Description of document: Twelve U.S. Department of The Interior (DOI) Office of Inspector General (OIG) audit reports, 2004-2005

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Office of Inspector General
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Department of The Interior (DOI) Office of Inspector General (OIG) audits reports included (in order of appearance in the file)

1. X-IN-NPS-0009-2005, Independent Auditors' Report on the National Park Service's Financial Statements for Fiscal Years 2005 and 2004

2. X-IN-MOA-0009-2006, Management Letter Concerning Issues Identified During the Audit of the Department of the Interior's Financial Statements for Fiscal Years 2005 and 2004

3. X-IN-BIA-0006-2005, Independent Auditors' Report on the Bureau of Indian Affairs' Financial Statements for Fiscal Years 2005 and 2004

4. X-IN-MOA-0011-2005, Independent Auditors' Report on the Department of the Interior's Annual Report on Performance and Accountability for Fiscal Year 2005

5. X-IN-NPS-0008-2006, Management Letter Concerning Issues Identified During the Audit of the National Park Service's Financial Statements for Fiscal Years 2005 and 2004 Report

6. X-IN-BIA-0010-2006, Management Letter Concerning Issues Identified During the Audit of the Bureau of Indian Affairs Financial Statements for Fiscal Years 2005 and 2004

7. X-IN-BLM-0005-2006, Management Letter Concerning Issues Identified During the Audit of the Bureau of Land Management's Financial Statements for Fiscal Years 2005 and 2004

8. X-IN-BOR-0013-2005, Independent Auditors' Report on the Bureau of Reclamation's Financial Statements for Fiscal Years 2005 and 2004

9. X-IN-BLM-0012-2005, Independent Auditors' Report on the Bureau of Land Management's Financial Statements for Fiscal Years 2005 and 2004

10. X-IN-MOA-0002-2006, Independent Auditors' Report on the Department of the Interior's Special Purpose Financial Statements for Fiscal Years 2005 and 2004

11. X-IN-MOA-0013-2006, report for the Department of the Interior (DOI) on "Applying Agreed-Upon Procedures for Intragovernmental Activity and Balances."

12. X-IN-BOR-0007-2006, Management Letter Concerning Issues Identified During the Audit of the Bureau of Reclamation's Financial Statements for Fiscal Years 2005 and 2004 Report

OFFICE OF
INSPECTOR GENERAL
U.S.DEPARTMENT OF THE INTERIOR

March 11, 2011

Re: 10-FOI-00076

This is in response to your letter dated June 18, 2006, which was received by the Office of Inspector General (OIG) on June 28, 2006, in which you ask for information under the Freedom of Information Act (FOIA), 5 U.S.C. § 552. You ask for a copy of an electronic version of 12 Department of the Interior, Office of Inspector General audits reports.

A search was conducted and all 12 of the audits reports you requested were found and are being released to you, in entirety. You are receiving the following reports:

X-IN-BIA-0006-2005
X-IN-BIA-0010-2006
X-IN-BLM-0012-2005
X-IN-BLM-0005-2006
X-IN-BOR-0013-2005
X-IN-BOR-0007-2006
X-IN-MOA-0011-2005
X-IN-MOA-0002-2006
X-IN-MOA-0013-2006
X-IN-MOA-0009-2006
X-IN-NPS-0009-2005
X-IN-NPS-0008-2006

Please contact me at 703-487-5467, if you have any questions concerning this response.

Sincerely,

Tara Walker
Program Analyst

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

December 21, 2005

Memorandum

To: Director, National Park Service

From: Anne L. Richards Anne L. Richards
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the National Park Service's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-NPS-0009-2005)

Attached is the subject auditors' report prepared by KPMG LLP (Attachment 1). KPMG issued an unqualified opinion on the National Park Service's (NPS) financial statements. However, KPMG identified three reportable conditions in NPS's internal controls over financial reporting, none of which were considered to be material weaknesses. KPMG also found two significant deficiencies in NPS's internal controls over Required Supplementary Information (RSI) and Required Supplementary Stewardship Information (RSSI.) In addition, KPMG identified two instances where NPS did not comply with laws and regulations, including noncompliance with the Federal Financial Management Improvement Act (FFMIA).

In its December 2, 2005 response to the draft auditors' report (Attachment 2), NPS partially agreed with the three reportable conditions in NPS's internal controls over financial reporting. NPS partially agreed with the two significant deficiencies in NPS's internal controls over RSI and RSSI. NPS agreed with the conclusions on compliance with the Single Audit Act Amendments of 1996, but disagreed with KPMG's position on compliance with the FFMIA. Based on the response, we consider recommendations A, B.1, B.2, B.3, D.1, E.1, E.2, E.4, and F resolved and not implemented, and recommendations B.4 and B.5, C, D.2, E.3, and G unresolved. We will refer the resolved and unimplemented recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. The unresolved recommendations will be referred for resolution.

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit the financial statements of NPS for fiscal years 2005 and 2004. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget's Bulletin 01-02, as amended, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency's *Financial Audit Manual.*

KPMG is responsible for the attached auditors' report and for the conclusions expressed in the report. We do not express an opinion on NPS's financial statements, conclusions on the effectiveness of internal controls, conclusions on whether NPS's financial management systems substantially complied with FFMIA, or conclusions on compliance with laws and regulations.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of NPS personnel during the audit. If you have any questions regarding the report, please contact me at (202) 208-5512.

Attachment

cc: Assistant Secretary, Fish and Wildlife and Parks
Chief Financial Officer, National Park Service
Acting Manager, Accounting Operations Center, National Park Service
Director, Office of Financial Management
Audit Liaison Officer, Assistant Secretary for Fish and Wildlife and Parks
Audit Liaison Officer, National Park Service
Audit Liaison Officer, Office of Financial Management
Focus Leader for Financial Reporting, Office of Financial Management
Focus Leader for Management Control and Audit Follow-up,
Office of Financial Management

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Director of the National Park Service and Inspector General
U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheets of the National Park Service (NPS) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, and financing, and the related combined statements of budgetary resources, for the years then ended (hereinafter referred to as the financial statements). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered NPS's internal control over financial reporting and tested NPS'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 the NPS'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 16 to the financial statements, NPS's fiscal year 2005 consolidated statement of net cost is not comparable to its fiscal year 2004 consolidated statement of net cost because NPS revised its method of allocating certain costs and revenues between programs in fiscal year 2005.

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

A. Security and General Controls over Financial Management Systems
B. Financial Reporting Controls
C. Controls over the U.S. Park Police Pension Plan

However, none of the reportable conditions are believed to be material weaknesses.

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 NPS's ability to collect, process, record, and summarize this information.

D. Deferred Maintenance Estimates
E. Stewardship Assets

The results of our tests of 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 Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

F. *Single Audit Act Amendments of 1996*
G. *Federal Financial Management Improvement Act of 1996*

The following sections discuss our opinion on NPS's financial statements, our consideration of NPS's internal control over financial reporting, our tests of NPS'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 National Park Service as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, and financing, and the related 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 the NPS as of September 30, 2005 and 2004, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 16 to the financial statements, NPS's fiscal year 2005 consolidated statement of net cost is not comparable to its fiscal year 2004 consolidated statement of net cost because NPS revised its method of allocating certain costs and revenues between programs in fiscal year 2005.

The information in the Management Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB 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 for deferred maintenance and the Required Supplementary Stewardship Information for stewardship assets and investments are not presented in conformity with accounting principles generally accepted in the United States of America. The Required Supplementary Information disclosures for deferred maintenance are not complete or current because NPS had not estimated deferred maintenance for all assets, did not consistently update deferred maintenance estimates, and reported deferred maintenance that should not be reported. In addition, the Required Supplementary Stewardship Information disclosures for stewardship assets and investments are not current, complete, or consistently supported because NPS did not consistently follow its established procedures and controls.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Other Supplementary Information has not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we express no opinion on it.

KPMG

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 NPS'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. However, none of the reportable conditions are believed to be material weaknesses.

A. Security and General Controls over Financial Management Systems

NPS needs to improve information technology security and general controls to protect its financial information systems as required by OMB Circular A-130, *Management of Federal Information Resources*. This condition could affect NPS's ability to prevent and detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information resources. NPS has made improvements to security and general controls during the year; however, NPS needs to improve the following controls.

1. Entity-wide Security Program and Planning

NPS needs to continue to improve its entity-wide security program. An effective security program includes a risk assessment process, certification and accreditation process, and application-level security plans. Specifically, we noted the following:

a. Security Program

NPS did not have Memorandums of Understanding or Service Level Agreement with the Department of the Interior's National Business Center (NBC) for the security responsibilities over the IDEAS Application for most of the fiscal year.

b. Background Investigations

NPS did not have fully documented or comprehensive hiring policies and procedures that address the background investigation requirements of employing new personnel.

c. Resource Classification

Although NPS performed risk assessments for NPS's major applications and general support systems during the past year, NPS had not classified computer information resources according to their sensitivity and criticality based on the results of the major application and general support system risk assessments.

KPMG

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. NPS needs to improve access controls for financial systems as follows.

a. *Unauthorized Access*

NPS did not fully establish controls to prevent and detect unauthorized access.

b. *Granting User Access*

NPS did not formally document the process for granting and monitoring user access for one financial system. For another system, NPS had not developed policies and procedures to monitor user access. Additionally, NPS did not periodically review access rights, verifying appropriateness of user access, and recertify users for certain financial applications. Furthermore, NPS did not consistently log changes to security profiles or review security profile changes for one of its financial applications.

c. *Terminating User Access*

Although NPS documented the process for the removal of terminated users, NPS did not consistently apply this process as we identified terminated employees with active accounts in various financial systems.

3. ***System Software Controls***

NPS did not consistently apply its system software change controls for the IDEAS system software, which includes a database and operating system. Specifically, NPS did not have a formally documented and approved change management process for the database, 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.

4. ***Software Development and Change Controls***

NPS's Information System Life Cycle document did not address all the security requirements of NIST 800-64.

5. ***Service Continuity***

NPS had not developed or documented a process to ensure that employees are periodically trained on their roles and responsibilities in regards to the contingency plan for a certain financial application. In addition, NPS did not periodically restore data from backup tapes for a certain financial application. Furthermore, NPS had not fully documented procedures that require periodic testing of the data center's power supply equipment.

6. ***Segregation of Responsibilities***

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

Recommendation

a. We recommend that NPS develop and implement a formal action plan to improve the general and application controls over its financial management systems. This plan should address each of the areas discussed above, as well as other areas that might impact the information technology control environment, to ensure adequate security and protection of NPS's 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 and recommendation. Management indicated that they do not agree with the systems software control findings because the application, associated with the findings, is owned and managed by the NBC.

Auditors' Response to Management's Response

In addition, to recommendation a above, we recommend that NPS:

b. Work with its service provider, NBC, to improve the system software controls over the application used and monitored by NPS to process certain NPS financial transactions. This should include developing and implementing formal change management policies, testing all system software patches in a test environment before installing the patches in the production environment, performing post-implementation reviews after installing emergency patches, preparing change request forms and plans, and maintaining documentation for upgrades.

c. Either ensure that its service provider implements controls to address the findings or NPS should implement controls as part of NPS operations to mitigate the findings.

B. Financial Reporting Controls

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

1. ***Property, Plant and Equipment***

NPS needs to improve controls over property, plant, and equipment to ensure transactions are properly classified and recorded timely. We identified 56 exceptions in the 462 transactions tested. Specifically, we noted that NPS capitalized costs that should have been expensed, recorded transactions in the current year that occurred in prior years, recorded current year transactions with prior year dates, or recorded dates or costs that did not agree with the supporting documentation. In addition, NPS has costs capitalized in 10 construction-in-progress projects that may need to be expensed. NPS also expensed costs that should have been capitalized for 6 of the 520 expense transactions that we tested. In addition, NPS did not transfer construction projects from the construction-in-progress account to real property accounts at the time of completion or properly approve the transfer from the construction in progress account for projects totaling $27 million.

Furthermore, NPS did not remove $18 million of concession assets from construction in progress in accordance with accounting guidance. As a result of our observations, NPS analyzed and appropriately adjusted the expense and property, plant and equipment balances.

2. ***Leases***

In accordance with Federal accounting standards, NPS is required to capitalize leases that meet certain criteria and disclose the future minimum annual lease payments. NPS has not fully established procedures to track and report leases as follows:

a. *Lease Assessment* – NPS did not consistently ensure that the lease determination schedules (i.e., capital versus operating lease determination) agreed with the related supporting documentation or ensure that a supervisor reviewed and approved the lease determination schedules. We identified differences between the supporting documentation and the lease determination schedule for the 9 leases that we tested. In addition, NPS did not effectively determine capital versus operating leases as we determined that 4 of the 9 leases tested should have been classified as a capital leases rather than operating leases. NPS analyzed the differences and adjusted the lease determination schedules as appropriate.

b. *Future Minimum Lease Payments* – NPS did not consistently prepare the future minimum lease payment schedule as the schedule included leases with the incorrect lease terms and amounts. Specifically, we identified differences between the future minimum lease payment schedule and the lease agreements for 16 of the 21 leases tested. As a result of our observations, NPS analyzed and adjusted its schedule of future minimum lease payments by approximately $58.9 million.

3. ***Cost Classification***

NPS discloses in its footnotes the costs associated with acquiring, constructing, and renovating heritage assets and the costs of acquiring and improving stewardship assets. NPS did not consistently classify 11 of 546 transactions tested as operating, heritage or stewardship costs resulting in misclassifications of $31 million. As a result of our observations, NPS corrected the misclassifications as appropriate.

4. ***Environmental Contingencies***

NPS needs to improve controls over the recording of environmental contingent liabilities. NPS did not consistently have a second individual review and approve the probability assessment, site identification worksheet, and the cost estimate worksheet for 21 of the 181 documents tested. In addition, 2 of the probability assessments did not agree with the supporting documentation. NPS also removed estimates recorded in the prior year or did not estimate costs for certain sites resulting in an understatement of the probable environmental liabilities of approximately $4 million and reasonably possible environmental liabilities ranging from $4 million to $20 million. Furthermore, NPS did not consistently update the estimates for inflation, which we estimated to be $2 million for the probable environmental liabilities and range from $3 million to $9 million for the reasonably possible environmental liabilities. As a result of our observations, NPS analyzed and adjusted the environmental disclosures as appropriate.

KPMG

5. Grants

NPS should monitor grantees to ensure grantees expend awards in accordance with the grant requirements and Federal regulations. The Department of Interior established a centralized office to assist NPS in monitoring grantees' compliance. However, the centralized office and NPS had not fully developed controls to monitor grantees to detect and prevent misuse of Federal awards. Specifically, we noted that the centralized office and NPS did not consistently perform the following:

a. *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.

b. *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 or Reimbursement*; and/or form SF-272, *Report of Federal Cash Transactions*. NPS did not receive the required forms for 15 of the 32 transactions that we tested. For Land and Water Conservation Fund (LWCF) grants, NPS prepared an annual report on the grantees behalf based on draw downs, but did not obtain any alternate reports from the grantee that convey the same information included in the above forms.

c. *Audit Reports* – Ensure that grantees complete single audits and submit reports within nine months of the grantees' year end. NPS and the Federal Clearinghouse had not received single audit reports within the required time period for 20 of the 25 grantees that we tested.

d. *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.

Recommendations

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

1. Property, Plant and Equipment

a. Continue to train park, region, and other personnel on the difference between costs that are capitalized versus expensed.

b. Implement procedures requiring Accounting Operation Center personnel to review disbursement transactions and the related source documents to ensure that transactions are properly expensed or capitalized and to ensure that the dates and amounts recorded match the supporting documentation.

c. Establish controls to ensure that construction projects are transferred to the real property account when the projects are completed.

d. Improve controls over recording equipment additions to ensure that assets are recorded when they occur.

e. Reinforce the requirement to ensure that the proper approvals are obtained prior to the start of construction projects.

KPMG

f. Develop and implement controls to ensure that concession related costs are properly expensed.

2. ***Leases***

Lease Assessment

a. Improve the process to document the evaluation of the criteria determining whether leases should be classified as capital or operating leases and require a supervisor to agree the evaluations to the supporting documentation and to approve the evaluations.

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

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

Future Minimum Lease Payments

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

b. 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.

3. ***Cost Classification***

a. Continue to communicate the cost classification requirements and train parks, regional, and other personnel on properly classifying heritage, stewardship, and operating costs in the accounting system.

b. Revise procedures to determine the "cost of stewardship land" disclosure to ensure that NPS captures all costs.

4. ***Environmental Contingencies***

a. Require a second individual review and approve the probability assessment, site identification worksheet, and the cost estimate worksheet to ensure that they are properly prepared and match the supporting documentation.

b. Require the environmental program office to notate their review and approval on the cost estimation worksheets when comparing them to the ECL database.

c. Implement procedures to estimate amounts for probable and reasonably possible sites using similar sites from NPS or other Department of the Interior components.

d. Annually adjust environmental estimates based on inflation.

KPMG

5. ***Grants***

NPS should work with the Department of the Interior's centralized office to improve monitoring efforts of grantees as follows:

a. *Grant Database* – Develop and maintain a grant database that enables NPS and the centralized office 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.

b. *Progress Reports* – Require grantees to submit form SF-269, *Report for Status of Funds*, form SF-270, *Request for Advance or Reimbursement*; and submit form SF-272, *Report of Federal Cash Transactions* when funds are paid in advance. In addition, NPS should require grantees that receive funds in advance to submit form SF-269, *Report for Status of Funds* periodically and at the end of the project. For LWCF grants, NPS should require the grantees to prepare and submit the information required on the annual consolidated report rather than compiling the report on their behalf.

c. *Audit Reports* – Establish a monitoring and follow up process to verify receipt of single audit reports within nine months of the grantees' year end. NPS and the centralized office should utilize the Federal Clearinghouse website on an ongoing basis to determine when an audit report has been submitted. If reports are not received, NPS or the centralized office should inquire of grantees and NPS should consider the need to limit future grant awards until reports are submitted.

d. *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 recommendations related to property, plant, and equipment; leases; and cost classification. However, management did not fully agree with the following findings and recommendations:

1. ***Environmental Contingencies***

Management indicated that they partially agreed with our findings and recommendations related to environmental contingencies. Management indicated that they already have procedures in place to estimate costs for sites using similar sites, do not need to estimate costs for certain sites, and do not believe the environmental contingency accruals and disclosures were understated.

2. ***Grants***

Management indicated that they partially agreed with our findings and recommendations related to grants. Management indicated that they already have grant databases and have established monitoring and follow up processes to verify receipt of single audit reports.

KPMG

Auditors' Response to Management's Response

1. ***Environmental Contingencies***

NPS did not have procedures in place to estimate costs for sites using similar sites. We identified that NPS had not estimated costs for approximately 60 of its 234 sites. As a result of our observations, management estimated costs for those sites, primarily using the costs of similar sites.

We understand that NPS may not be able to estimate environmental contingencies in certain conditions; however, the accounting standards require NPS to make an effort in estimating environmental contingencies. Federal Financial Accounting and Auditing Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government* states "The fact that an agency does not have a *department-wide* comprehensive study completed does not exempt an agency from making its best effort to estimate a liability for financial statement purposes..." We noted that the 60 sites, which NPS did not initially estimate costs for, included several sites that NPS had many years ago but did not take steps to estimate the clean up costs. In addition, NPS improperly removed estimated clean up costs for certain sites that NPS had reported estimates for in the prior year. Finally, subsequent to our observations, NPS prepared estimates for most of those 60 sites and adjusted its records so that the environmental contingencies were no longer understated.

Therefore, we recommend that NPS improve its procedures to estimate environmental contingencies, including considering the costs of similar sites from NPS or other Department of the Interior components.

2. ***Grant***

NPS's existing grant databases did not enable NPS and the centralized office to effectively monitor the status of the grants and document monitoring procedures completed because the existing databases did not include all of the following information for each grant: (1) grantee name; (2) grant number; (3) date granted; (4) award amount; (4) funds expended; (5) date audit reports are received; (6) period covered by the audit reports; (7) findings in the audit reports; (8) and management decisions on findings. As a result, we recommend that NPS develop and maintain a database that includes this information for each grant.

NPS did not establish an effective monitoring and follow up process to verify receipt of single audit reports because we noted that NPS and the Federal Clearinghouse had not received single audit reports within the required time period for 20 of the 25 grantees that we tested. As a result, we recommend that NPS and the centralized office establish a monitoring and follow up process to verify receipt of single audit reports within nine months of the grantees' year end. If reports are not received, NPS or the centralized office should inquire of grantees and NPS should consider the need to limit future grant awards until reports are submitted.

C. Controls over the U.S. Park Police Pension Plan

NPS 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). As NPS is not the plan administrator, NPS obtained the census data to calculate the liability from the District of Columbia, the plan administrator. NPS 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 under and over payments and 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. NPS 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 NPS work with the District of Columbia to investigate and resolve differences between the census data and the supporting documentation to ensure that pension liabilities and costs are properly presented in NPS's financial statements.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management did not agree with our finding and recommendation because NPS believes that they are not responsible for ensuring that the census data file agrees with the supporting documentation.

Auditors' Response to Management's Response

OMB Circular No. A-123, *Management Accountability and Control,* indicates the following:

- "Agency managers shall incorporate basic management controls in the strategies, plans, guidance, and procedures that govern their programs and operations. Controls shall be consistent with the following standards: Reasonable Assurance and Safeguards - Management controls must provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. Management controls developed for agency programs should be logical, applicable, reasonably complete, and effective and efficient in accomplishing management objectives."
- "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

As NPS reports the USPP Pension Plan liabilities and related expenses in its financial statements and is responsible for disbursing pension amounts to the District of Columbia, NPS should establish controls over those financial statements amounts and programs in accordance with OMB Circular A-123. Therefore, NPS should either work with the District of Columbia to establish controls over the USPP Pension Plan liabilities and related expenses or implement controls as part of NPS operations to mitigate the findings.

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 NPS management in a separate letter dated November 15, 2005.

KPMG

INTERNAL CONTROLS OVER REQUIRED SUPPLEMENTARY INFORMATION AND REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

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

D. Deferred Maintenance Estimates

NPS has not fully implemented the required accounting standards to estimate the deferred maintenance for its general, heritage, and stewardship assets. NPS has adopted the condition assessment survey method, which requires NPS to perform periodic inspections of assets to determine their current condition and estimate the cost to correct any deficiencies. NPS has implemented procedures to measure deferred maintenance for certain park assets. However, NPS has not fully established controls over the condition assessments performed to determine deferred maintenance for all assets as follows:

1. Heritage Assets

As reported in the Required Supplementary Stewardship Information section of the *NPS Annual Report,* NPS had not completed condition assessments and estimated deferred maintenance for all nonfacility property or for all known heritage assets, such as archeological sites, historic and prehistoric structures, paleontological sites, and cultural landscapes. Additionally, NPS had not completed condition assessments or estimated deferred maintenance for 21 of the 94 assets that we tested. In addition, NPS did not consistently update the condition assessments and related deferred maintenance estimates as we noted 4 of the 45 assessments and related estimates had been performed over five years ago. Furthermore, NPS also disclosed deferred maintenance ranging from $5 million to $10 million for concession assets that non-federal entities are responsible for maintaining.

2. Stewardship Land

NPS did not have procedures for assessing the condition and estimating deferred maintenance of stewardship land and the related improvements to stewardship land, nor did NPS have documented evidence that it completed condition assessments and the related deferred maintenance estimates for all stewardship land and the related improvements. Specifically, NPS did not have condition assessment documentation for all 28 land transactions that we requested documentation on. However, NPS incurs costs annually to improve and maintain stewardship land.

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

1. Heritage Assets

We recommend that NPS:

a. Perform condition assessments of all 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 NPS's policies.

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

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

2. Stewardship Land

We recommend that NPS implement procedures to conduct condition assessments and estimate deferred maintenance related to stewardship land and disclose this information in the *NPS Annual Report.*

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and recommendations related to heritage assets but did not agree with our findings and recommendations related to stewardship land. Management believes that condition assessments are not required for stewardship land and that they do not need to estimate deferred maintenance for such land.

Auditors' Response to Management's Response

NPS is required to conduct 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." Furthermore, paragraph 83 of SFFAS No. 6 requires NPS to disclose deferred maintenance information for all categories of property, plant and equipment including stewardship land.

As of September 30, 2005, NPS did not have documented evidence that it had completed condition assessments for all stewardship land and therefore, NPS was unable to demonstrate that there was no deferred maintenance for its stewardship land. Furthermore, NPS incurs costs annually to improve and maintain stewardship land. Therefore, we recommend that NPS complete the condition assessments of all its stewardship land and disclose the related deferred maintenance as required by the accounting standards.

E. Stewardship Assets

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

1. Stewardship Property, Plant and Equipment – Physical Units

NPS did not consistently record stewardship asset transactions accurately or in a timely manner. NPS recorded several adjustments in the current year for transactions that should have been identified and recorded in prior years as indicated in the Required Supplementary Stewardship section of the *NPS Annual Report*. In addition, NPS recorded stewardship transactions in the current year that should have been recorded in the prior year or incorrectly recorded the transaction for 96 of the 166 stewardship transactions that we tested. NPS also did not effectively identify and remove concession assets from the supplementary disclosures for 3 of the 30 concession contracts that we tested.

Furthermore, NPS did not consistently have a second individual review and approve the stewardship asset transactions in accordance with NPS's policies as NPS did not have evidence of approval for 38 of the 91 stewardship transactions that we tested.

2. ***Stewardship Property, Plant and Equipment – Documentation***

   NPS did not consistently maintain documentation supporting stewardship asset additions and deletions. NPS was not able to provide us adequate supporting documentation for 7 of 76 stewardship transactions that we tested.

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

   As further discussed in the Deferred Maintenance finding noted above, NPS has not completed condition assessments for all stewardship and heritage assets, including historic structures, prehistoric structures, stewardship land, paleontological sites, and archeological sites. In addition, NPS did not consistently update the condition assessments. Furthermore, NPS did not disclose the condition of museum collections in accordance with the accounting standards as NPS disclosed the condition of the facility housing the collection rather than the condition of the underlying museum collection. As a result, NPS did not disclose condition assessments of all of its heritage assets in the Required Supplementary Stewardship Information section as required by the accounting standards.

4 ***Stewardship Investments***

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

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

Recommendations

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

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

   a. Record and report stewardship asset transactions at the time the event occurs.

   b. Require supervisors to compare transactions recorded in the inventory systems to the supporting documentation.

   c. Require supervisors to document their review and approval of stewardship transactions.

   d. Identify and remove concession assets.

   e. Perform periodic inventories of stewardship property, plant and equipment.

2. ***Stewardship Property, Plant and Equipment – Documentation***

   Maintain source documentation for stewardship transactions.

KPMG

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

   Perform and report condition assessments for all assets as well as assess and disclose the condition of the museum collections rather than the facility housing the collection. Although the condition of the facility may be important criteria in determining the condition of the collection, we recommend that NPS consider other factors, such as whether or not NPS needs to improve the collection in defining whether the collection is in acceptable condition.

4. ***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 agreed with our findings and recommendations except for our recommendation on condition assessments of museum collections. Management indicated that they believe condition assessments are not required for museum collections.

Auditors' Response to Management's Response

NPS is required to disclose the condition of museum collections in accordance with the accounting standards. By only disclosing the condition of the facility housing the collection, NPS does not inform financial statement users of the condition of the underlying museum collection. Therefore, we recommend that NPS report condition assessment of the underlying museum collections rather than the facility housing the collection.

COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements described in the Responsibilities section of this report, exclusive of those referred to in *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed one instance of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

F. ***Single Audit Act Amendments of 1996***

As discussed in the Internal Control over Financial Reporting section of this report, NPS and the centralized office did not perform adequate monitoring of grantees in accordance with the *Single Audit Act Amendments of 1996*. NPS and the centralized office need to ensure that grantees submit progress reports, complete single audits, and submit single audit reports to NPS in a timely manner. In addition, NPS and the centralized office need to issue management decisions on findings in a timely manner.

Recommendation

We recommend that in fiscal year 2006, NPS and the centralized office improve its grantee monitoring process to ensure they and their grantees comply with the reporting requirements of the *Single Audit Act Amendments of 1996*.

Management Response

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

KPMG

Except as noted above, 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 the NPS's financial management systems did not substantially comply with the Federal accounting standards. The results of our tests of FFMIA disclosed no instances in which NPS's financial management systems did not substantially comply with the Federal financial management systems requirements and the United States Standard General Ledger at the transaction levels.

G. *Federal Financial Management Improvement Act of 1996*

1. Federal Accounting Standards

As discussed in the Internal Control Over Required Supplementary Stewardship Information and Required Supplementary Information section of this report, NPS needs to improve controls over reporting deferred maintenance and stewardship asset and investment disclosures to comply with Federal accounting standards. The Required Supplementary Information disclosures for deferred maintenance are not complete or current as NPS had not estimated deferred maintenance for all assets and did not consistently update deferred maintenance estimates. In addition, the Required Supplementary Stewardship Information disclosures for stewardship assets are not current, complete, or consistently supported as NPS did not consistently follow its established procedures and controls. As a result of these conditions, NPS's financial management systems do not substantially comply with Federal accounting standards.

Recommendation

We recommend that in fiscal year 2006, NPS review and improve its Required Supplementary Information and Required Supplementary Stewardship Information reporting processes, provide all required disclosures, complete all of its condition assessments of stewardship assets, and report the deferred maintenance estimates in accordance with the Federal accounting standards.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with our finding and recommendation. Management indicated that they believe condition assessments are not required for museum collections or stewardship land and that they do not need to estimate deferred maintenance for stewardship land.

Auditors' Response to Management's Response

NPS is required to disclose the condition of museum collections in accordance with the accounting standards. By only disclosing the condition of the facility housing the collection, NPS does not inform financial statement users of the condition of the underlying museum collection.

NPS is required to conduct 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." Furthermore, paragraph 83 of SFFAS No. 6 requires NPS to disclose deferred maintenance information for all categories of property, plant and equipment including stewardship land.

As of September 30, 2005, NPS did not have documented evidence that it had completed condition assessments for all stewardship land and therefore, NPS was unable to demonstrate that there was no deferred maintenance for its stewardship land. Furthermore, NPS incurs costs annually to improve and maintain stewardship land.

Therefore, we recommend that NPS improve its Required Supplementary Stewardship Information reporting process, complete condition assessments of stewardship assets, and report the deferred maintenance estimates in accordance with the Federal accounting standards.

RESPONSIBILITIES

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA), *Accountability of Tax Dollars Act, 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 assist the U.S. Department of the Interior in meeting the GMRA reporting requirements, NPS prepares annual 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 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 NPS 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 NPS's internal control over financial reporting. Accordingly, we express no such opinion.

KPMG

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 NPS's internal control over financial reporting by obtaining an understanding of NPS's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on NPS'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 NPS's internal control over the Required Supplementary Stewardship Information by obtaining an understanding of NPS's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management Discussion and Analysis section, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion thereon.

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

DISTRIBUTION

This report is intended solely for the information and use of the NPS'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

NATIONAL PARK SERVICE

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Condition	Status
A	Security and General Controls over Financial Management Systems	This condition has not been corrected and is repeated in fiscal year 2005. See finding A.
B	Financial Reporting Controls	This condition has not been corrected and is repeated in fiscal year 2005. See finding B.
C	Controls over U.S. Park Police Pension Plan	This condition has not been corrected and is repeated in fiscal year 2005. See finding C.
D	Deferred Maintenance Estimates	This condition has not been corrected and is repeated in fiscal year 2005. See finding D.
E	Stewardship Assets and Investments	This condition has not been corrected and is repeated in fiscal year 2005. See finding E.
F	*Single Audit Act Amendments of 1996*	This condition has not been corrected and is repeated in fiscal year 2005. See finding F.
G	*Federal Financial Management Improvement Act of 1996*	This condition has not been corrected and is repeated in fiscal year 2005. See finding G.

United States Department of the Interior

NATIONAL PARK SERVICE
1849 C Street, N.W.
Washington, D.C. 20240

IN REPLY REFER TO:

F4217(2625)

Memorandum

To: Roger La Rouche
Assistant Inspector General for Audits

From: Chief Financial Officer
National Park Service 12/2/05

Subject: Draft Independent Auditors' Report on the National Park Service Financial Statements for the Fiscal Years 2005 and 2004
(Assignment No. X-IN-NPS-0009-2005)

This is in response to the recommendations contained in the subject report.

A. Security and General Controls over Financial Management Systems. Recommendation. We recommend that NPS develop and implement a formal action plan to improve the general and application controls over its financial management systems. This plan should address each of the areas discussed in this report, as well as other areas that might impact the information technology control environment, to ensure adequate security and protection of NPS' information systems.

Response - NPS partially concurs with the recommendations related to Security and General Controls over Financial Management Systems. NPS does not concur with the finding or recommendation on systems software control.

1. Under Entity-wide Security Program and Planning, for the security program, the NPS Memorandum of Understanding with the National Business Center was signed by Contracting on August 5, 2005. A copy of the approval was provided to the audit team. Background investigations are being completed in accordance with HSPD-12 (smart cards), and all regions have certified that all employees have a minimum of a National Agency Check and Inquiry (NACI). NPS has procedures in place to ensure that each new appointee has at least a NACI and has an

unmitigated Advance National Agency Check (NAC) prior to appointment.

2. Under Access Controls, NPS will establish policy that requires system owners to review and validate the user access lists and report findings to the NPS OCIO. The Human Resources Office will provide a monthly termination report for comparison and appropriate removal of access to terminated employees.

3. Under System Software Controls, The IDEAS application is owned and managed by the Department of Interior's National Business Center (NBC). Therefore, NBC is responsible for developing and testing the application throughout its lifecycle. This includes ensuring the application can support normal and emergency patching of the operating system, database, and application. The system owner, only after fully managing the IDEAS application, releases the application to the Bureaus. The application should already have met the minimum requirements for configuration management and testing. Further, if the IDEAS application is not compliant with lifecycle management principles, the finding(s) should be sent to the NBC for resolution and closeout.

   Notwithstanding the responsibility of NBC to act as the system owner and fully manage the IDEAS application, the National Park Service will institute a test procedure to validate whether or not the NBC testing and other lifecycle management processes are going to impact NPS users. This test procedure will be conducted after each OS, database, and or application upgrade. This test will further document the need for the update and the resulting impact.

4. Under Software Development and Change Controls, The DOI-OCIO has published their final System Development Life Cycle (SDLC) handbook on September 30, 2005, and the NPS will implement all changes to be in compliance with their system development life cycle.

5. Under Service Continuity, An IT Training Plan has been developed based on the Office of Management and Budgets Online Learning Center IT roadmap. IT specialties are aligned to competencies and suggested training. The IT Roadmap allows IT professionals to conduct self-assessments to determine where skill gaps exist and to tailor career development plans to meet their specific needs. It will assist IT workers during discussions with their managers and help in the development of their Individual Development Plan. Managers can make recommendations and guide the IT professional tuning their training opportunities toward required skills to keep proficient in their career field. Finally, the IT Roadmap includes a Career Planning Guide that will assist IT professionals in setting and reaching career goals.

The NPS Training Center is also working on a project to input competencies for all positions in NPS. The Training Center will use the IT training plan book to get the information for IT positions. Employees will be able to go into My Learning Manager and see what competencies are required for their position or a position they are working towards. Universal competencies will show up as entry-level competencies for all employees. NPS training Managers and Training Practitioners can now link competencies with the catalog entries. When an employee completes a training event, their transcripts will show what competencies the training addressed.

Actual training conducted will be subject to fund availability.

NPS has published procedures for periodic restoration of data from back tapes as well as the testing of the data center's power supply equipment. We will continue to document testing results.

6. Under Segregation of Responsibilities, background checks are completed and access controls are in place for the Federal Personnel Payroll System.

The responsible officials for implementing the recommendations will be the DOI Office of the Chief Information Officer, the NPS Chief Information Office, and Human Resource Office.

B. Financial Reporting Controls, Recommendation. We recommend that NPS perform the following, to improve the recording and reporting of financial transactions:

1. Property, Plant and Equipment, Recommendation - Continue to train park, region, and other personnel on the difference between costs that are capitalized versus expensed. NPS should review disbursement transactions and the related source documents to ensure that transactions are properly expensed or capitalized, and ensure that the dates and amounts recorded match the supporting documentation. In addition, NPS should establish controls to ensure that construction projects are transferred to the real property account when the projects are completed. NPS should improve controls over recording equipment additions to ensure that assets are recorded when they occur. NPS needs to reinforce the requirement to ensure that the proper approvals are obtained prior to the start of construction projects, and develop and implement controls to ensure that concession related costs are properly expensed.

   Response - We concur. NPS continues to work with parks, regional and other personnel on the distinction between costs that are capitalized versus expensed. NPS will reemphasize the need for parks/regions to submit completion reports in a timely manner in order to reclassify Construction-in-Process costs to real property accounts. NPS will issue additional personal property acquisition guidance that specifically addresses the In-Service date and asset costs. In addition, NPS will develop additional expense reports to aid in the review of these transactions. All concession related costs for construction projects will be identified and properly expensed.

The responsible officials for implementing this recommendation will be the Financial and Accounting Services Team Leader, Manager of Concessions Program and the Property Management Program Manager.

2. Leases, Recommendation – For lease assessment, NPS needs to improve the process to document the evaluation of the criteria determining whether leases should be classified as capital or operating leases, and require a supervisor review, approval and maintain the lease evaluation documentation, including the related present value calculations and fair market value assessments. In addition, NPS should provide additional guidance and training to personnel on the process of identifying whether leases should be classified as capital or operating leases.

For Future Minimum Lease Payments, NPS needs to provide additional guidance and training to personnel on preparing the future minimum lease payment schedule. NPS also needs to 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 future minimum lease payment disclosure.

Response - We concur. During FY 2006, the NPS will update the Space Management Handbook #89 and develop a training module that includes the formal procedures issued to document evaluation of the criteria used to determine whether leases should be classified as capital or operating leases. In addition, supervisors have recently been notified of the requirement to review and approve these evaluations. They have also been made aware of the requirement to maintain the lease evaluation documentation that includes the related present value calculations and fair market value assessments. NPS will also develop and maintain a database of all real and personal property leases to assist in monitoring and reporting all future minimum lease payments

The responsible official for implementing this recommendation will be the Property Management Program Manager.

3. <u>Cost Classification, Recommendation</u> – NPS needs to continue communicating to and training parks, regional, and other personnel on properly classifying heritage, stewardship, and operating costs in the accounting system. NPS also should revise procedures to determine the "cost of stewardship land" disclosure to ensure that all costs are captured.

   Response – We concur. NPS will continue to train all responsible personnel on the proper coding of accounts in order to ensure the appropriate classification of costs. Reports will be developed and reviewed on a monthly basis to identify cost of stewardship land transactions and make appropriate adjustments as needed.

   The responsible official for implementing this recommendation will be the Financial and Accounting Support Team

4. <u>Environmental Contingencies, Recommendation</u> – NPS needs to require a second individual to review and approve the probability assessment, site identification worksheet, and the cost estimate worksheet to ensure that they are properly prepared and match the supporting documentation. In addition, the program office needs to notate their review and approval on the cost estimation worksheets when comparing them to the ECL database. NPS needs to implement procedures to estimate amounts for probable and reasonably possible sites using similar sites from NPS or other Interior components, and annually adjust environmental estimates based on inflation.

   Response – We partially concur with the findings and recommendations outlined in this report. NPS will review its processes and will document that ECL figures contained in cost estimation documents are consistent with the figures in the ECL database. However, NPS believes it already has in place an adequate process to estimate costs for sites using estimates of "similar" sites. The recommendation presupposes that NPS has enough information about a site to know whether it is "similar" enough to another to make any meaningful comparisons. NPS will investigate the possibility of including estimates derived from "similar" sites within other Interior bureaus.

   NPS does not agree with the auditor's interpretation of the accounting standards clearly articulated in SFFAS #5, paragraph #41 and Technical Release #2, Footnote 9, which state that a disclosure should include a statement that an estimate cannot be made when the nature of the contingency and an estimate of the possible liability, or a range of the possible liability, can not be determined. Therefore, the NPS does not believe that reasonably possible environmental contingent liabilities were understated in the range of $3.7 million to $19.6 million. Additionally, NPS does not agree that probable environmental contingent liabilities are understated by $4.2 million. NPS submits that averaging the cost of cleanup for sites with widely-varying site-specific conditions is arbitrary. Adding the cost of cleanup when a cost of study is already reported is double counting and inconsistent with the accounting guidance. Concerning inflation, NPS will review current policies and procedures to ensure that estimates appropriately reflect current costs

The responsible official for implementing this recommendation will be the Environmental Management Program Team Leader.

5. Grants, Recommendation – NPS needs to work with the centralized office to develop a grant database that enables offices to monitor the status of the grants and document monitoring procedures completed, and require the submission of progress reports by the grantees. L&WCF grants should require the grantees to prepare and submit the information required on the annual consolidated report rather than compiling the report on their own behalf. NPS also needs to establish a monitoring process to verify receipt of single audit reports within nine months of the grantees yearend, and ensure management decisions on audit findings are issued within six months after receipt of reports. NPS should verify grantees take appropriate and timely corrective action or consider the need to limit future grant awards until reports are submitted.

   Response – NPS partially concurs. NPS's grant programs have developed individual databases or worksheets that are updated at least quarterly. When a centralized database is developed the information collected could be transferred from the applications used by each grant program office. NPS is incorporating language in new grant agreements that require progress reports with funding requests, except for state grants under the Land and Water Conservation Fund (LWCF). LWCF will enforce reporting requirements found in Title 43, Part 12 of the Code of Federal Regulations, which captures the requirements of both OMB Circular A-110 and OMB Circular A-102. The latter provides guidance for grants and agreements with states and local governments.

   The NPS has established monitoring and follow-up processes to verify receipt of single audit reports, and utilizes the Federal Clearinghouse website to determine the status of the states audit report. Each grant program office follows up on states that are not compliant with issuing audit reports. They either add a special condition to the grant agreement notifying them of the deadline to submit the report or payments may be stopped on the grant, or take appropriate sanctions. NPS will continue to follow-up on audit findings, which are infrequent, and issue management decisions on audit findings within six months after receipt of the single audit report.

The responsible official for implementing this recommendation will be the Grant Program Managers for LWCF and Historic Preservation Funds, and the Property Management Program Manager.

C. Controls over U.S. Park Police Pension Plan, Recommendation - Work with the District of Columbia to investigate and resolve differences between the census data and the supporting documentation to ensure that pension liabilities and costs are properly presented in the NPS's financial statements.

Response – NPS partially concurs. NPS plans to hire additional resources to research the rules, procedures, and processes for calculating basic annuities for each category of annuitant, and to apply these rules to each annuitant currently receiving payment. This will establish a basis for evaluating all future annuities. However, we would continue to point out that by law the District of Columbia Government is the plan administrator. Further, the decision by KPMG to require NPS to validate what is the responsibility of the D.C. Government to simply be consistent with the U.S. Secret Service is arbitrary, and inconsistent with enacted law.

The responsible official for implementing this recommendation will be the Accounting Operations Center Manager.

D. Deferred Maintenance Estimates

1. Heritage Assets, Recommendation - NPS perform condition assessments of all heritage assets and estimate the related deferred maintenance. In addition, NPS should have supervisors review and approve condition assessments and deferred maintenance estimates to ensure they are performed consistently and in accordance with NPS's policies. Furthermore, NPS should periodically update deferred maintenance estimates at least every five years, and remove from the deferred maintenance disclosures, the estimates on concession assets that non-federal entities are responsible for maintaining.

   Response - NPS concurs with the findings and recommendations. All units of the NPS will be inventorying critical systems in high priority industry standard assets. By 2006, NPS plans to complete the first cycle of comprehensive assessments, and fully implement the capital asset planning program Servicewide. This will allow the Service to report a comprehensive estimate of the annual deferred maintenance in FY 2007.

The responsible official for implementing the recommendation will be the Chief, Park Facility Management Division.

2. Stewardship Land, Recommendation - NPS should implement procedures to conduct condition assessments and estimate deferred maintenance related to stewardship land and disclose this information in the NPS Annual Report.

Response – NPS does not concur. Paragraph 81, of SFFAS No. 8 outlining the "Minimum Reporting for Stewardship land was amended by SFFAS No. 14. NPS meets the reporting requirements by addressing the condition of the land in a narrative format. Also, it does not appear that SFFAS No. 8 states that condition assessments are required, only that condition information be provided. NPS's position is that the requirements in the Statement of Federal Financial Accounting Standards (SFFAS) No. 14, Section 80 (which amends No.'s 6 and 8) do not require condition assessments of Stewardship Land, or a monetary disclosure of deferred maintenance.

NPS follows OMB Circular A-136, Section 11.2 regarding Deferred Maintenance. In footnote 58 cited in par. 78 of SFFAS No. 6 provides that, "Acceptable services and condition many vary both between entities and among sites within the same entity. Management shall determine what level of service and condition is acceptable." In some cases, such as heritage assets and stewardship land, management may determine that maintenance is not needed. Since land is not subject to periodic and/or recurring maintenance cycles and requirements, NPS cannot defer maintenance on these assets. NPS has determined that deferred maintenance of stewardship land does not exist. NPS has employed a consistent approach for determining and reporting on the condition of Stewardship Land.

E. Stewardship Assets and Investments, Recommendation – NPS needs to strengthen internal controls over recording Required Supplementary Stewardship Information to:

1. Stewardship Property, Plant and Equipment – Physical Units, Recommendation - Record and report stewardship asset transactions at the time the event occurs, require supervisors to compare transactions recorded in the inventory systems to the supporting documentation, require supervisors to document their review and approval of stewardship transactions, and perform periodic inventories of

stewardship property, plant and equipment. In addition, NPS should identify and remove concession assets.

Response - NPS concurs. During FY 2006, Financial and Accounting Support Team Leader will work with the Associate Director, Cultural Resources, to ensure internal controls are in place and procedures are implemented that will document and support stewardship asset reporting requirements.

2. Stewardship Property, Plant, and Equipment - Documentation, Recommendation – Maintain source documentation for stewardship transactions.

   Response - NPS concurs. During FY 2006, the Financial and Accounting Support Team Leader will work with the Associate Director, Cultural Resources, to ensure internal controls are in place and procedures are implemented that will document and support stewardship asset reporting requirements.

3. Stewardship Property, Plant, and Equipment - Condition Assessments, Recommendation – Perform and report condition assessments for all assets as well as assess and disclose the condition of museum collections rather than the facility housing the collection. NPS should consider other factors in determining the condition of the collection, such as whether or not NPS needs to improve the collection in defining whether the collection is in acceptable condition.

   Response - NPS does not concur with the recommendation that the disclosure be the condition assessment for the museum collections rather than the facility housing the museum collection. NPS will consider condition assessment and treatment needs in defining the overall condition, subject to the funding and resource limitation noted above.

   NPS concurs with the recommendation that condition assessments are needed to be performed for other stewardship assets; however, the assessments can only be performed as funding and resources become available. The Associate Director, Cultural Resources will request additional funds to address this need.

4. Stewardship Investments, Recommendation – Accumulate and report actual expenses incurred for investments in research and development.

   Response – NPS concurs. NPS will also work to develop and implement processes for accumulating, documenting, and accurately reporting research and development.

The responsible officials for implementing these recommendations will be the Associate Director, Natural Resources Stewardship and Science, Associate Director, Cultural Resources and the Financial and Accounting Support Team Leader.

F. Single Audit Act Amendments of 1996, Recommendation – NPS and the Office of Financial Management improve its grantee monitoring process to ensure they and their grantees comply with the reporting requirements of the *Single Audit Act Amendments of 1996.*

Response – NPS concurs. NPS will work to improve their monitoring processes, and will continue to work with the Office of Financial Management to develop procedures where NPS' Grant Program Managers can ensure grantees comply with the stipulated reporting requirements.

The responsible officials for implementing these recommendations will be the Office of Financial Management, Grant Program Managers for L&WCF and HPF, and Financial and Accounting Support Team Leader.

G. Federal Financial Management Improvement Act of 1996, Recommendation – In fiscal year 2006, NPS review and improve its RSSI reporting process and provide all required disclosures and also complete all of its condition assessments of stewardship assets, and report the deferred maintenance estimates in accordance with the Federal accounting standards.

