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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 U.S. Department of the Interior (Interior) as of September 30, 2004 and 2003, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, consolidated statements of financing, and consolidated statements of custodial activity for the years then ended (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 the Interior's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements 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 as of and for the years ended September 30, 2004 and 2003 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, Interior's fiscal year 2004 consolidated statement of net cost is not comparable to its fiscal year 2003 consolidated statement of net cost because, in fiscal year 2004, Interior revised the presentation of costs and revenues to match the *Government Performance and Results Act* strategic plan applicable to fiscal year 2004, which is different from the plan applicable to fiscal year 2003. Also, as discussed in Note 20 to the financial statements, Interior changed its method of accounting for the liability related to the U.S. Park Police Pension Plan effective October 1, 2003.

Our consideration of internal control over financial reporting identified the following reportable conditions:

Reportable Conditions that are Considered to be Material Weaknesses

- A. Controls over property, plant, and equipment
- B. Process for year-end closing
- C. Reconciliation of intragovernmental transactions and balances
- D. Controls over the Indian Trust Funds



Other Reportable Conditions

- E. Application and general controls over financial management systems
- F. Controls over accruals
- G. Controls over legal and environmental contingencies
- H. Financial management at the Bureau of Indian Affairs
- I. Controls over revenue and other financing sources
- J. Controls over grants
- K. Controls over payments in lieu of taxes
- L. Controls over budgetary transactions
- M. Controls over charge cards
- N. Controls over benefit programs

We also noted the following significant deficiencies in internal control over Required Supplementary Information and Required Supplementary Stewardship Information that, in our judgment, could adversely affect Interior's ability to collect, process, record, and summarize this information:

- O. Deferred maintenance reporting
- P. Stewardship reporting

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

- Q. Single Audit Act Amendments of 1996*
- R. Debt Collection Improvement Act of 1996*
- S. Prompt Payment Act*
- T. Federal Financial Management Improvement Act (FFMIA) of 1996*

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



Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of the U.S. Department of the Interior as of September 30, 2004 and 2003, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, consolidated statements of financing, and consolidated statements of 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 Interior as of September 30, 2004 and 2003, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activities for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, Interior's fiscal year 2004 consolidated statement of net cost is not comparable to its fiscal year 2003 consolidated statement of net cost because, in fiscal year 2004, Interior revised the presentation of costs and revenues to match the *Government Performance and Results Act* strategic plan applicable to fiscal year 2004, which is different from the plan applicable to fiscal year 2003. Also, as discussed in Note 20 to the financial statements, Interior changed its method of accounting for the liability related to the U.S. Park Police Pension Plan effective October 1, 2003.

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. As a result of such limited procedures, we believe that the Required Supplementary Information for deferred maintenance and the Required Supplementary Stewardship Information (RSSI) for stewardship assets and investments are not presented in conformity with accounting principles generally accepted in the United States of America. The Required Supplementary Information disclosures for deferred maintenance are not complete or current, because Interior had not estimated deferred maintenance for all assets and did not consistently update deferred maintenance estimates. In addition, the Required Supplementary Stewardship Information disclosures for stewardship assets and investments are not current, complete, or consistently supported, because Interior did not consistently follow its established procedures and controls to accumulate and report the disclosure information. Finally, we determined that Interior did not reconcile intragovernmental transactions and balances with its trading partners, as specified by OMB requirements, because Interior did not reconcile transactions and balances throughout the year and because the trading partners did not consistently provide information by Interior component or Treasury fund symbol.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Performance Data and Analysis section and the Appendices are an integral part of Interior's *Fiscal Year 2004 Annual Report on Performance and Accountability*. However, this information is not a required part of the financial statements and is presented for purposes of additional analysis. The information in the Performance Data and Analysis section and the Appendices has not been subjected to the same auditing procedures and, accordingly, we express no opinion on it.

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 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

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 the 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 2004 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 D are material weaknesses as defined above.

A. Controls Over Property, Plant, and Equipment

Interior needs to improve controls over property, plant, and equipment to ensure transactions are promptly recorded, properly classified and accounted for, and to prepare timely and reliable financial reports. We noted control weaknesses in the following areas:

1. Land and Land Rights

Interior does not have a complete and accurate inventory system for \$1.9 billion in land and land rights, such as right-of-ways. Interior is in the process of completing an inventory of land and land rights and expects to complete this project in fiscal year 2005. In addition, during fiscal year 2004, Interior did not have controls to ensure land transactions were properly recorded. As a result, Interior did not record several land disposals.

2. Acquisitions

Interior does not consistently record property, plant, and equipment transactions. We identified 25 exceptions in the 404 transactions tested at certain components. Specifically, we noted that Interior expensed certain costs that should have been capitalized and capitalized certain costs that should have been expensed. The primary cause of this condition was lack of staff training on classifying costs. In addition, Interior does not consistently review and approve property adjustments, as we identified that Interior incorrectly recorded adjustments of over \$105 million related to construction costs and internal use software.

3. Construction-in-Progress

Interior needs to improve controls to monitor and reconcile the construction-in-progress account. We identified exceptions for 57 of the 167 construction projects tested at certain components. Specifically, we noted that Interior did not transfer construction projects from the construction-in-progress account to real property accounts at the time of completion, transfer costs from the construction-in-progress account to real property accounts prior to completion



of the project, and classified costs as construction-in-progress that should have been expensed or classified as equipment.

4. Leased Property

Interior did not consistently review leases to determine if they were capital or operating leases, and had difficulty providing documentation supporting certain lease reviews. In addition, Interior did not effectively prepare lease information for disclosure in its financial statements. As a result of our observations, Interior analyzed and adjusted its schedule of future minimum lease payments by a total of approximately \$82 million. Furthermore, Interior did not properly calculate the accumulated depreciation related to capital leases.

As a result of our observations, Interior expended a significant amount of time and resources analyzing and adjusting property, plant, and equipment balances and operating lease disclosures as of and for the year ended September 30, 2004.

Recommendations

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

1. Land and Land Rights

- a. Complete its 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.
- b. Establish controls to ensure land acquisitions and disposals are properly recorded in the general ledger.

2. Acquisitions

- a. Periodically train personnel on how to distinguish between costs that should be capitalized versus expensed.
- b. Require a second individual to review property transactions, expense transactions, and the related source documents to verify that transactions are properly expensed or capitalized.

