and related SF-269, *Financial Status Reports*, from grant recipients; however, Interior does not perform sufficient monitoring to ensure grant recipients submit these reports, timely. Interior uses the grant performance reports as the primary source for the required disclosure of certain investments in non-federal physical property and uses the SF-269s to help ensure that expenses are recorded in the proper period and funds are de-obligated at the end of the grant period.

As a result of our observations, Interior expended a significant amount of time and resources analyzing, reconciling, and adjusting its financial statement balances to ensure the amounts were fairly stated.

### Recommendations

We recommend that Interior perform the following, to improve the recording and reporting of financial transactions:

1. Financial Policies and Resources – We recommend that Interior develop Department-wide financial policies that all finance and program departments are required to implement. In addition, we recommend that Interior provide the policy-setting representatives the authority to enforce financial policies and ensure the finance departments have the resources needed to monitor compliance with policies. We also recommend that Interior implement succession planning for financial positions to minimize the impact of turnover. Finally, Interior should provide periodic training to finance and program representatives to ensure they understand and effectively implement Interior's financial policies.
2. Transaction Entry – We recommend that Interior record transactions during the year at the time the transactions are incurred, and utilize automated posting models throughout the year as well as during the year-end reporting process. For manual journal entries, we recommend that Interior have a second individual review the entries to ensure that they are accurate and complete, prior to posting.
3. Reconciliation – We recommend that Interior develop and implement formal month-end and quarter-end financial reporting processes to reconcile subsidiary ledgers to general ledgers, SF-133 reports to the general ledger, Treasury's records to the general ledger, the statement of financing to



other statements, and the budgetary to proprietary relationships as appropriate. Interior should also investigate and resolve old account balances, suspense account items, and accounts with unusual balances, timely.

4. Activity-based costing – We recommend that Interior develop and implement an activity-based costing methodology to accumulate costs in accordance with the Department's Annual Performance Plans. We also recommend that Interior establish an account code structure to track costs consistent with activity-based costing in its accounting system. Furthermore, we also recommend that Interior establish controls to ensure costs are properly charged to its customers.
5. Grant monitoring – We recommend that Interior require grant recipients to submit grant performance reports and related SF-269s prior to receiving new grants.

#### **Management Response**

Management concurs with this finding. Interior will include the issues identified above in its efforts to improve financial management for 2003 and will address the activity-based cost issues identified in its initiative to implement activity-based costing consistently across the Department.

#### **D. Controls to Reconcile Intra-governmental Transactions and Balances**

Interior needs to improve controls to reconcile its intra-departmental and intra-governmental activity and balances.

1. Intra-governmental Transactions – Interior reconciles its fiduciary intra-governmental transactions and balances; however, Interior has not reconciled its non-fiduciary intra-governmental transactions and balances, because its trading partners did not consistently provide information by Interior component or Treasury fund symbol. In addition, Interior did not designate the appropriate trading partner codes for certain transactions. Furthermore, Interior does not consistently determine the costs incurred to generate intra-governmental revenue. As a result, Interior's transactions and balances with other federal entities may not properly eliminate on the government-wide financial statements. We also recommend that Interior code intra-governmental transactions and balances to the appropriate trading partners.
2. Intra-departmental Transactions – Interior does not reconcile its intra-departmental transactions and balances, timely. We noted that this is a manual reconciliation process, and that Interior expended a significant amount of time and resources completing this reconciliation after the end of the year.

#### **Recommendations**

We recommend that Interior improve the process to identify and reconcile the intra-departmental and intra-governmental activity and balances, as follows:

1. Intra-departmental Transactions – We understand that Interior is developing an automated process to facilitate the reconciliation of intra-Departmental transactions. We recommend that Interior complete and implement this automated process. Until the automated process is implemented, we recommend that Interior improve the manual process to reconcile intra-departmental activity and balances.
2. Intra-governmental Transactions – We recommend that Interior establish procedures to reconcile non-fiduciary transactions and balances with other federal entities. We also recommend that Interior consistently code transactions to the appropriate trading partners and determine costs incurred to generate intra-governmental revenue.



These reconciliation processes should be completed quarterly and should include procedures to resolve any differences identified, timely.

#### Management Response

Management concurs with this finding. Interior will continue to improve intra-governmental transaction processing begun in 2002. This effort includes addressing the issues identified above.

#### E. Indian Trust Fund Controls

The U.S. Congress has designated the Secretary of the Interior as the primary fiduciary with responsibility for monetary resources held in trust on behalf of American Indian Tribes, Individual Indians, and Other Trust Funds (hereafter collectively referred to as the Indian Trust Funds). The Secretary carries out this fiduciary responsibility through the Office of the Special Trustee (OST), the Bureau of Indian Affairs (BIA), and other Interior bureaus.