Response – NPS does not concur. Refer to Section D of this response regarding the bureaus treatment of stewardship land. In addition, since the Department is reporting museum items at the collection level, it is appropriate to assess condition of the collection as a whole, not at the level of individual objects or other subcomponents of the reported collection unit. Refer to Section E.3 of this response.

NPS will work to implement the recommendations for other stewardship assets and will seek funding and resources to accomplish this effort.

The responsible officials for implementing these recommendations will be the Chief, Park Facility Management Division, Associate Director, Natural Resources Stewardship and Science, the Associate Director, Cultural Resources and Financial and Accounting Support Team Leader.

U.S. Department of the Interior
Office of Inspector General

Management Letter
Concerning Issues Identified During the
Audit of the Department of the Interior's
Financial Statements for
Fiscal Years 2005 and 2004

Report No. X-IN-MOA-0009-2006 **February 2006**

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

FEB 28 2006

Memorandum

To: Secretary

From: Earl E. Devaney
Inspector General

Subject: Management Letter Concerning Issues Identified During the Audit of the Department of the Interior's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-MOA-0009-2006)

Attached is the subject management letter (Attachment 1) prepared by KPMG LLP. It contains four findings, which are in addition to those contained in KPMG's audit report on the financial statements of the Department of the Interior (DOI). The management letter contains five recommendations that, if implemented, should resolve the four findings.

In its January 30, 2006 response (Attachment 2) to the draft management letter, DOI agreed with two findings, agreed in part with one, and disagreed with one. DOI also stated that with regard to recommendations, it has implemented one, plans to implement two, agreed in part with one, and disagreed with one.

We will refer the two unimplemented recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. The recommendation with which DOI agreed in part and the recommendation with which it disagreed will be referred for resolution (see Attachment 3, "Status of Management Letter Recommendations").

DOI contracted with KPMG LLP, an independent certified public accounting firm, to audit DOI's financial statements for fiscal years 2005 and 2004. The results of the audit are contained in KPMG's audit report dated November 15, 2005 (Report No. X-IN-MOA-0011-2005). In conjunction with its audit, KPMG noted certain internal control and other operational matters that should be brought to management's attention. This management letter presents those issues.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, we will include this report in our next semiannual report.

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

Attachments (3)

cc: Chief Financial Officer
Deputy Chief Financial Officer
Director, Office of Financial Management
Audit Liaison Officer, Office of Financial Management
Focus Leader for Financial Reporting, Office of Financial Management
Focus Leader for Management Control and Audit Follow-up,
Office of Financial Management

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Management Letter

November 15, 2005

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

We have audited the 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 for the years then ended (hereinafter referred to as the "financial statements"), and have issued our report thereon dated November 15, 2005. In planning and performing our audit of the above financial statements of Interior, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

Our audit of Interior's financial statements as of and for the year ended September 30, 2005 disclosed the following material weaknesses, reportable conditions, significant deficiencies, and compliance matters that are described in our auditors' report dated November 15, 2005:

Material Weaknesses:

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

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

KPMG

Significant Deficiencies:

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

Compliance Matters:

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

During our audit we noted certain other matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. The bureau-specific comments and recommendations are presented in separate letters to bureau management and the department level comments and recommendations are summarized as follows:

1. Consolidated Financial Statement Crosswalk

Interior did not follow Treasury's cross walk guidance as follows:

a. Interior cross walked Standard General Ledger (SGL) account 2190 – Other Accrued Liabilities and SGL account 2130 – Contract Holdbacks to the "Accounts Payable" line item in the balance sheet as opposed to the "Other Liabilities" line item as required by Treasury's crosswalk guidance.

b. Interior did not consistently use SGL account 2190 as certain bureaus used SGL account 2190 to account for the accounts payable accruals, while other bureaus used SGL account 2190 for other accrued liabilities.

Recommendations

We recommend that Interior:

a. Revise its chart of accounts to properly classify SGL account 2190 - Other Accrued Liabilities and SGL account 2130- Contract Holdbacks to the Other Liabilities line item in accordance with the Treasury crosswalk.

b. Issue guidance on the SGL accounts the bureaus should use to record account payable accruals and other accrued liabilities.

Management Response

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

KPMG

2. Management Review

The Office of Financial Management did not consistently review and approve the allocation of the change in actuarial liabilities as we noted the following:

Bureau name	Change in actuarial liabilities PFM originally allocated	Change in actuarial liabilities PFM should have allocated	Difference
BIA	$3,539,281	$2,957,122	$582,159
BLM	4,920,254	4,464,387	455,867
BOR	3,312,603	2,886,829	425,774
FWS	3,748,078	3,449,178	298,900
MMS	1,173,223	1,126,005	47,218
NPS	10,658,927	9,459,261	1,199,666
OS	(3,596,368)	(371,371)	(3,224,997)
OSM	55,998	37,436	18,562
USGS	638,004	441,153	196,851
Total	$24,450,000	$24,450,000	$0

Recommendation

We recommend that management review the allocation of the change in the FECA Actuarial Liability amounts on a thorough basis to ensure that the bureau/DO allocations are appropriate.

Management Response

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

3. Performance Goals

Interior did not include performance goals in the *Strategic Plan* and the related performance results in the *Annual Report on Performance and Accountability* for the Departmental Office's Working Capital Fund, Bureau of Reclamation's Working Capital Fund, Bureau of Land Management's Working Capital Fund, U.S. Geological Survey's Working Capital Fund, and Minerals Management Service's Interior Franchise Fund (herein after referred to as "the Funds") in accordance with the *Government Performance and Results Act* of 1993. Interior indicated that the Funds are not part of the primary mission of Interior; however, we noted that the Funds continue to grow in significance each year. As of September 30, 2005 the Funds represented approximately 10% of Interior's total gross costs and 19% of Interior's budgetary resources.

Recommendation

We recommend that Interior include performance goals in the *Strategic Plan* and the related performance results in the *Annual Report on Performance and Accountability* for the Funds.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. In summary, management did not agree with our finding and recommendation because management believes that the Funds do not have any specific strategic goal of their own but rather represent funds transferred from other agencies.

Auditors' Response to Management's Response

We believe that Interior should include performance goals in the *Strategic Plan* and the related performance results in the *Annual Report on Performance and Accountability* for the Funds based on the significance of the Funds. Because Interior did not agree with our recommendation, Interior could alternatively discuss the significance of the funds with OMB and obtain written confirmation that regardless of the significance of these activities that neither Interior nor the individual Interior components need to include the Funds and related performance measures in the *Strategic Plan* or the *Annual Report on Performance and Accountability.*

4. Performance Results

Interior did not report any results (preliminary or estimated) for 21 of its 214 performance measures in the fiscal year 2005 *Annual Report on Performance and Accountability.* This occurred because Interior did not have the information readily available or did not establish the baseline to report performance data. Interior plans to provide these fiscal year 2005 results in the fiscal year 2006 *Annual Report on Performance and Accountability.*

Recommendation

We recommend that Interior establish a process to report actual, preliminary, or estimated fiscal year results for all performance measures in the *Annual Report on Performance and Accountability.*

Management Response

Management has prepared an official response presented as a separate attachment to this letter. In summary, management partially agreed with our finding and recommendation. Management indicated that preliminary results are tabulated as "no reports" and do not count towards goals that are met or exceeded. Management also indicated that they are working to ensure that they have the infrastructure in place to conduct the data verification and/or rationale to report actual and estimated results as opposed to preliminary results.

Auditors' Response to Management's Response

We agree that Interior reported preliminary results for 18 of its performance measures; however, Interior did not report preliminary, estimated, or actual results for another 21 measures. The *Government Performance and Results Act* of 1993 requires that annual performance results be compared to performance goals for each program activity. As such, we recommend that Interior establish a process to report actual, preliminary, or estimated fiscal year results for all performance measures in the *Annual Report on Performance and Accountability.*

A summary of the status of prior year management letter findings is included as Exhibit I.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of Interior gained during our work to make comments and recommendations that we hope will be useful to you. We would be pleased to discuss these comments and recommendations with you at any time.

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

Very truly yours,

KPMG LLP

Exhibit I

DEPARTMENT OF THE INTERIOR

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Findings	Status
1	Performance Goals	The condition has not been corrected and is repeated at comment 3.
2	Performance Results	The condition has not been corrected and is repeated at comment 4.

ATTACHMENT 2

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

TAKE PRIDE IN AMERICA

JAN 30 2006

Memorandum

To: Anne L. Richards
Assistant Inspector General for Audits
U.S. Department of the Interior
Office of Inspector General
1849 C Street, NW, MS 5341
Washington, D.C. 20240

and

Mr. Jeff Norris
c/o KPMG LLP
2001 M St., NW
Washington, D.C. 20036

From: R. Thomas Weimer R. Thomas Weimer
Assistant Secretary – Policy, Management and Budget

Subject: Management Response to Draft Management Letter on the Department of the Interior's Financial Statements for the Fiscal Years 2005 and 2004 (Assignment No. X-IN-MOA-009-2006)

Thank you for the opportunity to comment on your draft management letter issues on the consolidated audit. The draft references four matters: consolidated financial statement crosswalk, management review, performance goals pertaining to working capital funds and franchise funds, and performance results.

The Department concurs, or partially concurs, with the draft management letter issues except for the matter on performance goals pertaining to working capital funds and franchise funds. While the Department has in place approaches for management of working capital funds and franchise funds, these funds are inter- and intra-governmental revolving funds that are authorized to fund centralized business and administrative services and systems that primarily support Interior bureaus and offices. As such, these funds are not directed toward the achievement of any specific mission goals. Therefore, the Department does not believe it is appropriate to include them as part of the Department's Strategic Plan and performance reporting. Including these implementation tools in the Strategic Plan and performance report would be contrary to the principles of the Government Performance and Results Act (GPRA) and the associated implementation guidance provided by the Office of Management and Budget (OMB) in Circular No. A-11, *Preparation, Submission and Execution of the Budget.*

In regard to the issue on performance results, the Department promotes the reporting of performance results in terms of actual and estimated data. However, the Department also realizes that the achievement of zero preliminary reports is an unlikely event when considering the short timeframe allowed for performance reporting after the close of the year and the unexpected nature of the work conducted by the bureaus.

The Department appreciates the opportunity to respond to your draft letter.

Responses to Recommendations

A. <u>Consolidated Financial Statement Crosswalk</u>

The Department concurs with the audit finding. In fiscal year 2006, the Department will review its chart of accounts, make appropriate changes, and distribute guidance to the bureaus on how to use these accounts.

B. <u>Management Review</u>

The Department concurs with the audit finding. Additional internal control has been instilled to prevent calculation errors and enhance the reviewer's ability to identify calculation errors.

C. <u>Performance Goals</u>

The Department does not concur with this recurring audit finding. The Department believes that working capital funds and franchise funds do not have any specific strategic goal of their own but rather represent transferred funds from mission organizations to help recipient organizations achieve their goals.

The principles of GPRA and the related OMB Circular No. A-11 instructions for its implementation emphasize focusing the Strategic Plan and its corresponding performance assessment on program outcomes. Consequently, the Department has no plans to include these enabling activities as part of the Strategic Plan, nor its associated performance measures. As these funding mechanisms and accounts, including the Departmental Office's Working Capital Fund, Bureau of Reclamation's Working Capital Fund, Bureau of Land Management's Working Capital Fund, U.S. Geological Survey's Working Capital Fund, and Mineral Management Service's Interior Franchise Fund, are tools that allow the Department to more effectively and efficiently manage a range of services to support programs, they do not, in themselves, have specific strategic mission objectives for the Department. Attempting to determine their individual effectiveness through the strategic plan process would be inappropriate and would distract from the need to ensure a more appropriate direct assessment and feedback process implemented directly by management organizations. As these are mechanisms for distributing funds to activities, it is not the working capital funds or franchise funds themselves that produce the results that fulfill the objectives of the Strategic Plan. They are one of many contributing resources and tools providing services and capabilities that, along with other assets conducted within our offices and programs, produce the outcome or results measured in the Strategic Plan performance assessment in accordance with GPRA's goal to focus on outcomes as opposed to the process.

The Department believes that the primary target for the Strategic Planning performance assessment is not the amount of funding in the pipeline, but rather the outcomes of what is ultimately accomplished by the use of those funds along with other procurements and program activities in producing program results. Our Strategic Plan does include a number of performance goals pertaining to efficiency and accountability. Currently the Department and bureaus present the financing for the Funds in the annual budget, which is overseen by the Department and bureaus, OMB, and the appropriations subcommittees of jurisdiction. In the case of the Department's Working Capital Fund, oversight is also provided by the Working Capital Fund Consortium, which includes representation of every bureau and office in the Department. The Consortium has input and approves/disapproves the annual budget and billings for the Working Capital Fund central billing. These mechanisms ensure that working capital fund and franchise fund management are reviewed in the context of these overall management goals.

D. Performance Results

The Department partially concurs with this recurring audit finding. The draft management letter specifies that the Department did not provide results for 27 of its 214 performance measures in the fiscal year 2005 Annual Report on Performance and Accountability. The Department encourages bureaus to report annual performance results as either actual or estimated. Preliminary results are tabulated as "no reports" and do not count towards goals that are met or exceeded.

Bureaus and offices are working to ensure that they have the infrastructure in place to conduct the data verification and/or rationale in place to report actual and estimated results as opposed to preliminary. However, the present date of providing completed data collections and all performance related materials to auditors three weeks after the close of the performance period does not facilitate the completion of data verification activities, leading to preliminary results. Also, due to the unexpected nature of natural phenomena, as with the gulf hurricanes this year, it is unlikely that a goal of zero preliminary reports can be achieved.

The Department is considering options, including modifying measures so results can be more timely, improving bureau internal data collection procedures, and possibly negotiating with the auditor for an improved schedule for data verification and integration after the close of the performance period, in order to minimize the number of preliminary results.

ATTACHMENT 3

STATUS OF MANAGEMENT LETTER RECOMMENDATIONS

Recommendation	Status	Action Required
1.a and 1.b	Resolved, not implemented.	Recommendations will be referred to the Assistant Secretary, Policy, Management and Budget for tracking of implementation.
3 and 4	Unresolved.	Recommendations will be referred to the Assistant Secretary, Policy, Management and Budget for resolution.
2	Resolved and implemented.	No further action is required.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

December 20, 2005

Memorandum

To: Assistant Secretary for Indian Affairs

From: Anne L. Richards Anne L. Richards
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Bureau of Indian Affairs' Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-BIA-0006-2005)

Attached is the subject auditors' report prepared by KPMG LLP. It contains an unqualified opinion on the Bureau of Indian Affairs' (BIA) financial statements. However, KPMG identified nine reportable conditions on BIA's internal controls over financial reporting, three of which were considered to be material weaknesses. KPMG also found significant deficiencies in internal control over Required Supplementary Information, Required Supplementary Stewardship Information, and Performance Measures that, in its judgment, could adversely affect BIA's ability to collect, process, record and summarize this information. In addition, KPMG found instances where BIA did not comply with OMB Circular A-133, the Debt Collection Improvement Act of 1996, OMB Circular A-25, and the Federal Financial Management Improvement Act of 1996 (FFMIA).

In its December 1, 2005 response to the draft auditors' report (which follows the attached report), BIA concurred with the findings and recommendations, except for Finding K on controls over Required Supplementary Stewardship Information and Recommendation K.1 that recommended BIA disclose the condition of museum collections instead of the condition of the facilities housing the collections. Based on the response, we consider all findings except Finding K resolved but not implemented, and we will refer them to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. We will refer Finding K to the Assistant Secretary for Policy, Management and Budget for resolution.

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit BIA's financial statements for fiscal years 2005 and 2004. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget's Bulletin 01-02, as amended, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency's *Financial Audit Manual*.

KPMG is responsible for the auditors' report and for the conclusions expressed in the report. We do not express an opinion on BIA's financial statements, KPMG's conclusions on the effectiveness of internal controls, conclusions on whether BIA's financial management systems substantially complied with FFMIA, or conclusions on compliance with laws and regulations.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of BIA personnel during the audit. If you have any questions regarding the report, please call me at (202) 208-5512.

Attachments (2)

cc: Chief Financial Officer, Assistant Secretary for Indian Affairs
Finance Officer, Bureau of Indian Affairs
Director, Office of Financial Management,
Director, Office of Audits and Evaluations, Assistant Secretary for Indian Affairs
Audit Liaison Officer, Assistant Secretary for Policy, Management and Budget
Audit Liaison Officer, Office of Financial Management
Audit Liaison Officer, Bureau of Indian Affairs
Focus Leader for Financial Reporting, Office of Financial Management
Focus Leader for Management Control and Audit Follow-up,
Office of Financial Management

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Assistant Secretary for Indian Affairs and Inspector General
U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheets of the Bureau of Indian Affairs (BIA) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing, for the years then ended (hereinafter referred to as the financial statements). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered BIA's internal control over financial reporting and tested BIA'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 BIA'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. We also noted that BIA implemented a new accounting standard effective October 1, 2004.

Our 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 Indian Trust Funds
B. Controls over Property, Plant and Equipment
C. Controls over Accounts Receivable and Deferred Revenue

Other Reportable Conditions

D. Controls over Accounting for Intradepartmental Transactions
E. Controls over Charge Cards
F. Controls over Clearing of Suspense Balances
G. Controls over Environmental Contingent Liabilities
H. Controls over Financial Management
I. Controls over Loans

We also noted certain significant deficiencies in internal control over Required Supplementary Information, Required Supplementary Stewardship Information, and Performance Measures that, in our judgment, could adversely affect BIA's ability to collect, process, record and summarize this information.

J. Controls over Required Supplementary Information – Deferred Maintenance Reporting
K. Controls over Required Supplementary Stewardship Information
L. Controls over Performance Measures

The results of our tests of 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 Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

M. OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*
N. *Debt Collection Improvement Act of 1996*
O. OMB Circular A-25, *User Charges*
P. *Federal Financial Management Improvement Act of 1996 (FFMIA)*

The following sections discuss our opinion on BIA's financial statements, our consideration of BIA's internal control over financial reporting, our tests of BIA'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 Bureau of Indian Affairs (BIA) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years then ended (hereinafter referred to as the financial statements).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BIA as of September 30, 2005 and 2004, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, BIA adopted the provisions of Federal Accounting Standards Advisory Board Interpretation No. 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS 4*, effective October 1, 2004.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB 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 for deferred maintenance is not presented in conformity with accounting principles generally accepted in the United States of America because BIA does not have adequate internal controls surrounding the compilation of deferred maintenance estimates and also is not computing deferred maintenance consistently for all heritage assets and stewardship land. Also, we believe that the Required Supplementary Stewardship Information for heritage assets is not presented in conformity with accounting principles generally accepted in the United States of America because BIA has not completed its identification and condition assessment of heritage assets. Finally, we noted certain significant deficiencies in internal controls over reported performance measures that, in our judgment, could adversely affect BIA's ability to collect, process, record, and summarize performance information and report performance measures in accordance with management's criteria.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The other accompanying information included in the Introduction and Appendices, as reflected in the accompanying table of contents, are an integral part of BIA's *Performance and Accountability Report: Fiscal Year 2005*. However, this information is not a required part of the financial statements and is presented for purposes of additional analysis. This information has not been subjected to the same auditing procedures and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

A. Controls over Indian Trust Funds

The United States Congress has designated the Secretary of the Interior as the primary fiduciary with responsibility for the monetary and non-monetary resources held in trust on behalf of American Indian Tribes, individual Indians, and other trust funds (hereafter collectively referred to as the Indian Trust Funds). The Secretary carries out this fiduciary responsibility through the Office of the Special Trustee for American Indians (OST), the Bureau of Indian Affairs (BIA), other Interior bureaus, and agreements with American Indian Tribes. OST is a component of Departmental Offices.

The Indian Trust Funds' balances include appropriated accounts that are considered Federal funds and non-Federal accounts that belong to beneficiaries of the Indian Trust Funds. The Federal accounts are reflected in Departmental Offices' financial statements, while the non-Federal accounts, which represent the majority of the Indian Trust Funds, are not reflected in Departmental Offices' financial statements. However, the Indian Trust Funds' transactions and balances are disclosed in a footnote to Departmental Offices' financial statements, in accordance with Federal accounting standards.

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 Departmental Offices. We noted the following weaknesses related to the internal controls performed by regional and agency offices:

1. Indian Trust Funds' Systems

BIA had not consistently implemented automated systems for tracking and processing activities of the Indian Trust Funds. Agency offices use "off-the-shelf" software, internally developed software, in-house databases, and manual processes to manage ownership records, track lease activity, account for receivables/revenue, and determine disbursement amounts. BIA 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.

2. *Segregation of Duties*

The responsibilities for Indian Trust Funds processing are not properly segregated to prevent or detect errors. BIA did not segregate realty and land management activities (i.e., lease compliance) from accounting activities (i.e., collecting, depositing, 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 bills, collecting funds, making deposits, and sending instructions to OST to create accounts and distribute funds.

3. *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.

4. *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.

5. *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 five business days and in others, delays were up to twelve days. In one instance, we noted a delay of thirty-eight days.

6. *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.

7. *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 completed 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 BIA develop and implement procedures and internal controls to address the deficiencies in controls related to Indian Trust Funds.

Management Response

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

B. Controls over Property, Plant and Equipment

BIA did not consistently follow or implement policies and procedures designed to ensure that property, plant and equipment (PPE) balances, including construction-in-progress and advances to others, are stated in accordance with Federal accounting standards. Specifically, we noted the following:

1. Construction-in-Progress (CIP) and Advances to Others

BIA did not consistently monitor the status of CIP projects to ensure that BIA transferred completed projects to depreciable PPE timely and that all amounts included in CIP qualified as capitalizable costs as outlined in BIA's *Construction-in-Progress (CIP) Accounting Management Handbook* and Federal accounting standards. Specifically, during our June 30, 2005 testwork over CIP, we noted that BIA was unable to provide documentation to support all significant balances included within CIP. As a result, we did not complete our planned interim testwork procedures, and instead deferred our substantive testwork procedures over CIP to year end in an effort to give BIA management time to perform a thorough reexamination of the balances in CIP as of September 30, 2005. During our September 30, 2005 testwork, we noted that BIA: improperly classified $7.3 million of Advances to Others in CIP; failed to transfer approximately $9.4 million in CIP project costs related to projects completed in various fiscal years from CIP into depreciable fixed assets on a timely basis; and improperly recognized $5.4 million in operating and maintenance disbursements as CIP when, in fact, they should have been expensed as incurred. As a result of our observations, BIA adjusted the CIP balance as of September 30, 2005.

In addition, we noted BIA transferred $29 million related to other completed projects to real property in the incorrect period. The projects were all completed in prior fiscal years, but were not transferred into depreciable fixed assets until fiscal year 2005. As a result, depreciation expense related to these assets was not calculated until this fiscal year and depreciation expense was overstated in the current year and understated in prior periods by $863 thousand.

2. Capitalized Asset Donations

BIA occasionally receives donations of capitalized assets from Indian Tribes. During our September 30, 2005 testwork over capitalized asset donations, we noted that the posting model being utilized by BIA was not in accordance with Federal accounting standards. BIA's use of the incorrect posting model resulted in a misstatement of approximately $16 million in the preliminary draft Consolidated Statements of Net Position and Net Cost for the year ended September 30, 2005 which was subsequently corrected in the final consolidated financial statements.

3. *Fixed Asset Additions*

During our September 30, 2005 testwork over a statistical sample of fixed asset additions, we noted the following:

a. Three instances where items were being capitalized even though they failed to meet BIA's capitalization threshold.

b. When an asset is acquired, the asset's acquisition information, including fixed asset number, fixed asset type, acquisition cost, and catalog code/budget object code is entered into the Fixed Asset System (FAS). Currently, BIA property personnel have the ability to both initiate and approve an adjustment of the useful life of a capital asset. There is no review process for assets not using the useful life associated with the assigned catalog code in FAS.

Additionally, in performing procedures to test the completeness of BIA's property inventory, we noted one instance out of 78 items tested, where the depreciable property observed in the field was not listed in FAS.

4. *Property, Plant and Equipment Account Reconciliations*

In performing our procedures over the monthly FAS to Federal Financial System (FFS), BIA's general ledger, reconciliation, we noted a material reconciling difference of $15 million. This difference was the result of two FFS manual journal vouchers transferring capitalized costs related to the Facilities Management Information System (FMIS) and Trust Asset Accounting Management System (TAAMS) from software in development into the internal use software, which were not subsequently entered into FAS. As a result of this oversight, no depreciation expense was calculated by FAS for the FMIS and TAAMS as of June 30, 2005. Prior to September 30, 2005, BIA posted the TAAMS and FMIS journal vouchers to FAS. As a result, accumulated depreciation and depreciation expense is correctly stated as of and for the year ended September 30, 2005.

In addition, we noted that BIA did not consistently monitor their software in development account. BIA improperly capitalized costs in software in development for amounts that should have been expensed. Additionally, BIA did not utilize the appropriate posting model to ensure that all costs incurred for development of software in development post directly to the correct account. As a result, as of September 30, 2005, the software in development account was misstated by approximately $7 thousand.

Recommendations

We recommend that BIA implement the following recommendations to improve controls over its property, plant and equipment, CIP and advances to others:

1. *Construction-in-Progress (CIP)*

a. Fully implement its current CIP policies and procedures.

b. Perform reviews of CIP detail, at least monthly, to ensure that: completed projects (or completed portions of on-going projects) are properly transferred from CIP to the appropriate PPE accounts in a timely manner; and amounts in CIP qualify as capitalizable costs as outlined in the *CIP Accounting Management Handbook*.

2. *Capitalized Asset Donations*

a. Review its policies and procedures to ensure that capitalized asset donations are recorded in accordance with Federal accounting standards.

3. *Fixed Asset Additions*

a. Implement policies and procedures to ensure BIA adheres to its capitalization threshold.

b. Implement policies that would prohibit the same person from both initiating and approving an adjustment of the useful life field when a capital fixed asset is recorded into FAS. BIA should also periodically perform an analysis of assets with useful lives that vary from the useful life associated with the assigned catalog code to ensure that the appropriate useful lives are being used.

c. Complete a more thorough review of "floor-to-book" inventory counts to ensure that all property, plant and equipment are input into FAS on a timely basis.

4. *Property, Plant and Equipment Account Reconciliations*

a. Implement the appropriate FAS to FFS reconciliation and related management review procedures to ensure that reconciling differences are properly resolved in a timely manner.

b. Perform periodic management review/analysis procedures over software in development balances.

Management Response

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

C. Controls over Accounts Receivable and Deferred Revenue

BIA needs to improve its policies and procedures over accounts receivable and deferred revenue, including unbilled accounts receivable and allowance for loss on accounts receivable, in order to ensure that they are recorded in accordance with Federal accounting standards. Specifically,

1. *Reconciliations between Subsidiary Ledger and General Ledger*

a. The majority of BIA's accounts receivable transactions are recorded into subsidiary systems that do not interface with FFS. The Continental Billing System (CBS) at Carlos Irrigation Project (SCIP) is an example of one of these subsidiary systems. BIA records transactions for these subsidiary ledgers into the general ledger at a summary level on a periodic basis. To ensure these items are properly recorded, BIA performs a monthly reconciliation of revenue and receivables between CBS and the summary level journal entry recorded in FFS. There is no effective reconciliation of the SCIP receivables in CBS and FFS. As of September 30, 2005, there were unreconcilled differences of $177 thousand, dating back to November 2001, between CBS and FFS that were not resolved.

b. BIA has no effective process in place to reconcile the receivable balance in CBS to the sub ledger (ARLT) and general ledger (GENJ) in FFS. SCIP performs a weekly reconciliation of the CBS balance to the GENJ but this reconciliation only reconciles the current week's activity in CBS and FFS within SCIP's specific organization code. At our request, BIA performed a cumulative reconciliation between CBS and the ARLT as of September 30, 2005 and found an unexplained variance of $180 thousand.

c. Although a quarterly reconciliation of ARLT to the GENJ is performed, it is not being performed on the organizational code level. At our request, BIA performed a reconciliation between the ARLT and the GENJ for power receivables and found multiple journal entries had been recorded to the wrong organizational codes. For example, the GENJ balance for SCIP was overstated by $1.8 million. Although the net receivable balance for power receivables was correct, an entry correcting the balances at the organization code level was necessary to allow management to properly analyze receivable balances.

2. *Review of Unbilled Accounts Receivable and Deferred Revenue*

BIA did not appropriately review unbilled accounts receivable and deferred revenue related to reimbursable agreements that are reported on the consolidated balance sheet as of September 30, 2005. This lack of review resulted in:

a. the inconsistent application of posting models resulting in both the deferred revenue account being improperly drawn down and the unbilled receivable account being improperly increased;

b. balances in the unbilled accounts receivable account not being billed in a timely manner;

c. instances of agreement numbers within FFS that appeared to be duplicative; and

d. instances where the lack of agreement numbers in FFS being applied to transactions inhibited the tracking of progress on a particular agreement.

As a result of the deficiencies noted above, we proposed an unrecorded audit adjustment amounting to approximately $10.6 million relating to deferred revenue. Additionally, based on the testwork completed, we noted $6.6 million (43%) of the unbilled accounts receivable was over one year old and had not been billed on a timely basis.

3. *Review of Reimbursable Agreements*

In performing control testwork over reimbursable agreements, we noted that for 5 of the 45 reimbursable agreements selected for control testing, the agreement had not been approved by an authorized BIA official, or documentation of the approval had not been properly retained.

Additionally, while performing our substantive testwork over balances related to reimbursable agreements including: revenue, expenses, receivables, and deferred revenue, we noted that BIA has not been monitoring the use of deferred revenue or recognizing revenue equal to expenditures at the reimbursable agreement program and job level.

In performing our initial analysis, we noted that revenues equal expenses at the fund level, which is appropriate as Fund 97000 (Education) is a reimbursable fund. However, revenues do not equal expenses at the reimbursable agreement program and job levels. We did, however, note that expenses appear to be applied appropriately at the reimbursable agreement program and job level. As such, advances are not being appropriately liquidated or unbilled receivables are being inappropriately recorded. Upon further discussion with management, we noted that BIA has a manual process to recognize revenue, and it has been performed incorrectly at the reimbursable agreement program and job level. Further, we noted that accounting personnel inappropriately liquidated existing deferred revenue agreements in lieu of billing for reimbursement of expenditures incurred as a result of the misclassifications noted above.

As a result of the conditions noted above, we requested that management prepare a reconciliation of the deferred revenue account for Fund 97000. In performing auditing procedures over this reconciliation, we noted an understatement of deferred revenue of approximately $14.9 million, of which $5.6 million should have been recorded as unbilled receivables. We proposed adjustments to correct these differences that were not recorded in the financial statements.

4. *Review of Allowance for Loss on Accounts Receivable*

   BIA management did not perform a review over the fourth quarter allowance calculation that had been prepared by third-party contractors.

Recommendations

We recommend that BIA improve its policies and procedures over accounts receivable, including unbilled accounts receivable, and the allowance for loss on accounts receivable by:

1. Resolving all differences between the accounts receivable subsidiary ledgers and the general ledger in a timely manner;

2. Developing consistent billing practices that permit recovery of unbilled accounts and application of deferred revenue balances. Billing practices should be more in line with BIA's normal vendor payment cycle, which is currently 30 days as required under the *Prompt Payment Act*. Additionally, BIA should reconcile deferred revenue and unbilled accounts receivable balances timely to ensure amounts are properly drawn down.

3. Developing policies and procedures to ensure that reimbursable agreements are appropriately authorized and that the related revenues, receivables, and deferred revenue balances are appropriately recorded in the general ledger.

4. Reviewing and approving the allowance for loss on accounts receivable calculation prepared by the third-party contractor.

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. Controls over Accounting for Intradepartmental Transactions

As part of the reporting process, BIA is required to reconcile intradepartmental transactions between other bureaus within the DOI (referred to as "trading partners"). Differences with trading partners indicate misstatements in financial reporting at both the bureau and DOI levels. Differences between trading partners are currently identified through a manual process, which includes entering transaction data into the DOI's financial reporting system (Hyperion), which is accessible by all the bureaus within the DOI. As of June 30, 2005, BIA was a party to 11 of the 12 highest dollar variances. As of September 30, 2005, we noted that BIA was a party to 6 of the top 10 out-of-balance conditions. Therefore, BIA's financial statements as of and for the year ended September 30, 2005 could be misstated by the following amounts: Assets–$2.2 million; Liabilities–$2.2 million; Expenses–$2.2 million; Revenue–$2.2 million; Transfers in-$251 thousand; and Transfers out–$251 thousand.

As more reliance is placed on quarterly financial reporting, manual process, and lack of accurate and timely trading partner data may impact BIA's ability to prepare reliable interim and year-end financial statements in a timely manner.

Recommendations

We recommend that BIA:

1. Improve its manual process to identify and reconcile the intradepartmental transactions in a timely manner.

2. Perform the reconciliation process at least quarterly and include procedures to resolve all material differences identified in a timely manner.

3. Add a date field to the reconciliation spreadsheet to give management the ability to age the variances.

4. Complete the supervisory review of these reconciliation procedures in a more thorough and timely manner.

Management Response

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

E. Controls over Charge Cards

In 2005, BIA charge cards were used in transactions totaling approximately $79 million. By not ensuring that controls are operating effectively, BIA increases its risk that charge cards may be used for purposes other than official government related business which could lead to poor public perception of BIA's ability to manage its financial resources. BIA issues 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, the DOI published guidance and instructions on the card's utilization through the *Integrated Charge Card Program Guide*. This guidance sets forth policy regarding the restrictions of use of the cards as well as certain internal control procedures such as timely and complete reconciliation of billing statements by cardholders and approving officials and surrender and destruction of charge cards and convenience checks upon a cardholder's resignation, transfer or termination. However, BIA does not consistently follow these internal control procedures due to the need for additional training on charge card procedures and the need for more diligent management oversight at the field level.

Specifically, during our testwork, we noted that out of 179 cardholder statements examined, 52 (29%) had not been properly reviewed and approved in a timely manner. While performing year end testwork procedures over terminated employees, we noted that 99 terminated employees, with the earliest termination date being August 23, 2004, still had active charge cards. Upon noting this anomaly, we confirmed that no unauthorized transactions were entered into after the termination date.

Recommendations

We recommend that BIA:

1. Provide users and approving official's additional training on DOI's charge card policies.

2. Approving officials be more diligent in monitoring and enforcing compliance with DOI's charge card policies.

3. Select a statistical sample of charge card purchases, on a quarterly basis, and obtain and review supporting documentation for the expenditures to ensure the validity of the purchases and to ensure BIA's compliance with established internal control policies and procedures.

4. Perform periodic (e.g. monthly) reviews of terminated employees and active charge card holders to ensure that terminated employees' charge cards are de-activated on a timely basis.

Management Response

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

F. Controls over Clearing of Suspense Balances

1. In some instances, BIA does not receive sufficient information to reference payments made to a vendor or receipts from a customer to the appropriate fund and general ledger account. In these cases, BIA records the disbursement or receipts of funds to one of its two suspense funds. Upon recording the transaction, BIA personnel should obtain additional documentation and/or communicate with the vendor or customer to determine the appropriate fund and general ledger account. BIA should then charge or credit the appropriate fund and general ledger account and clear the item from the suspense funds.

   In performing procedures over an aging of the balance in the suspense funds as of June 30, 2005, we noted significant amounts older than 180 days amounting to approximately $1 million and amounts relating to prior years of approximately $4 million that had not been transferred to the correct fund and general ledger account. In leaving balances in the suspense funds and not clearing them in a timely manner, BIA misstates various general ledger accounts. As of September 30, 2005, the balance in the suspense funds amounted to approximately $59 thousand and has been included in Other Miscellaneous Liabilities in the consolidated balance sheet.

2. In addition, we noted a lack of controls surrounding the receipts and subsequent disbursements, if applicable, of deposit-related suspense accounts, totaling $7.2 million, including the performance of reconciliations and maintenance of adequate supporting documentation.

Recommendations

We recommend that BIA:

1. Establish an effective management review process over the balances in its suspense funds to ensure that items are cleared in a timely basis. This review should be designed to ensure that bureau-wide guidance applicable to all personnel responsible for the posting of suspense items and the clearing of items posted to its suspense funds is implemented.

2. Establish a monthly reconciliation at the transaction level and management review process over all suspense funds related to deposits. This reconciliation should include an aging of transactions in order to track their flow in and out of suspense.

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 Contingent Liabilities

In order to address issues noted in prior audits regarding environmental contingent liabilities (ECL), BIA developed the Environmental Contingent Liability Guidance Handbook (the ECL Handbook). This handbook was designed to provide consistent processes and financial guidance to the Regional Scientists (the Scientists) and other BIA personnel responsible for ECL data management, and to improve the completeness and accuracy of financial data related to ECL. During our 2005 audit, we noted improvement by BIA in addressing ECL weaknesses, however, additional improvements still need to be made in the internal controls over ECL. In performing our testwork over BIA's estimated ECL balance at June 30, 2005 and September 30, 2005, we noted the following:

1. Implementation of Policies and Procedures

The ECL Handbook was inconsistently applied and interpreted by the Scientists. Specifically, we noted:

a. Environmental liability sites (sites) related to Indian lands were still being included in the BIA ECL rollforward for some regions. In prior years, BIA determined that it does not have statutory or regulatory responsibility to clean up non-BIA caused environmental contamination on Indian lands. Consequently, these sites should no longer be included in the ECL rollforward.

b. The Scientists completed the ECL site documentation required by the ECL Handbook; however, there were inconsistencies between how each of the Scientists completed them.

c. The Scientists inconsistently accounted for advances provided to Indian Tribes to remediate sites. Some Scientists incorrectly removed the sites prior to the remediation being performed by the Indian Tribe.

2. *Availability of Resources*

Although supplemented by contractors, there is lack of sufficient qualified personnel in the Regional Offices. One regional office covering approximately 27,000 square miles with over 70 ECL sites had only one acting Scientist for a significant part of the year. This condition contributes to the inability of the Scientists to complete annual inspections/reviews for all of the sites in their region.

3. *Communication*

BIA currently has a decentralized organizational structure that contributes to breakdowns in communication. For example:

a. The Scientists report directly to Regional Directors and not the Division of Environmental and Cultural Resources Management (DECRM), who has overall responsibility for ensuring that all BIA ECL's are identified and reported in BIA's *Performance and Accountability Report* (PAR) in accordance with accounting standards generally accepted in the United States of America. Therefore, DECRM cannot allocate Scientists to assist in other regions where there may be a need without first going through Regional Directors. This inevitably leads to conflicts between bureau–level and regional initiatives.

b. There were breakdowns in communication between Scientists and other regional personnel. In one instance, Office of Facility Management (OFMC) personnel removed a potential environmental hazard without consulting the appropriate Scientist, resulting in the need for soil analysis to be performed and additional funds to be expended.

4. *Site Remediation and Prioritization*

BIA currently provides for site prioritization at the regional level, however, there is no clear bureau-level ECL site prioritization plan. Although Scientists evaluate their individual regions on an annual basis, there is no global ranking to identify the most critical areas on a bureau-wide basis.

In addition, the ECL budget is currently developed on a regional basis, rather than based on a global site prioritization plan or other global framework. In order for BIA to reduce its overall ECL risk on an annual basis, a more appropriate methodology would be to review BIA's overall environmental risks at a bureau-level to identify the most critical ECL needs.

As a result of these weaknesses, BIA reassessed all ECL estimates prior to September 30, 2005 and increased their estimate of the environmental contingent liabilities by approximately $7 million and their upper and lower range estimates to remediate the reasonably possible sites by approximately $3 million at September 30, 2005.

Recommendations

We recommend that BIA:

1. *Implementation of Policies and Procedures*

Provide training for Scientists to ensure that the ECL Handbook is completely and accurately implemented. This training should also provide guidance to ensure that the Scientists are prepared to implement the Department of Interior (DOI) ECL guidance scheduled for distribution in fiscal year.

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2. *Resource Constraints*

Develop a human resources plan to ensure that the regions obtain sufficient qualified personnel to properly implement the policies and procedures in the ECL Handbook, including the completion of annual inspections/reviews for all of the sites in their region.

3. *Communication*

Implement an organizational structure that fosters communication between Scientists, DECRM, the CFO's office, and other regional personnel (e.g. OFMC personnel).

4. *Site Remediation and Prioritization*

a. Develop a comprehensive bureau-wide site prioritization and remediation plan; and

b. Develop a comprehensive ECL budget with targeted remediation dates and other annual objectives/goals.

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. Controls over Financial Management

BIA needs to improve its financial management organization and processes. BIA does not have enough sufficiently trained financial management 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 through an increased use of subcontractors. While these short-term measures have resulted in BIA being able to issue its PAR, it has not resulted in a financial management environment that will provide efficient and effective results on a long-term basis.

We also found that BIA financial management policies and procedures are 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 but not consistently implemented during fiscal year 2005. Additionally, we noted numerous other instances where procedures need to be developed including: suspense and deposit accounts; accounts receivables and deferred revenue related to reimbursable agreements; compliance with *Debt Collection Improvement Act;* and OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*. In addition, BIA does not always perform the necessary management review procedures timely throughout the year including analysis over select financial statement accounts, reconciling items with its trading partners, or differences between the general ledger and subsidiary ledgers. BIA also does not effectively review journal vouchers as we noted that BIA recorded adjustments to the incorrect accounts.

Additionally, during our review of BIA's performance measures, we noted issues that were a result of inadequate oversight of BIA staff who were responsible for compiling and preparing the disclosures related to the key performance measures that were included in BIA's PAR.

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, adjusting the general ledger, and finalizing the PAR at fiscal year end.

Recommendations

We recommend that BIA work with DOI's Office of Financial Management 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. Develop and communicate financial management policies and procedures to financial and program staff.

3. Enforce consistent application of financial management policies and procedures through internal control reviews.

4. Develop and implement formal month-end financial reporting processes to reconcile all subsidiary ledgers to general ledgers, reconcile balances and transactions with trading partners, and resolve differences. This should include having a supervisor review and approve the reconciliations.

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

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 Loans and Loan Guarantees

BIA has disbursed direct loans to Indian individuals and businesses from 1975-1995 and currently guarantees loans for Indian individuals and businesses who may not qualify for financing with commercial banking institution without the backing of a Federal agency. In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, all loans disbursed or guaranteed after 1991 (post-Credit Reform Act) must be accounted for on a present value basis. BIA uses the OMB Consolidated Credit Tool (the Tool) to make the calculations to comply with these requirements. In performing testing procedures over the loans process, we noted the following:

1. Loan Management and Accounting System (LOMAS) is the system used to manage and account for direct and guaranteed loans. BIA has not fully integrated LOMAS with FFS. Consequently, the financial data at the financial statement account level in the LOMAS and FFS differs by approximately $1 million.

2. LOMAS and FFS are not capable of tracking all necessary data for loans. As a result, a loan spreadsheet including financial and non-financial data is maintained outside of FFS. Specifically, the guaranteed loans outstanding portion of the loans footnote contains data maintained exclusively on spreadsheets and outside of BIA's accounting systems and there are no IT system controls over the spreadsheets. Consequently, there is an increased risk of loss of data or error in the subsidiary

spreadsheets that support certain information presented in BIA's financial statement note disclosures related to loans and loan guarantees.

3. Many loan related entries were booked through manual journal entries rather then through the use of posting models in FFS. Many posting models for loan entries have not been developed in FFS, despite their inclusion in guidance provided by Treasury. Although no materially incorrect journal entries were found during the audit, we noted that correcting journal entries had been booked, indicating the posting of incorrect entries during the year. The use of journal entries, rather than developed posting models in FFS, increases the risk of incorrect entries and misstated balances.

4. The Tool used to calculate the subsidy re-estimates uses data from FFS. Due to the amount of time required to populate the credit tool, the data from FFS is obtained during the final week of the fiscal year, although entries related to loans continue to be recorded. As such, the final data in FFS does not agree to the data used in the Tool. The total difference is immaterial as it is less than $1 million.

5. BIA management did not perform a documented management review for any of the following:

   a. Manual input of data into the Tool,

   b. Subsidy re-estimate, or

   c. All loan data maintained on spreadsheets outside of FFS and LOMAS.

6. Documented policies and procedures regarding subsidy re-estimates and the processing of loans are not available.

7. In the loan-related footnote disclosure in the draft PAR, we noted that BIA had misclassified the interest rate re-estimate portion of loan guarantee liability balance ($3.76 million) as interest accumulation on the liability balance.

Recommendations

We recommend that BIA implement policies and procedures to:

1. Reconcile FFS and the loan spreadsheet.

2. Develop posting models for recurring loan entries.

3. Limit the impact of using incomplete FFS data for the subsidy re-estimate calculation or at least a process to ensure that no material transactions have been excluded from the data used for the subsidy re-estimate.

4. Review the loan related supporting schedules.

5. Implement formal policies and procedures to ensure that loans are processed and reported correctly.

6. Review loan related footnote disclosures.

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 BIA in a separate letter dated November 9, 2005.

INTERNAL CONTROLS OVER REQUIRED SUPPLEMENTARY INFORMATION, REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION AND PERFORMANCE MEASURES

We also noted certain significant deficiencies in internal controls over Required Supplementary Information and Required Supplementary Stewardship Information (RSSI) discussed in the following paragraphs, that in our judgment, could adversely affect BIA's ability to collect, process, record and summarize this Required Supplementary Information and Required Supplementary Stewardship Information.

In addition, with respect to the design of internal controls relating to the existence and completeness assertions over performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we noted certain deficiencies, discussed in the following paragraphs that, in our judgment, could adversely affect BIA's ability to collect, process, record, summarize, and report performance measures in accordance with management's criteria.

J. Controls over Required Supplementary Information – Deferred Maintenance Reporting

BIA has not fully implemented the requirements of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, as amended by SFFAS No. 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS No. 6* and SFFAS No. 8, *Supplementary Stewardship Reporting*. SFFAS No. 6 requires BIA to estimate the deferred maintenance for its general, heritage, and stewardship assets using either the condition assessment survey or life cycle costing method. BIA has adopted the condition assessment survey method, which requires BIA to perform periodic inspections of assets to determine their current condition and estimate the cost to correct any deficiencies. Specifically, the deferred maintenance estimate and related condition of major classes of assets disclosed could be misstated due to the following:

1. Personnel responsible for obtaining the deferred maintenance estimates from the field do not have line authority over field personnel responsible for developing the estimates.

2. Limitations and lack of system controls over the systems used to manage BIA's deferred maintenance estimates. Specifically, deferred maintenance estimates associated with Roads, Bridges, and Trails and Irrigation, Dams, and Other Water Structures are accumulated using Excel spreadsheets while deferred maintenance estimates related to Buildings and Other Structures are accumulated using the Facilities Management Information System (FMIS).

3. BIA has not fully established policies and procedures to determine deferred maintenance for all assets. Specifically, BIA has not completed and disclosed estimated deferred maintenance for all heritage assets (e.g. museum property, archeological sites, and historic structures, etc.) and stewardship lands. Furthermore, BIA does not consistently update the condition assessments required under the condition assessment survey method for irrigation systems and power projects.

KPMG

Recommendations

We recommend that BIA:

1. Develop lines of authority to ensure that deferred maintenance estimates are submitted to proper personnel on a timely basis and that adequate effort and support is provided to personnel in the field developing the estimates.

2. Implement a management information system to track the deferred maintenance estimates associated with roads, bridges, equipment and power and irrigation projects to ensure those estimates are accurate.

3. Develop a process consistent with Federal accounting standards for estimating deferred maintenance costs on stewardship land and heritage assets.

Management Response

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

K. Controls over Required Supplementary Stewardship Information

BIA has not fully established internal controls to ensure that RSSI information is completely and accurately collected, processed, recorded and summarized as follows:

1. Museum Property Collections

During testwork performed on heritage assets as of September 30, 2005, we noted that less than 11% of individual museum property collections have been catalogued in the Re:discovery system. BIA utilizes the Re:discovery system (the system) to catalogue and maintain essential information related to the museum property collections. Additionally, BIA has not assessed the condition of all the individual museum property collections which have been catalogued.