3. Construction-in-Progress

- a. Review its construction-in-progress accounts to identify completed projects that should be transferred to the appropriate property account and projects that are improperly classified as construction-in-progress. This review should be performed monthly.

4. Leased Property

- a. Document the evaluation of whether leases should be classified as capital or operating leases and require a second individual to review and approve these evaluations.
- b. Maintain the lease evaluation documentation, including the related present value calculations and fair market value assessments.
- c. Develop and maintain a database of all real and personal property leases to assist in monitoring and reporting future minimum lease payments. This database should include lease number, type, term, payments, and other information that facilitates preparation of the future minimum lease payment disclosure.



Management Response

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

B. Process for Year-End Closing

Interior needs to improve controls over the recording and reporting of year-end transactions to ensure that transactions are promptly and properly recorded for timely and reliable financial reports, as follows:

1. Year-End Adjustments

Interior does not have adequate processes and controls to ensure that year-end transactions are recorded accurately or timely. For example, we determined that Interior incorrectly recorded approximately \$390 million of cash received in September 2004 as custodial revenue rather than as a decrease to accounts receivable related to Minerals Management Service. As a result of our inquiries, Interior also determined that it had not recorded over \$293 million of assets and custodial revenue related to Bureau of Land Management and Minerals Management Service transactions that occurred at the end of September 2004. In addition, Interior recorded several billion dollars in financial transactions after issuing trial balance reports on October 7, 2004, which management had certified as complete and accurate. Furthermore, Interior recorded several hundred million dollars of financial transactions subsequent to issuing component financial reports on October 18, 2004, which management had certified as complete and accurate.

2. Offsetting Receipts

Interior initially did not record offsetting receipts for the Utah Reclamation Mitigation and Conservation Account of approximately \$15 million. After we notified Interior of this condition, Interior inadvertently increased offsetting receipts by approximately \$1.182 billion, resulting in an overstatement of offsetting receipts by approximately \$1.167 billion. This occurred because Interior did not effectively review and approve the journal entry to ensure that the general ledger matched the TFS-6655 *Receipt Account Trial Balance* and the SF-224 *Statement of Transactions*.

As a result of our observations, Interior expended a significant amount of time and resources analyzing and adjusting its fiscal year 2004 financial statements.

Recommendations

We recommend that Interior implement the following recommendations to improve controls over the year-end closing process:

1. Year-End Adjustments

- a. Implement procedures to ensure transactions are identified and recorded at the end of the year. This should include requiring the finance personnel to review and approve the procedures performed by the program personnel to identify and report transactions that occurred in September 2004.
- b. Require individuals who certify the trial balance and financial reports to implement procedures to ensure transactions are recorded during the year rather than after management certifies the completeness and accuracy of the reports.



2. Offsetting Receipts

- a. Require a second individual to compare the offsetting receipts from the TFS-6655 *Receipt Account Trial Balance* and the SF-224 *Statement of Transactions* to the general ledger to ensure that offsetting receipts are properly recorded.
- b. Require a supervisor review and approve all journal entries.
- c. Train employees on reviewing and approving journal entries to ensure adjustments are properly recorded in the general ledger and properly supported.

Management Response

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

C. Reconciliation of Intragovernmental Transactions and Balances

Interior is required to reconcile transactions and balances with other Federal entities in accordance with OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and U.S. Department of the Treasury's *Federal Intragovernmental Transactions Accounting and Policies Guide*. Interior has not fully reconciled its intragovernmental transactions and balances because Interior did not reconcile transactions and balances during the year, and because the trading partners did not consistently provide information by Interior component or Treasury fund symbol. As a result, Interior's transactions and balances with other Federal entities may not properly eliminate on the government-wide financial statements.

Recommendation

We recommend that Interior establish quarterly procedures to reconcile transactions and balances with other Federal entities. These procedures should include confirming amounts at the Interior component level with trading partners and meeting with trading partners to resolve any differences identified.

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.

D. Control Over the Indian Trust Funds

The United States Congress has designated the Secretary of the Interior as the primary fiduciary with responsibility for the monetary and non-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 for American Indians (OST), the Bureau of Indian Affairs (BIA), other Interior bureaus, and agreements with American Indian Tribes.

The Indian Trust Funds' balances include appropriated accounts that are considered Federal funds and non-Federal accounts that belong to beneficiaries of the Indian Trust Funds. The Federal accounts are reflected in Interior's financial statements while the non-Federal accounts, which represent the majority of the Indian 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 Funds' activity and balances are recorded properly or timely. We noted the following controls that need to be improved:

1. *Trust Fund Balances*

As of September 30, 2004, several financial reporting differences from prior periods relating to the fairness of the Indian Trust Fund balances have not been resolved. Certain parties, for whom Interior holds monetary assets in trust, have filed a class action lawsuit for an accounting of Individual Indian Monies that may or may not lead to claims against the United States Federal Government. Additionally, other parties do not agree with the Indian Trust Funds balances reported by Interior and have filed claims against the United States Federal Government. Interior is in the process of providing an accounting to beneficiaries of the Indian Trust Funds.

2. *Individual Indian Monies Subsidiary Ledger*

The balance of the Individual Indian Monies control account does not agree to the sum of the balances from the subsidiary ledger and it cannot be determined which balance, if either, is correct. As of September 30, 2004, the aggregate sum of all positive balances included in the subsidiary ledger exceeded the control account by approximately \$6 million. Interior has requested funding from Congress to resolve the \$6 million difference. In addition, as of September 30, 2004, the subsidiary ledger contains negative account balances totaling approximately \$44 million (of which approximately \$238,000 is attributed to individual Indian accounts as of September 30, 2004).

3. *Special Deposit Accounts*

In accordance with Title 25 of the Code of Federal Regulations and as directed by BIA, OST records receipts into special deposit accounts within the subsidiary ledger when the recipient trust fund account is unknown at the time of receipt. When BIA 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 BIA instructions. A significant number of special deposit accounts have remained inactive for the past several years and new accounts continued to be established during fiscal year 2004. As of September 30, 2004, there were approximately 20,000 special deposit accounts, with balances totaling approximately \$46 million.