The Indian Trust Fund balances include balances considered federal funds and balances considered non-federal funds. The amounts considered federal funds are reflected in Interior's financial statements, while the non-federal trust funds are not reflected in Interior's financial statements. However, the Indian Trust Funds' transactions and balances are disclosed in a footnote to the Interior's financial statements, in accordance with federal accounting standards.

We noted that the procedures and internal controls are not adequate to ensure that the Indian Trust Fund activity and balances are recorded properly or timely. We noted the following weaknesses:

1. Cash Balances – OST is unable to reconcile the Indian Trust Fund cash balances that are disclosed in the footnotes to the Department of the Interior's financial statements with the cash balances reported by the U.S. Treasury. The Indian Trust Fund cash balances are approximately \$33 million greater than balances reported by the U.S. Treasury as of September 30, 2002 and 2001. In addition, OST needs to resolve approximately \$12.6 million of balances in Treasury suspense and budget clearing accounts as of September 30, 2002 and 2001.
2. Trust Fund Balances – OST is unable to provide accounting records to properly support the Indian Trust Fund balances. For example, the Individual Indian Monies (IIM) trust fund balances in the subsidiary ledger exceed the balance in the control account by approximately \$6 million and \$6.7 million as of September 30, 2002 and 2001, respectively. In addition, the Individual Indian Monies subsidiary ledger contains negative trust fund balances of approximately \$44 million as of September 30, 2002 and 2001. OST also is in the process of investigating and resolving undistributed interest. Furthermore, certain account holders do not agree with the trust fund balances and have filed claims against the U.S. Government and Department of the Interior, that remain unresolved.
3. Special Deposit Accounts – In accordance with section 25 of the Code of Federal Regulations, OST records receipts into a special deposit account within the IIM subsidiary ledger when the recipient trust fund account is unknown at time of receipt. When BIA identifies the proper trust fund account, OST transfers the amount from the special deposit account to the proper trust fund account in accordance with BIA instructions. During fiscal years 2002 and 2001, OST in conjunction with the BIA and a contractor, developed a formal plan to address special deposit accounts. The Department needs to resolve approximately \$62 million and \$67 million of special deposit accounts included in the IIM subsidiary ledger as of September 30, 2002 and 2001, respectively. A significant number of special deposit accounts have remained inactive for the past several years and new accounts continue to be established.



4. Trust Fund Information Systems –Interior needs to improve security and general controls over the Trust Fund information systems. Specifically, Interior needs to develop and implement a security policy and program, improve segregation of duties, accredit and certify its general and application systems, strengthen controls to prevent unauthorized access, and establish formal application software development and change controls.
5. Appraisal Compacts – One of the key elements in performing realty trust transactions is the requirement of obtaining appraisals for realty transactions. OST has a fiduciary duty to land title owners and monetary property recipients (e.g., life estate holders) to establish the fair value of property transactions, including establishing the fair value of property leases, before entering into lease agreements or sales transactions on behalf of the owners. Current laws allow the appraisal function to be compacted to tribes, who are often the named parties involved in realty transactions. As a result, transactions are consummated based on prices established or influenced by the eventual beneficial owners of the property. Controls are not in place to ensure that the fair value of property transactions are established by parties independent of the transaction.
6. Entering and Maintaining Trust Fund Information – The regional and agency offices of the Bureau of Indian Affairs (BIA) perform a critical role in the initial input and subsequent changes to the Indian Trust Funds information disclosed by Interior. We noted the following weaknesses related to the internal controls performed by regional and agency offices:
  - a. Segregation of Duties – The responsibilities for trust fund processing are not properly segregated to prevent or detect errors. Specifically, in some locations an individual employee has the ability to initiate lease agreements; generate annual billings for property leases; collect payment for leases; send instructions to OST to create IIM accounts; and send instructions to OST via a change order directing OST to change the named monetary property recipients and IIM accounts to which future collections should be posted.
  - b. Probate Backlog – The probate orders for land title are not entered into the trust management systems timely. One location has a probate backlog that is over a year old. This results in the potential for inaccurate distributions of lease income to the Indian Trust Fund account holders.
  - c. Untimely Deposits – We determined that agency offices did not consistently forward trust receipts to OST in a timely manner. Some of these delays occurred at agency offices where OST and BIA personnel reside and other delays occurred at agency offices occupied by BIA personnel only.

#### **Recommendation**

We recommend that Interior develop and implement procedures and internal controls to address these deficiencies.

#### **Management Response**

Management concurs with this finding. A variety of actions are underway within the Department of the Interior to correct these deficiencies.

#### **F. Financial Processes at the U.S. Geological Survey**

The U.S. Geological Survey does not have adequate procedures and internal controls to ensure that its financial transactions are recorded properly or timely. We noted that the U.S. Geological Survey financial management processes are not designed to facilitate recording financial transactions. U.S. Geological Survey headquarters accounting personnel are not sufficiently integrated into the decentralized accounting structure to establish effective policy and controls as well as provide needed



financial management oversight. In addition, U.S. Geological Survey does not have the financial personnel needed to manage accounting operations and ensure financial transactions are properly recorded and reported throughout the year. As a result, Interior expended a significant amount of time and resources reconciling and supporting financial statement balances as a result of our audit procedures.

