T-138

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

AUDIT REPORT

STATEMENT OF ASSETS AND TRUST FUND BALANCES AT SEPTEMBER 30, 1995, OF THE TRUST FUNDS MANAGED BY THE OFFICE OF TRUST FUNDS MANAGEMENT, BUREAU OF INDIAN AFFAIRS

REPORT NO. 97-I-196
DECEMBER 1996

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REPORT ON FINANCIAL STATEMENT AT SEPTEMBER 30, 1995, OF TRIBAL, INDIVIDUAL INDIAN MONIES AND OTHER SPECIAL APPROPRIATION FUNDS MANAGED BY THE OFFICE OF TRUST FUNDS MANAGEMENT, BUREAU OF INDIAN AFFAIRS 1

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C-IN-BIA-003-95

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

DEC 13 1995

Memorandum

To: Special Trustee
Office of Special Trustee for American Indians

From: Robert J. Williams
Acting Assistant Inspector General for Audits

Subject: Audit Report on Statement of Assets and Trust Fund Balances at September 30, 1995, of the Trust Funds Managed by the Office of Trust Funds Management, Bureau of Indian Affairs (No. 97-I-196)

This report presents the results of the audit of the Trust Funds statement of assets and trust fund balances at September 30, 1995, by Griffin and Associates, P.C., an independent public accountant. The Trust Funds, which are managed by the Office of Trust Funds Management, Bureau of Indian Affairs,[1] consist of tribal and individual Indian monies and other special appropriations funds.

The audit is required by the Chief Financial Officers Act of 1990, as amended. Our responsibility was to ensure that the audit was performed in accordance with the requirements of the Act and Office of Management and Budget Bulletin 93-06, "Audit Requirements for Federal Financial Statements." We made quality control reviews of the audit work performed by the accounting firm and provided technical assistance to both the accounting firm and the Office of Trust Funds Management. Based on our review, we found that the audit work by the independent public accountant was performed in accordance with the requirements of the Act and the Bulletin.

This was the first audit of the financial statements of the Trust Funds since 1990, and it was necessary to establish the beginning balances for future audits. Therefore, only the statement of assets and trust fund balances at September 30, 1995, was prepared by the Office of Trust Funds Management and audited by the independent public accountant. In

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[1] On February 9, 1996, the Trust Funds and the Office of Trust Funds Management were transferred from the Bureau of Indian Affairs to the Office of Special Trustee for American Indians, within the Office of the Secretary.

fiscal year 1996 the Office of Trust Funds Management anticipates preparing one additional financial statement to be audited.[2]

In its report on the financial statement, the independent public accountant issued a qualified opinion because of deficiencies in the accounting policies, practices, data, and automated systems and because cash and overnight investments could not be independently verified. These conditions prevented certain material accounts from being audited. In addition, the report stated that various tribal organizations and individual Indians for whom the Office of Trust Funds Management holds assets did not agree with certain recorded accountings and balances and have filed, or are expected to file, claims against the Office over its fiduciary responsibilities. The accountant's report further stated that a potential liability to the Federal Government existed because of these actual or potential lawsuits.

The independent public accountant's report on the internal control structure contained 16 recommendations to address four material weaknesses, six reportable conditions, and six advisory comments as follows:

- The four material internal control weaknesses related to cash balances that were unconfirmed and unreconciled, premiums or discounts on investments that were not being amortized as required by the accounting standards, differences in trust fund balances that were not reconciled, and area and agency offices' accounting policies and procedures that were not being applied consistently. In addition to these four material control weaknesses, the report also discussed material internal control operating deficiencies within the Office of Trust Funds Management. Specifically, the inadequate number of staff, the staff's inexperience and lack of training, and the inadequate computerized accounting systems all contributed significantly to limiting management's ability to manage the trust funds. However, the accountant's report stated that no recommendations were made for the operating deficiencies because the Office of Special Trustee for American Indians[3] had developed a strategic plan to address these issues.

- The six nonmaterial but reportable internal control findings identified weaknesses related to monthly earnings distributions that did not equal monthly earnings received, investment records that were incomplete, monies deposited into special deposit accounts within the Individual Indian Monies system that had not been distributed to beneficiaries'

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[2] Office of Management and Budget Bulletin 94-01, "Form and Content of Agency Financial Statements," requires four financial statements to be prepared and audited. However, three of the required financial statements do not apply to trust entities. As a result, the Office of Trust Funds Management plans to request, from the Department of the Interior and from the Office of Management and Budget, that a statement of changes in assets and trust fund balances be substituted for the three required financial statements that do not apply. Therefore, only two financial statements, the statement of assets and trust fund balances and the statement of changes in assets and trust fund balances, will be prepared and audited in the future.

[3] See footnote 1.

accounts and invested timely, delays in the updating of lease ownership records, a lack of written operating policies and procedures, and a lack of an accounts receivable system.

- The six advisory internal control comments related to improving cash reconciliation procedures, implementing a disaster recovery plan for the accounting data, improving password controls, operating parallel accounting systems after changes were made to the automated accounting programs, converting to a new computer system, and reporting the interest distributions to the Internal Revenue Service.

The independent accountant's report on compliance with laws and regulations stated that there were no instances of material noncompliance with selected provisions of laws and regulations that were tested for fiscal year 1995 but that there were six nonmaterial issues of noncompliance with laws and regulations. Although the report contained no recommendations, the Office of Trust Funds Management responded to each of the six nonmaterial issues.

Based on the response from the Office of Trust Funds Management to the 16 recommendations in the independent accountant's report, we consider all of the recommendations resolved but not implemented. Accordingly, the recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation and no further response to the Office of Inspector General is required (see the Appendix).

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 identification of each significant recommendation on which corrective action has not been taken.

U.S. DEPARTMENT OF THE INTERIOR
BUREAU OF INDIAN AFFAIRS
TRIBAL, INDIVIDUAL INDIAN MONIES AND OTHER SPECIAL APPROPRIATION FUNDS MANAGED BY THE OFFICE OF TRUST FUNDS MANAGEMENT

FINANCIAL STATEMENT
SEPTEMBER 30, 1995

WITH REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

U.S. DEPARTMENT OF THE INTERIOR
BUREAU OF INDIAN AFFAIRS
TRIBAL, INDIVIDUAL INDIAN MONIES AND
OTHER SPECIAL APPROPRIATION FUNDS
MANAGED BY THE
OFFICE OF TRUST FUNDS MANAGEMENT

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U.S. DEPARTMENT OF THE INTERIOR
BUREAU OF INDIAN AFFAIRS
TRIBAL, INDIVIDUAL INDIAN MONIES AND OTHER SPECIAL APPROPRIATION FUNDS MANAGED BY THE OFFICE OF TRUST FUNDS MANAGEMENT

OVERVIEW

SEPTEMBER 30, 1995

HISTORICAL PERSPECTIVE

Funds have been held in trust for American Indians by the federal government since 1820. The Office of Indian Affairs (OIA) was made a part of the War Department on March 11, 1824, and almost immediately criticisms arose regarding the management of Indian financial matters. The OIA operated informally until 1832, when the first Commissioner of Indian Affairs was appointed by Congress. In 1834, during the 23rd Congress, the House of Representatives Committee on Indian Affairs passed legislation to address the management of Indian trust funds. In 1849, the OIA was transferred to the Department of the Interior. The Act of February 12, 1929 authorized the payment of interest on certain funds held in trust by the United States for Indian Tribes, and the Act of June 24, 1938 authorized the deposit and investment of Indian monies. In 1947, the Bureau of Indian Affairs (BIA) was officially established. Since then, the responsibility for the management of Indian trust funds has been determined by a series of treaties, statutes, and court decisions.

In 1994, H.R. 4833, "American Indian Trust Fund Management Reform Act of 1994", was passed by the 103rd Congress and signed by President Clinton on October 25, 1994. The major provisions of H.R. 4833 allows Indian Tribes greater input and control over their trust fund accounts by:

1) providing for voluntary withdrawal and management of their own funds,

2) provisions to return withdrawn funds,

3) establishing a Special Trustee, reporting directly to the Secretary of the Interior, to oversee all aspects of trust funds management reform within the BIA, Bureau of Land Management and the Minerals Management Service including the coordination of policies, practices, systems development, technical assistance, training and recruitment of Indians in the management of trust funds, and regular reporting to Tribal and Individual Indian Money (IIM) account holders, and,

4) providing a grant program to address tribal capacity building for investment and management of trust funds, development of a comprehensive tribal investment plan, and training of personnel responsible for monitoring the investment of trust funds.

TREATIES, LAWS AND AGREEMENTS

The responsibility, or trusteeship, for the holding of funds by the United States for the benefit of individual Indians and Indian Tribes was first and most importantly established by treaties. However, it was not until 1820 that the federal government adopted the policy of holding tribal funds in trust.[1] However, since 1871, the Congress, acting within the scope of

[1] Historical and Legal Analysis of the Federal Government's Fiduciary Duties Regarding American Indian Trust Funds, by Curtis G. Berkey, May, 1988, Indian Law Resource Center.

its constitutional powers, controlled and managed Tribal and individual Indian funds through legislation.

There are also agreements involving fund management between the Tribes and the Federal government by which a particular/specific Indian trust fund is established. The holding and management of trust funds has also been a long standing policy of the federal government.

DESIGNATED TRUSTEE

The Secretary of the Interior has been designated as trustee of funds held by the federal government for Indian Tribes and individual Indians. The Secretary delegated authority for the management of trust funds to the Assistant Secretary - Indian Affairs. This authority was re-delegated to the BIA and was exercised by the BIA's Office of Trust Funds Management.

Secretarial Order No. 3137, dated October 26, 1989, established the Office of Trust Funds Management (OTFM). It is responsible for establishing proper controls and accountability for operation and management of trust funds, and reports directly to the Deputy Commissioner of Indian Affairs. The OTFM, located in Albuquerque, New Mexico, oversees the trust fund operations at the BIA Area/Agency Offices. Prior to October 1989, trust funds management within the BIA was spread across various offices with little or no coordination of policy and/or management controls. The mission of OTFM is, "To assure the highest level of accuracy, responsiveness and service in the collection, investment and disbursement of all judgment awards, Special Acts and income from trust resources belonging to Native Americans."

Secretarial Order No. 3197, dated February 9, 1996, established the Office of the Special Trustee for American Indians, and transferred the OTFM and other financial trust services functions from the BIA to the Office of the Special Trustee. The Special Trustee is required to develop and recommend a Strategic Plan of Reforms to the Secretary, Office of Management and Budget (OMB) and Congress. Once the plan is approved, the Special Trustee oversees but does not direct the implementation of the plan. Upon completion, the Special Trustee is terminated. There are no plans to transfer any other office or any other trust functions to the office of the Special Trustee. OTFM will be transferred to another unit, determined by congress, when the Office of the Special Trustee terminates.

