ATTACHMENT

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

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

We have audited the accompanying balance sheets of the U.S. Department of the Interior (Interior) as of September 30, 2007 and 2006, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our fiscal year 2007 audit, we also considered Interior's internal controls over financial reporting and performance measures and tested Interior's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that Interior's financial statements as of and for the years ended September 30, 2007 and 2006, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our opinion, Interior revised its method of allocating certain costs and revenues between programs on the statement of net cost in fiscal year 2007. Also, as discussed in our opinion, in fiscal year 2007, Interior changed its method of accounting for and reporting of the reconciliation of net cost to budget, allocation transfers, and the Sport Fish Restoration and Boating Trust Fund (SFRBTF), to adopt changes in accounting standards and Office of Management and Budget (OMB) requirements.

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

A. General and Application Controls over Financial Management Systems
B. Controls over Accruals
C. Controls over Undelivered Orders
D. Financial Reporting Controls
E. Controls over Charge Cards
F. Controls over Grants
G. Controls over the Indian Trust Funds

However, none of the significant deficiencies are believed to be material weaknesses.

We noted no deficiencies involving the design of the internal control over the existence and completeness assertions related to key performance measures.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

H. *Single Audit Act Amendments of 1996*

The following sections discuss our opinion on Interior's financial statements; our consideration of Interior's internal controls over financial reporting and performance measures; our tests of Interior's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying balance sheets of the U.S. Department of the Interior as of September 30, 2007 and 2006, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity, for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of the Interior as of September 30, 2007 and 2006, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 20 to the financial statements, Interior's fiscal year 2007 statement of net cost is not comparable to its fiscal year 2006 statement of net cost because Interior revised its method of allocating certain costs and revenues between programs in fiscal year 2007. Also discussed in Note 22 to the financial statements, Interior changed its method of reporting the reconciliation of net cost to budget in fiscal year 2007. Further, as discussed in Note 27 to the financial statements, Interior changed its method of accounting for and reporting allocation transfers and the SFRBTF in fiscal year 2007.

The information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. 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.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The consolidating information in the Other Supplementary Information subsection within the Financial Report section is presented for purposes of additional analysis of the consolidated financial statements 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 Introduction, Performance Data and Analysis, the Other Accompanying Information sections, and the special account funds in the Other Supplementary Information subsection within the Financial Report section are presented for purposes of additional analysis and are not required as part of the financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Interior's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Interior's financial statements that is more than inconsequential will not be prevented or detected by Interior's internal control over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Interior's internal control.

In our fiscal year 2007 audit, we consider the deficiencies described below to be significant deficiencies in internal control over financial reporting. However, we believe that none of the significant deficiencies described below are material weaknesses. Exhibit I presents the status of prior year reportable conditions.

A. General and Application Controls over Financial Management Systems

Interior continues to improve the security and controls over its information systems; however, we determined that Interior needed to improve controls in the areas described below, as required by OMB Circular No. A-130, *Management of Federal Information Resources.* These conditions could have affected Interior's ability to prevent and detect unauthorized changes to financial information, to control electronic access to sensitive information, and to protect its information.

1. *Entity-wide Security Program and Planning*
   An entity-wide security program, including security policies and a related implementation plan, is the foundation of an entity's security control structure. Interior did not fully document its certification and accreditation procedures for certain systems and applications, and did not perform certain procedures to support its certification and accreditations. Additionally, Interior had not certified and accredited one facility, used an earlier version than authorized for one of its applications, and had not assigned security responsibilities for one system. Finally, Interior did not establish agreements to document the minimum security requirements for the interconnections and interfaces between certain applications.

2. *Access Controls*
   Access controls protect computer resources from unauthorized modification, disclosure, and loss. Interior did not fully establish controls to prevent and detect unauthorized access. Interior did not formally document and approve policies and procedures regarding access control procedures, segregation of system roles and responsibilities, the monitoring and

revocation of inactive user accounts, monitoring security profile changes, and periodic recertification of user access for certain applications and systems.

In addition, Interior did not consistently complete the appropriate level of investigation for users, obtain and maintain rules of behavior forms, obtain and maintain user access approval forms, obtain and maintain awareness training evidence, review and document reviews of user access to ensure conflicting access rights are not granted, limit users to one account, limit access of administrator accounts, follow its password policies, perform and document periodic re-certifications to ensure that all users are authorized and the level of access rights was appropriate, or identify and review changes to user account and security profiles. Finally, Interior did not consistently monitor or remove inactive user accounts, remove access of separated users in a timely manner, complete the appropriate exit procedures, or maintain exit clearance documentation for certain systems.

