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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, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, financing, and custodial activity, and the related combined statements of budgetary resources (hereinafter referred to as the "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 audits, we also considered Interior's internal control over financial reporting 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, 2005 and 2004, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 24 to the financial statements, Interior changed its method of accounting for appropriated debt transactions in accordance with the provisions of Office of Management and Budget (OMB) guidance that became effective October 1, 2004. Also, as discussed in note 17 to the financial statements, Interior's fiscal year 2005 consolidated statement of net cost is not comparable to its fiscal year 2004 consolidated statement of net cost because Interior revised its method of allocating certain costs and revenues between programs in fiscal year 2005.

Our fiscal year 2005 consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

Reportable Conditions Considered to be Material Weaknesses

A. Controls over implementing new accounting policies and procedures
B. Controls over the Indian Trust funds

Other Reportable Conditions

C. Reconciliation of intragovernmental transactions and balances
D. Application and general controls over financial management systems
E. Controls over property, plant, and equipment
F. Controls over accruals
G. Controls over environmental contingencies

H. Financial management at the Bureau of Indian Affairs
I. Controls over revenue
J. Controls over grants
K. Segregation of responsibilities over purchases and entries
L. Controls over charge cards
M. Controls over obligations
N. Controls over the U.S. Park Police Pension Plan

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. Performance measure reporting
P. Deferred maintenance estimates
Q. Stewardship reporting

The results of our tests of fiscal year 2005 compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following 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 OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*:

R. Single Audit Act Amendments of 1996
S. Debt Collection Improvement Act of 1996
T. OMB Circular No. A-25, *User Charges*
U. Federal Financial Management Improvement Act (FFMIA) of 1996

The following sections discuss our opinion on Interior's financial statements, our consideration of Interior's internal control over financial reporting, our tests of Interior's compliance with certain provisions of applicable laws, 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, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, financing, and custodial activity, and the combined statements of budgetary resources 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, 2005 and 2004, 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 24 to the financial statements, Interior changed its method of accounting for appropriated debt transactions in accordance with the provisions of OMB guidance that became effective October 1, 2004. Also, as discussed in note 17 to the financial statements, Interior's fiscal year 2005 consolidated statement of net cost is not comparable to its fiscal year 2004 consolidated statement of net cost because Interior revised its method of allocating certain costs and revenues between programs in fiscal year 2005.

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 accounting principles generally accepted in the United States of America or OMB Circular A-136, *Financial Reporting Requirements*, Part A, *Form and Content of the Performance and Accountability Report*. 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 and the Required Supplementary Stewardship Information 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. Additionally, performance measure results may not be accurate, as Interior did not properly design controls to collect, process, record, summarize, and report performance measure information. We also noted that Interior did not disclose the costs incurred to generate intragovernmental revenues by budget functional classification, as required, and did not fully reconcile intragovernmental transactions and balances with its trading partners. Finally, 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 and did not disclose all required information.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The Performance Data and Analysis section, the Appendices, and the special account funds in the Other Supplementary Information section are an integral part of Interior's *Fiscal Year 2005 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, the Appendices, and the special account funds in the Other Supplementary Information section has not been subjected to 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 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 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 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 2005 audit, we noted certain matters, described below, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable conditions A and B are material weaknesses.

A. Controls over Implementing New Accounting Policies and Procedures

In March 2005, the OMB issued guidance in response to the Federal Accounting Standards Advisory Board's Accounting and Auditing Policy Committee's Technical Exposure Draft entitled *Recognition of the Transfer of Funds Between Interior's Reclamation Fund and Energy's Western Area Power Administration: In Accordance with SFFAS 1, Accounting for Selected Assets and Liabilities, and SFFAS 5, Accounting for Liabilities of the Federal Government*. OMB's guidance instructed Interior to record a receivable rather than transfers in/out for transactions with the Western Area Power Administration (Western). In addition, Interior applied OMB's guidance to similar transactions with the Bonneville Power Administration (BPA) and the U.S. Department of the Treasury (Treasury) General Fund.

Interior applied significant resources and effort, including coordinating with Western, BPA, the U.S. Department of Energy (Energy), the U.S. Treasury, and OMB to implement OMB's guidance in a relatively short time period. However, Interior did not consistently record certain transactions as Interior:

1. Recorded $261 million of repayments as part of the adjustment to beginning balances that should have been recorded as current year repayments.

2. Recorded $240 million of costs, of which $127 million should have been recorded as part of the beginning balance and $113 million should not have been recorded.

3. Recorded $206 million of repayments received in prior years as current year repayments that should have been recorded as part of the adjustment to beginning balances.

4. Did not properly allocate transactions among project sponsors, including $112 million of repayments.

5. Did not record $27 million in liabilities to Treasury.

6. Did not fully reconcile balances with Western by approximately $21 million.

These differences primarily resulted because Interior had not fully developed accounting policies and procedures to change its processes for recording these transactions and had not fully developed posting models by September 30, 2005. As a result of our observations, Interior analyzed and adjusted the financial statements as of and for the year ended September 30, 2005.

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Recommendations

We recommend that Interior improve its policies and procedures related to recording transactions with Western, BPA, and Treasury, in accordance with OMB guidance, as follows:

1. Improve policies and procedures related to recording additions to and repayments against the receivables and liabilities, including coordinating with the U.S. Department of the Treasury to determine the appropriate posting models.
2. Develop and implement procedures and controls for recording and reporting transactions with Western, BPA, and Treasury, including sufficient management oversight.
3. Require a second individual to compare the transactions recorded in the general ledger to supporting documentation and document his/her approval on the supporting documentation.
4. Continue to resolve the difference between Interior's receivable and Western's liability.

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. 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 monetary and nonmonetary 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 two categories: (1) Trust Funds that are held by Interior because the corpus of specific accounts that is non-expendable or the funds that are held for future transfer to Indian Tribes upon satisfaction of certain conditions and 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.