FIDUCIARY RESPONSIBILITY

In carrying out the management and oversight of the Indian Trust Funds, the Secretary has a fiduciary responsibility to ensure that trust accounts are properly maintained and invested in accordance with applicable laws, and that accurate and complete reports are provided to the account holders.

Decisions of the Supreme Court reviewing the legality of administrative conduct in managing Indian property have held officials of the United States to *"moral obligations of the highest responsibility and trust"* and *"the most exacting fiduciary standards,"* and be *"bound by every moral and*

equitable consideration to discharge its trust with good faith and fairness."

TRUST FUND ACCOUNTS

Indian Tribes and individual Indians trust funds are primarily derived from judgment awards from claims and proceeds from surface and sub-surface leasing such as agriculture, business, timber, minerals, or oil and gas. The major portion of tribal funds (69%) consist of judgment awards while individual Indian funds historically have come from per capita distribution of proceeds collected. The composition of trust funds in terms of the source of funds has not changed significantly over the years, however, the value of the funds and number of the accounts has grown.

OTFM PROGRAM STRUCTURE

The Office of Trust Funds Management was reorganized in 1994 and now operates in the following program structure.

- Division of Trust Funds Quality Assurance - Responsible for internal audits, financial and compliance reviews, and issues policies and procedures.

- Division of Trust Funds Services - The Branch of Investments is responsible for trust fund investment functions and the Branch of Customer Service interacts directly with account holders to provide timely and courteous customer services to tribal and individual account holders.

- Division of Trust Funds Accounting - Responsible for the day to day operations for all investment, Tribal and Individual Indian Money accounting functions.

- Division of Trust Funds Systems - Responsible for providing technical assistance to users of the OTFM systems, as well as new software systems or hardware enhancements.

- Division of Trust Funds Reporting/Reconciliation - Responsible for past/current reconciliation efforts and responsible for all financial reporting to the Office of Management and Budget, Department of the Treasury and other special reports.

TRUST FUND ACCOUNTING SYSTEMS

Prior to April 1, 1995, the primary accounting system for all trust funds accounts managed by OTFM was the Trust Funds Management System (TFMS). TFMS was a system developed in the 1960's by the BIA and was used by the BIA for all accounting activities prior to 1991. In 1991, the BIA

transferred its accounting functions onto Federal Finance System (FFS), while the trust funds remained on the TFMS.

During the TFMS era, a subsidiary accounting system was contracted for the purpose of managing the investment portfolios of the trust accounts. This system was known as the Money Max system, and later as Series II.

Individual Indian Money (IIM) accounts are kept on a subsidiary accounting system known as the IIM system. The IIM system is part of a larger BIA system known as the Integrated Records Management System (IRMS).

In addition to the main systems mentioned above there are additional smaller systems and applications developed to assist in various functions involved in management of the Indian trust funds.

There were, and are, many accounting, procedural, and systems problems associated with the accounting systems at OTFM. These difficulties led OTFM to contract for a commercial trust asset management system. The system selected, known as the OmniTrust system is used by a number of major trust departments across the country. On April 1, 1995, the OmniTrust system replaced the TFMS and the Money Max/Series II systems. The IIM accounts continue to be maintained on the IIM/IRMS system.

The OTFM continues to develop and implement incremental improvements to its existing systems. Despite these improvements, the current systems, including OmniTrust, are expected to continue to be deficient in various respects. The Special Trustee's assessment of the problems is that, "the U. S. Government, using present systems, was, is and will continue to be unable to furnish beneficiary American Indian Tribes and individual Indians with an accurate and full accounting of trust funds."

TRUST FUND REPORTING ENVIRONMENT

The Indian trust funds managed by OTFM are held in eight separate Treasury accounts called "Appropriations." Each appropriation may contain one or many separate trust funds, created and managed for different purposes and groups of beneficiaries. The financial activity in each of the appropriations is reported to Treasury on a monthly and annual basis through a series of reports required and defined by the Treasury.

Each of the Indian trust funds managed by OTFM has a particular history and set of organic documents which define why the trust was created, what its purposes are, who its beneficiaries are, and other information needed to manage the fund in accordance with the intent of its creators. In almost every trust the beneficiaries are either Indian Tribes, Native Alaska Villages, or Individuals. The beneficiaries are often referred to as account holders. Tribal trust funds managed in the OmniTrust system receive monthly and annual statements on their accounts. Other optional statements are available on request. Indians whose accounts are managed in the IIM system receive quarterly statements, as required by the American Indian Trust Funds Management Reform Act.

Financial statements on the Indian trust funds also must be filed as described by the Chief Financial Officers Act of 1990 (CFO Act), and the

American Indian Trust Funds Management Reform Act of 1994. The form and content of these financial statements, of which this overview is a part, are defined by the Office of Management and Budget. The CFO Act further requires that agencies obtain an annual financial audit in accordance with generally accepted government auditing standards. There is on-going discussion with the Federal Accounting Standards Advisory Board ("FASAB") as to whether the Indian Trust Funds are subject to the reporting requirements of the CFO Act.

CONCLUSION

The OTFM has made great strides in the improvement of the services it provides to account holders. Despite these strides, there still exists a wide disparity between what a private sector trustee offers its customers, and what the federal government provides its account holders. However, the OTFM is motivated, inspired, committed and challenged to close the gap of disparity.

GRIFFIN & ASSOCIATES, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

DAN D. GRIFFI

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON FINANCIAL STATEMENT

To the U.S. Department of the Interior
Bureau of Indian Affairs:

We have audited the accompanying Statement of Assets and Trust Fund Balances for the Tribal, Individual Indian Monies and Other Special Appropriation Funds managed by the U.S. Department of the Interior Bureau of Indian Affairs Office of Trust Funds Management (the "OTFM") as of September 30, 1995. This financial statement is the responsibility of management of the OTFM. Our responsibility is to express an opinion on this financial statement based on our audit. As discussed in Note 2, the accounting policies used by OTFM to prepare this financial statement are in accordance with Office of Management and Budget (OMB) Bulletin Number 94-01, which is a comprehensive basis of accounting other than generally accepted accounting principles.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards, standards for financial audits contained in *Government Auditing Standards* (1994 Revision) issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin 93-06, "*Audit Requirements for Federal Financial Statements*". Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used, and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed further in the Notes to the Financial Statement, (1) cash and overnight investments are maintained by a related U.S. Governmental Agency (U.S. Treasury) and cannot be independently confirmed, (2) cash balances reflected in the accompanying financial statement are materially greater than balances reported by the U.S. Treasury, (3) major inadequacies in the Trust Fund accounting systems, controls and records caused them to be unreliable, (4) various Tribal organizations and classes of Individual Indians for whom the OTFM holds assets in trust do not agree with certain OTFM accountings and balances recorded by the OTFM; and certain of these parties have filed, or are expected to file, claims against the OTFM. This may result in a potential liability to the Federal government so large that it is not reasonably estimable. Because of these matters, it was not practicable to extend our auditing procedures to enable us to express an opinion regarding the basis on which cash and trust fund balances are stated.

4730 TABLE MESA DRIVE, SUITE C100, BOULDER, COLORADO 80303
PHONE (303) 543-8868 • FAX (303) 543-8869
Members of the American Institute of Certified Public Accountants

In our opinion, except for the effect on the financial statement of adjustments that might have been determined had we been able to perform adequate audit procedures to verify the financial elements described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Tribal, Individual Indian Monies and Other Special Appropriation Funds managed by the U.S. Department of the Interior Bureau of Indian Affairs Office of Trust Funds Management as of September 30, 1995, in conformity with the comprehensive basis of accounting described in paragraph one above.

We have also issued separate reports dated May 17, 1996, on the OTFM's internal control structure and on its compliance with laws and regulations.

The information in the Overview Section, which management is required to submit, is not a required part of the basic financial statement, but is supplementary information required by OMB Bulletin Number 94-01, "Form and Content of Agency Financial Statements." We did not audit this information, and because of the exceptions set forth above, we do not express an opinion on such information.

Our audit was made for the purpose of forming an opinion on the basic financial statement taken as a whole. The supplementary combining statement of assets and trust fund balances as reflected on page 24 is presented for purposes of additional analysis and is not a required part of the basic financial statement. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statement, and in our opinion, except for the exceptions set forth above, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

Griffin & Associates, P.C.

GRIFFIN & ASSOCIATES, P.C.

Boulder, Colorado
May 17, 1996

U.S. DEPARTMENT OF THE INTERIOR
BUREAU OF INDIAN AFFAIRS
TRIBAL, INDIVIDUAL INDIAN MONIES AND OTHER SPECIAL
APPROPRIATION FUNDS
MANAGED BY THE
OFFICE OF TRUST FUNDS MANAGEMENT

STATEMENT OF ASSETS AND TRUST FUND BALANCES
SEPTEMBER 30, 1995

ASSETS

Non-Entity assets:	
Intragovernmental assets:	
Fund balance with Treasury (Note 4):	
Cash	$ 10,114,364
Investments (Note 5):	
Overnight investment	194,561,000
Government backed securities	2,090,359,573
Accrued interest receivable	26,256,216
Governmental assets:	
Investments (Note 5):	
Certificates of deposit	63,047,244
Equity securities	35,740,200
Mortgage backed securities	246,458,007
Accrued interest receivable	4,717,016
Accrued dividends receivable	197,500
Total assets	$ 2,671,451,120

TRUST FUND BALANCES

TRUST FUND BALANCES, held for Indian Tribes, individuals and Special Appropriation Funds held under trust, including unallocated balances	$ 2,671,451,120

The accompanying notes are an integral part of this statement.

U.S. DEPARTMENT OF THE INTERIOR
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APPROPRIATION FUNDS
MANAGED BY THE
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NOTES TO THE FINANCIAL STATEMENT
SEPTEMBER 30, 1995

NOTE 1 -- BACKGROUND AND DESCRIPTION OF THE ORGANIZATION

A. Overview of Trust Funds, the Bureau of Indian Affairs and the Office of Trust Funds Management ("OTFM")

Formation of the Trust Funds - The legislation which authorizes the Secretary of the Interior ("Secretary") to manage the Tribal and Individual Indian Monies ("IIM") Trust Funds ("Trust Funds") gives formal recognition to the relationship that exists between the Indian Tribes and the U.S. Government. At the time the U.S. Government was founded, Indian sovereignty was recognized. Agreements between the U.S. Government and the various Indian Tribes, therefore, took the form of treaties. During the course of the nation's history and the U.S. Government's varying policies toward Indian Tribes, this relationship has retained its original sovereign characteristics.

The balances that have accumulated in the Trust Funds have generally resulted from payments of claims by the U.S. Government, land use agreements, oil, gas and mineral extraction, and investment income.