3. *System Software Controls*
System software controls protect computer resources from unauthorized modification, disclosure, and loss. Interior had not implemented formal change management procedures for one system, and had not formally approved procedures regarding the system development life-cycle, segregation of duties, administrator access, and audit logging for certain systems. In addition, Interior did not consistently establish controls to limit access to systems, document the approval for system software changes, maintain system change documentation, identify and monitor for inappropriate changes to systems, review system change logs, or monitor activities performed by administrators.

4. *Software Development and Change Controls*
Software development and change controls ensure that only authorized programs and modifications are implemented. Interior needs to improve its change management policies to ensure that it includes detailed testing procedures for normal and emergency changes for certain applications and configuration management. Interior did not use library management software to control changes to one of its applications, fully segregate software development and change duties, and identify and review changes to ensure the changes were approved for certain applications.

5. *Service Continuity*
Service continuity plans protect information resources, minimize the risk of unplanned interruptions, and recover critical operations should interruptions occur. Interior did not have a finalized, approved, fully documented, and/or tested contingency plan to be used in the event of service disruption for certain systems and applications. Interior did not have a comprehensive plan to train certain essential employees on emergency responsibilities outlined within the critical system and application contingency plans. Interior also did not demonstrate that certain contingency plan test results and corrective actions were reviewed by the appropriate officials. Furthermore, Interior did not track and report service interruptions for one application or fully establish environmental controls for one of its server rooms. In addition, Interior personnel involved with media sanitization were not always aware of policies and procedures. Finally, Interior did not consistently sanitize tapes, maintain evidence that backup tapes were completed, use a tape library log, store backup tapes at off-site locations, or test backup tapes.

6. *Segregation of Responsibilities*
Proper segregation of responsibilities helps prevent and detect unauthorized actions. Interior did not formally document application-specific roles or access privileges that should be segregated for certain financial systems or formally document compensating controls when access privileges cannot be segregated. In addition, Interior did not consistently require management to review the design and operation of segregation of responsibility controls. Finally, Interior did not fully segregate responsibilities for certain applications and systems.

Recommendations
We recommend that Interior continue to improve the security and general controls over its financial information systems to ensure adequate security and protection of the information systems as follows:

1. Certify and accredit its facilities and systems, perform all certification and accreditation procedures, fully document its certifications and accreditations, assign security responsibilities, and establish agreements for interconnections and interfaces between applications.
2. Establish controls to prevent and detect unauthorized access, develop and finalize access control policies, complete investigations, obtain and maintain user access documentation, review and approve user access, restrict access, follow password policies, periodically re-certify user access, monitor user account and security profile changes, monitor inactive accounts, remove access of separated users timely, complete the appropriate exit procedures, and maintain exit documentation.
3. Implement and approve change management procedures, establish controls to limit access to systems, document the approval for system software changes, maintain system change documentation, identify and monitor for inappropriate changes to systems, review system change logs, and monitor activities performed by administrators.
4. Improve its change management policies, use library management software to control software changes, fully segregate software development and change duties, and identify and review changes.
5. Finalize, approve, and test contingency plans and related training plans, review test results and corrective actions, track and report service interruptions, establish environmental controls, communicate and follow media sanitation policies, and control and test back up tapes.
6. Formally document application-specific roles or access privileges that should be segregated, periodically review segregation of duties, and fully segregate responsibilities.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

B. Controls over Accruals

In accordance with Federal accounting standards, Interior is required to record liabilities based on the probable future outflow or other sacrifice of resources as a result of past transactions or events. Interior did not properly develop its accounts payable accrual methodology at two Interior components to consider changes in operations, and did not properly test the assumptions used to calculate its accounts payable accrual at two Interior components. In addition, Interior did not ensure that its accounts payable accruals consistently agreed to the supporting documentation

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or consistently documented its approval of the accounts payable accruals. Furthermore, Interior did not fully consider the results of its grants accrual analysis and adjust its grant accrual methodology appropriately for one of its grant programs.

As a result of our observations, Interior adjusted its accrual methodologies, tested its assumptions, and increased its accruals by $154 million. However, Interior did not effectively review the accrual adjustments because Interior did not properly de-obligate $58 million of undelivered orders when Interior recorded the accrual adjustments. As a result of our observations, Interior recorded the de-obligation.

