



United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

May 21, 2003

Memorandum

To: Assistant Secretary for Indian Affairs

From: Roger La Rouche
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Bureau of Indian Affairs' Financial Statements for Fiscal Years 2002 and 2001 (Report No. 2003-I-0052)

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

In its audit report dated January 21, 2003, except for Note 19, as to which the date is March 4, 2003 (Attachment), KPMG issued an unqualified opinion on BIA's financial statements. KPMG identified nine reportable conditions related to internal controls and financial operations: (A) information technology systems, (B) financial reporting, oversight, and organization structure, (C) processing Trust transactions, (D) legal liabilities, (E) property, plant and equipment, (F) environmental liabilities, (G) intra-governmental eliminations, (H) unbilled/reimbursable accounts receivable, and (I) undelivered orders. KPMG considered the first four reportable conditions to be material weaknesses. With regard to compliance with laws and regulations, KPMG found that BIA was not in substantial compliance with the three requirements of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Specifically, BIA's financial management systems did not substantially comply with federal financial management systems requirements, federal accounting standards, and the U.S. Standard General Ledger at the transaction level. KPMG also found BIA to be noncompliant with the Debt Collection Improvement Act 1996.

In connection with the contract, we monitored the progress of the audit at key points, reviewed KPMG's report and selected related working papers, and inquired of its representatives. Our review, as differentiated from an audit in accordance with the

Government Audit Standards, was not intended to enable us to express, and we do not express, an opinion on the BIA's financial statements, conclusions about the effectiveness of internal controls, conclusions on whether BIA's financial management systems substantially complied with the three requirements of FFMIA, or conclusions on compliance with laws and regulations. KPMG is responsible for the auditors' report and for the conclusions expressed in the report. Our review disclosed no instances where KPMG did not comply in all material respects with the *Government Auditing Standards*.

Management's response was incorporated into KPMG's report. Based on the response, all the recommendations are considered resolved but not implemented. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

Section 5(a) of the *Inspector General Act* (5 U.S.C. App. 3) requires the Office of Inspector General to list this report in its semiannual report to the Congress.

Attachment



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

SUMMARY

As stated in our opinion on the financial statements, we concluded that BIA's financial statements as of and for the years ended September 30, 2002 and 2001, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. As discussed in Note 17 to the financial statements, BIA implemented a change in accounting principle related to the method of accounting for allocation transfers as of October 1, 2001.

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

Reportable Conditions That Are Considered to be Material Weaknesses

- A. Information technology systems
- B. Financial reporting, oversight, and organization structure
- C. Processing Trust transactions
- D. Legal liabilities

Other Reportable Conditions

- E. Property, plant and equipment
- F. Environmental liabilities
- G. Intra-governmental eliminations
- H. Unbilled/reimbursable accounts receivable
- I. Undelivered Orders

The results of our tests of compliance with certain provisions of laws and regulations, exclusive of those referred in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed an instance of noncompliance with the following law and regulation that is 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 Statement*





J. Debt Collection Improvement Act of 1996

The results of our tests of compliance with the FFMIA disclosed instances where BIA's financial management systems did not substantially comply with Federal financial management systems requirements, the use of the U.S. Standard General Ledger at the transaction level and Federal accounting standards.

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

OPINION ON THE FINANCIAL STATEMENTS

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

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

As discussed in Note 17 to the financial statements, BIA implemented a change in accounting principle related to the method of accounting for allocation transfers as of October 1, 2001.

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 Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

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 2002 audit, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable conditions A through D, discussed below, are material weaknesses.