We noted that Interior's procedures and internal controls were not adequate to ensure that the Indian Trust Funds' activity and balances were recorded properly or timely. Specifically, we noted the following:

1. ***Trust Fund Balances***

   As disclosed in the footnotes to the financial statements, several financial reporting differences from prior periods relating to the fairness of the Indian Trust Funds balances have not been resolved. Certain parties, for whom Interior holds 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.

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2. ***Individual Indian Monies Subsidiary Ledger***

   The balance of the control account for Individual Indian Monies account holders did 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, 2005, 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 this difference. In addition, as of September 30, 2005, the subsidiary ledger contained negative account balances totaling approximately $44 million (of which approximately $192,000 was attributed to individual Indian accounts as of September 30, 2005).

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 special deposit accounts were established during fiscal year 2005. As of September 30, 2005, there were approximately 20,000 special deposit accounts, with balances totaling approximately $40 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, 2005. In addition, OST and BIA have not been able to determine the allocation of approximately $2.1 million of undistributed interest. Furthermore, there were 12 Tribal Trust Funds accounts with negative cash balances totaling approximately $724,000 as of September 30, 2005.

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 had not consistently implemented automated systems for tracking and processing activities of the Indian trust assets. 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 distribution amounts. BIA had developed an automated system for certain activities; however, BIA had not yet fully implemented this new system in all agency offices. This situation increases the risk that transactions are recorded inaccurately and untimely.

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b. ***Segregation of Duties***

The responsibilities for Indian trust processing are not properly segregated to prevent or detect errors. Although BIA improved segregation of responsibilities during the year, BIA did not segregate realty and land management activities (i.e., lease compliance) from accounting activities (i.e., collecting, depositing, and sending instructions to OST to create, record, and distribute receipts). Also, in limited cases, the same employee was responsible for all activities associated with trust transactions, including initiating lease agreements, generating billings, collecting funds, making deposits, and sending instructions to OST to create accounts and distribute funds.

c. ***Accounts Receivable***

BIA had not fully developed and communicated standardized policies and procedures for establishing, tracking, and pursuing accounts receivable for the Indian Trust Funds. This results in inconsistent processes and increases the risk that amounts due to Indian Trust Funds are not identified and ultimately collected. Several agency offices prepared bills after receiving payments rather than sending bills in advance of the payment due date. In addition, certain agency offices did not identify or pursue past due receivables and instead relied 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 did not consistently enter probate orders for land title into the trust management systems timely. Although BIA made progress in reducing the backlog, as of September 30, 2005, BIA indicated that it had probate orders that had not been recorded. This increases the potential for untimely distributions of income to the account holders of the Indian Trust Funds.

e. ***Untimely Deposits***

Several BIA agency offices did not consistently forward trust receipts in a timely manner to OST to be deposited. As a result, in certain instances, deposits of trust receipts were delayed for up to 5 business days and in others, delays were up to 12 days. In one instance, we noted a delay of 38 days.

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 active 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 by 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 compacted by tribes for the benefit of trust beneficiaries. BIA controls were not in place to ensure that all appraisals, conducted under compacts or contracts, completed by tribes for the benefit of trust beneficiaries had been approved by OAS.

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 agreed with our recommendations. Management indicated that Interior is in a position to draw conclusions that differences between supporting records and recorded transactions are not significant.

Auditors' Response to Management's Response

As summarized in our finding above, management had not resolved differences relating to the Trust Fund balances and did not have adequate controls to ensure that Trust Fund activity and balances were recorded properly and timely. Therefore, we continue to believe that the control weaknesses identified constitute a material weakness.

C. Reconciliation of Intragovernmental Transactions and Balances

Interior is required to reconcile transactions and balances with other Federal entities in accordance with the Treasury's *Federal Intragovernmental Transactions Accounting and Policies Guide.* Although Interior made substantial improvements to reconcile with other Federal entities, Interior had not fully reconciled its intragovernmental transactions and balances with other Federal entities because Interior did not consistently 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 eliminate on the Government-wide financial statements.

Recommendation

We recommend that Interior continue to improve its process 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.

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D. 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. Although Interior's financial management systems are consistent with the financial management systems requirements, we identified the following conditions during fiscal year 2005:

1. ***Entity-wide 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. Interior did not have procedures in place to appropriately track the implementation status of certain Service Level Agreements (SLA) and Security Service Agreements (SSA). In addition, the Interior did not have current SLA and SSA agreements with certain customers to designate security responsibilities. Interior had procedures for conducting background investigations; however, Interior did not perform background investigations for all new and current employees and contractors, consistently perform re-investigations in a timely manner, or consistently maintain investigation documentation. Interior did not have a process to monitor the periodic completion of technical training by certain information technology employees and certain contractors. Interior had performed risk assessments for its major applications and general support systems during the past fiscal year; however, Interior did not consistently classify certain computer information resources based on risk assessments.

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 did not fully establish controls to prevent and detect unauthorized access. In addition, Interior did not consistently monitor account creation, modification, and termination; effectively assign access privileges based upon job duties; periodically monitor security violations and inactive accounts; periodically review and recertify user accounts; periodically review transaction audit reports; remove access of terminated employees timely; or monitor system access to financial applications. Although Interior reviews the network system audit trail logs, Interior had not formally documented policies and procedures indicating the required frequency of the reviews or the responsibilities of the reviewers at certain components.

3. ***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 did not consistently document policies and procedures for restricting and monitoring access to system software, identifying and resolving system software issues, processing changes to system software, and reviewing event logs. Interior also did not consistently monitor the use of operating system software; formally document and approve the change management process for certain applications;

test all system software patches in a test environment before installing the patches in the production environment; perform post-implementation reviews after installing emergency patches; prepare change request forms and plans; or maintain documentation for upgrades. Although Interior reviewed event logs, Interior did not maintain evidence that the reviews were completed.