#### **Recommendation**

We recommend that Interior develop and implement procedures and internal controls to ensure that U.S. Geological Survey financial transactions are recorded properly and timely during the year. Specifically, Interior should:

1. Re-design the financial processes at U.S. Geological Survey to ensure that they support recording financial transactions accurately and at the time the events occur.
2. Improve the finance department at U.S. Geological Survey to ensure that it has effective leadership, federal accounting experience, and authority to enforce financial policies.

#### **Management Response**

Management concurs with this finding. Currently, efforts are underway to correct these deficiencies during 2003.

### **G. Controls over Undelivered Orders and Accruals**

Interior has not fully implemented internal controls to ensure that obligations are liquidated and liabilities are accrued for goods and services received prior to the end of the reporting period. In addition, Interior does not de-obligate funds in a timely manner. Specifically, we identified instances where the undelivered order balance and the accrued liability balance were either understated or overstated. As a result, Interior re-analyzed the undelivered order and accrued liability balances and adjusted the balances, appropriately.

#### **Recommendations**

We recommend that Interior:

1. Develop and communicate internal controls to ensure that accruals are recorded and undelivered orders are adjusted for services and products received prior to the end of the reporting period.
2. Implement internal controls to ensure that the accruals and undelivered orders that are recorded are properly supported. These procedures should be completed at least quarterly.

#### **Management Response**

Management concurs with this finding. In 2002, the National Park Service successfully piloted an approach to improve accrual processing. This approach will be reviewed as a possible standard for other bureaus to improve accrual processing. In 2003, the Department will be including full accruals as part of the quarterly financial statement reporting process.



## H. Controls for Recording and Disclosing Claims and Assessments

Interior has not fully implemented internal controls to ensure that claims and assessments are properly accrued or disclosed in the financial report. Specifically, we determined the following:

1. Communication with Solicitor – The financial management departments do not consistently communicate with the solicitor's office regarding claims and assessments. As a result, financial management departments generally do not receive or review any formal reports on the status of claims and assessments until after the end of the year.
2. Claims and Assessment System – Interior does not have an automated system to monitor claims and assessments and, therefore, relies on a time-intensive manual data collection process to summarize the claims and assessments for the year-end financial reporting process.
3. Consistency of Information Received from Solicitor – The claims and assessment information provided by the Solicitor for the year-end financial reporting process is not always complete and accurate. As a result, Interior spent a significant amount of time revising the year-end claim and assessment information and determining the claims and assessments that should be accrued and disclosed.

### Recommendations

We recommend that Interior improve internal controls to ensure that claims and assessments are properly accrued or disclosed in the financial report as follows:

1. Communication with Solicitor – We recommend that the solicitor's office provide to Interior's financial management departments a quarterly analysis of all legal claims and assessments and record an accrual or prepare a disclosure for inclusion in the interim and year end financial statements. In addition, the solicitor's office should provide updates, more frequently than quarterly, on the status of major cases to Interior's financial management departments.
2. Claims and Assessment System – We recommend that Interior implement an automated system that contains the information needed to monitor and report on claims and assessments for management and financial reporting purposes.
3. Consistency of Information Received from Solicitor – We recommend that Interior establish internal controls to ensure that the claims and assessment information provided by the Solicitor for the year-end financial reporting process includes all claims and assessments, properly and clearly indicates the status of the case, and includes the estimated range of loss.

### Management Response

Management concurs with this finding. Interior worked with the Office of the Solicitor to streamline the tracking of legal claims and assessments to accrue or disclose information in the year-end financial report. Improvements in this process will continue in 2003.

## I. Controls over Environmental Liabilities

We noted that Interior has not fully developed policies and procedures for estimating environmental liabilities. Specifically, we determined the following:

1. Guidance – Interior does not have a Departmental prioritized list of cleanup activities, planned cost studies, and projects by risk score factor. In addition, Interior does not provide sufficient direction to regional locations to prepare and submit funding requests and to communicate funding results back to the regions. Furthermore, Interior does not have policies to ensure identification of the





responsible party for environmental liabilities on Interior approved leased properties or properties transferred to Tribal authorities.

2. Estimation Process – Interior does not consistently apply the same methodology to estimate liabilities, consistently refine the estimates, or record material changes in estimates throughout the year. In addition, Interior does not always involve the appropriate environmental personnel or specialists to assess environmental cleanup needs and estimate environmental liabilities. Furthermore, Interior needs additional specialists to assist with the estimation process and monitor cleanup efforts.