A. Information technology systems

Weaknesses in the BIA's computer systems raise concerns about the integrity of information being reported in the financial statements. Although BIA has developed a formal security program, BIA has not implemented information systems security policies or procedures to effectively control and protect information systems, programs and data supporting BIA operations and assets and has failed to meet minimum information technology (IT) security requirements. Some of the identified weaknesses have been previously reported, and persist despite developed corrective action plans. Weaknesses were identified in the following IT control areas:

1. *Entity-wide Security Program* – BIA did not have an effective security management structure in place that provides a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer-related controls. While BIA has prepared a security program, it has not been fully implemented.
2. *Segregation of Duties* – BIA has not ensured proper segregation of duties through its policies, procedures, and organizational structure such that one individual cannot control key aspects of computer-related operations and thereby conduct unauthorized actions or gain unauthorized access to assets or records without detection.
3. *Access Controls* – BIA has not established access controls that limit or detect inappropriate access to computer resources, thereby increasing the risk of unauthorized modification, loss, or disclosure of electronic data. Various access control weaknesses consisted of: network configuration management weaknesses, password management, other logical access weaknesses, and physical controls over the BIA data center that could be improved.
4. *Application Software Development and Change Controls* – BIA has not established application software development and change controls that prevent unauthorized access to programs or modifications to an existing program from being implemented.
5. *System Software Controls* – BIA has not established system software controls that limit and monitor access to the programs and sensitive files that control the computer hardware and secure applications supported by the system.
6. *Service Continuity* – BIA has not established controls to ensure that critical operations continue without interruption or are promptly resumed and critical and sensitive data are protected, should unexpected events occur.

Recommendation

1. We recommend that BIA implement an Entity-wide Security Program to fully comply with OMB Circular A-130, *Management of Federal Information Resources*. Employee roles and responsibilities should be reviewed and restructured to achieve a higher degree of segregation of duties in computer-related operations. The BIA should improve its security management structure by taking immediate steps to secure the network vulnerabilities and access control deficiencies.
2. We also recommend that application software development, change controls, and system software controls be improved to prevent unauthorized program modification or access to read, modify, or delete critical or sensitive information and programs.



Management Response

The BIA concurs with the recommendations. The BIA is working to develop policies and procedures to correct the findings. With respect to separation of duties and access controls, the BIA has corrected the conditions identified in the findings.

B. Financial Reporting, Oversight, and Organizational Structure

BIA's financial management organization is not operating as effectively and efficiently as needed to fulfill the numerous duties necessary to support BIA's missions and complex organization. The managerial and administrative deficiencies listed below describe circumstances in which the general control environment needs improvement:

1. *Fragmented organizational structure* – The existing organizational structure creates inefficient, duplicative administrative duties and hinders the ability to administer policy effectively. The Regional Offices, Division of Education (Education) and the Office of Chief Financial Officer are not adequately aligned to enable the CFO's office to effectively develop, implement, monitor and manage financial management policy, including essential controls and procedures that would benefit mission related operations.

This situation resulted in a lack of communication and adherence to, financial policies and procedures, an unclear chain of reporting authority, inadequate financial management oversight within BIA during 2002 and hindered the timeliness and accuracy of processing transactions. We noted one division where several significant operational duties are duplicated (e.g. estimation of environmental liabilities), creating inefficiency, and in some cases, resulting in override of established controls and processes. This Division also has not reported GPRA results in time for inclusion in the Bureau's accountability report.

2. *Vacancy in key financial leadership positions* – One key management position remains vacant since the prior fiscal year and several key management positions were vacant during the fiscal year. This resulted in reassignment of critical management functions to existing employees who already had full workloads and created an environment where policies, procedures and controls could be circumvented and not timely discovered with ordinary review and supervision.
3. *Inadequate supervision of contracted accounting personnel* – BIA uses a service organization, the National Business Center (NBC), to perform several key accounting functions. The current service agreement with NBC does not allow for adequate management input, oversight and review of NBC's work, nor does it allow for the establishment of accounting related performance and quality measures by which to monitor and evaluate the performance of the contractor.
4. *Lack of ongoing account analyses and reconciliations* – Although we noted improvement from the prior year, a number of account analyses and reconciliation procedures were not performed routinely during fiscal year 2002, resulting in an excessive number of post-closing adjustments needed to produce accurate financial statements. BIA does not consistently utilize automated posting models that would minimize the need for manual journal entries, and in some instances, utilized erroneous posting models that then required post-closing adjustments to correct errors.