BIA's method for disclosing the condition of museum property collections is not in accordance with Federal accounting standards. The RSSI section of the BIA PAR states, "The museum collection "condition" is assessed based on the level of facility compliance with Departmental policy (411DM), with a rating of "Good" determined as meeting 70% of the Department's policy requirements. Facilities are assessed using the Department of the Interior Museum Checklist, reviewing American Associations of Museums accreditation, and adopting the Army Corps of Engineers Mandatory Center of Expertise (MCX-CMAC) scores for compliance with 36 C.F.R Part 79, Curation of Federally-Owned and Administered Archeological Collections, which is similar to 411DM, in collaboration with other Interior bureaus."

In other words, BIA considers museum assets to be in stable condition if the facility is in stable condition. If a collection is housed in a poor facility, the condition of the collection would be considered "poor", regardless of the actual condition of the collection itself. If that same collection is moved to a new facility which is in good condition, the collection would then be considered in "good" condition because the surrounding environment is in "good" condition and any environmental problems contributing to the deterioration of the collection would improve because of the condition of the new facility.

2. *Heritage Assets – Non-Collectibles*

BIA is unable to ensure the completeness of the "Non-Collectible Cultural and Natural Heritage Assets" as of September 30, 2005. In 2005, we noted an effort to report all assets that are located on the National Register of Historic Assets, but there are still assets recorded within the fixed assets subsidiary ledger which have not been evaluated to determine if the respective asset meets the criteria of a heritage asset. In addition, approximately 98% of the National Register of Historic Assets have an unknown condition assessment.

3. *Stewardship Lands*

BIA's determination of condition assessments on its stewardship lands could not be substantiated by any documentation and was performed based solely on inquiry of the Program Managers and the Custodial Property Officers.

Recommendations

We recommend that BIA:

1. Disclose the condition of the collection (i.e., the condition of the asset) instead of the condition of the facility housing the collection in accordance with the Federal accounting standards.

2. Devote more resources to the recording of heritage assets.

3. Document the assessments performed on stewardship lands.

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 will continue to report the condition of the facility housing the collection of heritage assets and stewardship property in accordance with current Departmental guidance.

L. Controls over Performance Measures

With respect to the design of internal controls relating to the existence and completeness assertions over performance measures determined by management to be key and reported in the Management's Discussion and Analysis (MD&A) section of the fiscal year 2005 PAR, we noted certain significant deficiencies in internal controls over reported performance measures disclosed within the MD&A. Specifically, we noted during our testwork that the fiscal year 2005 BIA draft MD&A included performance measures that could not be substantiated, such as the "Probates Received during the Year for which Assets were Distributed", "The Encumbrances Filed within Two Days", and "Children that can Read Independently (By the End of Third Grade)" performance measures. These unsupported performance measures were subsequently removed from the MD&A section of the PAR by BIA based on our testwork results. We noted through inquiry of BIA personnel that one of the performance measures still documented within the MD&A, "Leased Acres Achieving Desired Condition (Percent)", is compiled using 50 year old data of grazing and agricultural land assessments with regards to these lands' desired conditions. We noted that this documentation is not sufficient to be relied upon in preparing the PAR.

We further noted that there is no process whereby management reviews the performance data collected to ensure that the verification and validation of the data were both sufficiently performed by the GPRA coordinators.

Recommendation

BIA should ensure controls are in place to validate the reliability of transactions and other data that support reported performance measures.

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 significant deficiencies is included as Exhibit I. We also noted certain additional matters that we reported to the management of BIA in a separate letter dated November 9, 2005.

COMPLIANCE AND OTHER MATTERS

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed four 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.

M. OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*

OMB Circular No. A-133 subpart D – Federal Agencies and Pass-Through Entities and Appendix B – Circular A-133 Compliance Supplement requires Federal awarding agencies to perform the following procedures: 1) advise the recipients of the requirements imposed on them by Federal laws, regulations, and provisions of the contract or grant agreements; 2) ensure that the audits are completed and the reports are received in a timely manner and in accordance with the requirements; 3) provide technical advice and counsel to auditees and auditors as requested; 4) issue a management decision on audit findings within six months after receipt of the audit report and ensure that the recipient takes appropriate and timely corrective actions; and 5) assign a person responsible for providing annual updates of the Compliance Supplement to OMB. We noted that BIA was not in compliance with OMB Circular No. A-133 because BIA had not received 368 audited financial reports within the required time. Of these 368 Single Audit reports, 263 were due during fiscal year 2005 and the remaining 105 were due in prior fiscal years.

Additionally, we noted that BIA was not analyzing the Single Audit Reports and responding to the tribes within six months regarding BIA's management response on the Single Audit Reports. We obtained and reviewed BIA's Audit Status Report for September 2005 and noted that BIA had identified 59 instances where management responses had not been issued within six months of receipt of the audit report. BIA personnel responsible for preparing this response do not have the necessary training and technical guidance to issue management decisions. Additionally, workloads for those individuals need to be reallocated to ensure timely disposition of management responses. Without this, BIA has no method to ensure that recipients take appropriate and timely corrective action to ensure the proper utilization of Federal funds.

Recommendations

We recommend that BIA management:

1. Document and communicate policies to ensure roles and responsibilities for BIA personnel responsible for drafting and issuing management decisions are consistently understood and applied within a timely manner; and

2. Utilize the Federal Clearinghouse website on an on-going basis to determine when an audit report has been submitted and to obtain the report on a timely basis.

Management Response

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

N. Debt Collection Improvement Act of 1996

BIA has not formalized policies and procedures sufficient to meet the requirements of the DCIA. As such, BIA did not identify all accounts receivable that were delinquent for more than 180 days as eligible for transfer to the U.S. Department of Treasury (Treasury) for collection or offset. Specifically, during our June 30, 2005 testwork over DCIA, we noted the following:

1. BIA receivables with collection dates that exceeded 180 days were suppressed and not referred to Treasury.

2. BIA receivables were not charged the correct interest rate per the Treasury Financial Management Service.

3. BIA could not provide support or evidence that $7.7 million in direct loans and $2.8 million in guaranteed loans written off during the year were referred to Treasury.

4. BIA has an interagency agreement with the National Business Center (NBC) to refer BIA debts to Treasury. In June 2005, BIA notified the NBC to refer 2,649 accounts amounting to $1 million to Treasury. However, NBC was unable to process all of these accounts to Treasury in a timely manner.

5. BIA had no policies and procedures in place to review receivables referred to Treasury.

Recommendation

We recommend that BIA improve the overall debt collection process by establishing, implementing, and monitoring policies and procedures addressing debt collection issues to ensure compliance with the DCIA.

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.

KPMG

O. OMB Circular A-25, *User Charges*

OMB Circular A-25, *User Charges*, establishes various policies and procedures for Federal entities related to user charges associated with the sale or use of Federal resources (e.g. through reimbursable agreements). Specifically, it provides requirements to ensure that user charges will be sufficient to recover the full cost of providing the service, resource, or good. We noted that BIA does not charge users at a level sufficient to recover the full costs they incur. Specifically, BIA does not include the overhead costs associated with the administration of reimbursable contracts and agreements with other federal agencies or nongovernmental entities in the amounts billed under these contracts and agreements. As of August 17, 2005, BIA had approximately 2,134 reimbursable agreements totaling approximately $310 million. Additionally, BIA financial management has estimated its overhead burden rate to be approximately 25% of direct costs. Therefore, BIA is absorbing approximately $78 million of overhead costs that should be charged to its reimbursable customers under OMB Circular A-25.

Recommendations

We recommend that BIA management:

1. Implement policies and procedures to ensure compliance with the requirements of OMB Circular A-25.

2. Develop a methodology for computing its overhead burden rate and updating it periodically ensure compliance with applicable Federal standards.

3. Implement policies and procedures to ensure that a burden rate is applied to all reimbursable contracts and agreements and that a provision to do so is incorporated into all future contracts and agreements.

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.

P. *Federal Financial Management Improvement Act of 1996 (FFMIA)*

The results of our tests of FFMIA disclosed no instances in which BIA's financial management systems did not substantially comply with Federal financial management systems requirements, however, as described below, we identified instances where BIA's financial management systems did not substantially comply with (1) applicable Federal accounting standards, and (2) the United States Government Standard General Ledger at the transaction level.

1. *Federal Accounting Standards*

BIA 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 numerous reportable conditions that affected BIA'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, Required Supplementary Stewardship Information, and Performance Measures section of this report, BIA needs to improve its policies and procedures for determining and reporting deferred maintenance, cataloging and performing condition assessments related to museum collections, and preparing performance measures to comply with Federal accounting standards. As a result, BIA does not substantially comply with the accounting standard indicators of FFMIA.

2. *United States Government Standard General Ledger*

   BIA is not in substantial compliance with the United States Government Standard General Ledger (USSGL) at the transaction level. We noted that a portion of BIA's accounts receivable and all loan transactions are recorded in subsidiary systems that do not interface with FFS. These transactions are then periodically recorded at a summary level into FFS. As these transactions are recorded at the summary level, no detailed information is available in FFS to analyze or query. Additionally, as described in the Internal Control Over Financial Reporting section of this report, we identified instances where transactions were not recorded correctly in compliance with the USSGL at the transaction level. For example, BIA utilized the incorrect account posting model to record capitalized asset donations resulting in a misstatement of approximately $16 million in the Statement of Net Position and Statement of Net Cost.

Recommendations

We recommend that BIA management:

1. Address the control weaknesses described in this report on "Internal Control Over Financial Reporting."

2. Investigate alternatives for recording and reviewing transactions that will enable BIA to process transactions more efficiently and maintain compliance with FFMIA.

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 BIA in a separate letter dated November 9, 2005.

RESPONSIBILITIES

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA), *Accountability of Tax Dollars Act, 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 assist the U.S. Department of the Interior in meeting these reporting requirements, BIA prepares annual 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 BIA 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 BIA'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 BIA's internal control over financial reporting by obtaining an understanding of BIA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on BIA'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 BIA's internal control over the Required Supplementary Stewardship Information by obtaining an understanding of BIA's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, 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 the fiscal year 2005 financial statements are free of material misstatement, we performed tests of BIA'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 BIA. 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 BIA's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

This report is intended solely for the information and use of BIA'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 9, 2005

BUREAU OF INDIAN AFFAIRS

Summary of Status of Prior Year Findings

September 30, 2005

Ref	Condition	Status
A	Controls over Fund Balance with Treasury	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a reportable condition.
B	Controls over Property, Plant and Equipment	This condition has not been corrected and is repeated in fiscal year 2005. See finding B.
C	Controls over Indian Trust Funds	This condition has not been corrected and is repeated in fiscal year 2005. See finding A.
D	Application and General Controls over Financial Management Systems	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a reportable condition.
E	Controls over Accounting for Intradepartmental Transactions	This condition has not been corrected and is repeated in fiscal year 2005. See finding D.
F	Controls over Financial Management	This condition has not been corrected and is repeated in fiscal year 2005. See finding H.
G	Controls over Accounts Receivable	This condition has not been corrected and is repeated in fiscal year 2005. See finding C.
H	Controls over Contingent Liabilities	This condition has been partially corrected and is repeated in fiscal year 2005. See finding G.
I	Controls over Charge Cards	This condition has not been corrected and is repeated in fiscal year 2005. See finding E.
J	Controls over Deferred Maintenance	This condition has not been corrected and is repeated in fiscal year 2005. See finding J.
K	Controls over Heritage Assets	This condition has not been corrected and is repeated in fiscal year 2005. See finding K.
L	Debt Collection Improvement Act of 1996	This condition has not been corrected and is repeated in fiscal year 2005. See finding N.
M	OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*	This condition has not been corrected and is repeated in fiscal year 2005. See finding M.
N	*Federal Financial Management Improvement Act of 1996* (FFMIA)	This condition has not been corrected and is repeated in fiscal year 2005. See finding P.

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

DEC 1 2005

Memorandum

To: Anne Richards, Assistant Inspector General for Audits
Office of Inspector General

Jeff Norris
KPMG LLP

From: Associate Deputy Secretary James E Cason

Subject: Management Response to Draft Independent Auditors' Report on the Bureau of Indian Affairs' Financial Statements for Fiscal Year 2005 and 2004 (Assignment No. X-IN-BIA-0006-2005)

We appreciate the efforts of the Office of Inspector General, and its contractor KPMG LLP, in auditing the Bureau of Indian Affairs (BIA) consolidated financial statements. We are certainly pleased that the result of the audit is an "unqualified opinion" on our consolidated financial statements. In addition, we appreciate the acknowledgment and recognition noted within several findings of the continued progress we achieved during Fiscal Year 2005.

Although our challenges are many, we are determined to significantly improve our internal management control environment and our financial management and performance measurement activities in the coming years. We are confident that this will lead to more timely, meaningful and useful information for both programmatic and budgetary decision making.

We will work with the Department to develop and implement corrective action plans for the report recommendations that are responsive and measurable and demonstrate that BIA is moving forward in improving its financial and program management.

While we are pleased with the vast improvements we have made in Fiscal Year 2005, we recognize that more is still needed to achieve our planned goals, as well as enhance financial reporting that will allow for better-informed and timely decision-making, while simultaneously serving our Indian beneficiaries in the 21st century.

A. Controls over Indian Trust Funds

BIA concurs with the recommendation and will continue to develop and implement additional procedures and controls to address the issues identified in the audit report. As noted in the report, the management of Indian Trust Funds is a Department-wide process. BIA is working closely with the Office of the Special Trustee to develop processes, such as the lockbox initiative, to address the deficiencies.

B. Controls over Property, Plant and Equipment

BIA concurs with the recommendations. BIA plans to work with program offices to ensure proper monitoring of construction projects and the full implementation of current construction in progress policies and procedures. BIA also plans to broaden the scope of its existing reviews to include monthly reviews and certification of their accuracy and a more in-depth review and reconciliation process of the general ledger accounting.

In regards to software in development, BIA plans to create policies and procedures that will ensure the proper tracking of projects throughout the development phases and will implement the reconciling procedures used for other fixed asset general ledger accounts.

C. Controls over Accounts Receivable and Deferred Revenue

BIA concurs with the recommendations. BIA is aware of the current weaknesses and inefficiencies affecting its accounts receivable operations. During the coming fiscal year, BIA will take aggressive measures in resolving operational problems by assigning staff to address the issues and by hiring an accounts receivable supervisor to oversee the process.

D. Controls over Accounting for Intradepartmental Transactions

BIA concurs with the recommendations and is in the process of hiring staff whose sole responsibility will be the resolution of intradepartmental transactions. BIA has improved its reconciliation procedures and developed monthly milestones for the process that will result in management's review of the reconciliation prior to the Department's elimination due dates.

E. Controls over Charge Cards

BIA concurs with the recommendations. BIA will continue to educate and train cardholders and supervisors on charge card responsibilities and will hold program managers responsible for the proper use of charge cards by subordinates. BIA will perform quarterly reviews to ensure that approving officials and cardholders comply with BIA procedures.

F. Controls over Suspense Balances

BIA concurs with the recommendations. As noted in the report, BIA has made incredible progress in researching and correcting balances from prior years that have been aging in suspense accounts. BIA will continue to cleanup the remaining items and will implement Bureau-wide processes and procedures to ensure items entered into suspense accounts are then researched and moved to appropriate accounts in a timely manner. In addition, existing procedures will be reexamined to ensure the proper use of suspense funds related to deposits. Monitoring will be performed by trained staff and will be performed monthly in accordance with internally established procedures.

G. Controls over Environmental Contingent Liabilities (ECL)

BIA concurs with the recommendations. BIA continually evaluates the need for regional scientist training including the need for training based on the Department's revisions of its ECL guidance. BIA will also ensure that sufficient resources are available to complete the scheduled annual inspections/reviews. If necessary, BIA will supplement regional staff shortages with contract staff and "Tiger Teams" composed of regional scientists. In addition, BIA will revise its planning process to include Bureau-level prioritization of ECL sites.

H. Controls over Financial Management

BIA concurs with the recommendation that the hiring of permanent professional staff is necessary to take BIA through future years. Positions have been advertised and recruiting actions will continue until sufficiently qualified applicants are hired. In the meantime, BIA plans to continue contracting for professional private sector expertise to supplement the current workforce. In Fiscal Year 2005, BIA began developing the necessary policies and desk-level procedures to assure that financial management activities are conducted properly and reviewed timely. BIA will finalize and implement this guidance in Fiscal Year 2006.

I. Controls over Loans and Loan Guarantees

BIA concurs with the recommendations and will continue to assess and address the recommended improvements relating to the loan programs, especially in light of the non-integrated environment surrounding the Loan Management and Accounting System (LOMAS) and the Federal Financial System (FFS). Monthly reconciliations among the LOMAS, FFS and loan spreadsheets will continue to be performed and reconciled. Guidance addressing the overall business process and requisite management review will be implemented. Proper footnotes and posting models will be identified and developed.

J. Controls over Required Supplementary Information – Deferred Maintenance Reporting

BIA concurs with the recommendations and will develop written policies and procedures needed to document the deferred maintenance estimation processes to ensure adequate management reviews and proper disclosure in accordance with Federal accounting standards. BIA will require Regional Directors to certify that the submitted estimates are accurate and allow for proper disclosure. The Division of Transportation and Branch of Irrigation, Power and Safety of Dams are developing management information systems that will allow for the tracking of deferred maintenance estimates.

K. Controls over Required Supplementary Stewardship Information

BIA partially concurs with the recommendations. BIA will strive to improve its management of museum collections and other stewardship and heritage assets. However, BIA will continue to report the condition of the facility housing the collection of heritage assets and stewardship property in accordance with current Departmental guidance.

L. Controls over Performance Measures

BIA concurs with the recommendation and will take the appropriate actions in Fiscal Year 2006 to ensure that the performance measures data is accurate, consistent, and complete and provided in a timely manner. To ensure the timely completion and review, BIA will designate a coordinator to develop and track milestone dates and management review of its performance measures.

M. OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*

BIA concurs with the recommendations and will continue to provide the requisite training and technical assistance to ensure awarding officials issue management decisions in a timely manner. The continued court ordered Internet shutdown continues to hinder BIA's use of the Federal Audit Clearinghouse to determine when single audit reports are submitted.

N. ***Debt Collection Improvement Act of 1996.***

BIA concurs with the recommendation. Draft debt management policies and procedures will be finalized and implemented. As noted in BIA's response to Finding C, BIA plans on hiring an accounts receivable supervisor whose duties will include monitoring BIA's debt collection process.

O. OMB Circular A-25, *User Charges*

BIA concurs with the recommendations. BIA will assign staff to develop a methodology of its overhead burden rate. This staff will work in accordance with the accounts receivable project team to ensure proper application of its overhead burden rate against reimbursable agreements.

BIA believes the unabsorbed overhead costs computed by the auditors are inflated because the total amount of reimbursable agreements identified in the report includes the reimbursable agreements with the Department of Education to which BIA would not apply a burden rate.

P. *Federal Financial Management Improvement Act of 1996 (FFMIA)*

BIA concurs with the recommendations and will continue its efforts to improve controls over the FFMIA components related to Federal accounting standards and the U.S. Standard General Ledger at the transaction level. However, correcting the interface deficiency between the accounts receivable and loan receivable subsidiary systems and the FFS's general ledger will require the development of new accounts receivable and loans receivable systems.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

November 15, 2005

Memorandum

To: Secretary

From: for Earl E. Devaney Mary L. Kendall
Inspector General

Subject: Independent Auditors' Report on the Department of the Interior's Annual Report on Performance and Accountability for Fiscal Year 2005 (Report No. X-IN-MOA-0011-2005)

INTRODUCTION

The Department of the Interior (DOI) contracted with KPMG LLP, an independent certified public accounting firm, to audit the financial statements of DOI for fiscal years 2005 and 2004. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget's Bulletin 01-02, as amended, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency's *Financial Audit Manual.*

FINDINGS

In its audit report dated November 15, 2005, KPMG issued an unqualified opinion on the DOI financial statements. However, KPMG identified 14 reportable conditions in DOI's internal controls over financial reporting, of which two were considered to be material weaknesses. KPMG also found three significant deficiencies in DOI's internal controls over Required Supplementary Information and Required Supplementary Stewardship Information. In addition, KPMG identified five instances where DOI did not comply with laws and regulations, including two instances of noncompliance with the Federal Financial Management Improvement Act (FFMIA).

KPMG is responsible for the attached auditors' report and for the conclusions expressed in the report. We do not express an opinion on DOI's financial statements, conclusions on the effectiveness of internal controls, conclusions on whether DOI's financial management systems substantially complied with FFMIA, or conclusions on compliance with laws and regulations.

DOI CORRECTIVE ACTIONS

DOI agreed with 12 of the 14 reportable conditions over financial reporting, one of the three significant deficiencies in internal controls over Required Supplementary Information and Required Supplementary Stewardship Information, and three of the five instances of noncompliance with laws and regulations.

DOI partially concurred with KPMG's finding on controls over the Indian trust funds, which was considered a material weakness. Management will continue to develop and implement additional procedures and internal controls to address the issues noted in the audit. However, DOI stated that it is in a position to draw conclusions that the differences between supporting records and recorded transactions are few in number, small in size, and not widespread or systematic. KPMG reiterated that 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.

DOI also partially concurred with the reportable condition on application and general controls over financial management systems. DOI pointed out that it made substantial progress in improving controls over its systems in fiscal year 2005 and believed that there were no apparent systemic weaknesses at the Department level. KPMG acknowledged that DOI made improvements in security and controls but stated that it had identified a number of conditions that could have affected DOI's ability to detect unauthorized changes to financial information, to control electronic access to sensitive information, and to protect its information.

With regard to the finding on deferred maintenance estimates, which was considered a significant deficiency in internal control over the required supplementary information, DOI partially concurred. However, DOI stated that stewardship land managed by the Department does not have deferred maintenance as defined by the authoritative guidance. KPMG responded that as of September 30, 2005, DOI did not have documented evidence that it had completed condition assessments for all stewardship land, and that DOI was unable to demonstrate that maintenance had not been deferred for its stewardship land. KPMG also stated that DOI reported known instances of land that is in need of intervention and had requested future outlays to correct these conditions in various reports and budget requests.

The finding on stewardship reporting, which was considered a significant deficiency in the reporting of required supplementary stewardship information, was also partially concurred with by DOI. DOI admitted that processes can be improved related to stewardship reporting. DOI did not agree that condition assessments are required for stewardship land. DOI also believed that it is following standard practices. KPMG stated that DOI is required to disclose the condition of stewardship land in accordance with the accounting standards.

DOI partially concurred with the finding on noncompliance with the Single Audit Act Amendments of 1996, stating that while the noncompliance was at some bureaus, the instances did not rise to the level that justified reporting the noncompliance at the Departmental level. KPMG responded that DOI did not ensure that grantees submitted progress reports, completed single audits, and submitted single audit reports timely. KPMG also stated that DOI did not have single audit reports for 395 different grants and did not issue corrective action plans for 59 findings. Additionally, KPMG noted that one component did not obtain progress reports for 15 of a sample of 32 grants that it selected for testing. It reiterated its conclusion that DOI did not comply with the requirements of the Single Audit Act and the related OMB circular.

With regard to the finding on noncompliance with the Debt Collection Improvement Act of 1996, DOI disagreed, stating that it has appeals processes in place that, although they may vary from bureau to bureau, are defined by law and impact when payments become due for collection and subsequently eligible for debt referral. DOI also stated that, as Treasury guidance stipulates, amounts that are the subject of an administrative appeal do not become eligible for referral until the appeal is concluded and the amount of the debt is fixed. During fiscal year 2005, DOI claimed that it continued to improve its process to ensure eligible receivables were referred to Treasury in a timely manner. KPMG acknowledged that DOI is improving its debt referral processes but noted that, although Minerals Management Service (MMS) receivables represented DOI's largest receivables with the public, 9 of 32 receivables sampled that were over 180 days delinquent had not been referred to Treasury. KPMG also cited the Bureau of Indian Affairs (BIA) receivables as another example of receivables not referred in a timely manner. KPMG added that for BIA, the incorrect interest rate was applied.

The DOI response follows KPMG's audit report as an attachment to this memorandum.

REPORT DISTRIBUTION

The legislation, as amended, creating the Office of Inspector General (5 U.S.C.A. App. 3) requires semiannual reporting to Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report. The distribution of the report is not restricted and copies are available for public inspection.

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

Attachment

cc: Chief Financial Officer
Deputy Chief Financial Officer
Director, Office of Financial Management
Audit Liaison Officer
Focus Leader for Management Control and Audit Follow-up, Office of Financial Management

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

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

We have audited the accompanying 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.

KPMG

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.

KPMG

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.

KPMG

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.

KPMG

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.

KPMG

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.

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.

KPMG

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.

KPMG

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.

KPMG

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.

KPMG

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 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.

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.

KPMG

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.

KPMG

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.

KPMG

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.

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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.

Exhibit I

U.S. DEPARTMENT OF THE INTERIOR

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Condition	Status
O	Deferred maintenance reporting	This has not been corrected and is repeated at finding P.
P	Stewardship reporting	This has not been corrected and is repeated at finding Q.
Q	*Single Audit Act Amendments of 1996*	This has not been corrected and is repeated at finding R.
R	*Debt Collection Improvement Act of 1996*	This has not been corrected and is repeated at finding S.
S	*Prompt Payment Act*	This has been corrected.
T	*Federal Financial Management Improvement Act (FFMIA) of 1996*	This has not been corrected and is repeated at finding U.

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

TAKE PRIDE IN AMERICA

NOV 15 2005

Memorandum

To: Earl E. Devaney
Inspector General

KPMG LLP
2001 M. Street, N.W.
Washington, D.C. 20036

From: P. Lynn Scarlett
Assistant Secretary - Policy, Management and Budget

Subject: Management Response to Draft Independent Auditors' Report for Fiscal Year 2005 (Assignment No. X-IN-MOA-0011-2005)

The Department has reviewed the draft report and provides its responses to the findings and recommendations. The Department appreciates the recognition noted in several findings and recommendations of the substantial improvement and progress achieved during fiscal 2005, and we are pleased that the result of the audit is an unqualified opinion on the Department Consolidated Financial Statements.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Reportable Conditions that are considered to be Material Weaknesses

A. <u>New accounting policies and procedures</u>

Management concurs. Interior will improve its policies and procedures related to recording selected assets and liabilities in accordance with OMB guidance.

B. <u>Controls over the Indian Trust Funds</u>

Management partially concurs. Management concurs that the recommendations will improve our internal processes, and we will continue to develop and implement additional procedures and internal controls to address the issues noted in the audit. A variety of actions are underway within Interior to improve internal controls for non-Federal Indian Trust Funds, including providing an accounting for non-Federal accounts. Interior contends that, based upon the reconciliations conducted by independent accounting firms, Interior is in a position to draw conclusions with a high degree of confidence that the differences between supporting records and recorded transactions are few in number, small in size, and not widespread or systematic.

Other Reportable Conditions

C. **Reconciliation of intra-governmental transactions and balances**

Management concurs. Interior has implemented procedures to more timely reconcile and address trading partner differences. In addition Interior continues to actively work on improving trading partner coding of transactions.

D. **Application and general controls over financial management systems**

Management partially concurs. While management agrees that continued improvement is beneficial and continues to implement many of the recommendations, management does not concur that the finding rises to the level of a reportable condition. Interior has made substantial progress in improving controls over its systems in fiscal 2005 and believes there are no apparent systemic weaknesses at the Departmental level. Interior will continue its efforts to improve and enhance application and general controls in fiscal 2006 to address the issues noted in the audit report.

E. **Controls over property, plant and equipment**

Management concurs. During fiscal 2005, Interior continued to improve internal controls over property, plant, and equipment to ensure transactions are properly classified and recorded. A significant accomplishment included completing the land and land rights inventory reconciliation. Interior also released web-based training modules on new property policies and continued to aggressively monitor bureau compliance with the new policy guidance.

F. **Controls over accruals**

Management concurs. During fiscal 2005, Interior analyzed and revised a number of accrual calculations processes. Interior will continue to review and improve its controls over accruals.

G. **Controls over environmental contingencies**

Management concurs. In FY 2005, Interior established a departmental workgroup to standardize processes and documentation. In FY 2006, guidance and procedures will be revised to ensure that environmental information is effectively identified, maintained, and reported.

H. **Financial Management at the Bureau of Indian Affairs**

Management concurs. During fiscal 2005 Interior established a performance improvement plan to ensure that appropriate financial and program staffing and other resources were directed at financial management and reporting functions and continued to improve processes and procedures to promote better financial analysis, transaction entries and reconciliations were performed. In FY 2006, Interior will continue to improve financial management at the BIA.

I. **Controls over revenue**

Management concurs. Although Interior performed a detailed analysis of revenue transactions and adjusted the fiscal year 2005 financial statements accordingly, actions are planned to improve internal controls over the revenue process to ensure that the transactions are promptly and properly recorded for timely and reliable financial reporting. Interior is committed to improving its controls over revenue.

J. **Controls over grants**

Management concurs. Interior will continue to work with its financial assistance programs to improve grantee monitoring processes subject to the requirements of the *Single Audit Act Amendments of 1996.*

K. **Segregation of responsibilities over purchases and entries**

Management concurs. Interior will improve policies and procedures for better segregation of conflicting duties and to enhance review and approval responsibilities.

L. **Controls over charge cards**

Management concurs. Interior continues to believe it has a well-managed charge card program, although compliance issues are identified in several bureaus and offices. Interior continued to monitor supervisory reviews and approval, train and otherwise educate cardholders and supervisors on charge card responsibilities, and monitor the use of charge cards. In addition, through quarterly reviews of the personnel/payroll system, Interior continued to identify newly appointed supervisors who will have approving official responsibility.

M. **Controls over obligations**

Management concurs. Interior will implement new procedures for review and approval of purchase orders and revise guidance for the preparation and processing of transactions.

N. **Controls over the U.S. Park Police Pension Plan**

Management concurs. Interior will take action to investigate and resolve differences between the census data and the supporting documentation to ensure that the pension program is properly presented in the financial report.

INTERNAL CONTROL OVER RSI AND RSSI

O. **Performance Measure Reporting**

Management concurs. Interior will take action to improve internal control over reported performance measures including strengthening Interior's capability to collect, process, record, summarize, and report performance measurements in accordance with management's criteria.

P. **Deferred maintenance estimates**

Management partially concurs. Interior concurs that improvements can be made to processes related to management of appropriate cyclical reviews for those assets subject to deferred maintenance reporting, i.e., general property, plant and equipment, and constructed stewardship assets. However, Interior's consistent position has been that stewardship land managed by the Department does not have deferred maintenance as defined by SFFAS No. 6.

Q. **Stewardship reporting**

Management partially concurs. Interior concurs that processes can be improved related to stewardship reporting. However, Interior does not concur that condition assessments are required for stewardship land. While Interior believes that it is following standard practices, we will strive to improve our management of museum collections and other stewardship and heritage assets.

COMPLIANCE AND OTHER MATTERS

R. **Single Audit Act Amendments of 1996**

Management partially concurs. While Interior concurs that some bureaus must continue to take steps to obtain required reports from grantees previously issued grants, the Department and its bureaus have policies and processes in place that comply with the Single Audit Act and OMB Circular A-133. We do not agree that this issue rises to a Departmental level non-compliance issue.

S. **Debt Collection Improvement Act of 1996**

Management does not concur. Interior has an appeals process defined by law that impacts when payments become due for collection, and subsequently eligible for debt referral purposes. The appeals process may vary from bureau to bureau as to the specifics of its process. As Treasury guidance stipulates, amounts that are the subject of an administrative appeal do not become eligible for referral until the appeal is concluded and the amount of the debt is fixed. In FY 2005, Interior continued to improve its process to ensure eligible receivables were referred to the U.S. Department of the Treasury in a timely manner. Interior does not believe there is a noncompliance at the Departmental level.

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

Management concurs. Interior will implement policies and procedures that comply with OMB Circular No. A-25; develop and implement a methodology to track administration costs; and, charge other Federal entities for the administration costs.

U. Federal Financial Management Improvement Act (FFMIA) of 1996

Management concurs. Interior will continue its improve its controls over the FFMIA components related to Federal accounting standards and the U.S. Standard General Ledger at the transaction level. This will include improved monthly financial statement reporting, monitoring or performance metrics, and periodic reviews of financial performance with senior Department and bureau management.

We appreciate the value of the audit process and look forward to working with you to continue our marked improvement of financial management in the Department of the Interior.

U.S. Department of the Interior
Office of Inspector General

Management Letter Concerning Issues Identified During the Audit of the National Park Service's Financial Statements for Fiscal Years 2005 and 2004

Report No. X-IN-NPS-0008-2006

January 2006

United States Department of the Interior
OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

January 31, 2006

Memorandum

To: Fran Mainella
Director, National Park Service

From: Anne L. Richards
Assistant Inspector General for Audits

Subject: Management Letter Concerning Issues Identified During the Audit of the National Park Service's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-NPS-0008-2006)

Attached is the subject management letter (Attachment 1) prepared by KPMG LLP. It contains seven findings, which are in addition to those contained in KPMG's audit report on the financial statements of the National Park Service (NPS). The management letter contains 29 recommendations that, if implemented, should resolve the seven findings.

In its December 22, 2005 response (Attachment 2) to the draft management letter, NPS agreed with all the findings. NPS also addressed each recommendation, stating that it had implemented 7, was in the process of implementing 20, and disagreed with 2 of the recommendations (see Attachment 3, "Status of Management Letter Recommendations).

We will refer the 20 unimplemented recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. The two recommendations with which NPS disagreed will be referred to the Assistant Secretary for resolution.

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit NPS's financial statements for fiscal years 2005 and 2004. The results of the audit are contained in KPMG's audit report dated November 15, 2005 (Report No. X-IN-NPS-0009-2005). In conjunction with its audit, KPMG noted certain internal control and other operational matters that should be brought to management's attention. Those are the issues that are presented in this management letter.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of NPS personnel during the audit. If you have any questions, please contact me at 202-208-5512.

Attachments (3)

cc: Assistant Secretary, Fish and Wildlife and Parks
Chief Financial Officer, National Park Service
Director, Office of Financial Management
Audit Liaison Officer, Office of Financial Management
Audit Liaison Officer, Fish and Wildlife and Parks
Audit Liaison Officer, National Park Service
Focus Leader for Financial Reporting, Office of Financial Management
Focus Leader for Management Control and Audit Follow-up,
Office of Financial Management

ATTACHMENT 1

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Management Letter

November 15, 2005

Director, National Park Service and Inspector General
U. S. Department of the Interior:

We have audited the consolidated balance sheets of the National Park Service (NPS) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, financing, and the related combined statements of budgetary resources for the years then ended (hereinafter referred to as the "financial statements"), and have issued our report thereon dated November 15, 2005. In planning and performing our audit of the above financial statements of NPS, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

Our audit of NPS's financial statements as of and for the year ended September 30, 2005 disclosed the following reportable conditions, significant deficiencies, and compliance matters that are described in our auditors' report dated November 15, 2005.

Reportable Conditions:

A. Security and General Controls Over Financial Management Systems
B. Financial Reporting Controls
C. Controls Over the U.S. Park Police Pension Plan

Significant Deficiencies:

D. Deferred Maintenance Estimates
E. Stewardship Reporting

Compliance Matters:

F. Single Audit Act Amendments of 1996
G. Federal Financial Management Improvement Act of 1996

During our fiscal year 2005 audit we noted certain other matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies, and are summarized as follows:

1. System Vulnerabilities

NPS did not properly configure certain user accounts and passwords and did not install a messenger patch to help prevent and detect unauthorized changes to information, control access to information, and protect its non-financial information resources.

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Recommendations

We recommend that NPS perform the following:

a. Properly configure user accounts and change passwords.

b. Monitor the issuance of system patches and apply the system patches when they are issued.

Management Response

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

2. Reconciliation Controls

NPS needs to improve reconciliation controls to ensure that transactions are promptly and properly reconciled for timely and reliable financial reports, as follows:

Credit Card Receipt Reconciliation

NPS has established policies that require individual parks to reconcile credit card receipts from the cash register reports to the PCCN report provided by the Accounting Operations Center (AOC); however, NPS does not ensure that the individual parks perform these reconciliations. At the time of our site visits, Shenandoah National Park did not reconcile their receipts to the PCCN report between October 1, 2004 and May 31, 2005 and Glacier National Park did not reconcile their credit card receipts to the PCCN report between October 31, 2004 and November 14, 2004, several days during the months of December 2004 through March 2005, and the last reconciliation was performed on April 1, 2005 as of the date of our site visit on June 10, 2005.

Suspense Account Reconciliation

NPS's policies required the AOC to reconcile the suspense account balance each month; however, the policies did not designate a deadline for investigating and resolving suspense transactions. NPS did not investigate and resolve in a timely manner 36 of the 40 suspense transactions that we tested, as we noted most items tested were over a year old.

In addition, NPS's policy is to record funds received for performance bonds/tenant deposits in the suspense account until performance is completed and record tribal fees in the suspense account until payment is due; however, NPS should record the bonds, deposits, and tribal fees as deferred revenue, deposit liability, and accounts payable, respectively. We noted that 3 of the 40 suspense account transactions that we tested related to bonds/deposits or tribal fees and should have been recorded in other liability accounts in accordance with Treasury guidance and the accounting standards.

Purchase Card Statement Reconciliation

NPS needs to improve controls over the review and approval of purchase card statements to ensure that they are properly reconciled and authorized on a timely basis. Specifically, we determined that 2 out of the 45 purchase card statements tested were not properly reconciled and approved in a timely manner.

Recommendation

We recommend that NPS perform the following:

Credit Card Receipt Reconciliations

a. Implement procedures to ensure that parks properly perform the PCCN reconciliations timely. Procedures should include performing regular internal audits by parks management and/or review and approval of reconciliations by AOC.

Suspense Account Reconciliations

b. Implement and enforce policies that require the AOC to investigate and resolve items in the suspense account within a certain time period, such as 60 - 90 days during the year, and at year-end determine the appropriate accounting for the remaining suspense balance.

c. Record funds received related to performance bonds, tenant deposits, and tribal fees as deferred revenues, deposit liabilities, and accounts payable, respectively.

Purchase Card Statement Reconciliation

d. Continue to communicate the purchase card reconciliation and approval procedures to park, regional, and other personnel.

e. Train parks, regional, and other personnel on properly reconciling, reviewing, and approving purchase card statements.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. In summary, management has agreed with our findings and its comments were responsive to our recommendations. However, management indicated that it is the parks responsibility to ensure that the credit card receipt reconciliations are complete and that it is not feasible for AOC to oversee these reconciliations.

Auditor's Response to Management's Response

We believe that AOC needs to perform additional procedures to ensure that the parks follow the guidance provided by AOC. AOC has issued guidance in the past; however, the guidance alone has not ensured that the parks follow the guidance. Therefore, we recommend that AOC implement procedures to ensure that the parks properly perform the PCCN reconciliations timely. Procedures should include performing regular internal audits by parks management and/or review and approval of reconciliations by AOC.

3. Revenue Controls

NPS's revenue controls did not ensure that NPS consistently accounted for and classified revenue transactions as follows:

Reimbursable Agreements and Unfilled Customer Orders Without Advance

NPS needs to improve controls over reimbursable agreements to ensure that the agreements and related Unfilled Customer Orders without Advance balances (UCO balances) are properly recorded in the accounting system. The reimbursable agreement amounts in the accounting system did not match the balances on the reimbursable agreements for 6 of the 55 agreements tested. In addition, 5 of the 42 UCO balances tested were misstated because the reimbursable agreement amount in the accounting system did not match the amount on the reimbursable agreement or because the expenses in the accounting system did not match the supporting documentation.

Overspent Projects

NPS did not record certain revenue transactions accurately. For reimbursable agreements processed through the Project Cost Allocation System (PCAS), NPS incurred expenses in excess of the reimbursable agreement amounts and therefore, incorrectly recorded unbilled receivables and revenue of approximately $2.2 million, according to the September 30, 2005 "Overspent Project Report." In addition, NPS incorrectly recorded approximately $2.3 million of revenue in excess of expenses related to non-PCAS reimbursable projects.

Year-End Activity

NPS did not consistently accrue for certain revenue earned during the last week of the fiscal year as we determined that 6 of the 24 subsequent cash receipts recorded during the first month of fiscal year 2006, represented revenue earned and received during the last week of fiscal year 2005.

Recommendation

We recommend that NPS perform the following:

Reimbursable Agreements and Unfilled Customer Orders Without Advance

a. Require technicians who enter reimbursable agreements into the accounting system to perform a self review to verify that the agreement is properly entered.

b. Require supervisors to compare the reimbursable agreement to the accounting system to verify that the reimbursable agreement is properly entered and document review and approval on the reimbursable agreement.

Overspent Projects

c. Require supervisors to review the "Overspent Project Report" and monitor reimbursable agreements to identify projects for which total expenses have reached the maximum agreement amount.

d. For reimbursable agreements total expenses approaching the maximum agreement amount, require supervisors to work with the customer to obtain a contract modification to increase the project amount prior to incurring additional costs.

Year-End Activity

e. Establish procedures to estimate and accrue for the cash receipts collected during the last week of the fiscal year.

KPMG

Management Response

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

4. **Financial Disclosure Controls**

NPS needs to improve controls over the note disclosures to ensure that the disclosures are properly prepared for reliable financial reports, as follows:

a. *Accounts Receivable Note Disclosure*

NPS did not separately age its billed Federal accounts receivable balances and its billed public accounts receivable balances for inclusion in its notes to the consolidated financial statements. NPS determined the age of its total billed accounts receivable (including Federal and public), and calculated each aging category as a percentage of the balance of its total billed accounts receivable. NPS applied those percentages to the separate balances of its billed Federal accounts receivable and billed public accounts receivable.

b. *Fund Balance with Treasury (FBWT) Note Disclosure*

NPS did not consistently update the Fund Balance with Treasury note disclosure amounts for certain year-end adjustment. Specifically, the "Unobligated – Available" and "Obligated Not Yet Disbursed" amounts in the NPS's Fund Balance with Treasury note disclosure were misclassified by $9.7 million.

c. *Liability Analysis Note Disclosure*

NPS misclassified amounts between current and non current liabilities that it disclosed in the liability note disclosure. Specifically, NPS reported U.S. Park Police Pension Plan, storm damage, and capital lease liabilities as "Non-Current" liabilities; however, the portion of those liabilities that will be paid within the next year should be classified as "Current" liabilities.

d. *Property Note Disclosure*

NPS reversed the journal entry between buildings and other structures related to hurricane damage asset impairment amounts. Therefore the buildings and other structures and related accumulated depreciation balances in the general property, plant and equipment footnote disclosure is misclassified. Specifically, buildings and other structures was misclassified by $9.7 million and the related accumulated depreciation by $7.2 million.

Recommendations

We recommend that NPS perform the following to ensure that note disclosures are accurately presented:

a. *Accounts Receivable Note Disclosure*

Implement procedures to separately age its billed Federal and public accounts receivable balances based on the actual dates of the individual transactions.

b. *Fund Balance with Treasury (FBWT) Note Disclosure*

Implement procedures and controls to ensure that the note disclosures are updated to capture all year end adjustments.

c. *Liability Analysis Note Disclosure*

With the assistance of the U.S. Department of the Interior, Office of Financial Management, develop and implement a method to disclose the current and non-current portion of the U.S. Park Police Pension Plan, storm damage, and capital lease liabilities.

d. *Property Note Disclosure*

Enforce the requirement for supervisors to review and approve manual journal entries and also verify the accuracy of the recorded disclosure amounts.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. In summary, management has agreed with our findings and its comments were responsive to our recommendations, except for our recommendation related to the accounts receivable note disclosure. Management indicated that due to system limitations that preclude the ability to age by vendor type, they are unable to separately age public versus governmental receivables.

Auditor's Response to Management's Response

NPS has the information available to separately age its billed Federal and public accounts receivable balances because NPS uses this information to develop the existing disclosures, to monitor collection of receivables, and to refer receivables over 180 days past due from the public to the U.S. Department of the Treasury in accordance with legislation. Therefore, we recommend that NPS implement procedures to separately age its billed Federal and public accounts receivable balances based on the actual dates of the individual transactions.

5. Accounts Payable Accrual Controls

NPS's accounts payable accrual methodology was not fully described to enable a reader to understand the necessary calculations in order to arrive at the accrual amount. In addition, NPS did not consistently determine and record the accounts payable accrual. Specifically, we noted the following: (1) NPS recorded approximately $27.6 million as public accounts payable that should have been recorded as intragovernmental accounts payable; (2) NPS did not properly record payables related to intra-departmental transactions; (3) NPS understated the intragovernmental accounts payable accrual by approximately $1.6 million; and (4) NPS incorrectly included an advance payment for services in the information used to estimate the accrual that overstated the accrual by $1.5 million.

Recommendation

We recommend that NPS perform the following:

a. Document the accounts payable accrual methodology policies and procedures in sufficient detail to enable an individual not familiar with the process to perform the procedures. NPS should have someone that is not familiar with the accrual methodology review the documented policy and perform the documented steps to verify that they are clear and can be executed without further clarification.

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b. Require supervisors to compare the accounts payable accrual from the accounting system to the supporting calculations and documentation to ensure that the amounts are recorded in the proper general ledger accounts and document review and approval on the accounts payable journal voucher.

c. Revise the accounts payable accrual methodology to consider intra-departmental activity.

d. Perform an analysis by comparing prior year estimates to actual intragovernmental results and adjust the accrual methodology based on those results.

e. Record advances for services as a prepaid asset and amortize the costs over the term of the service or revise the accounts payable accrual methodology to eliminate advance payments from the information used to estimate the accrual.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. In summary, management has agreed with our findings and recommendations, except for our finding that the accrual methodology was not fully described to enable a reader to understand the necessary calculations in order to arrive at the accrual amount. Management indicated that the individual performing the accrual process should have knowledge of the accounting system and technical report writing skills, and therefore should not need the additional policies and procedures that we recommended. Management also indicated that procedures are in place to ensure the accounts payable accrual agrees from the accounting system to supporting documentation and to review and approve all journal voucher transactions.

Auditor's Response to Management's Response

NPS should be as detailed as possible in documenting the accounts payable accrual methodology policies and procedures because the accrual methodology is not a simple routine process and because we identified findings that may have been avoided if the policies and procedures had been more detailed. Therefore, we recommend that NPS document the accounts payable accrual methodology policies and procedures in sufficient detail to enable an individual not familiar with the process to perform the procedures. NPS should have someone that is not familiar with the accrual methodology review the documented policy and perform the documented steps to verify that they are clear and can be executed without further clarification.

We identified differences between the accounting system and supporting documentation, as discussed above, indicating that NPS did not effectively compare the accounts payable accrual from the accounting system to the supporting calculations and document review and approval on the accounts payable journal voucher. Therefore, we recommend that NPS require supervisors to compare the accounts payable accrual from the accounting system to the supporting calculations and documentation to ensure that the amounts are recorded in the proper general ledger accounts and document review and approval on the accounts payable journal voucher.

KPMG

6. Budget Controls

NPS's controls did not ensure that NPS consistently accounted for and classified budgetary transactions as follows:

Report on Budget Execution and Budgetary Transaction (SF-133)

NPS did not submit accurate budgetary information to Treasury through the FACTS II reporting system for 2 of the 7 appropriations tested for the quarter ending June 30, 2005. Specifically, we noted that the SF-133 for appropriation 14X1042 included $1 million on "Line 1E – Budget Authority, Other" that should have been reported on Line 3 –Spending Authority from Offsetting Collections and the SF-133 for appropriation 14051036 included a credit balance of $23.6 million on "Line 10C – Unobligated Balance Not Available, Other" that should not have been included.

In addition, NPS did not consistently certify its quarterly SF-133s as NPS did not certify its 3rd quarter SF-133 for appropriation 14051036 – Operation of the National Park System. As of June 30, 2005, this appropriation included approximately $1.7 billion of total budgetary resources.

Recoveries of Prior Year Obligations

The accounting system (i.e. Federal Financial System) incorrectly records recoveries of prior year obligations for reclassifications of obligations between program accounts, receipts, and other transactions, resulting in an overstatement of total budgetary resources and obligations incurred. NPS implemented policies and procedures to investigate and correct invalid recoveries resulting from the system configuration. However, we determined that for 12 of the 55 recoveries we tested were not valid recoveries and 4 of the 55 recoveries tested should have been recovered in prior years.

Recommendations

We recommend that NPS perform the following:

Report on Budget Execution and Budgetary Transactions (SF-133) Preparation

a. Require supervisors to compare budgetary transactions from the accounting system and the SF-133 *Report on Budget Execution and Budgetary Resources* to supporting documentation and document review and approval on the supporting documentation.

b. Require supervisors to review and certify the quarterly SF-133s *Report on Budget Execution and Budgetary Resources* within the FACTS II reporting deadline.