4. *Undistributed and Unusual Balances*

OST has not been able to determine the proper recipients of undistributed interest of approximately \$1.8 million as of September 30, 2004. In addition, OST and BIA have not been able to determine the proper recipients of approximately \$1.3 million transferred from certain special deposit accounts to undistributed interest accounts. Furthermore, there were twelve Tribal Trust Funds accounts with negative cash balances totaling approximately \$724,000 as of September 30, 2004.

5. *Entering and Maintaining Trust Fund Information*

The regional and agency offices of 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. **Trust Fund Systems** – BIA has not consistently implemented automated systems for tracking and processing activities of the Indian Trust Funds. Agency offices use “off-the-shelf” software, internally developed software, in-house databases, and manual processes to manage ownership records, track lease activity, account for receivables/revenue, and determine disbursement amounts. BIA has developed an automated system for certain activities; however, BIA has not yet implemented this new system in all agency offices. This situation increases the risk that transactions are recorded inaccurately and untimely.
- b. **Segregation of Duties** – The responsibilities for Indian Trust Funds processing are not properly segregated to prevent or detect errors. BIA did not segregate realty and land management activities (i.e., lease compliance) from accounting activities (i.e., collecting, depositing, recording, and distributing receipts). Also, in some offices the same employee was responsible for all activities associated with trust transactions, including initiating lease agreements, generating bills, collecting funds, making deposits, sending instructions to OST to create accounts, and distributing funds.
- c. **Accounts Receivable** – BIA has not developed and communicated standardized policies and procedures for establishing, tracking, and pursuing accounts receivable for the Indian Trust Funds. This has resulted in inconsistent processes and has increased the risk that amounts due to Indian Trust Funds are not identified and ultimately collected. Several agency offices prepare bills after receiving payments rather than sending bills in advance of the payment due date. In addition, certain agency offices do not identify and pursue past due receivables and instead rely on landowners/lessors to inquire of overdue payments before pursuing the receivable. Furthermore, several agency offices did not maintain a listing of leases and permits against which receivables could be established.
- d. **Probate Backlog** – BIA does not enter probate orders for land title into the trust management systems timely. Although BIA has made progress in reducing the backlog, BIA still has probate orders that have not been recorded. This increases the potential for inaccurate and untimely distributions of income to the account holders of the Indian Trust Funds.
- e. **Untimely Deposits** – Several agency offices did not consistently forward trust receipts to OST in a timely manner. In certain agency offices, deposits of trust receipts were delayed for up to five business days and in others, delays were between six and ten days. Finally, though rare, certain agency offices took up to sixteen business days to deposit receipts.
- f. **Supervised and Restricted Accounts** – BIA did not consistently maintain documentation for supervised accounts, including social service assessment and evaluation forms, disbursement documentation, annual review documentation, court orders, and notification of restriction letters. Furthermore, BIA did not consistently perform annual reviews of accounts or prepare distribution plans for inactive accounts.
- g. **Appraisal Review** – One of the key elements in performing realty trust transactions is the requirement to obtain appraisals for realty transactions. Current laws allow the appraisal function to be carried out to tribes, who are often the named parties involved in realty transactions. BIA is responsible for assisting trust beneficiaries in the negotiation and execution of realty transactions. Office of Appraisal Services (OAS) is responsible for conducting reviews of appraisals that are completed for the benefit of tribes or individual trust beneficiaries. Controls are not in place to ensure that all appraisals, conducted under compacts or contracts completed for the benefit of tribes or individual trust beneficiaries, are provided to OAS.



Recommendation

We recommend that the Department of the 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 agreed with our findings and its comments were responsive to our recommendations.

E. Application and General 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 A-130, *Management of Federal Information Resources*. These conditions could have affected Interior's ability to prevent and detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information. We identified the following conditions during fiscal year 2004:

1. Entity-wide Information Technology (IT) Security Program

An entity-wide 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. An effective security program includes a risk assessment process, certification and accreditation process, application-level security plans, training, and effective incident response and monitoring capabilities. Interior needs to improve assignment of security responsibilities, document and finalize certain security policies and procedures, enhance monitoring of the security program, monitor completion of security training, and consistently perform background investigations. In addition, Interior had not completed the certification and accreditation process for all applications and general support systems or classified certain resources according to their sensitivity or criticality.

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. Interior needs to document physical security plans and strengthen password policies at certain components. Interior also needs to improve controls over granting, terminating, and monitoring system access to applications. In addition, Interior did not consistently review security access profiles or generate and review security violation reports. Furthermore, Interior had not fully limited access to system information.

3. Segregation of Duties

Proper segregation of duties should be ensured through the establishment of policies, procedures, and organizational structure, so that one individual cannot control key aspects of financial transactions, and thereby conduct unauthorized actions or gain unauthorized access to assets or records. Interior had not fully documented and segregated processing responsibilities. Certain system configurations provide individuals, who are involved with programming, testing and migrating changes to production, access to source code, test, and production libraries.



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 needed to document and finalize certain system software policies and procedures and improve controls over migration of programs to the production environment. Interior did not consistently test system software patches using a test environment before installing the patches in the production environment or consistently perform post-implementation reviews after installing emergency patches.

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 could be 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 had not formalized and approved policies for changes to certain applications. In addition, Interior did not consistently apply change management procedures. Interior also did not consistently maintain documentation for required aspects of the change management processes or system software change logs. Furthermore, Interior did not consistently use library management software.

6. *Service Continuity*

Losing the capability to process, retrieve, and protect information maintained electronically could significantly affect Interior's ability to accomplish its mission. Consequently, procedures should be in place to protect information resources, minimize the risk of unplanned interruptions, and recover critical operations, should interruptions occur. However, Interior had not formalized an incident response capability to mitigate the risk of service interruptions. Interior needs to expand documentation and procedures for certain contingency plans and provide periodic training. Interior does not effectively maintain back up data and the related logs at certain components. In addition, Interior had not finalized, approved, or tested certain contingency plans. Furthermore, Interior had not consistently documented the test procedures, expectations, and testing results.

Recommendation

We recommend that the Interior continue to improve the security and general controls over the financial management systems. These controls should address each of the areas discussed above, as well as other areas that might affect the information technology control environment to ensure adequate security and protection of the information systems.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management partially agreed with our findings. Management indicated that Interior has made substantial progress improving internal controls and believes that our findings did not constitute a reportable condition principally because of the increase in the percentage of systems certified and accredited to 98 percent by the end of fiscal year 2004.