In addition, BIA does not consistently reconcile budgetary to proprietary accounts and does not routinely resolve suspense account or subsidiary ledger discrepancies (e.g. fixed asset subledger) in a timely manner.



5. *Preparation of financial statements* – BIA did prepare interim financial statements in accordance with OMB Bulletin No. 01-09 requirements during the year. However, the interim statements did not accurately depict the financial performance of BIA for the period presented. The accurate preparation of the annual financial statements required a significant effort to be expended after the year-end, particularly to prepare the consolidated statement of financing and the combined statement of budgetary resources.

Recommendations

1. We recommend that management realign reporting structure to provide proper authority to the CFO and key financial managers to establish, administer, manage and enforce compliance with financial management and accounting policies and procedures in a consistent manner throughout the entity.
2. We recommend that BIA fill the vacant position of Chief Accountant as soon as possible with a professional who is knowledgeable of federal government accounting and reporting standards, has experience in establishing and implementing accounting processes, procedures and internal controls and has experience managing accounting staff located in multiple locations.
3. We also recommend that BIA continue to gradually assume accounting functions currently contracted to NBC and consolidating some key accounting functions within BIA's Virginia offices to better control and manage key processes that could materially affect the financial statements.
4. We recommend that BIA routinely resolve aged suspense accounts, reconcile budgetary and proprietary accounts, and perform account and subledger analyses and reconciliations on other key accounts throughout the year, on a timely basis, in order to produce reliable interim financial reports and reduce post-closing adjustments at year-end. We also recommend that posting models be reviewed on a regular basis and to facilitate timely and accurate financial reporting.

Management Response

The BIA concurs with the recommendations. The BIA is developing a reorganization plan that addresses authority lines under the CFO. The BIA plans to advertise for key vacant positions and subsequently assume accounting functions from NBC with the desired result being improved data integrity throughout the financial systems.

C. Processing Trust transactions

The U.S. Congress has designated the Secretary of the Department of Interior (the Secretary) as the primary fiduciary with responsibility for monetary resources held in trust on behalf of American Indian Tribes, Individual Indians, and related Trust Funds. The Secretary carries out this fiduciary responsibility through the Office of Trust Funds Management (OTFM) in coordination with BIA.

BIA performs a critical role in the initial input and subsequent changes to trust accounting data, in its various regional and agency offices. In this fiduciary capacity, BIA performs a variety of functions related to trust transactions. We identified weaknesses related to BIA trust processes in the following areas:

1. *Probate Backlog* – In at least one regional office, probate orders have not been timely recorded into IRMS, the automated system used by BIA to process and track trust activity. This condition also existed in the prior fiscal year; however, the court-ordered shutdown of internet access by BIA in December 2001, has rendered the IRMS impractical to operate and increased the difficulty of managing probate matters. The probate backlog at this location is now estimated to be over one year old and is likely to have also increased in other regions/agencies during the year as well, since BIA



uses common processes elsewhere. This results in the potential for inaccurate and untimely distributions of income to Tribal and Individual Indian Money (IIM) account holders.

2. *Segregation of Duties* – In some agency offices, BIA does not have the proper segregation of duties when processing trust transactions. Specifically, in remote locations an individual agency employee may have the ability to initiate lease agreements, generate annual billings for property leases, collect payment for leases, send change order instructions to the OTFM to establish IIM accounts, direct name changes of the monetary recipients, enter IIM account management codes, and prepare journal vouchers to direct OTFM to re-direct present or future collections without sufficient oversight, review and approval of the transaction or modification.
3. *Untimely deposits* – At various agency offices, we noted instances where trust receipts were not forwarded to regional offices in a timely manner, due to delays caused by BIA personnel. Some of these delays occurred at agency offices where OTFM personnel reside, yet these personnel were not responsible for the collection process. Other delays occurred at agency locations occupied by BIA personnel only.

Recommendations

1. We recommend that BIA management improve the overall trust transactions processing environment in regional/agency offices by developing, implementing, and monitoring policies and procedures addressing timeliness of processing transactions, segregation of duties, managing probate backlog and correcting the known information technology environment deficiencies.
2. We also recommend that the BIA seek input from OTFM and other appropriate Indian representatives/officials to further enhance improvements and ensure satisfaction of all constituents.