Recoveries of Prior Year Obligations

c. Perform an analysis of budgetary recoveries on a monthly basis or more frequently, to identify invalid recoveries and adjust the recoveries balance to reflect the proper amount.

d. Enforce the policy that third party drafts and similar transactions should not be obligated prior to payment.

e. Review obligations outstanding at year-end to ensure that they are still valid and should not be recovered.

Management Response

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

7. **Benefits Controls**

We identified the following findings related to accounting for benefit elections:

Federal Employees' Health Benefits (FEHB)

NPS needs to improve its documentation of the review and approval of benefit elections as we noted that 8 of the 161 employees that we tested did not have a FEHB form authorized by both the employee and the Human Resources official. We noted that 3 of the 8 forms were only signed by the employee and 5 of the 8 forms were not signed by the employee or the Human Resources official.

Federal Employees' Group Life Insurance (FEGLI)

NPS did not ensure that the FEGLI deductions applied in the payroll system were consistent with the deductions elected on the FEGLI form (i.e., SF-2817) as we identified 1 exception for the 161 employees tested. Specifically, the employee elected Option B and C on the FEGLI form; however, the employee only received and paid for basic coverage.

Recommendation

We recommend that NPS perform the following:

Federal Employees' Health Benefits (FEHB)

a. Require the human resource officials to review and approve the benefit election forms and document approvals on the form.

b. For cases where the employee did not return the benefits election form, require the human resource officials to prepare a memo that documents that the employee did not complete the benefits election form or indicate such directly on the form and require the HR official to approve the memo/form. (Note: This recommendation was performed by certain human resource offices in fiscal year 2005.)

Federal Employees' Group Life Insurance (FEGLI)

c. Consistently compare the benefit elections from the benefit form to the information input in payroll system to ensure that complete and accurate benefit information is entered into the payroll system in a timely manner.

Management response

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

A summary of the status of prior year management letter findings is included as Exhibit I.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of NPS gained during our work to make comments and recommendations that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

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

Very truly yours,

KPMG LLP

Exhibit I

NATIONAL PARK SERVICE

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Findings	Status
1	Reconciliation Controls	The condition has been partially corrected. The conditions that were not corrected are repeated at comment 2.
2	Property, Plant, and Equipment	The condition has been partially corrected. The conditions that were not corrected are included in the auditors' report as reportable condition B.
3	Cost of Acquiring and Improving Stewardship Land	This condition has not been corrected and is included in the auditors' report as reportable condition B.
4	Transfers	This condition has been corrected.
5	Revenue	This condition has been partially corrected. The conditions that were not corrected are repeated at comment 3.
6	Segregation of Duties	This condition has been corrected.
7	Payroll System	This condition has been corrected.
8	Benefits	This condition has not been corrected and is repeated at comment 7.
9	Accruals	This condition has been corrected. However, we identified additional comments at comment 5.
10	Possessory Interest and Leasehold Surrender Interests	This condition has been corrected. However, we identified additional conditions that were included in the auditors' report as reportable condition B.

United States Department of the Interior

NATIONAL PARK SERVICE
1849 C Street, N.W.
Washington, D.C. 20240

IN REPLY REFER TO:

F4(0010)

DEC 22 2005

Anne L. Richards
Assistant Inspector General for Audits
U.S. Department of the Interior
Office of the Inspector General
1849 C Street, NW, MS 5341
Washington, D.C. 20240

Mr. Jeff Norris
C/O KPMG LLP
2001 M St., NW
Washington, D.C. 20236

Draft Management Issues

This is in response to the recommendations contained in the Draft Management Issues Report Identified During the Audit of the National Park Service's Fiscal Year 2005 and 2004 Financial Statements (Assignment No. X-IN-NPS-0008-2006).

1. Systems Vulnerabilities, Recommendations. NPS needs to properly configure certain user accounts and change passwords. In addition, NPS needs to monitor the issuance of system patches and apply the system patches when they are issued.

   Response: We concur. Corrective actions have been implemented.

   The responsible official for implementing the recommendations will be the NPS Chief Information Office.

2. Reconciliation Controls, Recommendation. NPS needs to improve reconciliation controls for the following areas to ensure that transactions are promptly and properly reconciled for timely and reliable financial reports.

a. Credit Card Receipt Reconciliation, Recommendation – Implement procedures to ensure that parks perform the PCCN reconciliations timely. Procedures should include performing regular internal audits by park management and/or review and approval of reconciliations by AOC.

Response – We concur. An Internal Control review questionnaire, which includes questions on credit card reconciliation, has been developed by the Accounting Operations Center, and will be issued to the parks/offices during FY 2006. Parks/Offices should periodically complete questionnaires and present findings to park management for their review to ensure reconciliations are being completed. It is the parks responsibility to ensure these reconciliations are complete, and is not feasible for the AOC to oversee these reconciliations.

b. Suspense Account Reconciliation, Recommendation. Establish and implement policies that require Accounting Operations Center to investigate and resolve items in the suspense account within a certain time period, such as 30 days.

Response - We concur. The Accounting Services Team will resolve unidentified items and take corrective action within 60 days. However, for those transactions that will remain in the suspense account longer, based on the purpose of the transaction, such as performance bonds, tenant deposits and tribal fees, NPS has segregated these items by Program Work Element. NPS will determine whether there is further need to post these items as recommended by this report.

c. Purchase Card Statement Reconciliation, Recommendation. Needs to improve controls over the review and approval of purchase card statements to ensure that they are properly reconciled and authorized on a timely basis.

Response – We concur. NPS will be requiring mandatory refresher training for all cardholders during FY 2006. In addition, we will be issuing updated policies and procedures on cardholder responsibilities, and will begin developing procedures for a service-wide audit process.

The responsible officials for implementing the recommendations will be the Accounting Services Team Leader and the Charge Card Coordinator.

3. Revenue Controls, Recommendations. NPS needs to improve revenue controls to ensure that NPS consistently accounts for and classifies revenue transactions as follows:

a. Reimbursable Agreements and Unfilled Customer Orders without Advance, Recommendations. Needs to improve controls over reimbursable agreements to ensure that the agreements and related Unfilled Customer Orders without Advance balances (UDO balances) are properly recorded in the accounting system. Specifically, NPS should require technicians who enter reimbursable agreements into the accounting system to perform a self-review to verify that the agreement is properly entered. In addition, require supervisors to compare the agreements to the accounting system to verify agreements are properly entered and document review and approval on the reimbursable agreement.

Response - We concur. Procedures have been established for technicians to prepare worksheets for agreements, which will be reviewed on a quarterly basis. Supervisors will periodically pull a random sample of reimbursable agreements to review and verify agreement data matches data processed in the accounting system.

b. Overspent Projects, Recommendation. Needs to require supervisors to review the "Overspent Project Report" and monitor reimbursable agreements to identify projects for which total expenses have reached the maximum agreement amount. In addition, for reimbursable agreements total expenses approaching the maximum agreement amount, require supervisors to work with the customer to obtain a contract modification to increase the project amount prior to incurring additional costs.

   Response – We concur. The first finding was an isolated incident and has been corrected. Procedures are in place for supervisors to review the appropriate reports, identify agreements that are approaching the maximum agreement amount, and take the necessary action to determine a need for modifying agreements.

c. Yearend Activity, Recommendation. Need to establish procedures to estimate and accrue for the cash receipts collected during the last week of the fiscal year.

   Response – We concur. Although NPS does not feel that certain revenue earned during the last week of the fiscal year are material to the financial statements, we will do additional research to determine the best method for accruing such revenue.

The responsible official for implementing the recommendations will be the Accounting Services Team Leader.

4. Financial Disclosure Controls, Recommendation. NPS needs to improve controls over the note disclosures to ensure that the disclosures are properly prepared for reliable financial reports as follows:

   a. Accounts Receivable Note Disclosure, Recommendation. Implement procedures to separately age its billed Federal and Public accounts receivable balances based on the actual dates of the individual transactions.

Response – We do not concur. Due to FFS/FRRS system limitations, that precludes the ability to age by vendor types, NPS will not be able to separately age public/governmental receivables. Until the implementation of FBMS, NPS will continue with current methodology for reporting aged receivables.

b. Fund Balance with Treasury (FBWT) Note Disclosure, Recommendation. Implement procedures and controls to ensure that the note disclosures are updated to capture all yearend adjustments.

   Response – We concur. This finding was a one-time event, a result of a Hyperion AJE for which the footnote schedule was not updated. Procedures will be followed to ensure reported information agrees with the disclosure.

c. Liability Analysis Note Disclosure, Recommendation. Implement a method to disclose the current and non-current portion of the U.S. Park Police Pension Plan, storm damage, and capital lease liabilities.

   Response – We concur. The U. S. Park Police Pension, Capital Lease Liability will be broken out between its current and non-current portions for FY 2006. The pension disclosure will require a modification to the current General Ledger Account Code roll-ups with PFM. The storm damage liability was administratively determined to be entirely non-current, as it often takes more than one operating cycle to get plans readied and construction begun. Any portion, which is administratively determined to be paid within the next operating cycle will be reclassified to current for next year's reporting.

d. Property Note Disclosure, Recommendation. Enforce the requirement for supervisors to review and approve manual journal entries and also verify the accuracy of the recorded amounts.

   Response – We concur. Policies and procedures will be reviewed to ensure manual journal entries are verified for accuracy and agree with recorded amounts.

The responsible official that will implement the recommendations will be the Financial and Accounting Support Team Leader.

5. Accounts Payable Accrual Controls, Recommendation. NPS needs to; document the accounts payable methodology policies and procedures in sufficient detail to enable an individual not familiar with the process to perform the procedures; require supervisors to compare the accounts payable accrual from the accounting system to the supporting calculations and documentation to ensure that the amounts are recorded ij the proper general ledger accounts and document the review and approval on the accounts payable journal voucher; revise the accounts payable accrual methodology to consider intra-departmental activity; perform an analysis by comparing prior year estimated to actual

intra-governmental results and adjust the accrual methodology based on those results; and record advances for services as a prepaid asset and amortize the costs over the term of the service or revise the accounts payable methodology to eliminate advance payments from the information used to estimate the accrual.

Response – We concur with the recommendations, except for the contention that the accrual methodology policies and procedures can be written so that an individual not familiar with the accrual process could perform the procedures. NPS feels that the individual performing this process should have good fundamental knowledge of the accounting system and technical report writing skills. The current policies and procedures will be reviewed and appropriately modified to have more specific language outlining the processes and reports utilized for preparing the accounts payable accrual. In addition, procedures are in place to ensure the accounts payable accrual from the accounting system agrees with supporting documentation. Procedures already exist for review and approval of all journal voucher transactions.

In regards to changing our methodology to consider intra-departmental activity, we will develop and implement policies and procedures to incorporate this activity into our accrual process, but note that this recommendation is contrary to our methodology used and accepted by the auditors last year. NPS will also implement procedures and document the analysis of prior year estimated accruals to actual intra-governmental results and will adjust the accrual methodology as needed. Procedures will be developed to eliminate advance payments from the data used to estimate the accrual.

The responsible officials for implementing the recommendations will be the Management Systems Team Leader and the Financial and Accounting Support Team Leader.

6. Budget Controls, Recommendation. NPS needs to ensure that budgetary transactions are consistently accounted for and properly classified.

   a. Report on Budget Execution and Budgetary Transactions (SF-133), Recommendation. Require supervisors to compare budgetary transactions from the accounting system and the SF-133 *Report on Budget Execution and Budgetary Resources* to supporting documentation, and document the review and approval on the supporting documentation. In addition, supervisors should review and certify the quarterly SF-133's within the FACTSII reporting deadline.

      Response – We concur. Procedures will be implemented to ensure supporting documentation reconciles with accounting system. Procedures are in place for the certification of quarterly SF-133's. The finding was a one-time issue on one appropriation, due to communication with Treasury, and has been corrected.

   b. Recoveries of Prior Year Obligations, Recommendation. Perform an analysis of budgetary recoveries on a monthly basis or more frequently, to identify invalid recoveries and adjust the recoveries balance to reflect the proper amount. NPS should enforce the policy that third party drafts and similar transactions should not be obligated prior to payment, and review obligations outstanding at year-end to ensure that they are still valid and should not be recovered.

Response – We concur. NPS has developed and implemented procedures and reports for analyzing and reviewing budgetary recoveries on a monthly basis. Invalid recoveries will be identified and appropriate adjustments will be reflected in the recovery balance. Parks/Offices are aware that obligations should not be posted to the accounting system if payments are made by third party drafts. Through our analysis, these errors will be identified and the specific park/office will be notified to take corrective action. The Accounting Operations Center, in conjunction with the parks/offices, reviews and validates outstanding obligations annually.

The responsible officials for implementing these recommendations will be the Financial and Accounting Support Team Leader, the Management Systems Team Leader and the Fiscal Services Team Leader.

7. Benefits Controls, Recommendation. Need to implement procedures that help ensure proper accounting for benefit elections.

    a. Federal Employees Health Benefits, Recommendation – Review the official personnel file to ensure all required approvals of benefit election forms are completed, and where election forms are not received prepare a memo that documents the issue.

       Response – We concur with the recommendation to improve the review and approval of benefit election forms. Employees are encouraged to make benefit elections online at employeeexpress.gov. While the Office of Personnel Management (OPM) requires employeeexpress.gov to submit paper documentation for subsequent signature of the election to client agencies, frequently employeeexpress.gov fails to submit such documentation. OPM is working to correct this longstanding issue.

       While the deficiencies within this process contribute to the failure to document benefit elections, the final responsibility for the deficiency lies with NPS.

       NPS concurs with the recommendation to prepare a memo that documents the employee did not complete the benefits election form. Policies and procedures are in place, which outlines requirements for employee personnel files to be complete and actions needed to ensure all required forms are accurate and complete. We feel the missing form that was identified during the audit test was an isolated error.

    b. Federal Employees Group Life Insurance (FEGLI), Recommendation – Consistently compare information from FPPS to the benefit forms to ensure the proper benefits are entered into FPPS in a timely manner.

Response – We concur with the recommendation to compare benefit elections information in the payroll system to the submitted FEGLI form. We note that employees are also responsible for reviewing individual leave and earning statements to ensure accuracy and that such review would also result in identification of any processing errors.

The responsible official for implementing these recommendations is the Chief, Division of Labor and Employee Relations Policy.

12/22/05

C. Bruce Sheaffer, Chief Financial Officer   Date

ATTACHMENT 3

STATUS OF MANAGEMENT LETTER RECOMMENDATIONS

Recommendation	Status	Action Required
2.a, 2.b, 2.c, 2.d, 2.e, 3.a, 3.b, 3.e, 4.b, 4.c, 4.d, 5.c, 5.d, 5.e, 6.a, 6.d, 6.e, 7.a, 7.b, and 7.c	Resolved; not implemented	Recommendation will be referred to the Assistant Secretary, Policy, Management and Budget for tracking of implementation.
4.a and 5.a	Unresolved.	Recommendation will be referred to the Assistant Secretary, Policy, Management and Budget for resolution.
1.a, 1.b, 3.c, 3.d, 5.b, 6.b, and 6.c	Implemented	No further action is required.

U.S. Department of the Interior
Office of Inspector General

Management Letter

Concerning Issues Identified During the

Audit of the Bureau of Indian Affairs

Financial Statements for

Fiscal Years 2005 and 2004

Report No. X-IN-BIA-0010-2006 **March 2006**

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

MAR 3 2006

Memorandum

To: James E. Cason
Associate Deputy Secretary for Indian Affairs

From: Anne L. Richards Anne L. Richards
Assistant Inspector General for Audits

Subject: Management Letter Concerning Issues Identified During the Audit of the Bureau of Indian Affairs Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-BIA-0010-2006)

Attached is the subject, KPMG LLP-prepared management letter (Attachment 1). It contains 13 findings, in addition to those contained in KPMG's audit report on the financial statements of the Bureau of Indian Affairs (BIA). The management letter contains 30 recommendations that, if implemented, should resolve the 13 findings.

In its February 14, 2006, response to the draft management letter (Attachment 2), BIA agreed with all the findings. BIA also addressed each recommendation, stating that it had implemented 6 recommendations and is in the process of implementing 24. We will refer the unimplemented recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation (see Attachment 3, "Status of Management Letter Recommendations").

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit BIA's financial statements for fiscal years 2005 and 2004. KPMG's Report No. X-IN-BIA-0006-2005, dated November 9, 2005, contains the results of the audit. In conjunction with its audit, KPMG noted certain internal control and other operational matters that should be brought to management's attention. This management letter presents those issues.

The legislation, as amended, that created the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, we will include this report in our next semiannual report.

We appreciate the cooperation and assistance of BIA personnel during the audit. If you have any questions, please contact me at 202-208-5512.

Attachments (3)

cc: Assistant Secretary, for Policy, Management and Budget
Chief Financial Officer, Assistant Secretary for Indian Affairs
Director, Office of Financial Management
Director, Division of Financial Management, Assistant Secretary for Indian Affairs
Director, Office of Audits and Evaluations, Assistant Secretary for Indian Affairs
Audit Liaison Officer, Assistant Secretary for Indian Affairs
Audit Liaison Officer, Bureau of Indian Affairs
Focus Leader, Financial Reporting, Office of Financial Management
Focus Leader, Management Control and Audit Follow-up,
Office of Financial Management

Attachment 1

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Management Letter

November 9, 2005

Assistant Secretary for Indian Affairs and Inspector General
U.S. Department of the Interior:

We have audited the consolidated balance sheets of the Bureau of Indian Affairs (BIA) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, and financing, and the related combined statements of budgetary resources, for the years then ended (hereinafter referred to as the "financial statements"), and have issued our report thereon dated November 9, 2005. In planning and performing our audit of the above financial statements of BIA, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

Our audit of BIA's financial statements as of and for the year ended September 30, 2005 disclosed the following material weaknesses, reportable conditions, significant deficiencies, and compliance matters that are described in our auditors' report dated November 9, 2005:

Material Weaknesses:

A. Controls over Indian Trust Funds
B. Controls over Property, Plant and Equipment
C. Controls over Accounts Receivable and Deferred Revenue

Reportable Conditions:

D. Controls over Accounting for Intradepartmental Transactions
E. Controls over Charge Cards
F. Controls over Clearing of Suspense Balances
G. Controls over Environmental Contingent Liabilities
H. Controls over Financial Management
I. Controls over Loans

Significant Deficiencies:

J. Controls over Required Supplementary Information - Deferred Maintenance Reporting
K. Controls over Required Supplementary Stewardship Information
L. Controls over Performance Measures

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Compliance Matters:

M. OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*
N. *Debt Collection Improvement Act of 1996*
O. OMB Circular A-25, *User Charges*
P. *Federal Financial Management Improvement Act of 1996 (FFMIA)*

During our audit, we noted certain other matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. These comments and recommendations are summarized as follows:

1. Service Continuity

BIA adopted a contingency plan, *Information Technology Systems Contingency Operation Plan*, in May 2004. The scope of the contingency plan includes the network infrastructure, client/server environment, and Unisys mainframe environment. However, the contingency plan lacks detailed recovery procedures to restore BIA's mission critical data processing operations in the event of a disaster. Although BIA has initiated preliminary disaster recovery testing for select critical systems, comprehensive disaster recovery testing had not been conducted due to lack of detail disaster recovery procedures.

Nevertheless, BIA continues to make progress in their efforts to minimize damage and potential interruptions of its systems and operations by developing a business continuity preparedness and prevention program. However, there are still issues that have not been addressed. For example BIA: 1) has developed a list of critical applications and included it in the contingency plan but a list of critical data has not been identified or documented; 2) has not identified or documented the resources necessary to support critical operations for disaster recovery purposes; 3) has not established or documented emergency processing priorities; 4) has not conducted formal training for the data center staff on data center emergency processing procedures; and 5) BIA did not store backup tapes for the Continental Billing System at an off-site location for a portion of the fiscal year.

Recommendations

We recommend that BIA management:

a. Allocate sufficient resources toward the development of a comprehensive disaster recovery plan, to be incorporated into the contingency plan, for the recovery of BIA's mission critical data processing operations in the event of a disaster. We recommend that such a plan provide detailed procedures for the recovery of all computer operations in the event of a disaster. This should include mainframes, microcomputers, workstations, networks and telecommunications, and hardware and facilities. Specific sections, which need to be developed, include:

   - Recovery timeline and major milestone requirements;
   - Alternate computer processing site resource requirements;
   - Detailed backup and data recovery procedures;
   - Detailed telecommunications recovery procedures;
   - Vendor agreements;
   - Off-site storage of forms, critical documents, and supplies;
   - Inventory of forms and magnetic media stored at an off-site location; and
   - Planned maintenance and testing procedures.

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b. Once a comprehensive disaster recovery plan has been fully developed, we recommend that procedures be established for the periodic testing of the plan, documenting test results, and updating the plan to reflect necessary improvements;

c. Develop and implement a policy for documenting a consolidated listing of critical data and systems for purposes of prioritizing emergency restoration;

d. Identify and document all resources supporting critical operations for purposes of disaster recovery;

e. Develop and conduct formal emergency procedures training for Herndon data center staff and other essential personnel who will assist in emergency processing and restoration. Training sessions should be updated and conducted at least annually on an on-going basis.

f. Develop and implement procedures to ensure that backup tapes are stored offsite. The tapes should be rotated offsite periodically, e.g., weekly. The offsite storage facility should be geographically remote from the production facility.

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.

2. Logical Access Controls

BIA's process to monitor logical access to IT resources needs improvement. We reviewed a complete listing of RACF users with access to the mainframe regions where Federal Financial System (FFS) and Federal Payroll Processing System (FPPS) reside and noted users with two or more assigned user identifications as well as active user accounts that belonged to employees who have separated from BIA.

Recommendations

We recommend that BIA management:

a. Perform periodic reviews of the access control listings of its various IT resources to ensure that active users have valid business needs for such access and that the access privileges are not excessive;

b. Continue efforts to enforce password policies using the technical tools available;

c. Integrating the user account removal process into the personnel exit procedures; and

d. Continue efforts to enhance coordination and communication with NBC regarding user account management.

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.

3. FFS Payment Authorities

FFS has been configured to limit the authority to override appropriation errors for the obligation of funds to certain individuals. During performance of our audit procedures, we noted one user with the ability to override appropriation errors in FFS that did not require such privileges based on their current job responsibilities. Upon noting this anomaly, we confirmed that no unauthorized overrides were made by the user.

Recommendation

We recommend that BIA management develop and implement procedures to periodically review the list of FFS users with override authorities. If user accounts with inappropriate override authorities are found, management should remove the inappropriate override authorities, and perform system queries of appropriation funding history to determine whether improper overrides were made using the user accounts in question and take necessary follow-up actions.

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.

4. FPPS System Access

During our testwork over FPPS, BIA's primary payroll system, we found that 34 of the 2,950 users' Social Security Numbers (SSNs) in their profiles did not agree with the SSNs in the FPPS master employee database. One of the key FPPS configuration controls prevents a user from approving his/her own personnel actions. When a user attempts to approve a personnel action in FPPS, the system utilizes checks the social security number (SSN) field in the user profile against the SSN in the FPPS master database, of the employee whose personnel action is being processed. The system rejects the transaction if the SSNs are the same.

Upon further investigation, we determined that 4 of the 34 users were not BIA employees, but were BIA contractors given limited access to produce reports. These users were properly not included in the employee master database. We obtained the security profile for each of the remaining 30 users, and noted that 11 of the users had approval authority within FPPS. We then obtained the history of personnel actions for the 11 users, noting that none had approved their own personnel actions.

Recommendations

We recommend that BIA management:

a. Remedy the FPPS vulnerability by implementing a programming change to automatically populate the SSN field in the user profile with the data in the master employee database, eliminating the need to manually enter the information for BIA employees; or alternatively,

b. Develop, approve, and implement policies, procedures, and guidelines that mandate all FPPS user profiles for BIA employees be established with SSNs that match the SSNs in the master employee database; and

c. Perform periodic (e.g. quarterly) reviews of the FPPS user listing to ensure that the SSNs in the user profiles agree with the SSNs in the FPPS master employee database.

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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.

5. Lack of Management Review over Power Usage Exception Reports

From October 2004 to May 2005, the San Carlos Irrigation Project (SCIP) used the Itron system to collect power usage data from their customers' meters monthly. This usage data is analyzed by the Itron system by route for possible incorrect usage data and an "exception report" is created. The Meter Foreman reviews the exception report and has the ability to alter the usage data in the Itron system. As such, SCIP has a policy requiring approval by the Customer Service Manager of changes to usage data made by the Meter Foreman. During the period May 2005 through September 2005, SCIP did not use the Itron system, but instead entered the usage data manually into the billing system (CBS).

During our testwork, we requested exception reports related to a sample of 45 routes and noted the following:

- Two out of 45 exception reports indicated adjustments to usage data that were not properly approved;
- Fifteen out of 45 exception reports could not be provided since usage data was manually entered into CBS, bypassing the Itron system;
- Seven out of 45 exception reports could not be provided related to the period when the Itron system was being utilized. BIA management indicated that there would be no exception reports available if there were no exceptions noted by the Itron system, however BIA management does not maintain a log of exceptions reports generated. Therefore, we could not determine whether or not a report should have been generated; and
- Although we did not note them as exceptions, 19 out of 45 exception reports provided had no adjustments and therefore, consistent with SCIP policy, had no documented evidence of management review. Without documented evidence of management review, we were unable to verify that a review of the exception report had been performed.

Recommendations

We recommend that the BIA management:

a. Ensure that its current policies and procedures related to the review and approval of exception reports with adjustments and approval of usage adjustments are properly implemented and operating effectively;

b. Modify its policies and procedures to provide for the review of all exception reports, not only those with adjustments;

c. Maintain a log of exception reports; and

d. Modify its policies and procedures to require documented evidence of management review of all exception reports.

KPMG

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.

6. Irrigation Services

During our testwork over accounts receivable, we identified two instances where BIA provided irrigation services to customers with past due balances referred to the U.S. Department of Treasury (Treasury). Specifically, we noted that BIA wrote off $17,558 in September fiscal year 2005 due to Treasury's inability to collect from these two customers; and Treasury is currently attempting to collect $1,383 from one of the customers for their April fiscal year 2004 bill.

Upon further inquiry with BIA management, we noted that customer amounts referred to Treasury are not always considered by BIA personnel when evaluating a customer's account status. Therefore, if a customer pays their current bills they will receive irrigation services even though they have past due amounts that were referred to Treasury.

Recommendations

We recommend that BIA management develop and implement policies and procedures to ensure that irrigation services are not provided to customers who have outstanding balances, including those referred to Treasury. Specifically, these policies and procedures should include reviews of Treasury monthly status reports to determine the current status of any referred account balances.

Management Response

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

7. Differences between SF-224 and FMS 6652

In performing our testing procedures related to the SF-224 *Statement of Transactions* and FMS 6652 *Statement of Differences – Disbursements* (FMS 6652), we noted that BIA did not resolve all amounts reflected on the FMS 6652 in a timely manner throughout the year. As of June 30, 2005, for disbursements, we noted the absolute value amount of unresolved differences was $37,280,806.56, of which $335,619.99 was greater than 6 months. In addition, for deposits, we noted the absolute value amount of unresolved differences was $697,814.05, of which $152,337.06 was greater than 6 months. As of September 30, 2005, for disbursements, we noted an absolute value amount of unresolved differences of $36,546.17, of which $7,805.54 was greater than 6 months old. In addition, for deposits, we noted an absolute value amount of unresolved differences of $140,879.56, of which $90 was greater than 6 months old.

Recommendation

We recommend that management continue to assign sufficiently trained personnel to perform and review the FMS 6652 and the SF-224 and to clear outstanding differences in a timely manner.

KPMG

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.

8. Untimely Resolution of FMS 6654 differences

In performing our testing procedures related to the FMS 6653: *Undisbursed Appropriation Account Ledger/FMS 6654: Undisbursed Appropriation Account Trial Balance* (FMS 6653/6654) reconciliation for June and September 2005, we noted that BIA did not resolve all reconciling differences in a timely manner. As of June 30, 2005 we noted a net difference of $(11,848,047) and an absolute value difference of $390,341,155. As of September 30, 2005, we noted a net difference of $4,315 and an absolute value difference of $972,548. While we were able to satisfy ourselves as to the Fund Balance with Treasury balance at year end, the differences reflect BIA's effort to correct past errors and inadequacies in its reconciliation process through manual adjusting entries.

Recommendation

We recommend that management continue to assign sufficiently trained personnel to identify and resolve the older outstanding differences identified on the reconciliation of the FMS 6653/6654.

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.

9. Proposal Logs

BIA approving officials are responsible for approving or rejecting contract, grant and compact proposals received from Indian tribes under *The Indian Self-Determination and Education Assistance Act,* Public Law 93-638, as amended. In performing this function, approving officials must either accept or reject such proposals within 90 days of receipt of the proposal. In the event that BIA does not accept or reject the proposal within this timeframe, the proposal is considered to be approved under the requirements listed in the Code of Federal Regulations title 25, part 900, section 18 (25 CFR 900.18).

During our testwork over the proposal approval process, we noted that BIA does not require its awarding officials to maintain a standardized proposal log to ensure that all proposals are either accepted or rejected within the 90 day timeframe required under 25 CFR 900.18. Consequently, BIA may not identify all instances when the 90 day timeframe has expired and an obligation should have been recognized.

Recommendations

We recommend that the BIA management:

a. Develop and implement a standardized proposal log for use by all awarding officials to ensure that all proposals received are either accepted or rejected within 90 days per 25 CFR 900.18.; and

b. Ensure regional awarding officials perform reviews of these proposal logs at least monthly to ensure that all proposals are either accepted or rejected within 90 days.

KPMG

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.

10. Accounting for Leases

During our audit testwork on a statistical sample of 64 leases, we found that BIA had inappropriately used or had not completed the *Determination of Capital Versus Operating Leases* spreadsheet for all 64 leases. By not using or not appropriately using the *Determination of Capital Versus Operating Leases* spreadsheet a misstatement to the financial statements could have occurred. However, our testwork determined these 64 leases had been correctly accounted for as operating leases. Specifically, we noted that the following in performing our testing procedures:

- For three leases, the *Determination of Capital Versus Operating Leases* spreadsheet was prepared using a different interest rate than the *Daily Treasury Yield Curve Rate*. Per the determination spreadsheet, BIA should use the appropriate rate given the lease term as indicated at www.treas.gov. In addition, for two of the three leases, BIA did not consider the effect of escalation clauses on the annual lease payment in calculating its determination of the lease as operating or capital;

- For 61 leases, the *Determination of Capital Versus Operating Leases* spreadsheet was not prepared. As such, BIA could not provide documentation supporting the determination of the lease as either an operating or capital lease; and

- For five leases, the lease agreements were not properly signed by BIA personnel and by the lessor.

In addition, while performing testwork over the future minimum lease payments disclosed for the 64 leases within the lease footnote we noted the following:

- For one lease, BIA is paying rent on a month-to-month basis and has no signed lease agreement with the lessor. Accordingly, BIA should not have included $202,404 per year for this lease in the future minimum lease payment footnote disclosure; and

- For one lease, BIA incorrectly classified monthly telephone billings as a lease agreement for purposes of preparing the future minimum lease payment footnote disclosure. As the fiscal year 2005 billings for these services was under one thousand dollars, we determined that there was no material effect on the future minimum lease payments footnote disclosure.

Recommendations

We recommend that BIA management:

a. Thoroughly train those personnel responsible for accounting for lease agreements to ensure that they always prepare the *Determination of Capital Versus Operating Leases* spreadsheet appropriately including always obtaining and fully documenting the details applicable to the lease agreement in assessing the classification of the lease as an operating or capital lease;

b. BIA reassess and redesign, as necessary, the Determination of Capital Versus Operating Leases spreadsheet to ensure flexibility for use with lease agreements with complex components (i.e., escalation clauses); and

c. BIA maintain signed copies of all lease agreements

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.

11. Management Review of Upward and Downward Adjustments

FFS has an automated control that eliminates invalid upward and downward adjustments posted to general ledger accounts GLAC 4871 - *Downward Adjustments of Prior-Year Unpaid Unexpended Obligations* and GLAC 4881 - *Upward Adjustments of Prior-Year Unpaid Unexpended Obligations*. In addition, BIA has established an automated monthly edit check in FFS that eliminates invalid upward and downward transactions if the transaction adjustments occur within the same month.

During our testwork over upward and downward adjustments, however, we identified 240 transactions where the FFS edit checks did not catch an invalid upward and downward adjustment. These transactions result in duplicate adjustments being posted to accounts GLAC 4871 and 4881, and did not represent true upward or downward adjustment activity (i.e., increases or decreases in prior-year obligations). As a result, accounts GLAC 4871 and 4881 were each misstated by $3.7 million.

Recommendations

We recommend that BIA management:

a. Establish policies and procedures requiring a monthly reconciliation, including appropriate management review, of GLAC's 4871 and 4881 to ensure that all activity represents true upward or downward adjustment activity; and

b. Investigate the underlying cause for the invalid adjustments we identified during our testwork procedures in order to eliminate any potential future occurrences.

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.

12. Management Discussion and Analysis (MD&A)

The November 3, 2005 draft version of the Management Discussion and Analysis (MD&A) section of the FY2005 Performance and Accountability Report (PAR) was not in accordance with the Statement of Federal Financial Accounting Standards No. 15 and OMB Bulletin No. 01-09. Based on our review of the MD&A, we noted the following exceptions:

- The analysis of the financial statements included in the FY2005 PAR was not presented completely. More specifically, the MD&A did not provide any quantitative figures with respect to the *Consolidated Statements of Net Cost*.

- A lack of BIA management review of the data reported as measuring BIA's progress with respect to its five year strategic plan. We noted multiple instances of a performance measure being included in the MD&A which could not be substantiated with reliable data.
- Multiple instances of financial and non-financial figures being included within the MD&A that could not be substantiated by support and were subsequently changed after we reviewed contrary supporting documentation.
- Multiple instances within the MD&A where BIA reported FY2005 budget enacted figures instead of actual expenditures BIA incurred during the year.
- The MD&A was compiled by a BIA contractor, and there was no formal review process over the contractor's work.
- Delays in the BIA Office of the Chief Financial Officer receiving pertinent information to be included within the MD&A. More specifically, we noted that the transmittal letter was not received until at least two weeks after the original draft PAR was due to the Department.

Recommendation

We recommend that the BIA management improve the process for preparing and reviewing the MD&A through additional training of employees as well as adding another level of management oversight.

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.

13. Noncompliance with Federal Managers Financial Integrity Act (FMFIA)

During our testwork over *The Federal Managers Financial Integrity Act of 1982 (FMFIA)*, OMB Circular A-123, and OMB Circular A-127, we noted that BIA's methodology and assessment process is insufficient in that it does not meet guidance found in OMB Circular A-123. We noted that there were material weaknesses identified by KPMG that had not been identified by BIA (i.e. Controls over Accounts Receivable and Deferred Revenue).

In addition, BIA's methodology and assessment process is insufficient in that it does not meet the guidance listed in OMB Circular A-127. We noted that the National Irrigation Information Management System (NIIMS) does not interface with the Federal Financial System (FFS) at the transaction level. Also, duplicative entries within the revenue generation process are recorded making transaction entries inefficient.

Recommendations

We recommend that BIA improve its policies and procedures to ensure compliance with FMFIA. Methods for improving BIA's policies and procedures include the establishment of a robust internal program review, and implementation of a fully integrated financial system that records transactions efficiently.

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 recommendations is included as Exhibit I.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of BIA gained during our work to make comments and recommendations that we hope will be useful to you. We would be pleased to discuss these comments and recommendations with you at any time.

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

Very truly yours,

KPMG LLP

BUREAU OF INDIAN AFFAIRS

Summary of Status of Prior Year Findings

September 30, 2005

Ref	Finding	Status
1	Accounting for Leases (BIA-2004-45)	The conditions have not been corrected and are included in the fiscal year 2005 management letter as finding 10.
2	Accounting for Loans (BIA-2004-43)	The conditions have not been corrected and are included in the BIA fiscal year 2005 auditors' report as reportable condition I.
3	Clearing of Suspense Fund Balances (BIA-2004-31)	The conditions have not been corrected and are included in the fiscal year 2005 auditors' report as reportable condition F.
4	Use of Burden Rate (BIA-2004-35)	The conditions have not been corrected and are included in the fiscal year 2005 auditors' report as noncompliance O.
5	Management Review of Unallowable Contract Costs (BIA-2004-36)	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a finding.
6	Statement of Budgetary Resources (SBR) to FACTS II Reconciliation (BIA-2004-47)	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a finding.
7	Non-performance of Reconciliation of SBR to the Budget of the United States Government (BIA-2004-27)	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a finding.
8	Disaster Recovery/Contingency Planning Plan (BIA-2004-4)	The conditions have not been corrected and are included in the fiscal year 2005 management letter as finding 1.
9	Security Infrastructure – NBC (BIA-2004-12)	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a finding.
10	FFS Payment Authorities (BIA-2004-5)	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a finding.
11	Continental Billing System (CBS) Continuity of Operations (BIA-2004-7)	The conditions have been partially corrected. The conditions that were not corrected are included in the fiscal year 2005 management letter as finding 1.
12	FPPS System Access (BIA-2004-44)	The conditions have not been corrected and are included in the fiscal year 2005 management letter as finding 4.
13	Internal Controls over the Government Performance and Results Act (GPRA) Performance Measures (BIA-2004-19)	The condition has not been corrected and are included in the fiscal year 2005 auditors' report as significant deficiency L.

(Continued)

EXHIBIT I

BUREAU OF INDIAN AFFAIRS

Summary of Status of Prior Year Findings

September 30, 2005

Ref	Finding	Status
14	Management Review of RSSI Human Capital Data Collection (BIA-2004-42)	Substantial progress has been made by BIA in addressing this issue and it is no longer considered a finding.
15	Management Discussion and Analysis (MD&A) (BIA-2004-17)	The conditions have been partially corrected. The conditions that were not corrected are included in the fiscal year 2005 management letter as finding 12.
16	Federal Managers Financial Integrity Act (FMFIA) (BIA-2004-39)	The condition has not been corrected and is included in the fiscal year 2005 management letter as finding 13.

Attachment 2

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

FEB 14 2006

Memorandum

To: Assistant Inspector General for Audits
Office of Inspector General

From: Associate Deputy Secretary James E Cason

Subject: Management Response to Draft Management Letter Containing Additional Issues Identified During the Audit of the Bureau of Indian Affairs' Financial Statements for Fiscal Years 2005 and 2004 (Assignment No. X-IN-BIA-0010-2006)

The Bureau of Indian Affairs (BIA) appreciates the opportunity to provide comments on the subject draft management letter. BIA concurs with the management issues and recommendations and is in the process of developing corrective action plans to address the recommendations contained in the management letter. While priority is being given to addressing the audit deficiencies identified in BIA's financial statement audit report, BIA is committed to addressing these management letter comments in a timely manner.

1. Service Continuity

The Office of the Chief Information Officer (OCIO) is continuing its efforts to complete BIA's Disaster Recovery Plan for restoring mission critical data processing operations. The list of critical systems has been identified. The OCIO is now in the process of prioritizing the systems and identifying and cataloging the critical documents necessary for their recovery. Periodic testing of the plan is taking place as part of BIA's Continuity of Operations Plan. Formal training at the Herndon, VA, and Albuquerque, NM, facilities will be accomplished when the plan is completed. The OCIO expects to complete the corrective actions by June 30, 2006. The responsible official is Gil Wake, Director, Office of Information Operations.

In addition, the San Carlos Irrigation Project developed and implemented procedures for storing backup tapes at Western Regional Office.

2. Logical Access Controls

The BIA reviewed the access needs for those users identified during the audit as having access to two or more accounts and deleted the second account where it was deemed necessary. The BIA also removed the accounts of the "terminated users." In addition, the Office of the Chief Financial Officer (OCFO) incorporated as part of its quarterly review process a validation of FFS accesses, including an additional step of confirming the need for any FFS user to have more than one USERID. In addition, BIA's personnel exit procedures will be modified to include verification that the user's access has been terminated. BIA will incorporate improved controls for user account management in the FY 2006 Service Level Agreement with the National Business Center (NBC). The corrective actions will be completed by June 30, 2006. The responsible official is Van Tran, Chief, Division of Accounting Operations.

3. FFS Payment Authorities

BIA immediately revised the override level authority of the individual identified by the audit as having an override level authority which was not commensurate with the individual's current job responsibilities. While override level authorities were reviewed during prior quarterly reviews, the OCFO revised its process to require supervisors to confirm the continuing need for their employee's existing override level authority. In addition, each supervisor, who has an employee with Override Level 9 authority, is required to certify that this authority is still required. Following each review, a combined list of all personnel with Override Level 9 authority in FFS will be provided to the Deputy Chief Financial Officer for management review and concurrence. The corrective actions for this management letter comment have been completed.

4. FPPS System Access

The BIA understands that NBC does not plan on implementing a programming change to automatically populate the Social Security Number (SSN) field in the user profile with data from the master employee database. In lieu of the programming change, BIA will receive from NBC the Departmental Social Security Number Error report which identifies mismatched SSNs. The BIA will review this report quarterly to ensure that no BIA employee is included in the report and that all BIA FPPS users SSNs agree with the SSNs in the FPPS master employee file. The corrective actions will be completed by June 30, 2006. A review of manual entries will be reviewed by a management official. The responsible official is Jeannie Cooper, Deputy Director, Human Resources Operations.

5. Lack of Management Review over Power Usage Exception Reports

The San Carlos Irrigation Project (SCIP) has amended its desk procedures (1) to require a review of all exception reports generated by SCIP's meter reading system for possible incorrect usage data and (2) to maintain evidence of this management review. In addition, SCIP will maintain a log of exception reports. In the event that the meter reading system cannot be used and the usage data is manually entered, an entry will be made into the log stating that the usage data was manually entered into the billing system. The corrective actions for this management letter comment have been completed.

6. Irrigation Services

The BIA's regulations state that irrigation water will not be delivered to water users until the annual operation and maintenance assessments are paid in accordance with the regulations. This includes current and prior year assessments. The BIA will re-enforce this requirement with its Irrigation Project Officers-in-Charge. The BIA will also require the projects to review the National Irrigation Information Management System's Treasury monthly status reports to ensure that no delinquent water users, as reflected on the status report, are receiving water. The corrective actions will be completed by April 30, 2006. The responsible official is John Anevski, Chief, Branch of Irrigation, Power & Safety of Dams.

7. Differences between SF 224 and FMS 6652
8. Untimely Resolution of FMS 6654 Differences

The BIA plans to continue assigning trained personnel to the tasks of identifying and resolving differences between the SF 224 and the FMS 6652 and the FMS 6653 and 6654. The OCFO continues to keep current with the monthly reconciliations. Because the differences greater than 6 months date back to 2002, extensive research is necessary to gain historical knowledge of the individual transactions. As a result, it is taking longer than expected to clear the unresolved differences. The BIA is committed to resolving these differences, which are for an immaterial amount, including writing-off the differences if necessary. The corrective actions will be completed by June 30, 2006. The responsible official is Van Tran, Chief, Division of Accounting Operations.

9. Proposal Logs

The BIA procedures require the approving official to appoint a Designated Agency Employee (DAE), who is responsible for assuring that the proposal is reviewed and acted upon in a timely manner. The procedures recommend that the DAE maintain a status log. The BIA will require the Regional Directors and Agency Superintendents with delegated awarding authority for Public Law 93-638 contracts to ensure that a DAE has been designated and that the log is maintained and reviewed. The corrective actions will be completed by April 15, 2006. The responsible official is Jerry Gidner, Deputy Director for Tribal Services.

10. Accounting for Leases

The BIA will provide to appropriate leasing officer(s) updated training on the use of the *Determination of Capital Versus Operating Leases* worksheet for real property leases. Leasing officer(s) will also be reminded to incorporate the following lessor-generated information into the lease or receive a separate document containing such information.

a. Estimated total useful life of the building.

b. Actual age of the building at lease inception.
c. Value of the building at lease inception.
d. Estimated value of the building at the end of the lease.
e. Interest rates (tenant improvements or other loans) associated with the building at lease inception.

The *Determination of Capital Versus Operating Leases* is a Departmental form. The BIA, therefore, can only submit the suggested changes to the Department's Office of Acquisition and Property Management for Departmental consideration. The corrective actions will be completed by March 31, 2006. The responsible official is B. J. Greene, Office of Acquisition.

11. Management Review of Upward and Downward Adjustments

The BIA will perform periodic reconciliations of the general ledger accounts, which adjust prior year unpaid obligations, to ensure that automated FFS edit checks are in fact eliminating invalid duplicate adjustments. The procedures requiring this reconciliation will also require proper management review and approval of the reconciliation. The corrective actions will be completed by June 30, 2006. The responsible official is Van Tran, Chief, Division of Accounting Operations.

12. Management Discussion and Analysis (MD&A)

The BIA is taking appropriate measures in FY 2006 ensuring the data supporting the performance measurements in the MD&A is valid, accurate, supportable, consistent and complete. The BIA assigned a coordinator to oversee preparing the MD&A and establishing milestone dates ensuring sufficient time for draft MD&A management review. The corrective actions will be completed by June 30, 2006. The responsible official is Fawn Freeman, Director, Office of Planning and Policy Analysis.

13. Noncompliance with Federal Managers Financial Integrity Act (FMFIA)

The BIA has taken steps to improve its internal management control process. The BIA has established an Office of Internal Evaluation within the Office of the Deputy Assistant Secretary – Indian Affairs (Management) to oversee the process. In developing their FY 2006 management control review submissions, Regional Offices, Field Education Offices and Headquarter Offices are now required to evaluate the risks and vulnerabilities of their programs and activities and conduct reviews as warranted. Current policies require assurance statements from all Office Directors. No additional corrective actions are planned except to oversee the process.

Regarding the latter part of the recommendation to implement a fully integrated financial system, there is limited action BIA can take at this time to provide transaction level interface between the subsidiary ledgers and the general ledger pending replacement of the aging financial legacy systems.

STATUS OF MANAGEMENT LETTER RECOMMENDATIONS

Recommendation	Status	Action Required
1.a, 1.b, 1.c, 1.d, 1.e, 1.f, 2.a, 2.b, 2.c, 2.d, 4.a, 4.b, 4.c, 6, 7, 8, 9.a, 9.b, 10.a, 10.b, 10.c, 11.a, 11.b, 12,	Resolved and not implemented.	Recommendations will be referred to the Assistant Secretary, Policy, Management and Budget for tracking of implementation.
3, 5.a, 5.b, 5.c, 5.d, 13	Resolved and implemented.	No further action is required.

U.S. Department of the Interior
Office of Inspector General

Management Letter
Concerning Issues Identified During the
Audit of the Bureau of Land Management's
Financial Statements for
Fiscal Years 2005 and 2004

Report No. X-IN-BLM-0005-2006 **February 2006**

United States Department of the Interior
OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

February 7, 2006

Memorandum

To: Kathleen Clarke
Director, Bureau of Land Management

From: Anne L. Richards
Assistant Inspector General for Audits

Subject: Management Letter Concerning Issues Identified During the Audit of the Bureau of Land Management's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-BLM-0005-2006)

Attached is the subject management letter (Attachment 1) prepared by KPMG LLP. It contains two findings, which are in addition to those contained in KPMG's audit report on the financial statements of the Bureau of Land Management (BLM). The management letter contains three recommendations that should resolve the two findings.

In its December 22, 2005 response (Attachment 2) to the draft management letter, BLM agreed with both findings. BLM also stated that it was in the process of implementing the three recommendations.

Because the three recommendations have not yet been implemented, we will refer them to the Assistant Secretary for Policy, Management and Budget for tracking of implementation (see Attachment 3, "Status of Management Letter Recommendations").

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit BLM's financial statements for fiscal years 2005 and 2004. The results of the audit are contained in KPMG's audit report dated November 4, 2005, except for Note 22 which is dated November 16, 2005 (Report No. X-IN-BLM-0012-2005). In conjunction with its audit, KPMG noted certain internal control and other operational matters that should be brought to management's attention. Those are the issues presented in this management letter.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of BLM personnel during the audit. If you have any questions, please contact me at 202-208-5512.

