AUDIT

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

INDEPENDENT AUDITORS' REPORT ON THE U.S. DEPARTMENT OF THE INTERIOR FINANCIAL STATEMENT FOR FISCAL YEARS 2017 AND 2016

Report No.: 2017-FIN-026 November 2017

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

Memorandum

NOV 15 2017

To: Secretary Zinke

From: Mary L. Kendall
Deputy Inspector General

Subject: Independent Auditors' Report on the U.S. Department of the Interior Financial Statement for Fiscal Years 2017 and 2016
Report No. 2017-FIN-026

This memorandum transmits the KPMG LLP (KPMG) auditors' report of the U.S. Department of the Interior's (DOI) financial statements for fiscal years (FYs) 2017 and 2016. The Chief Financial Officers Act of 1990 (Public Law 101-576), as amended, requires the DOI Inspector General, or an independent external auditor as determined by the Inspector General, to audit the DOI financial statements.

Under a contract issued by DOI and monitored by the Office of Inspector General, KPMG, an independent public accounting firm, performed an audit of DOI's FYs 2017 and 2016 financial statements. The contract required the audit to be performed in accordance with the Generally Accepted Government Auditing Standards (GAGAS), issued by the Comptroller General of the United States, and Office of Management and Budget Bulletin No. 17-03, "Audit Requirements for Federal Financial Statements."

Results of Independent Audit

KPMG's audit report includes: (1) an opinion on the consolidated financial statements of DOI, (2) a report on internal controls, and (3) a report on compliance with laws and regulations:

1. The consolidated financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles.
2. KPMG identified no material weaknesses in internal controls, but it did identify three significant deficiencies[1]:
    - Lack of Sufficient Controls over General Property, Plant, and Equipment
    - Lack of Sufficient Controls over Accounts Payable
    - Lack of Sufficient General Information Technology Controls
3. KPMG identified no instances of noncompliance with laws and regulations.

[1] A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Evaluation of KPMG's Audit Performance

To fulfill our oversight responsibilities under the Inspector General Act of 1978, as amended, for ensuring that high quality audit work is performed, we reviewed KPMG's report and related documentation and questioned KPMG auditors regarding the audit. We performed several tasks, to include –

- Reviewing KPMG's approach and planning of the audit;
- Evaluating the qualifications and independence of the auditors;
- Monitoring the progress of the audit at key points;
- Attending periodic meetings with DOI management and KPMG auditors to discuss audit progress, findings, and recommendations; and
- Reviewing KPMG's audit report.

Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, nor do we express, an opinion on DOI's financial statements, internal controls, or compliance with laws and regulations. KPMG is responsible for the attached auditors' report and the conclusions expressed. Our review of the report, however, disclosed no instances where KPMG did not comply, in all material respects, with GAGAS.

Report Distribution

The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all audit, evaluation, and inspection reports issued; actions taken to implement our recommendations; and recommendations that have not been implemented. Therefore, we will include the information in the attached report in our next semiannual report.

We appreciate the courtesies and cooperation extended to KPMG and our staff during this audit. If you have any questions regarding the report, please contact me at 202-208-5745.

Attachment

KPMG LLP
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Washington, DC 20006

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the U.S. Department of the Interior (the Department), which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements (hereinafter referred to as "consolidated financial statements" or "basic consolidated financial statements").

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the consolidated 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, 2017 and 2016, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the Agency Financial Report to provide additional information for the users of its financial statements. Such information is not a required part of the basic consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the *Management's Discussion and Analysis, Required Supplementary Information,* and *Required Supplementary Stewardship Information* sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The information in the *Introduction*, *Office of Inspector General Transmittal*, *Other Information*, and *We Would Like to Hear From You* sections of the Department's 2017 *Agency Financial Report* is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2017, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Exhibit I, as items that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's consolidated financial statements are free from material misstatement, we performed tests of its 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. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 17-03.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances in which the Department's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

Department's Responses to Findings

The Department's responses to the findings identified in our audit are described and presented as a separate attachment to this report. The Department's responses were not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the responses.