Management Response

The BIA concurs with the recommendations and is working to develop a corrective action plan.

D. Legal liabilities

BIA did not receive the necessary information from the Office of the Solicitor (Solicitor) to make quarterly adjustments to the estimated contingent liabilities accrual related to legal matters. BIA, as with other Federal government organizations, must rely on its legal counsel to provide information to record estimated and actual legal liabilities in the financial statements. In the past, the Solicitor has generally only provided this information for year-end reporting, which will not be sufficient to comply with the OMB interim reporting requirements for fiscal years 2003 and beyond. As of 90 days after year-end (December 30, 2002), BIA was still making inquiry and receiving information needed to produce materially correct financial statements.

The Statement of Federal Financial Accounting Standard (SFFAS) No. 5, *Accounting for Liabilities in the Federal Government* and other mandated accounting standards require that BIA record an estimated liability for legal matters when the likelihood of loss is “probable” and “reasonably estimable.” Further, descriptive information, including an estimated range of loss, for litigation that is “reasonably possible” of loss must be disclosed in the notes to the financial statements.



We noted the following matters regarding contingent legal liabilities and communications with the Solicitor:

1. *Communications with Solicitor* – The Solicitor does not have an established plan of communication that would ensure timely periodic (at least quarterly) material updates are provided to BIA accounting personnel;
2. *Quality and consistency of information received from Solicitor* – The information provided by the Solicitor is not always sufficient to determine the accounting treatment – requiring substantial follow-up to resolve questions and determine proper case status and dollar estimates; and
3. *Tracking of case status* – No comprehensive tracking system exists to monitor case status within the Solicitor's office or BIA to ensure completeness of information and assistance with monitoring of changes in status.

Recommendation

We recommend that BIA develop a communication plan with the Solicitor to ensure that timely, complete, and accurate information regarding legal cases is routinely provided to BIA's accounting personnel. The information must be sufficiently complete to allow BIA to fairly state contingent liabilities in the financial statements and the notes thereto, in compliance with applicable accounting standards. To improve the management and tracking of each case, including the case details and range of loss estimates, we recommend that BIA, in association with the Solicitor, develop a database to track the case status and report all relevant information to BIA on a quarterly basis.

Management Response

The BIA concurs with the recommendation and will work with the Solicitor's office to develop a procedure to obtain timely, complete and accurate information regarding legal issues impacting BIA.

E. Property, Plant and Equipment

BIA did not fully adhere to its policies and procedures designed to ensure that property, plant and equipment accounts are stated in accordance with Federal accounting standards. We noted deficiencies in the following areas:

1. *Additions and disposals* – The Education and the Law Enforcement divisions within BIA did not report property, plant and equipment additions and disposals to the BIA Office of Property Management in a timely manner during the year. This situation negatively affected BIA's ability to produce accurate interim financial statements and management reports. It also resulted in a substantial effort to research months-old data to prepare an accurate trial balance at year-end. If uncorrected, this situation could put in jeopardy BIA's ability to adhere to new OMB reporting requirements for interim reporting during fiscal years 2003 and beyond.
2. *Reconciliations* – BIA did not consistently reconcile its property, plant and equipment subsidiary ledger (FAS) to the general ledger (FFS) and did not resolve reconciling items in a timely manner throughout the year. The initial transaction (to purchase an asset) is recorded in FFS, however depreciation is computed from data in FAS. If FAS is not updated timely with transaction and classification data, the financial statements will not accurately reflect depreciation expense. At June 30, 2002, we noted a difference of more than \$35 million between the two systems, which required substantial effort to reconcile to within a slight variance by year-end.