Auditors' Response to Management's Response

We agree that Interior has made improvements in the security and controls over information systems. However, we identified a number of conditions that could have affected Interior's ability to detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information as summarized in our finding above. Therefore, we believe that the control weaknesses identified constitute a reportable condition.

F. Controls Over Accruals

In order to meet the accelerated reporting deadlines, Interior estimated certain accrual balances. However, Interior had to revise the accrual methodology related to its Departmental working capital funds at the end of the year as a result of our observations. In addition, the accrual calculation did not match the general ledger by approximately \$22 million. As a result of our observations, Interior expended additional time and resources revising its accrual methodology, reconciling the calculations to the ledger, and adjusting the September 30, 2004 accrual balances to ensure the amounts were fairly stated.

Recommendations

We recommend that Interior perform the following:

1. Test and finalize the accrual methodology for its interim financial statements to reduce the year-end accrual effort. Testing should include comparing prior year estimated to actual accrual results and adjusting the methodology based on these results.
2. Reconcile the accrual calculations to the general ledger and enhance controls to ensure that the accruals calculations are complete and accurate. This should include having a supervisor review and approve the accrual calculation and reconciliation from the calculation to the general ledger.

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.

G. Controls over Legal and Environmental Contingencies

Interior has not properly designed controls or sufficiently trained staff to ensure that legal and environmental information is effectively identified, maintained, and reported as follows:

1. Legal Contingencies

Interior uses an automated system to capture the contingency information used to record liabilities and prepare disclosures in accordance with Federal accounting standards. However, the information in the automated system is not always sufficient to determine the accounting treatment for each claim or assessment. In addition, the BIA financial management office does not have formally documented procedures relating to legal contingencies and did not review the information provided by the solicitors during the year. Finally, BIA did not consistently decrease the legal liability by approximately \$27 million for cases that are complete.



2. *Environmental Contingencies*

Interior did not issue policies for estimating environmental liabilities to BIA offices in a timely manner. As a result, individuals did not consistently interpret and apply these policies or consistently prepare documentation supporting the environmental liability estimates.

As a result, Interior spent a significant amount of time revising the legal and environmental supporting documentation and determining which contingencies should be accrued and which should be disclosed in its fiscal year 2004 financial statements.

Recommendations

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

1. *Legal Contingencies*

- a. Continue to train the solicitors on entering sufficient information in the system to enable the financial management offices to determine the appropriate accounting treatment of each claim or assessment.
- b. Require financial management offices to develop and issue procedures for monitoring and recording contingencies.
- c. Review the quarterly analysis provided by the solicitor's office, meet periodically with the solicitor's office to discuss the status of and changes in the legal contingency information, and adjust the legal liability for these changes in this information.

2. *Environmental Contingencies*

- a. Develop and communicate future updates to policies for estimating environmental liabilities at the beginning of the fiscal year.
- b. Continue to provide periodic training to scientists, financial management staff, and others to ensure that they understand Interior policies and the Federal accounting standards related to estimating and recording environmental liabilities.

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.

H. Financial Management at the Bureau of Indian Affairs

BIA needs to improve its financial management organization and processes. BIA does not have enough sufficiently trained financial staff to manage accounting operations and ensure financial transactions are properly recorded. BIA has attempted to compensate for staff departures by assigning additional responsibilities to the remaining personnel and subcontractors. However, assigning additional responsibilities to remaining personnel has not resulted in an effective and efficient management environment. In addition, the current service agreement with the Interior National Business Center does not provide for appropriate BIA management input and oversight of the transaction processing by the National Business Center.

We also found that BIA financial management policies and procedures are not fully developed or consistently applied throughout BIA. In addition, BIA does not reconcile several financial statement



accounts, reconcile with its trading partners, or resolve certain differences between the general ledger and subsidiary ledgers until the end of the year. BIA also does not effectively review journal vouchers as BIA recorded adjustments twice, to the incorrect accounts, or without including the budgetary accounts. Furthermore, BIA does not effectively reconcile Fund Balance with Treasury. For example, we determined that BIA had not performed certain reconciliations or resolved over 1,100 differences netting to \$5 million.

As a result, BIA expended a significant amount of time and resources reconciling its financial accounts, resolving differences between the general ledger and subsidiary ledgers, and adjusting the general ledger.

Recommendations

We recommend that Interior's Office of Financial Management work with BIA to perform the following:

1. Recruit additional accounting staff and continue to train existing staff to ensure that BIA has sufficiently trained resources to account for and report financial transactions.
2. Establish controls to review and approve the transactions processed by Interior's National Business Center.
3. Develop and communicate, to financial and program staff, financial management policies and procedures.
4. Enforce consistent application of financial management policies and procedures through internal control reviews.
5. Develop and implement formal month-end financial reporting processes to reconcile subsidiary ledgers to general ledgers, reconcile Treasury's records to the general ledger, reconcile balances and transactions with trading partners, and resolve differences. This should include having a supervisor review and approve the reconciliations.

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.

I. Controls Over Revenue and Other Financing Sources

Interior's revenue controls did not ensure that Interior consistently accounted for and classified revenue and other financing source transactions as follows:

1. Recording Activity

Interior did not effectively review over \$155 million of revenue and financing source transactions to ensure that the transactions were properly presented in accordance with Federal accounting standards. Specifically, Interior improperly classified appropriation transfers, recorded exchange revenue as non-exchange revenue, recognized revenue in the improper period, erroneously recorded revenue as a reduction to expenses, incorrectly calculated and supported the allowance for doubtful accounts, and did not impute interest on lease bonus revenue due over a long-term period.

2. Issuing Bills

Interior did not issue bills or reduce advances in accordance with the agreements and prudent business practices for 42 of the 252 revenue transactions tested at one component and for \$1.4



million at another component. In addition, Interior has not billed for all interest on late royalty payments. We identified approximately \$22 million of unbilled interest on late royalty payments.

3. Monitoring Accounts

Interior does not effectively analyze and reconcile accounts receivable and advances from others. Interior has not resolved over \$196 million of aged account receivables that are substantially reserved. In addition, Interior has not properly designed the reconciliation of certain subsidiary ledgers to the general ledger, as Interior has reconciling items that are not cleared in a timely manner. Finally, Interior has agreements with both accounts receivable and deferred revenue balances, which should not occur.