Recommendations
We recommend that Interior implement the following recommendations to improve controls over its accruals:

1. Evaluate and revise accounts payable accrual methodologies for changes in operations.
2. Test the assumptions used in the accounts payable accrual, including the subsequent activity report, to ensure that the subsequent activity report is accurate and complete.
3. Analyze the grants accrual analysis to ensure that the results support the grant accrual methodology.
4. Require supervisors to compare the accounts payable accrual adjustments from the accounting system to the calculations and the supporting documentation to ensure that the amounts are properly recorded and to document approval evidencing completion of comparison.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

C. Controls over Undelivered Orders

Undelivered orders should be promptly recorded, properly classified, and accounted for, in order to prepare timely and reliable reports. Interior policies requires its components to review and certify undelivered orders quarterly, including undelivered orders with no activity during the past 12 months, and to de-obligate invalid obligations; however, four of the nine Interior components did not effectively follow these policies. Two of the Interior components did not review and certify undelivered orders because the components were unable to obtain certain undelivered order reports from the accounting system. Two other components certified the undelivered order balances; however, the components did not effectively certify the undelivered order balances because they incorrectly certified 16 of the 166 undelivered orders tested. In addition, Interior did not consistently maintain documentation or modify orders that had expired in a timely manner to support its undelivered orders. As a result of our observations, Interior analyzed and decreased its undelivered orders by $80 million. Subsequent to management's analysis and adjustment, we identified 6 additional exceptions in the 281 undelivered orders tested at one Interior component.

Recommendations
We recommend that Interior implement the following recommendations to improve controls over its undelivered order balances:

1. Provide training to program and finance personnel on certifying and closing out undelivered orders.
2. Configure its accounting system to provide undelivered order reports.

3. Review and certify all undelivered order balances, on at least a quarterly basis.
4. Monitor and close out as appropriate undelivered orders with minimal to no activity during the past three months, on at least a quarterly basis.
5. Modify expired orders in a timely manner.
6. Improve and maintain documentation to support its undelivered order balances.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

D. Financial Reporting Controls

Interior needs to improve financial reporting controls to ensure transactions are properly recorded for reliable financial reports. Interior did not properly classify certain financial transactions resulting in over $181 million of activity being reported in the other fund column, rather than the earmarked fund column on the statement of changes in net position and resulting in misclassifications of $188 million in the reconciliation of net cost to budget disclosure and other note misclassifications. In addition, Interior did not effectively segregate responsibilities because certain individuals have the authority to both enter and approve journal entries in the accounting system without a secondary review at four of the nine Interior components.

Recommendations
We recommend that Interior implement the following to improve the recording and reporting of financial transactions:

1. Require a second person to analyze the financial statements and disclosures to ensure financial transactions are properly classified and presented and document such review.
2. Configure the accounting system to prevent the same individual from entering and approving journal entries in the accounting system or require an individual who does not have access to enter or approve journal entries to compare the journal entries recorded in the financial systems to the approved journal entries to ensure that all journal entries have been approved and were properly entered into the financial system, and document evidence of completion of the comparison.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management partially agreed with our findings and its comments were responsive to our recommendations. Management believes that there are adequate and mitigating controls. We did not audit Interior's response and, accordingly, we express no opinion on it.

Auditors' Response to Management's Response
As summarized above, Interior did not effectively segregate responsibilities because we identified certain individuals have the authority to both enter and approve journal entries in the accounting system without a secondary review. In addition, Interior implemented the mitigating controls after we identified the control deficiency and the mitigating controls did not operate effectively because the same people who performed the mitigating controls had the ability to enter and approve journal entries and therefore Interior did not segregate the responsibilities over journal entries. Therefore, we continue to believe that the control deficiencies identified constitute a significant deficiency.

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E. Controls over Charge Cards

Interior issues purchase, fleet, and travel charge cards to its employees to streamline acquisition and payment procedures and to reduce the administrative burden associated with traditional and emergency purchasing of travel items, supplies, and services. Interior uses charge cards to purchase goods and services totaling several hundred million dollars. In conjunction with the issuance of these cards, Interior published the *Integrated Charge Card Program Guide*. This guide sets forth restrictions on the use of the cards as well as certain internal control procedures such as timely and complete reconciliation of billing statements by the cardholders and approving officials.

However, we determined that Interior did not consistently follow these internal control procedures because we identified 69 exceptions in the 361 statements that we tested at 3 of the 7 Interior components that we tested. For example, cardholders and supervisors did not always sign and date the charge card statements, did not consistently sign and date the charge card statements in a timely manner, and did not consistently maintain charge card receipts to support the charges.