Attachments (3)

cc: Assistant Secretary, Land and Minerals Management
Chief Financial Officer, Bureau of Land Management
Director, Office of Financial Management
Audit Liaison Officer, Land and Minerals Management
Audit Liaison Officer, Bureau of Land Management
Audit Liaison Officer, Office of Financial Management
Focus Leader, Financial Reporting, Office of Financial Management
Focus Leader, Management Control and Audit Follow-up,
Office of Financial Management

KPMG

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

November 4, 2005

The Director of the Bureau of Land Management and the
Inspector General of the United States Department of the Interior:

We have audited the consolidated balance sheets of the Bureau of Land Management (BLM) as of September 30, 2005 and 2004, and the related consolidated statements of net cost of operations, consolidated statements of changes in net position, combined statements of budgetary resources, consolidated statements of financing, and the consolidated statements of custodial activity for the years then ended (hereinafter referred to as the "financial statements"), and have issued our report thereon dated November 4, 2005, except for note 22 (subsequent event) which was dated as of November 16, 2005. During fiscal year 2005, BLM adopted the provisions of Interpretation of Federal Financial Accounting Standards No. 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4,* for the year ended September 30, 2005. In planning and performing our audit of the above financial statements of BLM, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

Our audit of BLM's financial statements as of and for the year ended September 30, 2005 disclosed the following reportable conditions, significant deficiencies, and compliance matters that are described in our auditors' report dated November 4, 2005:

Reportable Conditions:

A. Security and Internal Control over Information Technology Systems
B. Adequate Segregation of Duties over Purchases
C. Accounting for Mineral Leases
D. Recording Year-end Liabilities

Significant Deficiencies:

E. Reporting of Performance Measure Information in Management's Discussion and Analysis
F. Reporting the Condition of Stewardship Land
G. Reporting the Condition of Museum Collections
H. Reporting of Deferred Maintenance Amounts for Stewardship Land

Compliance Matters:

I. Federal Accounting Standards under the Federal Financial Management Improvement Act (FFMIA) of 1996

During our audit, we noted certain other matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

1. Annual Management Review of the Collection Process

BLM policy requires BLM field and state offices to complete an annual review of the collection process. BLM takes into consideration the results of the review as part of its annual Federal Managers' Financial Integrity Act (FMFIA) assurance statement on the adequacy of internal controls. Per BLM policy, the collection process review is to be completed by November 15 of each year, and requires state and field offices to assess their procedures and report the results to BLM's National Business Center (NBC).

Our audit found the following related to the most recent collection review:

- Twenty-two out of 126 field and state offices did not complete the annual collection review that was required to be completed by November 15, 2004.
- BLM's policy for completing the collection review by November 15 is not timely, and thus does not support the relevant FMFIA assurance statement in the current year. For example, in September 2005, the BLM asserted that their systems of management, administrative, and financial controls provided reasonable assurance that the objectives of the FMFIA had been achieved. However, collection process information was not due until one month after the assurance statement, and thus prior year data (results collected from November 15, 2004) was used to make the 2005 assurance statement.

Recommendations

a. BLM should change the timing for the completion of collection process reviews to align with the timing of the FMFIA assurance statement.

b. All state and field offices should comply with BLM policies and procedures for completing assessments of the collection process and BLM should implement a controls process to ensure such compliance.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendations and will prepare new instructions for state and field offices concerning the timely submission of annual collections reviews.

2. Quarterly Certification of Undelivered Orders

In accordance with BLM policy, BLM state offices and centers (15 in total) are to perform quarterly reviews of outstanding obligations to ensure invalid amounts are deobligated in a timely manner. The primary control over this procedure is the completion of a *Quarterly Certification Report of Outstanding Procurement Obligations* (Certification Report). This report is to be submitted to the BLM National Business Center (NBC) within one month after the end of a quarter.

As part of our audit we selected a sample of 30 certification reports and found the following exceptions:

- Two of the reports were not submitted.
- Three of the reports were submitted late and were more than one month after the due date (i.e., more than two months after the quarter ended).
- Eight of the reports were submitted without proper approval (i.e., the reviewer's signature or director's transmittal memorandum was missing).

Failure to complete certification reports in a timely manner can result in invalid obligations at the end of a reporting period. This can cause misstatements in the financial statements and budget reports, and may not allow the BLM access to unrestricted monies.

Recommendation

BLM state offices and centers should comply with BLM policy for conducting quarterly reviews of outstanding obligations. Specifically, they should complete and submit an approved certification report within one month of the end of a quarter. BLM should implement appropriate controls to ensure compliance with this policy.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendations and will prepare new instructions in fiscal year 2006 concerning the review and certification of unliquidated obligations. Further, the NBC director and finance managers will closely monitor compliance with the new instructions.

* * * * * * *

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of BLM gained during our work to make comments and recommendations that we hope will be useful to you. We would be pleased to discuss these comments and recommendations with you at any time. A summary of the status of prior-year management letter comments is included as Exhibit I.

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

Very truly yours,

KPMG LLP

Exhibit I

BUREAU OF LAND MANAGEMENT

Summary of the Status of Prior Year Management Letter Comments

September 30, 2005

Ref	Comment	Status
1	Fund Balance With Treasury Discrepancy	This comment has been corrected.
2	Inaccurate Calculation of Payments in Lieu of Taxes	Comment no longer applies to BLM. PILT program has been transferred to another DOI agency.
3	Improving Performance Measures Reported in Management's Discussion and Analysis	This comment has not been corrected. See significant deficiency E in the Independent Auditors' Report dated November 4, 2005.
4	Improving the Identification and Reporting of Environmental Liabilities	This comment has been corrected.
5	Continued Improvement of Deferred Maintenance Reporting	This comment has been corrected with regards to operating assets. See significant deficiency H in the Independent Auditors' Report dated November 4, 2005 regarding deferred maintenance over stewardship land.
6	Improving Accounting for General Property, Plant, and Equipment	This comment has been corrected.

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240
http://www.blm.gov

TAKE PRIDE IN AMERICA

In Reply Refer To:
1306 (BC-610)

DEC 2 2 2005

MEMORANDUM

To: Assistant Inspector General for Audits
Attention: Anne L. Richards

From: ecr Kathleen Clarke Lawrence E. Benna
Director, Bureau of Land Management

Subject: Draft Management Letter on the Bureau of Land Management's (BLM) Financial Statements for Fiscal Years 2005 and 2004 (Assignment No. X-IN-BLM-005-2006)

Thank you for the opportunity to review and comment on the audit of the BLM's financial statements for Fiscal Years 2005 and 2004. We appreciate the efforts of the Office of Inspector General and KPMG. The BLM's comments are attached.

If you have any questions regarding this response, please contact Jeannette Davis-Callahan, BLM National Business Center, at (303) 236-7396.

1 Attachment
1 – Response to Management Letter Referenced Above (1 p)

Draft Management Letter on the Bureau of Land Management's
Financial Statements for Fiscal Years (FY) 2005 and 2004
(Assignment No. X-IN-BLM-0005-2006)

Recommendation 1: Annual Management Review of the Collection Process

a) BLM should change the timing for the completion of collection process reviews to align with the timing of the Federal Managers Financial Integrity Act (FMFIA) assurance statement.
b) All state and field offices should comply with BLM policies and procedures for completing assessments of the collection process and BLM should implement a controls process to ensure such compliance.

Response:
The BLM concurs with the recommendation.

a) The BLM will prepare a new Instruction Memorandum (IM) in FY 2006 stating that the State and field offices report the results of their annual review of collections by April 15. We agree that this would provide more current information for the FMFIA.
b) For the November 2004 review, 114 out of 126 (90 percent completion rate) offices completed their reviews and submitted them to their State offices. Ten of those reviews, however, were mailed to the National Business Center (NBC) but did not reach the BC-621 office. The BLM's goal for the November 2005 review is a 100 percent completion rate by the field office and submission to the NBC in a timely manner. The BLM is following up with the State and field offices to ensure that we reach that goal.

Recommendation 2: Quarterly Certification of Undelivered Orders
BLM state offices and centers should comply with BLM policy for conducting quarterly reviews of outstanding obligations. Specifically, they should complete and submit an approved Certification Report within one month of the end of a quarter. BLM should implement appropriate controls to ensure compliance with this policy.

Response:
The BLM concurs with the recommendation.

The BLM will prepare a new IM in FY 2006 for review and certification of unliquidated obligations that will include an emphasis on Undelivered Orders (UDOs) that are one year old or older, but will also require a review and certification of all procurement UDOs. The IM will state that the BLM NBC will follow up with States/centers who have not submitted their reports and/or certification letters, and will elevate if necessary to the appropriate Administrative Officer or Deputy State Director. If any State/center fails to respond, UDOs over a year old may be unilaterally deobligated by the NBC. Additionally, the NBC Director and finance managers will closely monitor responses and will ensure that any issues are addressed in a timely manner.

ATTACHMENT 3

STATUS OF MANAGEMENT LETTER RECOMMENDATIONS

Recommendation	Status	Action Required
1.a, 1.b, and 2	Resolved, not implemented.	Recommendations will be referred to the Assistant Secretary, Policy, Management and Budget for tracking of implementation.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

December 28, 2005

Memorandum

To: Commissioner, Bureau of Reclamation

From: Anne L. Richards Anne L. Richards
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Bureau of Reclamation's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-BOR-0013-2005)

Attached is the subject auditors' report prepared by KPMG LLP (Attachment 1). It contains an unqualified opinion on the Bureau of Reclamation's (Reclamation) financial statements. However, KPMG identified five reportable conditions on Reclamation's internal controls over financial reporting; one of the conditions was considered to be a material weakness. KPMG also found significant deficiencies in reporting the condition of heritage and stewardship assets and reporting the amount of stewardship land. In addition, KPMG found instances in which Reclamation's financial management systems did not fully comply with federal accounting standards and with the Federal Financial Management Improvement Act (FFMIA).

In its November 18, 2005 response to the draft auditors' report (Attachment 2), Reclamation agreed with findings A, B, and C; partially agreed with findings D, E, and G; and disagreed with finding F. Subsequent to issuing the draft auditors' report, management provided additional evidence to clear the portion of finding E related to recommendation E.2. KPMG reaffirmed its position that the remaining findings are valid. Based on the responses, we consider recommendations A.1, A.2, A.3, B.1, B.2, B.3, C.1, C.2, D.1, D.2, D.3, D.4, E.1, and G.1 resolved and not implemented and recommendations D.5, F.1, F.2, F.3, and G.2 unresolved. We will refer the resolved and not implemented recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. The unresolved recommendations will be referred for resolution.

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit Reclamation's financial statements for fiscal years 2005 and 2004. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget's Bulletin 01-02, as amended, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency's *Financial Audit Manual.*

KPMG is responsible for the auditors' report and for the conclusions expressed in the report. We do not express an opinion on Reclamation's financial statements, KPMG's conclusions on the effectiveness of internal controls, conclusions on whether Reclamation's financial management systems substantially complied with FFMIA, or conclusions on compliance with laws and regulations.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of Reclamation personnel during the audit. If you have any questions regarding the report, please contact me at (202) 208-5512.

Attachments (2)

cc: Assistant Secretary for Water and Science
Chief Financial Officer, Bureau of Reclamation
Director, Office of Financial Management
Audit Liaison Officer, Water and Science
Audit Liaison Officer, Bureau of Reclamation
Audit Liaison Officer, Office of Financial Management
Focus Leader for Financial Reporting, Office of Financial Management
Focus Leader for Management Control and Audit Followup,
Office of Financial Management

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

Independent Auditors' Report

The Commissioner of the U.S. Bureau of Reclamation and the Inspector General of the
U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheets of the U.S. Bureau of Reclamation (Reclamation) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years then ended (hereinafter referred to as the financial statements). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered Reclamation's internal control over financial reporting and tested Reclamation'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 Reclamation'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 1N to the financial statements, Reclamation changed its method of accounting for appropriated debt transactions in accordance with the provisions of OMB guidance effective October 1, 2004. Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

Reportable Condition Considered to be a Material Weakness

A. Controls over Implementation of New Accounting Principle

Other Reportable Conditions

B. Security and Internal Control over Information Technology Systems
C. Controls over Charge Card Reviews
D. Controls over Management Review and Approval of Process-level Activities
E. Controls over Credit Reform Loans

Our limited procedures over Required Supplementary Information and Required Supplementary Stewardship Information identified the following significant deficiency:

F. Reporting the Condition of Heritage and Stewardship Assets and Related Deferred Maintenance

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The results of our tests of FFMIA disclosed two instances where Reclamation's financial management systems did not substantially comply with the following:

G. Federal Accounting Standards

The following sections discuss our opinion on Reclamation's financial statements, our consideration of Reclamation's internal control over financial reporting, our tests of Reclamation'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 Reclamation as of September 30, 2005 and 2004, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Reclamation as of September 30, 2005 and 2004, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1N to the financial statements, Reclamation changed its method of accounting for appropriated debt transactions in accordance with the provisions of OMB guidance effective October 1, 2004.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Circular A-136, *Financial Reporting Requirements*, Part A, *Form and Content of the Performance and Accountability Report*. We did not audit this information and, accordingly, we express no opinion on it. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. As a result of such limited procedures, we believe that Reclamation's reporting of the condition of heritage and stewardship assets in Required Supplementary Stewardship Information and deferred maintenance in Required Supplementary Information is not in conformity with accounting principles generally accepted in the United States of America.

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 Reclamation'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 the internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable condition A is a material weakness.

A. Controls over Implementation of New Accounting Principle

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 Reclamation to cease recording appropriations to and subsequent recoveries from Western Area Power Administration (Western) as transfers and to prospectively record a receivable for the balance owed to the Reclamation Fund. In addition, Reclamation applied OMB's guidance to other similar conditions, including amounts due from Bonneville Power Administration (BPA) to the Reclamation Fund and amounts owed by Reclamation to the U.S. Treasury's General Fund (Treasury).

In implementing OMB's guidance, Reclamation applied significant resources and effort, including a coordinated effort with Western, BPA, the U.S. Department of Energy, the U.S. Department of the Interior (DOI), the U.S. Treasury, and OMB.

Western's appropriations from the Reclamation Fund are used for capital investment and operations and maintenance activities related to those functions. Associated recoveries received by Western are deposited into the Reclamation Fund. Unlike Western, BPA does not receive appropriations from the Reclamation Fund; however, BPA has legislatively assumed the repayment obligation to the Reclamation Fund for the appropriations used to construct certain Reclamation facilities. The amounts owed by Reclamation to Treasury consist of appropriations received to construct, operate, and maintain various multipurpose projects, a large portion of which are reimbursable and require subsequent repayment to Treasury.

In accordance with the change in accounting guidance, Reclamation calculated and recorded the September 30, 2004 receivables due from Western and BPA and a liability balance due to Treasury. These balances were recorded prospectively in fiscal year 2005 as an approximate $1.724 billion, $617 million, and $1.936 billion, respectively, cumulative effect on beginning equity balances as of October 1, 2004.

Despite Reclamation's efforts with regards to the Western receivable, at September 30, 2005, there existed an unreconciled amount of approximately $1.97 million (net) between Reclamation's receivable and Western's payable. Reclamation's receivable balance was approximately $1.97 million less than Western's payable, comprised of $39.78 million in positive differences and $41.75 million in negative differences. In addition, our testwork revealed that approximately $205.5 million of repayments received prior to fiscal year 2004 were recorded as current year repayments to the Reclamation Fund, misstating the cumulative effect on beginning equity. Both differences were corrected by management in the 2005 financial statements.

Our testwork over the Treasury liability revealed that: (1) repayments made to Treasury during the current fiscal year were recorded as prior-period activity, and (2) the repayments of one project were not appropriately allocated between Reclamation and other project sponsors, misstating the cumulative effect on beginning equity and the ending liability balance by $261.2 million and $111.9 million, respectively. In addition, we identified one project for which the beginning liability balance was understated by approximately $26.6 million. These differences were corrected by management in the 2005 financial statements. Further, we identified approximately $314,000 not recorded to the Treasury liability due to a miscommunication between Reclamation regional offices.

These deficiencies are partially a result of underdeveloped accounting policies and procedures and U.S. Treasury account posting models not implemented as of September 30, 2005.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

1. Improve its policies and procedures related to recording additions to and repayments against the Western receivable and the Treasury liability, including accounting policies and procedures and improved coordination with the U.S. Treasury regarding appropriate account posting models, as necessary.

2. Implement controls to ensure current-year additions to and repayments against the Treasury liability are properly recorded in the standard general ledger, including sufficient management oversight and review.

3. Implement controls, including sufficient management oversight and review, to ensure current-year appropriations to and repayments from Western are properly recorded in the standard general ledger and budgetary and proprietary balances are properly reported. Further, Reclamation should continue to resolve the unreconciled differences between Reclamation's receivable and Western's liability and continue to improve coordination between Western, the U.S. Department of Energy, DOI, and OMB.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendations and will improve its policies, procedures, and controls in accordance with the recommendations. The target date for implementation of the improvements is June 30, 2006.

B. Security and Internal Control over Information Technology Systems

Security and general controls over Reclamation's financial management systems have not been fully implemented. Improvement is needed in the area described below, as required by OMB Circular A-130, *Management of Federal Information Resources*. The condition identified below could affect Reclamation's ability to prevent or detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information resources.

Access controls should provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. The objectives of limiting access are to ensure that: (1) only authorized users have access to data and resources, (2) users have the minimum access necessary to perform their job functions, (3) access to very sensitive resources, such as security software programs, is limited to very few individuals, and (4) network security configurations are optimized to provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. Our audit found that Reclamation's user access authorization, user restriction, and termination procedures are not sufficient to minimize the risks of unauthorized access to its systems and its data.

Specifically, our audit identified 15 combined instances within the Water Operating and Record Keeping System (WORKS) and the Interior Department Electronic Acquisition System – Procurement Desktop (IDEAS-PD) where access granted was not evidenced by supervisor approval. In addition, we identified 71 combined instances within those systems where the user had inappropriate access for their specific job function. Our audit further identified 46 combined instances within the Moveable Property System (MPS) and IDEAS-PD where access rights for terminated employees were not removed. We noted, however, that the network accounts for the terminated employees were properly removed, which minimizes the risk of the user gaining access to the applications.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

1. Implement policies and procedures and related controls over the retention of new user authorization and access change documentation.

2. Ensure administrators and system managers receive adequate training to ensure responsible personnel are aware of existing policies and procedures governing user access. Reclamation should monitor personnel to ensure that policies and procedures are followed.

3. Monitor the process to ensure that periodic reviews of user access, including reviews at the Sys Operations task level, are performed at the designated intervals and that action is taken in a timely manner to investigate and modify or remove access as a result of the review. Supplement existing guidance to state explicit criteria that should be considered in the periodic review of user access listings and the appropriate personnel to perform the review. Specifically, someone familiar with the users and their current roles/responsibilities should perform the periodic review; an effective review may require involvement at the regional and/or office level. Further, the objectives of the review are two-fold: 1) to ensure users' access remains appropriate, and 2) to identify any terminated users.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendations and has updated and distributed user administration procedures in accordance with the recommendations. The target dates for implementation of the improvements are April 30, 2006, June 30, 2006, and May 30, 2006 for recommendations B.1, B.2, and B.3, respectively.

C. Controls over Charge Card Reviews

Reclamation, through DOI, has provided charge cards to its employees in order to streamline acquisition and payment procedures and to reduce the administrative burden associated with traditional purchasing of travel items, supplies, and services. In conjunction with the issuance of charge cards, DOI has published guidance and instructions on charge card utilization through the Integrated Charge Card Program Guide. This policy sets forth restrictions on the use of the charge cards as well as certain internal control procedures, including timely and complete reconciliation of the billing statements by the cardholders and approving officials. During fiscal year 2005, Reclamation had approximately 7,200 active charge cards, which include purchase, travel, fleet, and corporate cards and incurred approximately 241,370 transactions for approximately $60.3 million. Our audit identified control exceptions in eight of 22 statements tested, resulting in a total of 12 exceptions. These exceptions were as follows:

- One statement was not signed by the approving official.
- Two statements were not dated by the cardholder.
- Two statements were not dated by the approving official.

- Two statements were not reviewed by the approving official in a timely manner.

- One statement was not reviewed by the cardholder in a timely manner.

- Four statements did not include receipts to support all of the charges on the sampled statement.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

1. Ensure compliance with its established charge card policies. To help ensure compliance, Reclamation management at all regional, area, and field office locations should be more diligent in monitoring and enforcing compliance with DOI charge card policies.

2. Design and implement policies to monitor the results of internal reviews of charge card statements to ensure that the internal reviews are effective in ensuring compliance with charge card policies.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendations and will improve its policies, procedures, and controls in accordance with the recommendations. The target date for implementation of the improvements is June 30, 2006.

D. Controls over Management Review and Approval of Process-level Activities

OMB Circular A-123 (revised June 21, 1995), *Management's Accountability and Control*, Section II, bullet *Recording and Documentation*, states: "transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination." Lack of documented policies and procedures for preparing and reviewing journal entries and standard vouchers could result in improper amounts being reported, either due to intentional or unintentional errors. Further, ineffective management review of controls over key, process-level activities could result in ineffective controls and misstatements within the financial statements and related notes.

During our audit, we tested manual journal entries and key, risk-mitigating controls to determine if the activities and associated outputs were initiated by an appropriate individual, properly reviewed, supported by sufficient documentation, properly recorded, consistent with accounting principles, and consistent with Reclamation policy. Our testing of over 150 journal entries and process-level activities and controls identified the following:

Journal Entries

- Two instances in which there was insufficient supporting documentation for journal entries made to record anticipated budgetary resources.

- One instance in which the preparer and approver of a journal entry were the essentially same individual (the preparer, although a different individual, was asked by the approver to prepare an entry for which the preparer did not understand).

- Three instances where the journal entry was not approved prior to being entered into the Federal Financial System (FFS).

- Four instances in which there was no indication of the individual responsible for preparing the tested journal entry.

Process-level Activities

- Three of 26 billing documents totaling $319,015 were not reviewed prior to being mailed to the customer.

- Twenty of 20 Form 528 documents, which are used in support of certain land balances in the Foundation Information for Real Property Management (FIRM) database, were not reviewed when the transactions were initiated.

- Two of two monthly reconciliations lacked evidence that an investigation of the FMS 6652 differences was performed, nor was there any evidence of difference resolution as a part of the reconciliations performed in subsequent months.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

1. Establish and document policies and procedures for initiating, reviewing and documenting journal entries and standard vouchers to ensure proper segregation of duties and quality reviews.

2. Design and implement procedures and controls consistent across all regions for reviewing and approving billing documents. These procedures and controls should be designed to ensure that billing documents are accurate and properly supported, which will mitigate the risk of misstatement of accounts receivable and related revenues.

3. Design and implement a process and controls for reviewing and approving information entered onto the Form 528, which will ensure that the Form 528, which is used to support FIRM, is accurate and properly supported.

4. Improve its internal control environment to ensure that all controls performed are properly documented, including improved training of personnel to ensure awareness and knowledge of requirements and an internal assessment of controls to verify controls are being performed and are operating effectively.

5. Improve its reconciliation procedures over the FMS 6652 to ensure all differences are investigated. Improvements should include:

   a. Documentation of the investigation and resolution of each difference

   b. Signature and date of the person performing the investigation

   c. Documentation of follow-up procedures performed in instances where the difference was not cleared in the original month reported

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with recommendations D.1 through D.4 and will improve its policies, procedures, and controls in accordance with the recommendations by a target date of June 30, 2006. Management partially agreed with recommendation D.5 to improve its reconciliation procedures over the FMS 6652 to ensure all differences are investigated. Reclamation agreed that non-timing differences requiring investigation should be well-documented with pertinent details. The target date for implementation of the improvements is June 30, 2006. However, management indicated that the recommendation to document every difference is neither an efficient nor an effective use of Reclamation resources, as the majority of differences are temporary due to month-end timing differences.

Auditors' Response to Management's Response

The Treasury Financial Manual (TFM), Part 2, Chapter 5100, requires agencies to reconcile Fund Balance with Treasury on a monthly basis, including the FMS 6652 Statement of Differences. The TFM further requires agencies to investigate all Treasury-reported differences and research and trace all adjustments to supporting documents. The key focus of this finding is that Reclamation does not have sufficient policies, procedures, and controls in place to identify and document the nature and cause of stated differences and to ensure differences are due solely to timing.

E. Controls over Credit Reform Loans

Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, provides accounting standards for Federal direct loans. The standard requires that the cost of direct loans obligated after September 30, 1991 be accounted for on a present value basis consistent with the Federal Credit Reform Act of 1990. SFFAS No. 2, paragraph 22 states, "The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance." Further, paragraph 30 states, "The subsidy allowance for direct loans is amortized by the interest method...the amortized amount is recognized as an increase or decrease in interest income" and paragraph 32 states, "The subsidy cost for direct loans... [is] re-estimated each year as of the date of the financial statements...any increase or decrease in the subsidy cost allowance...resulting from the re-estimates is recognized as a subsidy expense."

Further, Section 502(5)(A) of the Federal Credit Reform Act states, "The term 'cost' means the estimated long-term cost to the Government of a direct loan or loan guarantee or modification thereof, calculated on a net present value basis, excluding administrative costs and any incidental effects on government receipts or outlays."

Reclamation does not have sufficient controls in place to ensure the subsidy re-estimate is accurately recorded and that all relevant factors, including cohort year, year-to-date loan disbursements, and associated subsidy rates are properly applied to the re-estimate calculation. As a result, the subsidy allowance and related subsidy amortization was misstated by an estimated $10.4 million in fiscal year 2005.

Recommendation

We recommend that the Commissioner, U.S. Bureau of Reclamation:

1. Develop and implement controls to ensure the subsidy re-estimate is accurately recorded based on all relevant factors. Also, the subsidy re-estimation should be revised and approved by appropriate management.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendations and will improve its policies, procedures, and controls in accordance with the recommendations. The target date for implementation of the improvements is June 30, 2006. Management's official response, as attached, refers to recommendation E.2 in the draft independent auditors' report regarding administrative costs. Subsequent to the issuance of our draft finding, which included a recommendation regarding the exclusion of administrative costs from the loans receivable balance, management provided additional evidence to sufficiently clear that portion of the finding.

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 Reclamation in a separate letter dated November 21, 2005.

INTERNAL CONTROLS OVER REQUIRED SUPPLEMENTARY INFORMATION AND REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

We noted certain significant deficiencies in internal control over Required Supplementary Information and Required Supplementary Stewardship Information discussed below, that, in our judgment, could adversely affect Reclamation's ability to collect, process, record, and summarize Required Supplementary Information and Required Supplementary Stewardship Information.

F. Reporting the Condition of Heritage and Stewardship Assets and Related Deferred Maintenance

Reclamation has not fully implemented the requirements of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, as amended by SFFAS No. 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS No. 6 and SFFAS No. 8*. SFFAS No. 6 requires Reclamation to estimate the deferred maintenance for its general, heritage, and stewardship assets using either the condition assessment survey or life cycle costing method. Paragraph 83 of SFFAS No. 6 requires Reclamation to disclose deferred maintenance information for all categories of property, plant, and equipment (general, stewardship, and heritage).

Reclamation has adopted the condition assessment survey method, which requires Reclamation to perform periodic inspections of assets to determine their current condition and estimate the cost to correct any deficiencies. Reclamation has implemented procedures to measure deferred maintenance for operating assets, including multi-use heritage assets. However, Reclamation has not fully established controls over the condition assessments performed to determine deferred maintenance for all assets as follows.

Reclamation has not completed condition assessments and estimated deferred maintenance for all known heritage assets. Specifically, conditions assessments performed in relation to archeological and historic sites, national historic landmarks, national register of historic places, paleontological sites, and museum collections are 82%, 20%, 69%, 99%, and 62% complete, respectively. No formal condition assessment program exists for archeological properties. Further, the condition of non-collectible, natural heritage assets remains largely undocumented.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

1. Perform condition assessments for all heritage assets and stewardship assets and estimate the related deferred maintenance.

2. Require supervisors to review and approve condition assessments and deferred maintenance estimates to ensure they are performed consistently and in accordance with policies.

3. Update the condition assessment and deferred maintenance estimates periodically and ensure the rotation schedule is properly maintained and monitored by individuals at the appropriate supervisory level.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management did not agree with our recommendations. Management indicated they do not believe condition assessments and deferred maintenance calculations on heritage and stewardship assets are required under SFFAS No. 6.

Auditors' Response to Management's Response

SFFAS No. 6 discusses four categories of property, plant, and equipment (PP&E), including heritage assets and deferred maintenance. SFFAS No. 6 outlines the requirements for estimated deferred maintenance for all categories of property, plant, and equipment, but does reference additional standards for the purpose of stewardship reporting. SFFAS No. 8, *Supplementary Stewardship Reporting*, was developed to establish standards over stewardship assets. SFFAS No. 8, paragraph 32, states, "many state and local governments, members of Congressional oversight committees, and national groups, have raised the issue of deteriorating condition of federally-owned PP&E because of deferred maintenance associated with these assets...as a result, a deferred maintenance standard in Accounting for Property, Plant, and Equipment, SFFAS No. 6, establishes reporting requirements related to the condition and future maintenance requirements for PP&E."

Further, SFFAS No. 8, paragraph 33, states, "the deferred maintenance standard is applicable to all PP&E whether the PP&E is reported as general PP&E or stewardship PP&E." Accordingly, SFFAS No. 6 is relevant with regards to heritage and stewardship assets and Reclamation is not in full compliance with this standard.

COMPLIANCE AND OTHER MATTERS

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed instances, described below, where Reclamation's financial management systems did not substantially comply with the requirements discussed below.

G. Federal Accounting Standards

As discussed in reportable condition A and significant deficiency F, Reclamation needs to: (1) improve its policies and procedures for recording activity in relation to the Western receivable and the Treasury general fund liability in response to the new accounting guidance, and (2) complete condition assessments and estimate any associated deferred maintenance for all known heritage and stewardship assets.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

1. Improve its policies and procedures related to recording additions to and repayments against the Western receivable and the Treasury liability, including accounting policies and procedures, and improved coordination with the U.S. Treasury regarding appropriate account posting models, as necessary.

2. Perform condition assessments for all heritage assets and stewardship assets and estimate the related deferred maintenance.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with recommendation G.1 to improve its policies and procedures related to recording additions to and repayments against the Western receivable and the Treasury general fund liability. Management did not agree with recommendation G.2 to perform condition assessments for all heritage assets and stewardship assets and estimate the related deferred maintenance. Management indicated they do not believe condition assessments and deferred maintenance calculations on heritage and stewardship assets are required under Federal accounting standards and accordingly, does not believe this finding to be a substantial non-compliance with FFMIA.

Auditors' Response to Management's Response

FFMIA requires an entity's financial management system to comply with all relevant Federal accounting standards. As discussed in significant deficiency F, Reclamation has not completed condition assessments and estimated deferred maintenance for all known heritage and stewardship assets in accordance with SFFAS No. 6, as amended by SFFAS No. 14.

The results of our tests of FFMIA disclosed no instances in which Reclamation's financial management systems did not substantially comply with the Federal financial management systems or the standard general ledger at the transaction level requirements.

RESPONSIBILITIES

Management's Responsibilities. The *Government Management Reform Act of 1994* (GMRA), *Accountability of Tax Dollars Act, 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 assist DOI in meeting the GMRA reporting requirements, Reclamation prepares annual 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;
- 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 Reclamation 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 Reclamation'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;
- 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 Reclamation's internal control over financial reporting by obtaining an understanding of Reclamation's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on Reclamation'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 Reclamation's internal control over the Required Supplementary Stewardship Information by obtaining an understanding of Reclamation's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis and Performance sections, we obtained an understanding of the design of 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 Reclamation's fiscal year 2005 financial statements are free of material misstatement, we performed tests of Reclamation'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 Reclamation. 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 Reclamation's financial management systems substantially comply with: (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

This report is intended solely for the information and use of Reclamation 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 21, 2005

Exhibit I

U.S. BUREAU OF RECLAMATION

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Condition	Status
A	Controls over land inventory	This condition has been corrected.
B	Controls over revenue recognition	This condition has been corrected.
C	Federal Financial Management Improvement Act of 1996	This condition has been corrected with regards to controls over land inventory. New findings were identified in fiscal year 2005 relating to the Federal Financial Management Improvement Act of 1996. See reportable condition A and significant deficiency F.

United States Department of the Interior

BUREAU OF RECLAMATION
Washington, D.C. 20240

IN REPLY REFER TO:
D-7400
ADM-1.00

MEMORANDUM

To: Office of the Inspector General
Attention: Assistant Inspector General for Audits

NOV 18

Through: Mark Limbaugh
Assistant Secretary - Water and Science

From: John W. Keys, III
Commissioner

John W. Keys, III NOV 15 2005

Subject: Bureau of Reclamation's Response to the Draft Independent Auditors' Report on the Bureau of Reclamation's Financial Statements for Fiscal Years 2005 and 2004 (Assignment No. X-IN-BOR-0013-2005)

We appreciate the opportunity to review and comment on the draft audit report titled Independent Auditors' Report on the Bureau of Reclamation's Financial Statements for Fiscal Years 2005 and 2004. Attached for your consideration is Reclamation's response to the recommendations as stated in the draft audit report.

If you have any questions or require additional information, please contact Reclamation's Audit Liaison Officer, Tom Lab, at 303-445-3436.

Attachment

cc: Assistant Secretary - Water and Science
Attention: Olivia Ferriter
Associate Director - Financial Policy and Operations
Attention: Debbie Smith
(w/copy of incoming and att to each)

Bureau of Reclamation
KPMG, LLP Draft Audit Report
Response to Draft Audit Report Recommendations
November 2005

A. Controls over Implementation of New Accounting Principle

Recommendation A.1

Improve its policies and procedures related to recording additions to and repayments against the Western receivable and the Treasury liability, including accounting policies and procedures and improved coordination with the U.S. Treasury regarding appropriate account posting models, as necessary.

Response

Concur. Reclamation will improve its policies and procedures related to recording additions to and repayments against the Western receivable and the Treasury liability, including accounting policies and procedures and improved coordination with the Treasury regarding appropriate account posting models, as necessary.

The responsible officials are the Deputy Commissioner, Operations and Deputy Commissioner, Policy, Administration and Budget. The target date for improving policies and procedures related to the Western receivable and Treasury liability is June 30, 2006.

Recommendation A.2

Implement controls to ensure current year additions to and repayments against the Treasury liability are properly recorded in the standard general ledger, including sufficient management oversight and review.

Response

Concur. Reclamation will implement controls to ensure current year additions to and repayments against the Treasury liability are properly recorded in the standard general ledger, including sufficient management oversight and review.

The responsible officials are the Deputy Commissioner, Operations and Deputy Commissioner, Policy, Administration and Budget. The target date for implementing controls to ensure that current year activity related to the Treasury liability is properly recorded in the standard general ledger is June 30, 2006.

Recommendation A.3

Implement controls, including sufficient management oversight and review, to ensure current year appropriations to and repayments from Western are properly recorded in the standard general ledger and budgetary and proprietary balances are properly reported. Further, Reclamation should continue to resolve the unreconciled differences between Reclamation's receivable and Western's liability and continue to improve coordination between Western, the U.S. Department of Energy, Department of the Interior, and Office of Management and Budget.

Response

Concur. Reclamation will implement controls, including sufficient management oversight and review, to ensure current year appropriations to and repayments from the Western Area Power Administration (Western) are properly recorded in the standard general ledger and budgetary and proprietary balances are properly reported. Further, Reclamation will continue to resolve the unreconciled differences between Reclamation's receivable and Western's liability and continue to improve coordination between Western, the Department of Energy, Department of the Interior, and the Office of Management and Budget.

The responsible officials are the Deputy Commissioner, Operations and Deputy Commissioner, Policy, Administration and Budget. The target date for implementing controls, including management oversight and review, to ensure that activity related to the receivable from Western is properly recorded and reported is June 30, 2006.

B. Security and Internal Control over Information Technology Systems

General Comments:

Although Reclamation agrees that application account management procedures could be further improved, other controls are in place to mitigate the risk of this weakness jeopardizing financial systems or the data provided in support of the financial statement. These controls include:

- Management and termination of Local Area Network (LAN) access
- Password requirements
- Data edits in the financial application
- Constraints on transmission of data to the financial system

These controls and procedures were effective in preventing LAN access, even though about 1 percent of the terminated users retained access to applications, as validated by KPMG.

Recommendation B.1

Implement policies and procedures and related controls over the retention of new user authorization and access change documentation.

Response

Concur. Reclamation Manual Directives and Standards, IRM 08-12, "Computer Protections, Anti-Virus, Access Control and Passwords" (available at www.usbr.gov/recman/irm/irm08-12.htm) provides policy for managing user accounts.

Reclamation has updated user administration procedures for the Movable Property System (MPS) and the Interior Department Electronic Acquisition System (IDEAS-PD). The updated procedures were completed and distributed in June and July 2005, respectively, and clarify requirements associated with user account maintenance and oversight responsibilities for system administrators. As of August 2005, Reclamation standardized user access forms for the Bureau of Reclamation Water Operations and Record Keeping System (BORWORKS) and developed a refined process for creating and modifying user accounts to help ensure access is properly authorized.

System administrators and local managers began implementing these procedures upon distribution. The new procedures will ensure that authorization and access documentation is maintained and reviewed by system managers and administrators. The procedures also require that the Reclamationwide functional system administrator conduct semiannual reviews of all user account activities to verify and validate that required reviews have been completed by local system administrators. These newly established procedures require the retention of new user authorization and access change documentation.

Mitigation of this finding will be tracked in the Reclamation Plan of Action and Milestones reports for systems as soon as the final audit report is received.

The responsible official is the Chief Information Officer. Reclamation has completed the task of developing and distributing policies and procedures. The target date for verifying the implementation of the newly established procedures is April 30, 2006.

Recommendation B.2

Ensure administrators and system managers receive adequate training to ensure responsible personnel are aware of existing policies and procedures governing user access. Reclamation should monitor personnel to ensure that policies and procedures are followed.

Response

Concur. Reclamation will conduct training on the new procedures described above to further ensure compliance and an understanding of requirements. Procedures will be implemented to provide adequate training on access controls for new system administrators and other personnel, as needed to ensure that responsible personnel are aware of policies and procedures. Reclamation has procedures in place to inform new system owners and managers of their responsibilities related to application access authorization and account management. As stated in our response to Recommendation B.1, new procedures include monitoring account management procedures.

Mitigation of this finding will be tracked in the Reclamation Plan of Action and Milestones reports for systems as soon as the final audit report is received.

The responsible official is the Chief Information Officer. The target date for initial training to ensure responsible personnel are aware of existing policies and procedures is June 30, 2006.

Recommendation B.3

Monitor the process to ensure that periodic reviews of user access, including reviews at the Sys Operations task level, are performed at the designated intervals and that action is taken in a timely manner to investigate and modify or remove access as a result of the review. Supplement existing guidance to state explicit criteria that should be considered during periodic reviews of user access listings, which will include the oversight of the appropriateness of personnel to perform the reviews. Specifically, someone familiar with the users and their current roles/responsibilities should perform the periodic review; an effective review may require involvement at the regional and/or office level. Further, the objectives of the review are two-fold: 1) to ensure users' access remains appropriate; and 2) to identify any terminated users.

Response

Concur. As stated in our response to Recommendation B.1, Reclamation has updated user administration procedures for MPS and IDEAS-PD. The procedures require that an independent system administrator conduct periodic audits of user account listings to verify and validate that required reviews have been completed by local system administrators. System administrators and local managers began implementing these procedures upon distribution.

In addition, Reclamation's Information Technology Security Assurance program will include a review of account management procedures in its site and system reviews this year.

Mitigation of this finding will be tracked in the Reclamation Plan of Action and Milestones reports for systems as soon as the final audit report is received.

The responsible official is the Chief Information Officer. The target date for a cycle of account management review is May 30, 2006.

C. Controls over Charge Card Reviews

Recommendation C.1

Ensure compliance with its established charge card policies. To help ensure compliance, Reclamation management at all regional, area, and field office locations should be more diligent in monitoring and enforcing compliance with DOI charge card policies.

Response

Concur. Reclamation will continue to implement internal controls and perform oversight to ensure compliance with established charge card policies. Draft Reclamation charge card guidance has been issued for review and comment and is scheduled to be formally issued in fiscal year 2006.

The responsible officials are the Deputy Commissioner, External and Intergovernmental Affairs, Deputy Commissioner, Operations, and Deputy Commissioner, Policy, Administration and Budget. The target date for implementing internal controls and performing oversight to ensure compliance with charge card policies is June 30, 2006.

Recommendation C.2

Design and implement policies to monitor the results of internal reviews of charge card statements to ensure that the internal reviews are effective in ensuring compliance with charge card policies.

Response

Concur. Draft Reclamation charge card guidance has been issued for review and comment and is scheduled to be formally issued in fiscal year 2006. This guidance includes policies and procedures which require charge card reviews to ensure compliance with charge card policies.

The responsible official is the Deputy Commissioner, Policy, Administration and Budget. The target date for implementing policies to monitor the results of internal charge card statement reviews is June 30, 2006.

D. Controls over Management Review and Approval of Process-level Activities

Recommendation D.1

Establish and document policies and procedures for initiating, reviewing and documenting journal entries and standard vouchers to ensure proper segregation of duties and quality reviews.

Response

Concur. Reclamation will establish and document policies and procedures for initiating, reviewing and documenting journal entries and standard vouchers to ensure proper segregation of duties and quality reviews.

The responsible officials are the Chief Financial Officer, Deputy Chief Financial Officer, and all Regional Directors. The target date for establishing and documenting policies and procedures for initiating, reviewing and documenting journal entries and standard vouchers to ensure proper segregation of duties and quality reviews is June 30, 2006.

Recommendation D.2

Design and implement procedures and controls consistent across all regions for reviewing and approving billing documents. These procedures and controls should be designed to ensure that billing documents are accurate and properly supported, which will mitigate the risk of misstatement of accounts receivable and related revenues.

Response

Concur. Reclamation will assess the internal controls over the billing process review for each region and design and implement additional procedures and internal controls as necessary.

The responsible officials are the Chief Financial Officer, Deputy Chief Financial Officer, and all Regional Directors. The target date for assessing the internal controls and implementing new controls is June 30, 2006.

Recommendation D.3

Design and implement a process and controls for reviewing and approving information entered onto the Form 528, which will ensure that the Form 528, which is used to support FIRM, is accurate and properly supported.

Response

Concur. Reclamation will design and implement a process and controls for reviewing and approving information entered onto the Form 528, which will ensure that the Form

528, which is used to support the Foundation Information for Real Property Management System, is accurate and properly supported.

The responsible official is the Regional Director, Mid-Pacific Region. The target date for designing and implementing new internal controls is June 30, 2006.

Recommendation D.4

Improve its internal control environment to ensure that all controls performed are properly documented, including improved training of personnel to ensure awareness and knowledge of requirements and an internal assessment of controls to verify controls are being performed and are operating effectively.

Response

Concur. Reclamation will improve its internal control environment to ensure that all controls performed are properly documented, including improved training of personnel to ensure awareness and knowledge of requirements and an internal assessment of controls to verify controls are being performed and are operating effectively.

The responsible official is the Deputy Commissioner, Operations and Deputy Commissioner, Policy, Administration and Budget. The target date for improving the internal control environment is June 30, 2006.

Recommendation D.5

Improve its reconciliation procedures over the FMS 6652 to ensure all differences are investigated. Improvements should include:

a. Documentation of the investigation and resolution of each difference.
b. Signature and date of the person performing the investigation.
c. Documentation of follow-up procedures performed in instances where the difference was not cleared in the original month reported.

Response

Partially concur. The recommendation to document every difference is neither an efficient nor an effective use of Reclamation resources. The majority of differences are temporary, due to month end timing differences between Treasury and Reclamation. Reclamation generates a monthly report that systematically documents the aging, by schedule and document number, of all differences for the month including those that have not been cleared in the original month reported. Reclamation agrees that non-timing differences, that require investigation, should be well documented with pertinent details, investigator's name, and dates of completion by the person performing the investigation.

The responsible official is the Deputy Chief Financial Officer. The target date for implementing new procedures to document differences requiring investigation is June 30, 2006.

E. Controls over Credit Reform Loans

Recommendation E.1

Develop and implement controls to ensure the subsidy re-estimate is accurately recorded based on all relevant factors. Also, the subsidy re-estimation should be revised and approved, by appropriate management.

Response

Concur. Reclamation will develop and implement controls to ensure the subsidy re-estimate is accurately recorded based on all relevant factors, and will also assess the proper level of management review of subsidy re-estimates.

The responsible official is the Deputy Commissioner, Policy, Administration and Budget. The target date for assessing and implementing this recommendation is June 30, 2006.

Recommendation E.2

Design and implement a mechanism to properly exclude administrative costs from the net loan receivable balance.

Response

Nonconcur. Reclamation properly includes **reimbursable** administrative costs due from loan recipients in the loan receivable balance reported in the financial statements. Reclamation properly excludes appropriated or nonreimbursable administrative costs associated with the loan program from the loan receivable balance reported in the financial statements.

Reclamation's direct loans authorized after September 30, 1991, are provided for by the Small Reclamation Projects Act of 1956 (Public Law 84-984). This Act states, "The reasonable cost of any plans, specification, and other unpublished material furnished by the Secretary pursuant to this section and the cost of making and administering any loan under this Act shall, to the extent that they would not be nonreimbursable in the case of a project constructed under the Federal Reclamation laws, be treated as a loan and covered in the provisions of the contract entered into under section 5 of this Act unless they are otherwise paid for by the organization." Reimbursable administrative costs become part of the loan balance due from the customer as incurred per the authorizing legislation. As these costs are reimbursable, they do not qualify as costs to the Government of a direct loan as defined in Section 502(5)(A) of the Federal Credit Reform Act of 1990.

F. Reporting the Condition of Heritage and Stewardship Assets

Recommendation F.1

Perform condition assessments for all heritage assets and stewardship assets, and estimate the related deferred maintenance.

Response

Non-concur. Reclamation does not believe that the requirements of the Statement of Federal Financial Accounting Standards (SFFAS) No. 6 for performing condition assessments and estimating deferred maintenance is applicable to its heritage assets. As discussed in the Executive Summary of SFFAS No. 6, paragraph c, there are four categories of Property, Plant, and Equipment (PP&E): (1) general PP&E; (2) Federal mission PP&E; (3) heritage assets; and 4) stewardship land. Paragraph d of the Executive Summary states that: "Complete accounting standards for general PP&E are included in this document." This infers that SFFAS No. 6 does not provide complete accounting standards for the other three categories, including heritage assets.

In SFFAS No. 6, accounting standards related to heritage assets are limited to the recognition and measurement of costs for financial statement reporting purposes (refer to paragraphs 61 and 62 of SFFAS No. 6). Paragraph 62 states that: "Additional reporting requirements will be developed for stewardship report items in a separate standard." The deferred maintenance requirements of SFFAS No. 6 do not apply to heritage assets.

SFFAS No. 8 "Supplementary Stewardship Reporting" provides additional guidance and requirements for stewardship assets, including heritage assets, Federal mission property, and stewardship land. SFFAS No. 8, Chapter 2, provides guidance for reporting heritage asset information as Required Supplementary Stewardship Information. Under the "Minimum Reporting" section, paragraph 50 provides agencies with **latitude** in determining the appropriate information to report, including condition and deferred maintenance. Paragraph 50 states:

"The determination of the most relevant information to be presented should be made by the preparer; however, reporting at the entity level shall be more specific than at the government-wide level. The following are examples of information that *should be considered* for presentation." (italics added for emphasis)

The fourth bullet under paragraph 50 is "condition." The fifth bullet states: "A reference to a note to the financial statements *if* deferred maintenance is reported for the assets." (italics added for emphasis)

By reviewing the deferred maintenance requirements that are addressed in SFFAS numbers 6, 8, and 14, it can also be inferred that the Federal Accounting Standards Advisory Board (FASAB) intended to provide agencies some latitude in the application of deferred maintenance, including the performance of condition assessments, for its PP&E. For example, paragraph y in the Executive Summary to SFFAS 6 states:

"The standards recognize that there are many variables in estimating deferred maintenance amounts. The standards acknowledge that condition rating is a management function since different conditions might be considered acceptable by different entities as well as for different items of PP&E held by the same entity. In addition, management *may* use condition assessment surveys or life cycle cost plans to estimate the amount of deferred maintenance." (italics added for emphasis)

SFFAS No. 8, paragraph 32, also includes inferences that the primary intent of the deferred maintenance requirements is to ensure that the operational PP&E of an agency is identified and reported. Paragraph 33 provides agency flexibility in the application of condition assessment and deferred maintenance requirements. This paragraph states that: "These requirements are flexible since different conditions may be considered acceptable by different entities, as well as for different items of PP&E held by the same entity."