As a result of our comments, Interior performed a detailed analysis of revenue transactions and adjusted the fiscal year 2004 financial statements accordingly.

Recommendations

We recommend that Interior implement the following recommendations to improve controls over the revenue and other financing sources:

1. Recording Activity

Establish controls to ensure that transactions are recorded in the proper account, at the proper amount, and in the proper period. These controls should also include periodic inspections by a second individual to ensure transactions are properly recorded.

2. Issuing Bills

- a. Standardize customer agreements and implement billing policies that enable Interior to issue bills or reduce advances when the associated costs are incurred.
- b. Bill for late interest on late royalty payments in a timely manner.

3. Monitoring Accounts

- a. Investigate and resolve all accounts over six-months old. This should include matching the agreement transactions, pursuing collections, and referring accounts to Treasury.
- b. Implement formal month-end financial reporting processes to reconcile the subsidiary ledger to the general ledger, investigate and resolve reconciling items as they are identified, as well as identify and resolve customer agreements with both an accounts receivable and advance balance.

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.

J. Controls over Grants

In accordance with *Single Audit Act Amendments of 1996* as well as Public Laws 93-638 and 100-297, Interior should monitor grantees to ensure grantees expend awards in accordance with the grant requirements and Federal regulations. However, Interior has not fully developed controls to monitor the grantees to detect and prevent misuse of federal awards. Specifically, we noted the following:



1. *Grant Database*

Interior does not maintain a grant proposal and award database that includes information such as the proposal data, grantee name, grant number, date granted, award amount, funds expended, date the audit reports were received, period covered by the audit reports, findings in the audit reports, and management decisions on findings.

2. *Progress Reports*

Interior does not ensure that grantees submit grant progress reports, such as form SF-269, *Report for Status of Funds*; form SF-270, *Request for Advance or Reimbursement*; and/or form SF-272, *Report of Federal Cash Transactions*. Interior has not received the required forms for 20 of the 32 transactions tested at certain components.

3. *Audit Reports*

Interior does not ensure that grantees complete single audits and submit reports within nine months of the grantees' year end. Interior had not received single audit reports within the required time period for 19 of the 30 grants tested at certain components. In addition, Interior indicated that it had not received single audit reports from 239 grantees within the required deadline.

4. *Findings*

Interior does not issue management decisions on audit findings within six months after receipt of audit reports and does not ensure that grantees take appropriate and timely corrective action.

Recommendations

We recommend the Interior perform the following to improve the monitoring efforts of grantees as follows:

1. *Grant Database*

Ensure that bureaus and offices develop and maintain a proposal and grant database that enables the Interior to monitor the status of the proposals and/or grant awards, and to document the monitoring procedures completed. This database should include the proposal data, grantee name, grant number, date granted, award amount, funds expended, date audit reports are received, period covered by the audit reports, findings in the audit reports, and management decisions on findings.

2. *Progress Reports*

Require grantees to submit form SF-269, *Report for Status of Funds*; or form SF-270, *Request for Advance or Reimbursement* with funding requests; and submit form SF-272, *Report of Federal Cash Transactions*, when funds are paid in advance. In addition, Interior should require grantees that receive funds in advance to submit form SF-269, *Report for Status of Funds*, periodically and at the end of the project.

3. *Audit Reports*

Establish a monitoring and follow up process to verify receipt of single audits reports. Interior should utilize the Federal Clearinghouse web site on an ongoing basis to determine when an audit report has been submitted. If reports are not received, Interior should inquire of grantees and consider the need to limit future grant awards until reports are submitted.



4. Findings

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.

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.

K. Controls over Payments in Lieu of Taxes

In accordance with legislation, Interior is required to provide payments in lieu of taxes of approximately \$200 million annually to counties and other local governments for lands within their boundaries that are administered by the Bureau of Land Management, Forest Service, National Park Service, Fish and Wildlife Service, and certain other agencies. However, Interior has not properly designed controls over this program as follows:

1. Segregation of Duties

Interior did not properly segregate responsibilities. That is, the same Bureau of Land Management individual calculated, recorded, approved, and disbursed the payments in lieu of taxes.

2. Payment Calculations

Interior did not calculate the payment in lieu of taxes in accordance with the formula designated in legislation. Specifically, Interior miscalculated the consumer price indices for 1999 through 2004. However, Interior disbursed the proper amounts because the total amount appropriated for payments in lieu of taxes was lower than the amounts calculated using the proper consumer price indices.

Recommendations

We recommend that Interior perform the following to improve controls over the payments in lieu of taxes:

1. Segregation of Duties

Segregate the responsibilities for calculating, recording, approving, and disbursing payments in lieu of taxes.

2. Payment Calculations

Implement policies and procedures to ensure that the payments in lieu of taxes are determined in accordance with legislation and use the proper consumer price indices.

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.



L. Controls over Budgetary Transactions

Budgetary transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely and reliable financial reports. Interior needs to improve the controls over the following budgetary accounts:

1. *Budgetary Resources*

The Utah Reclamation Mitigation and Conservation Commission, a component of Interior, is authorized by law to deposit contributions from project beneficiaries and transfers from the Secretary of Energy into an investment account. After the Mitigation and Conservation Commission elects to deposit the contributions and transfers into an investment account, these funds are no longer available for future obligations. However, Interior incorrectly presented approximately \$32 million of these funds as appropriations received and as available budgetary resources in the prior year.

2. *Unapportioned Authority*

At the beginning of the fiscal year, Interior recorded unapportioned authority for anticipated reimbursement agreements and during the fiscal year Interior recorded reimbursement authority as orders were received related to the Departmental working capital funds. However, Interior does not consistently reclassify unapportioned authority to apportioned authority at the time Interior receives customer orders. In addition, Interior does not properly reverse the remaining unapportioned authority at the end of the fiscal year in accordance with the reporting requirements. As a result of our observations, Interior decreased the unapportioned authority by \$29 million.