As a result of our observations, Interior analyzed and adjusted its environmental liabilities to ensure the amounts were fairly stated

### Recommendations

We recommend that Interior improve its policies and procedures over environmental liabilities, as follows:

1. Guidance – We recommend that Interior develop a Departmental prioritized cleanup plan that includes all known areas of contamination and the potential responsible parties. In addition, Interior should develop and communicate policies on preparing and submitting funding requests and identifying the parties responsible for cleanup.
2. Estimation Process – We recommend that Interior require its components to apply the same methodology to estimate liabilities, refine the estimates periodically, and record changes in estimates throughout the year. We also recommend that Interior consider hiring additional environmental specialists to assist with the estimation process and to monitor cleanup efforts.

### Management Response

Management concurs with this finding. The Department will investigate approaches to improve reporting on environmental liabilities under applicable rules and regulations to the extent possible with available resources.

## J. Controls over Revenue Process

Interior needs to improve controls over the revenue process as follows:

1. Recording Activity - Interior does not consistently review revenue transactions to ensure that they are properly recorded. Specifically, we identified the following:
  - a. Transactions recorded at the customer level instead of at the agreement level;
  - b. Reimbursable agreements, collections, and revenue recorded at the incorrect amount;
  - c. Billings in excess of customer agreements or in excess of expenses incurred;
  - d. Increases in accounts receivables that should be reductions of advances from others;
  - e. Expenses charged to the improper agreements; and
  - f. Revenue recorded in the improper period.
2. Billing - Interior does not consistently issue bills in a timely manner. Specifically, we identified certain accounts that have not been billed for over twelve months. We also noted that Interior manually prepares certain bills, which increases the risk of error.



3. Account Monitoring - Interior does not consistently analyze its balances of accounts receivable and advances from others. Specifically, we noted customer agreements with both an accounts receivable and an advances from others balance, accounts with unusual and older balances, and advance balances for projects that have ended and need to be returned to customers.
4. Documentation - Interior does not consistently maintain supporting documentation for reimbursable agreements. Specifically, we determined that agreements are not consistently signed, agreements do not consistently include fees to be charged to customers, and documentation supporting the related agreement revenue and expense is not always available.

As a result of our comments, Interior performed a detailed analysis of revenue transactions and adjusted the balances appropriately.

### Recommendations

We recommend that Interior improve controls over the revenue process as follows:

1. Recording Activity – We recommend that Interior establish controls to ensure that transactions are recorded in the proper account, at the proper amount, and in the proper period. These controls should include system controls to automatically record transactions in the proper accounts as well as to prevent billings in excess of customer agreement amounts and in excess of expenses incurred. These controls should also include periodic inspections by a second individual to ensure transactions are properly recorded.
2. Billing – We recommend that Interior continue to automate the billing process and issue bills on a regular basis.
3. Account Monitoring – We recommend that Interior investigate and resolve customer agreements with both an accounts receivable and an advances from others balance, investigate and resolve accounts with unusual balances, review and collect older accounts receivable balances, and return advance balances for projects that have ended, monthly. We also recommend that Interior configure its accounting systems to prevent customer accounts from having both an accounts receivable and an advances from others balance.
4. Documentation – We recommend that Interior obtain signed customer agreements, document the fees charged in the customer agreements, and maintain documentation supporting transactions related to these agreements.

### Management Response

Management concurs with this finding. The finding relates to services provided to other organizations on a reimbursable basis. Efforts to improve controls over revenue processing for reimbursable activities will include reviewing current practices and making modifications, as appropriate.

### K. Controls over Interior Franchise Fund

Interior Franchise Fund (IFF) is a “virtual organization” that utilizes personnel from both of its service providers. Although several personnel are fully dedicated to working on IFF activity, there are several personnel who only spend part of their time working on IFF activity. As a result of utilizing personnel from different service organizations, IFF does not have clear lines of responsibility or reporting and IFF activity does not consistently receive the same priority as the other activity processed by the service providers. We also determined that IFF did not record and reconcile transactions throughout the year and incorrectly recorded certain transactions. As a result, IFF expended a significant amount of time and resources analyzing and adjusting transactions during the year-end reporting process.



### **Recommendation**

We understand that Interior is in the process of re-organizing responsibilities of IFF. We recommend that Interior complete this re-organization process, ensure there is appropriate staffing to complete the day-to-day accounting processing during the year, and establish internal controls to ensure transactions are recorded properly.

### **Management Response**

Management concurs with this finding. The Department is taking the appropriate action to implement this recommendation.

## **L. Deferred Maintenance Reporting**

Interior has not fully established controls to identify and report deferred maintenance. We noted that Interior has not completed condition assessments for certain assets and, therefore, has not properly disclosed all deferred maintenance amounts. In addition, Interior does not report deferred maintenance by major asset category, and has not defined acceptable operating conditions for each major class of assets.