4. ***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 unintentional 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 formally developed, documented, or implemented data processing procedures to control and standardize the maintenance of two financial applications. In addition, Interior did not use library management software to control changes to one of the accounting applications. Additionally, Interior shared manager and account level passwords among several users at one component. Finally, Interior's system configurations did not adequately segregate duties at one component as the configurations provided individuals, who are involved with programming, testing and migrating changes to production, access to the source code, test, and production libraries.

5. ***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. Interior had not fully developed and documented a comprehensive contingency and disaster recovery plan for one of its applications. Interior also had not fully documented its service continuity procedures or fully trained team members for emergency response. In addition, Interior did not test certain contingency and disaster recovery or continuity of operations plans, did not consistently prepare daily and monthly backup files, and did not test the backup files for certain financial applications. We also noted that Interior did not have current maintenance agreements for all of its computer and related equipment. Finally, Interior should consider improving the location of plumbing lines and adding secondary air conditioning at one of its computer centers.

6. ***Segregation of Responsibilities***

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's policies identified the primary and secondary roles and responsibilities duties of information technology team members and indicate that roles may overlap; however, Interior's policies did not consistently indicate the responsibilities that must be segregated, or the compensating controls for those responsibilities not segregated.

Recommendation

We recommend that 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 rise to the level of a reportable condition.

Auditors' Response to Management's Response

We acknowledge 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 continue to believe that the control weaknesses identified constitute a reportable condition.

E. Controls Over Property, Plant, and Equipment

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

1. ***Recording Transactions***

   Interior needs to improve controls over property, plant, and equipment to ensure transactions are properly classified and recorded. We identified 67 exceptions in the 1,095 property and cost transactions tested at certain components. Specifically, we noted that Interior capitalized costs that should have been expensed, expensed costs that should have been capitalized, recorded transactions in the current year that occurred in prior years, recorded dates or costs that did not agree with the supporting documentation, or did not record an asset. In addition, Interior did not consistently classify 11 of 546 expenses as operating, heritage, or stewardship costs, resulting in misclassifications of $31 million. Furthermore, Interior did not properly record donated property of approximately $16 million and did not properly remove $18 million of concession assets that are not owned by Interior.

2. ***Construction-in-Progress***

   Interior did not consistently analyze and review its construction-in-progress account throughout the fiscal year. Interior also did not transfer construction projects from the construction-in-progress account to the appropriate completed property accounts at the time of completion or properly approve the transfer from the construction-in-progress account for projects totaling $65 million. In addition, Interior misclassified approximately $13 million of advances to others and expenses as construction-in-progress.

3. ***Reconciliation and Review***

   Interior did not properly reconcile one of its property subsidiary ledgers to the general ledger, because we identified a difference of $15 million. Interior also did not consistently establish controls to review and approve certain land inventory records, monitor internal use software, and account for changes to asset useful lives.

4. ***Capital versus Operating Lease Assessments***

   In accordance with the accounting standards, Interior is required to capitalize leases that meet certain criteria. Interior did not consistently review leases to determine if they were capital or operating leases, because Interior incorrectly capitalized one lease, did not properly capitalize four leases, and was unable to provide 30 of the 35 lease determination schedules selected for testing at certain components. In addition, Interior did not consistently ensure that the lease determination schedules agreed to the related supporting documentation and the general ledger for 11 of the 14 lease determination schedules that we received at certain components. Interior also did not require a supervisor to review and approve the lease determination schedules.

5. ***Future Minimum Lease Payments***

   In accordance with the accounting standards, Interior is required to disclose future minimum lease payments. Interior did not effectively prepare the future minimum lease payment schedule for disclosure in its financial report, because we identified differences between the future minimum lease payment schedule and the lease agreements for 32 of the 56 leases tested at certain components. As a result of our observations, Interior analyzed and adjusted its schedule of future minimum lease payments by a total of approximately $157 million.

As a result of our observations, Interior expended a significant amount of time and resources analyzing and adjusting property, plant, and equipment balances and future minimum lease payment disclosures as of and for the year ended September 30, 2005.

Recommendations

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

1. ***Recording Transactions***

   a. Periodically train personnel on how to distinguish between costs that should be capitalized versus expensed, and on properly classifying heritage, stewardship, and operating costs in the accounting system.

   b. Require a second individual to compare property and expense transactions to the related source documents to verify that transactions are properly expensed or capitalized as well as properly classified, and document his/her approval on the supporting documentation.

   c. Record property transactions at the time the transaction occurs.

   d. Perform periodic inventories of property.

2. ***Construction-in-Progress***

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

   b. Require a second individual to compare construction-in-progress transfers to the related source documents to verify that transactions are properly transferred, and to document his/her approval on the supporting documentation.

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3. ***Reconciliation and Review***

    a. Reconcile the property subsidiary ledgers to the general ledger and resolve any differences on a monthly basis.

    b. Require a second individual to review and approve certain land inventory records, internal use software transactions, and changes to asset useful lives.

4. ***Capital versus Operating Lease Assessments***

    a. Provide additional guidance and training to personnel on the process of identifying whether leases should be classified as capital or operating leases.

    b. Document the evaluation of whether leases should be classified as capital or operating leases.

    c. Require a second individual to agree the lease evaluations to the supporting documentation and to document his/her approval on the lease evaluations.

    d. Require a second individual to compare capital lease transactions from the general ledger to the supporting documentation and document his/her approval on the supporting documentation.

    e. Maintain the lease evaluation documentation, including the related present value calculations and fair market value assessments.

5. ***Future Minimum Lease Payments***

    a. Provide additional guidance and training to personnel on preparing the future minimum lease payment schedule.

    b. Require supervisors to compare the future minimum lease payment schedules to supporting documentation and document his/her approval on the future minimum lease payment schedules.