In addition, SFFAS No. 6, Chapter 3 indicates that deferred maintenance requirements are primarily applicable to an agency's operating PP&E. Paragraph 77 defines deferred maintenance as "maintenance that was not performed when it should have been or was scheduled to be and which, therefore, is put off or delayed for a future period." Paragraph 78 elaborates on the definition of maintenance:

"For purposes of this standard, maintenance is described as the act of keeping fixed assets in acceptable condition. It includes preventative maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life."

The third bullet of paragraph 83 states: "If the condition assessment survey method of measuring deferred maintenance is used, the following should be presented for each class of PP&E: (1) description of requirements or standards for acceptable operating condition; (2) any changes in the condition; (3) asset condition and a range estimate of the dollar amount of maintenance needed to return it to its acceptable operating condition." Since reference is made to acceptable operating condition, it appears that this requirement is applicable to fixed assets such as plant and equipment. It does not appear that heritage assets meet the criteria for the deferred maintenance requirement as required by SFFAS No. 6, paragraphs 77 and 78. If deferred maintenance is not applicable to heritage assets, it can be inferred that condition assessments on these assets are not required.

Finally, SFFAS No. 14, paragraph 80 indicates that amounts for deferred maintenance may be measured using condition assessment surveys. Paragraph 81 defines condition assessment surveys as "periodic inspections of PP&E to determine their current condition and estimated cost to correct any deficiencies." From the criteria specified in SFFAS No. 14, it can be inferred that deferred maintenance is generally not applicable to heritage assets when these assets are an incidental aspect of an agency. This SFFAS indicates that condition assessments may be performed to identify costs that need to be incurred to bring an asset up an acceptable operating condition. Operating condition is not an applicable measure, generally, for Reclamation's heritage assets as the great majority are archaeological properties. One exception might be multi-use heritage assets, heritage assets that are used to accomplish Reclamation's mission. For these situations, such assets would be included in Reclamation's assessment of deferred maintenance of its reserved water and power facilities.

Reclamation recognizes its responsibility to manage and protect heritage assets, and to comply with Federal law and regulations in that regard. However, the management of heritage assets is secondary to Reclamation's mission of delivering water and power. Highest priority, of necessity, is given to conducting condition assessments and addressing deferred maintenance of Reclamation water and power facilities. The Federal government has not issued any standards or guidance for conducting condition assessments and evaluating deferred maintenance of archaeological sites, which comprise the majority of Reclamation's non-collectible heritage assets. The Federal government also has no laws or regulations in place for evaluating the significance, condition, or deferred maintenance of paleontological resources, another category of non-collectible heritage assets.

It should be noted that Reclamation is in full compliance with condition assessment and deferred maintenance requirements for its general PP&E, as required by SFFAS No. 6. Reclamation has long-established policies and procedures for conducting comprehensive and rigorous condition assessments of all of its high and significant hazard dams, power plants, and associated facilities. Deferred maintenance on all Reclamation reserved works facilities (owned and operated by Reclamation) is updated quarterly. This would include multi-use heritage assets; e.g., Hoover Dam, which is a National Historic Landmark. The Department requires comprehensive condition assessments every 5 years. Reclamation currently performs condition assessments of its water and power facilities on a 3-year frequency.

Reclamation conducts scheduled condition assessments and determines deferred maintenance of its non-collectible heritage assets that fall under the definition of buildings and structures, in particular those that are multi-use heritage assets. In addition, Reclamation's reserved buildings are now also subject to scheduled condition assessments. In fiscal year 2004, Reclamation completed a preliminary condition assessment of all its reserved buildings that have a current replacement value of greater than $50,000. Over the next five years, comprehensive condition assessments of those properties will be scheduled and completed. Deferred maintenance needs will be identified and reported.

In terms of collectible heritage assets, Department standards exist for evaluating the condition of facilities that display, exhibit, or store museum property. Reclamation uses the Department Facility Checklist for assessing condition and maintenance needs of such facilities. Item-level condition assessments are conducted as part of annual inventories and when accessioned items are cataloged. Conservation surveys that would identify costs for rehabilitation of items occur only as needed, as per 411DM.

In addition, in an October 21, 2005, memo from the Assistant Secretary, Policy, Management and Budget (AS-PMB) to the Assistant Inspector General for Audits the Department resolved the disputed fiscal year 2004 Independent Auditors' Reports to several Department bureaus regarding the auditor's recommendations on collectable heritage assets. Specifically, KPMG noted significant deficiencies for those bureaus' internal controls over Required Supplemental Stewardship Information related to condition assessments of collectable heritage assets and controls over Required Supplementary Information related to deferred maintenance amounts for such assets. KPMG concluded that these deficiencies in internal control were also indicators of noncompliance with Federal Financial Management Improvement Act provisions relating to Federal accounting standards. In the AS-PMB's final conclusion and resolution, it was stated that:

"Collections that are housed in facilities in good condition are deemed to be in good condition. Therefore, Interior's policy of assessing the condition of museum objects based upon the condition of the facility housing the collection is considered appropriate and is supported by professional museum policy and practice."

It should be noted that the condition of heritage assets issue is a Department-wide issue. Reclamation is in full compliance with all Departmental reporting requirements regarding heritage assets. Due to budgetary constraints, it is unlikely that sufficient funding would be available to perform condition assessments and estimate deferred maintenance on all heritage assets. Accordingly, it would not be feasible or cost-effective to implement this recommendation.

Recommendation F.2

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

Response

Non-concur. Since Reclamation does not concur with Recommendation F.1, Reclamation cannot concur to this recommendation. Nevertheless, Reclamation believes it is important to note the supervisory requirements Reclamation does have in place. Reclamation has already instituted supervisory approval where required. Reclamation uses the Department Facility Checklist for assessing condition and maintenance needs of such facilities. Item-level condition assessments are conducted as part of annual inventories and when accessioned items are cataloged. Conservation surveys that would identify costs for rehabilitation of items occur only as needed, as per 411DM. Reclamation requires assessments of its non-collectable multi-use heritage assets. All assessments are reviewed and approved by supervisors and managers; for both collectable and non-collectable heritage assets these internal review and approval requirements are being codified in the Reclamation Manual.

Recommendation F.3

Update the condition assessment and deferred maintenance estimates periodically and ensure the rotation schedule is properly maintained and monitored by individuals at the appropriate supervisory level.

Response

Non-concur. Since Reclamation does not concur with Recommendation F.1, Reclamation cannot concur to this recommendation. Nevertheless, Reclamation believes it is important to note actions it does take with regard to performing condition assessments and deferred maintenance. Reclamation is in full compliance with condition assessment and deferred maintenance requirements for its general PP&E, as required by SFFAS No. 6. Reclamation has long-established policies and procedures for conducting comprehensive and rigorous condition assessments of all of its high and significant hazard dams, power plants, and associated facilities. Deferred maintenance on all Reclamation reserved works facilities (owned and operated by Reclamation) is updated quarterly. This includes multi-use heritage assets; e.g., Hoover Dam, which is a National Historic Landmark. The Department requires comprehensive condition assessments every 5 years. Reclamation currently performs condition assessments of its water and power facilities on a 3-year frequency.

Reclamation conducts scheduled condition assessments and determines deferred maintenance of its non-collectible heritage assets that fall under the definition of buildings and structures, in particular those that are multi-use heritage assets. In addition, Reclamation's reserved buildings are now also subject to scheduled condition assessments. In fiscal year 2004, Reclamation completed a preliminary condition assessment of all its reserved buildings that have a current replacement value of greater than $50,000. Over the next 5 years, comprehensive condition assessments of those properties will be scheduled and completed. Deferred maintenance needs will be identified and reported.

In terms of collectible heritage assets, Federal standards exist for evaluating the condition of facilities that display, exhibit, or store museum property. Reclamation uses the Department Facility Checklist for assessing condition and maintenance needs of such facilities. Item-level condition assessments are conducted as part of annual inventories and when accessioned items are cataloged. Conservation surveys that would identify costs for rehabilitation of items occur only as needed, as per 411DM.
All regional submittals of condition assessments and deferred maintenance data are processed through senior regional management prior to submission to those who compile

and write the quarterly or annual data reports. All data and reports submitted to the Department are monitored and approved by senior Reclamation management.

G. Federal Accounting Standards

Recommendation G.1

Improve its policies and procedures related to recording additions to and repayments against the Western receivable and the Treasury liability, including accounting policies and procedures and improved coordination with the U.S. Treasury regarding appropriate account posting models, as necessary.

Response

Concur. See response to Recommendation A.1.

Recommendation G.2

Perform condition assessments for all heritage assets and stewardship assets and estimate the related deferred maintenance.

Response

Non-Concur. See response provided for Recommendation F.1.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

January 31, 2006

Memorandum

To: Kathleen Clarke
Director, Bureau of Land Management

From: Anne L. Richards Anne L. Richards
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Bureau of Land Management's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-BLM-0012-2005)

Attached is the subject KPMG LLP-prepared auditors' report (Attachment 1), which contains an unqualified opinion on the Bureau of Land Management's (BLM) financial statements. However, KPMG identified four reportable conditions in BLM's internal controls over financial reporting, none of which were considered material weaknesses. KPMG also found significant deficiencies in BLM's reporting on performance measures, the condition of stewardship land and museum collections, and deferred maintenance for stewardship land. In addition, KPMG found instances in which BLM's financial management systems did not fully comply with federal accounting standards and with the Federal Financial Management Improvement Act of 1996 (FFMIA). The report contains 13 recommendations that, if implemented, should resolve the findings.

In its December 22, 2005 response (Attachment 2) to the draft auditors' report, BLM agreed with four findings, partially agreed with two findings, and disagreed with three findings.

BLM also stated in its response that it agreed with five recommendations, none of which have been fully implemented. We will refer the five unimplemented recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

In addition, BLM partially agreed with two and disagreed with six recommendations (see Attachment 3, "Status of Audit Report Recommendations). These eight recommendations will be referred for resolution and tracking of implementation.

The Department of the Interior contracted with KPMG, an independent, certified public accounting firm, to audit BLM's financial statements for fiscal years 2005 and 2004. The contract required that KPMG conduct its audit in accordance with the "Government Auditing Standards" issued by the Comptroller General of the United States, the Office of Management and Budget's "Audit Requirements for Federal Financial Statements," and the

Government Accountability Office's/President's Council on Integrity and Efficiency's "Financial Audit Manual."

KPMG is responsible for the auditors' report and for the conclusions expressed in the report. We do not express an opinion on BLM's financial statements or KPMG's conclusions on the effectiveness of internal controls, on whether BLM's financial management systems substantially complied with FFMIA, or on compliance with laws and regulations.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of BLM personnel during the audit. If you have any questions, please contact me at 202-208-5512.

Attachments (3)

cc: Assistant Secretary, Land and Minerals Management
Chief Financial Officer, Bureau of Land Management
Director, Office of Financial Management
Audit Liaison Officer, Office of Financial Management
Audit Liaison Officer, Land and Minerals Management
Audit Liaison Officer, Bureau of Land Management
Focus Leader for Financial Reporting, Office of Financial Management
Focus Leader for Management Control and Audit Follow-up,
Office of Financial Management

KPMG

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

Independent Auditors' Report

The Director of the Bureau of Land Management and
the Inspector General of the U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheets of the Bureau of Land Management (BLM) as of September 30, 2005 and 2004, and the related consolidated statements of net cost of operations, consolidated statements of changes in net position, combined statements of budgetary resources, consolidated statements of financing, and the consolidated statements of custodial activity for the years then ended (hereinafter referred to as the financial statements). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered BLM's internal control over financial reporting and tested BLM's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on its financial statements.

Summary

As stated in our opinion on the financial statements, we concluded that BLM'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 18 to the financial statements, BLM adopted the provisions of Interpretation of Federal Financial Accounting Standards No. 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*, for the year ended September 30, 2005.

Our consideration of internal control over financial reporting identified the following reportable conditions. However, none of the reportable conditions are believed to be material weaknesses.

A. Security and Internal Control over Information Technology Systems

B. Adequate Segregation of Duties over Purchases

C. Accounting for Mineral Leases

D. Recording Year-end Liabilities

Our limited procedures over Management's Discussion and Analysis, Required Supplementary Stewardship Information, and deferred maintenance reported as Required Supplementary Information identified the following significant deficiencies.

E. Reporting of Performance Measure Information in Management's Discussion and Analysis

F. Reporting the Condition of Stewardship Land

G. Reporting the Condition of Museum Collections

H. Reporting of Deferred Maintenance Amounts for Stewardship Land

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996*

(FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, or Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The results of our tests of FFMIA disclosed instances where BLM did not substantially comply with the following provisions of FFMIA.

I. Federal Accounting Standards

The following sections discuss our opinion on the financial statements, our consideration of BLM's internal control over financial reporting, our tests of BLM'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 Bureau of Land Management as of September 30, 2005 and 2004, and the related consolidated statements of net cost of operations, consolidated statements of changes in net position, combined statements of budgetary resources, consolidated statements of financing, and the consolidated statements of custodial activity for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BLM 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 activity for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 18 to the financial statements, BLM adopted the provisions of Interpretation of Federal Financial Accounting Standards No. 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*, for the year ended September 30, 2005.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information (Stewardship Assets), and Required Supplementary Information (Supplementary Statements of Budgetary Resources by Major Budget Accounts and Deferred Maintenance) 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 did not audit this information, and accordingly, we express no opinion on it. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. As a result of such limited procedures, we believe that the following is not in conformity with accounting principles generally accepted in the United States of America: (1) the reporting of relevant and timely performance measure information in Management's Discussion and Analysis, (2) the reporting of Required Supplementary Stewardship Information on the condition of stewardship land and museum collections, and (3) the reporting of Required Supplementary Information on the amount of deferred maintenance for stewardship land. Our limited procedures found BLM does not have adequate policies and procedures to report this information consistent with accounting principles generally accepted in the United States of America.

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 BLM'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.

We noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. However, none of the reportable conditions are believed to be material weakness.

(A) Security and Internal Control Over Information Technology Systems

Security and general controls over BLM's information technology systems have not been fully implemented. This is a repeat finding from the prior year, and even though BLM has made progress in implementing security controls in the past couple of years over its information systems, improvement is needed in the areas described below, as required by OMB Circular A-130, *Management of Federal Information Resources*. The access control conditions identified below could affect BLM's ability to prevent or detect unauthorized changes to subsidiary financial information, control electronic access to sensitive information, and protect its information resources.

Access controls should provide reasonable assurance that computer resources are protected against unauthorized modification, disclosure, loss, or impairment. The objectives of limiting access are to ensure that: (1) only authorized users have access to data and resources; (2) users have the minimum access necessary to perform their job functions; (3) access to very sensitive resources is limited to very few individuals; and (4) network security configurations are optimized to provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. Certain procedural and technical access controls over BLM's financial applications have not been implemented or are not operating effectively to minimize the risks of unauthorized access to its systems and its data. Specifically, our audit found:

- Employee termination procedures are not sufficient to effectively remove in a timely manner terminated user accounts from BLM information systems.

- BLM has not validated the appropriateness and need for a significant number of contractor user IDs on its network active directory, and it is unclear how many of these users still require access.

- A significant number of generic user IDs on BLM's network active directory. These accounts have not been validated as to why generic access is needed, as opposed to unique user access.

- Lack of approvals over BLM user access to the Federal Personnel and Payroll System (FPPS).

- Lack of documentation supporting periodic reviews of user access appropriateness for BLM's Collection and Billing System (CBS) and the Interior Department Electronic Acquisition System (IDEAS).

- Lack of a process or procedure for ensuring select production databases are configured with a common baseline security configuration. For example, select databases contain default username and password combinations.

Recommendation

BLM should continue the development and implementation of procedures to improve the internal security and general controls over its information technology systems. Improved procedures should address the areas discussed above, as well as other areas that might impact the electronic data processing control environment, to ensure adequate security and protection of BLM's financial management systems.

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) Adequate Segregation of Duties Over Purchases

The principles of segregation of duties stipulate that no individual should have complete control over incompatible transaction processing functions, which include the initiation, approval, and execution of a transaction. Allowing a single individual to control all phases of a transaction creates a situation that permits errors or irregularities to go undetected.

Our audit found there are individuals in several BLM offices that have the individual ability to execute all the essential duties of the purchasing function. For example, individuals have the ability to create and approve a purchase requisition and purchase order, and then also have the ability to approve the invoice for payment.

Recommendation

BLM should implement procedures to ensure critical duties of the purchasing function are adequately segregated at all offices. If segregation of duties cannot be established, then additional periodic management reviews of the purchasing functions should be performed to ensure transactions are accounted for properly and do not contain instances of theft or fraud.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management partially agreed with our recommendation. Management indicated additional reviews over the purchasing function are needed at its National Training Center. BLM disagreed that changes are needed in other offices, given that hard-copy documentation usually exists indicating additional reviews of purchase transactions were performed.

Auditors' Response to Management's Response

There are BLM employees, mostly in large offices, with the ability to perform all functions of a purchasing transaction. It is important these abilities be limited to help prevent the possibility of theft or misappropriation of assets. The critical point is not whether there is hard-copy documentation evidencing other reviews, but the ability for one individual to create and approve a purchase for payment. Further, the ability to enter and approve both purchase requisitions and purchase orders is against BLM policy, as outlined in BLM Instruction Memorandum No 99-135.

(C) Accounting for Mineral Leases

BLM processes collections from mineral leasing activity on its public lands, which includes leases for oil, gas, and coal. BLM collects the first year rent and bonus bid deposits related to this activity. These amounts are initially recorded as a liability awaiting adjudication. The adjudication process encompasses BLM's issuance or dismissal of a lease and is the determining factor in recognizing custodial revenue in BLM's statement of custodial activity. If adjudication results in a lease, the collections are transferred to the Minerals Management Service (MMS), which disburses the funds along with subsequent rents and royalties to states and other federal agencies. If a lease is not accepted, the collections are refunded. During fiscal year 2005, the BLM transferred approximately $610 million to MMS.

BLM needs to improve policies and procedures over the accounting for mineral lease activity and the transfer of monies to MMS. Specifically, we noted the following:

- BLM does not have a formal detailed accounting policy for recognizing custodial revenue. Lack of a detailed policy increases the risk that amounts will be misclassified and reported in the incorrect year.

- BLM does not adhere to its policy to prepare and date the transmittal form on the same date the lease agreement is executed. The transmittal form contains detailed accounting information and is used to transfer monies to MMS. MMS uses information on the form to make disbursements. BLM's accounting division uses the form to determine the period in which lease revenues should be recognized, which is to correspond with the execution of a lease agreement. Our audit determined the timing between the dating of the transmittal form and the lease agreement, or vice versa, varied from 0 to 50 days. Lack of adherence to BLM's transmittal form dating policy increases the risk that amounts will be recorded in the incorrect year.

- BLM does not have sufficient policies and procedures over the review of lease information sent to MMS. In most BLM offices, the same individual prepares, reviews, and approves the lease agreement and the transmittal form. Failure to segregate these incompatible duties increases the risk that amounts will be misclassified and incorrectly reported, as evidenced by errors our audit discovered in the coding of transmittal forms. We identified two military leases that were coded incorrectly during the year. This resulted in errors in the MMS distribution process with a state being owed approximately $6 million.

- BLM does not consistently transfer monies to MMS in a timely manner. BLM policy is to transfer monies to MMS within 14 days of the signing of a lease agreement. We selected a sample of 69 leases and determined that, on average, it took 28 days to complete the transfer once a lease had been signed, and, in some cases, took up to 180 days.

Recommendation

BLM should improve its policies and procedures over the accounting for mineral lease activity and the transfer of monies to MMS.

Management Response

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

(D) Recording Year-end Liabilities

BLM does not have adequate procedures to identify and record all liabilities at year-end. Our audit discovered approximately $21 million in unrecorded liabilities at the end of fiscal year 2005. Specifically, we identified the following misstatements.

- Federal accounting standards require that revenue from exchange transactions be recognized when goods or services are provided at a price, and if advance payments are made, such amounts should be recorded as a deferred revenue liability until the point in time the exchange occurs. As of year-end, BLM had collected $6.6 million from land sales for which it had not exchanged legal title to the land. BLM erroneously recognized these advance payments as earned revenue, as opposed to a deferred revenue liability.

- Undistributed collection liabilities are amounts collected by BLM from activity on its federal lands that are due to other governmental entities, primarily the U.S. Treasury. As of year-end, BLM had collected approximately $14.7 million for which it had erroneously not recorded an undistributed collection liability.

While the above adjustments are not considered material to BLM's fiscal year 2005 financial statements, a lack of adequate procedures and related controls in future years over the recording of year-end liabilities may result in more significant misstatements.

Recommendation

BLM should improve its procedures over the identification and recording of year-end liabilities. In addition, appropriate controls should be implemented to ensure the reviews of year-end liabilities are conducted.

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.

Internal Control Over Performance Measure Information Reported in Management's Discussion and Analysis

With respect to the design of internal controls relating to the existence and completeness of assertions over performance measures determined by management to be key and reported in Management's Discussion and Analysis, we noted certain significant deficiencies in internal control over reported performance measures discussed in the following paragraphs that, in our judgment, could adversely affect BLM's ability to collect, process, record, summarize, and report performance measures in accordance with management's criteria.

(E) Reporting of Performance Measure Information in Management's Discussion and Analysis

The Government Performance and Results Act (GPRA) requires agencies to formulate strategic plans, identify major strategic goals, and report performance measures and results related to these goals. Further, OMB Circular A-136 requires agencies to report in the Management's Discussion and Analysis section of the annual report objective and relevant performance measures that disclose the extent to which programs are achieving their intended objectives.

BLM can improve the type of performance measures it reports in Management's Discussion and Analysis. Specifically, BLM is currently not reporting performance measures related to its wildland fire management, land sales, and helium programs. These are large programs, referred to throughout BLM's annual report, that account for a significant portion of BLM's financial activity. For example:

- BLM provides fire protection on approximately 390 million acres of public and state land and was appropriated $800 million in fiscal year 2005 for wildland fire management.

- During 2005, BLM collected $1.2 billion from land sales. At year-end, BLM had $1.7 billion in investments related to these land sales, which will be used to acquire sensitive lands or to make improvements to existing government assets.

- During 2005, BLM collected $89 million in helium revenue. At year-end, BLM had 26 billion standard cubic feet of helium, which is carried at $304 million in the financial statements. The helium amounts will be used to repay approximately $1.1 billion in BLM debt.

A lack of performance information, for the above significant programs, results in users of the financial statements not having a basis to determine the extent such programs are achieving their intended objectives.

In addition to the above, for certain performance measures in Management's Discussion and Analysis, BLM has reported results based on prior-year data. Many of these measures are included in the Department of the Interior's Management's Discussion and Analysis. The Department cannot report accurate information when BLM has not established effective procedures for gathering information in a timely manner.

Recommendations

1. BLM should include in its Management's Discussion and Analysis section performance measures related to its significant programs, which include the wildland fire management, land sales, and helium programs.

2. BLM should revise its performance data collection processes to allow for up-to-date accomplishments to be reported for all performance targets.

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.

Internal Control Over Required Supplementary Stewardship Information

We noted certain significant deficiencies in internal control over Required Supplementary Stewardship Information discussed in the following paragraphs that, in our judgment, could adversely affect BLM's ability to collect, process, record, and summarize required supplementary stewardship information on the condition of stewardship land and museum collections.

(F) Reporting the Condition of Stewardship Land

Accounting standards for federal entities establish minimum reporting requirements for stewardship land. These standards require BLM to report, as required supplementary information in its stewardship section of its annual report, the condition of stewardship land.

In addition, the Accounting and Auditing Policy Committee of the Federal Accounting Standards Advisory Board (FASAB) commissioned the Stewardship Guidance Work Group to prepare the *Reporting and Assurance Guide for Stewardship Land (SL) and Heritage Assets (HA).* The report, which is still in draft form, concluded one of the most meaningful criteria for measuring the condition of stewardship land originates from the fact the federal government has been entrusted with, and made accountable for, stewardship lands that are held for the long-term benefit of the Nation. Hence, the most important information about the condition of stewardship land is whether or not it has been safeguarded and protected against waste, loss, and misuse; managed consistent with its intended use in accordance with federal laws and regulations; and not materially degraded while under government care. The report further concluded, for sources of condition information, an entity may assess condition as part of its normal management role and existing systems. This may include condition information assessment surveys, annual or perpetual inventories, technical studies, budget requests, etc.

Based on the above, we concluded BLM is not using the appropriate basis in its annual report for assessing and reporting the condition of its stewardship land. In its fiscal year 2005 annual report, BLM reported the condition of its stewardship land as acceptable, and that assessment was based on resource production and revenues generated from the public lands. That assessment did not consider the aggregate results of condition information that BLM gathers as part of its ongoing operational processes. For example, as part of its land management operations BLM performs various condition assessments, which include: (1) Ecological Site Inventories, which provide a reference for determining the land's capability to produce forage and habitat, for assessing land health, and for monitoring the characteristics of the resource. (2) Land Health Assessments, which ascertain whether land health standards have been achieved and which describe a level of ecologic functionality for water quality, wildlife habitat, soil stability, and nutrient and energy cycling. (3) Fire Regime Condition Class, which is a standardized tool for determining the degree of departure from reference condition vegetation, fuels, and disturbance regimes. In many cases, the completion of the above studies is ongoing, and the preliminary results indicate, in certain situations, that the condition of the land is not acceptable and is in need of intervention.

We believe BLM's disclosures on the condition of stewardship lands are substantially not complete. Asserting that the condition of land is evidenced merely by resource production and revenue generated from the land reports little or no substantive information on the true condition of the land. Further, BLM has not met its reporting responsibilities to the general public by not reporting, in its annual report, the results of condition assessments conducted as part of its general operations.

Recommendations

To provide more useful and meaningful information to the readers of BLM's annual report, BLM should consider the intent of the federal accounting standards in reporting the condition of its stewardship land and adhere to the principles incorporated in FASAB's commissioned Stewardship Guidance Work Group draft report, *Reporting and Assurance Guide for Stewardship Land (SL) and Heritage Assets (HA)*. Accordingly, we recommend:

1. BLM measure and report the condition of its land by taking into consideration the use of the land and the condition of the water and vegetation upon that land.

2. Develop a written policy on the types of land that do not need assessment based on limited human intervention and susceptibility to deterioration.

3. Complete, and periodically update, condition assessments that are performed as part of BLM's normal management role and existing systems (e.g. ecological site inventory assessments, land health assessments, and fire regime condition assessments).

4. Report the condition of the land based on the summarized results of existing systems. The condition, and support for the condition, should conceivably come from the current assessments that BLM performs as part of its normal management role and existing systems. These condition assessments and the related controls over the assessment process should be appropriately documented.

Through the use of these forms of information gathering techniques, BLM with limited effort and cost could report on the condition of the land as a whole, and provide more meaningful information to readers of stewardship land information.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with our recommendation. Management indicated the accounting standards define land as essentially rock and sediment, and as such, the definition excludes the resources upon the land.

Auditors' Response to Management's Response

Statement of Federal Financial Accounting Standards (SFFAS) No. 8, *Supplementary Stewardship Reporting*, paragraph 81, requires federal agencies to report in its stewardship section of its annual report the condition of stewardship land. We disagree the accounting standards, in assessing the condition of stewardship land, have excluded natural resources, such as the condition of vegetation and water upon the land. We believe BLM, with limited effort and cost, could report the condition of stewardship land using assessments it performs as part of its normal management operations. Such assessments have not indicated that BLM land, in all cases, is in acceptable condition.

Disclosing the results of land condition assessments would provide more meaningful information to the readers of BLM's annual report and would meet the intent of the federal accounting standards in reporting the condition of stewardship land.

(G) Reporting the Condition of Museum Collections

Accounting standards for federal entities establish minimum reporting requirements for museum collections taken off the public lands. These standards require BLM to report, as required supplementary information in its stewardship section of its annual report, the number of museum collections in terms of physical units and the condition of such collections. To meet the reporting requirements BLM defines a museum collection unit as an individual museum facility, and reports that it has identified, through questionnaires and its internal archaeological and paleontological permit process, 155 nonfederal museum facilities that contain museum items originating from BLM public lands.

BLM needs to improve its assessment and reporting of the condition of museum collections. Specifically, we found:

- BLM has not assessed, in accordance with the Department of the Interior's standards, the condition of 98 of its 155 identified facilities.

- BLM is not disclosing the condition of museum collections in accordance with federal accounting standards. BLM considers museum collections to be in stable condition if the facility is in stable condition. However, for financial reporting purposes, the assessment of museum collections should ultimately address the underlying condition of the individual items as opposed to the facility housing those items.

Recommendation

BLM should continue to complete its review of the nonfederal facilities in accordance with the Department of the Interior's guidance and consider such information in determining the condition of museum collections. However, for financial reporting purposes, the assessment of museum collections should ultimately address the underlying condition of the individual items as opposed to the facility housing those items. If BLM does not know the condition of the individual items, then such a statement should be made in the annual report along with the reasons why such condition is unknown.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with our recommendation. Management indicated that BLM believes museum objects in nonfederal facilities, which are the majority of BLM's museum collections, do not meet the definition of BLM property, and BLM is in the process of obtaining guidance from FASAB on this issue. BLM stated it reported condition information on museum collections in accordance with the Department of the Interior's policy.

Auditors' Response to Management's Response

BLM has assessed the condition of museum collections at the facility level for 57 of 155 facilities. However, it has not completed assessments on the majority of the identified facilities. Further, we believe reporting the condition of the facility does not address the true condition of the individual museum collections. The combination of these two conditions results in incomplete museum collection disclosures. We encourage BLM to continue to seek guidance from FASAB for reporting museum collections.

Internal Control Over Required Supplementary Information

We noted certain significant deficiencies in internal control over the reporting of deferred maintenance amounts discussed in the following paragraphs that, in our judgment, could adversely affect BLM's ability to collect, process, record, and summarize in a timely manner deferred maintenance amounts reported as Required Supplementary Information to the financial statements.

(H) Reporting of Deferred Maintenance Amounts for Stewardship Land

Accounting standards for federal entities establish minimum reporting requirements for stewardship land. These standards require BLM to report, as Required Supplementary Information to the financial statements, the amount of deferred maintenance for stewardship land. Federal accounting guidance defines deferred maintenance as maintenance that was not performed when it should have been or was scheduled to be and which, therefore, was put off or delayed for a future period. Maintenance is the act of keeping fixed assets in acceptable condition. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services.

Our audit found that BLM has not reported in its annual report deferred maintenance costs related to stewardship land. Throughout BLM's annual report and annual budget requests, there are references to known instances of BLM stewardship land in need of intervention, and future outlays of monies and efforts are necessary to bring the land into an acceptable condition. If land treatments require the expenditure of monies, or employee efforts, and are not performed within the current fiscal year, then maintenance has been deferred, and an appropriate dollar amount should be estimated and reported for financial reporting purposes.

Recommendation

BLM should develop a process, consistent with accounting principles generally accepted in the United States of America, for estimating deferred maintenance costs on stewardship land. Such costs should encompass land that is in need of intervention and future outlays of efforts and monies that are necessary to bring the land into an acceptable condition.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management disagreed with our recommendation. Management indicated that BLM's stewardship land does not have deferred maintenance as defined by the accounting standards.

Auditors' Response to Management's Response

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 83, requires federal agencies to report in its deferred maintenance section of its annual report the amount of deferred maintenance for stewardship land. BLM 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. Therefore, we recommend BLM develop a method to report deferred maintenance amounts on stewardship land as required by the accounting standards.

A summary of the status of prior year reportable conditions and significant deficiencies is included as Exhibit I. We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of BLM in a separate letter dated November 4, 2005.

Compliance and Other Matters

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements described in the Responsibilities section of this report, exclusive of those referred to in *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

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

(I) Federal Accounting Standards

As discussed in the sections of our report entitled Internal Control over Performance Measure Information Reported in Management's Discussion and Analysis, Internal Control Over Required Supplementary Stewardship Information, and Internal Control Over Required Supplementary Information, BLM needs to improve its policies and procedures for reporting relevant and timely performance measure information, the condition of stewardship land, the condition of museum collections, and the amount of deferred maintenance for stewardship land.

OMB Circular A-136, Section 2.2C Part 2: Performance Section, OMB Circular A-136 requires agencies to report in the Management's Discussion and Analysis section of the annual report objective and relevant performance measures that disclose the extent to which programs are achieving their intended objectives. Our audit determined BLM is not reporting relevant and timely performance measure information in Management's Discussion and Analysis.

SFFAS No. 8, *Supplementary Stewardship Reporting*, paragraph 81, establishes minimum reporting requirements for stewardship land. These requirements require BLM to report in its stewardship section of its annual report the condition of stewardship land. Our audit determined BLM's disclosures on the condition of stewardship lands are substantially not complete, and BLM is not meeting its reporting responsibilities to the general public by not reporting, in its annual report, the results of condition assessments conducted as part of its general operations.

SFFAS No. 8, *Supplementary Stewardship Reporting*, paragraph 50, establishes minimum reporting requirements for museum collections. These requirements require BLM to report in its stewardship section of its annual report the condition of museum collections. Our audit determined BLM's disclosures on the condition of such collections are substantially not complete, given BLM has not assessed a large number of the nonfederal facilities containing BLM museum collections, and such assessments don't address the underlying condition of the individual museum items.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 83, establishes minimum reporting requirements for deferred maintenance. These requirements require BLM to report in its deferred maintenance section of its annual report deferred maintenance for each major class of asset, which includes stewardship land. BLM has not reported in its annual report any deferred maintenance costs related to stewardship land.

Recommendation

We recommend BLM strengthen its policies and procedures to ensure performance measure information, reported in Management's Discussion Analysis; the condition of stewardship land and museum collections, reported as Required Supplementary Stewardship Information; and the amount of deferred maintenance for stewardship land, reported as Required Supplementary Information, are prepared in accordance with federal accounting standards.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our recommendation to improve the reporting of performance measure information in the Management's Discussion and Analysis section of the annual report. As discussed in the sections of our report entitled Internal Control over Required Supplementary Stewardship Information and Internal Control over Required Supplementary Information, management did not agree with our recommendations to improve disclosures on the condition of stewardship land and the condition of museum collections and to identify and report the amount of deferred maintenance for stewardship land.

Auditors' Response to Management's Response

As discussed in the sections of our report entitled Internal Control over Required Supplementary Stewardship Information and Internal Control over Required Supplementary Information, federal accounting standards require BLM to report in its annual report the condition of stewardship land, the condition of museum collections, and the amount of deferred maintenance for stewardship land. We believe BLM needs to improve its reporting in these areas to meet the requirements of the federal accounting standards.

Responsibilities

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA), *Accountability of Tax Dollars Act, and Government Corporation Control Act* require agencies each 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 assist the Department of the Interior in meeting these requirements, BLM prepares 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 Stewardship Information, and Required Supplementary Information;
- Establishing and maintaining internal controls over financial reporting; and

- Complying with laws, regulations, contracts, and grant agreements, including FFMIA.

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

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2005 and 2004 financial statements of BLM 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 BLM'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 BLM's internal control over financial reporting by obtaining an understanding of BLM's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on BLM'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 BLM's internal control over Required Supplementary Stewardship Information by obtaining an understanding of BLM's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over Required Supplementary Stewardship Information, and accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis section, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over reported performance measures, and accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether BLM's fiscal year 2005 financial statements are free of material misstatement, we performed tests of BLM'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 BLM. 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 BLM's financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

Distribution

This report is intended solely for the information and use of BLM'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 4, 2005, except for Note 22,
which is as of November 16, 2005

Exhibit I

BLM

Summary of the Status of Prior Year
Reportable Conditions and Significant Deficiencies

September 30, 2005

Ref	Condition	Status
A	Accounting for Mineral Leases	Condition has been downgraded from a material weakness in the prior year to a reportable condition in fiscal year 2005. See fiscal year 2005 reportable condition C.
B	Security and Internal Control Over Information Technology Systems	Condition has not been corrected and is repeated in fiscal year 2005. See fiscal year 2005 reportable condition A.
C	Internal Control Over Charge Cards	Condition has been corrected.
D	Internal Control Over Payments in Lieu of Taxes (PILT)	Condition no longer applies to BLM. PILT program has been transferred to another DOI agency.
E	Reporting the Condition of Stewardship Land	Deficiency has not been corrected and is repeated in fiscal year 2005. See fiscal year 2005 significant deficiency F.
F	Reporting the Number of Museum Items Held in Nonfederal Facilities	Deficiency has been corrected. SFFAS No. 29, *Heritage Assets and Stewardship Land*, provided clarification on reporting museum collections. SFFAS No. 29 allowed agencies to report the number of museum collections at the facility level as opposed to the individual object level.
G	Reporting of Deferred Maintenance Amounts for Stewardship Land	Deficiency has not been corrected and is repeated in fiscal year 2005. See fiscal year 2005 significant deficiency H.

ATTACHMENT 2

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240
http://www.blm.gov

TAKE PRIDE IN AMERICA

DEC 2 2 2005

In Reply Refer to:
1306 (BC-610)

MEMORANDUM

To: Assistant Inspector General for Audits
Attention: Anne L. Richards

From: for Kathleen Clarke Lawrence E. Benna
Director, Bureau of Land Management

Subject: Draft Independent Auditors' Report on the Bureau of Land Management's (BLM) Financial Statements for Fiscal Years 2005 and 2004 (Assignment No. X-IN-BLM-0012-2005)

Thank you for the opportunity to review and comment on the above-referenced draft report. We appreciate the efforts that the Office of Inspector General and KPMG have provided on our behalf. The BLM's written comments and responses are detailed in the attachment.

If you have any questions regarding this response, please contact Jeannette Davis-Callahan, BLM National Business Center, at (303) 236-7396.

1 Attachment
1 – Response to Auditor's Report above (8 pp)

Draft Independent Auditors' Report on the Bureau of Land Management's
Financial Statements for Fiscal Years 2005 and 2004
(Assignment No. X-IN-BLM-0012-2005)

Recommendation A: Security and Internal Control over Information Technology Systems

The BLM should continue the development and implementation of procedures to improve the internal security and general controls over its information technology systems. Improved procedures should address the areas discussed in the Independent Auditor's Report, as well as other areas that might impact the electronic data processing control environment, to ensure adequate security and protection of BLM's financial management systems.

Response:

The BLM concurs with the recommendations. The following actions will be taken to address the specific items noted.

Employee Termination Procedures

The BLM will develop formal policy and guidance for its information technology systems for separation of employees. Current policies will be evaluated for secondary controls. NHRMC will query the FPPS database on a bi-weekly basis to ensure terminated employees are out of the critical systems. Further control processes for performing timely periodic reviews will be established by all responsible divisions within the BLM.

Contractor User IDs on the BLM's Active Directory

The BLM will conduct an inventory of all user accounts; all unused accounts will be removed from the BLM's systems. Additionally, all used accounts will be checked for legitimacy. The BLM will develop a standardized contractor separation procedure and work with the contractor project managers and their representatives to ensure that the BLM is notified in a timely manner when contract personnel leave the BLM.

Significant Number of Generic User IDs

The BLM will conduct an inventory of all generic user accounts. All generic accounts that are not assigned to a specific person and justified in writing will be removed from the BLM's systems. Procedures will be developed to establish a standardized methodology and justification for establishing non-user accounts.

Lack of Approvals over BLM User Access to Federal Personnel Payroll System (FPPS)

The BLM will reissue an Instruction Memorandum instructing State/Center/Office Personnel Officers to review current users accessing FPPS for clearly defined need to access the system. The Human Resource Officers will provide copies of all access forms to the National Human Resources Management Center (NHRMC). Those individuals without an access form will be deleted from the system. NHRMC and Human Resource Officers will review system access on a quarterly basis.

Lack of Documentation Supporting Periodic Reviews of User Access in the Collections and Billings System (CBS) and Interior Department Electronic Acquisition System (IDEAS)
The CBS and IDEAS Management Teams will develop formal policy and procedures to establish timely periodic reviews of user access listings and to assign appropriate personnel to perform the review.

Lack of a Process for Ensuring Production Databases Are Configured with a Common Baseline Security Configuration
The finding is valid for three non-financial systems. The BLM will investigate the use of automated security tools to provide periodic audits of the Oracle database passwords. The only Oracle-based financial system identified is IDEAS, which had no default username and password combination during FY 2005.

Recommendation B: Adequate Segregation of Duties
The BLM should implement procedures to ensure critical duties of the purchasing function are adequately segregated at all offices. If segregation of duties can not be established, then additional periodic management reviews of the purchasing functions should be performed to ensure transactions are accounted for properly and do not contain instances of theft or fraud.

Response:
The BLM partially concurs with the recommendation. The BLM agrees additional approvals are needed and recommends that approvals be performed by an individual other than the person making the award for the National Training Center (NTC). This will require additional access to IDEAS by a Contracting Officer (Purchasing Agent) for approval authority of Purchase Requests.

KPMG identified 45 issues related to segregation of duties for 13 IDEAS users. Of the 45 instances, there were only 2 cases that did not have a hard-copy Purchase Request (PR) signed by a supervisor in the official file folder. The BLM disagrees that a review should be performed solely within the electronic application. The official file folder is the hard-copy award folder. Therefore, the risk is minimal because the official file copy contains a PR with a supervisor's signature.

Recommendation C: Accounting for Mineral Leases
The BLM should improve its policies and procedures over the accounting for mineral lease activity and the transfer of monies to MMS.

Response:
The BLM concurs with the recommendation. The BLM will improve its policies and procedures over accounting for mineral lease activity and the transfer of monies to MMS.

Recommendation D: Recording Year-end Liabilities
BLM should improve its procedures over the identification and recording of year-end liabilities related to undistributed collections. Specifically, BLM needs to improve its

year-end analysis of undistributed collection amounts to identify unusual account relationships that exist between collection and transfer accounts. In addition, appropriate controls should be implemented to ensure the review is conducted.

Response:
The BLM concurs with the recommendation.

The BLM performs monthly and quarterly general ledger account analytic reviews. During FY 2006, an edit check will be incorporated into this process to ensure proper general ledger account postings within the unavailable special receipt funds.

Recommendation E: Reporting of Performance Measure Information in Management's Discussion and Analysis
The BLM should include in its Management's Discussion and Analysis section performance measures related to its significant programs, which include the wildland fire management, land sales, and helium programs.

The BLM should revise its performance data collection processes to allow for up-to-date accomplishments to be reported for all performance targets.

Response:
The BLM concurs with the recommendations.

The BLM agrees to report performance measures for wildland fire management, land sales, and helium sales.

> In 2005 and earlier years, the Office of Fire and Aviation reported the GPRA measures on a Department-wide basis, so the BLM did not include BLM-specific information for these measures in the Performance and Accountability Report (PAR). However, the BLM has collected and reviewed this information on a Bureau-wide basis and agrees to include BLM-specific results for these measures in FY 2006.
>
> The BLM acknowledges that there were no efficiency measures for the land sales program in 2005. However, the BLM has developed one efficiency measure as a result of the PART process that examined the Southern Nevada Public Land Management Act program. This measure assesses the timeliness of the BLM's ability to offer land parcels for sale within 12 months of being nominated, thus measuring the BLM's responsiveness to the local government and the community. The BLM is in the process of implementing the measure and collecting performance information.
>
> The BLM has identified the need to develop appropriate performance measures for the helium program; we are developing these measures for finalization during FY 2006.

The BLM will develop a process to collect performance results in a timely manner for inclusion in its annual report

Recommendation F: Reporting the Condition of Stewardship Land
To provide more useful and meaningful information to the readers of BLM's annual report, BLM should consider the intent of the federal accounting standards in reporting the condition of its stewardship land and adhere to the principles incorporated in FASAB's commissioned Stewardship Guidance Work Group draft report, *Reporting and Assurance Guide for Stewardship Land (SL) and Heritage Assets (HA).*

Response:
The BLM does not concur with the recommendation.

Based on FASAB's authoritative pronouncements in Standards 8 and 29, the BLM believes that its reporting was done in accordance and fully in compliance with the current standards. On the other hand, the finding relies almost entirely not on officially issued standards but rather on a draft report, *Reporting and Assurance Guide for Stewardship Land (SL) and Heritage Assets (HA).* While the draft report was prepared by the Stewardship Guidance Work Group, which was commissioned by FASAB's Accounting and Auditing Committee and even included BLM and other Interior participation for the product, we believe retrospectively that the draft report was, at the very least, premature in much of its discussion relating to condition information.

The finding fails to take into consideration crucial language found in FASAB Standards 8 and 29 themselves. According to SFFAS 8, Paragraph 71, "'Land' is defined as the solid part of the surface of the earth. *Excluded* [emphasis added] from the definition are the natural resources (that, is depletable resources, such as mineral deposits and petroleum; renewable resources, such as timber; and the outer-continental shelf resources) related to land." The same identical definition of land is found in SFFAS 29, Paragraph 34. Footnote 17 to the latter states, "The Board presently has an active project to address standards for natural resources, for which the Board is considering developing individual standards for each type of natural resource separately. To begin the project, the Board will be addressing oil and gas resources. The framework for the oil and gas resource phase of the project will be used as a model when addressing the other types or logical sets of natural resources (e.g., timber, grazing land, solid leasable minerals) in subsequent phases of the project." FASAB in a very straightforward manner is clearly distinguishing between land as essentially rock and sediment from any type of natural resource.

The Department of the Interior has taken the position that it "will not perform formal condition assessments of stewardship land. Likewise, the Department will not perform parcel-by-parcel reviews of stewardship land, which would not be feasible or cost-effective."

The BLM has stewardship responsibilities over the natural resources on its lands and provides condition assessments on selected resources in the BLM's *Public Land Statistics* (PLS) and other reporting. For example, approximately 159 million acres of the BLM's

261 million acres is found within grazing allotments, and reporting on the vegetation on these lands is found in PLS Table 2-1, "Percent of Rangeland Acreage by Ecological Status by State." However, SFFAS 29 clearly states that FASAB will be addressing grazing land as a resource in future guidance, and there is currently no reporting requirement for this resource, particularly given FASAB's current definition of "land."

In light of BLM's multiple-use mission as defined by the Federal Land Policy and Management Act (FLPMA) of 1976, we believe that defining "acceptable" condition for "rock and sediment" in terms of "when it is adequate for the uses authorized during the period of the report" and the "needs intervention" condition category in terms of "not supporting any of the uses authorized during the period of the report" is entirely reasonable, useful, valid, and fully in accord with SFFAS 8 and 29. Using these definitions, the BLM can state that the condition of the Public Lands is "acceptable."

<u>Recommendation G:</u> Reporting the Condition of Museum Collections
BLM should continue to complete its review of the nonfederal facilities in accordance with the Department of the Interior's guidance and consider such information in determining the condition of museum collections. However, for financial reporting purposes, the assessment of museum collections should ultimately address the underlying condition of the individual items as opposed to the facility housing those items. If BLM does not know the condition of the individual items, then such a statement should be made in the annual report along with the reasons why such condition is unknown.

<u>Response:</u>
The BLM does not concur with the recommendation.

The BLM believes that collections in non-Federal facilities do not meet the SFFAS 6 criteria for being classified as BLM property. The collections in non-Federal facilities were not gathered for use by the BLM and the BLM does not plan to use them for any Federal purpose. The BLM does not intend to recover museum objects from the non-Federal facilities. As such, the BLM has only a reversionary interest in these items. Based on these considerations, a letter was sent to FASAB requesting a decision on whether or not museum collections in non-Federal facilities are in fact BLM property and should be included in reporting of heritage assets. At this point, a response has not been received from FASAB. However, the BLM continues to work with other agencies and bureaus within the Department of the Interior to secure information on the non-Federal facilities.