### **Recommendation**

We recommend that Interior develop and implement internal controls to ensure that condition assessments are completed following a standard methodology and on a regular basis, deferred maintenance is calculated for each asset following a standard methodology, and condition and deferred maintenance information is summarized and reported by major asset category.

### **Management Response**

Management concurs with this finding. Interior has identified "Department-wide Maintenance Management Capability" as a mission critical FMFIA material weakness. The corrective action plan includes implementing a comprehensive maintenance management system and appropriate linkages to the accounting systems, conducting comprehensive condition assessments, implementing a five-year deferred maintenance and capital improvement plan and utilizing a capital asset planning process. This process is underway. A new system is being implemented and condition assessments being conducted in all bureaus. The deferred maintenance and capital improvement plan has been in place for several years and the capital asset planning process was modified to be more effective in 2002.

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A summary of the status of prior year reportable conditions is included as Exhibit I.

## **COMPLIANCE WITH LAWS AND REGULATIONS**

Our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report, exclusive of the FFMIA, disclosed the following instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

### **M. Debt Collection Improvement Act of 1996**

In accordance with the *Debt Collection Improvement Act of 1996*, Interior is required to refer eligible receivables that are delinquent to the U.S. Department of the Treasury for collection or offset. Eligible receivables include those that are not the subject of litigation, related to foreclosure proceedings, or



from organizations in bankruptcy. We determined that Interior did not consistently refer Bureau of Indian Affairs receivables that are over 180 days delinquent to the U.S. Department of the Treasury.

#### **Recommendation**

We recommend that the Interior establish a process, in fiscal year 2003 to ensure eligible receivables are referred to the U.S. Department of the Treasury in a timely manner.

#### **Management Response**

Management concurs with this finding. The Department has been working with the Bureau of Indian Affairs for a number of years and has made steady improvement. However, further work remains and the Department is committed to continue these efforts to bring Interior into full compliance with the related provisions of the Debt Collection Improvement Act.

### **N. Section 113 of Public Law 104-208 – Advances for Interior Franchise Fund**

In accordance with Section 113 of Public Law 104-208, Interior is required to obtain advances from customers before costs are incurred to provide goods or services to the customer. We determined that Interior does not consistently obtain advances from customers as Interior Franchise Fund had accounts receivable of approximately \$78 million as of September 30, 2002.

#### **Recommendation**

We recommend that Interior require customers to pay in advance, in accordance with the law or consider requesting the U.S. Congress to change the law governing this requirement.

#### **Management Response**

Interior developed, with approval by the Office of Management and Budget, appropriation language establishing the Interior Franchise Fund applying the Government Management Reform Act that created the franchise fund pilot program and guidelines provided by the Office of Management and Budget. The intent of the pilot program was to allow these franchise funds to provide quality services at reduced costs to Federal agencies through competition. Interior does not believe the recommended appropriation language was intended to require advances for all services, but was intended to allow the pilot program to receive advances so that the organizations could operate in a more business like manner. However, Interior can see how the existing language could be interpreted as described above. Interior is working with the Office of Management and Budget and Congress to adjust the appropriation to support the intent of the Government Management Reform Act objectives.

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

The results of our tests of FFMIA disclosed instances, described below, where Interior's financial management systems did not substantially comply with the Federal financial management systems requirements, federal accounting standards, and the United States Government Standard General Ledger at the transaction level.

1. Federal Financial Management Systems Requirements – As discussed in the Internal Control over Financial Reporting section of this report, Interior has several weaknesses in its information technology general control environment that contribute to noncompliance with OMB Circular A-130. Interior needs to improve security policies and related training, monitor the security program, strengthen access controls, segregate information technology duties, fully develop and implement procedures for controlling changes to software, configure its accounting system to properly record



budgetary recoveries, and formalize its incident response processes. As a result, Interior does not substantially comply with the system requirements of FFMIA.

2. Federal Accounting Standards – Interior is required to prepare its financial statements in accordance with federal accounting standards. As discussed in the Internal Control over Financial Reporting section of this report, we identified weaknesses that affected Interior's ability to prepare its financial statements and related disclosures in accordance with federal accounting standards. Specifically, we determined that Interior needs to improve controls over property plant and equipment, financial reporting, intra-governmental transactions, Indian trust funds, and financial processes at the U.S. Geological Survey.
3. United States Standard General Ledger at the Transaction Level – In accordance with OMB Circular A-127, *Financial Management Systems*, Interior is required to record financial events consistent with the applicable account descriptions and attributes reflected in the United States Standard General Ledger (SGL) at the transaction level. We noted that one of Interior's accounting systems (i.e., Federal Financial System) incorrectly records budgetary recoveries for certain transactions resulting in an overstatement of total budgetary resources and obligations incurred. As a result, Interior recorded correcting entries at the summary level. We also determined that certain posting models related to royalty transactions are not consistent with Treasury's guidance and therefore Interior must manually adjust these balances for reporting purposes. Furthermore, we determined that Interior records certain receivables and property, plant, and equipment in the general ledger at a summary level, rather than at the transaction level.