    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.

F. Controls over Accruals

In accordance with the accounting standards, Interior is required to record liabilities based on a probable future outflow or other sacrifice of resources as a result of past transactions or events. Interior did not establish controls to ensure that three of its programs properly recorded liabilities at the end of the reporting period. In addition, for two programs, Interior did not test the accuracy of accrual methodologies by comparing estimated amounts to actual amounts. Interior also did not ensure that the subsequent activity report used to estimate accruals was complete by approximately $5 million for one of its programs. In addition, Interior did not properly allocate the accruals to receivables and advances from others, resulting in a net misclassification of approximately $2 million. Furthermore, Interior did not properly reconcile the accrual calculations to the general ledger for one component, because the general ledger exceeded the accrual calculations by approximately $15 million.

As a result of our observations, Interior performed additional analysis and recorded additional accruals of approximately $62 million.

Recommendations

We recommend that Interior perform the following:

1. Establish controls to ensure that accruals are properly recorded at the end of the reporting period.

2. Require all of its components to finalize and test the accrual methodology for the quarterly financial statements. Testing should include comparing prior year estimates to actual results and adjusting the methodology based on these results.

3. Provide guidance and training to personnel on the development and testing of accrual methodologies.

4. Reconcile the accrual calculations to the general ledger and enhance controls to ensure that the accrual 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 Environmental Contingencies

Interior has not properly designed controls or sufficiently trained staff to ensure that environmental information is effectively identified, maintained, and reported. Although Interior issued policies for estimating environmental liabilities, Interior did not consistently interpret and apply these policies, consistently prepare documentation supporting the environmental liability estimates, or consistently update the estimates for inflation. In addition, Interior did not estimate costs or had incorrectly removed prior year estimates for certain sites. Interior also did not consistently have a second individual review and approve the probability assessments, site identifications, and the cost estimate documentation for 21 of the 181 environmental liability projects tested at certain components. In addition, BIA's organizational and communication structure did not facilitate developing and assessing environmental liabilities for that component. Furthermore, Interior completed a site prioritization at the regional level, rather than across BIA. As a result, the accrued environmental liabilities were understated by approximately $13 million, and the disclosed range of environmental liabilities was understated by approximately $10 million to $32 million.

As a result of our observations, Interior analyzed and adjusted its environmental balances and disclosures.

Recommendations

We recommend that Interior improve internal controls to ensure that environmental contingencies are properly accrued or disclosed in its financial statements, as follows:

1. Continue to provide periodic training to scientists, financial management staff, and others, to ensure that they understand Interior policies and the accounting standards related to estimating and recording environmental liabilities.
2. Annually adjust environmental estimates based on inflation.
3. Require components to consistently estimate costs for each site, and consider the experience across Interior in developing these estimates.
4. Require a second individual to review and approve the probability assessment, site identification, and the cost estimate documentation, to ensure that they are properly prepared and match the supporting documentation.
5. Implement an organizational structure that fosters communication between scientists, financial management staff, and others at BIA.
6. Perform site prioritization across BIA.

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 BIA

Interior needs to improve its BIA financial management organization and processes, as follows:

1. BIA did 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, this does not provide an effective or efficient long-term solution.
2. BIA financial management policies and procedures were not fully developed or consistently applied throughout BIA. Specifically, we noted that the policies and procedures related to construction-in-progress and environmental contingent liabilities were developed in prior years, but not consistently implemented during fiscal year 2005. Additionally, BIA had not developed policies and procedures for several financial management areas, such as suspense and deposit accounts, reimbursable agreements, monitoring grantees, and referral of debt to Treasury.
3. BIA did not consistently perform timely management review procedures, including analysis of select financial statement accounts, reconciling items with its trading partners, and resolving differences between the general ledger and subsidiary ledgers. In addition, BIA did not investigate and resolve suspense accounts totaling $7 million, including $4 million from prior years. Furthermore, BIA did not effectively review journal vouchers, as we noted that BIA recorded adjustments to the incorrect accounts.

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 for purposes of preparing its fiscal year 2005 financial statements.

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. Evaluate and implement best practices of other Interior components and consider outsourcing certain functions.

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 review all financial statement accounts, reconcile balances and transactions with trading partners, investigate and resolve suspense accounts, and resolve differences between the general ledger and subsidiary ledgers. This should include having a supervisor review and approve the procedures and completed 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

Interior needs to improve controls over its revenue process, to ensure that transactions are promptly and properly recorded for timely and reliable financial reporting as follows:

1. Interior had not investigated and resolved over $98 million of royalty receivables that were over one year old and fully reserved as doubtful royalty receivables, or approximately $66 million of credit balances that were over 30 days old, including approximately $23 million of credits that are over one year old as of September 30, 2005.

2. Interior did not implement the appropriate controls to effectively reconcile subsidiary ledgers to the general ledger for receivables, review unbilled receivables and deferred revenue accounts on a regular basis, properly record revenue transactions, bill receivables in a timely manner, prevent duplicate bills, and consistently review and approve the related allowance calculation at BIA.

3. Interior did not adequately monitor certain reimbursable agreements, because Interior did not approve 5 of the 45 reimbursable agreements that we tested, did not include administrative costs in bills for reimbursable agreements, and did not consistently record advances and receivables at the agreement level, resulting in an understatement of $15 million in deferred revenue.

4. Interior did not have adequate controls to ensure that delinquent receivables for BIA and the Minerals Management Service (MMS) were identified for referral to Treasury for collection or offset in a timely manner.

5. Interior did not formally document procedures for certain mineral lease revenue transactions at the Bureau of Land Management (BLM), consistently prepare the accounting documentation for the mineral lease revenue transactions, effectively review and approve mineral lease documentation, or consistently transfer mineral lease revenues and the accounting documentation between its components in a timely manner.