The recommendation and its associated findings reflect a significant departure from the requirements of SFFAS 29. Moreover, the recommendation indicates a fundamental misunderstanding of condition reporting related to museum collections. SFFAS 29 states the following:

- Paragraph 81: "The standard emphasizes reporting on asset categories, rather than individual assets."

- Paragraph 84: "Defining physical units as individual items to be counted is neither required nor prohibited. Particularly for collection-type heritage assets, it may be more appropriate to define the physical unit as a collection, or a group of assets located at one facility, and then count the number of collections or facilities."

The recommendation directs the BLM to report museum collection information on an individual item basis for condition information. This is not required by SFFAS 29. Furthermore, reporting condition on individual museum collection items is at best a highly nebulous concept. Museum collections cannot be subject to the same condition standards as personal property. Pre-historic pottery, for example, that is retrieved from an archaeological dig in broken pieces ("shards") cannot be deemed to be in "poor" condition. The pottery shards may be glued together to recreate a partial or even an entire pottery piece, but the pottery is nevertheless still broken. The original condition in which the item was found cannot be reversed, but the item could deteriorate beyond the condition in which it was found through improper care. The emphasis for reporting museum collection condition information is correctly placed on the facility housing the museum collection itself, because the facility itself determines whether the collection is in stable condition. Numerous factors such as temperature, relative humidity, and dust and pest control are used to evaluate facilities to determine their ability to minimize any deterioration that could happen to its contents. This methodology is consistent with standard professional museum practice as recommended by museum conservators and museum associations. Moreover, attempting to do an item-by-item condition assessment could very well result in additional damage to museum collections through unnecessary handling, so it is therefore not a general museum practice to conduct such assessments.

The BLM reported condition information on museum collections in accordance with Departmental policy, standards, and guidance. The Department determined that the most relevant information in assessing condition of museum collections is the stability of the environment in which the collection is housed. This methodology was recommended by the Department-wide Interior Museum Property Committee (composed of museum professionals representing all Interior bureaus and offices) and approved by both the Department's Museum Program and the Assistant Secretary for Policy, Management, and Budget. This methodology is also consistent with performance measures in the Department's strategic plan.

Recommendation H: Reporting of Deferred Maintenance Amounts for Stewardship Land

BLM should develop a process, consistent with accounting principles generally accepted in the United States of America, for estimating deferred maintenance costs on stewardship land. Such costs should encompass land that is in need of intervention and future outlays of efforts and monies are necessary to bring the land into an acceptable condition.

Response:

The BLM does not concur with the recommendation.

Unlike buildings and machinery, land (defined by FASAB "as the solid part of the surface of the earth," i.e., rock and sediment) and the natural resources on land (minerals, trees, shrubs, water, grass, wildlife and fish, etc.) are not subject to periodic and/or recurring maintenance (the act of keeping fixed assets in a usable condition). As such, natural resources are not subject to deferred maintenance (postponed maintenance). Instead, land and the resources on land are subject to the forces of nature and man has only limited ability to influence the results of natural forces and no ability to know in advance what the location and results of those natural forces will be. Additionally, some of the effects of various natural events, such as fires, while initially seeming detrimental are actually beneficial to the long-term health of the land and its resources. For these reasons, the concept of "maintenance of fixed assets" does not apply to natural resources and the BLM does not schedule or defer maintenance activities on the natural resources that exist on the public lands. The Department of the Interior has taken the following position:

> The Department has determined that stewardship land managed by the Department does not have deferred maintenance as defined by SFFAS No. 6. Accordingly, deferred maintenance estimates will not be included in the Performance and Accountability Report for either stewardship land or for heritage assets comprising primarily land and natural features. For these reasons, the Department does not impose a reporting requirement for bureaus to estimate and report deferred maintenance for bureau stewardship land in their respective financial statements.

This situation is both recognized and supported by the Office of Management and Budget. OMB Circular A-136 (Financial Reporting Requirements) states under Section 11.2 (Deferred Maintenance), "Determination of acceptable condition, therefore, affects the amounts of deferred maintenance. In some cases, such as heritage assets and stewardship land, management may determine that maintenance is not needed. In that case, deferred maintenance would not exist."

The finding cites the BLM's Budget Justifications and other documents to show that the BLM does devote substantial attention and resources to natural resource treatments when and if inventory, assessment, and/or monitoring activities disclose that current resource conditions do not meet the objectives for one or more of the uses authorized at that time for a given tract of land. However, resource treatments are not maintenance and are never identified as such. Unlike regularly scheduled routine or preventative maintenance or repairs, resource treatments often consist of altering use on an as-needed, ad hoc basis and then letting nature take its course. Resource treatments take many forms, such as adjusting or withholding use, chemical or mechanical activities, plantings, seeding, prescribed fire, etc. Treatments are not typically applied universally, cyclically, annually, periodically, or in any other manner that is subject to recurring actions that can be planned or scheduled for defined tracts of land.

Recommendation I: Federal Accounting Standards
We recommend BLM strengthen its policies and procedures to ensure performance measure information, reported in Management's Discussion Analysis; the condition of stewardship land and museum collections, reported as Required Supplementary Stewardship Information; and the amount of deferred maintenance for stewardship land, reported as Required Supplementary Information, are prepared in accordance with federal accounting standards.

Response:

Performance Measure Information
The BLM concurs with the recommendation and, as discussed in recommendation E, will develop a process to collect and report performance measures for wildland fire management, land sales, and helium sales.

Condition of Stewardship Land
As discussed in recommendation F, the BLM does not concur with the recommendation to consider and adhere to standards and principles of FASAB's commissioned Stewardship Guidance Work Group. The BLM believes that its reporting was done in compliance with the current standards and guidance from the Department of the Interior.

Condition of Museum Collections
As discussed in recommendation G, the BLM does not concur with the recommendation to follow DOI's guidance as well as report the condition of individual items as opposed to the facility housing those items. The BLM reported condition information on museum collections in accordance with Departmental guidance and SFFAS 6 and 29.

Deferred Maintenance Amounts for Stewardship Land
The BLM does not concur with the recommendation. As discussed in recommendation H, the BLM feels that land and natural resources are not subject to recurring maintenance as defined in SFFAS 6.

ATTACHMENT 3

STATUS OF AUDIT REPORT RECOMMENDATIONS

Recommendation	Status	Action Required
A, C, D, E.1, and E.2	Resolved; not implemented.	Recommendation will be referred to the Assistant Secretary, Policy, Management and Budget for tracking of implementation.
B and I F.1, F.2, F.3, F.4, G, and H	Unresolved.	Recommendation will be referred to the Assistant Secretary, Policy, Management and Budget for resolution.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

November 18, 2005

Memorandum

To: Secretary

From: Earl E. Devaney
Inspector General

Subject: Independent Auditors' Report on the Department of the Interior's Special Purpose Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-MOA-0002-2006)

INTRODUCTION

The Department of the Interior (DOI) contracted with KPMG LLP, an independent certified public accounting firm, to audit the special purpose financial statements for fiscal years 2005 and 2004. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget's Bulletin 01-02, as amended, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency's *Financial Audit Manual.*

FINDINGS

In its audit report dated November 17, 2005, KPMG issued an unqualified opinion on DOI's special purpose financial statements. However, KPMG identified one reportable condition in DOI's internal controls over the closing package process, which was not considered to be a material weakness. KPMG's tests of compliance with the requirements of Chapter 4700 of the Department of the Treasury's *Treasury Financial Manual* (TFM), disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

KPMG is responsible for the attached auditors' report and for the conclusions expressed in the report. We do not express an opinion on DOI's special purpose financial statements, conclusions on the effectiveness of internal controls over the financial reporting process for the special purpose financial statements, or conclusions on compliance with TFM Chapter 4700.

DOI CORRECTIVE ACTIONS

In its response to the draft report, DOI agreed with the finding. DOI stated that it will continue to improve its controls over the classification and reporting of financial information in Treasury's Government-wide Financial Reporting System.

REPORT DISTRIBUTION

The legislation, as amended, creating the Office of Inspector General (5 U.S.C.A. App. 3) requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report. The distribution of the report is not restricted, and copies are available for public inspection.

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

Attachment

cc: Chief Financial Officer
Deputy Chief Financial Officer
Director, Office of Financial Management
Audit Liaison Officer
Focus Leader for Management Control and Audit Follow-up,
Office of Financial Management

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Special-Purpose Financial Statements

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

We have audited the accompanying Closing Package Financial Statement Reports – Balance Sheets as of September 30, 2005 and 2004, the related Closing Package Financial Statement Reports – Statements of Net Cost and Statements of Changes in Net Position for the years then ended, and the accompanying Financial Report (FR) Notes Detail Report (hereinafter referred to as the special-purpose financial statements) contained in the closing package of the U.S. Department of the Interior (Interior). These special-purpose financial statements are the responsibility of Interior's management. Our responsibility is to express an opinion on these special-purpose financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the special-purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the special-purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall special-purpose financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with the requirements of Chapter 4700 of the Department of the Treasury's *Treasury Financial Manual* (TFM), as described in Additional Note No. 22, solely for the purpose of providing financial information to the U.S. Department of the Treasury and the Government Accountability Office (GAO) to use in preparing and auditing the *Financial Report of the U.S. Government*, and are not intended to be a complete presentation of Interior's consolidated financial statements. Interior prepared FR Notes Detail Report Nos. 1 through 21, except for 10 and 16, which were not applicable to Interior. Interior added one note to the special-purpose financial statements, specifically Additional Note No. 22, *Summary of Significant Accounting Policies*, to disclose other data not contained in the special-purpose financial statements, but which is necessary for full disclosure. Interior also prepared Other Data Detail Report Nos. 1 through 18, except for 6 through 12, and 15 through 18, which were not applicable to Interior.

In our opinion, the special-purpose financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of the Interior as of September 30, 2005 and 2004, and its net costs and changes in net position for the years then ended in conformity with accounting principles generally accepted in the United States of America and the presentation pursuant to the requirements of *TFM Chapter 4700.*

KPMG

The accompanying "previously reported" special-purpose financial statements and the related "previously reported" data and "line item changes" presented in the FR Notes Detail and Trading Partner Summary Reports were not audited by us and accordingly, we do not express an opinion thereon.

As discussed in FR Notes Detail Report No. 17 to the special-purpose 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.

The information included in the Other Data Detail Report Nos. 4, 5, 13, and 14 and the information presented in the Trading Partner Summary Reports is presented for the purpose of additional analysis and is not a required part of the special-purpose financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America and the *TFM Chapter 4700.* 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 information included in the Other Data Detail Report Nos. 4, 5, 13, and 14 and the information presented in the Trading Partner Summary Reports are not presented in conformity with accounting principles generally accepted in the United States of America and the *TFM Chapter 4700.* The information in the Other Data Detail Report Nos. 4, 5, and 13 is not complete, current or consistently supported because Interior did not consistently follow its established procedures and controls to accumulate and report the information and did not disclose all required information. In addition, the information in the Other Data Detail Report No. 14 is not complete or current because Interior had not estimated deferred maintenance for all assets and did not consistently update deferred maintenance estimates. Finally, Interior did not fully reconcile intragovernmental transactions and balances with its trading partners.

Our audits were conducted for the purpose of forming an opinion on the special-purpose financial statements taken as a whole. The other accompanying information presented in the Other Data Detail Report Nos. 1, 2, and 3 is not a required part of the special-purpose financial statements and is presented for purposes of additional analysis. This information has been subjected to the auditing procedures applied in the audits of the special-purpose financial statements and, in our opinion, is fairly stated in all material respects in relation to the special-purpose financial statement taken as a whole.

The information in the sections entitled "Threshold" in FR Notes Detail Report Nos. 2, 3, 4A, 4B, 5, 6, 12, 15, and 19; the information entitled "Threshold" in the Other Data Detail Report No. 13; the information in the sections entitled "Text Data" in FR Notes Detail Report Nos. 4A and 4B; the information in the sections "Other Notes Info – Section C" in FR Notes Detail Report No. 5; the information in the sections entitled "Line Item Notes" and "Other Notes Info – Section C" in FR Notes Detail Report No. 6; the information in "Other Notes Info – Section C – Claim Amount (Unable to Determine Loss)" and "Other Notes Info – Section D – Claim Amount (Unable to Determine)"in FR Notes Detail Report No. 18; the information in the Reclassification Journal Voucher Report – Summary Level; and the information not included as components of the closing package described in Additional Note No. 22, have not been subjected to the auditing procedures applied in the audit of the special-purpose financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 01-02, we have also issued a combined independent auditors' report dated November 15, 2005, which presents our opinion on Interior's consolidated financial statements; our consideration of Interior's internal control over financial reporting; and the results of our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. That report is an integral part of the audits of Interior's consolidated financial statements, as of and for the years ended September 30, 2005 and 2004, performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 01-02, and should be read in conjunction with this report in considering the results of our audits of the special-purpose financial statements. Our audit of the Interior consolidated financial statements as of and for the year ended September 30, 2005, disclosed the following material weaknesses, reportable conditions, significant deficiencies, and compliance matters:

Material Weaknesses:

A. Controls over implementing new accounting policies and procedures

B. Controls over the Indian Trust funds

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

Significant Deficiencies:

O. Performance measure reporting

P. Deferred maintenance estimates

Q. Stewardship reporting

Compliance Matters:

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*

In planning and performing our audit of the special-purpose financial statements, we also considered Interior's internal control over financial reporting for the special-purpose financial statements and its compliance with *TFM Chapter 4700*. Management is responsible for establishing and maintaining internal control over financial reporting, including required supplementary information and other accompanying information, and for complying with laws, regulations, contracts, and grant agreements, including compliance with *TFM Chapter 4700* requirements.

Our consideration of internal control over financial reporting for the special-purpose financial statements 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 special-purpose 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 special-purpose 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.

We noted one matter, described below, involving internal control over financial reporting for the special-purpose financial statements and its operation that we consider to be a reportable condition. We believe that the reportable condition is not a material weakness. The objective of our audit was not to provide assurance on Interior's internal control over financial reporting for the special-purpose financial statements. Consequently, we do not provide an opinion thereon.

Condition

Interior did not establish sufficient controls to ensure that amounts were properly classified in the special-purpose financial statements, because we identified several hundred million dollars of reclassification adjustments necessary for the special-purpose financial statements. In addition, Interior did not consistently ensure that the disclosures agreed to Interior's records, because we identified various differences between the disclosures and supporting documents. As a result of our observations, Interior analyzed and adjusted its special-purpose financial statements and related disclosures.

Recommendation

We recommend that Interior improve controls to ensure that transactions are properly classified and reported in accordance with the requirements of the *TFM Chapter 4700* as follows:

- Continue to issue guidance to Interior components reminding them of the requirements to classify transactions in the same general ledger accounts.
- Review the classification and use of general ledger accounts for each Interior component to ensure consistency across Interior components and between fiscal years.
- Require at least one individual, not involved in preparing the special-purpose financial statements and disclosures, to agree all of the special purpose financial statements and disclosures to the supporting documentation. This individual should ensure that all differences are resolved and document their review and approval process.

KPMG

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.

Our tests of compliance with *TFM Chapter 4700* requirements disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02. However, providing an opinion on compliance with *TFM Chapter 4700* requirements was not an objective of our audit of the special-purpose financial statements and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of Interior's management, Interior's Office of Inspector General, the Department of the Treasury, OMB, and the GAO, in connection with the preparation and audit of the *Financial Report of the U.S. Government,* and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 17, 2005

United States Department of the Interior

OFFICE OF THE ASSISTANT SECRETARY
POLICY, MANAGEMENT AND BUDGET
Washington, DC 20240

TAKE PRIDE IN AMERICA

NOV 18 2005

Memorandum

To: Earl E. Devaney
Inspector General

KPMG LLP
2001 M. Street, N.W.
Washington, D.C. 20036

From: P. Lynn Scarlett P Lynn Scarlett
Assistant Secretary – Policy, Management and Budget

Subject: Management Response to Draft Independent Auditors' Report for Fiscal Year 2005 (Report No. X-IN-MOA-0002-2006)

The Department has reviewed the draft report for the special purpose financial statements and provides its response to the finding and recommendation.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Reportable Condition

A. <u>Accounting policies and procedures</u>

Management concurs. Interior will continue to improve its controls over the classification and reporting of financial information in Treasury's Governmentwide Financial Report System.

We appreciate the value of the audit process and look forward to working with you to continue our marked improvement of financial management in the Department of the Interior.

Report No. X-IN-MOA-0013-2006

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

December 2, 2005

Government Accountability Office
Attn: Lynda Downing
441 G Street, NW, Room 5V09
Washington, DC 20548

Dear Ms. Downing:

Enclosed is the report for the Department of the Interior (DOI) on "Applying Agreed-Upon Procedures for Intragovernmental Activity and Balances." This report is required by the U. S. Department of the Treasury's *Treasury Financial Manual*, Transmittal Letter No. 623, dated May 6, 2005. The report was prepared by KPMG LLP, an independent certified public accounting firm, under contract with DOI. The contract required that KPMG conduct its agreed-upon procedures engagement in accordance with the standards applicable to attestation engagements contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States; attestation standards established by the American Institute of Certified Public Accountants; and the Government Accountability Office/President's Council on Integrity and Efficiency's *Financial Audit Manual*.

KPMG is responsible for the enclosed report and for the conclusions expressed in the report. If you have any questions regarding the report, please contact me at (202) 208-5512 or Mr. Joseph Ansnick, Director of Financial Audits, at (202) 208-5659.

Sincerely,

Anne L. Richards

Anne L. Richards
Assistant Inspector General for Audits

Enclosure

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Accountants' Report on Applying Agreed-Upon Procedures for Intragovernmental Activity and Balances

Office of Inspector General,
U.S. Department of the Interior

We have performed the procedures enumerated in Exhibit A (attached), which were based on the procedures stated in the U.S. Department of Treasury's (Treasury) *Treasury Financial Manual*, Transmittal Letter No. 623, dated May 6, 2005, solely to assist the U.S. Department of the Interior (Department) Office of Inspector General (OIG) in evaluating the Department's assertion that it properly reported intragovernmental activity and balances in the Department's consolidated financial statements as of and for the year ended September 30, 2005, and in its *2005 Financial Report of the United States Government Closing Package* (*Closing Package*) submission to Treasury. The Department's management is responsible for the proper accounting, presentation, and reporting of its intragovernmental activity and balances, consolidated financial statements, and *Closing Package*.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. These procedures were based on procedures agreed to by, and the sufficiency of these procedures is solely the responsibility of, the Office of Management and Budget (OMB), the Treasury Financial Management Service (FMS), and the U.S. Government Accountability Office (GAO). Consequently, we make no representations regarding the sufficiency of the procedures described in Exhibit A either for the purpose for which this report has been requested or for any other purpose. The procedures we performed and our associated findings are presented in Exhibit A.

We were not engaged to, and did not, conduct an audit of the information addressed herein, the objective of which would be the expression of an opinion on such information. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Department, the Department's OIG, OMB, FMS, and GAO, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 1, 2005

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Procedures and Findings

Procedure 1

Obtain all *Intragovernmental Closing Package Line Item Reports* from Module 4 of the Governmentwide Financial Report System (GFRS) for intragovernmental activity/balances supporting the *Closing Package*:

- Reclassified Balance Sheet's Federal Assets and Liabilities,
- Reclassified Statement of Net Cost's Federal Gross Cost and Federal Earned Revenue, and
- Reclassified Statement of Changes in Net Position's Federal Nonexchange Revenue and Budgetary and Other Financing Sources.

Finding 1

A. We obtained the following "Intragovernmental Closing Package Line Item Reports" from Module 4 of the GFRS (hereinafter referred to as the Line Item Reports) for intragovernmental activity/balances supporting the "Closing Package:"

- *Reclassified Balance Sheet's Federal Assets and Liabilities*
- *Reclassified Statement of Net Cost's Federal Gross Cost and Federal Earned Revenue*
- *Reclassified Statement of Changes in Net Position's Federal Nonexchange Revenue and Budgetary and Other Financing Sources*

B. We also obtained the following "Trading Partner Identification Screen Reports" from Module 4 of the GFRS (hereinafter referred to as the Schedules) for intragovernmental activity/balances supporting the "Closing Package:"

1) Balance Sheet
- *Federal Investments*
- *Accounts Receivable*
- *Interest Receivable*
- *Loans Receivable*
- *Advances to Others and Prepayments*
- *Transfers Receivable*
- *Accounts Payable*
- *Interest Payable*
- *Loans Payable*
- *Advances from Others and Deferred Credits*

- *Other Liabilities (without reciprocals)*
- *Transfers Payable*
- *Benefit Program Contributions Payable*

2) Statement of Net Cost

- *Imputed Costs*
- *Benefit Program Costs*
- *Buy/Sell Costs*
- *Federal Securities Interest Expense*
- *Other Costs (without reciprocals)*
- *Buy/Sell Revenue*
- *Federal Securities Interest Revenue (exchange)*
- *Borrowing and Other Interest Expense*
- *Borrowing and Other Interest Revenue (exchange)*

3) Statement of Changes in Net Position

- *Other Financing Sources (custodial activity)*
- *Unexpended Appropriations transferred in*
- *Unexpended Appropriations transferred out*
- *Appropriation transfers-out*
- *Other Financing Sources*
- *Transfers-in Without Reimbursement*
- *Transfers-out Without Reimbursement*
- *Imputed Financing Source*
- *Federal Securities Interest Revenue*
- *Appropriation transfers-in*
- *Borrowing and other interest revenue*

Procedure 2

Compare the *Line Item Reports* intragovernmental activity/balances by Federal line item totals and/or trading partner activity/balances to the agency's general ledger and the Required Supplementary Information (RSI) data from the audited consolidated financial statements. Identify any differences.

Finding 2

A. *We compared the fiscal year 2005 intragovernmental balances for each Federal line item total from the "Line Item Reports" to the RSI data from the Department's audited consolidated financial statements.*

We identified the following differences, excluding rounding differences equal to or less than $2,000:

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Description	Balance Per Schedules (000s)	Balance Per RSI (000s)	Difference (000s)	Explanation
Federal Investments	$ 7,441,454	$ 7,463,669	$ (22,215)	1
Accounts Receivable	$ 498,332	$ 508,677	$ (10,345)	1
Interest Receivable	$ 31,813	$ -	$ 31,813	1
Loans Receivable	$ 2,458,075	$ 2,458,075	$ -	1
Advances to Others and Prepayments	$ 1,405	$ -	$ 1,405	1
Transfers Receivable	$ 747	$ -	$ 747	1
Accounts Payable	$ 395,957	$ 79,881	$ 316,076	1
Interest Payable	$ 822,689	$ -	$ 822,689	1
Loans Payable	$ 397,836	$ -	$ 397,836	1
Advances from Others and Deferred Credits	$ 1,624,226	$ -	$ 1,624,226	1
Other Liabilities (without reciprocals)	$ 3,015,503	$ 5,577,057	$ (2,561,554)	1
Transfers Payable	$ 439,930	$ -	$ 439,930	1
Benefit Program Contributions Payable	$ 181,322	$ -	$ 181,322	1
Debt	$ -	$ 1,220,525	$ (1,220,525)	4
Other	$ -	$ 1,405	$ (1,405)	4
Balance Sheet Total	**$ 17,309,289**	**$ 17,309,289**	**$ -**	
Imputed Costs	$ 544,978	$ -	$ 544,978	3
Benefit Program Costs	$ 1,070,200	$ -	$ 1,070,200	3
Buy/Sell Costs	$ 582,616	$ -	$ 582,616	3
Federal Securities Interest Expense	$ 76	$ -	$ 76	3
Other Costs (without reciprocals)	$ 239	$ -	$ 239	3
Borrowing and other Interest Expense	$ 25,662	$ -	$ 25,662	3
Total Expense	**$ 2,223,771**	**$ -**	**$ 2,223,771**	3
Buy/Sell Revenue	$ 2,974,165	$ -	$ 2,974,165	2
Federal Securities Interest Revenue (exchange)	$ 43,917	$ -	$ 43,917	2
Borrowing and Other Interest Revenue (exchange)	$ 153,760	$ -	$ 153,760	2
Total Revenue	**$ 3,171,842**	**$ 3,171,842**	**$ -**	
Unexpended Appropriations Transferred In	$ 123,814	$ -	$ 123,814	2

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Description	Balance Per Schedules (000s)	Balance Per RSI (000s)	Difference (000s)	Explanation
Unexpended Appropriations Transferred Out	$ 30,173	$ -	$ 30,173	2
Other Financing Sources	$ 51,404	$ -	$ 51,404	2
Other Financing Sources – CUST	$ (12,198,540)	$ -	$ (12,198,540)	2
Imputed Financing Source	$ 451,533	$ -	$ 451,533	2
Federal Securities Interest Revenue	$ 159,432	$ -	$ 159,432	2
Borrowing and Other Interest Revenue	$ 2	$ -	$ 2	2
Total Financing Sources	**$ (11,382,182)**	$ -	**$ (11,382,182)**	2
Transfers-in Without Reimbursement	$ 211,577	$ -	$ 211,577	2
Appropriations transfers-in	$ 624,260	$ -	$ 624,260	2
Total Transfers In	$ 835,837	$ 835,835	$ 2	
Transfers-out Without Reimbursement	$ 242,618	$ -	$ 242,618	2
Appropriation transfers-out	$ 682,861	$ -	$ 682,861	2
Total Transfers Out	$ 925,479	$ 925,477	$ 2	

We communicated the differences noted above to the Department and requested explanations for the differences. We received the following explanations from the Department:

1. *The Department indicated that the difference relates to reclassifications made in accordance with the "Treasury Financial Manual Chapter 4700" for the "Closing Package" financial statements.*

2. *The Department indicated that the difference relates to different reporting requirements; and therefore, the "Line Item Reports" included line items that are not reported in the RSI.*

3. *The Department indicated that the difference is due to different reporting requirements; and therefore, the RSI did not include expenses, while the "Line Item Reports" included expenses.*

4. *The Department indicated that the difference relates to different reporting requirements; and therefore, the RSI included line items that are not reported in the "Line Item Reports."*

Except as noted above, no additional procedures were performed with respect to management's explanations as to the reasons for the differences.

We were unable to compare the fiscal year 2005 intragovernmental activity/balances for each trading partner from the "Line Item Reports" to the Department's general ledger because the "Line Item Reports" did not include activity/balances by trading partner.

B. *We compared the fiscal year 2005 intragovernmental activity/balances for each trading partner from the Schedules to the Department's general ledger. We noted no differences, excluding rounding differences equal to or less than $2,000.*

Procedure 3

Compare trading partner activity/balances from the intragovernmental RSI schedules in the agency's audited consolidated financial statements to the agency's *Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report* for FY 2005. Compare the RSI schedules in the Department's audited consolidated financial statements to the *Closing Package Material Differences/Status of Disposition Certification Report* (Section II of the CFO Representations). For items where agency reporting differences exist, compare the explanations to supporting documentation and identify any differences.

Finding 3

A. *We compared the fiscal year 2005 trading partner activity/balances from the intragovernmental RSI schedules in the Department's audited consolidated financial statements, adjusted for the reclassifications made in accordance with the "Treasury Financial Manual Chapter 4700" for the "Closing Package" financial statements, to the column entitled "Agency Reported Amount – Closing Package" of the Department's "Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report" for FY 2005. We identified the following differences, excluding rounding differences equal to or less than $2,000:*

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Line Item/ Trading Partner	Balance Per RSI (000s)	Total per Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report (000s)	Difference (000s)	Explanation
Fund Balance with Treasury				
Department of the Treasury	$ 32,031,132	$ -	$ 32,031,132	1
Reciprocal Category 22 - A/R, A/P, Other Liabilities				
Independent and Other Agencies	$ 14,582	$ 14,199	$ 383	3
Unidentified	$ 808	$ 1,192	$ (384)	3
Reciprocal Category 29 - Uncategorized				
Department of the Treasury	$ -	$ 1,646,472	$ (1,646,472)	2
Department of Agriculture	$ -	$ 173	$ (173)	2
Department of Justice	$ -	$ (113)	$ 113	2
Office of Personnel Management	$ -	$ 430	$ (430)	2
General Services Administration	$ -	$ 259	$ (259)	2
Department of Homeland Security	$ -	$ 29	$ (29)	2
Department of Education	$ -	$ (83)	$ 83	2
Treasury - General Fund	$ -	$ 1,369,423	$ (1,369,423)	2
Department of Energy	$ -	$ (2,348)	$ 2,348	2
Department of Commerce	$ -	$ 19	$ (19)	2

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Line Item/ Trading Partner	Balance Per RSI (000s)	Total per Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report (000s)	Difference (000s)	Explanation
United States Postal Service	$ -	$ 4	$ (4)	2
Department of State	$ -	$ 3	$ (3)	2
Federal Communications Commission	$ -	$ (20)	$ 20	2
National Science Foundation	$ -	$ 8	$ (8)	2
Environmental Protection Agency	$ -	$ 955	$ (955)	2
Department of Transportation	$ -	$ (59)	$ 59	2
Agency for International Development	$ -	$ 4	$ (4)	2
Department of Health and Human Services	$ -	$ (36)	$ 36	2
National Aeronautics and Space Administration	$ -	$ 23	$ (23)	2
Unidentified	$ -	$ 21	$ (21)	2
Independent	$ -	$ 118	$ (118)	2
Total	**$ 32,046,522**	**$ 3,030,673**	**$ 29,015,849**	
Transfers In/Out				
Treasury - General Fund	$ 359,223	$ -	$ 359,223	1
Treasury - General Fund	$ 475,590	$ -	$ 475,590	1
Total Transfers	**$ 834,813**	**$ 834,813**	$ -	
Department of Agriculture	$ 1,791	$ -	$ 1,791	1
Department of Agriculture	$ 155,094	$ -	$ 155,094	1
Total Transfers	**$ 156,885**	**$ 156,885**	$ -	

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Line Item/ Trading Partner	Balance Per RSI (000s)	Total per Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report (000s)	Difference (000s)	Explanation
Office of Personnel Management	$ 5	$ -	$ 5	1
Office of Personnel Management	$ 13	$ -	$ 13	1
Total Transfers	**$ 18**	**$ 19**	**$ (1)**	
General Services Administration	$ 21,166	$ -	$ 21,166	1
General Services Administration	$ 13,938	$ -	$ 13,938	1
Total Transfers	**$ 35,104**	**$ 35,104**	**$ -**	
Department of Transportation	$ 314,307	$ -	$ 314,307	1
Department of Transportation	$ 11	$ -	$ 11	1
Total Transfers	**$ 314,318**	**$ 314,318**	**$ -**	
Department of Energy	$ 123,677	$ -	$ 123,677	1
Department of Energy	$ 140,961	$ -	$ 140,961	1
Total Transfers	**$ 264,638**	**$ 264,639**	**$ (1)**	
U.S. Army Corps of Engineers	$ 17	$ -	$ 17	1
U.S. Army Corps of Engineers	$ 58,054	$ -	$ 58,054	1
Total Transfers	**$ 58,071**	**$ 58,073**	**$ (2)**	
Department of Commerce	$ 68	$ -	$ 68	1
Department of Commerce	$ 3,534	$ -	$ 3,534	1

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Line Item/ Trading Partner	Balance Per RSI (000s)	Total per Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report (000s)	Difference (000s)	Explanation
Total Transfers	**$ 3,602**	**$ 3,602**	**$ -**	
Department of Justice	$ 2,207	$ -	$ 2,207	1
Department of Justice	$ -	$ -	$ -	1
Total Transfers	**$ 2,207**	**$ 2,207**	**$ -**	
Department of Labor	$ 12,410	$ -	$ 12,410	1
Department of Labor	$ 12,410	$ -	$ 12,410	1
Total Transfers	**$ 24,820**	**$ 24,820**	**$ -**	
Department of Homeland	$ -	$ -	$ -	1
Department of Homeland	$ 64,002	$ -	$ 64,002	1
Total Transfers	**$ 64,002**	**$ 64,002**	**$ -**	
Environmental Protection	$ 989	$ -	$ 989	1
Environmental Protection	$ 1	$ -	$ 1	1
Total Transfers	**$ 990**	**$ 990**	**$ -**	
Unidentified	$ 2,182	$ -	$ 2,182	1
Unidentified	$ (338)	$ -	$ (338)	1
Total Transfers	**$ 1,844**	**$ 1,844**	$ -	

We communicated the differences noted above to the Department and requested explanations and supporting documentation for the differences. We received the following explanations from the Department.

1. *The Department indicated that the difference relates to different reporting requirements; and therefore, the RSI included line items that are not reported in*

the "Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report."

2. *The Department indicated that the difference relates to different reporting requirements; and therefore, the "Intragovernmental Closing Package vs. 4th Quarter Submission Comparative Data Report" included line items that are not reported in the RSI.*

3. *The Department indicated that the difference relates to net differences due to intradepartmental activity.*

No additional procedures were performed with respect to management's explanations as to the reasons for the differences.

B. We compared the "Reporting Agency" amount, by trading partner, in the "Closing Package Material Differences/Status of Disposition Certification Report" (Section II of the CFO Representations) to the intragovernmental RSI schedules in the Department's audited consolidated financial statements, adjusted for the reclassifications made in accordance with the "Treasury Financial Manual Chapter 4700" for the "Closing Package" financial statements. We identified no differences.

Procedure 4

Obtain the Treasury Financial Management Service's (FMS') *Intragovernmental Reporting and Analysis System (IRAS) Status of Disposition Report* (*FMS' Comparative Report*) for intragovernmental activity/balances. Compare the differences between the agency and its trading partners by reciprocal category/line-item from *FMS' Comparative Report* to explanations from the agency's supporting documentation. For items where agency reporting differences exist, compare the explanations to the supporting documentation. Identify any inconsistencies in amounts or explanations between *FMS' Comparative Report* and agency supporting documentation. In the event of nonreporting by trading partners, as indicated in the footer section of *FMS' Comparative Report*, identify that the difference is due to a nonreporting partner and do not proceed further with the review of the differences.

Finding 4

We obtained the "FMS' Comparative Report" for intragovernmental activity/balances. We requested explanations and obtained supporting documentation from the Department for the reported differences on the "FMS' Comparative Report," presented below:

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Recip-rocal Category	Trading Partner	Reporting Agency Amount (000's)	Trading Partner Amount (000's)	Material Difference (Absolute Value) (000's)	Reported Adjustments (Absolute Value) (000's)	Unknown/ Unreconciled (Absolute Value) (000's)	Expla-nation
19	69 - Department of Transportation	$ 314,307	$ -	$ 314,307	$ -	$ 314,307	1
24	80 - National Aeronautics and Space Administration	$ (45,180)	$ 22,016	$ 67,196	$ 68,619	$ 1,423	2
18	89 - Department of Energy	$ -	$ 1,181,000	$ 1,181,000	$ -	$ 1,181,000	3
23	91 - Department of Education	$ 89,884	$ -	$ 89,884	$ 89,884	$ -	4
24	91 - Department of Education	$ 309,794	$ 187,000	$ 122,794	$ 54,988	$ 67,806	5
24	97 - Office of Secretary of Defense - Defense Agencies	$ 1,766,901	$ 1,291,800	$ 475,101	$ -	$ 475,101	6

We received the following explanations and supporting documentation from the Department:

1. *The Department indicated that this difference resulted because of allocation transfers with the Department of Transportation, where the Department is the child and the Department of Transportation is the parent. The Department indicated that OMB Circular No. A-136 "Financial Reporting Requirements,"* Part A, *"Form and Content of the Performance and Accountability Report" requires that the child agency report the proprietary information in its financial statements when that information is material to the child agency, and for that reason, the Department reports that information in its consolidated financial statements. However, the Department of Transportation established a policy of reporting all activity, both budgetary and proprietary at the parent level. We inspected email documentation from the Department of Transportation stating that this was the Department of Transportation's policy.*

2. *The Department indicated that $68,619 thousand of the difference resulted because the Department reversed a prior year accrual coded to Trading Partner 80, National Aeronautics and Space Administration. We inspected the journal entry indicating that the accrual was incorrectly coded to Trading Partner 80, National Aeronautics and Space Administration. The Department indicated that the remaining difference of $1,423 thousand is immaterial.*

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

3. *The Department indicated that this difference resulted because of a difference in accounting treatment between the Department and the Department of Energy. The Department records Royalty-in-Kind transfers to the Department of Energy in SGL account 5990, which is custodial revenue. However, the Department of Energy records the amounts as a financing source transferred in, SGL account 5720. We inspected email documentation sent by the Department to the Department of Energy indicating the Department's accounting treatment.*

4. *The Department indicated that this difference resulted because the Department of Education (Education) reported the balance using a different accounting methodology and in a different period than the Department. We inspected email documentation from the indicating that Education did not record advances at the time of the transaction, but recorded the transactions directly to expense. We also inspected a reconciling schedule, prepared by Education, and agreed the amounts from the reconciling schedule to the "FMS' Comparative Report."*

5. *The Department indicated that this difference resulted because Education reported the balances using a different accounting methodology and in a different period than the Department. We inspected email documentation from the Education indicating that Education did not record advances at the time of the transaction, but recorded the transactions directly to expense. We also inspected a reconciling schedule, prepared by Education, and agreed the amounts from the reconciling schedule to the "FMS' Comparative Report."*

6. *The Department indicated that this difference resulted because the Department of Defense reported the balance using a different accounting methodology than the Department. The Department of Defense did not record advances at the time of the transaction, but recorded the transaction directly to expense. The Department did not provide any supporting documentation related to this difference because the Department did not receive information from Department of Defense.*

Except as noted above, no additional procedures were performed with respect to management's explanations as to the reasons for the differences.

Procedure 5

Identify and include copies of internal control findings related to intragovernmental activities from the consolidated financial statement audit, including items cited in the management letter. Also, identify and report auditor-proposed intragovernmental adjustments that were waived by the Department.

Exhibit A

U.S. Department of the Interior
Agreed-Upon Procedures for
Intragovernmental Activity and Balances

Finding 5

A. We included a copy of the Independent Auditors' Report as Exhibit B, which includes the internal control findings related to the Department's accounting for intragovernmental activities from the Department's consolidated financial statement audit that we have identified below.

- *Controls over implementing new accounting policies and procedures*
- *Reconciliation of Intragovernmental transactions and balances*
- *Application and general controls over financial management systems*
- *Controls over property, plant, and equipment*
- *Controls over accruals*
- *Financial management at the Bureau of Indian Affairs*
- *Controls over revenue*
- *Segregation of responsibilities over purchases and entries*

B. We included a copy of the Independent Auditors' Report as Exhibit C, which includes the internal control findings related to the Department's accounting for intragovernmental activities from the Department's "Closing Package" financial statement audit that we have identified below.

- *Control over financial reporting for the special-purpose financial statements*

C. We did not identify and include copies of internal control findings that would be cited in the management letters, because the management letters have not been issued as of the date of this report.

D. We identified and reported auditor-proposed intragovernmental account adjustments, presented as Exhibit D to this report, that were waived by the Department.

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Exhibit B

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.

KPMG

Exhibit B

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.

Exhibit B

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.

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.

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.

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.

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.

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.

KPMG

Exhibit B

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.

KPMG

Exhibit B

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.

Exhibit B

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 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.

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

Intérior 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.

KPMG

Exhibit B

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.

Exhibit B

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.

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

Exhibit B

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

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.

(Continued)

Exhibit B

Exhibit I

U.S. DEPARTMENT OF THE INTERIOR

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Condition	Status
O	Deferred maintenance reporting	This has not been corrected and is repeated at finding P.
P	Stewardship reporting	This has not been corrected and is repeated at finding Q.
Q	*Single Audit Act Amendments of 1996*	This has not been corrected and is repeated at finding R.
R	*Debt Collection Improvement Act of 1996*	This has not been corrected and is repeated at finding S.
S	*Prompt Payment Act*	This has been corrected.
T	*Federal Financial Management Improvement Act (FFMIA) of 1996*	This has not been corrected and is repeated at finding U.

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

Exhibit B

TAKE PRIDE IN AMERICA

NOV 15 2005

Memorandum

To: Earl E. Devaney
Inspector General

KPMG LLP
2001 M. Street, N.W.
Washington, D.C. 20036

From: P. Lynn Scarlett P. Lynn Scarlett
Assistant Secretary - Policy, Management and Budget

Subject: Management Response to Draft Independent Auditors' Report for Fiscal Year 2005 (Assignment No. X-IN-MOA-0011-2005)

The Department has reviewed the draft report and provides its responses to the findings and recommendations. The Department appreciates the recognition noted in several findings and recommendations of the substantial improvement and progress achieved during fiscal 2005, and we are pleased that the result of the audit is an unqualified opinion on the Department Consolidated Financial Statements.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Reportable Conditions that are considered to be Material Weaknesses

A. New accounting policies and procedures

Management concurs. Interior will improve its policies and procedures related to recording selected assets and liabilities in accordance with OMB guidance.

B. Controls over the Indian Trust Funds

Management partially concurs. Management concurs that the recommendations will improve our internal processes, and we will continue to develop and implement additional procedures and internal controls to address the issues noted in the audit. A variety of actions are underway within Interior to improve internal controls for non-Federal Indian Trust Funds, including providing an accounting for non-Federal accounts. Interior contends that, based upon the reconciliations conducted by independent accounting firms, Interior is in a position to draw conclusions with a high degree of confidence that the differences between supporting records and recorded transactions are few in number, small in size, and not widespread or systematic.

Other Reportable Conditions

C. Reconciliation of intra-governmental transactions and balances

Management concurs. Interior has implemented procedures to more timely reconcile and address trading partner differences. In addition Interior continues to actively work on improving trading partner coding of transactions.

D. Application and general controls over financial management systems

Management partially concurs. While management agrees that continued improvement is beneficial and continues to implement many of the recommendations, management does not concur that the finding rises to the level of a reportable condition. Interior has made substantial progress in improving controls over its systems in fiscal 2005 and believes there are no apparent systemic weaknesses at the Departmental level. Interior will continue its efforts to improve and enhance application and general controls in fiscal 2006 to address the issues noted in the audit report.

E. Controls over property, plant and equipment

Management concurs. During fiscal 2005, Interior continued to improve internal controls over property, plant, and equipment to ensure transactions are properly classified and recorded. A significant accomplishment included completing the land and land rights inventory reconciliation. Interior also released web-based training modules on new property policies and continued to aggressively monitor bureau compliance with the new policy guidance.

F. Controls over accruals

Management concurs. During fiscal 2005, Interior analyzed and revised a number of accrual calculations processes. Interior will continue to review and improve its controls over accruals.

G. Controls over environmental contingencies

Management concurs. In FY 2005, Interior established a departmental workgroup to standardize processes and documentation. In FY 2006, guidance and procedures will be revised to ensure that environmental information is effectively identified, maintained, and reported.

H. **Financial Management at the Bureau of Indian Affairs**

Management concurs. During fiscal 2005 Interior established a performance improvement plan to ensure that appropriate financial and program staffing and other resources were directed at financial management and reporting functions and continued to improve processes and procedures to promote better financial analysis, transaction entries and reconciliations were performed. In FY 2006, Interior will continue to improve financial management at the BIA.

I. **Controls over revenue**

Management concurs. Although Interior performed a detailed analysis of revenue transactions and adjusted the fiscal year 2005 financial statements accordingly, actions are planned to improve internal controls over the revenue process to ensure that the transactions are promptly and properly recorded for timely and reliable financial reporting. Interior is committed to improving its controls over revenue.

J. **Controls over grants**

Management concurs. Interior will continue to work with its financial assistance programs to improve grantee monitoring processes subject to the requirements of the *Single Audit Act Amendments of 1996*.

K. **Segregation of responsibilities over purchases and entries**

Management concurs. Interior will improve policies and procedures for better segregation of conflicting duties and to enhance review and approval responsibilities.

L. **Controls over charge cards**

Management concurs. Interior continues to believe it has a well-managed charge card program, although compliance issues are identified in several bureaus and offices. Interior continued to monitor supervisory reviews and approval, train and otherwise educate cardholders and supervisors on charge card responsibilities, and monitor the use of charge cards. In addition, through quarterly reviews of the personnel/payroll system, Interior continued to identify newly appointed supervisors who will have approving official responsibility.

M. **Controls over obligations**

Management concurs. Interior will implement new procedures for review and approval of purchase orders and revise guidance for the preparation and processing of transactions.

N. Controls over the U.S. Park Police Pension Plan

Management concurs. Interior will take action to investigate and resolve differences between the census data and the supporting documentation to ensure that the pension program is properly presented in the financial report.

INTERNAL CONTROL OVER RSI AND RSSI

O. Performance Measure Reporting

Management concurs. Interior will take action to improve internal control over reported performance measures including strengthening Interior's capability to collect, process, record, summarize, and report performance measurements in accordance with management's criteria.

P. Deferred maintenance estimates

Management partially concurs. Interior concurs that improvements can be made to processes related to management of appropriate cyclical reviews for those assets subject to deferred maintenance reporting, i.e., general property, plant and equipment, and constructed stewardship assets. However, Interior's consistent position has been that stewardship land managed by the Department does not have deferred maintenance as defined by SFFAS No. 6.

Q. Stewardship reporting

Management partially concurs. Interior concurs that processes can be improved related to stewardship reporting. However, Interior does not concur that condition assessments are required for stewardship land. While Interior believes that it is following standard practices, we will strive to improve our management of museum collections and other stewardship and heritage assets.

COMPLIANCE AND OTHER MATTERS

R. Single Audit Act Amendments of 1996

Management partially concurs. While Interior concurs that some bureaus must continue to take steps to obtain required reports from grantees previously issued grants, the Department and its bureaus have policies and processes in place that comply with the Single Audit Act and OMB Circular A-133. We do not agree that this issue rises to a Departmental level non-compliance issue.

S. Debt Collection Improvement Act of 1996

Management does not concur. Interior has an appeals process defined by law that impacts when payments become due for collection, and subsequently eligible for debt referral purposes. The appeals process may vary from bureau to bureau as to the specifics of its process. As Treasury guidance stipulates, amounts that are the subject of an administrative appeal do not become eligible for referral until the appeal is concluded and the amount of the debt is fixed. In FY 2005, Interior continued to improve its process to ensure eligible receivables were referred to the U.S. Department of the Treasury in a timely manner. Interior does not believe there is a noncompliance at the Departmental level.

T. <u>OMB Circular No. A-25, *User Charges*</u>

Management concurs. Interior will implement policies and procedures that comply with OMB Circular No. A-25; develop and implement a methodology to track administration costs; and, charge other Federal entities for the administration costs.

U. <u>Federal Financial Management Improvement Act (FFMIA) of 1996</u>

Management concurs. Interior will continue its improve its controls over the FFMIA components related to Federal accounting standards and the U.S. Standard General Ledger at the transaction level. This will include improved monthly financial statement reporting, monitoring or performance metrics, and periodic reviews of financial performance with senior Department and bureau management.

We appreciate the value of the audit process and look forward to working with you to continue our marked improvement of financial management in the Department of the Interior.

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Exhibit C

Independent Auditors' Report on Special-Purpose Financial Statements

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

We have audited the accompanying Closing Package Financial Statement Reports – Balance Sheets as of September 30, 2005 and 2004, the related Closing Package Financial Statement Reports – Statements of Net Cost and Statements of Changes in Net Position for the years then ended, and the accompanying Financial Report (FR) Notes Detail Report (hereinafter referred to as the special-purpose financial statements) contained in the closing package of the U.S. Department of the Interior (Interior). These special-purpose financial statements are the responsibility of Interior's management. Our responsibility is to express an opinion on these special-purpose financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the special-purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the special-purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall special-purpose financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with the requirements of Chapter 4700 of the Department of the Treasury's *Treasury Financial Manual* (TFM), as described in Additional Note No. 22, solely for the purpose of providing financial information to the U.S. Department of the Treasury and the Government Accountability Office (GAO) to use in preparing and auditing the *Financial Report of the U.S. Government*, and are not intended to be a complete presentation of Interior's consolidated financial statements. Interior prepared FR Notes Detail Report Nos. 1 through 21, except for 10 and 16, which were not applicable to Interior. Interior added one note to the special-purpose financial statements, specifically Additional Note No. 22, *Summary of Significant Accounting Policies*, to disclose other data not contained in the special-purpose financial statements, but which is necessary for full disclosure. Interior also prepared Other Data Detail Report Nos. 1 through 18, except for 6 through 12, and 15 through 18, which were not applicable to Interior.