The Secretary has been designated by the U.S. Congress as the U.S. Government trustee on behalf of the account holders of the Trust Funds. Through February 8, 1996, the Secretary, in turn, delegated authority for management of the Trust Funds, including accounting and financial reporting, to the Assistant Secretary - Indian Affairs, who carried out the management of the Trust Funds through the OTFM. As discussed in Note 7, on February 9, 1996, the Secretary delegated authority for management of the Trust Funds to the Office of the Special Trustee for American Indians, which now oversees the OTFM.

Organization of the Bureau of Indian Affairs ("the Bureau") - The management of the Trust Funds is accomplished through a network of offices within the Bureau.

- Agency and Field Office - The Bureau's 93 Agency and Field Offices maintain direct contact with the Tribes located throughout the United States. Generally, Agency and Field Offices are physically located near the Tribes served. The Agency and Field Offices may play a significant role in tribal affairs through assistance in financial planning, financial operations, and policy and program development.

- Area Office - Each of the Agency and Field Offices is organized under one of 12 Area Offices. The Area Offices provide administrative and operational support for their respective Agency and Field Offices.

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NOTES TO THE FINANCIAL STATEMENT
SEPTEMBER 30, 1995

- Office of Trust Funds Management - The OTFM, established in October 1989, has management responsibility over all Indian Trust Funds. The OTFM carries out its responsibilities through the following Divisions and Staff Offices.

  - ◊ Division of Trust Funds Quality Assurance - This Division plans, develops, operates, and controls the internal management systems evaluation program. The division advises the OTFM on the efficiency, economy, legality and effectiveness of operations at the program and field level. It is responsible for receiving, communicating and monitoring compliance with all mandated laws and regulations.

  - ◊ Division of Trust Funds Systems - This Division provides daily Bureau-wide data system support for Trust Funds. It is responsible for proper maintenance of the existing systems and support of the financial management of trust funds.

  - ◊ Division of Trust Funds Accounting - This Division processes and controls accounting activities which record and report funds collected, disbursed, invested, and held in trust. It plans, develops, and recommends policies and procedures governing collection of trust funds and monitors collection and recording of funds. The Division disburses funds from trust accounts in coordination with other Federal agencies managing trust funds programs. It is also responsible for investment accounting activities and for providing custodial services for investment activities.

  - ◊ Division of Trust Funds Services - This Division plans, develops, operates, and controls the buying, selling, and trading of investments in accordance with applicable laws, regulations, and policies. It provides technical advice and assistance to Area Offices, Agency Offices, and Indian Tribes in developing financial plans and investment strategies for trust funds.

  - ◊ Division of Reporting/Reconciliation - This Division is responsible for reconciling subsidiary accounts and monitoring Trust Fund activities. The Division prepares certain financial and accounting reports for use within the federal government and for inclusion in various Bureau-wide reports.

U.S. DEPARTMENT OF THE INTERIOR
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NOTES TO THE FINANCIAL STATEMENT
SEPTEMBER 30, 1995

B. Description of the Trust Funds

The Trust Funds are managed by OTFM on behalf of Tribes, IIM account holders, and Other Special Appropriation Funds (formally referred to as "Public Funds"). A brief description of each Trust Fund follows:

- Tribal Fund - Approximately 300 Tribes have an interest in the Tribal Fund; however, some Tribes have multiple accounts. As a result, approximately 1,600 separate accounts comprise the Tribal Fund. Approximately 71% of the Tribal Fund assets are held on behalf of 5% of the Tribes.

  Accounts are maintained for Tribes within the Trust Funds. Tribes realize receipts from a variety of sources including land use agreements, royalties on natural resource depletion, tribal enterprises related to trust resources, awards of Indian claims and investment income.

- IIM Fund - The IIM Fund is primarily a deposit fund for individuals as well as estates, Tribes and other organizations which may have a fiduciary interest in the Trust Funds. IIM account holders realize receipts primarily from royalties on natural resources depletion, land use agreements, enterprises having a direct relationship to Trust Fund resources and investment income. In addition, the IIM Fund contains disbursing accounts for certain tribal operations and enterprises. Approximately 346,000 accounts are held for participants and tribal enterprises in the IIM Fund. Approximately 83% of the IIM fund assets are held by six Area Offices, on behalf of the account holders they serve. Because of the nature of Trust Fund assets, these interests may represent allocated or unallocated monies derived from a variety of sources.

- Other Special Appropriation Funds - Other Special Appropriation Funds represent other trust assets currently managed by the Bureau. Authorization for management of these assets is based on U.S. Congressional Acts establishing such Funds. A brief description of each Fund follows:

  - Alaska Native Escrow Fund - The Alaska Native Escrow Fund was established by Congressional act for Alaska Native Corporations and Villages for land of which boundaries were disputed. Proceeds received or deposited into this fund were derived primarily from contracts, leases, licenses, permits, rights-of-way, etc. The proceeds, plus accrued interest, are paid out to the appropriate corporation or individual to which the land was conveyed by the U.S. Government.

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NOTES TO THE FINANCIAL STATEMENT
SEPTEMBER 30, 1995

◊ Cochiti Wetfields Fund - The Pueblo de Cochiti ("Pueblo") and the U.S. Army Corps of Engineers entered into a settlement agreement for water seepage problems at the Cochiti Dam on tribal lands. The agreement established a fund for the sole and specific purpose of operating, maintaining, repairing and replacing this drainage system. Although the fund is invested and managed by the OTFM, the fund remains the property of the United States, and will revert to the Department of the U.S. Treasury ("Treasury") if Cochiti Dam becomes non-operational and the Pueblo agrees that the drainage system is no longer needed.

◊ Tribal Economic Recovery Fund - The Three Affiliated Tribes and the Standing Rock Sioux Tribe were awarded a settlement for land by the U.S. Government for the site of the Garrison Dam and Reservoir and the Oahe Dam and Reservoir. The fund will be used for educational, social welfare, economic development, and other programs, subject to the approval of the Secretary.

◊ Northern Cheyenne Reserved Water Rights Fund - The Northern Cheyenne Tribe was awarded a settlement for reserved water rights claims in the Tongue River Basin. This fund was established by the Treasury to implement the Tongue River Dam Project, which was to correct safety inadequacies of the dam, conserve and develop the fish and wildlife resources in the Tongue River Basin, and to authorize certain modifications to the management and operation of the Big Horn Reservoir.

◊ Papago Cooperative Fund - The Papago Tribe, with respect to the San Xavier Reservation and the Schuk Toak District of the Sells Papago Reservation, was awarded a settlement in the form of water rights for water which was taken from reservation land. The water rights give the Tribe flexibility in the management of water resources and encourage allocation of those resources to their highest and best uses. The awarded funds are to be used for Tribal government, health, education, social services, capital improvements and economic development programs.

◊ Navajo Rehabilitation Trust Fund - The Navajo Rehabilitation Trust Fund was established to support the rehabilitation and improvement of Navajo communities and to enhance the economic, educational, and social condition of Navajo and Hopi families impacted by the Navajo and Hopi Indian Relocation Amendments of 1988.

◊ Contributed Funds - The Bureau maintains eight (8) contributed funds which were established by donations. The individual funds each have a specific use or purpose in some form to better the American Indians by giving assistance for education or tribal operations.

◊ George C. Edgeter Fund - This fund is available, according to the terms of the bequest, for expenditure, as determined by the Assistant Secretary - Indian Affairs, for the relief of indigent American Indians.

Certain of the Tribal, IIM and Special Appropriation Funds described above are subject to legal, regulatory, budgetary, court ordered or other restrictions. In addition, certain account beneficiaries have discretionary investment decision-making rights.

C. Investment of Trust Fund Assets

Authorizing legislation and a substantial body of case law specify how the Indian Trust Fund assets should be managed and which financial instruments constitute appropriate investments for the Indian Trust Fund. Indian Trust Fund assets are invested with financial institutions at which such deposits are subject to Federal depository insurance, or collateralized by U.S. Government securities for amounts deposited in excess of Federal depository insurance limitations. Trust fund assets are also invested in U.S. Government securities, including U.S. Treasury and certain U.S. Government Agency issues, as well as certain other securities which are guaranteed by the U.S. Government.

NOTE 2 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

The Secretary of the Treasury, the Director of the Office of Management and Budget ("OMB") and the Comptroller General have approved a hierarchy of accounting principles that constitutes an other comprehensive basis of accounting. The accounting principles and standards applied in preparing the principal financial statement and described in this note are in accordance with the following hierarchy of accounting principles:

- Statements of Federal Financial Accounting Standards (SFFAS). These statements reflect the accounting principles, standards, and requirements recommended by the Federal Accounting Standards Advisory Board and approved by the Comptroller General of the United States, the Director of OMB and the Secretary of the Treasury,

- Form and content requirements for financial statements, as presented in OMB Bulletin No. 94-01 (Form and Content of Agency Financial Statements), and

- The accounting principles and standards contained in the Departmental and Bureau accounting policy and procedures manuals, and/or related guidance.

The Bureau uses the cash basis of accounting for the Trust Funds; however, accrual adjustments were recorded in the accompanying financial statements as of September 30, 1995, to reflect interest and dividends earned and to record any applicable accretion of discount/amortization of premium over the terms of the investments. Investments are stated at amortized historical cost. Investments have not been adjusted to reflect changes in market value because the Bureau's intent is to generally hold investments until maturity.

The Trust Funds account for assets held for others in a trust capacity and do not involve measurement of operations. Receipts, other than interest on invested funds, are recorded when received because it is not practicable to measure the majority of such items prior to receipt. Accordingly, receivables other than accrued interest receivable are not reflected in the accompanying financial statement. The accompanying financial statement includes only the balances held in trust by the Bureau and the OTFM for others and does not include (1) the account balances of the Bureau (general appropriations, personnel and occupancy costs, etc.), or (2) the values of Indian Lands, buildings or other non-monetary assets regardless of the source of funding (Tribal monies, Congressional appropriations, Indian Trust Fund resources, etc.). In addition, the Bureau does not have the accounting systems or personnel resources necessary to accumulate or account for the value of oil and gas, and other mineral reserves held in trust on Indian lands. Such information is typically disclosed by commercial enterprises that engage in natural resource extraction activities.

B. Interest Income

IIM Fund account holders receive an allocated portion of interest earned on the total IIM investment pool based on an average return applied to each individual account. Accrued interest earned by the pool is then used to fund distributions to account holders. Interest is recorded to IIM accounts using the average daily balance method and is distributed on a monthly basis.

Resources in the Tribal Trust and Other Special Appropriation Funds are invested separately by account with interest recorded based on actual income from each investment. The Tribal Trust and Other Special Appropriation Funds earn interest in two ways: (1) directly from investment securities in which the Tribal funds are placed, such as certificates of deposit at financial institutions or U.S. Government Agency securities, or (2) from a U.S. Treasury ("Treasury") overnight investment

("overnighter"), which earns a rate comparable to Treasury bill rates. The interest on the overnighter investments is calculated daily, compounded, accumulated separately for participating accounts, and posted to the separate accounts monthly.