As a result of our comments, Interior performed a detailed analysis of revenue transactions and adjusted the fiscal year 2005 financial statements accordingly.

Recommendations

We recommend that Interior implement the following recommendations to improve controls over revenue:

1. Analyze and resolve aged and credit accounts receivable balances.

2. Reconcile the subsidiary ledger and the general ledger on a monthly basis, including investigating and resolving any differences identified.

3. Review unbilled receivables and deferred revenue accounts on a regular basis, to ensure that revenue transactions are properly recorded, receivables are billed in a timely manner, and bills are not issued more than once.

4. Require a second individual to review the allowance calculation and reimbursable agreements, and to document his/her approval.

5. Develop and implement a methodology to identify, record, and bill for the administration costs related to reimbursable agreements.

6. Record advance and receivable transactions at the agreement level.

7. Identify and resolve customer agreements with both an accounts receivable and advance balance.

8. Implement controls to ensure timely referral of delinquent debt to the U.S. Department of the Treasury.

9. Develop and implement formal documented procedures to account for mineral lease revenue at BLM.

10. Require supervisors to review and approve the accounting documentation for the related mineral lease revenue transactions, to ensure that the documentation is consistently prepared and approved.

11. Transfer mineral lease revenues and the accounting documentation between components at the time the transactions occur.

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. Interior improved its monitoring processes during the year; however, Interior had not fully developed controls to monitor the grantees to detect and prevent misuse of federal awards. Specifically, we noted that Interior did not consistently perform the following:

1. Grant Database

Maintain a grant database that includes information such as the 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

Ensure that grantees submit grant progress reports, such as form SF-269, *Report for Status of Funds*, form SF-270, *Request for Advance of Reimbursement*, and/or form SF-272, *Report of Federal Cash Transactions*. Interior did not receive the required or equivalent forms for 15 of the 32 transactions that we tested at the National Park Service.

3. Audit Reports

Ensure that grantees complete single audits and submit reports within nine months of the grantees' year end. Interior had not received 395 single audit reports within the required time period. Interior indicated that it had provided extensions to seven of these grantees; however, Interior did not formally document extensions provided to five of those seven grantees.

4. Findings

Issue management decisions on audit findings within six months after receipt of audit reports and ensure that the grantees take appropriate and timely corrective action, because Interior identified 59 instances where Interior had not issued responses within the required timeline.

Recommendations

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

1. Grant Database

Maintain a grant database that enables Interior to monitor the status of the grants and document monitoring procedures completed. This database should include the 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 forms SF-269, SF-270, and SF-272 when funds are paid in advance. In addition, Interior should require SF-269 to be submitted periodically and at the end of the project.

3. ***Audit Reports***

   Establish a monitoring and follow-up process to verify receipt of single audit reports within nine months of the grantees' year end. Interior should utilize the Federal Clearinghouse website on an ongoing basis to determine when an audit report has been submitted. If reports are not received, Interior should require grantees to submit formal requests for audit extensions, evaluate the requests, and formally document approval of the requests. In addition, Interior should consider the need to limit future grant awards until extensions are provided or audit reports are received.

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. Segregation of Responsibilities over Purchases and Entries

The principles of segregation of duties stipulate that no one individual should have complete control over transaction processing functions, which include the initiation, approval, and execution of a transaction. Allowing a single individual to perform all phases of a transaction increases the likelihood that errors or irregularities may occur and not be detected. Interior did not properly segregate BLM purchasing responsibilities, as certain individuals had the ability to create and approve a purchase requisition, create and approve a purchase order, and approve invoices for payment. Additionally, for 10 of the 150 Bureau of Reclamation journal entries that we tested, Interior did not have a second individual review and approve the entry or complete the review in a timely manner. Finally, Interior did not have evidence of supervisory review and resolution for differences on two monthly reconciliations between the general ledger and reports from Treasury.

Recommendation

We recommend that Interior perform the following:

1. Segregate the responsibilities for creating and approving a purchase requisition, creating and approving a purchase order, and approving invoices for payment, to ensure transactions are properly recorded and assets are safeguarded.

2. Require a second individual to compare journal entries to supporting documentation and document his/her approval on the journal entry.

3. Document review and resolution of reconciliation differences.

4. Require a second individual to review and approve 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.

L. 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 did not consistently follow these internal control procedures, as we identified 90 exceptions in the 255 statements that we tested at certain components. For example, cardholders and supervisors did not always sign and date the charge card statements or consistently sign and date the charge card statements in a timely manner. In addition, card holders did not consistently maintain charge card receipts to support the charges. Interior also did not consistently investigate and resolve transactions on the unusual charge card transaction reports. Furthermore, Interior had not terminated cards for 99 former employees at one component.

Recommendations

We recommend that Interior perform the following:

1. Continue to provide training to personnel on charge card procedures.
2. Require approving officials to be more diligent in monitoring and enforcing compliance with Interior's charge card policies.
3. Allocate sufficient resources to oversee compliance with DOI charge card policies and procedures, including investigating and resolving transactions on the unusual charge card transaction reports.
4. Terminate charge cards at the time an employee separates from Interior.

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 Obligations

Obligations should be promptly recorded, properly classified, and accounted for, in order to prepare timely and reliable reports. Interior incorrectly documented the sum of the current order amount and the estimated future potential order amounts rather than the actual order amount on certain purchase orders. Interior recorded obligations based on these incorrect purchases orders, resulting in an overstatement of obligations and an understatement of unobligated balances. Interior performed an analysis and adjusted its financial statements by $85 million.

Recommendations

We recommend that Interior improve internal controls to ensure that obligations are properly recorded in the financial report, as follows:

1. Provide additional guidance and training to personnel on the process of preparing purchase orders and entering purchase orders into the accounting system.