3. *Recoveries of Prior Year Obligations*

The accounting system (i.e., Federal Financial System) incorrectly records recoveries of prior year obligations for reclassifications of obligations between program accounts, receipts, and other transactions, resulting in an overstatement of total budgetary resources and obligations incurred. Although Interior implemented new policies and procedures in fiscal year 2004 to investigate and correct invalid recoveries resulting from the system configuration, Departmental Offices and National Park Service did not consistently follow these policies and procedures. As a result, Interior incorrectly reported budgetary recoveries of over \$13 million.

As a result of our observations, Interior expended additional time and resources analyzing, reconciling, and adjusting its budgetary balances to ensure the amounts were fairly stated for fiscal year 2004.

Recommendations

We recommend that Interior implement the following recommendations to improve internal controls to ensure that budgetary transactions are properly recorded in the financial report:

1. *Budgetary Resources*

- a. Research the appropriation laws and regulations surrounding transactions to ensure that Interior properly records budgetary resources as unavailable or available.
- b. Require the budget office to review and approve these determinations.



2. *Unapportioned Authority*

- a. Reclassify unapportioned authority to apportioned authority at the time Interior receives customer orders.
- b. Require management to review the year-end unapportioned authority general ledger accounts to ensure that they are correct.

3. *Recoveries of Prior Year Obligations*

- a. Modify the system configuration of its accounting system to properly record budgetary recoveries.
- b. Until the accounting system is properly configured or until Interior implements a new financial system that properly records recoveries, Interior should analyze the amounts included in recoveries of prior year obligations and record correcting entries on a monthly basis.

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.

M. 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. 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, Interior does not consistently follow these internal control procedures, as we identified 47 exceptions in the 286 statements tested at certain components. For example, cardholders did not always sign and date the charge card statements in a timely manner and did not consistently maintain charge card receipts to support the charges. In addition, approving officials did not consistently review and approve the charge card statements in a timely manner.

Recommendation

We recommend that Interior approving officials be more diligent in monitoring and enforcing 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.

N. Controls over Benefit Programs

Interior needs to improve controls over the benefit programs to ensure transactions are properly presented and recorded in the financial reports. We noted the following:



1. U.S. Park Police Pension Plan

During fiscal year 2004, Interior adopted guidance from OMB that required Interior to change its method of accounting for the U.S. Park Police Pension Plan (USPP Pension Plan). OMB's guidance required Interior to determine and record a liability for the actuarial present value of the future benefits of the USPP Pension Plan. As Interior is not the plan administrator, Interior obtained the census data to calculate the liability from the District of Columbia, the plan administrator. As the plan administrator, the District of Columbia calculates and adjusts the annuity payments and disburses funds to the beneficiaries.

Interior recalculated a sample of annuity payments and identified several differences between its and the District of Columbia's calculations. As part of our testing of the USPP Pension Plan liability, we also recalculated a sample of the annuity payments and identified differences between our and the District of Columbia's calculations for 171 of the 191 annuity payments recalculated. These differences included both under and over payments. In addition, we compared the census data and personnel records for 253 participants and identified 11 differences in gender, age, and other factors. Interior in consultation with its specialists, evaluated the differences identified and concluded that the USPP Pension Plan liability was fairly stated as of September 30, 2004.

2. Imputed Costs and Unemployment Liabilities

Interior's Office of Financial Management (PFM) performs the calculation and allocation of imputed costs, related financing sources, and the Federal Unemployment Compensation Act liabilities to Interior's components. However, PFM did not properly segregate responsibilities, as the same individual calculated and allocated the amounts to the Interior components. In addition, we noted that PFM used an incorrect rate to calculate the imputed costs and financing sources related to Civil Service Retirement System, and allocated these improper amounts to the individual Interior components. As a result of our inquiries, PFM subsequently recalculated the total amounts using the proper rates and re-allocated the correct amounts to the Interior components.

Recommendations

We recommend that Interior implement the following recommendations to ensure that benefit programs are properly presented in the financial report as follows:

1. U.S. Park Police Pension Plan

- a. Work with the District of Columbia to investigate and resolve differences in the annuity payments and census data.
- b. Establish controls to verify that the census data and annuity payments are supported, maintained, and updated.

2. Imputed Costs and Unemployment Liabilities

Require a second individual to review and approve the calculation and allocation of the imputed costs, related financing sources, and the Federal Unemployment Compensation Act liabilities.



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.

A summary of the status of prior year reportable conditions is included as Exhibit I. We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of Interior in a separate letter dated November 15, 2004.

We have identified controls over property, plant, and equipment; year-end closing process; and intragovernmental reconciliations as material weaknesses that were not reported in Interior's *Federal Managers' Financial Integrity Act* report.

Internal Controls Over Required Supplementary Information and Required Supplementary Stewardship Information

We noted certain significant deficiencies in internal control over Required Supplementary Information and Required Supplementary Stewardship Information discussed in the following paragraphs that, in our judgment, could adversely affect Interior's ability to collect, process, record, and summarize this information.

O. Deferred Maintenance Reporting

Interior has not fully implemented the requirements of Statement of Federal Financial Accounting Standard (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, as amended by SFFAS No. 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS No. 6 and SFFAS No. 8*. SFFAS No. 6 requires Interior to estimate the deferred maintenance for its general, heritage, and stewardship assets using either the condition assessment survey or life cycle costing method. In addition, SFFAS No. 8 requires Interior to assess the condition of stewardship land as indicated in paragraph 81, which states: "Reporting at the entity level for stewardship land shall be more specific than at the government-wide level. Minimum reporting shall include the following...the condition of the stewardship land, unless it is already reported in deferred maintenance information included elsewhere, in which case a reference to the information will suffice. A reference to information if deferred maintenance is reported for the assets."

Interior has adopted the condition assessment survey method, which requires Interior to perform periodic inspections of assets to determine their current condition and estimate the cost to correct any deficiencies. However, Interior has not fully established controls over the condition assessments performed to determine deferred maintenance for all assets as follows:

1. General Property, Plant, and Equipment and Heritage Assets

Interior has not fully established policies and information systems to account for and report condition assessments and the related deferred maintenance at certain components. Interior also has not completed condition assessments and estimated deferred maintenance for all property and equipment. In addition, Interior has not completed condition assessments and estimated deferred maintenance for all known heritage assets, such as, historic structures, prehistoric structures, museum collections, paleontological sites, archeological sites, and National trails. Finally, Interior does not consistently adjust its deferred maintenance estimates for major repairs that occurred since the last assessment.