#### Recommendations

1. Federal Financial Management Systems Requirements – We recommend that during fiscal year 2003, Interior improve the security and general controls over its financial management systems to meet the requirements set forth in OMB Circular A-130.
2. Federal Accounting Standards – We recommend that during fiscal year 2003, Interior implement strengthened procedures and internal controls that ensure the financial statements and related disclosures are prepared in accordance with the federal accounting standards.
3. United States Standard General Ledger at the Transaction Level – We recommend that during fiscal year 2003, Interior analyze the budgetary recovery entries generated by the accounting system and record correcting entries at the transaction level, in accordance with the SGL. We also recommend that Interior revise its process for recording receivables, royalties, and property, plant and equipment during fiscal year 2003, to ensure that this activity is recorded consistent with the SGL at the transaction level.

#### Management Response

Management concurs with this finding. Efforts are underway to improve information technology security and general controls for the Department that effect financial management systems (see also management's response to item A above). Efforts are underway to strengthen procedures and internal controls to ensure financial statements and related disclosures are prepared in accordance with federal accounting standards at all levels in the Department (see also management's response to items B, C, D, E, and F above). Efforts are underway to improve compliance with the SGL in the isolated cases where non-compliance issues may exist in the Department that are now being corrected through manual procedures, however, the system changes necessary to reach full compliance are dependent on the implementation of the Finance and Business Management Systems project.



## RESPONSIBILITIES

### *Management's Responsibilities*

The *Government Management Reform Act of 1994* (GMRA) requires each federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, Interior prepares annual financial statements.

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis (including the performance measures), the Required Supplementary Information, and the Required Supplementary Stewardship Information, and
- Complying with laws and regulations, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

### *Auditors' Responsibilities*

Our responsibility is to express an opinion on the 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*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 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:

- 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 2002 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.



As required by OMB Bulletin No. 01-02, we considered Interior's internal control over required supplementary stewardship information by obtaining an understanding of Interior's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether Interior's fiscal year 2002 financial statements are free of material misstatement, we performed tests of Interior's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to Interior. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether Interior's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

#### **DISTRIBUTION**

This report is intended for the information and use of Department of the Interior's management, Department of the Interior's Office of the Inspector General, OMB, 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*

January 28, 2003

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

## Summary of the Status of Prior Year Findings

September 30, 2002

Ref	Condition Area	Status
A	Improve general and application controls over financial management systems.	This condition has not been corrected and is repeated in fiscal year 2002.
B	Improve timeliness of transaction entry and reconciliation.	This condition has not been corrected and is repeated in fiscal year 2002.
C	Improve controls over undelivered orders and accruals.	This condition has not been corrected and is repeated in fiscal year 2002.
D	Improve controls over property, plant, and equipment.	This condition has not been corrected and is repeated in fiscal year 2002.
E	Improve reconciliation of intra-departmental and intra-governmental transactions.	This condition has not been corrected and is repeated in fiscal year 2002.
F	Improve Indian Trust Fund management controls.	This condition has not been corrected and is repeated in fiscal year 2002.
G	Improve financial accounting processes at the U.S. Geological Survey.	This condition has not been corrected and is repeated in fiscal year 2002.
H	Improve controls over the revenue process.	This condition has not been corrected and is repeated in fiscal year 2002.
I	Improve controls for recording and disclosing claims and assessments.	This condition has not been corrected and is repeated in fiscal year 2002.
J	Improve controls over the Aquatic Resources Trust Fund.	This condition has been corrected.



## U.S. DEPARTMENT OF THE INTERIOR

## Summary of the Status of Prior Year Findings

September 30, 2002

Ref	Condition Area	Status
K	Improve recording of budgetary transactions.	This condition has not been corrected and is repeated in fiscal year 2002.
L	Improve controls over Interior Franchise Fund financial reporting.	This condition has not been corrected and is repeated in fiscal year 2002.
M	Improve controls over credit card purchases.	This condition has been corrected.
N	Improve accounting for inventory.	This condition has been corrected.
O	Improve deferred maintenance reporting.	This condition has not been corrected and is repeated in fiscal year 2002.
P	Debt Collection Improvement Act of 1996.	This condition has not been corrected and is repeated in fiscal year 2002.
Q	Prompt Payment Act.	This condition has been corrected.
R	Section 113 of Public Law 104-208 – Advances for Interior Franchise Fund.	This condition has not been corrected and is repeated in fiscal year 2002.
S	Federal Financial Management Improvement Act of 1996 – Systems Requirements.	This condition has not been corrected and is repeated in fiscal year 2002.
T	Federal Financial Management Improvement Act of 1996 – Accounting Standards.	This condition has not been corrected and is repeated in fiscal year 2002.
U	Federal Financial Management Improvement Act of 1996 – United States Standard General Ledger.	This condition has not been corrected and is repeated in fiscal year 2002.