2. Require contract supervisors to review purchase orders to ensure that they are properly prepared and properly entered into the accounting system and document his/her approval on the purchase order.

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 the U.S. Park Police Pension Plan

Interior is required to determine and record a liability for the actuarial present value of the future benefits of the U.S. Park Police Pension Plan (USPP Pension Plan). Interior obtained the census data to calculate the liability from the District of Columbia, the plan administrator. Interior recalculated a sample of annuity payments based on the supporting documentation available in the pension files maintained by the District of Columbia and identified several differences between the census data file and the supporting documentation maintained in the pension files.

As part of our testing of the USPP Pension Plan liability, we also recalculated a sample of the annuity payments and identified differences between the census data file and the supporting documentation. These differences included both underpayments and overpayments that netted to approximately 1% of the total annuity payments that we tested. In addition, we compared the census data file to the supporting documentation for 219 participants and identified 69 differences in gender, age, and other factors. Interior, in consultation with its actuaries, evaluated the differences identified and concluded that the USPP Pension Plan liability was fairly stated as of September 30, 2005. However, all census data differences need to be resolved so as not to affect future actuarial projections and to ensure pension payments for retirees are not adversely affected.

Recommendation

We recommend that Interior work with the District of Columbia to investigate and resolve differences between the census data and the supporting documentation to ensure that pension liabilities are properly presented in Interior's financial statements.

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 certain additional matters that we reported to the management of Interior in a separate letter dated November 15, 2005.

INTERNAL CONTROL OVER REQUIRED SUPPLEMENTARY INFORMATION, INCLUDING PERFORMANCE MEASURES, AND REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

O. Performance Measure Reporting

With respect to the design of internal controls relating to existence and completeness assertions over performance measures determined by management to be key and reported in Interior's *Fiscal Year 2005 Annual Report on Performance and Accountability*, we noted certain significant deficiencies in internal control over reported performance measures discussed in the following paragraph that, in our judgment, could adversely affect Interior's ability to collect, process, record, summarize, and report performance measures in accordance with management's criteria.

Interior did not properly design controls to collect, process, record, summarize, and report performance measures related to the BIA and the BLM programs. Specifically, we noted that Interior did not consistently provide adequate evidence to support the performance measure results and revised the performance results as a result of our observations for the BIA programs. In addition, Interior had reported prior year results as current year results for many of the BLM programs. In addition, BIA management did not review and approve the reported performance measures results.

Recommendation

We recommend that Interior perform the following related to the BIA and the BLM programs:

1. Design and implement controls to collect, process, record, summarize, and report performance measures.
2. Document performance results and maintain this documentation.
3. Implement procedures to estimate performance results when actual results are not available.

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. Deferred Maintenance Estimates

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

Interior has not fully implemented the required accounting standards to estimate the deferred maintenance for its general, heritage, and stewardship assets, using either the condition assessment survey or life cycle costing method. Interior has adopted the condition assessment survey method, which requires Interior to perform periodic inspections of assets at least every five years, 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***

   As reported in the Required Supplementary Stewardship Information (RSSI) section of Interior's *Fiscal Year 2005 Annual Report on Performance and Accountability*, Interior had not completed condition assessments for all property and equipment, such as archeological sites, historic sites, historic and prehistoric structures, landmarks, paleontological sites, national register of historic places, museum collections, and world heritage properties. As a result, Interior had not estimated the related deferred maintenance for these assets. Interior also had not assigned responsibility or fully implemented information systems to account for and report condition assessments and the related deferred maintenance at certain components. Interior also disclosed deferred maintenance ranging from $5 million to $10 million for concession assets that non-federal entities are responsible for maintaining. Furthermore, Interior did not consistently update the condition assessments and related deferred maintenance estimates for certain irrigation systems and power projects and had not performed condition assessments and estimated related deferred maintenance during the past five years, for 4 of the 45 assets that we tested at one component.

2. ***Stewardship Land***

   Interior is required to disclose deferred maintenance information for all categories of property, plant, and equipment, including stewardship land and related improvements in accordance with the accounting standards. Interior incurred costs to improve and maintain stewardship land and related improvements. In addition, Interior identified known instances of land in need of intervention and requested future outlays in various budget requests and reports. However, Interior did not estimate or disclose deferred maintenance of stewardship land and the related improvements. In addition, Interior did not have documented evidence that it completed condition assessments for all stewardship land and related improvements and, therefore, had not demonstrated that there was not any related deferred maintenance for all stewardship land and related improvements.

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:

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

   a. Perform condition assessments of all general, property, plant, and equipment; and heritage assets and estimate the related deferred maintenance.
   b. Require supervisors to review and approve condition assessments and deferred maintenance estimates to ensure they are performed consistently and in accordance with Interior's policies.
   c. Assign responsibilities and implement systems to account for and report condition assessments and deferred maintenance at all components.

d. Remove from the deferred maintenance disclosures, the estimates on concession assets that non-federal entities are responsible for maintaining.

e. Update the condition assessment and deferred maintenance estimates at least every five years.

2. *Stewardship Land*

a. Implement procedures to conduct condition assessments and estimate deferred maintenance related to stewardship land.

b. Disclose deferred maintenance estimates for stewardship land.

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 the stewardship land managed by Interior does not have deferred maintenance as defined by the accounting standards.

Auditors' Response to Management's Response

As of September 30, 2005, Interior did not have documented evidence that it had completed condition assessments for all stewardship land and therefore, Interior was unable to demonstrate that there was no deferred maintenance for all of its stewardship land. Furthermore, Interior has reported known instances of land that is in need of intervention and has requested future outlays to correct these conditions in various budget requests and reports. Therefore, we recommend that Interior complete the condition assessments of all its stewardship land and disclose the related deferred maintenance as required by the accounting standards.