3. *Construction-in-process transfers* – Although BIA recorded the transfer of completed construction in a timely manner in the general ledger, there were delays in recording the transfer of assets in FAS. We noted that the primary reason for the delay is a lack of necessary documentation, e.g. the engineers certificate of safety and operability, or transfer documents signed by the project managers, indicating when the construction projects are complete and placed-in-service. This situation distorts interim financial statements and has been a recurring problem for BIA and financial management in recent years.
4. *Leases* – BIA did not adequately perform procedures to determine, at the inception of the lease, if the lease should be accounted for as a capital or operating lease. BIA also did not maintain a database to track and monitor all operating and capital leases to facilitate reporting this information in its financial reports.

Recommendations

1. We recommend that BIA develop and implement formal month-end financial reporting processes to reconcile the property, plant and equipment subsidiary ledger (FAS) to the general ledger (FFS). The recommendation could be accomplished by timely resolution of exceptions listed on the RFA 70 asset report. BIA should ensure that there is appropriate staffing to complete and review these month-end reporting procedures, and that divisions and agency offices operate with full cooperation in providing information to Property Management in a timely manner.
2. We recommend that BIA improve its policy regarding accounting for construction-in-progress transfers and to ensure a timely matching of depreciation expense with assets placed in-service, while also accommodating the operational acceptance concerns of regional field personnel.
3. We recommend that BIA establish procedures to determine, at the inception of the lease, if the lease should be accounted for as a capital or operating lease. BIA should also establish a database to track and monitor all operating and capital leases to enable BIA to properly report this information in its financial reports.

Management Response

The BIA concurs with the recommendations. The BIA will review and adjust procedures as needed to ensure timely reconciliation of the general ledger to the subsidiary records. The BIA will implement a regular review process over fixed asset additions and disposals and review leases to ensure timely and accurate recording of transactions.

F. Environmental liabilities

BIA's Division of Environmental and Cultural Resource Management (DECRM) prepared a summary listing of estimated environmental cleanup liabilities and/or costs of studies based on information provided by its regional offices. We noted that BIA has not fully developed policies and procedures for estimating the contingent environmental liability for financial statement purposes. Specifically, we noted that BIA's policies and procedures need to be improved to address the following concerns:

1. *Estimation* – Achieving consistency in liability estimation between the regions;
2. *Prioritization* – Creating a national/regional prioritized listing of cleanup activities, planned cost studies, and projects by risk score factor;



3. *Instructions* – Providing sufficient direction to regional employees in preparing and submitting funding requests and in communicating funding results back to the regions;
4. *Clear Lines of Responsibility* – Identifying the responsible party for environmental liabilities on BIA approved leased properties and properties transferred to Tribal authorities;
5. *Continuous Reporting* – Continuously monitoring, refining estimates, and reporting material changes in estimates throughout the year to facilitate accurate interim reporting; and
6. *Completeness* – Ensuring that all divisions of BIA operate under approved processes and procedures to estimate liabilities. In particular, the Education division should utilize BIA's DECRM personnel/specialists to assess environmental cleanup needs and determine estimated liabilities.

We also noted that BIA needs additional specialists, in each region, to facilitate the tracking, monitoring, and cleanup efforts and to perform other duties, particularly in regions that cover vast acreage (e.g. Navajo, Oklahoma).

Recommendation

We recommend that BIA improve its policies and procedures to address the deficiencies noted above. Specifically, BIA should develop a nationally prioritized cleanup plan that includes all known areas of contamination. BIA should require all divisions to operate under this nationally organized plan. In addition, all sites should be identified, tracked, monitored and cleaned under the supervision of DECRM personnel as the Bureau's credentialed environmental specialists. The plan will allow BIA to convert general contingency cost estimates to site specific cost estimates – improving the overall accuracy and enhancing management's ability to monitor project status budget and cleanup costs. We also recommend that BIA consider hiring additional specialists for understaffed areas to work under the direction of the regional scientists in executing the revised policy, procedures, and cleanup plans.

Management Response

The BIA concurs with the recommendation. The BIA will cooperatively develop and implement policy and procedures to consistently identify all liabilities and insure accurate accounting and timely reconciliation on a prioritized basis.