2. *Stewardship Land*

Interior does not have procedures for assessing the condition and estimating deferred maintenance of stewardship land and the related improvements to stewardship land, and does not have documented evidence that it completed condition assessments and the related deferred maintenance estimates for all stewardship land and related improvements. However, Interior incurs costs annually to improve and maintain stewardship land. Furthermore, in the Required Supplementary Stewardship Information section of the *Annual Report on Performance and Accountability*, Interior implied that improvements and maintenance are needed on stewardship land by stating that: “While individual units of stewardship land can be improved, the condition of National Park Service land as a whole is generally sufficient to support the NPS mission and is considered to be in acceptable condition... While some individual units of stewardship lands can be improved at any time during management cycles, the condition of the stewardship lands as a whole, which are protected by inclusion in both the National Wildlife Refuge System and the National Fish Hatcheries System, is sufficient to support the mission of Fish and Wildlife Service and the statutory purpose for which these conservation systems were established.”

As a result, the Required Supplementary Stewardship Information disclosure on the condition of major classes of assets and the Required Supplementary Information disclosure on deferred maintenance amounts are not complete or current.

Recommendations

We recommend that Interior implement the following recommendations:

1. *General Property, Plant, and Equipment and Heritage Assets*

- a. Establish policies and systems to account for and report condition assessments and deferred maintenance at all components.
- b. Perform condition assessments of all general, property, plant, and equipment; and heritage assets and estimate the related deferred maintenance.
- c. Have supervisors review and approve condition assessments and deferred maintenance estimates to ensure they are performed consistently and in accordance with Interior’s policies.
- d. Periodically update deferred maintenance estimates.

2. *Stewardship Land*

We recognize that Interior does not believe that it needs to perform condition assessments over stewardship land and report any related deferred maintenance. However, paragraph 83 of SFFAS No. 6 requires Interior to disclose deferred maintenance information for all categories of property, plant and equipment (general, stewardship, and heritage). In addition, paragraph 81 of SFFAS No. 8, *Supplementary Stewardship Reporting*, indicates that Interior is required to perform condition assessments of stewardship land and estimate the related deferred maintenance. Therefore, we recommend that Interior:

- a. Meet with the Federal Accounting Standards Advisory Board to discuss its position.
- b. Until FASAB provides new guidance, Interior should implement procedures to conduct condition assessments and estimate deferred maintenance related to stewardship land and disclose this information in the Performance and Accountability Report.



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.

P. Stewardship Reporting

Interior does not consistently follow its established procedures and controls over recording Required Supplementary Stewardship Information. Specifically, we noted the following:

1. Stewardship Property, Plant, and Equipment – Physical Units

Interior does not consistently record stewardship property, plant, and equipment (stewardship asset) transactions accurately or in a timely manner. Interior recorded several adjustments in the current year for transactions that should have been identified and recorded in prior years, including 3,765 archeological site additions, 660 archeological site deletions, 3 stewardship land additions, and 5 stewardship land deletions. Interior does not consistently maintain documentation supporting the stewardship asset additions and deletions. For example, Interior was not able to provide us adequate supporting documentation for 678 of 716 stewardship asset transactions reported at certain components. In addition, a second individual does not consistently review and approve the stewardship asset transactions as required by Interior's policies. In addition, Interior has not completed annual inventories and verifications of several stewardship asset categories, including historic structures, prehistoric structures, and museum collections. Finally, Interior has provided millions of museum items to non-Federal facilities; however, Interior does not have an accurate or recent inventory of these museum items.

2. Stewardship Property, Plant, and Equipment – Condition Assessments

Interior has not completed condition assessments for all stewardship and heritage assets, including the National trail system, historic structures, prehistoric structures, stewardship land, museum collections, paleontological sites, and archeological sites. In addition, Interior components did not consistently follow the Department's five-year assessment policy, as we noted that some condition assessments are over five-years old. As a result, Interior has not disclosed condition assessments of all of its heritage assets in the Required Supplementary Stewardship Information section of the annual report as required by paragraph 81 of SFFAS No. 8.

3. Stewardship Investments

Interior reported obligations rather than expenses incurred for natural resource research and development investments, because Interior does not track actual expenses related to such investments. In addition, Interior does not consistently identify and report investments in non-Federal physical property.

As a result, the Required Supplementary Stewardship Information disclosures for stewardship assets and investments are not complete, current, or consistently supported.

Recommendations

We recommend that Interior strengthen internal controls over recording Required Supplementary Stewardship Information to:



1. Stewardship Property, Plant, and Equipment – Physical Units

Record and report stewardship property, plant, and equipment transactions at the time the event occurs, require supervisors to review and approve these transactions, maintain source documentation for these transactions, and perform periodic inventories of stewardship assets.

2. Stewardship Property, Plant, and Equipment – Condition Assessments

Perform and report condition assessments for all stewardship property, plant, and equipment.

3. Stewardship Investments

Accumulate and report actual expenses incurred for investments in research and development and non-Federal physical property.

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.

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 FFMA, disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and are described below.

Q. Single Audit Act Amendments of 1996

As discussed in the Internal Control over Financial Reporting section of this report, Interior does not perform adequate monitoring of grantees in accordance with the *Single Audit Act Amendments of 1996*, the related OMB Circular A-133, *Audits of States, Local Governments, and Non-profit organizations*, and Public Laws 93-638 and 100-297. Interior needs to develop and maintain a data-base to monitor grant proposals and awards. Interior also needs to ensure that grantees submit progress reports, complete single audits, and submit single audit reports in a timely manner. In addition, Interior needs to issue management decisions on findings in a timely manner.

Recommendation

We recommend that in fiscal year 2005, Interior improve its grantee monitoring process to ensure compliance with the reporting requirements of the *Single Audit Act Amendments of 1996* and the related OMB Circular A-133, *Audits of States, Local Governments, and Non-profit organizations*.

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.

R. 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. Interior did not consistently refer receivables that are over 180 days delinquent to the U.S. Department of the Treasury. Interior did not refer 2 of the 32 Minerals Management Services receivables tested or refer over \$2.5 million in Bureau of Indian Affairs receivables tested. In addition, Interior was unable to refer Bureau of Indian Affairs receivables due to the age and lack of customer information. Interior has over \$25 million of Bureau of Indian Affairs receivables that were over 180 days past due as of September 30, 2004.