Recommendations
We recommend that Interior perform the following:

1. Continue to provide training to personnel on proper charge card procedures.
2. Require approving officials to be more diligent in monitoring and enforcing compliance with Interior's charge card policies.
3. Periodically test a sample of charge cards for compliance with Interior's charge card policies.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations. We did not audit Interior's response and, accordingly, we express no opinion on it.

F. Controls over Grants

Interior is required to monitor its grantees in accordance with the *Single Audit Act Amendments of 1996,* and the related OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular No. A-133). Interior needs to improve controls over grant monitoring at four Interior components. Interior did not maintain documentation that Interior formally communicated the grant award name, grant number, catalog of federal domestic award number, and/or the list of applicable laws and regulations to the grantees for 32 of the 45 grant awards tested at one component. Interior also did not have a complete listing of grantees to ensure that it obtained Single Audit reports and issued management decisions on audit findings for one Interior component. In addition, two Interior components did not obtain Single Audit reports within nine months of the grantee's fiscal year-end for 13 of 44 grantees tested and did not issue management decisions on audit findings within six months after receipt of Single Audit reports or ensure that the grantees completed appropriate and timely corrective action on such findings for 8 of the 66 grantees tested. Further, two Interior components, did not obtain or follow up on past due Financial Status Reports for 15 of the 77 grantees tested. Additionally, one Interior component did not obtain Grant Performance Reports for 8 of 32 grantees tested or obtain Annual Reports for 3 of the 32 grantees tested. Finally, Interior did not review the reconciliation from the grant system to the accounting system at one Interior component.

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Recommendations
We recommend that Interior perform the following to improve its grant monitoring process:

1. Review the grant award to ensure that the grant awards include the award name and number, the catalog of federal domestic number and title, award year, if the award is for research and development, and list of laws and regulations and document approval on the grant award.
2. Maintain a complete and accurate listing of grantees to enable monitoring of receipt of Single Audit Reports and issuance of management decisions on findings.
3. Follow up on Single Audit, Financial Status, Grant Performance, and Annual Reports not received and consider the need to limit future grant awards until these reports are received.
4. Issue management decisions on audit findings within six months after receipt of Single Audit reports and verify that grantees take appropriate and timely corrective action.
5. Require a supervisor to review the reconciliation from the grant system to the accounting system and to document evidence of such review.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendation. We did not audit Interior's response and, accordingly, we express no opinion on it.

G. Controls over the Indian Trust Funds

The United States Congress has designated the Secretary of the Interior as the trustee delegate with responsibility for the financial and non-financial resources held in trust on behalf of American Indian Tribes (Tribal Trust Funds), 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 for American Indians (OST), Indian Affairs (IA), other Interior bureaus, and agreements with American Indian Tribes.

The Indian Trust Funds' balances include two categories: (1) Trust Funds that are held by Interior because the corpus of specific accounts is non-expendable or the funds that are held for future transfer to Indian Tribes upon satisfaction of certain conditions and thus are reflected in Interior's financial statements; (2) Trust Funds for Indian Tribes and individual Indians that are considered non-Federal accounts and thus are not reflected in Interior's financial statements but are disclosed in a footnote to Interior's financial statements, in accordance with the accounting standards.

Interior has invested a significant amount of resources to improve controls over Indian Trust Funds; however, we noted that Interior needs to continue its efforts to resolve historical differences for items 1 through 4 below, and to improve procedures and internal controls for entering and maintaining Trust Fund information, including recording receivables, to ensure that the Indian Trust Funds' activity and balances are recorded properly and timely, as follows:

1. Trust Fund Balances
The financial information systems and internal control procedures used in the processing of Indian Trust Fund transactions have suffered historically from a variety of system and procedural internal control weaknesses. In addition, Interior is burdened with the ongoing impact of decades of accumulated discrepancies in the accounting records. Furthermore, certain Indian Trust Fund beneficiaries do not agree with the trust fund balances and/or have requested an accounting of the Indian Trust Funds. However, Interior has invested a significant amount of resources identifying historical records, isolating and working to

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resolve historical differences, and preparing an accounting of the Indian Trust Fund balances and will continue with this historical accounting effort.