## ATTACHMENT 2



**United States Department of the Interior**  
**OFFICE OF INSPECTOR GENERAL**  
 Washington, D.C. 20240

**DEPARTMENT OF THE INTERIOR**  
**TOP MANAGEMENT CHALLENGES**

**1. Financial Management**

Department of the Interior (DOI or the Department) financial management does not maintain current and accurate financial data during the course of the year. As a result, the Department undertakes a massive effort every year to compile, analyze, and correct its financial data in order to prepare accurate financial statements. DOI must enhance both the depth and breadth of its financial management personnel, must improve its policies and procedures to ensure consistent accounting practices, and must continue its endeavor to secure funding for an updated, integrated financial management system Department-wide.

DOI has made some progress in correcting financial management weaknesses. However, it has not yet made the major changes needed to address the longstanding weaknesses in financial management.

**2. Information Technology**

Many shortcomings in policies, procedures, and controls need to be addressed before Information Technology (IT) systems and data at DOI are adequately protected. According to the Office of Inspector General (OIG) and General Accounting Office (GAO) reports, establishing effective security over information systems remains a material weakness in DOI.

OIG's September 2002 *Executive Summary of the Annual Evaluation of the Security Program and Practices Over the Department of the Interior's Non-National Security Information Systems* reported that:

- DOI had not ensured that all IT systems have security plans, empowered Chief Information Officers (CIOs) to fulfill all legislative duties and responsibilities necessary to effectively carry out the program, issued adequate guidance for reporting security incidents, adequately tested and evaluated security controls, and effectively trained key personnel.

DOI had not assessed risks and determined the appropriate level of security to adequately protect all IT systems. Further, the bureaus were not able to adequately manage risks for systems and supporting operations and assets because they have not yet identified all IT systems.

- Contractors engaged by the court-appointed Special Master conducted penetration tests of DOI networks and systems, finding that some systems that had been reconnected to the Internet (on December 6, 2001, a U.S. District Court Judge prohibited DOI from connecting to the Internet because Indian trust systems and data were not adequately safeguarded), such as those operated by the National Business Center and the Geological Survey, continued to have security weaknesses.

According to the October 2002 GAO Report No. GAO-03-225, DOI continues to have “computer systems riddled with weaknesses that make them highly vulnerable to computer-based attacks and place a broad range of critical operations and assets at risk of fraud, misuse, and disruption.”

DOI needs to establish a monitoring program to ensure that the data contained in electronic information systems is factually based and therefore reliable for use in decision-making and historical support. DOI needs to develop and implement archival procedures to ensure that essential physical operating records are preserved and protected for retrieval and use. Such records provide the bases for past scientific conclusions and management decisions.

DOI information technology systems have achieved Level 1 (establishing documented security policies and standards) under the five-level framework used by the General Accounting Office to assess the security of Federal information technology systems. By fiscal year 2005, DOI plans to conduct a comprehensive information technology assessment and implement a security plan that will meet Level 5 requirements. In December 2002, the CIO for DOI was empowered to meet the information system management requirements of the Clinger-Cohen Act.

### **3. Health, Safety and Emergency Management**

DOI must protect millions of visitors, hundreds of thousands of employees and volunteers, thousands of facilities, and millions of acres of property from both internal and external threats. Risk assessments conducted by the OIG and other entities conclude that:

- Water and power facilities and national icons remain vulnerable to outside threats.
- Visitor safety and security remains inadequate at many DOI parks and other facilities.
- Employee safety and security remains inadequate at many DOI facilities.
- The physical isolation of some DOI lands and facilities increases their vulnerability to threats and inhibits DOI's response time.

DOI has undertaken steps to address these vulnerabilities, but needs to continue these efforts within an aggressive timeframe.

#### **4. Maintenance of Facilities**

DOI must maintain a large and aging inventory of bridges, dams, schools, buildings, irrigation systems, roads, historical buildings, and other structures entrusted to its care. The deferred maintenance backlog on this inventory was estimated at \$12.1 billion. The present decentralized maintenance operations, with their complex funding mechanisms and little or no standardized information, processes, or procedures, have contributed to this backlog. We issued a report in December 2001 outlining a comprehensive approach to maintenance management within DOI.

- DOI needs to implement a comprehensive maintenance management system to effectively plan, prioritize, conduct, and track the condition and maintenance of facilities within all bureaus, especially the National Park Service.
- DOI needs to provide long-term leadership to keep money available to address the long-standing issues of deferred maintenance.

DOI has adopted a computer-based facilities maintenance management system, which it tested at multiple locations during fiscal year 2002, and has been assessing the condition of facilities, developing a 5-year maintenance plan, and establishing goals to reduce the deferred maintenance backlog.