Recommendation

We recommend that the Interior establish a process, in fiscal year 2005, to ensure eligible receivables are referred to the U.S. Department of the Treasury in a timely manner.

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.

S. Prompt Payment Act

In accordance with the *Prompt Payment Act*, Interior is required to pay interest penalties when payments are late. However, Interior did not comply with the Prompt Payment Act. Interior did not properly configure its Minerals Management Service accounting system to calculate prompt payment interest. As a result of the system configuration, Interior calculates and pays simple interest rather than the required compounded interest on invoices that are over a month past due and uses an incorrect interest rate to calculate and pay prompt payment interest for certain disbursements. In addition, Interior incorrectly included prompt payment interest on 1 of the 32 Mineral Management Service disbursements that we tested. Furthermore, Interior did not update its Departmental Offices accounting systems to properly reflect the semi-annual interest rate changes as published by the U.S. Department of the Treasury. As a result, Interior used an incorrect interest rate from January through September of 2004.

Recommendations

We recommend that in fiscal year 2005, Interior perform the following:

1. Modify the Mineral Management Service accounting system to calculate prompt pay interest using the appropriate interest rate and using the compound method. If this modification is not cost beneficial as Interior is in the process of implementing a new accounting system, Interior should consider implementing manual procedures to assess and adjust the prompt payment interest amounts to ensure compliance with the prompt payment act.
2. Provide periodic training to personnel responsible for entering the prompt payment information into the accounting system to ensure that they understand the requirements and properly enter information into the accounting system.
3. Update the accounting systems for the semi-annual interest rates published by the U.S. Department of the Treasury.

Management Response

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



The results of our tests of compliance with certain provisions of other laws and regulations, exclusive of those referred to in FFMIA, disclosed no other instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

T. 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 Federal financial management systems requirements, Federal accounting standards, or the United States 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, monitor the security program, strengthen access controls, segregate information technology duties, further develop and implement procedures for controlling system and other software, and improve its service continuity processes. As a result, Interior does not substantially comply with the Federal financial management system requirements.

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, Interior needs to improve controls over property, plant, and equipment; the year-end closing process, intragovernmental reconciliations, and the Indian Trust Funds. Also, as discussed in the Internal Control over Required Supplementary Information and Required Supplementary Stewardship Information section of this report, Interior needs controls over reporting deferred maintenance and stewardship asset and investment disclosures to comply with Federal accounting standards. The Required Supplementary Information disclosures for deferred maintenance are not complete or current, as Interior had not estimated deferred maintenance for all assets and did not consistently update deferred maintenance estimates. In addition, the Required Supplementary Stewardship Information disclosures for stewardship assets and investments are not current, complete, or consistently supported, as Interior did not consistently follow its established procedures and controls. As a result, Interior does not substantially comply with the accounting standard indicators of FFMIA.

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. Interior records certain Bureau of Indian Affairs receivables as a total in its subsidiary ledgers rather than recording the individual transactions. As a result, Interior does not substantially comply with the SGL requirements.



Recommendations

We recommend that Interior perform the following, during fiscal year 2005:

1. ***Federal Financial Management Systems Requirements***
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***
Improve procedures and internal controls to ensure that 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***
Revise the process for recording receivables to ensure that Interior records activity consistent with the SGL at the transaction level.

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.

Responsibilities

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA) requires each Chief Financial Officer (CFO) Act 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 the financial statements, including:

- 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 preparing the Management's Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information; and
- Complying with laws, regulations, contracts, and grant agreements, 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 fiscal year 2004 and 2003 financial statements of the 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 2004 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 *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. Also, projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, our internal control testing may not be sufficient for other purposes. 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 the Interior's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the 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 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 section, 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 the Interior's fiscal year 2004 financial statements are free of material misstatement, we performed tests of the 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 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, regulations, contracts, and grant agreements applicable to the Interior. Accordingly, noncompliance may occur and not be detected by these tests and such testing may not be sufficient for other purposes. 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. 01-02 and FFMIA, we are required to report whether the 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 the Department of the Interior's management, the Department of the Interior's Office of the Inspector General, the U.S. Government Accountability Office, 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

November 15, 2004

U.S. Department of the Interior
Summary of the Status of Prior Year Findings
September 30, 2004

Ref	Fiscal Year 2003 Condition	Fiscal Year 2004 Status
A	Controls over property, plant, and equipment	This condition has not been corrected and is repeated at finding A.
B	Financial reporting controls	This condition has not been corrected and is repeated at finding B.
C	Intragovernmental reconciliation	This condition has not been corrected and is repeated at finding C.
D	Indian Trust Funds controls	This condition has not been corrected and is repeated at finding D.
E	Application and general controls over financial management systems	This condition has not been corrected and is repeated at finding E.
F	Controls over accruals	This condition has not been corrected and is repeated at finding F.
G	Controls for recording and disclosing legal contingencies	This condition has not been corrected and is repeated at finding G.
H	Controls over environmental liabilities	This condition has not been corrected and is repeated at finding G.
I	Controls over revenue process	This condition has not been corrected and is repeated at finding I.
J	Controls over grants	This condition has not been corrected and is repeated at finding J.
K	Intra-departmental reconciliation	This condition has been corrected.
L	Controls over budgetary transactions	This condition has not been corrected and is repeated at finding L.
M	Controls over charge cards	This condition has not been corrected and is repeated at finding M.
N	Deferred maintenance reporting	This condition has not been corrected and is repeated at finding O.
O	Stewardship assets and investments	This condition has not been corrected and is repeated at finding P.

Exhibit I

U.S. Department of the Interior
Summary of the Status of Prior Year Findings
September 30, 2004

Ref	Fiscal Year 2003 Condition	Fiscal Year 2004 Status
P	<i>Single Audit Act Amendments of 1996</i>	This condition has not been corrected and is repeated at finding Q.
Q	<i>Debt Collection Improvement Act of 1996</i>	This condition has not been corrected and is repeated at finding R.
R	<i>Prompt Payment Act</i>	This condition has not been corrected and is repeated at finding S.
S	<i>Federal Financial Management Improvement Act of 1996</i>	This condition has not been corrected and is repeated at finding T.