In our opinion, the special-purpose financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of the Interior as of September 30, 2005 and 2004, and its net costs and changes in net position for the years then ended in conformity with accounting principles generally accepted in the United States of America and the presentation pursuant to the requirements of *TFM Chapter 4700*.

KPMG

Exhibit C

The accompanying "previously reported" special-purpose financial statements and the related "previously reported" data and "line item changes" presented in the FR Notes Detail and Trading Partner Summary Reports were not audited by us and accordingly, we do not express an opinion thereon.

As discussed in FR Notes Detail Report No. 17 to the special-purpose 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.

The information included in the Other Data Detail Report Nos. 4, 5, 13, and 14 and the information presented in the Trading Partner Summary Reports is presented for the purpose of additional analysis and is not a required part of the special-purpose financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America and the *TFM Chapter 4700*. 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 information included in the Other Data Detail Report Nos. 4, 5, 13, and 14 and the information presented in the Trading Partner Summary Reports are not presented in conformity with accounting principles generally accepted in the United States of America and the *TFM Chapter 4700*. The information in the Other Data Detail Report Nos. 4, 5, and 13 is not complete, current or consistently supported because Interior did not consistently follow its established procedures and controls to accumulate and report the information and did not disclose all required information. In addition, the information in the Other Data Detail Report No. 14 is not complete or current because Interior had not estimated deferred maintenance for all assets and did not consistently update deferred maintenance estimates. Finally, Interior did not fully reconcile intragovernmental transactions and balances with its trading partners.

Our audits were conducted for the purpose of forming an opinion on the special-purpose financial statements taken as a whole. The other accompanying information presented in the Other Data Detail Report Nos. 1, 2, and 3 is not a required part of the special-purpose financial statements and is presented for purposes of additional analysis. This information has been subjected to the auditing procedures applied in the audits of the special-purpose financial statements and, in our opinion, is fairly stated in all material respects in relation to the special-purpose financial statement taken as a whole.

The information in the sections entitled "Threshold" in FR Notes Detail Report Nos. 2, 3, 4A, 4B, 5, 6, 12, 15, and 19; the information entitled "Threshold" in the Other Data Detail Report No. 13; the information in the sections entitled "Text Data" in FR Notes Detail Report Nos. 4A and 4B; the information in the sections "Other Notes Info – Section C" in FR Notes Detail Report No. 5; the information in the sections entitled "Line Item Notes" and "Other Notes Info – Section C" in FR Notes Detail Report No. 6; the information in "Other Notes Info – Section C – Claim Amount (Unable to Determine Loss)" and "Other Notes Info – Section D – Claim Amount (Unable to Determine)"in FR Notes Detail Report No. 18; the information in the Reclassification Journal Voucher Report – Summary Level; and the information not included as components of the closing package described in Additional Note No. 22, have not been subjected to the auditing procedures applied in the audit of the special-purpose financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 01-02, we have also issued a combined independent auditors' report dated November 15, 2005, which presents our opinion on Interior's consolidated financial statements; our consideration of Interior's internal control over financial reporting; and the results of our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. That report is an integral part of the audits of Interior's consolidated financial statements, as of and for the years ended September 30, 2005 and 2004, performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 01-02, and should be read in conjunction with this report in considering the results of our audits of the special-purpose financial statements. Our audit of the Interior consolidated financial statements as of and for the year ended September 30, 2005, disclosed the following material weaknesses, reportable conditions, significant deficiencies, and compliance matters:

Material Weaknesses:

A. Controls over implementing new accounting policies and procedures

B. Controls over the Indian Trust funds

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

Significant Deficiencies:

O. Performance measure reporting

P. Deferred maintenance estimates

Q. Stewardship reporting

Compliance Matters:

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*

In planning and performing our audit of the special-purpose financial statements, we also considered Interior's internal control over financial reporting for the special-purpose financial statements and its compliance with *TFM Chapter 4700*. Management is responsible for establishing and maintaining internal control over financial reporting, including required supplementary information and other accompanying information, and for complying with laws, regulations, contracts, and grant agreements, including compliance with *TFM Chapter 4700* requirements.

Our consideration of internal control over financial reporting for the special-purpose financial statements 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 special-purpose 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 special-purpose 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.

We noted one matter, described below, involving internal control over financial reporting for the special-purpose financial statements and its operation that we consider to be a reportable condition. We believe that the reportable condition is not a material weakness. The objective of our audit was not to provide assurance on Interior's internal control over financial reporting for the special-purpose financial statements. Consequently, we do not provide an opinion thereon.

Condition

Interior did not establish sufficient controls to ensure that amounts were properly classified in the special-purpose financial statements, because we identified several hundred million dollars of reclassification adjustments necessary for the special-purpose financial statements. In addition, Interior did not consistently ensure that the disclosures agreed to Interior's records, because we identified various differences between the disclosures and supporting documents. As a result of our observations, Interior analyzed and adjusted its special-purpose financial statements and related disclosures.

Recommendation

We recommend that Interior improve controls to ensure that transactions are properly classified and reported in accordance with the requirements of the *TFM Chapter 4700* as follows:

- Continue to issue guidance to Interior components reminding them of the requirements to classify transactions in the same general ledger accounts.

- Review the classification and use of general ledger accounts for each Interior component to ensure consistency across Interior-components and between fiscal years.

- Require at least one individual, not involved in preparing the special-purpose financial statements and disclosures, to agree all of the special purpose financial statements and disclosures to the supporting documentation. This individual should ensure that all differences are resolved and document their review and approval process.

KPMG

Exhibit C

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.

Our tests of compliance with *TFM Chapter 4700* requirements disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02. However, providing an opinion on compliance with *TFM Chapter 4700* requirements was not an objective of our audit of the special-purpose financial statements and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of Interior's management, Interior's Office of Inspector General, the Department of the Treasury, OMB, and the GAO, in connection with the preparation and audit of the *Financial Report of the U.S. Government,* and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 17, 2005

Exhibit C

United States Department of the Interior

OFFICE OF THE ASSISTANT SECRETARY
POLICY, MANAGEMENT AND BUDGET
Washington, DC 20240

TAKE PRIDE IN AMERICA

NOV 18 2005

Memorandum

To: Earl E. Devaney
Inspector General

KPMG LLP
2001 M. Street, N.W.
Washington, D.C. 20036

From: P. Lynn Scarlett
Assistant Secretary – Policy, Management and Budget

Subject: Management Response to Draft Independent Auditors' Report for Fiscal Year 2005 (Report No. X-IN-MOA-0002-2006)

The Department has reviewed the draft report for the special purpose financial statements and provides its response to the finding and recommendation.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Reportable Condition

A. Accounting policies and procedures

Management concurs. Interior will continue to improve its controls over the classification and reporting of financial information in Treasury's Governmentwide Financial Report System.

We appreciate the value of the audit process and look forward to working with you to continue our marked improvement of financial management in the Department of the Interior.

U. S. Department of the Interior
Summary of Unadjusted Misstatements
Consolidated Financial Statement Audit
September 30, 2005

Financial Statement Line Item	Adjustment Number	Description of Unadjusted Misstatement	Known Misstatements			Likely Misstatements			Fiscal Year	U.S. Government's CFS Line Item
			Debit	(Credit)	Net	Debit	Credit	Net		
	1	To record a liability to recognize collections owed to Treasury at year-end.							2005	
Trans In/Out without Reimbursement, net			14,685,519							Other Taxes and Receipts
Other Liabilities				(14,685,519)						Other Liabilities
	2	To adjust the royalty accruals to actual subsequent receipts.							2005	
Custodial Liability			11,032,791							Other Liabilities
Custodial Liability			2,303,442							Other Liabilities
Custodial Liability			2,919,536							Other Liabilities
A/R				(16,255,769)						Accounts Receivable
Rents and Royalties				(16,255,769)						Miscellaneous Earned Revenue
Change in Untransferred Rev				16,255,769						Miscellaneous Earned Revenue
Royalties Retained				(2,919,536)						Miscellaneous Earned Revenue
Resource Use				2,919,536						Gross Cost

Summary of Unadjusted Misstatements
Special-Purpose Financial Statement Audit
September 30, 2005

Financial Statement Line Item	Adjustment Number	Description of Unadjusted Misstatement	Known Misstatements			Likely Misstatements			Fiscal Year	U.S. Government's CFS Line Item
			Debit	(Credit)	Net	Debit	Credit	Net		
	1.	To reclassify interest revenue from exchange revenue to nonexchange revenue								
Earned Revenue			35,255,469						2005	Earned Revenue
Other Taxes and Receipts				(35,255,469)						Other Taxes and Receipts

U.S. Department of the Interior
Office of Inspector General

Management Letter Concerning Issues Identified During the Audit of the Bureau of Reclamation's Financial Statements for Fiscal Years 2005 and 2004

Report No. X-IN-BOR-0007-2006

February 2006

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

February 10, 2006

Memorandum

To: John Keys
Commissioner, Bureau of Reclamation

From: Anne L. Richards Anne L. Richards
Assistant Inspector General for Audits

Subject: Management Letter Concerning Issues Identified During the Audit of the Bureau of Reclamation's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-BOR-0007-2006)

Attached is the subject management letter (Attachment 1) prepared by KPMG LLP. It contains 10 findings, which are in addition to those contained in KPMG's audit report on the financial statements of the Bureau of Reclamation (Reclamation). The management letter contains 14 recommendations that should resolve the findings.

In its December 21, 2005 response (Attachment 2) to the draft management letter, Reclamation agreed with six findings, partially agreed with two, and disagreed with two. Reclamation also stated that it had implemented one recommendation, was in the process of implementing eight, partially implementing one, and disagreed with four recommendations.

We will refer the unimplemented recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. The recommendations that Reclamation partially implemented or disagreed with will be referred for resolution (see Attachment 3, "Status of Management Letter Recommendations").

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit Reclamation's financial statements for fiscal years 2005 and 2004. The results of the audit are contained in KPMG's audit report dated November 21, 2005 (Report No. X-IN-BOR-0013-2005). In conjunction with its audit, KPMG noted certain internal control and other operational matters that should be brought to management's attention. Those are the issues presented in this management letter.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of Reclamation personnel during the audit. If you have any questions, please contact me at 202-208-5512.

Attachments (3)

cc: Assistant Secretary, Water and Science
Chief Financial Officer, Bureau of Reclamation
Director, Office of Financial Management
Audit Liaison Officer, Water and Science
Audit Liaison Officer, Bureau of Reclamation
Audit Liaison Officer, Office of Financial Management
Focus Leader, Financial Reporting, Office of Financial Management
Focus Leader, Management Control and Audit Followup,
Office of Financial Management

KPMG

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

MANAGEMENT LETTER

November 21, 2005

The Commissioner of the U.S. Bureau of Reclamation and the
Inspector General of the U.S. Department of the Interior:

We have audited the consolidated balance sheets of the U.S. Bureau of Reclamation (Reclamation) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years then ended (hereinafter referred to as the "financial statements"), and have issued our report thereon dated November 21, 2005. During fiscal year 2005, Reclamation changed its method of accounting for appropriated debt transactions in accordance with the provisions of Office of Management and Budget (OMB) guidance effective October 1, 2004. In planning and performing our audit of the above financial statements of Reclamation, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

Our audit of Reclamation's financial statements as of and for the year ended September 30, 2005 disclosed the following material weakness, reportable conditions, significant deficiency, and compliance matters that are described in our auditors' report dated November 21, 2005:

Material Weakness:

A. Controls over Implementation of New Accounting Principle

Reportable Conditions:

B. Security and Internal Control over Information Technology Systems
C. Controls over Charge Card Reviews
D. Controls of Management Review and Approval of Process-level Activities
E. Controls over Credit Reform Loans

Significant Deficiency:

F. Reporting the Condition of Heritage and Stewardship Assets

Compliance Matters:

G. Federal Accounting Standards under the Federal Financial Management Improvement Act (FFMIA) of 1996

During our audit, we noted certain other matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized below:

1. 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 management controls, there is an increased risk that either intentional or unintentional changes are made to the system's processing functionality, the wrong version of a program could be implemented, a virus could be inserted, or security features could be excluded or disabled. Reclamation has formalized procedures for system software maintenance and change management. However, our audit found that the change management procedures are not practiced consistently among information system support groups/functions. Further, documentation is not consistently maintained for required aspects of the change management process. Specifically, our audit identified one change within the Reclamation Water Operating and Record Keeping System (BOR WORKS) that was not approved by the accounting team lead and four changes where a test plan did not exist and appropriate testing of the change was not performed.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Ensure approvals are consistently obtained and documented prior to initiating the development of a system change.

b. Ensure release packages include all necessary documentation at the component level and that testing is performed where necessary.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendations to ensure consistent approval of system modifications and release package documentation and testing requirements. Management will update its Change Management Plan for BOR WORKS to include periodic approval reviews and to clearly establish test and data validation procedures for all release packages. The target date for implementation of the improvements is January 15, 2006 for the periodic approval review plan and December 30, 2005 for the test and data validation procedures.

2. Background Investigations

The Department of the Interior, *Departmental Manual Section 441*, states, "all positions must be designated at a national security sensitivity or public trust risk level based on the degree of damage that an individual, by virtue of the occupancy of the position, could effect to the national security or the efficiency of the Federal service." Further, the manual states, "responsibilities of the Personnel Officers include...ensuring the appropriate background investigation is conducted based on the position sensitivity or risk level [and for] maintaining appropriate personnel security/suitability file documentation" and "responsibilities of the Security Officer include...ensuring that initial investigations and periodic reinvestigations are conducted commensurate with the position sensitivity or risk level." Our audit revealed that existing processes are not sufficient to ensure information related to background investigations is sufficiently communicated. Specifically, our audit identified one instance where an individual's background investigation status was erroneous or inconsistent with the associated position description.

Lack of consistent and timely background investigations for all employees and contractors may result in the hiring or retaining of services by individuals who are not suitable for employment under federal regulations. These individuals may have the ability or opportunity to gain knowledge of sensitive information and/or assignment of sensitive duties that is inconsistent with the interests of national security.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Monitor processes to ensure that policies and procedures related to periodic background investigations are properly followed.

b. Validate the current background information in the system/database and ensure that information is consistent with formal position descriptions.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendation to validate current background information in the system and is establishing a procedure to annually review a sample of active position descriptions. The target date for implementation of the review procedure is April 30, 2006. Management did not agree with the recommendation to monitor background investigation processes to ensure policies and procedures are properly followed. Management does not believe the audit finding supported this recommendation.

Auditors' Response to Management's Response

The key focus of this finding is that one instance was identified where an individual's background investigation status was erroneous or inconsistent with the associated position description. Consequently, management's process for monitoring compliance with required background investigations is not sufficient to ensure all employees are compliant with established policies.

3. Open Obligations and Payables

During fiscal year 2005, Reclamation continued to implement a regional office certification process whereby offices certify the validity of certain unliquidated obligations and payables. The certification reports indicate open obligations and accruals that are inactive or are otherwise invalid. Our audit revealed instances where open balances identified as invalid during the certification process were not reversed in a timely manner or were not sufficiently supported. Specifically, our audit of open obligations and payables revealed the following exceptions:

Fourteen obligations were identified as invalid during the regional quarterly certification process; however, Reclamation did not follow through and de-obligate the funds in a timely manner. These exceptions remained obligated for the following time period after the request to de-obligate was submitted:

- Five exceptions were de-obligated after a period of eight months
- Three exceptions were de-obligated after a period of 12 months
- One exception was de-obligated after a period of 24 months
- Five exceptions remained obligated after a period of 10 months

In addition, during our audit tests of details, we identified approximately $1.6 million out of a $2.0 million obligation that was not sufficiently supported by a corresponding contract or purchase order. Further, Reclamation was unable to provide supporting documentation for one accrual totaling $3,078, which was subsequently reversed by management during fiscal year 2005.

Recommendation

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Improve and document its review procedures over open obligations and payables to ensure invalid amounts are removed on a timely basis. Improvements should include:

   - Regional follow-up on requests made to remove invalid balances
   - Increased oversight by acquisitions and finance personnel in Denver, Colorado to ensure requested actions are completed in a timely manner

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management partially agreed with the recommendation to improve and document its review procedures over open obligations and payables. Management agreed and will improve its procedures to ensure invalid open obligations are removed in a timely manner. The target date for implementation of the improvement is June 30, 2006. Management did not agree with the recommendation to improve and document its review procedures over open payables, stating that the identified exception was not indicative of a weakness given the volume of transactions processed each quarter.

Auditors' Response to Management's Response

This finding is concentrated on the exceptions identified regarding open obligations. However, our audit did identify one exception relating to an invalid payable. We determined, given the similar nature of the exceptions, to include the exception in this letter to management with the recommendation for management to review and document Reclamation's control procedures with regards to open payables.

4. Documentation of Process-level Activities

OMB Circular A-123 (revised June 21, 1995), *Management's Accountability and Control*, Section II, bullet *Recording and Documentation,* states, "transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination." Lack of documented performance of controls over key, process-level activities could result in ineffective controls and the inability of management to assert control performance and control effectiveness.

During our audit, we tested multiple process-level activities and controls and identified the following deficiencies:

- Three of 26 revenue billing documents tested were reviewed by an appropriate level of management; however, the review was not sufficiently evidenced. The three billing documents totaled approximately $156,000.

- Two monthly Intra-governmental Payment and Collection System suspense reconciliations where there was no evidence of management review and/or discrepancies in the review performed. One of the two exceptions did not contain physical evidence of management review. With regards to the other exception, although there was evidence of management review, the reviewer stated the unreconciled difference was $0 when, in fact, the difference was approximately $8,000.

In addition, we noted that Reclamation makes available to its managers payroll labor cost reports to assist managers in evaluating their projects. Accordingly, on a routine basis, managers review these reports to ensure the correct payroll costs are being charged to their projects. However, evidence that the review is performed is limited solely to certain corrective actions taken to move payroll costs within one program to another program. This evidence does not ensure the control is being performed Reclamation-wide, as the corrective actions may be limited to a select group of managers.

Recommendation

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Design and implement procedures and controls consistent across all regions for documenting the performance of control-level activities. Such documentation will allow management to assert the control is being performed and is functioning effectively.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with the recommendation to design and implement procedures and controls consistent across all regions and will assess and test existing controls as part of their OMB Circular A-123 efforts during fiscal year 2006. The target date for implementation of the improvements is June 30, 2006.

5. Correction of Prior-Period Errors

Paragraph 10 of Statement of Federal Financial Accounting Standards (SFFAS) No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles,* states, "...When errors are discovered after the issuance of financial statements, and if the financial statements would be materially misstated absent correction of errors, then the error should be corrected in the earliest affected period presented by correcting any individual amounts on the financial statements."

Reclamation has made entries to the financial statements during the current fiscal year to correct or adjust prior period transactions and have not sufficiently assessed whether, in the aggregate, the adjustments materially affect the financial statements. As part of the 2005 audit, we tested approximately 1,344 transactional sample items. Of the 1,344 transactions, we identified approximately 20 sample items totaling $5,689,213 that recorded a correction of a prior period error.

Reclamation currently relies on two mechanisms for analyzing the impact of entries recorded in a given fiscal year as a correction from a prior period error: (1) quarterly and annual fluctuation analysis is performed on each financial statement line item to identify significant prior period corrections, and (2) transactions with a potential prior period impact are denoted in the Federal Financial System (FFS) as "PY ADJ" in the description field. Reclamation's fluctuation analysis is designed to detect significant fluctuations in account balances between the analyzed periods. However, Reclamation's analysis is not sufficient to identify balances that are consistent from one period to the next that would have fluctuated had it not been for the prior period correction. Accordingly, certain prior period corrections may not be identified in their analysis.

Reclamation's denotation in FFS is a tool used by management to indicate an entry may require additional analysis and consideration of its impact on prior periods. However, the current procedures are not sufficient to ensure all denoted transactions are investigated. Further, the denotation does not indicate a final resolution that the entry does or does not, in fact, impact prior periods. Accordingly, management is not able to query FFS for "PY ADJ" transactions and provide a reasonable conclusion regarding the impact on current and prior periods.

Recommendation

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Improve existing policies and procedures to ensure all prior period corrections are sufficiently analyzed in accordance with SFFAS No. 21. These policies and procedures should be sufficient to identify whether or not corrections made during the current year relating to prior periods would have a significant impact on the current or prior period financial statements.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management did not agree with our recommendation to improve existing policies and procedures to ensure all prior period corrections are sufficiently analyzed. Management believes its existing procedures, including transaction analysis and account fluctuation analysis, are sufficient to identify material errors resulting from prior period adjustments.

Auditors' Response to Management's Response

Although management does perform transaction analysis and account fluctuation analysis, the transactions we identified as having a prior period impact were not sufficiently labeled as such. Accordingly, there was not sufficient evidence that a review had been performed at the transaction level. A portion of this finding focuses on the recommendation that management should improve its policies and procedures to document its review over transactions with a potential prior period impact and document the final resolution.

Further, management's fluctuation analysis is designed to identify large variances between current- and prior-period balances. If the fluctuation exceeds a certain threshold, the variance is investigated and documented. Generally, this approach would identify any significant adjustments impacting the prior period. However, the key focus of this finding is that management should enhance its existing fluctuation analysis to investigate account balances where balances are consistent from one period to the next but would have fluctuated had it not been for the prior period corrections.

6. Withdrawn Lands

Paragraph two of the Reclamation Manual/Directives and Standards LND 03-01, *Land Withdrawals, Withdrawal Reviews, and Withdrawn Revocations*, states, "...it is imperative that Reclamation personnel work closely with BLM when applying for new withdrawals, reviewing existing withdrawals, and requesting revocations of withdrawals..." Further, Section 10 of Reclamation's Land Withdrawal Handbook, *Maintenance of Records*, states, "...the Reclamation information on RIS [Resource Information System] should be reconciled to BLM's [Bureau of Land Management] Automated Lands and Minerals Record System (ALMRS) and Master Title Plat (MTP) records." Although Reclamation's Land Withdrawal Handbook is not considered mandatory by Reclamation management, the handbook represents the recommended course of action with regards to withdrawn land.

Our audit, as confirmed by Reclamation's Regional Realty Officers, revealed that Reclamation is "double" counting a portion of its withdrawn land acreage disclosed in the Required Supplemental Stewardship Information (RSSI) section of the financial statements. Additionally, Reclamation has not implemented procedures to reconcile withdrawn lands per their records to the BLM records. Although the withdrawn land acreage disclosed in RSSI does not have an associated cost, as the land was withdrawn at no cost to the federal government, the disclosure is required in accordance with generally accepted accounting principles. Reclamation does not have sufficient policies and procedures in place to ensure the required disclosure is accurate.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Improve existing policies and procedures to comply with Reclamation Manual/Directives and Standards LND 03-01, *Land Withdrawals, Withdrawal Reviews, and Withdrawn Revocations* and Reclamation's Land Withdrawal Handbook to ensure withdrawn lands exist, are complete and accurate.

b. Ensure policies and procedures are sufficient to prescribe an appropriate level of management oversight regarding compliance with the established procedures.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management did not agree with our recommendations to improve existing policies and procedures to ensure compliance with manuals and handbooks and to prescribe an appropriate level of management oversight. Management contends that the manuals and handbooks cited in the finding are non-mandatory and that the acreage overlap issue is isolated to the Lower Colorado Region and is a direct result of a complex project history. Management will take steps during fiscal year 2006 to address the overlap issue, but does not believe it warrants changes to existing policies and procedures. Further, management states that the Lower Colorado region is primarily reconciled to BLM and the remaining regions coordinate on an ongoing basis with their respective BLM state offices.

Auditors' Response to Management's Response

Although the projects in the Lower Colorado region have a complex history of legislation and activity, this complexity should be the driver of strong policies and procedures surrounding withdrawn lands. At September 30, 2005, the Foundation Information for Real Property Management (FIRM) system contained more acreage than actual. The existence of this overstatement suggests insufficient policies and procedures to either identify and/or correct the condition.

Further, although management has stated that the listed manuals and handbooks are non-mandatory, they do represent, at a minimum, expected procedures and best practices. According to the manuals and handbooks, Reclamation's withdrawn land information in FIRM should be reconciled to BLM's system. With the exception of the Lower Colorado region, the regions have not sufficiently completed and maintained this reconciliation.

7. Interest During Construction and Interest on Investment

Section 1 of the Reclamation Manual Directives and Standards Supplement to the Department of the Interior Departmental Accounting Manual, *Interest on Investment*, states, "The regional Finance Offices are responsible for calculating and recording interest on investment (IOI) on an annual basis..." Section 2 further states, "Interest on investment applies to the unamortized balance of costs (including movable property) allocated to power, municipal and industrial water, reimbursable recreation, reimbursable fish and wildlife, and other interest-bearing reimbursable functions..."

Section 1 of the Reclamation Manual Directives and Standards Supplement to the Department of the Interior Departmental Accounting Manual, *Interest During Construction*, states, "The Regional Finance Offices are responsible for calculating and recording interest during construction (IDC) on an annual basis in accordance with the procedures in this Supplement, and the attachments thereto." Section 2 further states, "Generally, the costs (original construction costs and costs of additions and replacements regardless of source of funds) allocated to reimbursable functions, except irrigation, are subject to IDC unless otherwise provided by law."

Reclamation has not designed and implemented control procedures to ensure that IOI and IDC are calculated and recorded on every applicable project in accordance with its policy. Our audit procedures identified the following exceptions:

IOI

- Fiscal year 2005 IOI recorded for Boulder Canyon did not include Visitor Facilities 2, a program within the Boulder Canyon project. As a result, IOI was understated by $203,922.

- Region 6 failed to record IOI to standard general ledger (SGL) account 578A, Imputed Financing Sources – Operating, and 6730, Imputed Costs, for projects 0492, 0763, 0835, 0882, 1012 and 8255. As a result, IOI was understated by $3,927,276.

IDC

- Region 2 failed to record IDC for a project in fiscal year 2004. During fiscal year 2005, the region recognized the understatement and recorded the IDC for both fiscal years. As a result, IDC was understated by $24,651 in fiscal year 2004 and overstated by $24,651 in fiscal year 2005.

Recommendation

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Document and implement a process and procedures to ensure the completeness of SGL 578A, Imputed Financing Sources – Operating, and SGL 578C, Imputed Financing Sources – Cap Assets, in accordance with the Reclamation Manual Supplement to the Department of the Interior Departmental Accounting Manual, *Interest on Investment* and *Interest During Construction.*

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our recommendation and will develop, document, and implement a process and procedures to ensure the completeness of IOI and IDC. The target date for implementation of the improvements is June 30, 2006.

8. Overtime Authorization

The Code of Federal Regulations (CFR), *Authorization of Overtime Pay*, defines overtime work as "work in excess of eight hours in a day or in excess of 40 hours in an administrative workweek that is – (1) officially ordered or approved; and (2) performed by an employee." Further, the CFR states "overtime work in excess of any included in a regularly scheduled administrative workweek may be ordered or approved only in writing by an officer or employee to whom this authority has been specifically delegated." Further, Reclamation Instructions, *Supplement to Federal Personnel Manual, Series 550 – Position Classification, Pay & Allowances* requires all overtime to be officially ordered and approved in advance and adequate funding must be certified by appropriate budgetary or finance officers prior to overtime approval. Additionally, Reclamation Administrative Directive, PER-2-91, states, "...overtime pay for a period exceeding 90 calendar days...for any individual employee require the approval of the Commissioner or Deputy Commissioner."

Reclamation has not fully implemented policies and procedures to ensure that all overtime is properly approved in accordance with the CFR and Reclamation's policies. Our audit of timesheets and overtime authorization identified multiple instances in which the overtime authorization was not properly approved as follows:

- Two overtime authorization forms in Regions 6 and 8 did not indicate the number of overtime hours authorized.
- One overtime authorization form in Region 6 did not include a description of the cause for overtime hours.
- One exception was due to the number of overtime hours worked in Region 1, as reported on the timesheet, exceeding the number of overtime hours approved per the authorization form.
- Four blanket overtime authorizations in Region 1 were approved for a period exceeding the maximum period of 90 days and did not detail the employees covered under the authorization.

Recommendations

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Ensure compliance with its established overtime authorization guidance and policies, as well as the CFR. Reclamation management at all field, area, or regional office locations should improve diligence in monitoring and enforcing compliance with these policies. Such diligence may include formal internal audit programs to ensure compliance with established policies.

b. Communicate to all employees and managers the importance of complying with the CFR and Reclamation policies.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our recommendations and is currently providing training for all timekeepers to ensure awareness of their responsibilities for overtime and is developing a schedule for oversight reviews of overtime authorization. The target date for implementation of the improvements is June 30, 2006. On July 15, 2005, management communicated to all employees the rules and regulations governing overtime, as attached in management's official response.

9. Recording Gains/Losses on the Sale of Property, Plant, and Equipment

Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant and Equipment,* paragraph 38, states, "In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service."

Property disposals at Reclamation are recorded in the following manner. At the time of the disposal, the asset is removed and the entire amount is recorded as a loss. A second entry is prepared to record the cash received, which may be delayed several weeks depending on the timing of the cash receipt, a gain is recorded in the amount of cash received. For financial reporting purposes, the total amount of the gains is reported as revenue and the total amount of the loss is reported as cost. As such, total revenue and costs are overstated on the financial statements because the disposal is not properly netted at the standard general ledger level. The maximum amount of the overstatement in revenue and costs is estimated to be $8.3 million and $9.2 million, respectively. Nonetheless, net cost is not impacted.

Recommendation

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Improve processes and procedures to comply with Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant and Equipment,* paragraph 38, to ensure that the net effect of asset disposals are being reported properly as gains or losses. Procedures may include quarterly adjustments to properly state the net effect of asset disposals.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our recommendation and will review its processes and procedures for recording gains and losses to ensure transactions are recorded in accordance with applicable accounting standards. The target date for implementation of the improvements is June 30, 2006.

10. Environmental Liabilities

Paragraph 19 of SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, states, "General purpose federal financial reports should recognize...probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date."
In addition, the Federal Financial Accounting and Auditing Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*, states, "federal agencies are required to recognize a liability when a future outflow or other sacrifice of resources as a result of past transactions or events is 'probable' and 'reasonably estimable'." This Technical Release requires an agency to consider various factors in determining whether a future outflow of resources from a federal agency for environmental cleanup is probable. These factors include:

- Likely contamination

- Government-related and legally liable

- Government-acknowledged financial responsibility

- Monies appropriated/transaction occurred

- No known remediation technology exists

Reclamation, as confirmed by Reclamation's HAZMAT coordinator, does not have control procedures in place which specifically ensures that environmental liabilities are complete and fully disclosed in the financial statements in accordance with applicable accounting standards. However, Reclamation does have the following control in place which helps mitigate the risk that Reclamation would have an unknown environmental liability associated with a tract of land that has either been recently purchased or disposed of.

- Prior to the acquisition or disposal of property, the Environmental Site Assessment (ESA) documentation is reviewed by an individual with the appropriate level of authorization and knowledge.

Nonetheless, this control does not mitigate the risk that Reclamation may have an unknown environmental liability associated with a tract of land which has been held by Reclamation over a period of time.

Recommendation

We recommend that the Commissioner, U.S. Bureau of Reclamation:

a. Document and implement procedures and sufficient controls to directly ensure the completeness of environmental liabilities.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our recommendation and will revise existing policies and procedures and will develop new directives and standards to ensure the completeness of environmental liabilities. The target date for implementation of the improvements is June 30, 2006.

* * * * * * *

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of Reclamation gained during our work to make comments and recommendations that we hope will be useful to you. We would be pleased to discuss these comments and recommendations with you at any time. A summary of the status of prior-year management letter comments is included as Exhibit I.

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

Very truly yours,

KPMG LLP

Exhibit I

U.S. BUREAU OF RECLAMATION

Summary of the Status of Prior Year Management Letter Comments

September 30, 2005

Ref	Comment	Status
1	Application and General Controls over Financial Management Systems	This comment has been partially corrected. Existing and new findings were identified in fiscal year 2005. See reportable condition B in the Independent Auditors' Report dated November 21, 2005.
2	Charge Card Reviews	This comment has not been corrected. See reportable condition C in the Independent Auditors' Report dated November 21, 2005.
3	CIP and Property Transfers/Removals	This comment has been corrected.
4	Account Classification	This comment has been partially corrected. See 2005 management letter comment 9.

United States Department of the Interior

BUREAU OF RECLAMATION
Washington, D.C. 20240

IN REPLY REFER TO:
D-7400
ADM-1.00

MEMORANDUM

To: Office of Inspector General
Attention: Assistant Inspector General for Audits

Through: Mark Limbaugh
Assistant Secretary - Water and Science

DEC 21

From: John W. Keys, III
Commissioner

John W. Keys, III DEC 19

Subject: Response to the Draft Management Issues Identified During the Audit of the Bureau of Reclamation's Fiscal Years 2005 and 2004 Financial Statements (Assignment No. X-IN-BOR-0007-2006)

We appreciate the opportunity to review and comment on the draft audit report Management Issues Identified During the Audit of the Bureau of Reclamation's Fiscal Years 2005 and 2004 Financial Statements. Attached for your consideration is Reclamation's response to the recommendations as stated in the draft audit report.

If you have any questions or require additional information, please contact Reclamation's Audit Liaison Officer, Tom Lab, at 303-445-3436.

Attachment

cc: Assistant Secretary - Water and Science
Attention: Olivia Ferriter
Associate Director - Financial Policy and Operations
Attention: Debbie Smith

Bureau of Reclamation
Response to Draft Audit Report Recommendations
Management Issues Identified During the Audit of the Bureau of Reclamation's
Fiscal Years 2005 and 2004 Financial Statements
December 2005

1. Software Development and Change Controls

Recommendation 1.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation ensure approvals are consistently obtained and documented prior to initiating the development of a system change.

Response:

Concur. Reclamation is revising the Bureau of Reclamation Water Operations and Record Keeping System's (BORWORKS) Change Management Plan to include periodic reviews to ensure approvals are consistently obtained.

The responsible official is the Regional Director, Mid-Pacific Region. The target date for revising the BORWORKS Change Management Plan is January 15, 2006.

Recommendation 1.B:

We recommend that the Commissioner, U.S. Bureau of Reclamation ensure release packages include all necessary documentation at the component level and that testing is performed where necessary.

Response:

Concur. Reclamation will modify the BORWORKS Change Management Plan to clearly establish test and data validation procedures and the level of test effort for all releases. It will also review release plans periodically to ensure they are signed by the appropriate personnel. In addition, Reclamation will revise the release plan form to more fully document test case, test plan, and data validation efforts at the work request level.

The responsible official is the Regional Director, Mid-Pacific Region. The target date to modify the BORWORKS Change Management Plan to clearly establish test and data validation procedures and the level of test effort for all releases is December 30, 2005.

2. Background Investigations

Recommendation 2.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation monitor processes to ensure that policies and procedures related to periodic background investigations are properly followed.

Response:

Nonconcur. Reclamation does not see support for this recommendation in the description of the audit report finding. The requirement for periodic re-investigations is tracked by our personnel security/suitability staff, but this information was not requested during the audit.

Recommendation 2.B:

We recommend that the Commissioner, U.S. Bureau of Reclamation validate the current background information in the system/database and ensure that information is consistent with formal position descriptions.

Response:

Concur. Reclamation recognizes the need to verify consistency between the position descriptions and systems used to help manage background investigations. Even though Reclamation questions that the one inconsistency identified in the audit merits spending the resources required to review position descriptions for all employees, the Human Resources Division will establish a procedure to annually review a sampling of active position descriptions. This review will compare active position descriptions against information in the databases related to background investigations.

Reclamation concurs with the audit report finding that "existing processes are not sufficient to ensure information related to background investigations is sufficiently communicated." We have verified that the individual sited in the audit report finding came to our organization from a high public trust position and the related background investigation was verified by the local Human Resources organization. Reclamation documentation is being updated to reflect that fact.

The responsible official is the Director, Administration. The target date for establishing the subject review procedure is April 30, 2006.

3. Open Obligations and Payables

Recommendation 3.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation improve and document its review procedures over open obligations and payables to ensure invalid amounts are removed on a timely basis. Improvements should include:

- Regional follow-up on requests made to remove invalid balances
- Increased oversight by acquisitions and finance personnel in Denver, Colorado to ensure requested actions are completed in a timely manner

Response

Partially concur/partially non-concur. Reclamation will improve and document its procedures for ensuring that invalid open obligations are removed in a timely manner. Reclamation, however, does not concur with the recommendation to improve and document its review procedures over payables. As noted in the management letter, there was only one exception pertaining to a potential invalid payable, due to Reclamation's inability to provide supporting documentation for an accrual totaling $3,078. Given the volume of accrual transactions that Reclamation processes each quarter, one exception due to the inability to provide supporting documentation is not indicative of insufficient review procedures.

The responsible officials are the Deputy Commissioner, Operations and the Director, Administration. The target date for improving and documenting procedures for ensuring the timely removal of invalid obligations is June 30, 2006.

4. Documentation of Process-level Activities

Recommendation 4.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation design and implement procedures and controls consistent across all regions for documenting the performance of control-level activities. Such documentation will allow management to assert the control is being performed and is functioning effectively.

Response

Concur. As part of revised OMB Circular A-123 compliance activities, Reclamation will design and implement procedures and controls, consistent across all regions, as applicable, for documenting the performance of control-level activities. Reclamation will assess and test existing controls and, as necessary, design, document, and implement additional controls.

The responsible official is the Deputy Commissioner, Operations and the Director, Administration. The target date for designing and implementing procedures for documenting the performance of control-level activities is June 30, 2006.

5. Correction of Prior-Period Errors

Recommendation 5.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation improve existing policies and procedures to ensure all prior period corrections are sufficiently analyzed in accordance with SFFAS No. 21. These policies and procedures should be sufficient to identify whether or not corrections made during the current year relating to prior periods would have a significant impact on the current or prior period financial statements.

Response:

Nonconcur. In our response to the corresponding Notice of Finding and Recommendations, Reclamation explained that existing procedures and controls are sufficient to assess whether prior period corrections would have a material impact on current or prior period financial statements. Reclamation analyzes transactions at the time they are prepared, including a review of prior period corrections to determine whether the correction would have a material impact on the financial statements and should be recorded as a prior period adjustment, in accordance with the U.S. Standard General Ledger (SGL).

Additionally, Reclamation analyzes its SGL accounts periodically during the year to identify any significant fluctuations from prior periods. Any significant fluctuations are researched to identify the reason. Reclamation believes that any material errors resulting from the aggregate of prior period adjustment would be identified during these analyses. The need for any reclassification would be assessed at that time.

6. Withdrawn Lands

Recommendation 6.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation improve existing policies and procedures to comply with Reclamation Manual/Directives and Standards LND 03-01, *Land Withdrawals, Withdrawal Reviews, and Withdrawn Revocations* and Reclamation's Land Withdrawal Handbook to ensure withdrawn lands exist, are complete and accurate.

Response:

Nonconcur. The Reclamation Manual Directives and Standards LND 03-01 (*Land Withdrawals, Withdrawal Reviews, and Withdrawn Revocations*) and the Land Withdrawal Handbook, which is non-mandatory guidance, may need to be reviewed and possibly updated as they were implemented in 1997 and 1998, respectively. However, this review and update would not be pursued in response to KPMG's October 2005 Notice of Findings and Recommendations (NFR), which provides their conclusions as to the reason for the withdrawn lands overlay issue cited in KPMG's draft management letter. Although this NFR stated that problems with processes, procedures, and management oversight were the reasons for the withdrawn lands overlay issue, this issue affects only Reclamation's Lower Colorado (LC) Region. It is a direct result of a rather complex history of pre-planning withdrawals and subsequent withdrawals authorized by project legislation in the LC Region, combined with the design of the Foundation Information for Real Property Management (FIRM) real property inventory system, which accounts for acres by project. This combination created more "paper acres" in Reclamation's FIRM system than actually exists in the "net acre footprint" on the ground encompassing the LC regional projects. Reclamation will take steps to address this issue in FIRM during 2006, but it does not require changes to existing policies and procedures.

The LC Region has worked closely with the Bureau of Land Management (BLM) over the years to ensure Reclamation's Plat Books and the BLM's Master Title Plats essentially match one another. The remaining regions, which do not have withdrawal overlap issues, do coordinate on an ongoing basis with their respective BLM state offices for the purposes of relinquishing withdrawals and other land management issues.

Recommendation 6.B:

We recommend that the Commissioner, U.S. Bureau of Reclamation ensure policies and procedures are sufficient to prescribe an appropriate level of management oversight regarding compliance with the established procedures.

Response:

Nonconcur. See response under Recommendation 6.A. Reclamation already has sufficient policies and procedures to ensure an appropriate level of management oversight. This includes, but is not limited to, (1) annual cyclical review of projects to identify lands no longer needed for project purposes; (2) individual withdrawn land reviews for the purpose of relinquishment under the Federal Land Policy and Management Act; and (3) under the Required Stewardship Information report, the newly-required annual certifications of condition assessments of withdrawn lands.

7. Interest During Construction and Interest on Investment

Recommendation 7.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation document and implement a process and procedures to ensure the completeness of SGL 578A, Imputed Financing Sources – Operating, and SGL 578C, Imputed Financing Sources – Cap Assets, in accordance with the Reclamation Manual Supplement to the Department of the Interior Departmental Accounting Manual, *Interest on Investment* and *Interest During Construction.*

Response:

Concur. Reclamation will develop, document, and implement a process and procedures to ensure the completeness of SGL 578A (Interest on Investment - IOI) and SGL 578C (Interest During Construction - IDC) in accordance with applicable Reclamation guidance.

The responsible official is the Director, Administration. The target date for developing, documenting, and implementing a process for ensuring the completeness of IOI and IDC is June 30, 2006.

8. Overtime Authorization

Recommendation 8.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation ensure compliance with its established overtime authorization guidance and policies, as well as the CFR. Reclamation management at all field, area, or regional office locations should improve diligence in monitoring and enforcing compliance with these policies. Such diligence may include formal internal audit programs to ensure compliance with established policies.

Response:

Concur. To ensure compliance with its established overtime authorization guidance, policies, and Code of Federal Regulations, Reclamation is currently providing training for all timekeepers to ensure awareness of their responsibilities for overtime. A training program for managers has been developed and is currently available. Additionally, Reclamation will develop a schedule for oversight reviews of overtime authorization compliance for all Reclamation offices.

The responsible official is the Director, Administration. The target date for developing a schedule for oversight reviews of overtime authorization compliance for all Reclamation offices is June 30, 2006.

Recommendation 8.B:

We recommend that the Commissioner, U.S. Bureau of Reclamation communicate to all employees and managers the importance of complying with the CFR and Reclamation policies.

Response:

Complied. Reclamation distributed an all employees memorandum, Reminder of Overtime Rules and Regulations on July 15, 2005 (see attached). The subject memorandum was a reminder to all employees regarding the rules, regulations, and requirements in approving and paying overtime within the Bureau of Reclamation.

9. Recording Gains/Losses on the Sale of Property, Plant, and Equipment

Recommendation 9.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation improve processes and procedures to comply with Statement of Federal Financial Accounting Standards No. 6 *Accounting for Property, Plant and Equipment,* paragraph 38, to ensure that the net effect of asset disposals are being reported properly as gains or losses. Procedures may include quarterly adjustments to properly state the net effect of asset disposals.

Response:

Concur. Reclamation will review its processes and procedures for recording gains and losses to ensure that the net effect of asset disposals is properly recorded in accordance with applicable accounting standards.

The responsible official is the Director, Administration. The target date for reviewing processes and procedures for recording gains and losses to ensure that they are properly recorded is June 30, 2006.

10. Environmental Liabilities

Recommendation 10.A:

We recommend that the Commissioner, U.S. Bureau of Reclamation document and implement procedures and sufficient controls to directly ensure the completeness of environmental liabilities.

Response:

Concur. Reclamation will revise Directives and Standards (D&S) ENV 02-04 (Hazardous Waste Site Surveys of Existing Reclamation Lands and for Lands or Interest in Lands to be Acquired) and develop a second lands management D&S to include sufficient land management controls to ensure the completeness of Reclamation's environmental liabilities.

The responsible official is the Director, Office of Program and Policy Services. D&S ENV 02-04 and a new lands management D&S will be finalized by June 30, 2006.

Attachment

United States Department of the Interior

BUREAU OF RECLAMATION
P.O. Box 25007
Denver, Colorado 80225-0007

TAKE PRIDE IN AMERICA

IN REPLY REFER TO:

JUL 15 2005

D-7511
ADM-1.00

VIA ELECTRONIC MAIL

MEMORANDUM

To: All Bureau of Reclamation Employees

From: Ellie Hasse
Acting Manager, Human Resources Division

Subject: Reminder of Overtime Rules and Regulations

This is a reminder to all employees regarding the rules, regulations, and requirements in approving and paying overtime within the Bureau of Reclamation.

Overtime is paid for work in excess of 8 hours per day or 40 hours per week for employees on a conventional or a flexible work schedule. Employees who are assigned to work compressed work schedule, overtime is paid for work in excess of their daily scheduled hours and weekly tour of duty. Title 5 stipulates that overtime must be "officially ordered or approved," and the OPM regulation requires that overtime must be approved "in writing." Reclamation employees are required to use the Overtime Authorization Form, 7-1390 (attached).

As noted in Reclamation Instruction R550.1.4:
"The decision of authorized officials to recommend or approve overtime shall include a review and analysis of the overtime request documents submitted for the purpose of considering possible alternatives such as (1) having the work performed by someone on regular time, (2) shifting, staggering, or adjusting the workweek, and (3) postponing the work. A complete and sound justification for overtime work is required on Form 7-1390. Authorizing officials should carefully review all proposals to ensure that they are fully justified and that the overtime meets the above criteria."

Under the Fair Labor Standard Act nonexempt employees are paid one and one-half times the hourly rate of regular pay and are excluded from the aggregate salary limitation provision.

Exempt employees are paid under Title 5 of the United States Code (5 U.S.C.); and are entitled to receive the hourly rate of overtime pay which is now the greater of:

1) One and one-half times the minimum hourly rate of basic pay for GS-10, step 1, or
2) The employee's own hourly rate of basic pay.

For 2005 the Aggregate Salary Limitation, under 5 U.S.C. 5547(a) and 5 CFR 550.105, states that General Schedule (GS) exempt employees and other covered employees may receive certain types of premium pay for a biweekly pay period only to the extent that the sum of basic pay and premium pay for the pay period does not exceed the **greater** of the **biweekly** rate for:

(1) GS-15, step 10 (including any applicable special salary rate or locality rate), or

(2) Level V of the Executive Schedule.

The biweekly rate is computed by (1) dividing the applicable scheduled annual rate by 2,087 hours, (2) rounding the resulting hourly rate to the nearest cent, and (3) multiplying the hourly rate by 80 hours. Compensatory time earned is included when calculating the biweekly aggregate limitation.

For example, in Washington, DC, the GS-15, step 10, scheduled annual locality rate of $135,136 divided by 2,087 hours yields an hourly rate of $64.75 and a biweekly rate of $5,180.00 ($64.75 x 80 hours). Similarly, the Executive Level V annual rate of $131,400 divided by 2,087 hours yields an hourly rate of $62.96 and a biweekly rate of $5,036.80 ($62.96 x 80 hours).

The attached table provides the biweekly premium pay caps for 2005 by locality pay area from the Office of Personnel Management's web site.

Managers and supervisors must be aware of the overtime worked by their employees in order to limit the amount of hours of overtime worked to ensure the employees do not go over the maximum biweekly aggregate limitation. There is no provision in law to compensate employees when they have exceeded the aggregate ceiling. Employees should be made aware of the law to avoid the loss of any compensation for overtime purposes.

Bargaining Board employees are covered by their negotiated contract and the provision of the contract may take precedence over FLSA rules.

All questions should be directed to your servicing Human Resources Office.

Attachments

Distribution E

ATTACHMENT 3

STATUS OF MANAGEMENT LETTER RECOMMENDATIONS

Recommendation	Status	Action Required
1.a, 1.b, 2.b, 4.a, 7.a, 8.a, 9.a, and 10.a	Resolved, not implemented.	Recommendations will be referred to the Assistant Secretary, Policy, Management and Budget for tracking of implementation.
2.a, 3.a, 5.a, 6.a, and 6.b	Unresolved.	Recommendations will be referred to the Assistant Secretary, Policy, Management and Budget for resolution.
8.b	Resolved and implemented.	No further action is required.