2. *Individual Indian Monies Subsidiary Ledger*
   The control account for Individual Indian Monies (IIM) account holders represents the aggregate net balance of trust funds held on behalf of IIM account holders, house accounts, and suspense accounts as reflected in the detailed subsidiary ledger of IIM accounts (subsidiary ledger). The control account balance has historically not agreed to the sum of the balances from the subsidiary ledger, and it cannot be determined which balance, if either, is correct. The amount invested for IIM is based on the IIM control account balance. Consequently, the balance of funds invested for IIM account holders may not be correct, which in turn would affect interest earnings. As of September 30, 2007, the aggregate sum of all balances included in the subsidiary ledger exceeded the control account by approximately $6 million.

   As of September 30, 2006, the subsidiary ledger contained negative account balances totaling approximately $44 million (of which approximately $164,000 was attributed to individual Indian accounts as of September 30, 2006). During fiscal year 2007, management adjusted the subsidiary ledger eliminating the negative account balances totaling approximately $44 million (of which approximately $113,000 was attributed to individual Indian accounts as of September 30, 2007); however, we were unable to conclude on the propriety of such adjustment.

3. *Special Deposit Accounts*
   As of September 30, 2007 and 2006, there were approximately 13,000 and 22,000 special deposit accounts reflected in the subsidiary ledger with balances totaling approximately $33 million and $36 million, respectively. In accordance with Title 25 of the Code of Federal Regulations and as directed by IA, historically OST recorded receipts into special deposit accounts within the subsidiary ledger when the recipient trust fund account was unknown at the time of receipt. When IA identifies the trust fund account(s), OST transfers the amount from the special deposit account(s) to the designated trust fund account(s) in accordance with IA instructions. A significant number of special deposit accounts have remained inactive for the past several years and new special deposit accounts were established during fiscal year 2007 and 2006. As of September 30, 2007, a significant number of special deposit accounts represent historical balances and continue to require resolution.

4. *Undistributed Interest and Unusual Balances*
   OST and/or IA had not been able to determine the proper recipients of undistributed interest related to Tribal Trust Funds of approximately $2.0 million as of September 30, 2006. However, in prior years OST commissioned a report to assist in determining the recipients of these funds, and based on that report distributed the balance of these funds during fiscal year 2007. Additionally, OST and/or IA have not been able to determine the proper recipients of undistributed interest related to IIM of approximately $3.8 million and $3.6 million as of September 30, 2007 and 2006, respectively. Furthermore, there were Tribal Trust Funds accounts with negative cash balances totaling approximately $721,000 as of September 30, 2007 and 2006, which continue to require resolution.

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5. *Entering and Maintaining Trust Fund Information*
The regional and agency offices of IA perform a critical role in the initial input and subsequent changes to the Indian Trust Funds' information disclosed by Interior. We noted weaknesses in the following areas:

a. *Trust Fund Records*
IA did not consistently maintain ownership records for rights of way lease agreements on lands held in trust for the Indian Trust Funds because IA was unable to provide evidence of ownership for 38 of the 45 lease agreements tested. Additionally, IA did not consistently obtain appraisals from the Bureau of Land Management prior to entering into the lease agreements related to lands held in trust for the Indian Trust Funds. Finally, IA did not consistently follow its policies contained in Part 53 of the Indian Affairs Manual because IA did not obtain and approve Forest Management Plans for 2 of 30 locations tested.

b. *Distribution of Funds to OST*
IA did not consistently sign the Trust Funds Receivable Worksheet prior to submitting funds to OST for 9 of the 115 items tested. In addition, IA did not consistently transfer funds to OST within 24 hours of the lease agreement approval for 15 of 115 items tested and within 24 hours of receipt for 3 of the 115 items tested in accordance with its policies. Finally, IA did not use the fastest means possible in forwarding funds to the lockbox in accordance with its policies for 5 of 115 items tested.

c. *Accounts Receivable*
IA had not fully developed and communicated standardized policies and procedures for establishing, tracking, and pursuing historical accounts receivable for the Indian Trust Funds. This resulted in inconsistent processes and increases the risk that amounts due to Indian Trust Funds are not identified and ultimately collected.

d. *Probate Backlog*
IA did not consistently enter probate orders for land title into the trust management systems timely. Although IA made progress in reducing the backlog, IA indicated that it had probate orders that had not been prepared, adjudicated, recorded, and/or encoded. IA expects to have the backlog resolved in September 2009. This increases the potential for untimely distributions of income to the account holders of the Indian Trust Funds.

e. *Supervised and Restricted Accounts*
IA did not consistently perform reviews over active supervised accounts. Finally, although each of the regions that we visited had compiled a listing of active supervised accounts, the regions expended significant efforts generating the listing. IA has identified reports from the Trust Fund Accounting System (TFAS) and Strata Vision, which list all active supervised accounts and needs to work with OST to ensure its timely distribution to the appropriate agency offices.