G. Intra-departmental Transactions

BIA did not reconcile intra-departmental transactions and balances in a timely manner in accordance with the Department of the Interior's *Fiscal Year 2002 Financial Statement Preparation Guidance*, OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and Department of the Treasury's *Federal Intra-governmental Transactions, Accounting and Policies Guide*. We noted that periodic reconciliation of eliminating entries is principally a manual process that requires a significant amount of time and resources, Department-wide, to complete at year-end.

The Department of Interior (DOI) reconciled its fiduciary intra-governmental transactions and balances; however, DOI has not reconciled its non-fiduciary intra-governmental transactions and balances. As a result, BIA transactions and balances with other federal entities may not properly eliminate on the government-wide financial statements.



Recommendation

We understand that the Department is developing an automated process to facilitate the reconciliation of intra-Departmental and intra-governmental transactions. We recommend that the Department complete and implement this automated process. Until the automated process is implemented, we recommend that BIA and the Department improve the manual process to reconcile intra-Departmental and intra-governmental transactions and balances on a timely basis. This process would also benefit from more active Departmental involvement/oversight.

Management Response

The BIA concurs with the recommendation. The BIA plans to develop and implement procedures to manually reconcile intra-Department and intra-governmental transactions.

H. Unbilled/reimbursable accounts receivable

BIA did not properly code, review, and monitor expenses incurred which were associated with reimbursable agreements. Also, several receivable balances were more than one year old and remained unbilled or uncollected. Recording errors occurred throughout the year, and resulted in a misstatement of the year-end balance of accounts receivable on reimbursable agreements, necessitating analysis and a post-closing adjustment to correctly state the year-end accounts receivable balances.

In addition, adequate supporting documentation for the activity was not maintained to support transactions affecting reimbursable activities.

Recommendation

We recommend that reconciliations of expenses incurred on reimbursable agreements be performed monthly and reimbursement requests (billings) be prepared and processed simultaneously with the recognition of expenses. Likewise, advances should be tracked and specifically matched to reimbursable activity (expenses). This process will ensure that reimbursable revenue is recognized by BIA as expenses are incurred. It will also help generate timely billing of reimbursement requests and improve cash flow. We also recommend that the regional offices be required to maintain adequate supporting documentation of the expenses incurred to support billing statements as needed.

Management Response

The BIA concurs with the recommendation. The BIA will develop and implement corrective actions.

I. Undelivered Orders

BIA has not fully implemented its policy to ensure that obligations are liquidated and liabilities are accrued for goods and services received prior to the end of the reporting period. In addition, BIA does not de-obligate funds in a timely manner. Specifically, we identified instances where the undelivered order balance and the accrued liability balance were either understated or overstated. As a result, BIA re-analyzed the undelivered order and accrued liability balances and adjusted the balances, appropriately. Although we did not identify any circumstances in which BIA was in violation of the Anti-Deficiency Act, we noted that internal controls regarding the obligation process need to be strengthened to eliminate the vulnerability to becoming anti-deficient.



Recommendation

1. We recommend that BIA fully implement and communicate their policies and procedures to ensure that accruals are recorded and undelivered orders are adjusted for services and products received prior to the end of the reporting period. We also recommend that BIA fully implement their policies to ensure that the accruals and undelivered orders that are recorded are properly supported. These procedures should be completed at least each quarter.
2. We recommend that BIA strengthen existing policy and procedures regarding the obligation process to ensure that the Bureau can not become anti-deficient at the fund level.

Management Response

The BIA concurs with the recommendations. The BIA will work to implement policy and communicate internal controls to ensure proper recording of accruals. The BIA will work to improve the obligation process to ensure timely recording and timely de-obligation.

COMPLIANCE WITH LAWS AND REGULATIONS

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

J. Debt Collection Improvement Act of 1996

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 for collection or offset, resulting in a significantly lower transfer than would have otherwise been made.