***Purpose of the Other Reporting Required by* Government Auditing Standards**

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
November 15, 2017

EXHIBIT I

SIGNIFICANT DEFICIENCIES

During fiscal year (FY) 2017, the Department initiated implementation of corrective action plans to address internal control weaknesses and strengthen internal controls. Although the Department made progress in certain financial management and reporting areas, internal control deficiencies remain in certain areas of accounting and reporting of general property, plant, and equipment; accounts payable; and general information technology (IT) controls, as outlined below. The Department indicated that additional remediation is scheduled to continue in FY 2018.

A. Lack of Sufficient Controls over General Property, Plant, and Equipment

Conditions

The Department reported $21.4 billion in property, plant, and equipment (PP&E) net of accumulated depreciation, as of September 30, 2017, including $2 billion in construction in progress (CIP). Controls were not operating effectively to determine that completed CIP projects are monitored and transferred to property, plant, and equipment in a timely manner. We continue to note instances where:

- Completed projects were not transferred out of CIP and into the associated property, plant and equipment account as of September 30, 2017.
- Projects related to non-federal physical property were inappropriately capitalized rather than expensed.
- Completed projects were transferred to property, plant and equipment as of September 30, 2017, but not in a timely manner per bureau policy.

Criteria

- Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government* (Green Book) Principle 4 and 10 – *Demonstrate Commitment to Competence* and *Design Control Activities*, respectively.
- Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, Section IV, *Assessing Internal Control*.
- Financial Accounting Standards Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*.
- National Parks Service (NPS) Real Property Capitalization Policy Memo.
- Bureau of Reclamation (BOR) Temporary Reclamation Manual Release 92 (TRMR-92) *Assets Under Construction*.
- Bureau of Indian Affairs (IA) *Assets Under Construction Handbook Accounting Management Handbook 27 IAM 15-H*.

Cause and Effect

Project managers are not properly and timely notifying the appropriate finance offices when a project is substantially complete, and regional/finance offices are not obtaining sufficient documetation in a timely manner to intiate and complete transfers. In addition, title, or ownership, of PP&E may not be determined in a sufficiently timely manner as to allow the timely recording and transfer of assets. If left un-remediated, these conditions present an increased risk that errors in PP&E will not be prevented, or detected and corrected, by the Departments' management in the normal course of performing their assigned functions.

Recommendations

We recommend that the Department and Bureaus enhance internal control over general property, plant, and equipment to prevent a misstatement as follows:

- Reinforce existing policies, procedures, and controls over assets under construction with project managers and accounting personnel to ensure projects are monitored timely and that transactions are recorded accurately and timely.
- Perform an assessment and update Department-wide property, plant, and equipment policies and procedures over proper recording of capital assets, including guidelines for timely recording, to ensure consistent monitoring of assets under construction and to ensure proper recording and classification of capital assets/assets under construction. Additionally, the Department should consider developing and monitoring construction related aging reports based on estimated completion dates.
- Communicate updated policy to help bureaus properly record costs incurred for assets constructed on behalf of other entities.

B. Lack of Sufficient Controls over Accounts Payable

Conditions

The Department reported $1.9 billion in accounts payable as of September 30, 2017. The Department estimates accounts payable balances on either the past history of payments in the current period that relates to prior periods, a percentage of undelivered orders, or a current assessment of services/products received but not paid. The Department continued to implement corrective actions to address internal control weaknesses and strengthen internal controls over accrued liabilities. However, we continue to note deficiencies in controls over accruing for accounts payables, as follows:

- Controls were not properly designed and implemented to perform a comprehensive review of policies, procedures, and estimation methodology variances impacting accounts payable to determine whether balances were in accordance with applicable accounting standards and were not misstated at the financial statement line level.
- Controls were not consistently applied by the Department to accrue for certain contracts where assessments reported costs were incurred though not billed as of the end of the fiscal year.