C. Financial Statement Captions

Brief descriptions of the major captions used in the accompanying financial statement as recommended by the OMB follow:

- Non-Entity Assets - These are assets that are held by the Trust Fund but are not available to the U.S. Government.
  - Intragovernmental Assets - Intragovernmental nonentity assets are claims of the Trust Fund against U.S. Governmental entities. These amounts, when collected, can be spent by the Trust Fund on behalf of beneficiaries unless otherwise restricted.
  - Fund Balances with Treasury - Balances on deposit, suspense and clearing accounts that are assets of the Trust Fund on behalf of beneficiaries unless otherwise restricted.
- Governmental Assets - Governmental nonentity assets are claims of the Trust Fund against nonfederal entities. These amounts, when collected, can be spent by the Trust Fund on behalf of beneficiaries unless otherwise restricted.

D. Comparative Data

Comparative data for the prior year has not been presented because this is the first year financial statements have been prepared for the Trust Fund since fiscal year 1990. In future years, comparative data is expected to be presented to provide an understanding of changes in the financial position and operations of the Trust Fund.

NOTE 3 -- ACCOUNTING SYSTEMS AND MATERIAL INTERNAL CONTROL WEAKNESSES

The accounting systems and internal control procedures used by the Bureau and the OTFM have suffered from a variety of system and procedural internal control weaknesses and other problems; such as understaffed accounting

operations at all levels, a lack of experienced accounting supervisors, a lack of minimum standards for key positions in the accounting process, inadequate training programs, and out-of-date accounting policy and procedure manuals. Certain of these internal control weaknesses are so pervasive and fundamental as to render certain significant accounting systems unreliable. Some of these problems are as follows:

- There is a lack of consistency in the accounting and related procedures being utilized Bureau-wide, which has caused accounting errors in the Indian Trust Funds. Standardized documented policies and procedures have not been instituted for some significant Bureau-wide accounting processes, while certain others remain seriously out-of-date.

- There is inadequate segregation for many key duties, particularly in the accounting processes performed at the Area and Agency Offices.

- Records management is inconsistent and inadequate to ensure the proper filing and safekeeping of Trust Fund records to support trust financial activity.

- Internal financial statements are not prepared in accordance with OMB accounting principles and standards. Most significantly, accretion of discounts and amortization of premiums are either not recorded, or are recorded in a manner inconsistent with OMB accounting principles and standards.

- Internal reporting for Trust Fund investments lacks adequate investment performance information. These financial and managerial reporting deficiencies are detrimental to the OTFM's ability to effectively manage the Trust Funds.

- The IIM detailed subsidiary ledger contains certain accounts with negative balances aggregating approximately $46 million.

- There is an unreconciled material difference between the IIM detailed subsidiary ledger and the corresponding general ledger control account.

- There is an unreconciled material difference between the total cash balances reflected in the accompanying financial statement and the balances held by Treasury. Treasury reports reflect balances significantly less than OTFM balances.

- The balances reflected in the Treasury records are not maintained entirely independent of the OTFM, in that Treasury records are in part updated with information reported by the OTFM, as well as other federal agencies.

As a result of the material weaknesses in internal controls referred to above, it is not possible to determine whether cash and trust fund balances as reflected in the accompanying financial statements are fairly stated and presented.

In some instances, the OTFM has researched and corrected the balances held in trust for specific Indian Tribes, individuals, and Other Special Appropriation Funds. Many individual Tribal and IIM accounts still need to be reconciled and/or resolved through negotiation and settlement before reliance can be placed on the balances reflected in the Trust Fund accounts.

The OTFM recognizes the weaknesses noted above and is in the process of implementing several corrective measures to address them. These measures include certain organizational changes, including recent appropriations to increase staffing levels, the conversion in March 1995 to a new trust and investment system, Omni, and the new oversight authority of the U.S. Department of the Interior Office of the Special Trustee for American Indians, as more fully discussed in Note 7.

NOTE 4 -- CASH AND OVERNIGHT INVESTMENTS WITH U.S. DEPARTMENT OF THE TREASURY

Treasury functions as the disbursing agent for the OTFM. When Treasury checks are written by the OTFM, the amounts are deducted from the Indian Trust Funds, regardless of when (and whether) the checks written are eventually negotiated by payees. During the fiscal year ending September 30, 1995, Treasury checks are only negotiable for one year from the date of issuance and the OTFM receives credit, and credits back to the appropriate account holders, amounts which are not negotiated. Cash balances do not include any checks on hand at the Area and Agency Offices waiting for deposit to Treasury.

Overnight investments consist of available cash invested with Treasury. As investments are required to be called in to Treasury by 1:00PM, the overnight investment balance generally totals the prior day available cash balance, adjusted for current day cash activity up to sweep cut-off time, plus overnight investment interest earned month to date.

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NOTE 5 -- INVESTMENTS

Investments are recorded at cost adjusted for accumulated amortization of premiums and accretion of discounts utilizing the effective interest method.

The Trust Fund assets have a concentration of credit risk in U.S. Government securities.

Insurance Coverage and Pledged Securities

Following is an analysis of depository insurance and collateral on certificates of deposit at September 30, 1995:

Deposits covered by depository insurance	$ 8,004,037
Deposits covered by securities pledged as collateral	55,043,207
Total certificates of deposit	$ 63,047,244

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Maturities

Investments with scheduled maturities at September 30, 1995, are as follows:

Fair Market Value

	Tribal	Individual Indian Monies	Other Special Appropriation Funds	Combined
Less than 1 Year	$ 243,357,058	$ 11,686,562	$ 39,601,552	$ 294,645,172
1-5 Years	548,577,864	33,350,265	105,615,037	687,543,166
5-10 Years	558,853,329	192,601,191	119,744,789	871,199,309
Greater than 10 Years	168,129,923	113,460,386	28,365,799	309,956,108
	1,518,918,174	351,098,404	293,327,177	2,163,343,755
Equity securities with no scheduled maturities	15,885,288	20,650,000	-	36,535,288
Mortgage backed securities with varying maturities	143,026,398	107,375,071	-	250,401,469
	$ 1,677,829,860	$ 479,123,475	$ 293,327,177	$ 2,450,280,512

Amortized Cost

	Tribal	Individual Indian Monies	Other Special Appropriation Funds	Combined
Less than 1 Year	$ 243,410,221	$ 11,666,942	$ 39,536,734	$ 294,613,897
1-5 Years	555,280,536	32,781,196	104,835,441	692,897,173
5-10 Years	552,749,056	195,786,055	118,815,714	867,350,825
Greater than 10 Years	148,082,547	123,645,524	26,816,851	298,544,922
	1,499,522,360	363,879,717	290,004,740	2,153,406,817
Equity securities with no stated maturities	15,740,200	20,000,000	-	35,740,200
Mortgage backed securities with varying maturities	139,984,032	106,473,975	-	246,458,007
	$ 1,655,246,592	$ 490,353,692	$ 290,004,740	$ 2,435,605,024

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The original cost, net accumulated amortization and accretion, amortized cost and market value of the investments held at September 30, 1995, are as follows:

Tribal

Investment Class	Cost	Net Accumulated (Amort.)/ Accret.	Amortized Cost	Market Value
Certificates of deposit	$ 35,237,962	$ -	$ 35,237,962	$ 35,237,962
Equity securities	15,740,200	-	15,740,200	15,885,288
Government backed securities	1,428,736,173	35,548,225	1,464,284,398	1,483,680,212
Mortgage backed securities	136,151,335	3,832,697	139,984,032	143,026,398
	$ 1,615,865,670	$ 39,380,922	$ 1,655,246,592	$ 1,677,829,860

Individual Indian Monies

Investment Class	Cost	Net Accumulated (Amort.)/ Accret.	Amortized Cost	Market Value
Certificates of deposit	$ 5,892	$ -	$ 5,892	$ 5,892
Equity securities	20,000,000	-	20,000,000	20,650,000
Government backed securities	355,199,156	8,674,669	363,873,825	351,092,512
Mortgage backed securities	104,366,684	2,107,291	106,473,975	107,375,071
	$ 479,571,732	$ 10,781,960	$ 490,353,692	$ 479,123,475

Other Special Appropriation Funds

Investment Class	Cost	Net Accumulated (Amort.)/ Accret.	Amortized Cost	Market Value
Certificates of deposit	$ 27,803,390	$ -	$ 27,803,390	$ 27,803,390
Equity securities	-	-	-	-
Government backed securities	258,986,778	3,214,572	262,201,350	265,523,787
Mortgage backed securities	-	-	-	-
	$ 286,790,168	$ 3,214,572	$ 290,004,740	$ 293,327,177

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NOTE 6 -- COMMITMENTS AND CONTINGENCIES

The Secretary has been designated by Congress as the fiduciary with responsibility for investing resources held in trust, collecting all monies due from outside individuals/organizations for the use of Indian lands and the extraction of natural resources from Indian lands, and disbursing such monies collected to the appropriate beneficiaries.

Tribal organizations and classes of Indian individuals have filed various claims against the United States for failure to fulfill its fiduciary responsibilities and for related charges. Neither the OTFM nor the Office of the Solicitor for the U.S. Department of the Interior can presently determine the outcome of these actions or the total amount, responsibility and funding source of the potential liability.

Any actual liabilities resulting from adverse outcomes of the contingencies described above are generally expected to be satisfied with U.S. Government funds, and not assets of the Trust Fund. No amounts have been accrued in the accompanying Trust Fund financial statement for potential claims receivable from the U.S. Government.

NOTE 7 -- REALIGNMENT UNDER THE OFFICE THE OF SPECIAL TRUSTEE

On February 9, 1996, Secretarial Order 3197 implemented Department of the Interior's Office of the Special Trustee for American Indians (OSTAI), which was established by the American Indian Trust Fund Management Reform Act of 1994. The Order also transferred the OTFM, and financial trust services performed at Bureau of Indian Affair's Area and Agency Offices, from the Bureau to the OSTAI.

NOTE 8 -- TRUST FUND BALANCES

Disputed Balances and Beneficiaries Unable to Confirm Balances and Similar Matters

A portion of the Beneficiaries for whom the Bureau holds assets in trust do not receive adequate information to determine whether their account balances reflected in the Bureau's records are proper.

A significant number of IIM accounts and balances are held for the benefit of minors and other individuals who have been determined by the Bureau to require assistance in managing their trust account activities and balances. It is the practice of the Bureau to not forward financial data to minors and other IIM account holders with supervised accounts. Agency Superintendents typically act as custodians for these supervised accounts. In addition, some IIM account holders have not furnished the Bureau their addresses which would allow the Bureau to forward their account statements. Accordingly, certain

account holders do not, or are unable to, agree with the balances reflected in their accounts.