Q. Stewardship Reporting

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

Interior did not consistently follow its established procedures and controls over recording RSSI. Specifically, we noted the following:

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

Interior did not consistently record stewardship property, plant, and equipment (stewardship asset) transactions accurately or in a timely manner. Interior incorrectly recorded certain transactions and recorded several adjustments in the current year that should have been recorded in prior years, including 96 of the 166 stewardship transactions that we tested at certain components. In addition, Interior reported in the RSSI section of Interior's *Fiscal Year 2005 Annual Report on Performance and Accountability* that Interior identified adjustments in the current year that should have been recorded in the prior year. Interior also did not consistently have a second individual review and approve the stewardship asset transactions in accordance with Interior policies, as Interior did not have evidence of approval for 38 of the 91 stewardship transactions that we tested at certain components. In addition, Interior was not able to provide us adequate supporting documentation for 11 of 76 stewardship transactions that we tested at certain components and did not properly remove concession assets. Furthermore, one Interior

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component adjusted the number of museum collections as a result of our request for supporting documentation.

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

   As reported in the RSSI section of Interior's *Fiscal Year 2005 Annual Report on Performance and Accountability*, Interior had not completed condition assessments for all stewardship and heritage assets, including archeological sites, historic sites, historic and prehistoric structures, landmarks, stewardship land, paleontological sites, national register of historic places, museum collections, and world heritage properties. In addition, Interior components did not consistently follow Interior's five-year periodic assessment policy, as we noted that 4 of the 45 condition assessments that we tested were over five years old at one component and another component had not updated the condition assessments for certain irrigation systems and power projects in the past five years. In addition, Interior did not have documented evidence that it completed condition assessments for all stewardship land and related improvements. Interior also did not consistently consider the use of the land in determining the condition of the land. Furthermore, Interior did not disclose the condition of museum collections in accordance with the accounting standards, as Interior disclosed the condition of the facility housing the collection rather than the condition of the underlying museum collection.

3. ***Stewardship Investments***

   Interior reported obligations rather than expenses incurred for natural resource research and development investments, because Interior did not track actual expenses related to such investments.

As a result, the RSSI 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***

   a. Record and report stewardship property, plant, and equipment transactions at the time the event occurs.

   b. Require supervisors to review and approve stewardship transactions to ensure that they are properly recorded and disclosed.

   c. Maintain source documentation for stewardship transactions.

   d. Identify and remove concession assets.

   e. Perform periodic inventories of stewardship assets.

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

   a. Perform and report condition assessments for all stewardship property, plant, and equipment on a periodic basis.

   b. Document condition assessments and maintain the source documentation.

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c. Require supervisors to review and approve condition assessments to ensure they are performed consistently and in accordance with policies.

d. Consider the use of the land in determining the condition of the land.

e. Assess and disclose the condition of the museum collections rather than the facility housing the collection. Although the condition of the facility may be an important criterion in determining the condition of the museum collection, we recommend that Interior consider other factors, such as whether or not Interior intends to improve the collection, in defining the acceptable condition for museum collections.

3. Stewardship Investments

Accumulate and report actual expenses incurred for investments in research and development.

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 they believe condition assessments are not required for stewardship land.

Auditors' Response to Management's Response

We believe that Interior is required to report condition assessments for stewardship land in accordance with the accounting standards. For example, paragraph 83 of Statement of Federal Financial Accounting Standard (SFFAS) No. 8, *Supplementary Stewardship Reporting*, indicates "Minimum reporting shall include the following…the condition of the stewardship land, unless it is already reported in a note to the financial statement, in which case a reference to the note will suffice." In addition, paragraph 41 of SFFAS No. 29, *Heritage Assets and Stewardship Land* indicates "Entities should report the condition of the stewardship land (which may be reported with the deferred maintenance information) as required supplementary information." As a result, we recommend that Interior perform condition assessments for all stewardship land and related improvements and disclose those condition assessments.

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 FFMIA, disclosed three 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.

R. Single Audit Act Amendments of 1996

As discussed in the Internal Control over Financial Reporting section of this report, Interior needs to continue improving its processes and controls over monitoring of grantees in accordance with the *Single Audit Act Amendments of 1996,* and the related OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*. Interior needs to develop and maintain a database 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. If grantees do not submit single audit reports, Interior should require grantees to submit formal requests for audit report extensions, evaluate the requests, and formally document approval of the requests or consider the need to limit future grant awards. In addition, Interior needs to issue management decisions on findings in a timely manner.

Recommendation

We recommend that in fiscal year 2006, 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.

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 they believe Interior has implemented policies and procedures to comply with *Single Audit Act Amendments of 1996* and the related OMB Circular A-133.

Auditors' Response to Management's Response

Interior did not effectively ensure that grantees submitted progress reports, completed single audits, and submitted single audit reports in a timely manner for Interior programs that administer over $2 billion in annual grant expenditures. For example, as discussed in the Internal Control over Financial Reporting section of the report, we noted that Interior did not have Single Audit Reports for 395 different grants and did not issue corrective action plans for 59 findings. In addition, we noted that one component did not obtain progress reports for 15 of a sample of 32 grants that we selected for testing. As a result, Interior did not comply with the requirements of *Single Audit Act Amendments of 1996* and the related OMB Circular A-133.

S. 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 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 have adequate controls to ensure that they identified MMS and BIA receivables for referral to Treasury in a timely manner. Interior had over $79 million of MMS receivables that were over 180 days past due as of September 30, 2005. In addition, Interior reported that it had not referred certain BIA receivables to Treasury and did not consistently charge the proper interest rate.

Recommendation

We recommend that in fiscal year 2006, Interior establish a process to ensure that eligible receivables are referred to Treasury in a timely manner.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with our findings because Interior has an appeals process and receivables that are the subject of an appeals process are not eligible for referral and because Interior improved its process such that Interior does not believe that there is non-compliance at the Department level.