Recommendation

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

K. FFMIA

The results of our tests of FFMIA disclosed instances, described below, where BIA financial management systems did not substantially comply with the FFMIA requirements. FFMIA requires that each Federal agency implement financial management systems that comply substantially with (1) Federal financial management systems requirements; (2) the U.S. Standard General Ledger at the transaction level; and (3) applicable Federal accounting standards. Our findings in each area are described below:

1. *Financial Management Systems Requirements -EDP General Controls* – We noted matters which we believe indicate that ineffective general controls exist over the BIA's automated information systems, and represented significant departures from certain requirements of OMB Circulars A-127, *Financial Management Systems*, and A-130, *Management of Federal Information Resources*, and were therefore instances of substantial non-compliance with the Federal financial management systems requirements under the *Federal Managers Financial Integrity Act of 1996*.



As discussed in the comment in this report entitled *Information Technology Systems* within the Internal Control over Financial Reporting section, BIA needs to improve its EDP security and general control environment. BIA has not fully implemented an entity-wide security plan; has not configured the operating systems to provide optimal security and protection and to limit access to sensitive datasets and libraries; has not fully established system software controls that limit and monitor access to the programs and sensitive files; has not fully developed or segregated procedures for controlling changes over application software; and needs to improve maintenance of its off-site storage records.

2. *Standard General Ledger* – BIA is not in substantial compliance with U.S. Standard General Ledger financial recording requirements at the transaction level. The majority of BIA's accounts receivable transactions are recorded into subsidiary systems that do not interface with the general ledger (FFS). These transactions are then periodically recorded at a summary level into FFS. While some of these subsidiaries systems data are recorded at a summary level monthly, at least one is recorded at a summary level annually. In addition, BIA's property, plant and equipment subsidiary ledger (FAS) is not electronically interfaced with the general ledger (FFS). Further, extensive adjustments were required after yearend to correct transaction postings.
3. *Federal Accounting Standards* - We believe that the effects of the items described in the Internal Control over Financial Reporting section constitute substantial non-compliance with Federal accounting standards. Extensive adjustments were required after year-end to prepare accurate financial statements in material compliance with Federal accounting standards. Consequently, interim financial information was not accurate and reliable and BIA was only able to produce accurate financial statements at year end through extensive and time consuming effort.

Recommendation

We recommend that in fiscal year 2003, the BIA devote resources to:

1. Improve the automated information systems environment;
2. Address the control weaknesses in this report section on Internal Control Over Financial Reporting;
3. Investigate alternatives for recording accounts receivable transactions that will enable BIA to process transactions more efficiently and maintain compliance with FFMIA.

Management Response

The BIA concurs with the recommendations. The BIA will work to improve the overall information systems environment and to address internal control weakness over Financial Reporting. The BIA will investigate alternative processes for recording receivable transactions.

RESPONSIBILITIES

Management's Responsibilities

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



Management is responsible for:

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

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

Auditors' Responsibilities

Our responsibility is to express an opinion on the financial statements of the BIA based on our audit. We conducted our audit 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

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

We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our fiscal year 2002 audit, we considered the 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 OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the FFMIA. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, we considered the BIA's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the 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 Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and



completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

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

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether the 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 for the information and use of the Department of the Interior's management, the Department of the Interior's Office of the Inspector General, OMB, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 21, 2003, except for Note 19, as to which the date is March 4, 2003.

Bureau of Indian Affairs
Summary of the Status of Prior Year Findings
September 30, 2002

Ref	Condition Area	Status
A	Controls over information technology systems	This condition has not been corrected and is repeated in fiscal year 2002.
B	Controls over financial reporting and oversight	This condition has not been fully corrected and is partially repeated in fiscal year 2002.
C	Controls over processing Trust transactions	This condition has not been fully corrected and is partially repeated in fiscal year 2002.
D	Controls over property, plant, and equipment	This condition has not been fully corrected and is partially repeated in fiscal year 2002.
E	Controls over year-end accruals	This condition is no longer considered a reportable condition.
F	Controls over unbilled/reimbursable accounts receivable	This condition has not been fully corrected and is partially repeated in fiscal year 2002.
G	Controls over Treasury reporting	This condition was corrected in fiscal year 2002.
H	Debt Collection	This condition has not been corrected and is repeated in fiscal year 2002.
I	FFMIA	This condition has not been corrected and is repeated in fiscal year 2002.