Criteria

- GAO *Standards for Internal Control in the Federal Government* (Green Book) Principle 10, 13 and 16 – *Design Control Activities, Use Quality Information,* and *Perform Monitoring Activities*, respectively.
- FASAB SFFAS No. 1 *Accounting for Selected Assets and Liabilities*.
- Statement of Federal Financial Accounting Concept (SFFAC) No. 5 *Definitions of Elements and Basic Recognition Criteria for Accrual*.
- OMB Circular No. A-136, *Financial Reporting Requirements*.
- DOI Financial Management Memorandum 2017-029, *Estimation Methodology and Validation for Accounts Payable Accruals.*

Cause and Effect

The Department has not designed and implemented a comprehensive control which considers all variances in order to conclude upon whether accounts payable as of the end of a fiscal year are complete and accurate at the financial statement line level. If left un-remediated, these conditions present an increased the risk that errors in accounts payable will not be prevented, or detected and corrected, by the Departments' management in the normal course of performing their assigned functions. As a result of our observations, the Department analyzed its estimation process and recorded an additional $68.5 million of Intragovernmental Accounts Payable.

Recommendations

We recommend that the Department and Bureaus improve controls over the monitoring and accounting of accounts payable as follows:

- Refine the existing retrospective review policy to require reviewers to validate inputs and any resulting conclusions or action items are taken before year end as a result of the retrospective review and are appropriately documented and retained by control operators.
- Design policies and procedures to evaluate, in aggregate, the results of the analyses performed at the financial statement line level, Public Accounts Payable and Intragovernmental Accounts Payable, to determine that appropriate conclusions are reached regarding the fair presentation of the financial statements.

C. Lack of Sufficient General Information Technology Controls

Conditions

The Department had several control deficiencies related to its financial IT systems that are summarized as follows:

Provisioning of Access and Segregation of Duties:

Preventive controls, such as provisioning of IT access, are controls designed to reduce the risk of unauthorized and/or inappropriate access to the relevant financial IT systems. When IT personnel or users are given, or can gain, access privileges beyond those necessary to perform their assigned duties, a breakdown in segregation of duties can occur. This unauthorized access could result in inappropriate and/or unauthorized transactions or changes to programs or data that affect the financial statements. The Department did not effectively review annual recertifications of user access rights, did not monitor an individual with access to the development and production environments, did not document or timely assess and apply system patches, and did not remove user access rights due to changes in assigned duties or separations timely.

Change Management:

Detective controls, such as change management, are controls designed to determine that changes to financial IT systems are authorized, tested, approved, properly implemented, and documented. The Department did not have adequately designed controls over the review of user access rights, did not have adequate monitoring procedures for an individual with access to the development and production environments, did not document or timely assess and apply system patches, and did not remove user access rights due to changes in assigned duties or separations timely.

Criteria

- GAO *Standards for Internal Control in the Federal Government* (Green Book) Principle 5, 10, 11 and 12 – *Enforce Accountability, Design Control Activities, Design Activities for Information System* and *Implement Control Activities*, respectively.
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, provides specific requirements for assessing and reporting on controls in the federal government.
- National Institute of Standards and Technology (NIST) Special Publication 800-53, Revision 4, *Security and Privacy Controls for Federal Information Systems and Organizations*.
- System Security Plan (SSP) for Federal Personnel and Payroll System
- BOR SSP for Electronic Time and Attendance System
- Minerals Revenue Management SSP

Cause and Effect

The Department does not have sufficient procedures and controls in place to support compliance with the Green Book and the Department's Security Control Standards and Manuals. The aforementioned IT control deficiencies pose a risk to the completeness, accuracy, and integrity of the Department's financial information, which could ultimately affect the Department's ability to produce accurate and timely financial statements. The Department is at risk that unauthorized, unanticipated, and/or inappropriate activities or changes, made to the relevant financial IT systems, may go undetected by management. The related systems are at risk of data leakage, denial-of-service, or unauthorized modification of data held within the IT systems that are necessary for the complete and accurate presentation of the financial statements.

Recommendations

We recommend that the Department develop and maintain effective general information technology controls to reduce the risks posed to the completeness, accuracy, and integrity of the Department's financial information. Specifically, the Chief Information Officer should:

- Develop policies, procedures and controls to address the provisioning of access and change management control deficiencies identified in the Department's financial IT systems.
- Continue to formalize and disseminate security control standards and guidelines to the bureaus and formally establish security control implementation and testing policies and procedures.
- Monitor progress to ensure that procedures and controls are appropriately designed, implemented, and maintained.

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