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Auditors' Response to Management's Response

We acknowledge that Interior is in the process of improving its debt referral processes; however, we noted the following conditions:

1. MMS receivables represent Interior's largest receivables with the public. Interior did not perform timely follow up procedures over the MMS receivables as MMS had receivables over 180 days delinquent that may be eligible for referral. We tested a sample of 32 MMS receivables and found no evidence that 9 of those receivables had been referred to Treasury or documentation to support that the receivables did not need to be referred to Treasury, within 180 days (i.e., the receivables were not the subject of an appeal).
2. Interior indicated that it did not refer certain BIA receivables in a timely manner and did not charge the correct interest rate for BIA receivables.

As a result, Interior did not comply with the requirements of the *Debt Collection Improvement Act of 1996.*

T. OMB Circular No. A-25, *User Charges*

OMB Circular No. A-25, *User Charges*, establishes policies for Federal entities related to user charges associated with the sale or use of Federal resources within the Federal Government. Specifically, it requires Federal agencies to ensure that charges to other Federal agencies are sufficient to recover the full cost of providing the service, resource, or goods. Interior did not recover the full costs they incurred at BIA because Interior did not charge other Federal agencies for the administration costs associated with the reimbursable agreements. Interior had over 2,000 reimbursable agreements at BIA totaling approximately $310 million in fiscal year 2005. Interior has estimated that the administration costs associated with these reimbursable agreements may be as high as 25% of direct costs or $103 million.

Recommendation

We recommend that in fiscal year 2006, Interior:

1. Implement policies and procedures to ensure compliance with the requirements of OMB Circular No. A-25, *User Charges*.
2. Develop and implement a methodology to identify and track the administration costs.
3. Charge other Federal entities for the administration costs.

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

The results of our tests of FFMIA disclosed instances, described below, where Interior's financial management systems did not substantially comply with the Federal accounting standards and the United States Government Standard General Ledger at the transaction level. The results of our tests of FFMIA disclosed no instances in which Interior's financial management systems did not substantially comply with the Federal financial management systems requirements.

U. Federal Financial Management Improvement Act of 1996

1. 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 two material weaknesses that affected Interior's ability to prepare its financial statements and related disclosures in accordance with Federal accounting standards.

Also as discussed in the Internal Control over Required Supplementary Information, including Performance Measures, and Required Supplementary Stewardship Information section of this report, Interior needs to improve controls over reporting deferred maintenance, performance measures, stewardship assets, and stewardship investment disclosures to comply with Federal accounting standards. 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. Additionally, performance measure results may not be accurate as Interior did not properly design controls to collect, process, record, summarize, and report performance measure information. Furthermore, Interior did not disclose the costs incurred to generate intragovernmental revenues by budget functional classification, as required. Interior also did not fully reconcile intragovernmental transactions and balances with its trading partners. Finally, 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 and did not disclose all required information. As a result, Interior did not substantially comply with the Federal accounting standard requirements.

2. United States Government 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 SGL at the transaction level. Interior records certain BIA receivables as a total in its subsidiary ledgers rather than recording the individual transactions. As a result, Interior did not substantially comply with the SGL requirements.

Recommendations

We recommend that Interior finance offices perform the following during fiscal year 2006:

1. 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.

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2. ***United States Government Standard General Ledger at the Transaction Level***

   Revise the process for recording BIA 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), *Accountability of Tax Dollars Act of 2002, and Government Corporation Control Act* 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 Part A of OMB Circular A-136.

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;
- Preparing the Management's Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information;
- Establishing and maintaining internal controls over financial reporting; and
- Complying with laws, regulations, contracts, and grant agreements, 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. 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 2005 and 2004 financial statements of Interior based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 2005 audit, we considered Interior's internal control over financial reporting by obtaining an understanding of Interior's internal controls, 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*. The objective of our audit was not to provide assurance on Interior's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, we considered Interior's internal control over the Required Supplementary Stewardship Information by obtaining an understanding of Interior's internal controls, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal controls related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis and Performance Data and Analysis sections, 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 reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether Interior's fiscal year 2005 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 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 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. 01-02 and FFMIA, we are required to report whether Interior's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

KPMG

DISTRIBUTION

This report is intended solely for the information and use of Interior's management, the U.S. Department of the Interior Office of Inspector General, OMB, the 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 15, 2005

Exhibit I

U.S. DEPARTMENT OF THE INTERIOR

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Condition	Status
A	Controls over property, plant, and equipment	This has been partially corrected and is repeated at finding E.
B	Process for year-end closing	This has been corrected.
C	Reconciliation of intragovernmental transactions and balances	This has been partially corrected and is repeated at finding C.
D	Controls over Indian Trust funds	This has not been corrected and is repeated at finding B.
E	Application and general controls over financial management systems	This has not been corrected and is repeated at finding D.
F	Controls over accruals	This has not been corrected and is repeated at finding F.
G	Controls over legal and environmental contingencies	This has been partially corrected and is repeated at finding G.
H	Financial management at the Bureau of Indian Affairs	This has not been corrected and is repeated at finding H.
I	Controls over revenue and other financial sources	This has not been corrected and is repeated at finding I.
J	Controls over grants	This has not been corrected and is repeated at finding J.
K	Controls over payments in lieu of taxes	This has been corrected.
L	Controls over budgetary transactions	This has been corrected.
M	Controls over charge cards	This has not been corrected and is repeated at finding L.
N	Controls over benefit programs	This has not been corrected and is repeated at finding N.

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U.S. DEPARTMENT OF THE INTERIOR

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K	Controls over payments in lieu of taxes	This has been corrected.
L	Controls over budgetary transactions	This has been corrected.
M	Controls over charge cards	This has not been corrected and is repeated at finding L.
N	Controls over benefit programs	This has not been corrected and is repeated at finding N.