The ultimate account holders of a portion of the monies held in the IIM Trust Fund have not been determined by the Bureau and, accordingly, such monies have not been distributed. Also, included in the Tribal Trust Funds are balances not identified to specific Tribes because judgment awards were granted to several Indian Tribes in a particular geographic area for settlement of claims related to certain lands. Because such amounts were not awarded to a specific Tribe or individual, there is no independent party (independent of the Bureau) to determine the ownership of these account balances.

IIM account holders who have been determined by the Bureau to require assistance in managing their financial affairs have had instances of payments made from their accounts that have not been adequately reviewed and approved in accordance with applicable regulations. At many Bureau locations procedures are inadequate to ensure that such expenditures are made in accordance with applicable regulations.

Unallocated Balances, Net

The net unallocated balances for the IIM Trust Fund balances, consisting of cumulative differences between Omni and subsidiary detail of account holders' balances and activity ("IRMS System") totaled $30,440,708 as of September 30, 1995.

NOTE 9 -- SIGNIFICANT TRANSACTIONS WITH OTHER U.S. GOVERNMENT ORGANIZATIONS

Debt Arrangements

The Bureau is a party to various note payable agreements. These agreements are primarily between the Indian Tribes and the U.S. Department of Agriculture Farmers Home Administration ("FmHA") or the U.S. Department of Commerce Economic Development Administration ("EDA"). The proceeds of the FmHA loans are used by Indian Tribes to repurchase fractional ownership interests in allotted lands from individual Indians.

The receipts from the acquired ownership interests are deposited into "Special Deposit" accounts in the IIM Trust Fund, and principal and interest payments are made from these accounts. EDA loans are utilized for construction of tribal facilities (governmental/administrative buildings, and facilities for enterprise activities such as manufacturing, hotel/motel facilities, etc.). Individual Tribes are primarily liable for repayment of these loans, however, trust funds are utilized for payment on these loans.

Minerals Management Services

The Bureau receives royalty payments from the U.S. Department of the Interior Minerals Management Service ("MMS") on behalf of Indian Tribes and individuals holding mineral rights. MMS generally transfers the royalty payments to the Bureau upon receipt. At the time the royalty payments are received, MMS also provides the Bureau with a breakdown of the tribal royalties, thus permitting the Bureau to allocate the receipts directly into tribal accounts. However, MMS does not provide the Bureau with ownership information for IIM account holders until several weeks after the related royalty payments are received. Accordingly, the Bureau holds the royalty receipts until it receives information on how the royalties are to be allocated. Upon receipt of the IIM account holders royalty ownership data, the Bureau distributes the royalty receipts to the IIM account holders. IIM account royalty payments are then either paid by check or held in IIM accounts until account holders wish to make a withdrawal. MMS and the U.S. Department of the Interior Bureau of Land Management both perform auditing and other monitoring procedures of mineral royalties collected.

Overpayments are sometimes made by private companies to MMS. These are first paid to the Bureau on behalf of Indian Tribes and individuals, and then disbursed by the Bureau to the beneficiaries. The overpayments generally result from payments being made based on estimated mineral production, in order to comply with the Federal Oil and Gas Royalty Management Act of 1982 which requires timely distribution of royalties. Such overpayments are recovered by the private companies by adjusting future payments. The amount of such overpayments as of September 30, 1995, have not been quantified.

Other

As discussed in Note 4, the Treasury holds cash and overnight investments and acts as a disbursing agent for the Bureau. As discussed in Note 6, the U.S. Department of the Interior Office of the Solicitor serves as legal counsel for the Bureau.

NOTE 10 -- CONVERSION TO NEW TRUST AND INVESTMENT SYSTEM

The OTFM converted from its old general ledger system (TFMS) and the related investment subsidiary system (MoneyMax) to a new trust and investment system (OmniTrust) as of March 31, 1995. The OmniTrust system eliminates the necessity for subsidiary systems because cash and investment activity is entered and recorded directly on the OmniTrust system. However, IIM activity is grouped together and reflected as one line item in OmniTrust. The IIM Trust balances are still maintained on a subsidiary ledger.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON INTERNAL CONTROL STRUCTURE

SEPTEMBER 30, 1995

GRIFFIN & ASSOCIATES, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

DAN D. GRIFFIN

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON INTERNAL CONTROL STRUCTURE

To the U.S. Department of the Interior
Bureau of Indian Affairs:

We have audited the Statement of Assets and Trust Fund Balances for the Tribal, Individual Indian Monies and Other Special Appropriation Funds managed by the U.S. Department of the Interior Bureau of Indian Affairs Office of Trust Funds Management ("OTFM") as of September 30, 1995, and have issued our report thereon dated May 17, 1996.

We conducted our audit in accordance with generally accepted auditing standards, the standards for financial audits contained in *Government Auditing Standards* (1994 Revision) issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin Number 93-06, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of OTFM is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives on an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with the comprehensive basis of accounting described in OMB Bulletin Number 94-01, "Form and Content of Agency Financial Statements". Also, projection of any evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the Statement of Assets and Trust Fund Balances for the Tribal, Individual Indian Monies and Other Special Appropriation Funds managed by OTFM as of September 30, 1995, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing an opinion on the Statement of Assets and Trust Fund Balances and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion. Also, in accordance with OMB Bulletin Number 93-06, for those significant internal control structure policies and procedures that were

4730 TABLE MESA DRIVE, SUITE C100, BOULDER, COLORADO 80303
PHONE (303) 543-8868 • FAX (303) 543-8869
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properly designed and placed in operation, we performed tests to determine whether such policies and procedures were operating effectively at September 30, 1995.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin Number 93-06. These matters are described in the "Reportable Conditions" section of this report. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control structure that, in our judgment, could adversely affect OTFM's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements and in reported performance measures in the Overview section.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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. These matters are described in the "Material Weakness" section of this report.

We also noted other matters involving the internal control structure and its operation as well as certain other advisory comments which we did not consider to be reportable conditions. These comments are set forth in the "Other Advisory Comments" section of this report.

Material Weaknesses

Cash

Cash balances converted from the prior general ledger to Omni were approximately $27 million higher than the balance per the U.S. Treasury. Cash reconciliation procedures only reconcile current activity from Omni to Treasury and do not address the unreconciled beginning balance. The composition of the difference is not known and no reliance has been obtained that either the OTFM balance or the Treasury balance is accurate.

This results in an unconfirmed and unreconciled cash balance on OTFM's books.

The General Accounting Office's report dated September 1994, (GAO/AIMD-94-185), recommended that the OTFM contract for banking services. The report noted that "Maintaining trust fund cash balances in a bank or other financial institution could help BIA to provide its account holders with comprehensive trust account statements, automatic interest accruals, and reporting of taxable interest earnings to the Internal Revenue Service. If BIA decides to maintain Indian trust funds in financial institutions, it would need to provide instructions, in accordance with its fiduciary responsibility, to the financial institutions on how the accounts are to be managed." Moving trust fund cash balances to a bank or other financial

institution would also provide a reliable third party from which to obtain balance confirmation. This would be an important step in removing the related audit report qualification from future audit reports.

Recommendation (1) - In addition to moving cash balances to a financial institution, the resolution of the unreconciled difference between the general ledger and the U.S. Treasury needs to be addressed. Due to the volume and age of transactions comprising this difference, and the lack of internal and independent documentation to effectively analyze the difference, an eventual successful reconciliation of the difference may not be practical. We suggest that OTFM begin efforts to mediate with the beneficiaries and the U.S. Treasury to eliminate the unreconciled difference.

Client Response (1) - Treasury balances are reconciled monthly. Treasury activity is reconciled daily. Differences are isolated to the period of October 1, 1992 and prior, and have been controlled since that date. Adjusting entries are made with proper documentation and review.

Moving the function to a private sector financial institution has been discussed and poses two major obstacles. The first obstacle is the negotiability of a private sector check versus a U.S. Treasury check. This would obviously cause problems for account holders in remote locations as U.S. Treasury checks are readily negotiated at local merchants. A private sector financial institution's checks would not be as negotiable. The second obstacle is the financial resources required to obtain the services of a private sector institution. Treasury services that are currently provided could not be provided by a private sector financial institution at the funding level the Treasury currently operates within. With the streamlining of government comes the decrease in funding each year which would clearly be an issue with a private sector financial institution.

Investments

The Omni trust and investment system does not amortize premiums nor accrete discounts on investment purchases using the effective interest method as required by OMB 94-01, "Other Comprehensive Basis of Accounting."

The amortization and accretion calculations must be computed separately and recorded as an adjustment at year end.

This results in interim financial reporting which does not reflect the investment portfolio's true yield.

Omni can calculate amortization and accretion only on the straight line method but currently is unable to calculate on the effective interest method.

Recommendation (2) - Management should investigate and consider implementing reporting features including, but not limited to, those described below:

- Amortization and accretion of premiums and discounts utilizing the effective interest method.

- Timely and accurate calculation and posting of interest and investment earnings for IIM account holders.

- Investment performance measurement reports to management and beneficiaries, detailed by month and by year. It should also have annual historical detail for at least five years, on the following information:

    - Investment carrying values and market values detailed by individual securities
    - Investment earnings
    - Gains and losses on investments
    - Unrealized appreciation/depreciation in market value
    - Percentage return on investment
    - Total portfolio return compared to various market averages and benchmarks

- Managerial reporting capabilities to measure and evaluate the performance of individual OTFM portfolio managers.

Client response (2) - Amortization and accretion. The OTFM is in the process of contracting for a new system that will handle amortization and accretion for the assets using the Effective Interest Method (Retrospective for Collateralized Mortgage Obligations) in order to show the assets at cost in the OTFM financial statements as required by the CFO Act. We have requested a Solicitor's opinion to determine whether the OTFM should be complying with the Uniform Principal and Income Act with regards to fiduciary customer account information and statements. The Uniform Principal and Income Act is the accepted practice for the private sector trust industry. The Uniform Principal and Income Act states that no allowance or adjustments should be made for amortization and accretion on assets which receive at least an annual interest payment. In the event that it is determined that we should be complying with the Uniform Principle and Income Act, the Branch of Investment Accounting will reflect in OmniTrust amortization and accretion for redeemed, called or matured securities using the Effective Interest Method.

Timely and accurate calculation and posting of interest and investment earnings for IIM account holders. The findings described are the result of not having adequate systems. Once new systems are in place, the following options would be available.

Option 1. Continue to operate as we are, based on reasonable assurances of the long term nature of the IIM program. This is to be tempered, however, with the new ten year horizon limitation as expressed in the proposed Investment Policy Guidelines. With a portfolio ultimately laddered by the month out to ten years, exposure to market volatility would be drastically reduced from present levels and presumably would minimize gains and losses from a substantial liquidation. Also, income yields to account holders will be reduced from past and present levels.