Recommendation
We recommend that Interior develop and implement procedures and internal controls to address the deficiencies in controls related to Indian Trust Funds.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with the findings because management believes that its efforts to address internal control deficiencies in the Indian Trust Funds are substantially complete and that the auditors' report did not contain findings suggesting current operational control deficiencies. We did not audit Interior's response and, accordingly, we express no opinion on it.

Auditors' Response to Management's Response
As summarized above, we identified control deficiencies in the current year that adversely affect Interior's ability to initiate, authorize, record, process, and report Indian Trust Fund data reliably. Therefore, we continue to believe that the control deficiencies identified constitute a significant deficiency.

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We noted certain additional matters that we have reported to management of Interior in a separate letter dated November 13, 2007.

INTERNAL CONTROL OVER PERFORMANCE MEASURES

Our tests of internal control over performance measures, as described in the Responsibilities section of this report, disclosed no deficiencies involving the design of the internal control over the existence and completeness assertions related to key performance measures.

COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed one instance of noncompliance or other matters that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and is described below.

H. *Single Audit Act Amendments of 1996*

As discussed in the Internal Control over Financial Reporting section of this report, Interior did not perform adequate monitoring of grantees in accordance with the *Single Audit Act Amendments of 1996* and the related OMB Circular No. A-133. Interior needs to ensure that it communicates grant award information, obtains Single Audit, Financial Status, Grant Performance, and Annual Reports, and issues management decisions on audit findings in a timely manner.

Recommendation
We recommend that in fiscal year 2008, Interior obtain Single Audit, Financial Status, Grant Performance, and Annual Reports and issue management decisions on audit findings in accordance with the requirements of the *Single Audit Act Amendments of 1996* and the related OMB Circular No. A-133.

Management Response
Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our

recommendation. We did not audit Interior's response and, accordingly, we express no opinion on it.

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The results of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no other instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed no instances in which Interior's financial management systems did not substantially comply with the three requirements discussed in the Responsibilities section of this report.

RESPONSIBILITIES

Management's Responsibilities. The United States Code Title 31 Sections 3515 and 9106 require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, Interior prepares and submits financial statements in accordance with OMB Circular No. A-136.

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with U.S. generally accepted accounting principles;
- Preparing the Management's Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information;
- Establishing and maintaining effective internal control; and
- Complying with laws, regulations, contracts, and grant agreements applicable to Interior, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2007 and 2006 financial statements of Interior based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Interior's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2007 audit, we considered Interior's internal control over financial reporting by obtaining an understanding of Interior's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. 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 express an opinion on the effectiveness of Interior's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Interior's internal control over financial reporting.

As required by OMB Bulletin No. 07-04 in our fiscal year 2007 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis and Performance sections, we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We limited our testing to those controls necessary to report deficiencies in the design of internal control over key performance measures in accordance with OMB Bulletin No. 07-04. However, our procedures were not designed to provide an opinion on internal control over reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether Interior's fiscal year 2007 financial statements are free of material misstatement, we performed tests of Interior's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including 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, regulations, contracts, and grant agreements applicable to Interior. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 07-04 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.

KPMG

This report is intended solely for the information and use of Interior's management, Interior's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 13, 2007

Exhibit I

U.S. DEPARTMENT OF THE INTERIOR

Status of Prior Year Findings

September 30, 2007

Ref	Condition	Status
A	Controls over the Indian Trust Funds	This condition has not been corrected and is repeated in fiscal year 2007. See finding G.
B	Application and general controls over financial management systems	This condition has not been corrected and is repeated in fiscal year 2007. See finding A.
C	Controls over property, plant, and equipment	This condition has been corrected.
D	Reporting the Sport Fish Restoration and Boating Trust Fund	This condition has been corrected.
E	Controls over the U.S. Park Police Pension Plan	This condition has been corrected.
F	Controls over charge cards	This condition has not been corrected and is repeated in fiscal year 2007. See finding E.
G	Control assessment and assurance statement process	This condition has been corrected.
H	Controls over spending authority	This condition has been corrected.
I	Museum collections	This condition has been corrected.
J	*Single Audit Act Amendments of 1996*	This condition has not been corrected and is repeated in fiscal year 2007. See finding H.
K	Potential non-compliance with the *Anti-Deficiency Act*, acquisition regulations, and leasing laws and regulations	This condition has been corrected.
L	*Federal Financial Management Improvement Act of 1996*	This condition has been corrected.