#### **5. Responsibility to Indians and Insular Areas**

DOI continues to labor to meet its overall trust responsibilities to American Indians, to improve Indian Education, and to address long-standing challenges with financial and operational management in the Insular Area governments.

The challenges facing the Department in the trust arena are being addressed under the scrutiny of a Federal District Court.

Low scores on standardized tests, recruitment and retention of qualified teachers, and the poor condition of Indian school facilities are issues that plague Indian education. There are 171 Indian schools and 14 dormitories, which serve about 50,000 Indian students in 23 states. OIG audits have identified problems in construction and operational planning. To improve Indian educational opportunities, DOI has developed programs, such as those for early childhood and family literacy, to begin to moderate the influences of economic and family conditions on students' academic performance. In addition, Congress substantially increased the funds that DOI can use to repair some education facilities and replace others.

Insular area governments experience difficulties in accurately accounting for expenditures, collecting taxes and other revenues, controlling the level of expenditures, and delivering program services. Contributing to the long-standing problems is the fact that, although each of the Insular Areas has an internal audit organization - known as public auditors, these organizations, with few exceptions, lack the staff, resources, or independence necessary to provide effective and objective audit coverage of local government operations.

To help address Insular Area challenges, the Secretary upgraded the head of the Office of Insular Affairs to the Assistant Secretary level. DOI also announced that it will allocate millions of dollars in discretionary grants among Insular Area governments by assessing the strength and independence of Insular Area public auditor offices and the responsiveness shown to our audit recommendations and DOI and other official inquiries.

## **6. Resource Protection and Restoration**

DOI resource managers face the challenge of safeguarding our natural resources, while meeting increasing and often competing demands from users of DOI lands and facilities. Major contributors to the challenge of effective resource management include increased population, environmental issues, shortages of resources such as water, oil and gas, and demands for more recreation areas.

DOI faces challenges in implementing policy goals for repairing and maintaining ecosystems within budget limitations. Of special concern are wildfires, water allocations, a changing land and recreation base, and invasive (non-native) species.

Federal lands account for 30 to 35 percent of energy produced in the United States. The primary challenge is developing energy resources while protecting natural resources, including endangered plant and animal species.

DOI has implemented a fire management plan in coordination with the Forest Service and state and local governments. DOI is working with the State of Florida and local governments to implement the Everglades Restoration Program. The National Invasive Species Council, established by DOI in 1999 to combat the threat of invasive species, is working to establish Federal and non-Federal task teams to implement the action items of the Council's 2001 Management Plan. According to an October 2002 General Accounting Office report, however, Federal efforts to control these species, including the Council's Plan, are stymied by a lack of "clear long-term outcomes and quantifiable measures of performance."

## **7. Revenue Collections**

Although DOI collects over \$9.3 billion in revenues each year, OIG and GAO reports have shown that bureaus could enhance revenues collected for royalty payments, recreational fees, and costs recovered for services provided. In 16 reports issued over the last five years, OIG identified more than \$141 million in lost or potential additional

revenues, including \$71.7 million of under collected royalties, \$17.5 million lost because excess lands were not sold, and \$6.6 million of unrecovered firefighting costs. Also, since 1998, OIG, MMS, and the Department of Justice have recovered underpaid royalties of about \$500 million through settlements with energy companies resulting from our investigations.

MMS collects the bulk of the revenues realized by the DOI, over \$5 billion a year. Most of those revenues have been collected in the form of royalty in value (RIV) payments. An OIG evaluation issued in September 2002 concluded that RIV is much more susceptible to underreporting than taking royalties in kind (RIK). Under RIK, royalties are received as products (oil/gas) and then marketed by MMS. In its document, "Implementing Royalty in Kind, Business Processes and support Systems, Road Map to the Future," MMS outlined a strategy to move from piloting RIK to implementing an operational RIK program.

## **8. Procurement, Contracts, and Grants**

DOI spends substantial resources each year in contracting for goods and services and in providing Federal assistance to states and Indian organizations. Procurement has historically been an area subject to fraud and waste government-wide, and managing procurement activities is an unending challenge requiring constant attention. In FY 2002, the volume of procurement activity was about \$6.9 billion, of which over \$3.8 billion was provided to states and Indian tribes in grants and other types of Federal aid assistance

DOI has reported on the material inadequacy of BIA's acquisition management organization, policies, procedures, and guidelines since FY 1991. DOI has also reported since 1999 that controls over management oversight and accountability in FWS's Federal Aid Program have been materially weak because of inadequate management controls and lack of a centralized audit follow-up program and guidance governing the administration of the Program. Implementation of corrective actions has not yet been completed.

OIG completed an audit of procurement activities in DOI's integrated charge card program. We found that improper transactions went undetected because DOI had not established an effective process to review and validate purchases, sufficiently monitor and adjust credit limits, or deactivate ex-employee cards. The total effect of these deficiencies included not only the potential loss of monetary resources, but also the potential loss of confidence in the integrity of DOI operations.