Option 2. Take Option #1 a step further to include a monthly portfolio valuation with the unrealized gain or loss versus the previous month's valuation being added to or subtracted from the current month's earnings. This step would virtually eliminate market volatility as a concern, but would probably result in greater gyrations in the monthly interest rate than is presently experienced.

Option 3. Establish a mutual fund. This requires that all balances and/or receipts go into the fund at dollar amounts represented by shares. i.e., if an account is opened at $125.50, then at the end of business that day, the account holder would own 125.5 shares of the fund. At the close of business each day all investments are marked to market (appraised by a third party pricing service as to their market value). The total market value of all assets is then divided by the number of shares outstanding to determine the fund's Net Asset Value (NAV). Subsequent deposits into the fund by account holders are issued shares at that day's NAV. Obviously, this option produces a changed NAV each day, assuming the pool of investments is made up of fixed income marketable securities as prescribed in 25 U.S.C. 162. It would take a great deal of education in Indian Country to explain how a mutual fund works, and even when explained properly, the tolerance for great price fluctuations in NAV would be a constant source of irritation to the participants and tribal leadership. To hold the NAV fluctuations to a minimum, the maturities of the securities owned should be shortened, and the variety should be limited to only the most readily marketable type of security to minimize price fluctuations. The result would be the effective yield in the portfolio would greatly diminish from the past levels enjoyed by IIM account holders. Since there are several thousand mutual funds in existence, it would be easy to contract out the entire operation of the IIM fund to establish mutual fund operations service providers. It could be run as a proprietary fund with investment decisions made by our staff, or by a contract money manager. All options would have various effects upon costs to operate OTFM.

Option 4. Establish a Money Market Fund. The mechanics of this option are basically the same as described above in the Mutual Fund Option. The major difference is in the type of investments owned by the portfolio. A money market fund invests in very short term, high liquid, cash equivalent securities, and CD's with maturities not exceeding 90 days. The result is that the NAV is maintained at $1.00 with no fluctuation. The significant difference to the IIM account holder would be that his yield would drop considerably from present and past levels. This is not a prudent strategy for long term accounts such as minor accounts.

Option 5. Establish a Credit Union with the IIM pool. This option would require that the investments be segregated as an asset account and the deposits as liabilities just like any credit union or bank enterprise. The IIM accounts would essentially be passbook savings accounts. Rather than calculating and paying a floating rate each month as we are now doing, a set interest rate would be paid on the accounts, changing only periodically to reflect "profit" levels experienced from the investment of the assets. On the premise that the program continues to have a long life expectancy, the market value of the portfolio could again take a back seat, being replaced with the new discipline of shortening duration through judicious sales and more prudent/restrictive buying practices. Account holders probably would like the idea of predictable interest rates even if their

yield is lower. This option would probably be the easiest to explain to the IIM account holders and tribal leadership since the majority of people understand and accept the concept of being paid a fixed rate on a "deposit" account. Excess earnings might one day become available for defraying expenses or they might be used to pay periodic bonuses to account holders. The investments and accounting could continue to be done with the present OTFM staff with little modification to job activities. This option would fit as an integral part of conceptual development bank mentioned by the Special Trustee.

Option 6. Create a "Fund" with U.S. Treasury. Place all of the IIM funds with Treasury to invest in non-marketable Treasury securities. It is our understanding that Treasury pays the average of all Treasury securities with maturities greater than four years to government employees participating in the Thrift Savings Plan "G Fund". The accounting would be similar to the credit union concept, only the investment process would be greatly simplified. The result would be a less costly operation to run, but the yield to the IIM account holder would decline from present and past levels, but not as drastically as in the other options.

Option 7. Treasury Overnighter. If the Treasury can't be convinced that the approach discussed as Option 6 represents a savings to the taxpayer, then we could default to the Treasury's "Overnighter" program. This would virtually eliminate the investment process, reducing the fund to a money market account with a one day average life paying the "fed funds" rate. It would be super liquid, no portfolio accounting would be required once all existing investments had matured or been sold, and no investment staff would be needed. Of course, the account holder would earn much less on his "deposit" during periods when the yield curve is positively sloped which is most of the time.

All of the options listed will produce lower yields to the account holders than they presently are receiving, but a much more equitable distribution of earnings would be achieved.

Investment Performance Measurement. Although the Omni System is state of the art in many aspects, the contractor has been unable to provide the performance measurements and amortization and accretion capabilities required of the OTFM. The OTFM is presently negotiating with vendors in the private sector to provide performance measurement capability currently not available. Included will be all of the features listed in the recommendation as well as the ability to evaluate the performance of individual OTFM portfolio managers. We recognize the requirements of the Association for Investment Management and Research (AIMR). The AIMR requirements will be included in any state-of-the art system. Implementation should be completed the end of fiscal year 1996.

Trust Fund Balances

The Budget Clearing Account #6875 with Treasury has a balance of approximately $11.7 million, of which only approximately $168,000 is reflected on Omni. This is a shared account with the Division of Accounting Management and it cannot be determined at this time to whom the balances belong.

An "Undistributed Interest Account from TFMS" (the prior general ledger system) exists on Omni with a balance of approximately $1.8 million at September 30, 1995.

There is a difference between the general ledger summary account of Individual Indian Monies ("IIM") on Omni and the total of the balances per the IIM subsidiary ledger detail. The difference was approximately $30 million at September 30, 1995 with the general ledger carrying the higher balance. There are also negative cash balances on the IIM subsidiary system aggregating approximately $46 million.

The effect of the above items is to further substantiate the unreliability of the trust fund balances as reflected by OTFM.

The above differences have arisen over time due to a lack of reconciliation successes.

Recommendation (3) - Differences existing at the individual trust fund balance level between OTFM subsidiary detail records and corresponding general ledger control accounts, as well as differences between OTFM accounting records and the U.S. Treasury are pervasive. These past differences need to be analyzed and resolved, and current reconciliation procedures established and closely monitored to prevent future problems. Management is currently in the process of isolating and analyzing differences between the IIM subsidiary system and the corresponding general ledger control account. Based on preliminary assessments, it appears that OTFM will require additional funds to fully rectify the existing problem. We encourage this process and recommend continued efforts to resolve the problem.

Client Response (3) - Budget Clearing. The account referred above as a Budget Clearing Account is actually a Bureau Suspense Account (14X6875) shared with the Division of Accounting Management. The portion of the suspense account balance identified as Indian trust funds, approximately $168,000 at September 30, 1995, is reflected on the OmniTrust System. The Bureau, Division of Accounting Management, has a contractor working jointly with OTFM to identify and clear the remaining balances in the shared portion of this account. The target date for identifying the balances is September 30, 1996.

Undistributed Interest. Undistributed Interest Account from Trust Funds Management System (TFMS). The OTFM, Branch of Tribal Trust Funds Accounting is currently working on a reconciliation of the Undistributed Interest Account from TFMS (OT-8365-01-8). The amounts in this account were accumulated prior to the conversion to the OmniTrust System.

Difference between the general ledger summary account of Individual Indian Monies (IIM) on Omni and the total of the balances per the IIM subsidiary ledger detail. As stated in the audit report, these differences and negative balances are an accumulation of many years of out of balance situations. By September 30, 1996, the differences and the negative balances will be segregated from the aggregate pool, and researched as funding is made available.

Area and Agency Offices

A review of questionnaire responses from the Area and Agency offices indicated that there is no consistency in the application of accounting processes and procedures. There were also inconsistencies reported in duties performed by certain key personnel at the Agency offices, as well as inadequate segregation of duties. During the period under audit, staff in the Area and Agency offices were supervised by the Bureau, and did not report to the OTFM.

During 1994, the OTFM prepared and distributed to Area and Agency offices a desktop operating manual which documents IIM procedures. The Areas and Agencies often did not rely on the most recent procedure manuals. The 42 BIAM was reported as being utilized most frequently, yet several Agencies reported not having a copy of the 42 BIAM.

This lack of standardization resulted in the OTFM having minimal control over the staff accounting for the majority of the receipts and disbursements in the IIM system. With the exception of investment related transactions, transactions affecting the IIM system originate in the Area and Agency offices.

Recommendation (4) - During fiscal year 1996, the OTFM was given responsibility for approximately 170 Area and Agency office financial trust accounting personnel. With this direct authority, we recommend the OTFM begin comprehensive and aggressive efforts to implement and enforce standard and consistent operating procedures. This process will require a comprehensive review of the applicability and adequacy of existing procedures, focusing on sound internal accounting controls and operating efficiencies. Once the procedures are implemented, the OTFM should provide ongoing training and continually monitor performance and compliance with the prescribed procedures.

Client Responses (4) - Area and Agency Offices. Preparation for a comprehensive review of existing procedures in use at the Area and Agency offices is underway and will be reviewed and updated continually as funding is available.

General

The accounting systems and internal control procedures used by the OTFM have suffered from a variety of system and procedural internal control weaknesses, and other problems, such as understaffed accounting operations at all levels, a lack of experienced accounting supervisors, a lack of minimum standards for key positions in the accounting process, inadequate training programs and inherent limitations in existing computerized accounting systems. In addition, current management is burdened with the ongoing impact of decades of accumulated errors in the accounting records. These factors place significant limitations on management's ability to effectively manage the Trust Funds entrusted to the OTFM.

In an effort to effectively address these pervasive issues, the OTFM was placed under the direction of the Office of the Special Trustee for American Indians ("OSTAI"), effective February 9, 1996. The OSTAI has

developed the conceptual framework for a comprehensive strategic plan to address the issues set forth herein. However, given the recency of the OSTAI involvement, it is not possible at this time to provide any meaningful feedback on the viability of the strategic plan or to assess progress on its implementation.

Reportable Conditions

Cash

Negative Cash Balances

There are thirteen (13) cash accounts on Omni with negative balances totaling approximately $742,000.

Standardized procedures have been instituted to address the handling of negative cash balances and a time limit has been established to address such balances. We recommend that the OTFM continue such procedures. The current balances, however, are likely to remain intact until the U.S. Government and the beneficiaries reach a resolution regarding past activities and balances.

IIM Investment Earnings

During the fiscal year ended September 30, 1995, no IIM reconciliation process was in place to reconcile the cash interest received during the month to the cash interest withdrawn per the monthly interest accrual. In addition, no process existed to reconcile the interest allocated to individual accounts to the amounts distributed. Due to the manually calculated distributions made during the month, the interest ultimately distributed by the Area and Agency offices does not agree to the actual amount of interest earnings.

Recommendation (5) - Standardized procedures should be introduced to reconcile the monthly interest allocation at the IIM account level. In addition, a policy should be developed to address the clearing of differences created during the allocation process. Time limits should be established for items to be cleared and a review process should be instituted to ensure that these procedures are followed.

Client Response (5) - IIM Investment Earnings. The OTFM, Branch of Investment Accounting is currently working on bringing current a reconciliation of IIM accrued earnings distributed to interest payments received. In addition, the Branch of Investment Accounting is tracking all amortization and accretion distributed on assets held in order to properly reflect gains and losses in the IIM monthly factor. The OTFM, Branch of IIM has drafted procedures for the field staff covering the reconciliation of interest distributed to the individual accounts to interest funded by the OTFM. All differences will be resolved on a monthly basis. The target date for the reconciliation procedures to be in place is July 1996 for the June interest distribution. These procedures will be fully automated with the conversion to a modern fund type of IIM system. This system will be implemented as funding is made available.

Investments Records Management

As part of the investments testwork, specific investments were selected and the carrying value per Omni was agreed to third party purchase documentation. The third party documentation consisted of brokers' advices confirming the purchase amount, interest rate and other information. Of a sample of 73 securities, 14 (19 percent) were not supported by purchase confirmations. Three securities, or 4 percent of the missing documentation, related to securities purchased during fiscal year 1995. All of the documents were later obtained by contacting brokers directly and having the information faxed to the OTFM or were verified in the custodial reconciliation process.

Recommendation (6) - A review of the investment records management process should be performed. A step should be added and enforced to ensure that the filing of information is secure and available if needed to prove ownership by the OTFM.

Client Response (6) - Investment Records Management. The OTFM, Branch of Investments Accounting holds the official purchase ticket file which contains all critical information on a security purchase. A log has been put in place which tracks all missing information on individual security purchases. Outstanding documents on the log will be requested. This official purchase ticket file is now secured. These records are kept in the Branch of Investments Accounting for 60 days, then placed in the Branch of Records Management secured storage until archived. Any documents needed must be checked out and signed for in order to ensure the integrity of the file. It should also be noted that a custodian reconciliation is performed monthly to compare securities in the OmniTrust System Inventories to the third party custodial statements.

The OTFM, Branch of Records Management protects all OTFM records, to include Investment Records, in accordance with requirements of the National Records Act, as well as those of the Department Manual (DM). This includes records storage requirements such as limited access to these documents and by storing them in secure storage facilities within the organization. Individuals can research records but only if they are supervised by Records Management personnel. Storage procedures include locks on the basement storage area, with access limited to Records Personnel. An inventory of all OTFM records, to include investment records, is 90% complete. The remaining 10% will be completed no later than December 31, 1996. Most documents can be located within the hour on the OTFM automated inventory.

IIM Special Deposit Accounts

Through the Area and Agency offices, the Bureau deposits money into special deposit accounts within the IIM system when a means to allocate the money is not immediately clear. There appears to be no control at the central office or at the Area and Agency office level to verify that items are eventually cleared.

These monies which may belong to a trust beneficiary, remain unposted to the beneficiary's account and subsequent investment or disbursement of the funds is delayed.

Lack of standardized procedures and adequate resources to identify and allocate these monies is the primary cause of the deposit account balances.

Recommendation (7) - Standardized procedures should be introduced for the use of special deposit accounts. Included in these standardized procedures should be a time limit for items to be cleared and a review and reconciliation process for ensuring that these procedures are followed.

Client Response (7) - Preparation for a comprehensive review of existing procedures in use at the Area and Agency offices is underway and will be reviewed and updated continuously as funding is available.

Ownership Records

Ownership records at the Area and Agency offices are not updated in a timely manner. This results in the potential for inaccurate distributions of lease income to IIM account holders. Lack of resources to process the significant number of changes causes this backlog.

Recommendation (8) - The long-term solution is to identify and implement a system for handling the ownership changes in a more efficient manner. However, until a more capable system is implemented, additional staff should be added to reduce and eliminate the backlog, and then to maintain a current status. Standards should be written identifying time limits for making changes to the existing system and a review process should be implemented to verify that the standards are being met on a consistent basis.

Client Response (8) - Ownership records. Ownership records are maintained by the Land Titles and Records Center and are updated in the automated Land Records Information System (LRIS). This system is managed by the BIA. OTFM has submitted a copy of this Internal Control Report to the Deputy Commissioner of Indian Affairs for consideration.

General

Policies and Procedures

In reviewing the internal control structure for the OTFM, other than the IIM desktop manual, we were unable to locate current written policies and procedures. No formal written procedures were located to document the investment process, accounting for investments and accounting for Tribal Trust Funds.

Recommendation (9) - Written polices and procedures should be updated for every process and transaction handled by the OTFM. Once written, policies and procedures should be implemented and OTFM personnel thoroughly trained. Compliance with OTFM policies and procedures should be closely monitored and personnel should be held accountable for noncompliance. A rotating schedule should also be established for periodic review and updating of all policies and procedures.

Client Response (9) - Policies and Procedures. In May 1996, OTFM published 25 CFR Part 144, the proposed rule to implement Pub. L. 103-412, The

American Indian Trust Fund Management Reform Act in the Federal Register. This rule describes the process for Tribes to remove their funds from trust. In Nov., 1994, the Loss Policy was published as Supplement 5, Chap. 85 of the Bureau of Indian Affairs Manual (85 BIAM). In addition, since 1992 the OTFM has issued Numbered Memorandums regarding its trust fund management activities. These include Accounting, Systems, Investment, and ISSDA areas. These documents were all to be published in 85 BIAM. However, the February, 1996 transfer of OTFM from BIA to the Office of the Special Trustee delayed this plan. Now all OTFM policies will be placed in the Departmental Manual (DM). The OTFM Numbered Memorandums are currently reviewed once a year for accuracy, and updated as necessary. In addition, OTFM also relies on the 25 CFR for direction in such matters as IIM, per capita payments, and management of trust funds. Finally, a number of documents are in draft such as the Investments Policy, and the OmniTrust Policies and Procedures Manual. Once policies and procedures are published in the DM, formal training of all staff will be performed, and reviews and updates will be made on a rotating schedule. In the meantime, informal training is performed by a number of ways: (1) notification of publication of new OTFM policy, regulation, or procedure (this is by the Branch of Policies and Procedures, and includes hard copies, explanations, etc.); or (2) establishment of a Task Force to address new procedures, such as Withdrawal of Trust Funds Workgroup, which reviews Tribal requests to withdraws funds from trust.

Accounts Receivable System

The Bureau does not have an accounts receivable system in place. The GAO, in its report dated April 25, 1994, (GAO/AIMD-94-110R) recommended that the Bureau develop an accounts receivable system. Currently, the Bureau has no assurance that all lease revenues are billed and subsequently collected.

Such a system should provide reasonable assurance that earned revenues are billed, collected and posted to the appropriate beneficiary's account.

Recommendation (10) - We recommend that an accounts receivable system be developed and implemented. The system should encompass all revenue susceptible to accrual and should integrate with both the Tribal Trust and the IIM accounting systems.

Client Response (10) - Accounts Receivable System. Accounting of trust receipts begins once the funds are received by the government. The accrual and billing of income from trust resources resides with systems currently managed by BIA. With the Omni System, OTFM is able to utilize reports that detail upcoming investment security interest payments, principal pay downs, maturities and calls. A copy of this Internal Control Report has been provided to BIA for consideration.

Other Advisory Comments

Cash Reconciliation Process

The daily cash reconciliation prepared is not presented in a traditional bank reconciliation format with adjusted bank agreed to adjusted book. The

reconciliation ignores the differences between Omni's opening balance and that of the Treasury and lists only reconciling items created subsequent to the conversion. A section of the daily reconciliation is titled "Omni adjustments and prior period" with all the items in this section representing partial clearings of the opening difference. If the opening difference were carried on the daily reconciliation, the items in this section could be netted against the opening difference and would no longer need to be included on the daily reconciliation worksheet. Because the daily reconciliation does not reflect the actual cash balance per Treasury, a second reconciliation is performed at month end which reconciles the Treasury cash per the daily reconciliation to the actual month-end cash balance reported by Treasury.

Recommendation (11) - The daily reconciliation should be presented in a traditional bank reconciliation format comparing adjusted book to adjusted bank. In addition, the month end reconciliation of the Treasury balances should be incorporated into the daily reconciliation process. All reconciling items between the total cash per Omni and the total cash per Treasury, including the opening difference, should be listed in the daily reconciliation. This presentation would make it easier to identify which reconciling items were applicable to the Treasury and which were applicable to Omni. In addition, all the reconciling items would be on one document providing a complete picture of the differences between Omni and the Treasury.

Client Response (11) - Cash Reconciliation Process. Presentation of the daily cash reconciliation presently appears in a traditional bank reconciliation format. In the future, the unknown difference will be presented as a separate item.

Electronic Data Processing

Disaster Recovery

Disaster recovery planning over the Omni application is adequate. However, our review noted there currently is no formal agreement for disaster recovery pertaining to the Unisys A-17 or the IBM 3090. Our observations also noted that the physical location of the two mainframes is at the Albuquerque Federal Court Building, a high risk location. Informal arrangements have been made with other governmental agencies to provide recovery services in the event of a disaster.

Recommendation (12) - We suggest that disaster recovery planning over the mainframe environment continue to be a high priority for the Bureau. Our understanding is that the disaster recovery contract is currently up for bid and has been delayed pending government funding. In the interim, steps should be taken to ensure the Bureau has the ability to efficiently and effectively recover operations in order to reduce both the risk of financial loss and the level of disruption to the Bureau and its Area offices. Recovery from government agencies with compatible systems is a viable option; however, tests of such arrangements should be performed to identify potential compatibility or capacity problems.

Client Response (12) - Disaster Recovery. The IBM 3090 and the Unisys A-17 are managed by the BIA. A copy of this Internal Control Report has been

provided to the Deputy Commissioner of Indian Affairs for consideration. The OTFM has been in contact with BIA officials and has learned that inquiries have been initiated to determine the cost of using COLD (Computer Output to Laser Disk) technology to store the transactions developed within the IIM system on a monthly, weekly or daily basis. Contact has been made with FEDSIM and a local COLD provider has been determined. Resolution should be achieved prior to second quarter fiscal Year 1997 with an emergency purchase order developed to cover the short term need. Two CD's would be created. One would be held here at the OTFM an the other will be stored at Commons Warehouse.

Password Controls

Security controls over the Unisys A-17 mainframe are inadequate. The system does not require automatic password changes periodically, users are not automatically logged out after a specified period of inactivity, and there is no limit to the number of invalid password attempts made by a user. Furthermore, our discussion noted that "Help Desk" personnel have the ability to reinstate or reset passwords which have been revoked.

Recommendation (13) - We suggest that the Bureau evaluate options to increase the level of security controls implemented. Those controls identified in the observation should be taken into consideration. We also suggest that only those individuals with system administrator designation be allowed to reset passwords.

Client Response (13) - Password Controls. The Unisys A-17 is managed by the BIA. A copy of this Internal Control Report has been provided to the Deputy Commissioner of Indian Affairs for consideration. Access to the IIM system is one of the items which will be changed when IIM is removed from the A-17. OTFM proposes to move the system to the IBM 3090 prior to movement to a client server. The OTFM would like to make this move prior to December 31, 1996.

Application Change Controls

Our review noted that changes to the Individual Indian Monies (IIM) application are not performed in a test environment on the Unisys A-17 mainframe. There are also no procedures in place for subsequent review after changes have been implemented by the programmer. Review is limited to verification of the output by the requesting party.

Recommendation (14) - We suggest that the Bureau evaluate the cost/benefit of developing a segregated test and production environment on the Unisys. Separate environments will assist in maintaining the integrity of the data and the production application. Procedures should be implemented requiring the review of all application changes by a technical individual other than the programmer. At a minimum, each of the two IIM programmers should review the work of the other and document approval before Data Management places the application into production.

Client Response (14)- Application Change Controls. The Unisys A-17 is managed by the BIA. A copy of this Internal Control Report has been provided to the Deputy Commissioner of Indian Affairs for consideration.

When the IIM system is moved from the A-17, a test/development region will be established.

Conversion to OmniTrust

We noted that the OTFM did not retain an outside consultant to assist in the 1995 computer conversion. Although an OTFM employee was responsible for the conversion, they also had daily tasks to perform and could not devote 100% of their time to the conversion process.

Recommendation (15) - Because the OTFM is currently in the process of investigating, and later implementing a new IIM system, a computer conversion is again anticipated. Due to the complexity and volume of the information carried on the IIM system, a systems consultant should be considered. A consultant would have the benefit of not having every day tasks to perform for the OTFM and could dedicate time to an initial and ongoing needs analysis, investigating and presenting alternative systems and rating their advantages and disadvantages. The consultant would also be able to assist in the implementation of the system and the training of OTFM personnel. Before another conversion is undertaken, the OTFM should complete a detailed plan noting who will be involved, what each individual's responsibilities will be, and their corresponding deliverables.

Client Response (15) - Conversion to OmniTrust. OTFM agrees with the recommendation and will pursue hiring of a consultant for future system conversions as funding is available.

1099 Interest Reporting

Currently, there are individuals with no known social security number receiving interest income on trust investments. Because the social security number is unknown, the OTFM reports the interest earnings to the Internal Revenue Service ("IRS") with no recipient social security number. They do not withhold taxes prior to the interest distribution. Of the approximately 260,000 accounts on the IIM system held by individuals, approximately half, or 130,000, have no social security number.

Recommendation (16) - Tax withholding prior to distribution of interest earnings to individuals should be implemented. A program of withholding taxes and subsequent remittance to the IRS, if implemented properly, would ensure the collection of taxes and timely reporting to the IRS. This program would eliminate any exposure to the OTFM for penalties assessed by the IRS for non-reporting of interest distributions.

Client Response (16) - 1099 Reporting. The OTFM desires and anticipates development and implementation of such a program as funding is made available. Upon implementation of a new IIM system, a tax withholding module will be available. Funding for data clean-up and the new IIM system has been requested in the President's fiscal year 1997 budget request.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above.

This report is intended for the information of the Inspector General, the Assistant Secretary for Indian Affairs, the Office of Special Trustee for American Indians of the U.S. Department of Interior and management of OTFM and is not intended for any other purpose. However, this report is a matter of public record and its distribution is not limited.

Griffin & Associates, P.C.

GRIFFIN & ASSOCIATES, P.C.

Boulder, Colorado
May 17, 1996

U.S. DEPARTMENT OF THE INTERIOR
BUREAU OF INDIAN AFFAIRS
TRIBAL, INDIVIDUAL INDIAN MONIES AND
OTHER SPECIAL APPROPRIATION FUNDS
MANAGED BY THE
OFFICE OF TRUST FUNDS MANAGEMENT

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON COMPLIANCE WITH LAWS AND REGULATIONS

SEPTEMBER 30, 1995

GRIFFIN & ASSOCIATES, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

DAN D. GRIFFIN

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON COMPLIANCE WITH LAWS AND REGULATIONS

To the U.S. Department of the Interior
Bureau of Indian Affairs:

We have audited the Statement of Assets and Trust Fund Balances for the Tribal, Individual Indian Monies and Other Special Appropriation Funds managed by the U.S. Department of the Interior Bureau of Indian Affairs Office of Trust Funds Management ("the OTFM") as of September 30, 1995, and have issued our report thereon dated May 17, 1996.

We conducted our audit in accordance with generally accepted auditing standards, the standards for financial audits contained in *Government Auditing Standards* (1994 Revision) issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin 93-06, "*Audit Requirements for Federal Financial Statements.*" Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to the OTFM is the responsibility of the management of the OTFM. As part of obtaining reasonable assurance about whether the statement referred to above is free of material misstatement, we performed tests of OTFM and compliance with certain provisions of laws and regulations. As part of our audit, we also obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by the *Federal Managers' Financial Integrity Act* (FMFIA) and compared the material weaknesses reported in the Bureau of Indian Affairs, Office of Trust Funds Management's FMFIA report that relate to the financial statement under audit to the material weaknesses and other reportable conditions found during the evaluation we conducted of the OTFM's internal control system. However, the objective of our audit was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in law or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Statement of Assets and Trust Fund Balances, or the sensitivity of the matter would cause it to be perceived as significant by others. The results of our tests disclosed no material instances of noncompliance that are required to be reported under *Government Auditing Standards*.

As communicated to us by the Office of the Solicitor (Solicitor) for the Department of the Interior, tribal organizations and classes of Indian

4730 TABLE MESA DRIVE, SUITE C100, BOULDER, COLORADO 80303
PHONE (303) 543-8868 • FAX (303) 543-8869
Members of the American Institute of Certified Public Accountants

individuals have filed various claims against the U.S. Government for failure of the Federal Government to fulfill its fiduciary responsibilities and related charges.

We also noted certain immaterial instances of noncompliance. The results of our tests of compliance disclosed the following instances of immaterial noncompliance.

- Instances of noncompliance with 25 CFR, Part 162 were noted during visits to Agency offices as follows:
  - The Pima Agency had one lease with the following exceptions:
    - The lease was not advertised nor put out for bid prior to letting the lease.
    - A surety bond guaranteeing the contractual obligation was not obtained.
    - The January 1, 1995, payment was received June 2, 1995. No interest was charged nor received on the late payment.
  - The Uinta and Ouray Agency had two leases with the following exceptions:
    - Two leases had no documentation indicating that the leases were let at fair market rental.
    - Two leases contained no surety bond guaranteeing the contractual obligation.

Client Response - The leasing of trust resources is the responsibility of the BIA. A copy of this Report on Compliance with Laws and Regulations has been forwarded to the BIA.

- The Pima Agency had one violation of the Treasury Fiscal Requirements whereby funds had been accumulated in excess of $1,000 and a timely deposit was not made.

Client Response - The collection officer function at the Pima Agency is currently performed by BIA. A copy of this Report on Compliance with Laws and Regulations has been forwarded to BIA. In addition, OTFM will reach an agreement with BIA whereby the collection officer at the Pima Agency routes the collections to the Phoenix Area Office for deposit using certified overnight mail versus regular mail (regular mail time lag, 2-3 days). The 42 BIAM Supplement 3 states, "Deposits shall, to the extent possible, be made within 24 hours of the receipt of public funds, or the next workday, in a designated Federal Depository."

- The OTFM is not in compliance with the policy statement requirements of the CFO Act.

Client Response - It was determined that the cost of auditing the intervening years cannot be justified by the benefits to be obtained. The recently concluded (20 year backward) reconciliation project demonstrated that the financial records were not supportive of an audit effort. The problems encountered by the past reconciliation project contractor (Arthur Andersen and Company, LLP) only began to be addressed during the 1993 through 1995 period, primarily at the central office level. OTFM believes the audit of current operations will provide the best information for moving forward with continuous improvements in trust fund management policy and practice. A contract is in place for Fiscal Year 1996 CFO Act financial statement audit requirements.

- The OTFM is not in compliance with certain requirements of OMB Circular 125 and 127.

Client Response - To comply with OMB Circular 125 the OTFM is in the process of a comprehensive review of all existing policies and procedures in order to update them. In addition, draft accounting operating procedures for the Omni System are in process. The February 1996 transfer of OTFM from BIA to the Office of the Special Trustee has complicated the process as now all OTFM policies and procedures will need to be incorporated into the Departmental Manual (DM). OTFM numbered policy and procedure memorandums currently in use will be reviewed in the Branch of Policy and Procedure annually. Completion of the comprehensive review is dependent on adequate funding.

To comply with OMB Circular 127 the OTFM will established performance measurements for fiscal year 1998.

- We are aware that the Solicitor for the Department of the Interior is aware of certain possible violations of various laws and regulations which may affect the OTFM.

Client Response - OTFM agrees that the Office of the Solicitor is aware of certain possible violations of various laws and regulations that may affect OTFM. OTFM is in close contact with the Office of the Solicitor regarding all issues with potential liability for the Federal Government.

- The OTFM has not complied with certain requirements of the U.S. General Accounting Office Accounting Series pronouncement.

Client Response - To comply with the Comptroller General's internal control standards as required by the Federal Managers' Financial Integrity Act of 1982, the OTFM is in the process of conducting a comprehensive review of the internal control structure. Additionally, OTFM has established the Division of Quality Assurance which includes the Branches of Policy and Procedures, Field Review and Internal Review. The Branch of Field and Internal Review was not fully staffed until fiscal year 1996. In fiscal year 1996, the Branch of Field Review completed several field visits. The Branch of Policies and Procedures was also not fully staffed until fiscal year 1996. A complete review of all the internal and field policies (regulations, BIAMs, DMs and other federal guidance) was begun but progress was delayed due to the impacts of the February 1996 secretarial

order which transferred OTFM from BIA to the Office of the Special Trustee. Numerous initiatives to improve internal controls were begun in 1996 such as the reorganization of OTFM to include the field locations. The organization, policies and control of records were all assessed, and improvements have been made throughout the year. OTFM continues to implement improvements as funding is available.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the OTFM complied with the provisions referred to in the third paragraph of this report, and with respect to items not tested, nothing came to our attention to cause us to believe the OTFM had not complied, in all material respects, with those provisions.

This report is intended for the information of the Inspector General, the Assistant Secretary for Indian Affairs, the Office of Special Trustee for American Indians of the U.S. Department of Interior and management of OTFM and is not intended for any other purpose. However, this report is a matter of public record and its distribution is not limited.

Griffin & Associates, P.C.

GRIFFIN & ASSOCIATES, P.C.

Boulder, Colorado
May 17, 1996

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
1-16	Resolved; not implemented.	No response to this report is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

☆ U.S. GOVERNMENT PRINTING OFFICE: 1996 404-986/60015